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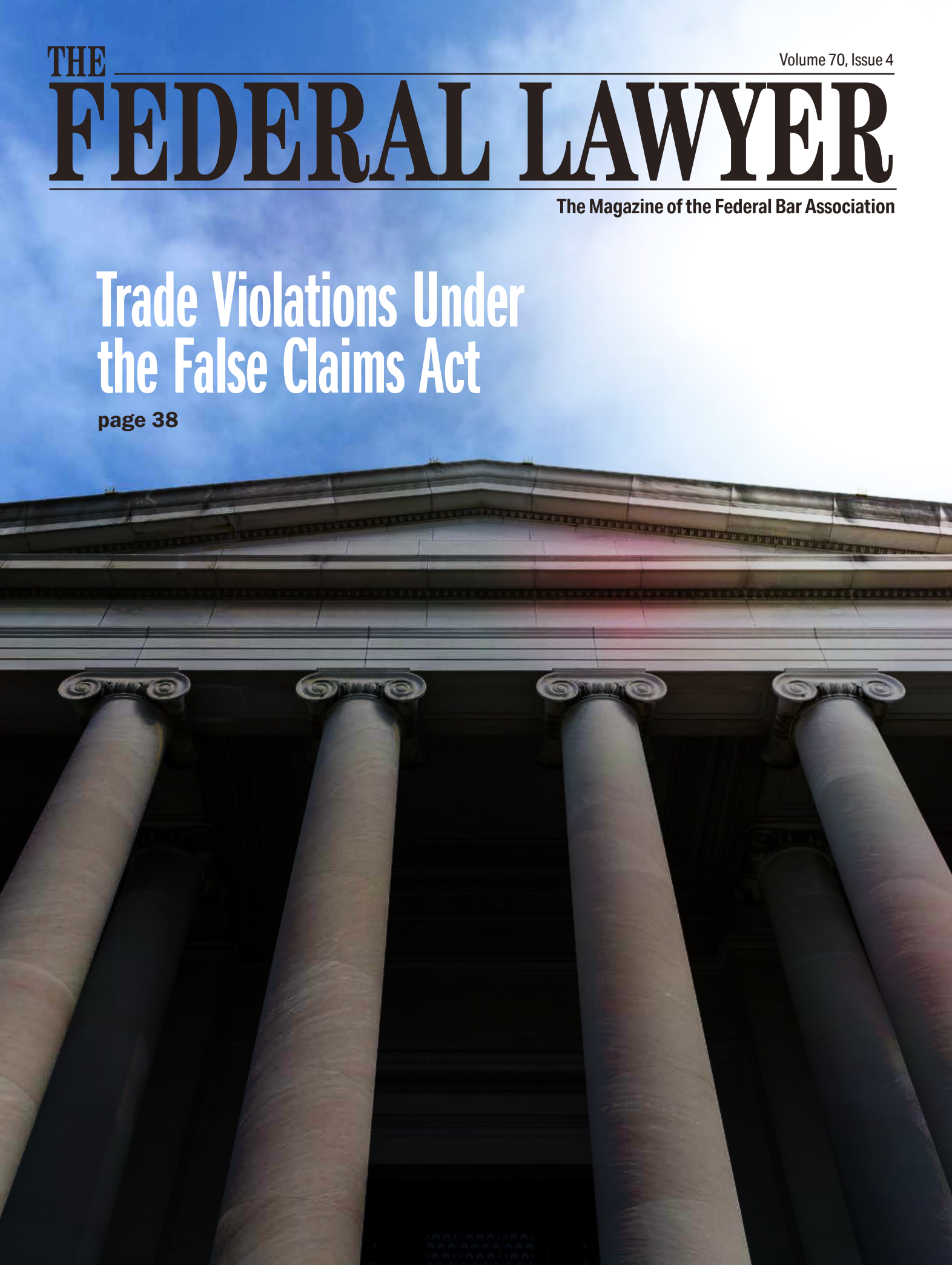

Trade Violations Under the False Claims Act

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On February 7, the U.S. Department of Justice (DOJ) announced that settlements and judgements under the False Claims Act (FCA) exceeded $2 billion for the 2022 fiscal year. The 2022 fiscal year also had the second-highest number of settlements and judgments for any given year in the history of the act.[1]

This news reflects the increasingly firm stance the U.S. government has taken on cases involving fraud against the government. Notably, President Biden's most recent State of the Union Address was heavy with themes of holding businesses accountable for fraudulent or exploitive behavior.[2] In addition, the DOJ has signaled multiple times since the beginning of March that the department will increase focus on corporate compliance and enforcement actions that combat corporate fraud. For example, on March 2, Deputy Attorney General Lisa Monaco, delivered remarks at the American Bar Association's National Institute on White Collar Crime where she announced department updates related to combatting corporate crimes. The updates included the addition of 25 new prosecutors to the DOJ's National Security Division "who will investigate and prosecute sanctions evasion, export control violations and similar economic crimes." Deputy Attorney General Monaco also stated in her speech that "increasingly, corporate criminal investigations carry profound national security implications."[3] That same day, the Department of Commerce, the Department of Treasury, and the DOJ issued a Joint Compliance Note on Russia-related sanctions and export controls. The Joint Compliance Note detailed how bad actors have attempted to evade these trade controls and stated that the three departments "will continue to use all tools at [their] disposal to prevent bad actors from circumventing the comprehensive export controls put in place to deter Russian aggression."[4]

One potential tool that could be used by the DOJ is the False Claims Act, that can serve as a vehicle for the enforcement of U.S. trade regulations. The FCA statute prohibits individuals and/or entities from fraudulently receiving payments from the government or wrongly withholding payments to the government. As stated by Deputy Attorney General Brian Boynton in the DOJ's February 7 announcement mentioned above, "the False Claims Act remains one of the most important tools for ensuring public funds are spent properly and advance public interest."

Generally, the FCA is most well-known for its application in cases where a party has fraudulently claimed money from the U.S. government. For example, the DOJ's February announcement discussed FCA cases involving companies that wrongfully billed federal health care programs for medically unnecessary services, banks that improperly disbursed COVID-19-related assistance funds, and a company that sold defective bullet proof vest material to the government. In each of these cases, the FCA was used to recover government funds that were distributed to these parties. However, the FCA also enables the government to recover payments that it should have received but did not due to the fraudulent actions of a third party. The provision of the FCA that allows this recovery is called the "reverse false claim" provision.[5] Recent FCA cases indicate an upward trend in the application of the FCA, and more specifically, the reverse false claim provision, to cases involving U.S. trade law and national security. For example, it has become increasingly common to see the FCA applied in cases involving violations of customs regulations. In addition, there has also been an uptick in recent years of FCA cases involving violations of U.S. export control laws and economic sanctions.

Against this backdrop of FCA application to trade cases and government-wide policy trends toward fighting corporate bad actors and safeguarding national security, we can expect increasingly robust use of the FCA to impose liability on businesses and individuals that falsely claim government funds or fraudulently withhold payments to the government. This article will first provide an overview of the FCA, its relevant provisions, and how FCA cases are initiated. It will then discuss how the FCA applies in cases involving Customs violations as well as how the FCA applies in cases involving export controls or economic sanctions. In addition, the article also touches on the implications of increased FCA application to trade violation cases and reviews penalties that may be assessed under the act.

False Claims Act Basics

The FCA is codified in Title 31 of the U.S. Code, §§ 3729-3733. It was originally enacted in 1863 to combat defense contractor fraud that took place during the Civil War. Since then, the FCA has been amended multiple times. In the trade context, one of the more significant amendments to the FCA came under the 2009 Fraud Enforcement & Recovery Act (FERA).

First, we must note that the FCA is most well-known for its use in cases where a party has fraudulently claimed money from the U.S. government. However, the act also applies in cases where a party has knowingly avoided payment to the government. The latter application, aptly called the "reverse false claim," is often used in trade-related cases where a party becomes liable under the FCA because they have fraudulently avoided paying customs duties, or other trade-related fees, to the U.S. government. Thus, instead of improperly *receiving* government funds, a party that is liable under the reverse false claims provision is one that fails to properly *pay* required fees to the government. While the reverse false claims provision has been a part of the FCA since 1986, the 2009 FERA amendments altered and expanded the reach of the provision.

FERA Amendments & The Reverse False Claim

Prior to the FERA, a party was only liable under the FCA if it submitted a false record or statement to the government in avoidance of an obligation to make a payment to the government. The FERA amendments took away the requirement that there be a false record or statement to the government as a prerequisite to liability. The FCA was also expanded to hold liable parties that "knowingly and improperly avoid or decrease an obligation to pay or transmit money or property to the government...." In addition, the term "obligation" was defined to include an "established duty, whether or not fixed, arising... from statute or regulation."[6] Importantly, the Senate Report accompanying the FERA also expressly states that the term "obligation" includes the payment of customs duties.[7]

Thus, the FERA amendments made it easier to hold parties engaged in customs violations liable under the FCA. Importers and exporters now face an increased risk of liability under the FCA, especially those that self-blind against potential trade violations or lack proper internal compliance systems and trained personnel. The sections below will provide examples of FCA claims against parties that violated U.S. trade laws. While each case involves varying facts, they all illustrate how important it is for parties engaged in international trade, as well as the brokers, agents, attorneys, and other individuals involved in facilitating the trade, to be aware of potential compliance risks and maintain robust compliance programs.

How FCA Cases Are Initiated

Before turning to FCA application in specific trade-related cases, it is helpful to understand how FCA cases are initiated. Importantly, the FCA's *qui tam* (a Latin phrase referring to a person who sues on behalf of the King or the government) provisions allow private parties that know of fraudulent behavior to initiate lawsuits under the FCA on behalf of the United States. FCA actions initiated by private parties are initially filed under seal. The government then has 60 days to investigate the claims and then choose whether to proceed with the action or decline to intervene. If the government declines to intervene, the private party, referred to as the "relator," may continue the action on their own. Importantly, a relator may be able to receive a share of the recovery in an FCA case even where the government declines to intervene. Thus, relators have an incentive to report FCA violations when they witness them.

Not surprisingly, the number of lawsuits initiated by individuals has "grown significantly since 1986," with the DOJ reporting an average of more than 12 new cases each week that are initiated by private parties.[8] Relators typically have direct knowledge of FCA violations, understand the policies or actions that led up to an FCA violation, and know what actors within the company facilitated the violations or knew of the wrongful actions. Accordingly, relators provide significant value to the government because they can provide unique knowledge and insight related to an FCA violation and can be a driving force for FCA enforcement. In fact, Senator Chuck Grassley, a long-time champion of the FCA, has stated that without "whistleblowers, the False Claims Act would simply not work."[9]

FCA Cases Involving Customs Violations

Although the FCA can apply in multiple types of trade-related cases, in the trade context, the FCA is most often used in cases involving violations of the customs regulations. Thus, we will first turn to these specific FCA trade cases. While customs violations in FCA cases generally stem from the underpayment of duties, the facts underlying those underpayments can vary from case to case. Recent cases provide illustrative examples of two of the most common types of customs violations in FCA cases: (1) the submission of false documentation to Customs and Border Protection (CBP) that undervalues imported goods, and (2) the misclassification goods under the Harmonized Tariff Schedule (HTS) to avoid the proper payment of duties.

Submission of False Documentation

To pay less in duties, individuals or companies will in some cases submit false invoices that do not reflect the true value of the items imported. Under customs law, the amount in duties owed to the government upon the importation of certain goods will typically be a percentage of the value of the relevant goods. Thus, invoices that falsely undervalue goods will result in an improper decrease in the amount of duties owed to the government.

As an example, on Dec. 19, 2022, the DOJ announced that it had settled claims brought under the FCA against Noble Brand Holdings (Noble), a Chinese manufacturer that knowingly underpaid customs duties by running a double invoicing scheme. Under this scheme, Noble would generate two sets of parallel invoices. The invoices with correct pricing for its products would be sent to the U.S. company purchasing the products, while false invoices with improperly reduced pricing were sent to customs brokers for valuation purposes.

As a result, Noble paid an improperly reduced amount in duties to the government based on the incorrect prices it included on the false invoices.[10]

Additionally, a settlement of an FCA action brought against Luchiano Visconti announced by the DOJ on Aug. 11, 2022, also involves the submission of false documentation to the government. Luchiano Visconti, a New York-based menswear company and its manager admitted to knowingly providing incorrect reports to CBP that undervalued apparel items the company imported into the United States. In some instances, the company and its manager would change the invoices to reflect improper valuations before submitting them to a customs broker. In other instances, the parties did not themselves falsify the invoices but did have reason to know that the invoices submitted by their foreign manufacturers to CBP included incorrect values for the goods. Ultimately, the parties in this case owed over $1.8 million in unpaid customs duties because of their schemes to avoid the payment.[11]

Misclassification of Goods

Misclassifying goods under the HTS is another method companies use to improperly avoid payment of Customs duties. The DOJ announced on January 30 that it had settled an FCA lawsuit brought against International Vitamins Corporation (IVC) for incorrectly classifying imported goods to avoid paying full customs duty amounts. IVC reported improper HTS classifications for imported items for more than four years, even failing to correct the misclassifications after hiring a consultant who confirmed with IVC that the classifications were incorrect. The DOJ stated that IVC's actions resulted in the underpayment of "millions of dollars of duties owed to CBP."[12]

More recently, the DOJ announced a settlement agreement it reached with a footwear company on February 7. Similar to IVC, the footwear company admitted to providing its customs brokers with documentation that incorrectly classified the items under the HTS so it could underpay customs duties. A U.S. attorney involved in the case stated that his office "is committed to combatting customs fraud by holding companies accountable when they misclassify goods and evade paying their legally required duties."[13]

In addition to false documentation declaring incorrect values and incorrect HTS classifications, FCA customs cases over the past several years have shown that companies are also willing to use other schemes to avoid paying duties, including the failure to properly include costs for customs assists (*e.g.*, parts or components, tooling, or molds used in the production of the merchandise) or transportation in the price declared to CBP,[14] the false representation of a country of origin,[15] and the fraudulent classification of goods as samples.[16]

Settlements in Customs Violation FCA Cases

A review of 2022 settlement agreements reflects robust penalties imposed on companies found liable for customs violations under the FCA. In fact, in FCA cases, a multiplier is typically added to the amount the responsible party owes in unpaid duties.[17] Multipliers vary case by case, but recent settlement agreements show that parties in FCA customs violations settlements can expect the unpaid duties to be multiplied by at least two.

For example, Noble Brand Holdings was required to pay a settlement amount of $500,000, roughly two and a half times the restitution owed to the government. International Vitamins Corporation paid $22,856,055 in the settlement of its FCA case, which was also more than double the amount it owed in restitution.

Individuals and companies should take these cases as a warning that schemes to avoid payment of customs duties can have dire consequences. For companies aware of potential customs or other trade violations, they should carefully consider consulting with an international trade attorney and the potential benefits of submitting voluntary disclosures to the government.[18]

FCA Application in Other Trade-Related Cases

As discussed above, FCA trade-related cases most often concern violations of customs regulations related to the importation of goods. But the FCA can also be applicable in cases involving violations of U.S. export laws, such as the Export Administration Regulations (EAR) and the International Traffic in Arms Regulations (ITAR), and violations of U.S. economic such as those in place against Russia or Iran. The following cases provide recent examples of how the FCA has been used to prosecute non-Customs-related trade violations.

For example, the U.S. Attorney's Office for the Northern District of Texas announced on February 27 that it had settled claims under the FCA with 3D Systems Corporation (3D Systems) for violations of the export control laws, including the EAR and the ITAR. According to the press release, 3D Systems was either directly or indirectly involved in manufacturing contracts issued by the Department of Defense and the National Aeronautics and Space Administration. 3D Systems exported certain items and intellectual property covered in the contracts to the People's Republic of China in contravention of U.S. export laws.[19]

In 2019 the DOJ entered into a global settlement with Unitrans International Inc. (Unitrans) and Anham FZCO (Anham) to settle FCA violations. Anham and Unitrans were government contractors that falsely certified their compliance with U.S. economic sanctions to the government in order to be awarded wartime contracts. During the duration of the contracts, the companies transshipped items through Iran in violation of U.S. sanctions to fulfill the government contracts. As such, the companies were liable under the FCA for the payments they fraudulently received on the contracts from the U.S. government.[20]

Similarly, the Second Circuit case *U.S. ex rel. Brutus Trading LLC v. Standard Chartered Bank et al.,* offers another example of how violations of U.S. sanctions may give rise to liability under the FCA. In that case, Standard Chartered Bank, a London-based multinational bank, faced FCA claims for violations of U.S. sanctions against Iran. Standard Chartered Bank allegedly failed to pay billions of dollars in penalties to the U.S. government for its unlawful facilitation of transactions for Iranian businesses and individuals made through U.S. financial institutions. Although this case was recently dismissed, the facts demonstrate how the FCA may pose a liability risk for companies engaged in actions that violate U.S. economic sanctions.[21]

As these cases show, the FCA is likely to be used as a tool to enforce import *and* export laws if the circumstances involve a fraudulent claim of money or failure to pay money to the U.S. government. While the FCA has a long history of combatting fraud against the government, recent statements and policy shifts made by federal officials suggest that the spotlight on corporate compliance is now brighter than ever and that we will continue to see frequent use of the FCA as an enforcement mechanism. For those in the trade world, it is important to keep in mind that the FCA has broad applicability

and its use by the DOJ to prosecute trade violations is becoming increasingly more common. As such, it is important for importers and exporters to ensure that they have a sufficient understanding of U.S. trade regulations and have internal compliance measures in place. ⊙

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