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**TO CLIENTS AND FRIENDS:**

***REASONABLE CARE:***

***An assessment of importers' actions and whether they rise to the occasion***

The Customs Modernization and Informed Compliance Act (“Mod Act”) added the requirement that importers exercise “reasonable care” when entering merchandise.<sup>1</sup> Under the Mod Act, the failure to exercise reasonable care may result in the imposition of section 592<sup>2</sup> penalties for fraud, gross negligence or negligence.<sup>3</sup>

To meet “reasonable care” the Mod Act drafting committee noted an importer should consider: seeking a pre-importation or formal ruling from Customs; consulting with a *Customs Expert* – an individual who specializes in customs matters, such as, a licensed customs broker, attorney or consultant; and, using in-house employees with experience and knowledge of Customs laws, regulations, and procedures.<sup>4</sup>

For purposes of administrative penalty proceedings, Customs’ guidelines accept that an importer can demonstrate it has not acted negligently by demonstrating that it took actions in conformance with reasonable care to fulfill its responsibilities for entry of merchandise, including, among other things:

- providing a classification and value for the merchandise;
- furnishing information sufficient to permit Customs to determine the final classification and valuation of merchandise;

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<sup>1</sup> The Mod Act was passed in 1993 as part of the North American Free Trade Agreements Implementation Act.

<sup>2</sup> 19 U.S.C 1592 is referred to as “section 592.” *See e.g.* 19 C.F.R. Pt. 171, App. B. Section 592 dictates “no person through fraud, gross negligence, or negligence may enter, introduce, or attempt to enter or introduce any merchandise into the United States by means of a material false document or statement, or a material omission.” *United States v. Jac Natori Co.*, 108 F.3d 295, 298 (Fed. Cir. 1997) (citing 19 U.S.C. § 1592(a)).

<sup>3</sup> *See* 19 C.F.R. Pt. 171, App. B(D)(6).

<sup>4</sup> *See* H. Rep. No. 103-361 at 120, 1993 U.S.C.C.A.N. 2670 (1993).

- taking measures that will lead to and assure the preparation of accurate documentation;
- Determining whether any applicable requirements of law with respect to these issues are met.<sup>5</sup>

All parties, including the importer, must also use reasonable care to provide accurate information or documentation to enable Customs to determine if the merchandise may be released.

The Mod Act also introduced the concepts of “informed compliance” and “shared responsibility” into the entry process. “Shared responsibility” captures Customs’ responsibility to inform the trade community of Customs’ requirements and business practices, and the trade community’s reciprocal responsibility to assure compliance with U.S. trade rules. Generally, informed compliance explains an importer’s right to be informed about Customs rules, regulations and interpretive rulings in order to establish consistency in the application of Customs law.

*The Parameters of Reasonable Care as a Defense: United States v. Optrex America, Inc.*<sup>6</sup>

An importer’s failure to follow a binding Customs ruling or unreasonable classification of an item will be considered to be indicative of a lack of reasonable care. The Court of International Trade (“CIT”) just recently considered the parameters of reasonable care when it was presented in a summary judgment motion as a complete defense to a CBP negligence penalty claim, in *United States v. Optrex America, Inc.*

The case concerned Customs’ attempt to collect a four million dollar plus penalty claim on two million dollars of disputed duties. In October 2002, Customs initiated a penalty case against Optrex America, Inc. (“Optrex”) alleging Optrex made negligent<sup>7</sup>, materially false statements on its entries of certain liquid crystal display (“LCD”) articles, primarily LCD panels.<sup>8</sup> Specifically, Customs asserted that Optrex’s classification of various LCD articles

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<sup>5</sup> See 19 C.F.R. Pt. 171, App. B(D)(6).

<sup>6</sup> *United States v. Optrex, America, Inc.*, dated May 17, 2006, Slip Op. 06-73, Barzilay, Judge.

<sup>7</sup> Negligence may arise out of an act or acts (of commission or omission) done through the failure to exercise the degree of reasonable care and competence expected from a person in the same circumstances. See 19 C.F.R. pt. 171, App. B(B) (emphasis added). See *United States v. Ford Motor Co.*, 395 F. Supp. 2d 1190, 1207 - 1208 (2005).

<sup>8</sup> Section 592 derogates from common law negligence, *i.e.* duty, breach, causation, and damages, by shifting the burden of persuasion to the defendant to show lack of negligence. *Ford Motor Co, supra.*

under heading 8531 of the Harmonized Tariff Schedule of the United States (“HTSUS”), instead of under heading 9013, HTSUS, resulted in a \$2,033,562.10 loss of revenue. In earlier stages of this comprehensive litigation, the CIT had ruled in favor of the government as to the classification issue, in *Optrex America Inc. v. United States*, Slip Op. 06-26 (CIT February 27, 2006), currently on appeal, and the CIT had rejected Customs’ efforts to add gross negligence and fraud as alternative claims in court proceedings, pursuant to the statutory language providing for proceedings *de novo*, even though there had been no such claims raised in the administrative penalty proceedings. *United States v. Optrex America, Inc.* Slip Op. 05-160 (CIT December 15, 2005). In the current phase of the case, Optrex argued that it was entitled to partial Summary Judgment and dismissal of the penalty claim because it had exercised reasonable care in the classification process. Two weeks ago, the CIT denied Optrex’s Summary Judgment motion, in the process shedding light on the parameters of a “reasonable care” defense. *United States v. Optrex America, Inc.*, Slip Op. 06-73 (CIT May 17, 2006).

#### Optrex’s Arguments in Support of Reasonable Care

In 1997, the Court of Appeals for the Federal Circuit sided with the government, holding that LCD panels are classifiable within Heading 8531, HTSUS.<sup>9</sup> In 1998, on the heels of that victory, Customs initiated an investigation into Optrex’s classification of shipments of LCD products within heading 9013, HTSUS, eventually asserting that Optrex’s classification actions constituted “negligence” in failing to provide sufficient information for Customs to classify the imported merchandise. While it is established that the exercise of reasonable care is a complete defense to the penalty claim, the penalty statute, 19 U.S.C. 1592(e)(4) places the burden of proof on the importer to establish reasonable care and the absence of negligence by a preponderance of the evidence; Customs need only establish the material false statement or omission occurred by a preponderance of the evidence to assert the claim. *Ford Motor Co. v. United States*, 395 F. Supp. 2d 1190, 1208 (CIT 2005).

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<sup>9</sup> *Sharp Microelec. Tech Inc. v. United States*, 122 F. 3d 1446 (Fed. Cir. 1997).

In response to Customs' penalty claim, Optrex claimed that it had exercised "reasonable care," inasmuch as it had consulted Customs professionals (Customs broker and attorney) in addition to its in-house technical experts to classify its merchandise. To further support its claims of reasonable care, Optrex asserted it cooperated with Customs officials. Optrex further averred Customs had failed to provide it with "clear, consistent, well reasoned publications and guidance on which to base its classifications and that there was a professional disagreement over the classification of the subject LCD articles. Optrex argued Customs' rulings on the classification of LCD articles were "incomprehensible." Finally, Optrex declared its reliance on a "decision tree" created by its Customs attorney was indicative of reasonable care because the tree was created in accord with judicial precedent and Customs Rulings.

#### Consultation with Customs Professionals

Primarily, Optrex asserted that it satisfied the duty of reasonable care through consultation with Customs professionals, including its Customs broker, an in-house expert and a Customs attorney. The Court found that Optrex did not support the consultation claims with sufficient evidence to warrant summary judgment. It is important to note that the court found no evidence of consultation with a Customs broker, despite the importer's assertions of that fact; moreover, the broker testified to the contrary, asserting that it was the importer who had instructed the broker as to entry of the technologically complex LCD products. As to consultations with the Customs attorney, Customs' asserted that "consultation" with a Customs attorney was insufficient because there was no evidence that Optrex had actually followed the attorney's advice and had possibly ignored the advice. The Court stated "consultation with an attorney is *evidence* of compliance; it is not compliance in itself."<sup>10</sup> In short, the Court found the mere assertion of consultation with a Customs expert does not establish reasonable care, especially when the advice may not have been followed.

#### Cooperation with Customs

Optrex also argued that its co-operation with Customs, including allowing Customs to interview employees and review files, catalogs, part number keys, and spreadsheets, were evidence of reasonable care. However, the Court explained it could not decide the significance of the asserted cooperation in light of Optrex's employees' inability to remember whether or not

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<sup>10</sup> *Optrex, America, Inc., supra*, at 21.

Optrex had actually sought classification advice from Customs. The Court opined that in such circumstances the existence of a ruling request is a significant element in a cooperation analysis.

The Court did not attempt to decide on summary judgment whether Optrex's practice of maintaining import accrual accounts for possible adverse Customs classification action should be considered suggestive of Optrex's knowledge that certain imported LCD articles were properly classifiable under a higher duty rate than entered. In that regard, knowledge of improper classification would be a direct affront to reasonable care. Despite these accounting practices, the Court stated "Optrex's accrual account was not an unusual accounting practice, and that it had been reviewed by Optrex's auditors."<sup>11</sup> Overall, limited evidence of cooperation with Customs is not likely to definitively establish reasonable care by a preponderance of the evidence.

#### The Double Edged Sword of Informed Compliance and Shared Responsibility

Relying on the concepts of informed compliance and shared responsibility, Optrex contended that it did not breach its duty of reasonable care because Customs failed to provide "clear, consistent, well reasoned publications and guidance" for classification. The Court rejected these arguments, explaining Optrex should have sought a Customs ruling for the LCD articles "[p]recisely because the classification of the LCD products was such a complex area."<sup>12</sup>

Moreover, despite Optrex's possession of a "decision tree" for classification, the mere existence of tree alone did not establish "reasonable care" where there was no evidence to show that Optrex employees actually relied on the decision tree when entering merchandise. The Court found reliance on the decision tree especially problematic because the tree was formulated after the entries were made. Similarly, an Optrex letter to Customs, which was not a ruling request, was not persuasive where it was questionable if the letter was written for the purpose of seeking Customs guidance. Ultimately, Optrex did not meet the heavy burden of shifting responsibility for the misclassification to Customs where it failed to seek a clarifying ruling.

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Importers should be aware of *U.S. v. Optrex America, Inc.* and the court's perception of certain actions:

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<sup>11</sup> *Optrex, America, Inc., supra*, at 22-23.

<sup>12</sup> *Optrex, America, Inc., supra*, at 25.

- *Consultation* with Customs professionals will provide evidence of reasonable care, but is not *per se* proof of compliance, particularly if the advice is not followed or if the information is received post importation;
- Merely having a broker make entry on your behalf does not qualify as a *consultation*;
- Keeping a record of meetings / consultations with Customs officials is a primary element in the assertion of cooperation with Customs;
- Import accrual accounts, although commonplace, can be evidence of undervaluation or mis-classification; and,
- If prior rulings lead to confusion over the classification of a particular item, a ruling should be sought for the item in question.

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