

# And Up to Twenty Years in Prison: The Criminalization of US Customs Violations

July 2015

**Authors:** [Fernando Aenlle-Rocha](#), [Dean Barclay](#), [David Bond](#), [Darryl Lew](#), [Gregory Spak](#), [Luca Winer](#)

The United States' traditional reliance on only civil penalties against trade violators is changing. During the past several years, the US government has increasingly brought criminal charges against alleged violators, both corporate entities and their top executives. This trend towards criminalization arguably began in 2008, when contaminated goods entered the United States in several high-profile cases. Since then, US Customs and Border Protection (CBP) has been referring a growing number of cases to the US Department of Justice (DOJ) and Homeland Security Investigations for review, investigation, and, if appropriate, prosecution. Whereas a customs violation in the past might only have affected a company's pocketbook, now companies and their executives increasingly are facing criminal investigations and felony charges carrying potential terms of imprisonment of up to 20 years, probation, supervised release and potential career ending reputational damage.

## **Prison Time and Pecuniary Penalties: The Sobering Recent Case of *United States v. Garcia-Adarme***

Though by no means the only case in which a customs violation conviction resulted in prison time, *Garcia-Adarme* illustrates the trend. On November 12, 2010, the US Department of Commerce imposed antidumping and countervailing duties on certain aluminum extrusions originating in China (e.g., window and door frames, solar panels, curtain rods and furniture). Intended to remedy the alleged effects of unfairly priced imports and government subsidies that distorted the free flow of goods and hurt the US domestic industry, duties as high as 33.28% (antidumping) and 374.15% (countervailing) of the declared value of the imported aluminum were imposed. On June 19, 2013, three companies and their key executives were indicted for attempting to avoid paying these duties. CBP and Immigration and Customs Enforcement (ICE) were first alerted to this possible customs evasion by the aluminum companies' competitors — a fairly common practice. According to the indictment, the defendants shipped aluminum extrusions from China to Malaysia, where the defendants repackaged the product to make it appear as if Malaysia were the country of origin. The defendants then allegedly imported these mislabeled goods into the United States, "transshipping" them to avoid US duties on Chinese products—leading to a demand for \$2,185,702.60 in antidumping duties and a staggering

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\$24,572,735.26 in countervailing duties. Though the government later determined the defendants owed only about two million dollars in unpaid duties, the executives still faced possible sentences of up to 20 years in prison.

In late 2014 to early 2015, four of the five executives pleaded guilty and were sentenced. Though three of the executives merely had to pay a \$1,000 criminal fine, the US District Court for the District of Puerto Rico sentenced Armando Garcia-Vázquez, the vice president of one indicted company and the chief financial officer of another, to 18 months behind bars, in addition to a three-year term of supervised release and a fine of \$25,000. The judge stated that Garcia-Vázquez's sentence was higher than the original plea agreement's proposed year and a day because the offense was serious and Garcia-Vázquez's sentence needed to serve as deterrence to others. The United States was no longer going to allow violators to circumvent US trade laws and receive a "slap on the wrist."

## US Government Uses the Threat of Criminal Penalties Under Statutes Not Traditionally Applied to Trade Violations to Increase the Amount and Frequency of Civil Settlements

As seen in *Garcia-Adarme*, the US government is increasingly turning to criminal statutes — commonly used to prosecute and deter other offenses — to enforce customs laws. For example, statutes used in recent customs violation prosecutions include 18 U.S.C. § 1519 (obstruction of justice), 18 U.S.C. § 371 (conspiracy), 18 U.S.C. §§ 1956, 1957 (money laundering), 18 U.S.C. § 545 (smuggling), 18 U.S.C. § 2 (aiding and abetting) and 31 U.S.C. §§ 3729-33 (the False Claims Act or FCA). These are being used in conjunction with the more prosaic statutes used in trade matters, including 19 U.S.C. § 1592 (entering goods into the United States via fraud, gross negligence or negligence), 18 U.S.C. § 541 (entry of goods falsely classified) and 18 U.S.C. § 542 (entry of goods by means of false statements).

As the DOJ combines traditional and more novel charges against non-compliant importers, it has also begun seeking higher criminal penalties. For example, each count of 18 U.S.C. § 541 (entry of goods falsely classified) is punishable by up to only two years in prison. However, a violation of the less frequently invoked statute, 18 U.S.C. § 545 (smuggling), is punishable by up to 20 years in prison, as are violations of 18 U.S.C. § 1519 (obstruction of justice) and § 1956 (money laundering). If an importer's actions violate one of these statutes, often the conduct will simultaneously violate others. The exercise of prosecutorial discretion in this manner can lead to multi-count indictments and potentially decades of incarceration for convicted corporate executives. Thus far, most prison sentences have not exceeded two to three years for individual defendants, and most criminally convicted corporations have not been sentenced to more than two to three years of corporate probation.<sup>1</sup> This may change, however, as statutes carrying increasingly higher penalties are added to charging instruments and voluntary dismissal of such charges becomes more difficult politically.

Indeed, these various civil and criminal charges work in tandem: if a corporation negotiates a settlement agreement, the company will likely pay drastically higher civil penalties in return for no criminal charges, or may be required to pay twice for the same violation: once for each civil claim, and once for criminal restitution. An example can be found in *United States v. Premier Manufacturing*, in which a cigarette importer pleaded guilty to under-weighting cigarettes to avoid customs duties. In 2005, to resolve the criminal charges leveled against it, the company agreed to pay the government \$7.6 million in restitution. DOJ dropped the criminal charges but continued to prosecute civilly through an FCA enforcement action. In 2007, the company paid an additional \$3.1 million to resolve the FCA claim.

The government is also attempting to expand the number of entities and individuals who can be found civilly liable in customs cases. The U.S. Supreme Court recently denied a writ of certiorari in *United States v. Trek*

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<sup>1</sup> See, e.g., *Chavez* (one customs broker was sentenced to 37 months and the other defendant received 27 months in prison. Both of their corporations were sentenced to a five-year term of probation); *CMAI Industries* (the company was placed on 24-months' probation); *Fai Po* (36-months of probation for the corporate entity); *Garcia-Adarme* (three individuals were sentenced to probation and one to 18-months in prison followed by a three-year term of supervised release); and *Wolff* (one executive was sentenced to 12-months and a day in prison, followed by a three-year term of supervised release, and the other to six months' home detention followed by a term of supervised release).

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*Leather*, an *en banc* decision in which the U.S. Court of Appeals for the Federal Circuit held that individuals who helped to introduce imported merchandise into the United States could be held personally liable even if they were not the “importer of record.” This is true even if there was no showing of fraud under 19 U.S.C. § 1592. This recent decision demonstrates the government’s willingness to bring enforcement actions against a variety of corporate actors involved in the importation process who, historically, would not be charged.

## **Traditional Civil Enforcement Meets Criminal Penalties: 19 U.S.C. § 1592 and 18 U.S.C. §§ 541, 542**

Importers are often familiar with laws that specifically or obviously regulate trade, but are not as aware of potential penalties for non-compliance. For example, the elements of a 19 U.S.C. § 1592 claim require proving that a company or individual, by fraud (intentionally), gross negligence (with actual knowledge or wanton disregard for the truth) or negligence (with a failure to exercise reasonable care), entered or attempted to enter or introduce merchandise into the commerce of the United States by means of a materially false document or electronically transmitted data or statement or act, or any material omission. The penalties for violating this statute depend on the importer’s level of culpability. For example, a finding of negligence will result in a penalty equal to the lesser of the merchandise’s “domestic value” or two times the total duty loss, or 20% of “dutiable value” in non-revenue loss cases.

Compare this to penalties arising from a finding of fraud, punishable by a civil penalty in an amount never to exceed the “domestic value” of the merchandise. This seemingly simple calculation can get complicated, however, when CBP interprets statutorily distinct phrases like “dutiable value” and “domestic value.” CBP has been known to argue that the “domestic value” of imported merchandise includes antidumping and countervailing duties, reasoning that an importer would normally import such goods despite the punitive duties and that a sales price in the United States would need to absorb those costs. For example, in *Garcia-Adarme*, if the PRP Trading Corporation imported \$1,000 worth of aluminum and was penalized under 19 U.S.C. § 1592, even under a negligence theory, CBP could argue that the “domestic value” of the merchandise—and therefore the “lesser” maximum penalty—would be \$5,071.50 (the \$1,000 export transaction value plus 33% of \$1,000 plus 374.15% of \$1,000), rather than the \$1,000 export transaction value. With higher antidumping and countervailing duties come high “domestic value,” as interpreted by CBP, making the maximum penalty for negligence no less than it would be for fraud. The export transaction value of the imported product does not necessarily cap potential monetary penalties under this interpretation of the statute.

Expanding enforcement mechanisms from monetary penalties to prison terms, *United States v. Chavez* shows how the government is using traditional civil statutes, like 19 U.S.C. § 1592, in tandem with other civil and criminal statutes in a multi-pronged approach to combat customs violations. In *Chavez*, licensed custom brokers and their companies were allegedly involved in a “diversion scheme”—they supposedly imported Chinese-made textiles, foreign-made cigarettes and Mexican food products (some of which were infected with Salmonella) while avoiding the requisite customs duties by falsely claiming the goods were not entering the United States for sale. The defendants allegedly helped their clients evade at least \$18 million in import duties between 2007 and 2012. Two individuals and their corporations were charged with and found guilty of multiple criminal counts, including, between them, conspiracy (18 U.S.C. § 371), money laundering (18 U.S.C. § 1956) and entry of goods by means of false statements (18 U.S.C. § 542). The defendants were also charged with obstruction of justice (18 U.S.C. § 1519), which, along with the money laundering charges, exposed the defendants to a potential prison term of 20 years. On October 22, 2013, the first customs broker pleaded guilty and was sentenced to 37 months in prison and was ordered to pay \$3.5 million in restitution and forfeit real property where he maintained his corporate offices. His company was sentenced to five years’ probation. The second defendant did not plead guilty but was convicted at trial, sentenced to 27 months in prison, and ordered to pay more than \$65,000 in restitution. He was also ordered to forfeit \$30,000, the contents of a Hong Kong bank account, and about 220,000 pairs of blue jeans aggregately valued at more than \$1 million. His company was also sentenced to five years’ probation. Two other defendants remain fugitives.

*United States v. Chen*, which is still ongoing, provides a similar example, demonstrating that these criminal sanctions do not affect merely the rare unlucky importer. In 2012, the government brought criminal and civil charges (entry of goods by means of false statement, 18 U.S.C. §§ 541, 542 and conspiracy, 18 U.S.C. § 371)

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against a paper supply company and some of its controlling officers. The defendants allegedly imported paper from China, labeling it with “Made in Taiwan” stickers, before importing it into the United States, avoiding over \$20 million in antidumping duties.

In sum, DOJ is now attacking customs violations both civilly and criminally, and both companies and their executives — and any intermediaries who help along the way — face potential liability.

### **No Longer Under-Used: Anticipatory Fabrication or Destruction of Documents Could Lead to an Obstruction of Justice Violation, Even Before an Enforcement Action Is Initiated**

Congress enacted 18 U.S.C. § 1519, titled “Destruction, Alteration, or Falsification of Records in Federal Investigations and Bankruptcy,” under section 802 of 2002’s Sarbanes-Oxley Act. It has a broad reach:

“Whoever knowingly ... makes a false entry in any record, document ... with the intent to impede ... the investigation or proper administration of any matter ... or in relation to *or contemplation of any such matter or case*, shall be fined under this title, imprisoned not more than 20 years, or both.” [Emphasis added]

Simply put, the statute arguably prohibits *anticipatory* obstruction. The government may not need to prove that a defendant undertook his obstructive act with the intent of affecting any particular and enumerated then pending federal investigation: if a defendant ever falsified, mishandled or obstructed access to any record that ultimately related to any proceeding or investigation initiated in the future, that person may be found complicit in obstructing justice under 18 U.S.C. § 1519.

In the now infamous “honey laundering” case, *United States v. Alexander Wolff*, the US government used 18 U.S.C. § 1519 to criminally prosecute corporate executives for participating in an alleged scheme to evade nearly \$80 million in antidumping duties on honey imported from China. The 70-page, 44-count indictment alleged, among other violations, that between 2002 and 2009, the Alfred L. Wolff Company falsified US Customs entry forms and sales documentation, as well as instructed co-conspirators to delete related emails.

Two of the company’s US-based executives cooperated with the DOJ and pleaded guilty: one to one count of conspiracy and the other to one count of obstructing justice, pursuant to 18 U.S.C. § 1519. The first was sentenced to one year and a day in prison and a one-year term of supervised release, and was ordered to pay over \$17 million in restitution. The other was sentenced to six months’ home detention, three years’ supervised release and \$500,000 in restitution. Both left the country after serving their sentences.

It could have been worse. The maximum sentence for a violation of § 1519 is 20 years in prison, instead of the usual two years possible under trade-specific statutes such as 18 U.S.C. § 542 (entry of goods by means of false statements). Meanwhile, Wolff’s numerous German-based executives never appeared in US court and are all fugitives subject to arrest and extradition should they travel outside Germany and potentially subject to extradition within Germany (though the current state of German extradition practices makes it unlikely the German government would extradite them to the United States).

One of the clear lessons from *Wolff* is that corporations cannot afford to engage in actions that can be viewed as prospectively attempting to insulate themselves from a future adverse proceeding. *Wolff* and *Garcia-Adarme* reflect the new reality: a movement by the US government to bring criminal charges whenever possible in conjunction with use of civil enforcement statutes — all designed to increase the risk and severity of penalties for trade violations.

### **The New Teeth to the Old False Claims Act, 31 U.S.C. §§ 3729-33**

Further evidence of this trend is the use of the False Claims Act. Until the 1986 amendments, the False Claims Act (FCA), codified at 31 U.S.C. §§ 3729-33, was an under-utilized tool. Since 2008, however, DOJ

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has vigorously used the statute to prosecute trade violations. In 2014, DOJ recovered nearly \$6 billion from FCA cases, which brought total recovery under the FCA from January 2009 through the end of 2014 to \$22.75 billion. Each successful prosecution of an FCA claim potentially enables the government to recover treble damages, plus penalties and an additional fine of up to \$11,000 per false claim.<sup>2</sup> To prevail on an FCA claim, the government must prove that the defendant knowingly submitted a false claim for payment, knowingly acted to avoid having to pay money to the government, or conspired to do either. Acting “knowingly” includes acts made in “deliberate ignorance” or “reckless disregard” of the truth.

Perhaps more notable is what the government does not need to show: that an importer acted with specific intent to defraud the government. In contrast, consider the False Statements Act (“FSA”), 18 U.S.C. § 1001, which attaches criminal liability to anyone who “knowingly and willfully falsifies, conceals or covers up ... a material fact, or makes any false, fictitious or fraudulent statement or representation, or makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry” to any agency or branch of the U.S. government. Given that trade violations often involve allegedly false representations made to the U.S. government, the FSA is well suited for use in such cases. This was borne out just last week, in *United States v. Meunerie Sawyerville Inc.*, a criminal trade enforcement action brought by the U.S. Attorney’s Office for the District of Vermont, which resulted in the conviction of a Canadian exporter of animal feed that made shipments containing unlawful amounts of monensin into the United States. The importer aggravated the situation by delivering the merchandise against CBP’s orders, making a sham shipment for re-delivery to Customs, and falsifying the related documentation. The facts described in the DOJ’s July 9, 2015 press release<sup>3</sup> serve to remind us that the government has the ability to gather evidence inside and outside the U.S. in order to build a case that satisfies the high burden of proof required by criminal statutes. Importers need to be aware of not just the increasing use of the FCA, but also other comparable criminal statutes.

The FCA is also unusual in the Customs context because its penalties do not vary based on the level of culpability. Thus, the liability can be the same regardless of whether the violator acts with deliberate ignorance of the truth, has actual knowledge that the information is false, or acts with specific intent to make false statements and to mislead the government. One can avoid the tripling of damages only by disclosing any errors found within 30 days of learning of that information, and by cooperating fully with the government’s investigation. Contrast this, for instance, with penalties under 19 U.S.C. § 1592, which in theory should vary depending on the importer’s level of culpability in presenting the false information.

The power of applying the FCA to customs violations does not end with its stringent penalty regime. When a statute so authorizes, a private citizen may bring a “*qui tam*” lawsuit against a person or company believed to have violated the law. The FCA’s *qui tam* provision significantly increases the likelihood of an enforcement action occurring because both the government and private persons have the ability and incentive to sue an importer in US District Court. There are significant financial incentives for whistle-blowers, or “relators,” to bring suit. If they prevail, relators are entitled to a portion of the recovery (between 15 and 30 percent, depending on whether the government intervenes), as well as legal fees and expenses. Additionally, the scope of potential relators in a *qui tam* action is broad: it includes competitors, employees or anyone else with a monetary incentive to file suit. During 2013, *qui tam* plaintiffs initiated 753 of the 846 FCA claims that were filed. And, after a *qui tam* claim is brought, a federal criminal investigation is more likely to be initiated.

Thus, while violating the FCA itself typically results in civil penalties, it brings potential customs infractions to the government’s attention, leading to criminal investigations and/or prosecutions and a higher probability of a multitude of claims, both civil and criminal, for the same incident. Several recent examples of this sequence of events are instructive. In 2012, *United States v. Toyo Ink Manufacturing* extended the FCA’s reach into the trade area when the president of a domestic producer of a violet pigment brought a *qui tam* action against a Japanese competitor. Imports of this pigment originating in China and India were subject to antidumping and countervailing duties. The complaint alleged that Toyo had avoided paying these antidumping and countervailing duties by falsely stating that Japan and Mexico were the countries of origin, when under US

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<sup>2</sup> Each individual customs entry may constitute a separate claim under the FCA. Each trade case is likely to include hundreds, if not thousands, of entries.

<sup>3</sup> For more information on this case, please see the [relevant DOJ press release](#).

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country of origin rules, the products actually originated in China and India. The suit sought damages in excess of \$61 million, which, if trebled under the usual FCA calculus, meant that Toyo could be liable for as much as \$183 million. Perhaps due to its staggering exposure, Toyo settled, agreeing to pay \$45 million, plus interest, without admitting fault. The original relator not only received almost \$8 million for his part in initiating the claim, but no doubt derived some commercial benefit from the misfortune of a foreign competitor.

This outcome demonstrates that genuine incentives exist for domestic or foreign companies to file FCA *qui tam* claims against their foreign competitors or against US importers of foreign goods. DOJ has also continued aggressively to pursue these actions, encouraged by the financial success of past prosecutions. As FCA claims have risen every year since 2009, what was once a novel way of attacking customs violations is quickly becoming a well-established tool of regulatory enforcement.

## Settlement, Instead of Litigation, Incentivizes a Vicious Cycle of Aggressive Government Enforcement

*Toyo Ink* also typifies a second, perhaps related, trend: an increase in corporations acquiescing to large financial demands without mounting a defense. To avoid bad headlines, loss of shareholder value, possible criminal sanctions or higher civil penalties, corporations faced with customs claims are strategically choosing to settle instead of litigate.

In *United States v. Bank of China*, the United States sued mushroom importers who had allegedly attempted to avoid customs duties by transshipping Chilean mushrooms through Canada. The Bank of China financed the original transaction and was named a defendant in the ensuing FCA case. Despite denying all liability, the bank nonetheless settled for \$5.25 million. Such a result, in the face of litigation, invariably leads to a cycle of aggressive prosecution met with minimal resistance, which further encourages enforcement officials to continue to use laws not tailored to trade violations, such as the FCA. Premature corporate settlement also leads to more aggressive enforcement because, in the absence of judicial review, the government is free to interpret enforcement statutes — and their scope — without the risk of defeat.

## Conclusion: What Is the Careful Importer to Do?

The United States has multiple weapons when bringing claims against importers, both civil and criminal, and it is increasingly using this wider arsenal to enforce custom laws. In response, companies must also broaden their approach towards regulatory compliance. Every corporation should have a strong, written compliance regime in place, with company-wide training and transaction-based testing as appropriate. A company whose standard operating procedures meet the elements of an “Effective Compliance and Ethics Program,” as set forth in section 8B2.1 of the U.S. Sentencing Guidelines Manual, can lessen a company’s liability should a violation occur. In the event a potential violation is discovered, procedures should be in place for reporting the potential violation both to the top executives of the company and the board of directors, and potentially to CBP. While not eliminating any duties owed, a prior voluntary disclosure before, or without knowledge of, the commencement of a formal investigation can greatly reduce or eliminate any penalties, as the government seeks to incentivize self-policing.

Prudent companies involved in international trade also will engage in risk-based diligence with an eye towards high-risk jurisdictions. For example, companies should regard imports from China (or from countries commonly used for transshipping from China, such as Malaysia or India) with heightened scrutiny to avoid even the appearance of impropriety or custom duties evasion. Because the United States has levied strict, often punitively high, antidumping and countervailing duties against many goods from China, CBP is paying particularly close attention to goods that could have originated there.

No company or executive wants to be the next target of an investigation or, worse yet, defendant. Being aware of the burgeoning enforcement regime that applies non-trade specific statutes to customs violations will help importers stay ahead of this regulatory curve and minimize the risk of investigation and prosecution.

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White & Case LLP  
701 Thirteenth Street NW  
Washington DC 20005 - 3807  
United States

**T +1 202 626 3600**

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