The high cost of customs fraud

The incentive to bring private suits for customs fraud in the US is enormous. William E. Perry of Skadden Arps Slate Meagher & Flom, Washington, DC explains how the law stands.

With the proliferation of subsidiaries in the United States, it is becoming increasingly common for foreign companies to find themselves involved in investigations for fraudulent practices under the US Customs laws. Although these statutes are often overlooked and misunderstood, violations can result in civil and criminal penalties in the form of fines and imprisonment. Moreover, recent publicity given to the informer's statute and to a possible private right of action under the US False Claims Act provide incentives for private individuals to report Customs fraud, which may cause the suits against foreign companies and their subsidiaries to multiply rapidly.

Often the fraudulent schemes are to avoid duties by understating the value of the imported merchandise. For example, the US Customs Service has recently undertaken a widespread inquiry into allegations that import documents have been manipulated so as to underestimate the dutiable value of goods, while shipment and insurance were inflated. Under such a scheme, exporters allegedly would receive kickbacks or commissions from the shipping line or the insurance company.

Fictitious schemes

Within the last few years, there have been several significant fraud investigations against foreign companies involving attempts to evade orders issued under the US trade laws. One of the most publicised cases involved a large Japanese trading company's attempt to evade the trigger price mechanism (TPM), a system established to monitor steel imports for indications of dumping, and outstanding antidumping orders. Using various schemes, the trading company evaded the TPM and the outstanding orders. For example, it set fictitious higher prices to deceive the US Customs Service, while actually charging lower prices to its US customers. In addition to the substantial legal fees incurred, the Japanese trading company paid a multimillion dollar penalty to settle the civil charges arising from the importation of the steel.

Other significant fraud investigations have involved Japanese television sets imported by large US retailers. These retail companies paid low prices for the imported Japanese television sets, but the documents submitted to the US Customs Service, allegedly, set forth high fictitious US prices. The difference between the real low US price and the fictitious high US price was claimed to have been rebated to the Japanese bank accounts of the US retailers. This practice resulted in civil and criminal prosecutions of the importing companies.

The US government is now going to trial against a Korean company in a case involving Customs fraud to steel imports. The penalties in that case are potentially as high as US$160m, an amount equal to the domestic value of the steel under investigation.

Many foreign producers and exporters question how the US Customs Service could discover the fraudulent practices or false entries on Customs invoices. One vehicle for obtaining information about fraud is the informer's statute. Section 619 of the Tariff Act of 1930 provides that if a private person furnishes the US government original information concerning any fraudulent activity or other violation of the Customs laws and such information leads to a recovery of any duties or any fine, penalties or forfeiture of property incurred, the Secretary of the Treasury may award that person up to 25 per cent of the recovered amount, up to US$250,000.

This reward can be earned by employees of foreign producers or foreign exporters who inform the Customs Service or US Attorney about suspected violations of the US Customs laws if that information leads to the imposition of penalties. Although it is best to provide the information directly to US Customs officers or to one of the many overseas Customs Attache's at US embassies, information can be provided through other government officials or embassy employees, so long as that official passes the information to the US Customs Service on behalf of the informant and not to some other government agency.

Another method is prior disclosure of the fraudulent act by the unrelated importer. If an unrelated importer is suspicious of possible fraudulent activity by the foreign exporter, in order to protect itself, it may feel it necessary to make such a prior disclosure, because of the substantial reduction of any penalties.

Section 592(c) of the Tariff Act of 1930 provides that if a person discloses the circumstances of a fraudulent violation before, or without the knowledge of the commencement of a formal Customs investigation of such a violation, the merchandise will not be seized and the penalty will not exceed 10 per cent of the domestic value of the merchandise (if the violation did not affect revenue) or the actual amount of the lawful duties of which the United States has been deprived. To benefit from this provision, the person reporting the fraudulent situation must tender the lawful duties at the time of disclosure. Where the matter involves negligence or gross negligence, the penalty is further limited to the interest due on the duties, as computed from the date of assessment of the duty, so long as the duties are tendered at the time of disclosure. In comparison to a potential loss of 100 per cent of the value of the merchandise, prior disclosure reduces the penalties substantially.
Civil penalties

Section 592 of the Tariff Act of 1930 is the principal statutory provision which the US Customs Service uses to enforce the tariff laws as they relate to commercial transactions. This section generally provides that no person may import or attempt to import any merchandise into the United States by means of any material false statement, document or omission, or help any other person to commit such acts. Liability under this section does not depend on whether the United States is deprived of all or a portion of any duties.

Section 592 imposes civil penalties that vary with the degree of culpability. Three levels of liability are set: the most serious being fraud, that is, a false statement made by a person knowing it to be false, then an intermediate stage of gross negligence, and the least serious being an error attributed to simple negligence.

For actual fraud, section 592(c) provides for a civil penalty up to the domestic value of the merchandise. For instance, if the fraudulent conduct related to the importation of 100 automobiles worth US$10,000 each, a penalty for fraud could be a monetary penalty as high as US$1m, the total value of the shipment. As described in more detail in Appendix B to part 171 of the Customs regulations, the penalties decline by stages — to four times the loss of revenue or 40% of the dutiable value, if there is no loss of duties, for gross negligence; and to twice the loss of revenue or 20% of the dutiable value, if there is no loss of duties, for simple negligence.

Criminal penalties

18 USCS §§ 496, 541-551 are criminal statutes that prohibit various forms of Customs fraud. They provide for punishment by fines and imprisonment for various types of fraudulent acts, including:

- the knowing entry of merchandise at less than its true weight, quantity, or value or by payment of less than the amount of duty legally due;
- the entry of goods by means of any fraudulent or false statements or documents;
- smuggling;
- fraudulently concealing, removing, or repacking merchandise in any bonded warehouse;
- making false claims for refund of duties; and
- willfully concealing or destroying invoices or other papers after an inspection has been demanded by a Customs official or for the purpose of suppressing fraud.

Although each of these statutes prescribes a rather modest maximum fine (for example, Section 342 has a maximum fine of US$5,000), another fairly recent addition to US law, 18 USC § 3571, allows alternative fines of up to US$500,000 for corporations and US$250,000 for individuals or up to double the gain derivable from the offence. Individuals are subject to imprisonment which, under the US Sentencing Guidelines, is mandatory in most cases and involves substantial periods of incarceration.

There are several other ways that Customs may uncover fraudulent conduct. One is through the routine examination of a shipment by an inspector, or a routine audit of a importer's, exporter's or broker's records by a regulatory auditor. Under section 629 of the Tariff Act, the US Customs Service may also, under certain circumstances, audit foreign producers' records. In each of these cases, aroused suspicion may lead to further examination or even an administrative summons of the US producer's or importer's records under sections 509-510.

In addition, under section 628 of the Tariff Act, foreign customs services often provide information that results from their investigations to the US Customs Service because of bilateral and multilateral agreements that provide for mutual assistance in customs matters.

False Claims Act

Attempts to provide a private right of action for Customs fraud as part of the 1988 Omnibus Trade Act were defeated in Congress. However, such a right may already exist in the form of a Qui Tam action under the US False Claims Act. This Act was originally passed in the Civil War to prevent widespread cheating in the sale of military supplies to the government. In 1986 the Act was amended to provide under section 3729(a)(7), 'any person who . . . knowingly makes, uses, or causes to be made or used, a false record or statement to conceal, avoid, or decrease an obligation to pay or transmit money or property to the Government, is liable to the United States Government for a civil penalty of not less than US$5,000 and not more than US$10,000, plus three times the amount of damages which the Government sustains because of the act of that person.' Thus, a false declaration of value to avoid the antidumping law by a foreign producer could well create liability under this statute.

Section 3730 of the False Claims Act provides a private right of action, that is, a private person may sue for a violation of section 3729 on behalf of the US government. The private party files a copy of the complaint and written disclosure of all material evidence and information possessed by the person under seal in the Federal District Court. The complaint and the information are not served on the defendant, but on the US government, which has 60 days to determine whether or not to intervene in the case. If it does, and decides to prosecute the action, the private party is still entitled to 15 to 25% of whatever is recovered. If the government decides not to prosecute the action, the private party may continue the action, and is entitled to keep 25 to 35% of any recovery.

Recently, a disgruntled ex-employee of an importer brought a Qui Tam action for Customs fraud against an importer in the US District Court in Maryland. This precedent raises the possibility of a competitor, for example, a US steel producer or automobile manufacturer, bringing a Qui Tam action against foreign producers for Customs fraud and obtaining 15 to 35% of treble damage recoveries. Since damages in Customs fraud actions can run into millions of dollars, such a recovery could be quite substantial.

As indicated by the above examples, many Customs fraud investigations are the result of attempts to evade orders issued under the trade statutes. Although the Omnibus Trade Act has provided the
government, in certain situations, with the means to stop such avoidance once it has occurred, foreign producers and exporters should understand that there frequently are legitimate ways to avoid orders issued under the trade statutes. The important point to remember is to read carefully the precise language of any trade order.

For example, an order was issued under the textile restraint law limiting imports of men's suits into the United States. One alert foreign manufacturer of suits was able to avoid what may have been a poorly drafted order by separately shipping the suit jackets and trousers to the United States by air on alternate days.

Another example of legitimate avoidance of a quota order concerned the recent restraints on imports of motorcycles. The language in the order establishing the quota was worded so as to permit the importation of motorcycle subassemblies into the United States.

By reading closely the precise language of any order restricting imports into the United States, it is possible legitimately to avoid the order. If, however, the foreign producer, foreign exporter or the importer make false statements to the US Customs Service, such as falsely stating the country of origin or the Customs value on the invoice so as to evade a quota or an antidumping order, that is a violation of the Customs fraud statutes and can result in civil and criminal prosecution.

Since sanctions for violations of the Customs fraud statutes are severe — with substantial fines, imprisonment, civil penalties and damages — these laws must be strictly obeyed. Foreign producers and foreign exporters should understand that they may legitimately attempt to avoid a trade order so long as they do not make false statements or provide false information to the US Customs Service.

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**Swiss stock exchanges: what does the future hold?**

**Carlo Lombardini of Pons CET Turrettin Amaudruz & Neyroud, Geneva, discusses some of the legal problems related to share dealing on stock exchanges in Switzerland.**

Swiss stock market activity in shares is highly developed. However, there are areas connected with Swiss stock exchange regulations that give cause for concern: the organisational structure, insider trading problems and the limitations set by some Swiss companies on the purchase of their registered shares.

Although banking activity is governed by federal law the Swiss confederation has no authority to issue laws regulating stock exchange transactions. These matters rest mainly with cantonal authorities. However, some principles of federal law do apply, either directly or indirectly. The cantons of Zürich, Basel and Geneva have issued laws dealing with stock exchanges; in other cantons (Bern, Lausanne, Neuchâtel and St Gallen, where stock exchange activity is rather modest), stock exchanges are private organisations free to regulate themselves. The existing laws deal mainly with organisational questions and do not give clear answers to most of the questions which are raised by share dealing.

There is no central supervising authority in Switzerland for stock exchange transactions; a very limited and indirect degree of general control is exercised by the Federal Banking Commission, which is the watchdog of the Swiss banking system but only in so far as transactions are carried out through banks. Stock exchanges have issued their own regulations dealing with practical questions, regulations which are often revised and which are subject to approval by the cantonal governments.

Recently, the stock exchanges of Basel, Geneva and Zürich issued uniform regulations for the admission to quotation of both shares and bonds. All requests for quotation must be made by a member of the exchange; the issuer itself or a third party (for instance the issuer's bank) has no right to file a request. The new rules stipulate that:

- the issuer must have a share capital of at least SFr5m and, for foreign companies, total equity must reach SFr10m;
- balance sheet as well as profit and loss accounts for five years must be available;
- the issued shares must have a nominal value of at least SFr10m or the total capitalisation of the issuer must be at least SFr25m; in the case of foreign companies, these must amount to 20 and 50m;
- consolidated accounts must be produced if they are available. Swiss accounting standards are accepted for Swiss companies, although they impose only a limited amount of disclosure to shareholders;
- accounts must be audited.

**Protecting investors**

In the case of foreign issuers, a special approval (both for shares and bonds) must first of all be obtained from the Securities Admission Board (the Board). A decision of the Board to refuse the quotation of a foreign security is binding on all the stock exchanges. Basically the Board makes sure that the investor is not running an unusual risk in view of either the situation of the debtor, the structure of the issue, or the country. For bonds, a minimum rating of BBB (Standard and Poor's or equivalent) is requested; there is no such requirement for a Swiss company, which is rather surprising since the need for protection is the same. The Board has the possibility to revoke its approval although this has never happened so far. The **Guidelines for decisions by the Securities Admission Board** were last modified in 1988.

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