MATERIALITY REQUIREMENT OF SECTION 592 AS APPLIED TO COUNTRY-OF-ORIGIN DECLARATIONS

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Correct identification of the country of origin is fundamental to the administration of several statutes administered in whole or in part by U.S. Customs and Border Protection (CBP)[1]. Tariff rates—be they "normal trade relations" (NTR) rates,[2] preferential duty rates, or "duty column two" rates[3]—depend on the country of origin.[4] Section 304 of the Tariff Act of 1930, as amended (the Tariff Act), requires that "every article of foreign origin" (or its container) imported into the United States must be marked to indicate the country of origin of the article.[5] Other U.S. federal agencies must make country of origin determinations as well.[6]

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[1] Prior to its reorganization in 2003, CBP was referred to as the U.S. Customs Service. *See* Reorganization Plan Modification for the Department of Homeland Security (Jan. 30, 2003); 6 U.S.C. § 542. For ease of reference, CBP will be used herein to refer to this agency both before and after the reorganization.

[2] NTR rates, formerly known as "most-favored-nation" rates, apply to imports from all countries, other than Column 2 rates (*see infra* note 2), imports that qualify for duty-free or preferential tariff treatment under bilateral or multilateral agreements (*e.g.*, North American Free Trade Agreement (NAFTA), U.S.-Australia Free Trade Agreement), or imports that qualify for duty-free under U.S. preference programs (*e.g.*, Generalized System of Preferences (GSP), African Growth and Opportunity Act, Andean Trade Preferences Act (ATPA)).

[3] U.S. INT'L TRADE COMM'N, HARMONIZED TARIFF SCHEDULE OF THE UNITED STATES (2012) (hereinafter HTS), Gen. Note 3(a)-(b). The HTS is incorporated by reference into the U.S. Code under 19 U.S.C. § 1202. Column 2 rates currently apply only to Cuba and North Korea. HTS Gen. Note 3(b).

[4] The rules for determining country of origin in the case of goods that are not wholly the growth, product, or manufacture of one particular country were traditionally governed by identifying the last country in which a "substantial transformation" had occurred, based on a change in name, character, or use. *Anheuser-Busch Brewing Ass'n v. United States*, 207 U.S. 556 (1908). In the case of NAFTA and several bilateral free trade agreements to which the United States is a party, the rules for determining whether imported goods are covered by the preferential duty rate is determined largely on the basis of a *tariff shift* method, or change in tariff classification, as a result of production occurring entirely in one or more of the parties to the agreement. Under several trade preference programs and bilateral free trade agreements, the primary test for determining whether imported merchandise is eligible for preferential or duty-free treatment is based on a *value added* method, whereby the cost or value of the input materials produced in the beneficiary country (or countries) and the direct cost of processing operations performed in the beneficiary country (or countries) must constitute at least 35 percent of the appraised value of the merchandise at the time the merchandise is entered into the United States. *See, e.g.,* 19 U.S.C. § 2463(a)(2)(ii) (GSP); 19 U.S.C. § 2703(a)(1)(B) (Caribbean Basin Economic Recovery Act), 19 U.S.C. § 3203(a)(1)(B) (ATPA); HTS Gen. Note 18(c)(ii)(B) (United States-Jordan Free Trade Area Implementation Act).

[5] 19 U.S.C. § 1304(a).

[6] The U.S. Department of Commerce has authority to determine country of origin for purposes of determining whether imported merchandise is subject to an antidumping or countervailing duty order, independent of the country of origin as determined by CBP for tariff or marking purposes. *See* Certain Cold-Rolled Carbon Steel Flat Products from Argentina, 58 Fed. Reg. 37,062, 37,066 (Dep't of Commerce July 9, 1993) (final determ.) (explaining that Department of Commerce applies its own "substantial transformation" rule for determining country of origin for purposes of scope of an antidumping duty order, is not bound by CBP rulings on substantial transformation, and concluding that galvanized steel sheet is substantially transformed in country where galvanizing takes place, even though CBP had previously ruled that galvanizing alone does not constitute a substantial transformation).

All of the above determinations begin with critical information provided to CBP when foreign merchandise enters U.S. territory. In order to ensure that correct country of origin, value, and other relevant information is provided to CBP for purposes of administering U.S. customs laws, Section 592 of the Tariff Act provides for civil penalties for negligence, gross negligence, or fraud when incorrect *material* information is provided (or omitted) in the entry documents.[7] While it is uncontroversial that incorrect country-of-origin information would give rise to a Section 592 action where the incorrect information causes CBP either to collect the wrong ordinary duty, fail to collect a cash deposit against potential antidumping or countervailing duties, or allow entry of merchandise that would otherwise be excluded as a result of a quota, it remains unsettled law whether incorrect country-of-origin information provided at the time of entry, with the requisite level of culpability, would constitute a *per se* violation of Section 592. This article addresses attempts by the U.S. Court of International Trade (CIT) to tackle that problem. Section I briefly outlines the statutory requirement of Section 592(a), the core customs civil penalty statute, with particular emphasis on the requirement of the statute that the incorrect or omitted information must be *material* to give rise to a Section 592 claim. Section II analyzes two competing views in the CIT's jurisprudence as to whether incorrect country-of-origin information is *per se* material for purposes of Section 592. Section III weighs the merits of the

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Even where a product is not required to be marked as foreign origin under the Tariff Act, the U.S. Federal Trade Commission (FTC) determines whether the product may permissibly be labeled as "Made in USA" or some variation thereof. *See* FED. TRADE COMM'N, ENFORCEMENT POLICY STATEMENT ON U.S. ORIGIN CLAIMS (Dec. 1997) (claiming authority to regulate "Made-in-USA" labeling claims based on Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, which prohibits "unfair or deceptive acts or practices").

Finally, numerous federal agencies determine the country of origin of merchandise for purposes of determining whether the merchandise complies with government procurement rules that require or establish a preference for purchasing U.S.-origin products. *See* Buy American Act, 41 U.S.C. § 10a-10d; Surface Transportation Assistance Act of 1982, 48 U.S.C. § 5323(j); American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, §1605, 2009 U.S.C.C.A.N. (123 Stat.) 115.

[7] 19 U.S.C. § 1592.

two approaches and suggests a test for determining materiality in the context of incorrect country-of-origin information.

I. THE STATUTORY REQUIREMENT OF SECTION 592(A)

Section 592(a)(1) of the Tariff Act provides the following general rule:

> Without regard to whether the United States is or may be deprived of all or a portion of any lawful duty, tax, or fee thereby, no person, by fraud, gross negligence, or negligence—
>
> > (A) may enter, introduce, or attempt to enter or introduce any merchandise into the commerce of the United States by means of—
> >
> > > (i) any document or electronically transmitted data or information, written or oral statement, or act which is ***material*** and false, or
> >
> > > (ii) any omission which is ***material***, or
> >
> > (b) may aid or abet any other person to violate subparagraph (A).[8]

The statute does not define the term "material" for purposes of liability for Section 592 civil penalties. As stated in the initial clause to the statute, the importer may be liable for civil penalties even if the U.S. Government is not deprived of revenue by reason of the violation. However, Section 592(b) clarifies that "[c]lerical errors or mistakes of fact" do not constitute violations of the statute, "unless they are a part of a pattern of negligent conduct."[9]

Finally, Section 592(d) makes clear that CBP has an independent right to recover any duties lost as a result of Section 592(a) violation, in addition to the civil penalty itself:

> Notwithstanding section 1514 of this title, if the United States has been deprived of lawful duties, taxes, or fees as a result of a violation of subsection (a) of this section, the Customs Service

[8] 19 U.S.C. § 1592(a)(1) (emphasis added).

[9] *Id*. § 1592(b).

> shall require that such lawful duties, taxes, and fees be restored, whether or not a monetary penalty is assessed.[10]

The legislative history provides only sparse guidance to the question of what constitutes a "material" document, electronic datum or piece of information, written or oral statement, act, or omission. Prior to 1978, Section 592 contained no materiality requirement.[11] The Customs Procedure Reform and Simplification Act of 1978 fundamentally changed the nature of the statute from what was previously strictly an *in rem* penalty against the merchandise itself, into a civil monetary penalty against the individual violator.[12] The Senate Report accompanying the 1978 legislation noted that "existing Section 592 is strongly criticized by all segments of the importing public because it requires a fixed penalty regardless of the nature of the violation, lacks due process safeguards, and does not permit effective judicial review."[13] The Senate Report further explained that the purpose of the Section 592 customs penalty was "to encourage accurate completion of the entry documents upon which customs must rely to assess duties and administer other customs laws."[14]

The legislative history did not specifically discuss the materiality requirement, except to underscore that materiality was an independent requirement of the revised Section 592:

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[10] 19 U.S.C. § 1592(d).

[11] *See* S. REP. NO. 95-778, at 17, *reprinted in* 1978 U.S.C.C.A.N. 2211, 2228-29 (explaining that the version of Section 592, prior to 1978, "penalize[d] any person who imports, attempts to import, or aids or procures the importation of merchandise into the United States 'by means of any fraudulent or false invoice, declaration, affidavit, letter, paper, or by means of any false statement, written or verbal, or by means of any false or fraudulent practice or appliance whatsoever' unless that person has 'reasonable cause to believe the truth of such statement.'"); *see also United States v. Ven-Fuel, Inc.,* 758 F.2d 741, 761-62 (1st Cir. 1985) (interpreting pre-1978 version of Section 592 and explaining that no materiality requirement was implied in caselaw interpreting statute at that time).

[12] The House Report to the legislation originally introduced in 1977 explains that "[t]he existing 592 is essentially a penalty against the merchandise itself, that is, an in rem proceeding. The revised provision is more properly one which assesses a monetary penalty against the individual violator." H.R. REP. NO. 95-621, at 13 (1977). The 1978 amendment retained seizure only as a provisional remedy. *See id*. ("[i]n certain specific instances, the merchandise itself may be seized as a provisional remedy"); *see also* 19 U.S.C. § 1592(c)(6) (detailing seizure provision of statute).

[13] *Id*. at 2, *reprinted in* 1978 U.S.C.C.A.N. at 2213.

[14] S. REP. NO. 95-778, at 17, *reprinted in* 1978 U.S.C.C.A.N. at 2229.

> There are also two basic categories of definitions. In the first, enumeration is made of several tangible items generally used for the importation of goods; included in this category are written or oral statements. For those items, it must be established that they were both false and material. Second, a violation may occur by means of an omission which [sic] is material, whether or not accompanied by any tangible form of evidence.[15]

The House Report further explained that part of the rationale for retaining a seizure remedy in limited instances was to address situations where the misclassification did not affect the tariff rate, but did affect admissibility of merchandise subject to a quota:

> The bill also authorizes the customs officer to seize merchandise when he has reasonable cause to believe that the action is "otherwise essential" to protect the revenue of the United States, or to "prevent the introduction of prohibited or restricted merchandise into the customs territory of the United States." This language was considered necessary since violations involving misdescription of quota merchandise, prohibited or restricted merchandise are often non-loss of revenue violations.[16]

II. TWO VIEWS IN CIT JURISPRUDENCE

Setting aside the distinct issue of level of culpability (mere mistake of fact, negligence, gross negligence, or fraud), in most cases the issue of whether a false listing in entry documents of the country of origin of merchandise is "material" is fairly cut and dried. For example, if, as a result of listing the country of origin incorrectly on the customs entry form, CBP entered the merchandise duty-free, pursuant to a preferential tariff program (such as GSP) or a free-trade agreement (such as NAFTA), but if the correct country of origin had been listed, such merchandise would not have been eligible for duty-free treatment, then there could be no serious dispute that the false country-of-origin information would have been "material" for purposes of Section 592. Similarly, if merchandise from the true country of origin was subject to some type

[15] H.R. REP. NO. 95-621, at 13.

[16] *Id*.

of quantitative limitation (such as the old Multi Fibre Arrangement)[17] or a safeguards quota,[18] but the country actually listed was not subject to a quota limit, then the false country-of-origin information would indisputably be "material" under Section 592. However, what if the incorrect listing of the country of origin affected neither the applicable duty rate nor quota limitations? The U.S. Court of Appeals for the Federal Circuit has not yet squarely settled the issue of whether incorrect country-of-origin information on entry documents would be *per se* material for purposes of Section 592, but two opinions of the U.S. Court of International Trade (CIT) have addressed this issue, and reached conflicting answers to the question.

A. *UNITED STATES V. PENTAX CORP.*

In *United States v. Pentax Corp*.,[19] the defendants were responsible for marking and importing cameras into U.S. customs territory.[20] The defendants marked the cameras as Hong Kong origin, when in fact the cameras should have been marked "made in China."[21] The goods would have been admitted and assessed duties at the same rate if they had been marked properly.[22] The defendants moved for summary judgment, arguing that they could not be liable for civil penalties under Section 592 because no change in duty rate or quotas were involved, and

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[17] For background on the Multi Fibre Arrangement, and its phase out under the Uruguay Round Agreements, *see* Alice J.-H. Wohn, Comment, *Toward GATT Integration: Circumventing Quantitative Restrictions on Textiles and Apparel Trade Under the Multi-Fibre Arrangement*, 22 U. Pa. J. Int'l Econ. L. 375 (2001).

[18] *See* Section 201 of the Tariff Act of 1974, 19 U.S.C. § 2251 *et seq*. The Section 201 safeguards mechanism allows for a wide variety of remedies for import relief, including quotas and tariff-rate quotas. *See* 19 U.S.C. § 2252(e)(2)(B)-(C).

[19] 23 CIT 668, 69 F. Supp. 2d 1361 (1999).

[20] *United States v. Pentax Corp*., 23 CIT at 668, 69 F. Supp. 2d at 1362.

[21] *Id*. at 668, 69 F. Supp. 2d at 1362-63.

[22] *Id*. at 668, 69 F. Supp. 2d at 1363.

therefore the false information presented to CBP could not be "material."[23] The Court denied defendants' motion, holding that "[c]ountry of origin is always, or nearly always, material."[24]

First, the court held that the country of origin "has the potential to affect all of Customs' core decisions."[25] The court did not, however, identify which "core decision" was (or might have been) affected in this instance. Second, the Court offered the following rationale:

> False country of origin declarations certainly also affect Customs' record-keeping, which in turn has the potential to affect decisions as to whether to bring unfair trade action, which in turn has the potential to affect duties.[26]

Here, the court did not find that there was a struggling U.S. camera industry that was even arguably contemplating bringing an antidumping, countervailing duty, or safeguards action. Instead, by merely using the phrase "potential to affect decisions as to whether to bring unfair trade action," the court seemed effectively to suggest that because the filing of unfair trade actions under U.S. law requires some sort of evidence regarding import volumes and values on a country-specific basis, and because the usual source of such evidence was the very import statistics that are gathered by CBP (and subsequently compiled by the Census Bureau), *any* false information provided regarding the country of origin *must* be material in all instances.

The third rationale the court provided was to note that incorrect declaration of the country of origin affects not only potential duty decisions or customs statistics, but also administration of the country-of-origin marking laws:

> Further, the concealed mismarking also has the potential to affect admissibility. Had the mismarking been discovered before release by Customs, the goods would not have been admitted as marked.

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[23] *Id*. at 668, 69 F. Supp. 2d at 1362.

[24] *Id*. at 669, 69 F. Supp. 2d at 1363.

[25] *Id*.

[26] *Id*.

> Remarking, exportation, or destruction, would have been required. If none of these measures were accomplished and if the mismarking had been discovered before liquidation, marking duties would have been assessed.[27]

In other words, the independent country-of-origin marking requirement under Section 304 of the Tariff Act means that as long as the country of origin for tariff purposes and marking purposes are the same,[28] then a discrepancy between the country of origin listed on the customs entry form and the country-of-origin marking on the good itself would mean that there must be a material violation affecting either duty or marking. Conversely, if both the country of origin and the marking are incorrect/false, then the false country of origin on the entry document must be material for purposes of Section 592 because it prevented CBP from demanding destruction or re-exportation as provided under Section 304.

However, this rationale required the Court carefully to distinguish the prior law of the case. *United States v. Pentax Corp.* was the continuation of litigation following the decision of the Federal Circuit in *Pentax Corp. v. United States Customs Service*.[29] In the Federal Circuit case, the court explained that the action arose after CBP notified the importer (Pentax) that it intended to conduct an audit.[30] This promoted Pentax to file a prior disclosure in order to mitigate any Section 592 penalties.[31] CBP then informed Pentax that, in order to perfect the

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[27] *Id*. (citing 19 C.F.R. § 134.51(a) (1991) and 19 U.S.C. § 1304(f) (1988). The statutory reference is to what is now codified as 19 U.S.C. § 1304(h), which provides for a 10 percent additional duty for importation of merchandise that is "not marked in accordance with the requirements of this section," unless the merchandise is re-exported, destroyed, or "marked after importation in accordance with the requirements of this section."

[28] In some cases, the country-of-origin rules for tariff purposes and marking purposes differ, even under the same free-trade agreement. *Compare* 19 C.F.R. Pt. 102 (NAFTA marking rules) with HTS Gen. Note 12(t) (NAFTA duty preference rules); *see also* Customs Ruling HQ 562266 (Jan. 30, 2002) (CBP private ruling holding that certain cotton pants should be marked as made in Mexico under the NAFTA marking rules per 19 C.F.R. § 102.21, but not eligible for NAFTA duty preference under the NAFTA tariff shift rules per HTS Gen. Note 12(t)/62.16.

[29] 125 F.3d 1457 (Fed. Cir. 1997), *amended*, 135 F.3d 760 (1998).

[30] *Pentax Corp. v U.S. Cus. Serv*., 125 F.3d 1457, 1460 (Fed. Cir. 1997).

[31] *Id*.

prior disclosure, Pentax must tender the marking duties that would have been owed under Section 304.[32] This prompted Pentax to file suit, seeking an injunction against CBP and review of CBP's determination that pre-payment of marking duties were necessary to perfect the prior disclosure.[33] CBP also initiated an enforcement action at the CIT, claiming civil penalties and restitution of duties from Pentax and its suppliers.[34] The CIT upheld CBP's determination, holding that marking duties are "lawful duties" subject to recovery under Section 592, and that the initial Section 502 violation, and the continuation of the violation, resulting from Pentax's failure to disclose the mismarking to CBP, caused the loss of marking duties.[35] In order to receive prior disclosure treatment, the CIT ruled that Pentax must first pay the marking duties.[36] Pentax then appealed this partial final judgment to the Federal Circuit, which reversed.[37] The Federal Circuit held that:

> We interpret the section 1592(d) causation requirement as requiring nothing less than but-for causation. We agree with plaintiffs that the government was not deprived of the § 1304(f) *ad valorem* duties "as a result of the *section 1592(a)* violation," as required by section 1592(d), because it is not the case that the section 1304(f) violation would not have occurred but for the section 1592(a) violation. Section 1592(a) prohibits misrepresentations resulting from misconduct—fraud, gross negligence, or negligence. Thus, the actions that violate § 1592(a) are the acts of fraudulently or negligently mismarking imported goods. If the act of culpably mismarking the goods deprived the government of duties, for example, if the goods were marked with a country of origin having a lower duty than the country from which the goods actually originated, then those duties of which the government was deprived are of the type whose tender is required

[32] *Id*.

[33] *Id*.

[34] *Id*.

[35] *Id*.

[36] *Id*. at 1461.

[37] *Id*. at 1463.

> for prior disclosure treatment. We hold that the 10 percent *ad valorem* mismarking duties do not fall into this category.
>
> The act of culpably mismarking goods cannot be said to have deprived the government of the 10 percent *ad valorem* duty assessed under 1304(f). To the contrary, but for the mismarkings (followed by the failure to export, destroy, or remark the articles in accordance with section 1304), the duty could not have arisen. Thus, the proper characterization of the relationship between sections 1304(f) and 1592(d) is that the two sections are coupled only to the extent that the act of mismarking can give rise to a violation of both sections—section 1304(f) if the mismarking is not cured, and 1592(d) if the mismarking occurred as a result of fraud, gross negligence or negligence.[38]

Following the Federal Circuit's reversal, CBP sought rehearing by the panel, alleging two errors: (1) the Federal Circuit overlooked the fact that Pentax had filed false entry documents, and (2) the Federal Circuit did not address the government's theory that these false entry documents were an independent violation of Section 592(a) that provided for a separate basis for recovery of marking duties pursuant to Section 592(d).[39] Although the Federal Circuit agreed to amend its prior opinion by acknowledging the factual omission, the Federal Circuit declined to address the government's theory that the entry of false entry documents constituted a separate violation under Section 592(a), on the grounds that this theory was not raised on appeal.[40]

The case then reverted back to the CIT for consideration of the remainder of the pending action, specifically Pentax's demand for summary judgment against CBP's action seeking enforcement of the Section 592 penalty.[41] The CIT, acknowledging the Federal Circuit's ruling, nevertheless stated as follows:

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[38] *Id*.

[39] *Pentax Corp. v. U.S. Cus. Serv*., 135 F.3d 760, 762 (Fed. Cir. 1998).

[40] *Id*.

[41] *United States v. Pentax Corp*., 23 CIT at 668, 69 F. Supp. 2d at 1362.

> The court declines to expand the Federal Circuit's decision in *Pentax*, into a holding that mismarking, which makes goods further dutiable or inadmissible, if timely recognized by Customs, is completely immaterial for purposes of 19 U.S.C. § 1592, unless *but for* the mismarking the goods would have been inadmissible or subject to other duties.[42]

The CIT contended that the Federal Circuit's decision did not foreclose the CIT's third rationale (regarding the interplay between Section 592 and 304), on the grounds that the Federal Circuit's decision merely held that "*duties* were not owed under 19 U.S.C. § 1592(d) because the mismarking did not deprive the United States of duties directly."[43] The CIT added that "[b]y adopting a reading of 19 U.S.C. § 1592 which [sic] does not encourage proper marking or proper use of the prior disclosure statute, *Pentax* obviously indicates that the statute needs amendment."[44]

Having distinguished the Federal Circuit's prior holding, the CIT characterized the issue as a choice of whether the test to determine if a false statement or omission was "material" should be a "but for" or a "natural tendency" test. The CIT held that, notwithstanding the Federal Circuit's application of a "but for" test for Section 592(d), a "natural tendency" test should be used to determine what is "material" for purposes of Section 592(a).[45] In so doing, the CIT cited *United States v. An Antique Platter of Gold*,[46] a case in which the Second Circuit interpreted the materiality requirement in the context of the *criminal* customs fraud provision.[47] Adopting the "natural tendency" approach, the Second Circuit explained as follows:

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[42] *Id*. at 669, 69 F. Supp. 2d at 1363 (emphasis original).

[43] *Id*. at 669 n.3, 69 F. Supp. 2d at 1363 n.3 (emphasis original).

[44] *Id*. at 670 n.7, 69 F. Supp. 2d at 1364 n.7.

[45] *Id*. at 669, 69 F. Supp. 2d at 1363.

[46] 184 F.3d 131 (2d Cir. 1999).

[47] 18 U.S.C. § 542.

> We therefore hold that "a false statement is material under [S]ection 542 if it has the potential significantly to affect the integrity or operation of the importation process as a whole, and that neither actual causation nor harm to the government need be demonstrated." For a trier of fact to determine whether a statement can significantly affect the importation process, it need ask only whether a reasonable customs official would consider the statements to be significant to the exercise of his or her official duties. This analysis is analogous to the securities context, where a statement (or omission) is material if there is a "substantial likelihood" that a reasonable investor would view it as "significantly alter[ing] the 'total mix' of information made available."[48]

The CIT also cited to *United States v. Rockwell International Corp.*,[49] an earlier CIT case which held that "'[i]n determining whether a false statement is material, the test is whether it has a natural tendency to influence, or was capable of influencing, the decision of the tribunal in making a determination required to be made.'"[50]

The CIT quoted CBP's Penalty Guidelines, which define "materiality" as follows:

> A document, statement, act, or omission is material if it has the *potential* to alter the classification, appraisement, or admissibility of merchandise, or the liability for duty, or if it tends to conceal an unfair trade practice under the antidumping, countervailing duty or similar statute, or an unfair act involving patent or copyright infringement.[51]

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[48] *United States v. An Antique Platter of Gold*, 184 F.3d at 136 (quoting *United States v. Holmquist*, 36 F.3d 154, 159 (1st. Cir. 1994) and *TCS Indus., Inc. v. Northway, Inc.,* 426 U.S. 438, 449, 96 S.Ct. 2126, 49 L.Ed.2d 757 (1976)).

[49] 10 CIT 38, 628 F. Supp. 206 (1986).

[50] *United States v. Rockwell Int'l Corp.,* 10 CIT 38, 42, 628 F. Supp. 206, 210 (quoting *United States v. Krause*, 507 F.2d 113, 118 (5th Cir. 1975)).

[51] *United States v. Pentax Corp.,* 23 CIT at 670 n.5, 69 F. Supp. 2d at 1364 n.5 (emphasis added by the court) (quoting 19 C.F.R. Pt. 171, App. B, ¶ A (1999)).

The CIT reasoned that if the Penalty Guidelines "is read to require a *but for* standard, it would conflict with 19 U.S.C. §§ 1304 and 1592, and render those provisions meaningless for mismarking not affecting revenue and not discovered before liquidation.[52]

Finally, the CIT argued that a contrary reading was not tenable, because it would allow an unacceptable loophole that would render the statute meaningless:

> If penalties, as well as duties, are not owed, importers seeking to fool Customs or the public by such mismarking may simply lie, conceal the lie, and risk no harm. This cannot be so.[53]

B. *UNITED STATES V. ACTIVE FRONTIER INTERNATIONAL, INC.*

Approximately twelve years later, the question of materiality in Section 592 arose again in *United States v. Active Frontier International, Inc.*[54] The defendant, Active Frontier International, Inc. (AFI) allegedly imported wearing apparel on seven entries made during 2006 and 2007.[55] According to CBP, all of the merchandise in question was manufactured in the People's Republic of China, but AFI's entry documentation filed with CBP showed the country of origin to be one of three countries: Indonesia, South Korea, or the Philippines.[56] CBP issued a pre-penalty notice informing AFI that it was considering imposing a civil penalty under Section 592, based on a degree of culpability of negligence.[57] AFI did not respond to the pre-penalty notice, nor to the final penalty notice demanding payment, and so CBP initiated an action at the

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[52] *United States v. Pentax Corp.,* 23 CIT at 670, 69 F. Supp. 2d at 1364 (emphasis original).

[53] *Id.*

[54] Ct. No. 11-00167, Slip Op. 12-112 (Ct. Int'l Trade Aug. 30, 2012).

[55] *United States v. Active Frontier Int'l, Inc.,* Ct. No. 11-000167, Slip Op. 12-112, at 1 (Ct. Int'l Trade Aug. 30, 2012).

[56] *Id*. at 1-2.

[57] *Id*. at 2.

CIT to recover the civil penalty.[58] Again, AFI did not plead or defend itself, so CBP applied to the court for a judgment by default under USCIT Rule 55(b).[59]

The court denied without prejudice the application for judgment by default,[60] on the grounds that CBP's complaint "does not allege facts from which the court can conclude that the alleged false statements of country of origin made upon entry were 'material' within the meaning of Section 592."[61] The court noted that CBP acknowledged in its complaint that the violations did not affect the assessment of duties.[62]

The court noted that the use of the qualifier "material" in the text of Section 592 indicated the intention of Congress that "not every false statement made in connection with the entry of merchandise will subject an importer to civil penalty liability."[63] However, the statute does not define the term "material."[64] The court found that the legislative history of the 1978 amendment to Section 592 indicated that the purpose was "to encourage accurate completion of the entry documents upon which Customs must rely to assess duties and administer other customs laws.'"[65] The court further cited to the definition of "material in *Black's Law Dictionary* as being "'[of] such a nature that knowledge of the item would affect a person's decision-making; significant; essential.'"[66]

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[58] *Id*.

[59] *Id*.

[60] *Id*. at 14.

[61] *Id*. at 5.

[62] *Id*.

[63] *Id*.

[64] *Id*.

[65] *Id*. (quoting S. Rep. No. 778, at 17 (1978)).

[66] *Active Frontier*, Slip Op. 12-112 at 5 (quoting BLACK'S LAW DICTIONARY 998 (8th ed. 2004)).

With this backdrop, the court in *Active Frontier* found that the only "fact" alleged that addresses the issue of materiality stated that the documents were "materially false" because these documents "'influenced, among other things, CBP's determinations as to the origin and admissibility of the merchandise entered by AFI.'"[67] The court held that this statement was circular and implied, as a premise, the conclusion of law that *any* false country of origin statement made in connection with the entry of merchandise is *per se* "material" under Section 592(a).[68]

The court flatly rejected a *per se* rule of materiality. The court first noted that CBP cited no *binding* authority for the proposition that listing the wrong country of origin in entry documents is *per se* material for purposes of Section 592.[69] The court noted the "natural tendency" language in CBP's Penalty Guidelines.[70] However, the court concluded that the Penalty Guidelines are not binding on the Court, observing that the preamble to the Guidelines states that "[t]he Penalty Guidelines were designed upon issuance as non-binding on Customs and as being disseminated only to inform the public of internal agency guidance."[71] The court held that "[b]ecause the Penalty Guidelines are not a legislative rule and, instead, are expressly intended as non-binding on the agency that issued them, they cannot bind the Judicial Branch."[72]

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[67] *Active Frontier*, Slip Op. 12-115 at 6 (quoting CBP's complaint).

[68] *Id*.

[69] *Id*. In addition to explaining in detail that CBP's penalty guidelines were not binding, the court did not appear to give much weight to the CIT's earlier decision in *United States v. Pentax Corp.* Aside from the fact that CIT judges do not treat each other's opinions as "binding" (only the decisions of the Federal Circuit and the U.S. Supreme Court are "binding" on the CIT), the court in *Active Frontier* impliedly distinguished *United States v. Pentax Corp.* based on the fact that that *Pentax* involved a marking issue, whereas no allegation was made in *Active Frontier* that the imported merchandise was incorrectly marked.

[70] *Active Frontier*, Slip Op. 12-115 at 6-7 (quoting 19 C.F.R. Pt. 171 App. B(B) (2006)).

[71] *Id*. at 7 (citing Guidelines for the Imposition & Mitigation of Penalties for Violations of 19 U.S.C. 1592, 65 Fed. Reg. 39,087, 39,089 (June 23, 2000).

[72] *Active Frontier*, Slip Op. 12-115 at 7 (citing CHARLES H. KOCH, JR., 3 ADMINISTRATIVE LAW & PRACTICE § 10.22 (3d ed. 2010)).

The court did note that the Penalty Guidelines might be entitled to "a degree of deference" along the lines of *Skidmore* deference, which "instructed that courts may resort for guidance to a non-binding agency interpretive ruling and defer to such a ruling based on 'all those factors which give it the power to persuade, if lacking the power to control.'"[73] Ultimately, however, the court decided not to defer to the Penalty Guidelines, because the definition of "material" in the Penalty Guidelines is "unpersuasive, and at odds with the statutory purpose, in categorically deeming any false statement of origin 'material' within the meaning of Section 592."[74]

First, the court referred again to the purpose embodied in the legislative history, concluding that "a misstatement of country of origin made upon entry will be material for purposes of Section 592 if it affects, or has the potential to affect, some determination Customs is called on to make with respect to the imported merchandise in question."[75]

Second, the court rejected CBP's argument based on the potential connection to textile quotas then in effect.[76] Apparently each of the seven entries in question contained some apparel items subject to quota, and other items not subject to quota.[77] The court held that these facts were stated in a supplemental brief, rather than in the complaint as required. Furthermore,

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[73] *Active Frontier*, Slip Op. 12-112 at 7-8 (quoting *Skidmore v. Swift & Co*., 323 U.S. 134, 140 (1944)); *see also United States v. Mead Corp*., 533 U.S. 218, 228 (2001) (holding that Customs rulings were not entitled to *Chevron* deference, but rather to *Skidmore* deference, reasoning that "[t]he fair measure of deference to an agency administering its own statute has been understood to vary with circumstances, and courts have looked to the degree of the agency's care, its consistency, formality, and relative expertness, and the persuasiveness of the agency's position"). In *Mead*, the Supreme Court further held that "classification rulings are best treated like interpretations contained in policy statements, agency manuals, and enforcement guidelines. They are beyond the *Chevron* pale." Mead, 533 U.S. at 234 (citations and internal quotation marks omitted).

[74] *Active Frontier*, Slip Op. 12-112 at 8.

[75] *Id*.

[76] *Id*. at 9-11.

[77] *Id*. at 10.

> Even had these additional facts been alleged in the complaint, however, they would not establish that the mere presence of both non-quota and quota merchandise on the same entry, for all of which merchandise the origin was allegedly declared falsely, sufficed to make the origin declaration material as to the non-quota merchandise on the entry. None of the facts plaintiff alleges—within or outside of the complaint—would allow the court to conclude that the origin statements could have affected the determination of the admissibility of non-quota merchandise, whether or not present on the same entry as quota merchandise.[78]

Third, the court rejected CBP's argument, relying on *United States v. Pentax Corp.*, that, even where the material was not subject to quota, false statements are "always or nearly always material."[79] The court rejected the *per se* approach advocated in *United States v. Pentax Corp.* on the grounds that

> Finding materiality to exist merely because a misstatement or material omission affected the accuracy of CBP record-keeping or of import statistics would impose serious penalty liability for any of a great number of common and inconsequential errors appearing in entry documentation. Such a low threshold for penalty liability would stretch the concept of Section 592 materiality to the point where it is practically meaningless.[80]

Fourth, in addition to finding that the open-ended liability that such a rule would imply, the court held that application of *per se* rule based on tainting accuracy of import statistics would lead to anomalous results. For example, what if an importer incorrectly enters product under a dutiable tariff item, when the item should have been entered under a duty-free provision? If the importer discovers the error and protests, would CBP be entitled to a 20 percent non-revenue loss penalty for negligence under Section 592, "grounded in nothing more than import statistics"?[81]

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[78] *Id*. at 10-11.

[79] *Id*. at 11 (quoting CBP's supplemental brief, which in turn quoted and cited *United States v. Pentax Corp*.).

[80] *Id*.

[81] *Id*. at 12.

Finally, the court rejected the argument that tainted import statistics made the violation material because it might affect future legislation in imposing a quota.[82] The court reasoned that a connection to merely the *potential* that quotas might be adopted in the future is too tenuous, explaining that

> Virtually any import statistic might be consulted as to enactment of a future trade law and, for reasons the court has discussed, basing Section 592 materiality on the effect an error has on trade statistics renders the materiality concept practically meaningless. The legislative history discusses the need for information with which to "assess duties and administer other customs *laws*." *Senate Report* 17 (emphasis added). The court does not glean from the legislative history a congressional intent that any error affecting import statistics should be deemed material under Section 592 simply because it conceivably could be considered by Congress in enacting a future law.[83]

As a result of its analysis, the court in *Active Frontier* denied the application for default judgment without prejudice, and offered CBP an opportunity to amend its complaint to add the requisite facts necessary to allege that the false statements in the entry documents were indeed material.

III. ASSESSING THE MERITS OF THE TWO APPROACHES

A. COMMON GROUND

As noted at the outset of this paper, anytime that a misidentification of country of origin results in a change in ordinary duty rates (*e.g.*, from Category 2 to Category 1, or from Category 1 NTR to preferential rates), then the misidentification must be material for purposes of Section

[82] *Id*. at 13-14.

[83] *Id*. at 14.

592. The same is true in a situation where the imported merchandise would be subject to a quota if the country of origin had been properly reported.[84]

Furthermore, anytime that the misclassification touches on some unfair trade action that has actually been set in motion, whether it be a pending antidumping or countervailing duty petition, a scope request, or an anti-circumvention petition, then it would appear indisputable that the materiality test is met. The false country-of-origin information would, at a minimum, allow the importer to avoid having to post cash deposits or surety bonds against potential antidumping or countervailing duties, and therefore the false declaration on the entry form would surely be material under any reasonable definition of the term. Even if the Department of Commerce had not yet issued a preliminary determination in the investigation, there is a compelling case that providing incorrect country-of-origin information for imported merchandise of the class or kind subject to investigation would be material, because the misclassification of the country of origin could potentially affect whether the petitioner is able to allege, and the Department of Commerce is able to conclude, that "critical circumstances" exist.[85] Finally, there is at least a fair case to make that if the government can show, *but for* the misclassification, that the Department of Commerce's analysis in a pending scope inquiry[86] or anti-circumvention proceeding[87] might have been different, then the misclassification must be deemed to be material.

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[84] In theory, if the quota for the product and country in question historically had never reached its limit, then the importer could argue that the misclassification under a country not subject to a quota (or subject to a larger quota) was not material, but that might be a stretch, and in any event such an historical-based argument would need to be supported by evidence and therefore would be insufficient to dismiss a complaint by CBP at the pleading stage. The authors are aware of no reported cases in which such an argument has been made.

[85] *See* 19 U.S.C. § 1673b(e)(1)(B) (stating that finding of critical circumstances, and consequent retroactive suspension of liquidation, depends in part on a finding that "there have been massive imports of the subject merchandise over a relatively short period").

[86] *See* 19 C.F.R. § 351.225 (scope inquiry regulations).

[87] *See* 19 U.S.C. § 1677j (statutory provision governing circumvention of antidumping and countervailing duty orders).

B. PROBLEMS WITH *PER SE* APPROACH OF *UNITED STATES V. PENTAX CORP.*

The position of the CIT in *United States v. Pentax Corp.*, namely that "[c]ountry of origin is always, or nearly always, material," presents several problems, some of which were identified in the *Active Frontier* opinion. First, it seems too attenuated and speculative to argue that country-of-origin misclassification affects CBP's record-keeping, which in turn has the potential to affect decisions by hypothetical U.S. producers as to whether to bring unfair trade actions, which in turn has the potential to affect ultimate duty rates. As noted by the CIT in *Active Frontier*, this reasoning truly renders the term "material" meaningless in the statute, because all country-of-origin classifications could affect import statistics, and any set of import statistics could, *in theory*, be used to construct an antidumping or countervailing duty petition.

Second, the CIT in *Pentax* appears to miss the central point by emphasizing the "natural tendency" test over the "but for" test for materiality. The "natural tendency" test would appear to be a reasonable alternative to the stricter "but for" test in terms of the quantum of proof required by the government, but where the *Pentax* "natural tendency" test goes astray is that it begs the question of *what* difference the mismarking might have made. To say generally that mismarking might have been "significant to the exercise" of CBP's "official duties" or that it might have "significantly altered" the "total mix of information available" is too general a standard with respect to the object. The test should at least be tied to an actual *decision* that some government official had to make, not just the official's ministerial duty of summarizing data that the government generates in the ordinary course of admitting merchandise for entry in U.S. customs territory.

Finally, the argument in *Pentax* that a stricter test gives the importer license to "fool" CBP or the public is unpersuasive. Again, it simply begs the question. The importer is only "fooling" CBP (or the Department of Commerce, International Trade Commission, or some other

governmental agency) if the false information could conceivably have made a difference in a decision-making process, as opposed to execution of strictly ministerial responsibilities.

C. AN ALTERNATIVE APPROACH

As noted above, there is nothing inherently wrong with using a "tendency" test as opposed to a strictly "but for" test in determining whether a particular piece of information is "material" for purposes of Section 592. But the application of the "tendency" test should focus on the quantum of proof, not the fact pattern than makes a given incorrect statement material or simply trivial. A reasonable approach would be to state that the government need not prove that a governmental decision *would* have been different *but for* the incorrect country of origin, but rather that there is at least a fair possibility that a government decision (as opposed to a ministerial action) *might* have been different *but for* the incorrect country of origin. The court need not engage in making complex counter-factual predictions as to what would have actually occurred had the country-of-origin information had actually been correct. The court would permit pleading, and introduction of evidence, by the government to show, for example, that the class or kind of merchandise in question was of a type that had been the subject of past unfair trade complaints, or quota regulations (*e.g.*, steel, bearings, or textiles). Those pleadings, and evidence, would be used to support a conclusion that there is a reasonable possibility that U.S. producers might have been more inclined to actually file a trade complaint if the entry information had been correct, and thus the import statistics had been accurate.

IV. CONCLUSION

As globalization of manufacturing continues, CBP's role in protecting the integrity of numerous statutes designed to protect U.S. producers and consumers will only grow in importance. One of the most important tools in CBP's arsenal for policing the border is the power under Section 592 to impose civil penalties for negligent, grossly negligent, and

fraudulent reporting of data on customs forms. This power is limited to the terms of the statute, including the requirement in the statute that any false information or omission of information must be "material" in order for civil liability to be imposed.

The statute itself provides no definition, and the legislative history supplies scarce guidance. The Court in *Pentax* views the term broadly, as least with respect to country-of-origin questions, based largely on a view that a narrower interpretation could affect the integrity of a multitude of data collected by CBP, for its own purposes and on behalf of other governmental agencies. This perspective emphasizes the leading role that CBP plays as a gate-keeper for trade laws (as well as certain consumer protection laws). The Court in *Active Frontier*, by contrast, emphasizes that while the term "material" should not be interpreted too narrowly, at the same time there must be some meaningful limit on what kind of information would be "material." According to the view in *Active Frontier*, the term "material" must have some independent limiting quality under basic principles of statutory construction, and to hold otherwise would lead to absurd results. An alternative approach presented herein would require courts to draw some sort of tie between the false (or omitted) information and a potential effect on some agency decision in order for the materiality test to be satisfied. Ultimately, the issue of how broadly the term "material" is construed in Section 592 will be up for the Federal Circuit to decide.

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