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Whistleblower Lawyers See a Growth Area: Customs Fraud

By Henry Cutter
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Trucks lined up to cross the U.S. border in Tijuana, Mexico, this month. PHOTO: AGENCE FRANCE-PRESSE/GETTY IMAGES

Whistleblower lawyers see room for extra business on a new front: chasing customs-linked wrongdoing ranging from failing to label imported goods to shipping rhinoceros horn across the border.

A U.S. appeals-court ruling opened the door to more whistleblower lawsuits in 2016, making it clear that a Civil War-era law known as the False Claims Act applies in a broader range of cases. The Supreme Court backed that view last October, declining to hear an appeal of the case, United States ex. Rel. Customs Fraud Investigations LLC v. Victaulic Co.

"It gave a green light to prosecuting importers who don't mark their goods with the foreign country of origin," Anna Haac, one of the Tycko & Zavareei LLP lawyers who argued the case on behalf of the whistleblower, said of the Victaulic decision. "It strengthened the FCA as an enforcement mechanism that can be used to go after customs-duty evasion."

Although only a few customs-related suits have become public in recent months, the legal shift could encourage FCA lawyers—and whistleblowers—raising risks for corporations. Already, some 600 FCA cases, ranging from health care to defense fraud, are filed each year. The Justice Department collected $3.4 billion as a result of of False Claims suits brought by whistleblowers in fiscal 2017.

The case, now being reconsidered in district court, centers on whether Victaulic avoided an obligation to the government by failing to label pipe fittings it imported with the country of origin, and by not disclosing that the fittings weren't marked. Customs Fraud Investigations alleges that Victaulic evaded 10% duties that accrue when unmarked goods enter the country; Victaulic denies the allegations.

The FCA allows people who allege wrongdoing against the government to sue on its behalf, sharing whatever funds are collected. Most suits involve allegations that companies received too much money from the government, but some, known as reverse claims, involve the failure to pay "obligations" owed.

The Victaulic ruling weighed in on when reverse claims may be made. Prior to 2009, when Congress passed the Fraud Enforcement Recovery Act, only people who made false statements to the government to shirk a debt to it were subject to claims. FERA changed that, saying it was sufficient to knowingly avoid paying, and making it clear that an obligation should be defined broadly.

The 2016 ruling cited FERA in finding a company that violates a requirement that imported goods be marked with the country of origin is subject to False Claims action. Although earlier court rulings had opened the door to FCA claims in areas such as nonpayment of antidumping duties, lawyers see the Victaulic decision as making more cases possible.

“”Until very recently attorneys had not made cases based on the statute’s reverse false claim provisions for this offense,” said Tony Munter, a plaintiffs’ lawyer at Price Benowitz LLP. “As a result, the industry itself is only now becoming aware of the fact that this law can work to enforce such duties.”

False Claims cases, which are filed under seal, often remain out of the public eye for years, so it is hard to tell how large an upswing in customs-related cases may be happening. Bob Wagman, a defense lawyer at Bracewell LLP who handles FCA work on government contracts. said he has yet to see an increase.

Still, a few cases have surfaced. American Dawn Inc., a textile importer, agreed to pay $2.3 million to settle a whistleblower’s complaint that it mislabeled towels as polishing cloths in order to pay lower tariff rates, the Justice Department said Jan. 11.

“This recent settlement highlights how reverse False Claims Act actions have the potential to impact tomorrow’s legal landscape,” said Jacklyn DeMar, director of legal education at Taxpayers Against Fraud Education Fund, a nonprofit group that works in support of whistleblowers. If more cases come through, she said, court decisions will make defendants’ obligations clearer, encouraging more whistleblower action.

A settlement disclosed in October caught the attention of Stephen Kohn, executive director of the National Whistleblower Center, a second advocacy group. Notations Inc., a garment wholesaler, admitted it failed to take notice of multiple signs that suppliers were avoiding duties by submitting fake invoices to customs officials. Prosecutors targeted Notations’ supplier as well as the company itself.

A similar approach could work for targeting illegal trade in endangered species, Mr. Kohn said. To import any wildlife listed under the Convention on International Trade in Endangered Species, companies must pay the U.S. Fish and Wildlife Service for a permit. Failing to pay amounts to shirking an obligation owed to the government—fair game for action under the FCA, he argued.

The Notations case shows companies involved in the supply chain could be on the hook as well, Mr. Kohn said. A whistleblower who brought such a case would share in the funds collected from both the original claim and those from potential U.S. prosecutions of related matters. Those could include violations of the Lacey Act, a law that imposes penalties for a broad range of wildlife-related offenses, along the supply chain.

“It’s not been done before, but the laws are all there,” Mr. Kohn said. “Once there’s a successful case or two, the [whistleblower] bar will jump in.”

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