Expect Increased Use of Whistleblower Law Under Trump

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Mark Strauss July 3, 2017

One of the few federal agencies not slated for funding cuts under President Trump's proposed budget is US Customs and Border Protection. In fact, CBP, which is responsible for enforcing US customs and trade laws, is proposed to receive an additional $300 million to recruit, hire, and train thousands of new personnel.

On March 31, 2017, President Trump signed an executive order calling for CBP to ramp up its efforts to combat customs law violations – in particular, breaches of antidumping and countervailing duty orders1 – as an element of the administration's trade policy of preventing foreign competitors from gaining an unfair advantage over US industries.

With these developments, we can expect stepped up efforts to counter import duty evasion under President Trump. CBP has authority under the US Tariff Act to assess penalties and seize merchandise for trade violations including duties underpayment. But schemes to evade import duties through fraud – for example, by misrepresenting goods ' country of origin in order to avoid antidumping or countervailing duties – increasingly are being prosecuted by the US government, aided by whistleblowers, under the US False Claims Act. We expect this trend to accelerate under the new administration given its trade objectives.

Trade enforcement under the False Claims Act

The False Claims Act is the US government's primary anti-fraud tool. It imposes significant civil liability – three times damages, plus penalties – on parties found to

have knowingly overcharged (or underpaid) federal agencies. The statute dates back to the Civil War, when Congress enacted it to combat fraud by suppliers of materiel to the Union Army.

A key feature of the False Claims Act is its *qui tam* provision, pursuant to which private parties with knowledge of fraudulent conduct – whistleblowers or " relators " – can file lawsuits on the government's behalf. The government has the right to intervene in and take over the lawsuit after investigating the allegations. Whistleblowers are incentivized through rewards of 15 percent to 30 percent of the recovery obtained from the violator, which can be sizable.

Whistleblowers in False Claims Act lawsuits involving customs violations have generally been former or present employees of the violator – i.e., parties with inside knowledge of the wrongdoing. Competitors, consultants, and others with expertise in particular markets, however, increasingly are whistleblowers in this area. In some cases, claims have been asserted not just against the importer, but also downstream third-party customers on the theory that those parties participated in and benefitted from the violations.

The influential United States Attorney's Office for the Southern District of New York has been particularly active in prosecuting customs enforcement cases under the False Claims Act. Not surprisingly, most such cases involve imports from the People's Republic of China, the United States ' largest goods trading partner.

Three types of violations are prevalent in these lawsuits – transshipment, undervaluation, and tariff misclassification.

Third country transshipment

Transshipment frauds involve disguising imports ' country of origin in order to evade antidumping and countervailing duties. The goods are shipped to third countries before being re-shipped to the US with the documentation manipulated to conceal the true source country. Frequently, such schemes involve false product markings or packaging designed to look like goods produced in the third country, making detection difficult.

One example is the *Univar* case. There, the violator allegedly evaded antidumping duties on imports of the artificial sweetener saccharin from the PRC by transshipping the product through Taiwan, " re-bagging " it, and falsely identifying Taiwan as the country of origin. The whistleblower – a US saccharin distributor that competed with the violator – uncovered the scheme by analyzing trade data and investigating Taiwanese manufacturing capabilities. It traced Taiwanese saccharin imports from the PRC to matching saccharin exports to the US, and found that no factories in Taiwan even possessed the chemical-use

permits required to make saccharin. The government sued Univar to recover unpaid antidumping duties and penalties in a lawsuit now pending in the US Court of International Trade in New York.

Another transshipment case was *Tai Shan Golden Gain Aluminum Products*. There, four US manufacturers allegedly colluded to evade antidumping and countervailing duties on aluminum extrusions that they imported from the same suppliers in the PRC. The manufacturers arranged to transship the goods through Malaysia – falsely relabeling them as Malaysian in origin – using a dummy, front corporation that they set up to be the importer of record. The government intervened, and, in 2015, reached settlements with the defendants totaling $4.5 million. The whistleblower, a Florida-based Asia-Pacific trade consultant, received 18 percent as a reward.

Undervaluation frauds

When goods are entered, the importer is required to declare their value and submit verifying commercial invoices. Undervaluation frauds generally involve false declarations accompanied by fake invoices containing understated prices. Sometimes this occurs as part of a double-invoice scheme in which the importer issues corresponding true invoices, reflecting accurate prices, to its US customers. In other instances, the fraud involves the submission of invoices from a purportedly unrelated third-party manufacturer, when, in fact, the manufacturer is an affiliate of the importer and the invoices therefore fail to satisfy the requirement that they be "arm's length." Still other undervaluation frauds involve the failure to include the cost of "assists" – items or services supplied by the importer to the manufacturer – in the values declared to CBP as required.

In the *Motives* case, for example, the whistleblower alleged that the violator provided CBP with fake invoices undervaluing certain apparel imports while secretly issuing a second set of true invoices – characterized as "debit notes" – to its customers reflecting the actual amounts charged. The government intervened, and, in July 2016, the defendants paid $13.4 million to settle the claims.

Similarly, in *Yinghsun Garments*, a case currently being litigated in federal court in New York, the whistleblower alleges that an apparel manufacturer evaded millions of dollars in import duties through a double-invoice scheme that resulted in undervaluing its imports by 75 percent. The government intervened, bringing claims against one of the manufacturer's US customers as well. The government alleges that the customer violated the False Claims Act by failing to monitor the manufacturer's customs entry practices, accepting "irregular" documentation from the manufacturer, and providing it with "assists" in the form of fabric without taking appropriate steps to ensure that their cost was included in the declared entry value. The government has also claimed that the customer profited from the scheme by receiving "below-market" prices on the garments that it purchased from the manufacturer.

And in *Otter Products*, a Colorado case, a producer of protective cases for mobile devices allegedly underpaid millions of dollars in import duties by failing to include the value of engineering, design, and product-mold "assists" that it provided to its overseas manufacturers in its entry declarations. The whistleblower – a former logistics coordinator for the company who was fired after trying to bring it into compliance – received a reward of 20 percent of the $4.3 million that the company paid to settle the case in April 2014.

Tariff misclassification

Tariff misclassification frauds involve attempts to misrepresent the type of goods being imported in order to declare them under incorrect duty classifications. The violator's goal may be to evade antidumping or countervailing duties, get a lower duty rate, or avoid duties altogether.

A prime example is the *AmeriSource* case. There, an importer allegedly evaded antidumping duties on small diameter graphite electrodes (a product used in steel manufacturing) from the PRC by misclassifying the goods as larger diameter electrodes not subject to such duties. It paid $3 million to settle the claims in February 2016. The whistleblower – a competitor of the violator that lost business due to the violator's underselling – uncovered the fraud through its own market checks and analysis of public trade data. It received a 16 percent reward.

Another example is the *FSM Group* case. There, an importer of military grade ultra-fine magnesium powder from the PRC falsely identified the goods on its entry documents as magnesium desulphurization reagent – a distinct product made up 90 percent of magnesium powder. It thereby avoided antidumping duties of over 300 percent.

The False Claims Act whistleblower, a competitor of the violator, discovered the fraud through its own investigation. It found evidence that the violator was importing the ultra-fine magnesium powder under the guise of magnesium desulphurization reagent by shipping it with aluminum rods – easily removed after delivery – comprising 10 percent by weight of each package. The government intervened, and the violator settled the claims in March 2016 for $8 million.

Notably, the misclassification of the goods in *FSM Group* was part of a larger scheme in violation of the False Claims Act. After importing the ultra-fine magnesium powder, the violator supplied it to a US military contractor, falsely passing it off as manufactured in the US or Canada – not overseas – in order to meet governmental contracting requirements. Five former employees and agents of the violator pled guilty to criminal offenses in connection with the scheme and were ordered to pay $14 million in restitution.

Another, rarer type of duty evasion scheme is " failure to manifest " – otherwise known as smuggling. This is when an importer circumvents duties by failing to declare the goods at all on its entry documents. These types of schemes generally are prosecuted under criminal laws, but may also form the basis for whistleblower lawsuits under the False Claims Act.

The US government recovered $4.7 billion from False Claims Act litigation last year, of which $2.9 billion came from cases initiated by qui tam whistleblowers who received a total of $519 million in rewards. Although duty evasion cases accounted for a small fraction of this haul – the bulk came from cases relating to health care and defense spending – we anticipate more activity in this area under the new administration. The result should be a higher rate of government intervention in whistleblower actions, larger recoveries, and more substantial whistleblower rewards.

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