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This BNA Insights article by Lawrence M. Friedman of Barnes, Richardson & Colburn in Chicago examines the impact of the recent Trek Leather decision from the U.S. Court of Appeals for the Federal Circuit. Friedman says the Customs Modernization Act of 1993 brought significant changes to customs law and to corporate customs compliance, including introducing the notion of ''reasonable care'' as the basic obligation of importers. The lasting impact of the Trek Leather decision, however, may be that it has unhinged the notion of reasonable care from negligence in customs law and appears to have created two distinct paths by which Customs can bring a penalty case.

Trek Leather and the Decline of Reasonable Care

BY LAWRENCE M. FRIEDMAN

The Customs Modernization Act of 1993 brought significant changes to customs law and to corporate customs compliance. The most visible of those changes was introducing the notion of ''reasonable care'' as the basic obligation of importers. Since 1994, the trade has defined a violation as being the absence of reasonable care. The recent *Trek Leather* decision from the U.S. Court of Appeals for the Federal Circuit has caused deserved concern among trade professionals because it highlights potential risks of personal liability. See *United States v. Trek Leather, Inc., and Harish Shadadpuri*2014 BL 256080, Fed. Cir., No. 2011-1527, 9/16/14. But, the lasting impact of the decision may be that it has unhinged the notion of reasonable care from negligence in customs law and appears to have created two distinct paths by which U.S. Customs and Border Protection can bring a penalty case. For importers of record, ''reasonable care'' remains the standard. ''Negligence'' is the separate standard applicable to everyone else in the import supply chain. Whether these two standards are the same remains to be seen. If they diverge, *Trek Leather* potentially undoes a major accomplishment of the Mod Act.

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The Customs Modernization Act and Reasonable Care. Congress apparently intended that negligence should be interpreted as being the absence of reasonable care. This is evident from the legislative history. According to the House Report that accompanied the Mod Act (H. Rep. 103-361), Congress intended that importers exercise reasonable care as part of the concept of ''shared responsibility.'' Under this concept, Congress assigned to importers the responsibility of exercising reasonable care to correctly report information Customs needs to properly process entries. According to the report:

> In the view of the Committee, it is essential that this ''shared responsibility'' assure that, at a minimum, ''reasonable care'' is used in discharging those activities for which the importer has responsibility. These include, but are not limited to: furnishing of information sufficient to allow Customs to fix the final classification and appraisal of merchandise; taking measures that will lead to and assure the preparation of accurate documentation; and providing sufficient pricing and financial information to permit proper valuation of merchandise.

That language comes from the section of the report describing changes to the entry process. The very next sentence in the report says ''Section 621 above elaborates on the criteria used in evaluation whether a 'rea-

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sonable care' standard is achieved.'' This is important because Section 621 corresponds to the amended penalty laws codified in 19 U.S.C. § 1592. Thus, ''reasonable care'' is linked to the penalty statute, which refers to ''negligence'' rather than ''reasonable care.''

When discussing negligence in the context of the customs penalty law, the report makes the following statement:

> A violation is determined to be negligence if it results from an act or acts (of commission or omission) done through either the failure to exercise the degree of reasonable care and competence expected from a person in the same circumstances in ascertaining the facts or in drawing inferences therefrom, in ascertaining the offender's obligations under the statute, or in communicating information so that it may be understood by the recipient. As a general rule, a violation is determined to be negligent if it results from the offender's failure to exercise reasonable care and competence to ensure that a statement made is correct.

What all of that means is that when Congress enacted the Customs Modernization Act of 1993, it intended that importers exercise reasonable care in reporting information to the U.S. Customs Service (now U.S. Customs and Border Protection). It also means that Congress intended that negligence be defined as the failure to exercise reasonable care.

But that is not exactly what the penalty statute says. Rather 19 U.S.C. § 1592 provides that:

> no person, by fraud, gross negligence, or negligence—
>
> (A) may enter, introduce, or attempt to enter or introduce any merchandise into the commerce of the United States by means of—
>
> (i) any document or electronically transmitted data or information, written or oral statement, or act which is material and false, or
>
> (ii) any omission which is material, or
>
> (B) may aid or abet any other person to violate subparagraph (A).

That means that for a violation to occur, a ''person'' must ''enter, introduce, or attempt to enter or introduce'' merchandise by means of fraud, gross negligence, or negligence. It also means that a violation occurs when a person either attempts to do so or aids or abets another person to do so.

From that summary, it should be clear that there is some disconnect between the Congressional intent and the penalty statute.

Enter Trek Leather. In 2002, Customs investigated Mercantile Wholesale, Inc., a company 40 percent owned by Mr. Harish Shadadpuri. At the end of that investigation, Customs determined that Mercantile had consistently failed to report dutiable assists on its entry documentation. An assist is something provided by the buyer free or at a reduced cost for use in the production of the imported good. In this case, that was fabric used to make the garments. Under 19 U.S.C. § 1401a, assists must be reported as part of the value of imported merchandise. Because customs duties are usually assessed as a percentage of value, the addition of assists increases duty liability. Mercantile paid Customs over $46,000 in unpaid duties and Customs explained to Shadadpuri the importance of properly declaring assists.

Trek Leather is also an importer of wearing apparel and is also operated by Shadadpuri. In 2004, Trek imported 72 entries of men's suits. Shadadpuri was the president and sole shareholder of the company. Once again, Shadadpuri failed to include fabric assists in the reported value of the suits, thereby reducing the duty paid to Customs.

Customs and Border Protection commenced a penalty case against Trek Leather and Shadadpuri individually alleging fraud, gross negligence, and negligence. That is not a new or novel approach. Prior penalty cases have named individuals. Prior decisions of the Court of International Trade have held that individuals can be subject to customs penalties even though they are not the importer. But, the Trek situation was different.

The interesting thing here is that Trek Leather agreed to accept a gross negligence or negligence penalty and the U.S. dropped the fraud case. With the fraud case over and Trek Leather liable for negligence, the question was what happens to Shadadpuri.

At this point, Shadadpuri raised a novel argument. His counsel noted that under a prior decision involving Hitachi, the Federal Circuit held that it is impossible to aid or abet the negligence of another person. See *United States v. Hitachi America Ltd.*, 172 F. 3d 1319, Fed. Cir., Nos. 97-1431, -1447, -1452, 3/25/99. That makes sense. Negligence and gross negligence do not happen on purpose. They are the result of an absence of appropriate care. Aiding and abetting requires that a person intentionally assist another person. Aiding and abetting usually applies to fraud (which is intentional) or to a criminal act (which is also intentional). In the *Hitachi* case, the court said it is impossible to aid or abet negligence.

On that basis, Shadadpuri argued that he cannot be personally liable for Trek's negligence because he is not Trek Leather and cannot have aided or abetted Trek's negligence. The Court of International Trade rejected this argument, which formed the basis of Shadadpuri's appeal to the Federal Circuit.

Federal Circuit Decisions. The case was first heard and decided by a typical three-judge panel of the Court of Appeals for the Federal Circuit in Washington, D.C. The court's first decision in this case was a complete victory for Shadadpuri.

The court's analysis focused on the definition of reasonable care contained in the statute. As the court noted, that definition assigns the duty to exercise reasonable care to the importer who makes entry of the merchandise. That was Trek Leather, not Shadadpuri. Because he had no duty of care to the government, he could not breach that duty. Absent a breach of the duty, Shadadpuri could not be negligent for purposes of the customs penalty law, although he may be been liable under other theories not discussed here.

The U.S. requested that the full appeals court review that decision sitting en banc. The court agreed and ordered briefing from the parties and other interested ''friends of the court.'' The first issue to be addressed was how the court should define ''person'' whether any other provisions of the customs laws affect the meaning of the term. That question goes right to the heart of whether someone who is not the importer of record is a ''person'' for purposes of a customs penalty. The second question was the one that has generated the most interest in the trade community. The court asked:

> If corporate officers or shareholders qualify as ''persons'' under § 1592(a), can they be held personally liable for du-

  ITR ISSN 1098-4240

> ties and penalties imposed [for negligence and gross negligence] when, while acting within the course and scope of their employment on behalf of the corporation by which they are employed, they provide inaccurate information relating to the entry or introduction of merchandise into the United States by their corporation? Is so, under what circumstances?

Also important is that in the order granting a full-court rehearing, the court vacated its prior decision. Thus, this issue was getting a complete review by the entire court. See Order of March 5, 2014 (Appeal No. 2011-1527).

The rehearing decision took a decidedly different tack.

The first decision by the court was the relatively obvious determination that Shadadpuri is a ''person'' for purposes of the law. There was no real dispute on that point. He is a natural person. Second, there was no significant discussion of whether Shadadpuri entered or attempted to enter the merchandise into the U.S. He did not. Trek Leather was the importer of record. Shadadpuri was not the importer and, therefore, did not make entry. That, however, did not resolve the matter.

As noted above, the penalty statute prohibits negligently entering or introducing merchandise into the U.S. Because Shadadpuri did not enter the merchandise, the final question was whether he ''introduced'' the merchandise. If so, he could be liable for negligence directly, not as an aider or abettor of Trek's negligence.

On this point, the appeals court reached back to a Supreme Court decision from the early 20th Century. In *United States v. 25 Packages of Panama Hats* , 231 U.S. 358 (1913), the Supreme Court had to determine whether merchandise could be subject to forfeiture under the old penalty law when it had not been formally entered. Under the then-current statute, merchandise could be seized and forfeited when there was an attempt to improperly ''introduce any imported merchandise into the commerce of the United States.'' The Supreme Court stated that:

> [I]n the present case when the goods, fraudulently undervalued and consigned to a person in New York, arrived at the port of entry there was an attempt to introduce them into the commerce of the United States. When they were unloaded and placed in General Order [official custody in a customs warehouse] they were actually introduced into that commerce, within the meaning of the statute intended to prevent frauds on the customs.

Id. at 362 as cited in *Trek Leather*. From this, the Federal Circuit made the following conclusion:

> Panama Hats confirms that, whatever the full scope of ''enter'' may be, ''introduce'' in section 1592(a)(1)(A) means that the statute is broad enough to reach acts beyond the act of filing with customs officials papers that ''enter'' goods into United States commerce. Panama Hats establishes that ''introduce'' is a flexible and broad term added to ensure that the statute was not restricted to the ''technical'' process of ''entering'' goods. It is broad enough to cover, among other things, actions completed before any formal entry filings made to effectuate release of imported goods. We need not attempt to define the reach of the term. Under the rationale of Panama Hats, the term covers actions that bring goods to the threshold of the process of entry by moving goods into CBP custody in the United States and providing critical documents (such as invoices indicating value) for use in the filing of papers for a contemplated release into United States commerce even if no release ever occurs.
>
> What Mr. Shadadpuri did comes within the commonsense, flexible understanding of the ''introduce'' language of section 1592(a)(1)(A). He ''imported men's suits through one or more of his companies.'' . . . . While suits invoiced to one company were in transit, he ''caused the shipments of the imported merchandise to be transferred'' to Trek by ''direct[ing]'' the customs broker to make the transfer . . . . Himself and through his aides, he sent manufacturers' invoices to the customs broker for the broker's use in completing the entry filings to secure release of the merchandise from CBP custody into United States commerce . . . . By this activity, he did everything short of the final step of preparing the CBP Form 7501s and submitting them and other required papers to make formal entry. He thereby ''introduced'' the suits into United States commerce.

With this broad and flexible definition of ''introduce,'' the Court of Appeals was able to find that Shadadpuri was individually liable for negligence with respect to the introduction of wearing apparel by his company Trek Leather.

The Impact of Trek Leather. This decision has generated a lot of commentary. Most of that has focused renewed attention on the potential personal liability of individuals for corporate negligence or gross negligence. As an agency, Customs might reasonably dispute that there is any new law in *Trek Leather* and that the situation for corporate officers and agents has not changed. Certainly, older cases including *United States v. Golden Ship Trading*, 22 CIT 950, Ct. Int'l Trade, No. 97-09-01581 (Slip Op. 98-138), 09/25/98 indicate that individuals may be liable for corporate acts. The important point about *Trek Leather* is that this is the first time the U.S. Court of Appeals for the Federal Circuit has addressed the issue. Absent an unlikely intervention by the Supreme Court, this will be the law. Consequently, it should eliminate any lingering doubts about the position of corporate officers and agents with respect to Customs penalties.

The important point about Trek Leather is that this is the first time the U.S. Court of Appeals for the Federal Circuit has addressed the issue. Absent an unlikely intervention by the Supreme Court, this will be the law.

More importantly, the court reached its conclusion by adopting a broad interpretation of the term ''introduce.'' As discussed above, the court views ''introduce'' to be flexible and broad enough to encompass many individuals who play a role in the import process. Thus, it is likely that the scope of the penalty statute has been expanded beyond those who are traditionally thought of as part of supply chain management and the corporate compliance team. For example, is it now possible that an engineer who incorrectly describes the material from which an imported product is made might be liable for penalties if that incorrect information impacts the tariff classification or rate of duty for the goods? It would appear that the answer to that question is yes.

Another important point that follows from *Trek Leather* is that the negligence that can result in a penalty under § 1592 is now divorced (or at least separated) from the concept of ''reasonable care.'' It remains the case that ''reasonable care'' is a statutory creation made applicable to importers. It creates a duty on importers to act with the degree of care that would be applied by similarly situated reasonable importers. Separate and apart from ''reasonable care,'' all ''persons'' who ''enter or introduce'' merchandise must not do so negligently (or grossly negligently).

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It is not at all clear that there is a meaningful difference between these two statutory standards. Nevertheless, the scope of the people covered by each standard is different. That creates two possibilities. First, there is a possibility that the two concepts will diverge as each is interpreted by subsequent courts. For example, the legislative history discussed above relates to the meaning of ''reasonable care,'' not to ''negligence.'' Could it eventually be that relying on the advice of a licensed customhouse broker would be reasonable care (as indicated by the House report) but not enough to overcome alleged ''negligence?'' Speaking only of the legal analysis, that seems possible.

If, on the other hand, negligence is essentially synonymous with reasonable care, a more difficult question arises: Why did Congress bother to put reasonable care in the statute at all? If it means the same thing as ''negligence,'' then it was already there in § 1592. That makes reasonable care and parts of 19 U.S.C. § 1484 redundant. Courts traditionally avoid making statutes redundant, which again points to a different meaning for negligence and reasonable care.

Conclusion. This decision should not result in too many nights of lost sleep for diligent compliance professionals. Corporate import managers and officers have absorbed reasonable care as the legal standard by which their performance has been measured since 1994. Whether to avoid corporate or personal liability, individuals who have taken reasonable steps to ensure the accuracy and completeness of the information reported to Customs and Border Protection and who have documented the records on which they are relying, do not face a particularly different environment post-*Trek Leather*. On the other hand, unscrupulous importers, brokers, and individuals should no longer assume that they can avoid personal liability for their actions by standing behind a corporate importer.

Rather than significantly change the compliance environment, *Trek Leather* creates the possibility of significant changes in the legal environment. It appears to introduce a new theory of liability based on negligence separate and apart from reasonable care. How that plays out in enforcement and in the courts remains to be seen.

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