

Court clears air on prior disclosure

DUE TO PENTAX CORP.'S RECENT decision to pay the U.S. government \$20 million in a settlement of various claims associated with its violation of marking laws, the court opinions that resolved various points at issue have been brought back into the spotlight.

Most important of these was the decision by the Court of Appeals for the Federal Circuit in *Pentax Corp. vs. Robison*.

In that case, the court held that the 10% ad valorem duties required to be assessed on goods which are marked in violation of the marking statute do not constitute an "actual loss of revenue" to the government. Therefore, they do not have to be tendered upon submission of a prior disclosure.

This issue is significant because an importer must normally pay the actual loss of revenue to the government when filing a prior disclosure.

Here, Pentax entered merchandise marked with Hong Kong as the country of origin, while it was actually manufactured in China. Although this is a violation of the marking law, it did not result in any loss of the revenue to the government.

Consequently, upon submission of its prior disclosure covering the preceding five years (i.e., the period in which Customs can review records and assess penalties for a violation), Pentax did not tender any duties. Customs determined that

the marking duties (which it estimated to exceed \$5 million) did constitute a loss of revenue and refused to accept the company's prior disclosure until payment was made.



CUSTOMS UPDATE

STEVEN WEISER
&
ARI KAPLAN

By way of historical perspective, Pentax is an importer and distributor of photographic and optical equipment.

In the early 1970s, Pentax imported merchandise into the United States which was manufactured by its affiliate in Hong Kong and correctly marked with Hong Kong as its country of origin.

Sometime during this period, however, Pentax's affiliate began producing certain equipment in China, but it failed to make the appropriate changes in the country of origin markings on the goods. As such, Pentax was importing equipment from China marked with Hong Kong as the country of origin, a major error.

Importing for years before problems arose

Pentax apparently imported these mismarked goods for years without incident. Nevertheless, as is bound to happen, in 1990, Customs notified Pentax that an audit of its U.S. corporation, its Hong Kong affiliate and its Japanese parent was imminent.

Prior to commencement of the audit, a few months later, in early 1991, Pentax filed a prior disclosure admitting to marking violations which took place between 1987 and 1991 under the relevant provision of section 1592, the Customs penalty statute. The agency, however, would not accept Pentax's

disclosure without the payment of 10% ad valorem marking duties.

The penalty statute prohibits the importation of merchandise through false and material acts. These provisions are enforced without regard to whether the government is deprived of any lawful duties.

A prior disclosure is a means through which an importer can admit to a violation of the penalty statute. By filing a prior disclosure, the importer can limit the penalties for which it may be liable.

By way of example, if a violation of section 1592 is found, and an importer does not admit such violation through a prior disclosure, it could be subject to penalties in the amount of the domestic value of the merchandise for fraud, the domestic value or four times the lawful duties owed for gross negligence, or the domestic value or two times the lawful duties owed for negligence.

Filing a prior disclosure reduces the penalty

If the importer files a prior disclosure, however, the penalty, in the case where fraud is found, is reduced down to a maximum of a 100% of the lawful duties owed (if the violation affected the assessment duties), or 10% of the dutiable value of the merchandise.

The penalty is similarly reduced to the interest on the amount of duties of which the U.S. government is or may be deprived, for gross negligence or negligence.

When Customs required payment of the marking duties as a condition of accepting the company's prior disclosure, Pentax refused and sought administrative review of the matter.

The agency affirmed its decision not to accept Pentax's prior disclosure. Pentax then

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sought judicial review in the U.S. Court of International Trade ("CIT"), which also affirmed the decision. It was not until Pentax appealed that it prevailed.

The appeals court, in a brief but thorough decision, held that while Customs correctly determined that upon submission of a prior disclosure, an importer must submit the "actual loss of revenue" to the government, the 10% ad valorem mismarking duties do not fall within this category.

Court disputes government's claim of deprivation

In arriving at this conclusion, the appeals court used a basic "but for" analysis. It reasoned that the act of mismarking goods cannot be said to have deprived the government of the 10% ad valorem duties assessed under the marking statute.

As such, Pentax was not required to tender the money as a condition for receiving prior disclosure treatment under section 1592.

On the heels of this victory, Pentax brought suit in the CIT arguing that the company is not liable for any penalties under section 1592 for mismarking because the action was not 'material', i.e., that it did not affect any loss of revenue to the government or did not affect the admissibility of the goods. The CIT disagreed.

The court cited the fact that Pentax previously admitted that it made 'material' false statements, i.e., by entering goods marked with the incorrect country of origin.

The court further noted that the country of origin is almost always a material element in importing goods. It highlighted that such information could affect recordkeeping, the government's decision of whether to bring an unfair trade action or even duties and admissibility. The court also pointed out that

if, in fact, Customs did discover the mismarking prior to clearing the goods, it would have required Pentax to remark, export or destroy them.

The CIT distinguished the CAFC decision in Pentax and refused to use such holding to conclude that mismarking is completely immaterial for purposes of assessing a penalty under section 1592. Based upon this analysis, the CIT denied Pentax's claim.

The recent settlement not only resolves all of the claims which were the subject of the above litigation, it also addresses allegations that Pentax, its parent and affiliate, misled Customs in its investigation and destroyed key documents.

The Justice Department cited this as possibly the largest amount ever paid in a situation where misconduct did not directly affect Customs revenue.

Early Customs consultation is still recommended

And the ultimate lesson to be learned in the settlement is in understanding the nature and purpose of a prior disclosure. Certainly, before filing, an importer should consult Customs counsel in order to take advantage of the nuances in the law, such as those demonstrated by Pentax.

However, extreme caution must be utilized when admitting a violation of the law. Professional guidance is important for protecting a company's interests and limiting its liability, especially in light of Customs' recent campaign in connection with "enforced," rather than "informed," compliance.

Steven S. Weiser and Ari L. Kaplan are partner and associate, respectively, in the international law firm Graham & James LLP