Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Reverse FCA Cases Rise With 'America First' Trade Policies

By **Alexander Schaefer, Jason Crawford and Allegra Flamm** (April 18, 2019, 5:18 PM EDT)

Alexander Schaefer

Jason Crawford

Allegra Flamm

On March 27, 2019, the U.S. Department of Justice intervened in United States ex rel Vale v. Selective Marketplace Ltd., a False Claims Act suit brought against an importer of premium women's wear from the United Kingdom.[1] The suit alleges that the company knowingly evaded duties by splitting up single orders into multiple parcels in order to fall below the level at which duties would be charged.

This enforcement action is just the latest example in a growing number of FCA suits brought against importers for concealing obligations to pay duties to U.S. Customs and Border Protection, or CBP. This article analyzes the rising trend of "reverse" false claim cases in situations where an importer is alleged to have made false statements on customs documents.

Overview

Historically, if an importer submitted false statements about tariff classification or country of origin, or misreported the value of goods to avoid duties, the company could face an administrative penalty proceeding before CBP and potentially an enforcement action in the U.S. Court of International Trade. But in recent years, the potential exposure for making a false statement on a customs declaration has increased given the rise in the number of suits filed against importers under the FCA.

The civil FCA is widely recognized as the federal government's weapon of choice for recouping losses suffered through fraud. Every year the statute returns billions to taxpayer-funded programs. One way in which the statute ferrets out fraud is by incentivizing private whistleblowers — referred to as "relators" under the statute — to bring suit in the name of the U.S. under the statute's qui tam provisions. These provisions provide strong incentives for relators to file suit in light of the statute's treble damages combined with a provision allowing relators to receive a share of up to 30% of any recovery.

While the FCA seeks to reward those who bring fraud to light, it also seeks to impede opportunistic or parasitic lawsuits that merely piggyback on previous disclosures of fraud. For this reason, the statute contains several bars to qui tam actions, including the "public disclosure bar." The public disclosure bar prohibits a relator from bringing a FCA lawsuit based on a fraud that has already been publicly disclosed unless the relator is an original source of the information.[2]

Less frequently invoked, but important in the trade arena, is the "government-action bar" which prevents a relator from bringing a qui tam suit "based upon allegations or transactions which are the subject of a civil suit or an administrative civil money penalty proceeding in which the government is already a party."[3]

The Reverse False Claim Provision

Most FCA suits are based on allegations that a defendant presented to the government — or caused someone else to present — a false claim for payment. While these "presentment" cases are most common, the statute also includes a provision covering the wrongful retention of payments owed to the government. This so-called reverse false claim provision extends liability to any person who:

"knowingly makes, uses, or causes to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the Government, or knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the Government."[4]

In order to have acted "knowingly," within the meaning of the statute, a defendant must have acted with (1) actual knowledge, (2) deliberate ignorance or (3) reckless disregard of the truth or falsity of the information.[5] Moreover, the false record or statement must be material — i.e., having a natural tendency to influence — to the obligation to pay the government.[6]

The reverse false claim provision was first added to the FCA as part of the seminal 1986 amendments to the statute. In the years following the amendment, courts generally agreed that the provision was intended to reach situations where an individual or entity made material misrepresentations to avoid paying money owed.

However, courts were split on how the term "obligation" should be defined, which led to some confusion as to whether the amount owed had to be a "fixed" amount. Congress responded by adding a definition of "obligation" to the statute as part of the Fraud Enforcement and Recovery Act of 2009, or FERA, which defined obligation as "an established duty, whether or not fixed."[7]

An Established Duty to Pay Duties

The FERA amendment was widely perceived as extending the reach of the reverse false claim provision and, at a growing rate, relators brought suit against importers that misreported the value or misclassified goods. However, it would be several years before a circuit court of appeals would grapple with the new statutory definition of "obligation" in an import duties case.

In United States ex rel. Customs Fraud Investigations (CFI) v. Victaulic Co, the U.S. Court of Appeals for the Third Circuit vacated the district court's dismissal of a qui tam complaint and held that a company's failure to mark country of origin could be actionable under a reverse FCA theory of liability.[8]

The Third Circuit found that the defendant pipe manufacturer had an established obligation under 19 U.S.C. Section 1484(a)(1) to disclose to CBP that its goods were unmarked. If the defendant had knowingly failed to notify CBP of its pipe fittings' non-conforming status, then this could give rise to reverse false claims liability for unpaid marking duties.

The Third Circuit's favorable ruling for plaintiffs in CFI created fertile ground for plaintiffs to bring FCA cases against importers, and the past few years have seen a rise in these cases. This trend was on display in a DOJ press release at the end of FY 2018, which trumpeted the $2.88 billion that the government had recovered under the FCA during the fiscal year.

This press release highlighted several settlements with companies for evasion of antidumping duties, which included a home furnishings company's $10.5 million settlement to resolve allegations that it knowingly made false statements on customs declarations and a textile importer's $2.3 million settlement of allegations that it misclassified goods imported into the country.

Notably, these cases had been filed before the Trump administration's recent efforts at leveling the playing field for U.S. companies, which suggests that the rise in FCA cases against importers may only accelerate.

Not Your Typical Qui Tam Relator

The paradigmatic FCA suit is filed by an internal whistleblower with first-hand knowledge of the purported fraud, yet several of the cases involving evasion of duties have been filed by company outsiders. For instance, the relator in the CFI matter was a corporate entity established for the sole purpose of filing the suit after the creator of the LLC discovered the defendant's failure to mark country of origin while searching on eBay. The relator in the Vale case — in which the government recently intervened — was a customer of the apparel importer.

A similar phenomenon can be observed in cases premised on misstatements about a product's country of origin where qui tam suits have been filed by both competitors[9] and serial relators who rely on publicly-available information, such as General Services Administration websites.[10] Indeed, given the nature of these cases, a relator need not be a traditional company insider. A visit to Home Depot may be enough to put a relator on the trail to uncovering fraud, which occurred in United States ex rel Schagrin v. LDR Industries LLC — a case that is still being litigated some nine years after a company's avoidance of duties was first discovered.[11]

The origins of the Schagrin case can be traced to 2010 when an international trade lawyer noticed that Home Depot was carrying LDR's circular welded pipe imported from China. The lawyer surmised that LDR could not have paid the substantial antidumping duties applicable to the pipe given the low retail prices.

In 2012, the trade lawyer reported his suspicion to CBP, which investigated and issued a notice of action to the importer stating that antidumping and countervailing duties were owed on unliquidated entries. However, the notice did not assess a penalty under 19 U.S.C. Section 1592 because LDR declared bankruptcy as CBP was in the process of preparing a pre-penalty notice. In February 2015, CBP pursued the penalties by filing a proof of claim in LDR's bankruptcy proceedings.

In the intervening months between LDR's bankruptcy and the decision by CBP to file a proof of claim, the trade lawyer filed a qui tam suit against LDR alleging that the company violated the FCA by evading antidumping duties as well as marking duties that became established obligations once the goods were imported and distributed without proper country-of-origin markings. The DOJ declined intervention, and the company moved to dismiss the complaint after the case was unsealed.

Initially, the district court granted the motion to dismiss with prejudice finding that a penalty proceeding qualifies as an "administrative civil monetary penalty proceeding" for purposes of the government-action bar.[12] In response, the relator filed a motion for reconsideration and the DOJ filed a statement of interest in support, arguing that a penalty proceeding under 19 U.S.C. Section 1592 can only be initiated by issuance of a pre-penalty notice.[13] There was no factual dispute among the parties that a pre-penalty notice was never issued, and so the court reversed its earlier ruling that the case could not proceed on account of the government-action bar. On March 19, 2019, the revived lawsuit survived a motion to dismiss suggesting that the long-running case is far from over.[14]

Protections From the FCA in a Trade Protectionist Environment

Importers now face heightened FCA risks in light of increased duties stemming from the current administration's use of Section 232 and 301 tariffs, as well as the ever-increasing number of antidumping and countervailing duty orders. Moreover, the domestic industries in support of these various measures closely monitor imports for potential violations.

Due to the high dollars at stake, competitors, customers, industry insiders and disgruntled former employees all have strong incentives to bring FCA suits in an effort to capitalize on a company's alleged non-compliance with import laws. While there is no guaranteed way for an importer to insulate itself against FCA suits, there are certain steps that importers can take to help mitigate the risks:

- Establish strong internal compliance programs. If mistakes are uncovered, a robust compliance program can show that the importer exercised reasonable care which can be important evidence in a FCA case that the importer did not act with the requisite knowledge — i.e., a false record or statement was made but it was an innocent mistake and not the result of reckless disregard.

- Consider making safe harbor "prior disclosures" to CBP upon discovery of underpaid import duties. When filing a prior disclosure, an importer's penalties are capped at the amount of underpayment, if any, plus interest. Moreover, if CBP issues a pre-penalty notice after investigating, this could serve as the basis of the government-action bar if a qui tam suit is subsequently filed.

- If importers are uncertain about the applicability of particular regulatory requirements, they might consider disclosing the company's interpretation to the government because the government's awareness of a good faith interpretation of a requirement — even if this interpretation is eventually found to be wrong — can potentially foreclose a finding of FCA liability.

Companies would be well-served to consider these steps because the Trump administration's protectionist policies combined with the expansion of the FCA into the international trade realm suggests that the upward trend in qui tam actions against importers could continue for years to come.

Alexander H. Schaefer is a partner at Crowell & Moring LLP.

Jason M. Crawford is counsel and Allegra K. Flamm is an associate at the firm.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its *clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.*

[1] United States ex rel Vale v. Selective Marketplace, 2:17-cv-00380, Dkt. 28 (D. Me. March 27, 2019).

[2] 31 U.S.C. Section 3730(e)(4)(A).

[3] Id. Section 3730(e)(3).

[4] Id. Section 3729(a)(1)(G).

[5] Id. Section 3729(b)(1)(A).

[6] Id. Section 3729(b)(4).

[7] Id. Section 3729(b)(3).

[8] United States ex rel. Customs Fraud Investigations (CFI) v. Victaulic Co., 839 F.3d 242 (3d Cir. 2016).

[9] United States ex rel. Berkowitz v. Automation Aids Inc., 896 F.3d 834 (7th Cir. 2018).

[10] See, e.g., United States ex rel. Folliard v. Comstor Corp., 308 F. Supp. 3d 56 (D.D.C. 2018).

[11] United States ex rel. Schagrin v. LDR Industries LLC, No. 14 C 9125, 2018 WL 2332252, at *1 (N.D. Ill. May 23, 2018).

[12] Id. at *2.

[13] See United States ex rel. Schagrin v. LDR Industries LLC, No. 14 C 9125, 2018 WL 6064699, at *1 (N.D. Ill. Nov. 20, 2018).

[14] United States ex rel. Schagrin v. LDR Industries LLC, No. 14 C 9125, 2019 WL 1254923, at *1 (N.D. Ill. March 19, 2019).