

1998

## United States Customs and Trade Regulation: Important Issues for Clients

James R. Cahil

Peter A. Quinter

Michelle Salem

Robert G. Schrader

Follow this and additional works at: <http://digitalcommons.wcl.american.edu/auilr>



Part of the [International Law Commons](#)

---

### Recommended Citation

Cahill, James R., et al. "United States Customs and Trade Regulation: Important Issues for Clients." American University International Law Review 13, no. 4 (1998): 1019-1068.

This Article is brought to you for free and open access by the Washington College of Law Journals & Law Reviews at Digital Commons @ American University Washington College of Law. It has been accepted for inclusion in American University International Law Review by an authorized administrator of Digital Commons @ American University Washington College of Law. For more information, please contact [fbrown@wcl.american.edu](mailto:fbrown@wcl.american.edu).

# UNITED STATES CUSTOMS AND TRADE REGULATION: IMPORTANT ISSUES FOR CLIENTS

JAMES R. CAHILL  
PETER A. QUINTER  
MICHELLE SALEM  
ROBERT G. SCHRADER

PANEL INTRODUCTION .....	1021
MODERATOR, ROBERT G. SCHRADER	
THE CUSTOMS MODERNIZATION ACT .....	1021
PRESENTATION BY JAMES R. CAHILL	
Introduction .....	1021
I. Private Laboratory Accreditation .....	1022
II. Merchandise Detention .....	1023
III. Protest Reviews .....	1024
IV. Penalties for Fraud .....	1025
V. Drawback & Refund of Duties .....	1026
VI. Broker Liability .....	1027
Conclusion .....	1027
VALUATION METHODS AND PITFALLS .....	1028
PRESENTATION BY MICHELLE SALEM	
Introduction .....	1028
I. Methods of Appraisal .....	1028
A. Transaction Value .....	1028
B. Deductive Value .....	1030
C. Computed Value .....	1031
II. Verifying Value .....	1032

ENFORCEMENT METHODS AND PRIORITIES  
OF THE UNITED STATES CUSTOMS SERVICE..... 1033  
PRESENTATION BY PETER A. QUINTER

Introduction .....	1033
I. Embargoed Countries .....	1034
II. Counterfeiting .....	1036
III. Currency Reporting .....	1037
IV. Internal Controls & Restraints .....	1038
V. Profiles .....	1039
VI. Mis-description .....	1041
VII. Country of Origin & Transshipment .....	1041
A. Country of Origin .....	1041
B. Transshipment .....	1042
C. Transshipment Under NAFTA .....	1042
1. Substantial Transformation .....	1043
2. NAFTA Tariff Shift Rules .....	1043
VIII. Harmonized Tariff Schedules .....	1044
IX. Commercial Ruling Requests .....	1045

MINIMIZING DUTY LIABILITY  
AND ISSUES OF EXPORT CONTROLS .....
 1046 |

PRESENTATION BY ROBERT G. SCHRADER

Introduction .....	1046
I. Minimizing Duty Liability .....	1047
A. Re-Classification Via Customs Ruling .....	1047
B. Preference Programs and Duty Free Treatment .....	1047
C. Foreign Trade Zones .....	1049
1. Subzones .....	1049
2. Privileged & Zone Restricted Status .....	1050
D. Bonded Warehouses .....	1051
1. Deferred Duty .....	1051
2. Time Limitations .....	1051
3. Trademark Issues .....	1052
4. Labeling, Marking, Packaging .....	1052
5. Manufacturing & Other Bonded Warehouses .....	1053
6. Bonded Warehouse Considerations .....	1054
E. Drawback .....	1055

II. Export Controls .....	1056
A. Licensing .....	1056
B. Embargoed Countries .....	1057
C. List of Denied Persons .....	1059
D. Specially Designated Nationals and Blocked Persons ..	1059
E. Client Export Management System.....	1060
F. Increased Customs Scrutiny .....	1061

AUDIENCE QUESTIONS .....	1063
--------------------------	------

I. Careers in Customs Law .....	1063
II. Customs Litigation .....	1066

## PANEL INTRODUCTION

MODERATOR, ROBERT G. SCHRADER

When you are importing merchandise into the United States, it is important to be well versed in many different areas of the law. This is because there are a number of different agencies involved, all with different requirements. Any mistakes may involve large penalties. With that, I will turn the podium over to Jim Cahill.

## THE CUSTOMS MODERNIZATION ACT

PRESENTATION BY JAMES R. CAHILL  
PRESIDENT, CAHILL CUSTOMS CONSULTING, INC.

### INTRODUCTION

Since retiring from the United States Customs Service about twelve years ago, I have been involved in consulting activities in every facet of customs. I work with many law firms that inquire about the intricacies of customs law, and I frequently testify as an expert witness. Despite all the attorney jokes you may hear, I find the customs attorneys I come in contact with very easy to deal with. They are generally very intelligent people who are extremely competent in

their field. In that respect, I have enjoyed my tenure.

I do not know all of your particular backgrounds. However, the issues I want to speak about are broad and very timely. This is due to the regulations associated with the 1993 Modernization Act just now being promulgated and only now beginning to take effect.

The Act was called Title VI and was part of the Modernization Act that was passed along with NAFTA. I think you are all familiar with NAFTA. Title VI became effective at the same time. However, many of the provisions of the Modernization Act were not implemented or applied until Customs took on the role of promulgating the rules and regulations, which detail how the Act will actually be applied in practice. After examining the particular changes—the Act is very thick—I selected a few topics that I thought would be especially interesting to you and that have a significant impact on traders and the importing community, including brokers and freight forwarders. These topics include private laboratory accreditation, merchandise detention, protest review, fraud penalties, drawback and refunding of duties, and broker liability.

#### I. PRIVATE LABORATORY ACCREDITATION

Section 613B of the Act (H.R. 3450) allows Customs to accredit private laboratories to perform tests that are normally done by Customs. Years ago, Customs did a great deal of testing and operated all of its own laboratories. It is only in recent years that Customs has started to reduce the number of its laboratories. While I was still at Customs, they reduced the number of laboratories to San Francisco, Washington, and Baltimore. Now the system is completely changed, and private laboratories can be fully accredited to do the testing.

Under the Modernization Act, Customs is moving away from doing all the work itself, meaning that it is moving closer to the selective audit approach. Under the new laboratory testing rule, Customs will be able to ensure the composition testing of any imported merchandise. An importer of record will now be able to request a release of samples of his goods from Customs in order to do his own testing at his own expense. In the absence of Customs testing, Customs will accept the results only if they are certified to the entry to which the goods were sampled, meaning that the goods were taken from the same shipment. A good example of the importance of this procedure

is found in the shoe industry.

My wife is the traffic manager of a major shoe company. Her job is to control all of the customs activities, broker's activities, and drawback activities, as well as to bring in new shoes for private laboratory verification where they verify the composition of these imports. To give you an idea of what is at stake in properly classifying the content, the duty rates for shoes range from about seven and a half percent to thirty-seven and a half percent, depending on the classification.

Clearly, when a shoe takes on a different classification it can significantly impact the importer's ability to make a profit on those particular shoes. A few of the private laboratories are run by former Customs employees who are experts in this field. I know a couple of cases in which importers were able to determine the correct classification simply by having two different labs compare notes. It is a great advantage to importers to have access to their own materials to do this.

In addition, there is another phase that we have always closely scrutinized—and I think my colleague Peter Quinter is going to speak about this issue—enforcement. In enforcement, Customs focuses its attention on a high risk area, namely this broad spectrum of duty rates. At one point Customs had a little operation called "hot foot." Of course, "hot foot" euphemistically meant that Customs was going to examine shoes more intensively. In general, Customs has begun to focus on a more extensive list of sensitive products, products that have a wide range of duty rates.

## II. MERCHANDISE DETENTION

The second topic, which I can cover a little more quickly, deals with the examination of merchandise that Customs has detained. In the past, when Customs detained goods to examine them and make decisions, the goods sometimes languished in a state of limbo. The new rules force Customs to decide within five days whether it will release the goods or detain the merchandise, although weekends and holidays are excluded from the five-day requirement. If the goods are not released within the five-day period, they are considered detained.

Suppose Customs is having difficulty notifying the importer at the point of detention. They have another five days to issue a notice to

the importer and other interested parties of their decision to detain. The importer should receive notice of an initiation of such a detention with the specific reasons, the anticipated length of the detention, the nature of any tests that are going to be performed on the products, and any inquiries performed. Customs will also request any information that it could use to accelerate this position on an importation.

PETER QUINTER: I think that there is a difference between the law and practice. For example, on July 22, 1997, Customs detained the merchandise of one of my clients for over two months. I have still not received any notice from Customs describing that situation and their course of action.

JAMES CAHILL: There is a difference between implementation and reality. Customs will reserve all rights to this information and thereby control the direction of legislation until it standardizes its own approach. Legally and properly, this information should be released in order to formulate regulations that meet the demands of all parties involved. Presently, Customs is obliged to release testing results upon request. However, in practice, Customs rarely releases such results. So far, Customs information has remained relatively inaccessible to the public.

### III. PROTEST REVIEWS

The third topic deals with the higher level review of protests of Customs practices. Generally, a protest involves a client importer and the government. The client disagrees with the government about the classification and rate of duty for their goods. Such a dispute is considered a disagreement in the construction of law. In order to dispute the disagreement, the client importer has ninety days, after the date on which Customs finally liquidates the entries, to file a formal protest. Liquidation means that Customs accepts the value, the rate of duty, the classification, and the quantity of the goods as correct. In the past, if the client's protest was denied for almost any reason, there was no further opportunity to resolve the dispute.

The Modernization Act provides a sixty-day window that allows a client to challenge the denial of the request for further review of a protest. The importer also may be able to have the disputed determination set aside under the law.

#### IV. PENALTIES FOR FRAUD

The fourth topic, which is rather interesting, is section 621, which deals with fraud penalties. The major issue in Customs concerns commercial fraud. This addresses the two-sided issue of reasonable care and informed compliance on the part of Customs and reasonable care by the importer. In other words, Customs is supposed to convey to the importer all of the requirements the importer needs to uphold, and the importer must take reasonable care in asking all of the necessary questions regarding a given importation to ensure that it is proper.

The new law considers such things as the repetition of an initial clerical error due to an electronic system as not constituting a pattern of negligent conduct. However, a human error, rather than an electronic system error, will not be treated so lightly. Repetitive human errors may only be afforded the same treatment if they are based on such things as the type of quality control the importer has in place and the number of importations handled by the importer. Failure to exercise reasonable care shall constitute negligent conduct. Customs defines compliance as a demonstrated good faith understanding of the legal requirements and procedures that have been explained to employees and included in the company's guidelines.

Customs views this reasonable care approach as a shared responsibility in the trade community. Customs, therefore, must thoroughly define the requirements placed on importers. Some elements analyzed in determining whether the importer exercised reasonable care include consideration of an importer's use of pre-importation guidance from Customs, formal rulings, and use of laboratory testing. The purpose of these requirements is to enable Customs to determine final classifications and appraisals and to ensure accurate documentation of financial information for proper evaluation.

As an example of the reasonable care approach, I recently represented a freight forwarder with a small mishap. The freight forwarder had been doing the same kind of exporting for a long time, and, without their knowledge, Customs issued a directive on self-propelled vehicles. There had previously been no requirement for specific types of documentation for these self-propelled vehicles. This small freight forwarder faced five penalty actions of several thousand dollars each. Receiving five penalties like that can cripple a



small freight forwarder or similar individuals who may have as few as two or three employees.

The first thing I did was to obtain the directive to see what the requirements were and what exactly the freight forwarder had violated. In fact, the directive only applied to customhouse brokers, importers of record, and some others. Freight forwarders were not named in the directive. We managed to get the penalty actions mitigated for a very reasonable amount, but it hurts a business of this type to pay five hundred dollars or more in consulting fees to solve a problem that they were unaware existed. There is a long way to go and a large gap to be closed between reasonable care and informed compliance.

#### V. DRAWBACK & REFUND OF DUTIES

I will not go too deeply into the subject of drawback, but there have been some sweeping changes in the area of refund of duties. It is a fascinating area because drawback allows for the refund of ninety-nine percent of the duty paid on foreign components and foreign materials that are incorporated into the manufacturing process. There have been some interesting changes in the law. For example, you could previously export goods in the "same condition," if they were not used, and claim the drawback.

There was a ruling where someone imported televisions that only required a minor adjustment in order to receive the signals from stations. They were denied drawback under the "same condition" law because, technically, the goods were no longer in the same condition. Thus, the same condition drawback law was interpreted in a highly technical manner. As well, there was not enough done to the televisions to qualify the importation as a manufacture under the manufacturing drawback law, which created a large gray area in drawback.

The law now requires that the goods must not have been used, and the "same condition" wording no longer applies. That does not mean that Customs will not look at minor processes and determine whether it is a "use" or not. Nonetheless, there are going to be some major changes in the drawback field.

Another important part of the drawback law that Customs has changed is the name of a drawback claim. It is referred to as a "drawback entry." Customs has taken the position that you must be a licensed broker to file drawback entries for refunds. Most impor-

tantly, the new law creates penalties for filing a false entry or a false claim. In the past, Customs simply rejected the claim. The penalty provision tightens the enforcement of drawback laws.

There was also a dramatic change in the treatment of rejected merchandise. To get drawback on rejected merchandise, the old rule required submission within ninety days. For example, say you wanted two-inch O-rings, and you received three-inch O-rings. You could reject the shipment and obtain drawback upon exportation. Customs was also fairly liberal if you exported such goods in the same condition. On the other hand, Customs did not permit rejection after a long time had passed. For example, when someone came to Customs and said, we have these big O-rings for milking machines that wore out in three years, but were supposed to last five years, of course, Customs denied this attempt to claim drawback under rejected merchandise provisions.

The new law says that the importer has three years in which to reject merchandise. Therefore, in the above example the goods could qualify for rejected merchandise drawback. Another interesting aspect of this is the Customs Service's role in dispute resolution. Suppose you and your overseas supplier do not have any disagreements on the reason for rejection. In this case, Customs is going to allow the drawback. If there is a problem or dispute, Customs will resolve it for you. A lot of latitude is given with the new procedures under the Modernization Act.

## VI. BROKER LIABILITY

Topic six is very brief, but very important because it deals with broker liability. I have not seen any rules promulgated yet, but the Secretary of the Treasury is precluded from preventing brokers from limiting their liability to others in the conduct of customs business. In the past, brokers could not even purport to have any limited liability in brokerage transactions. This is a very significant change.

## CONCLUSION

As I said, there is a large gap that Customs must bridge regarding these issues. I think that these are very important issues. I would like to defer to my colleagues now that I have given you a little bit to think about.

## VALUATION METHODS AND PITFALLS

PRESENTATION BY MICHELLE SALEM  
PRESIDENT, MILLENNIUM CONSULTING, INC.

### INTRODUCTION

I am going to speak about Customs valuation. Even though I am going to be speaking from the perspective of the United States, most countries use similar valuation methods. Most of the major trade countries have accepted internationally negotiated statements on value. There are nuances that will make one country's valuation method different from another, but basically the same premises apply across the board.

### I. METHODS OF APPRAISAL

I am going to start with the methods of appraisal. In determining a price for Customs, reasonable care is extremely important because an appraisal is meant for the Customs Service's purposes. There are several methods of appraisal that follow a hierarchy. You go from the beginning to the end, and only when you disqualify the merchandise in a prior category do you go to the next category. I will illustrate this concept with an example. I am going to use apparel in our discussion for the purpose of determining price, transaction value, duty, and so forth.

#### *A. Transaction Value*

Transaction value is the first method of appraisal. If you go to Hong Kong and buy a garment for five dollars and nothing else was involved in that transaction, this is the price that you have to report to Customs. You are going to pay duty on five dollars. You do not have to classify or worry about what the duty rate is; you pay the duties, and you are done.

Perhaps you do not have identical merchandise with which to compare your garment. The next method of appraisal would be transaction value of similar merchandise. For example, you may want to use another transaction value if you have the exact same item from another vendor that costs \$4.50. If you determine that this is the most

valid transaction value, you can seek to have duties computed on the transaction value of the identical merchandise. I once had a case where someone was making tee shirts. With tee shirts you have two types: a crew neck which is round and a v-neck which is in the shape of a "V." My client needed a transaction value for the crew neck, but only had a v-neck to use for similarity and interchangeability purposes. The determination took forever at Customs. There were so many units to use for the v-neck and so many statements for the crew neck, it became so difficult that my client eventually abandoned the idea. Nevertheless, the concept is that one should be able to retain a similar garment and use its transaction value, assuming it is from the same country and purchased in similar quantities.

Transaction value is basically the price paid for the merchandise. You may pay five dollars now, and you may owe one dollar in the future. The cost of that garment is six dollars whether it was paid at the time the transaction took place or whether five dollars was paid immediately and one dollar was promised at some time in the future. The cost is the price paid or payable.

There are some additions to that cost. One addition is something called an assist. Assists include things like tools, dies, molds, and materials. I will give you an example. I brought a bra figuring that we would all be very tired, it would be past 3:00 p.m., and everybody would be half asleep. The bra is the closest thing I could come to a prop. It is a good illustration because it has a lot of parts. A bra is a very complex garment—some contain as many as thirty parts. The way in which it is manufactured has a lot to do with its valuation.

For instance, my client who manufactures these bras has its vendor in China supply all of the parts. However, my client must supply the lace because the lace that many vendors use cannot be obtained in China. My client may be purchasing this particular garment for ten dollars, but my client had to provide the vendor with the lace in order to complete the garment. Essentially, my client is paying ten dollars for the garment, but has additional value in the lace. Since the vendor neither supplied nor charged for the lace, it is not included in the ten dollar price, but the lace was not obtained free of charge. Consequently, the price paid or payable through the customs valuation method should reflect the added value of the lace, perhaps another dollar must be added on to the original ten dollar price. Thus, the true

value of the garment is eleven dollars.

In another example, using the same garment, perhaps the manufacturer does not have the proper sewing machines to make this garment. However, you need the garments now. Say you are having the goods manufactured in El Salvador, and you decide that, strategically, it is a good idea for you to go ahead and send the manufacturer a sewing machine because you need your garments now. They have the work force and the training, but they simply do not have the appropriate machines. You decide to send them four hundred sewing machines. Again, the manufacturer charges you ten dollars, however, this time, you supplied the lace *and* you supplied the machines. The value for Customs purposes becomes ten dollars for the assembly, a dollar for the lace, and the value of the machines, let us say one hundred dollars. These are the kinds of complexities involved in the valuation of a garment.

Valuation can get even more complicated. You have to account for things like freight to transport the items, staff, and other costs. These are the little nuances that you need to know about. It is not as simple as it might seem to make a garment and bring it back. If you are doing something other than just buying a finished product you have to know what the law is and how it works. Some of the questions you will have to ask yourself are whether the cost for transportation, the machine, or the personnel that you are sending are subject to duty. My discussion thus far concerns transaction for companies unrelated to one another, but as we go into other issues that involve related party transactions, it can get involved.

### *B. Deductive Value*

As I mentioned, the transaction value is the price payable, but if you do not have a valid transaction value, you can move on to something called deductive value. Deductive value allows you to calculate the value of your merchandise by taking the price of what you are going to sell in the United States, or whatever export country, and deducting certain items to arrive at your port of export price, the one that would be used for Customs. The items that you subtract from your sales price or final sales price in the United States are things like 9802-eligible components, sales commissions, or profit and general expenses in the United States. Other deductible costs might consist

of transportation and insurance costs on the term voyage and also duty and some additional costs that might be charged in the United States.

### *C. Computed Value*

Another method of appraisal, commonly used in related party transactions, is computed value. Computed value takes all costs into consideration, including the costs of application, materials, profit, assists, and packing. Basically all the different costs associated with making the garment are tallied.

The problem with computed value, as it relates to related party transactions, is that generally if you are related to someone who owns or controls the company offshore, you tend not to operate at arms-length. You may provide machines, components, money, and other things that you would not normally give to an entity to which you are not related.

Under computed value, there can be discrepancies between the value stated on the Customs invoice and what it actually cost you. Comparing your price declared to Customs to your general ledger and all of your expenses, including fabric, labor costs, etc., you may discover that you did not claim enough cost. This is generally a problem. What you might do is perform a cost reconciliation at the end of the year.

A lot of companies do not realize that additional costs incurred by a related offshore facility can be dutiable. Some companies think that if the guy next door makes the same garment and he is charging ten dollars, then that is the fair market value. However, you are not buying the garment from the guy next door. Some ask, "If it is only worth ten dollars, why should I have to value more in my commercial imports?" If it is costing you one hundred dollars to make that particular garment, and you cannot establish a transaction value of your own, identical, or similar merchandise, and you cannot use deductive value, you are likely going to be stuck in computed value. If in a particular year your bra at cost is one hundred dollars, but you are only going to be able to sell it for twenty-five dollars under computed value, you will be required to declare the merchandise at the one hundred cost. This happens to a lot of importers. It happens most often to importers who are just starting a factory and assembly opera-

tion. In the beginning, it may not be possible to assemble the garment for ten dollars, and it is going to take two years before your factory will run as efficiently as the one belonging to the guy across the street who has been doing it for ten years. Initially, you may be forced to pay duty on much higher values. If you determine that your client may face these sorts of duties, you can assist your client to avoid such duties by advising your client to get into the proper method of appraisal so they will not be required to pay duty on excess costs in the first years of the operation.

As I mentioned before, a related party generally does not operate at arms-length. In this circumstance, you should try to use deductive or computed value because it is very rare that related parties will restrict themselves to what is required to qualify for transaction valuation. They want to operate as if they are common owners.

## II. VERIFYING VALUE

The cost submission allows a company to reconcile its value each year. It specifies the actual costs for materials, assembly, packaging, and so on, and usually takes into account additional costs incurred during the year. Customs examines related parties more closely.

People operating under the 807 program are generally more closely examined because they benefit from a preference program. Customs wants to make sure they were eligible for this preference. Customs may be checking value or origin. In the case of value, Customs may ask about your transaction in a number of different ways. One method is called a CF28, which is a request for information. Customs asks three or four specific questions to identify the particulars of your transaction. The answers to those three or four questions may highlight potential problems and help you decide whether you need to file a cost submission or a prior disclosure.

This simple three or four question inquiry by the Customs Service may alert you as to a potential problem. You may have been using a related party in your manufacturing, or even a non-related party. Perhaps you forgot the lace or the shipping costs. Maybe your assembly value was incorrect, or the sixty machines you shipped were never declared. You may find yourself in need of consultation and assistance to come up with additional duty and analysis for Customs.

Customs also contacts people through audits. Audit targets are

usually selected randomly, but obviously they can also be triggered by suspiciously low entered value, confidential informants, etc. A related party transaction may even be enough for Customs to review your information. A full audit could last two to six months. Recently, however, Customs has been conducting reviews by compliance assessment teams. Essentially, they are auditing the reasonable care a company undertakes in its compliance with customs rules and laws. While they are looking at the values and the origin, they are really targeting the use of reasonable care.

Reasonable care is proven in two ways. The first is prior establishment of written and itemized procedures. When Customs asks to see your procedures, you should be able to document them through manuals and the like. Once you have these procedures, they will audit your following of such procedures. The CAT review, as it is called, is a very popular “audit” that targets the biggest importers. These large importers are scrambling to get their manuals and procedures in place and are establishing methods to verify enforcement. Failure to follow these procedures could result in penalties, even if there was no loss of revenue.

In summation, the valuation of merchandise can be simple or complicated, depending on the structure of the transaction. There are numerous items one must consider before assessing a value.

## ENFORCEMENT METHODS AND PRIORITIES OF THE UNITED STATES CUSTOMS SERVICE

PRESENTATION BY PETER A. QUINTER

CUSTOMS AND INTERNATIONAL TRADE DEPARTMENT, BECKER & POLIAKOFF, P.A.

### INTRODUCTION

The bra analogy highlights some important things about the United States Customs Service. I also brought some friends with me, whom I will introduce later in the discussion—these are not your average cigars. As Bob explained earlier, I am here because I was the attorney for the Customs Service in Miami from 1989 to 1994. I also publish a newsletter, every couple of months, that some of you may have



seen.

PETER QUINTER: We have been talking for awhile now. Is everyone here from the United States or from overseas? Where is everyone from?

Belgium, Venezuela, welcome. Is everybody else from the United States? Is everyone an international trade attorney or working in the trade area? No, you are from different areas? Is anybody in Customs or an international trade attorney?

I will discuss four or five general areas, without much legal detail, focusing only on some basic customs laws and rules. If, at any time, you cannot understand me or I am speaking too quickly, please interrupt me and tell me to slow down or ask me questions. That is the only way to establish a dialogue between us.

The United States Customs Service has over twenty thousand employees worldwide. At each United States embassy there is a Customs attaché, who is the United States Customs official designated for that country. If, for example, the United States Customs Service is interested in a particular European company's transaction value so that it may issue a penalty against the company here, it would contact the United States Customs attaché in Belgium.

Any merchandise shipped into the United States commercially can and will be examined by the Customs Service. Let us say you have a steamship line. A cargo vessel arrives with 400 twenty-foot long containers. Customs certainly cannot examine all four hundred containers, so agents select one or two. Customs then conducts what it calls an "intensive examination" of those chosen containers.

Agents perform a careful inventory of the items in the container and compare the result to the invoice and description filed. If the invoice described the product as glasses, but the container held paper cups, the incorrect description may pose a serious problem. On the first violation, the company might escape with a small penalty. If the inconsistency is a second, third, or fourth violation, the company will not have its items returned. Furthermore, Customs may levy a significant monetary penalty based upon the value of the merchandise.

## I. EMBARGOED COUNTRIES

I brought some cigars with me to demonstrate something about

embargoes. As you know, the United States has an embargo in place against Cuba. During the last two years, the United States also initiated embargoes against Haiti and Panama. Embargoes come and go, and this is expected. I have to handle this particular issue daintily because I am dealing with the United States Customs Service on Cuban embargo situations, specifically regarding the Cuban cigar.

According to the Customs Service, these are Cuban cigars. This particular variety, Cohiba Cigars, is the real thing. Customs seized twenty thousand Cuban cigars here in Miami—the largest seizure of cigars ever made by the United States Customs Service. Unfortunately, my client happens to be the person from whom they seized the cigars. This importer owns a small Miami company, and he insists the merchandise is from Honduras. All the documentation indicates that the merchandise arrived from Honduras. All the packaging indicates that it is Honduran. The factory owner also asserts that the tobacco is from Honduras. Everyone except the United States Customs Service says it is from Honduras. The Customs officials have an informant, whom they will not name, and a laboratory report both of which support the conclusion that the tobacco filler in these cigars differs from the tobacco in a Honduran facility's sample. Therefore, the Customs Service contends that the cigars are from Cuba. Obviously, my client disagrees.

This is merely a forfeiture matter—not a criminal matter. Customs takes the merchandise when it enters the United States, and keeps it. In this case, Customs will permanently retain the cigars unless my client can prove that the cigars are not Cuban. We are now litigating the origin of the cigars in federal court. If you are a local resident, you may have read about it in the *Miami Herald*. If my client pays the fines, Customs will return his goods. Alternatively, if my client is unable to prove that the cigars are indeed Honduran, the government will destroy all twenty thousand of these cigars. Of course, I will get to smoke a few of them before that happens.

In 1995, due to a border dispute between Ecuador and Peru, the United States issued an embargo that prohibited United States parties from supplying military equipment to either nation. If an American company attempted to ship any military equipment to Ecuador or Peru, Customs would seize the goods in Miami. Furthermore, if a company transported equipment by plane, Customs would put the

company out of business. Any individuals involved in that shipment could be arrested and criminally prosecuted. Unfortunately, the Peruvian Air Force successfully exported United States merchandise to Peru to fight the battle in Ecuador. I represented the Peruvian Air Force in that matter, and we avoided criminal prosecution. The Peruvian Air Force remained in the United States without further difficulties.

Embargoes are reciprocal. There is a tire exporting company north of here, in West Palm Beach, that exports tires all over the world. It exported five hundred fifty thousand tires to the Dominican Republic. All the documentation indicates that the tires traveled from the port of Palm Beach to the Dominican Republic. The Customs Service, however, does not believe that the tires ended up in the Dominican Republic. The Customs Service believes the tires ended up in the same place those Cuban cigars come from—Cuba. In general, if a company sends merchandise to one country, and it ends up in Cuba (or any other embargoed country), you may have a serious problem if the Customs Service can prove that you knew it was going to Cuba or an embargoed country. At the very least, Customs will conduct a criminal investigation, which may result in criminal prosecution.

In the tire company's case, the Customs Service went to the company's premises and seized all of its computers and business records, but did not arrest anyone. The Service hoped to find something indicating that the tires were exported to Cuba or that the company was doing business in Cuba. Agents did find one incriminating document, a telephone record. My client happened to make one phone call to Cuba. The Customs Service, or any other law enforcement agency, can request a copy of long distance phone records from the phone company. So, Customs traced that call and proved my client's business connection to Cuba. There is more to this story, but the lesson is to be careful to whom you make your phone calls.

## II. COUNTERFEITING

The prevention of counterfeit imports is one of the Customs Service's two major enforcement efforts. What makes a product counterfeit? Counterfeiters contravene trademark and copyright law by producing imitations of brand name products. Counterfeit items entering the United States include fake Levis jeans, Disney shirts, and Mo-

torola phones. The United States Customs Service seizes such items.

Asia produces most of the counterfeit goods that reach the United States, but Latin America is a major counterfeit producer as well. Sometimes the importer does not know that the merchandise is counterfeit. The importer should contact a Customs attorney or an intellectual property attorney to verify that the merchandise is genuine and that the exporter has a license to manufacture that product and export it to the United States. Once the merchandise is inside the United States and Customs declares it as counterfeit, the importer will not likely see the goods again.

I have clients who have lost entire containers, each lot holding a couple hundred thousand dollars worth of merchandise. Today, a client called me from Oakland, California, because Customs had seized a container of Tiffany lamps. Tiffany did not authorize my client to bring those products to the United States, so the company has a problem. We will see what happens.

### III. CURRENCY REPORTING

Another problem I would like to highlight is currency reporting. When you enter or depart the United States and carry over ten thousand dollars or its equivalent in foreign currency, traveler checks, or money orders, you must report the funds to Customs. If you fail to do so, Customs has the authority to seize your money. One of my clients purchased a helicopter from a Venezuelan company. The Venezuelan gentleman had a bank check for one hundred thousand dollars issued by Citibank of Miami. The client mailed the check via Federal Express to the Bahamas, but the check never got there. Instead, one of the over one hundred Customs officers staffed at the Federal Express facility in Memphis, Tennessee, pulled this particular envelope. As part of his responsibilities, this employee examined parcels coming into and going out of the United States. He opened the envelope and saw the check for one hundred thousand dollars without a Customs form. Customs subsequently retained the package and kept the hundred thousand dollars.

Mr. Cahill briefly described a procedure by which parties can petition the Customs Service to remedy currency seizures. Parties may explain to the Customs Service the circumstances under which the check arrived without the required form. Fortunately, Customs

eventually returned ninety-five thousand dollars to my client, but he lost five thousand dollars because he did not fill out the proper form. Of course, the client had to pay attorneys fees as well. To reiterate, when bringing more than ten thousand dollars into or out of the country, whether in person or by mail, you must complete a Customs form. Any airport or post office can supply the proper forms.

#### IV. INTERNAL CONTROLS & RESTRAINTS

AUDIENCE PARTICIPANT: You were with the Customs Service for many years. Can you comment on Customs agents' behavior in the smaller, less developed countries, such as those in the Caribbean. My family is Haitian and has experienced some problems with Customs. They feel they have been treated unfairly. Who is watching Customs?

PETER QUINTER: Good question. We have an article in the *Miami Herald* this week, addressing similar concerns. I think Customs sometimes behaves inappropriately in its enforcement. Customs officers have a great deal of discretion. For example, the Dominican Republic and Haiti have many textile facilities. The companies in these countries often use guesswork to determine the value of their merchandise. To protect themselves, they should hire experts to help them accurately value the goods and properly complete the Customs forms for export to the United States. A Customs broker should be able to provide that sort of advice.

What is a small company to do? I wish I knew the answer. They cannot afford to properly evaluate the merchandise. Once Customs seizes the goods or questions whether the United States importer properly valued it, that United States importer may fault the Haitian manufacturer and cease doing business with that Haitian company.

ROBERT SCHRADER: If particular agents are acting excessively, there is a procedure whereby you can file an internal administrative complaint. I had a case where a Customs agent in the Virgin Islands harassed a major company. He penalized the company for no apparent reason and ignored Customs regulations. The company filed an administrative complaint, which spurred the Customs official's demotion. Unfortunately, his "demotion" was a transfer back to Miami, so we ended up dealing with him more often, and I was not his favorite person. The point is that there is always the option of filing an administrative complaint if an agent's actions are clearly out of line.

## V. PROFILES

Customs agents use profiles to target individuals and companies with regard to enforcement. I have had Customs seize client's currency when travelling between two domestic airports, Texas and Miami. No importation or international trade was involved. If individuals carry cash and fit a certain profile, they can and will be stopped. Customs agents might stop a man if he is unshaven, wearing jeans, and carrying a suitcase through a domestic airport. Drug couriers, mules, and money launderers all fit certain profiles. These profiles are used as one means of enforcement.

Obviously, profiles are based to a certain extent on stereotypes, and, arguably, are discriminatory. Courts, however, usually uphold these profiles as reasonable, in part because law enforcement agencies can show that the profiles are successful. Customs agents occasionally stop innocent people. These individuals do not possess anything illegal, and Customs does not seize anything. Nonetheless, Customs may detain them for several hours at the airport, question them extensively, and even strip-search them simply because they fit the profile. Courts have held that these stops are permissible.

PETER QUINTER: The other side of the argument is that the United States Customs Service is actually one of the more efficient federal agencies. Customs has an internal affairs department that investigates its own employees. If one has a complaint of misconduct against an employee, one can report it to the Customs Service's Office of Internal Affairs.

For commercial matters, there is a trade ombudsman at Customs headquarters in Washington, D.C. People may file complaints with this office as well. For example, when I was with Customs, there was an unusually high number of Nigerian drug smugglers who carried drugs inside their bodies. These couriers are often called "mules." It is actually fairly common for people to arrive at Miami National Airport having swallowed money, cocaine, marijuana, and all kinds of things. You may have read about some of these cases in your local newspapers. In several cases, the profile of a Nigerian drug courier caused Customs agents to harass innocent black people at many United States airports. These actions are illegal and discriminatory. A group of people filed a class action suit against the United States Customs Service for this harassment. The court awarded the plain-

tiffs one hundred fifty thousand dollars. I would encourage people to confront the government when they have been treated unjustly.

I hope that this answers some of your questions. On a related point, whenever the owners of a cigar importing company travel, they are stopped and questioned by Customs. Customs also often stops and questions people because of negative or derogatory information in the Treasury Enforcement Communications System—the Customs computer. If this happens to you, first find out what information the system contains about you. Then have that information deleted or corrected. The system may list you as a drug smuggler! You can have the information corrected, whether its source is the United States Customs Service, the Federal Bureau of Investigation, the Drug Enforcement Administration, or even the Internal Revenue Service.

JAMES CAHILL: The information in the computer might not be about you, *per se*. Your name could be very similar to a criminal's name. My sister was quite heavily interrogated at the Miami Airport upon returning from the Bahamas because her last name was the same as known smugglers. The system is complicated by criminals' use of aliases. As a Customs inspector in Philadelphia, the first heroin smuggler I encountered had altered his name by switching his middle name to his first name and leaving out his initial. We suspected he was an antique dealer smuggling heroin. The computer system may not contain information about you in particular, but your name may be similar to a known criminal's name or alias.

AUDIENCE PARTICIPANT: The authorities stopped me at the airport and started to question me. Can I ask to see what information is in the computer about me?

ROBERT SCHRADER: No. Actually, you can ask them, but they will not disclose the information to you.

AUDIENCE PARTICIPANT: No? Why not?

ROBERT SCHRADER: You must use another process called a Freedom of Information Act request, which can take from several months to over a year to get a response. For example, one of my clients was listed in Customs' computer for no apparent reason. Apparently, he had a falling out with a United States Customs agent who was fairly new and who kept placing him back in the system. When we asked for the information under the Freedom of Information Act, we re-

ceived a letter with everything redacted except for a few common words—the, and, in, etc. Under the Freedom of Information Act, Customs is not required to disclose information that is under active investigation, but this was ridiculous. We filed an appeal of the FOIA request. Finally, we received enough of a response to figure out what the allegation was and to have the damaging information removed from the system. This does not prevent Customs, however, from inputting new information in the future

## VI. MIS-DESCRIPTION

PETER QUINTER: Next, we will discuss the basic concept of mis-description. One of my clients exports electronic products to Venezuela from Miami. On the form he filed with Customs, however, he listed non-electronic items. For instance, he indicated on the form that one item was a paper box. That is a major mis-description. Customs discovered the problem and temporarily seized his merchandise until I could get it released.

Mis-description is a problem, especially when the mis-described item has a lower value than the actual product. If a product coming into the United States is actually worth one hundred thousand dollars, but you decide you will just put down fifty thousand dollars and see what happens, that discrepancy will be a major problem if Customs selects that entry to examine. Not only can Customs seize your merchandise, it may assess a penalty based upon the value or the duty of the merchandise. Grounds for the penalty might be bribery, negligence, or gross negligence, depending upon the importer's degree of culpability.

## VII. COUNTRY OF ORIGIN & TRANSSHIPMENT

### *A. Country of Origin*

We have talked about counterfeiting as one of the main priorities for Customs. Country of origin is another major issue for United States Customs purposes. Michelle spoke about production costs, but production location is another issue.

A product made abroad must be permanently, legibly, and conspicuously marked. I brought these cute little beanbag pets to show you what happens. You can see the little stickers that say "Made in



Peru” and the other labels that say the tab was “Made in Thailand.” Look at that sticker move; it is not permanent. Customs seized all of these. As you can tell, the other label is permanent. However, “permanent” does not mean permanent to the point of importation, but up to the point the consumer purchases the product. We have to know where the item was made. All products manufactured outside the United States are labeled “Made in Thailand,” “Made in China,” “Made in Taiwan,” etc. Although most people do not care, Customs agents make a habit of checking country of origin.

ROBERT SCHRADER: If the importer repackages the product after importation, the new packaging must state the correct country of origin. Customs enforces proper country of origin markings on imported merchandise. Once imported, issues regarding false or deceptive labeling fall under Federal Trade Commission jurisdiction.

### *B. Transshipment*

PETER QUINTER: The next topic is a process called transshipment. Assume that the People’s Republic of China is allowed to export to the United States fifty thousand beautiful suits like the one Michelle is wearing. After fifty thousand, China may not bring any more suits into the United States. China makes two hundred fifty thousand suits a year, so they have two hundred thousand extra suits. To deal with the surplus, Chinese clothing manufacturers ship the suits to Thailand, Vietnam, or some other country that places a sticker on them that says “Made in Vietnam,” or whatever country. Subsequently, the suits are exported to the United States. That process, which occurs frequently, is called transshipment. Most of the time, companies get away with it, but sometimes they get caught, and Customs then prohibits them from doing business with and exporting merchandise to the United States. Transshipping is quite common for textile products, as well as other types of merchandise.

### *C. Transshipment Under NAFTA*

Let us talk about NAFTA’s relationship to transshipments. Under NAFTA, the rules are essentially the same. Most Canadian and Mexican goods come into the United States duty free. A European manufacturer, seeing that direct exports from Belgium to the United States are dutiable at ten percent, might attempt to circumvent the

duty by sending the goods to Mexico, labeling them "Made in Mexico," and then exporting them to the United States. Some companies use this illegal method to escape duties.

On the other hand, Toyota, Nissan, Honda, and other major companies have actually moved their operations from elsewhere to Mexico. They legitimately produce goods that may be brought to the United States duty free. It is not legitimate business to make a product in Belgium, ship it to Mexico, and then bring it into the United States claiming it is a product of Mexico. This process violates the country of origin principle. The exporter signs a certificate of origin for its goods and should be honest about the true country of origin.

### *1. Substantial Transformation*

AUDIENCE PARTICIPANT: Is there a requirement of transformation in Mexico and/or Canada?

PETER QUINTER: Absolutely. That is an excellent question. Transformation, particularly "substantial transformation," is a more sophisticated customs concept. A company takes product A, ships it to another country, then changes the nature of that product. Let us say that I have a belt made in Chile. I would ship the leather to Mexico and then add the buckle. I would argue that the merchandise was just a strip of leather when it left Chile, but after I added the buckle in Mexico, it became a belt. I would argue that adding the buckle substantially transformed the product and that it would now be a product of Mexico. Whether it qualifies under NAFTA or not, it would be a product of Mexico.

### *2. NAFTA Tariff Shift Rules*

JAMES CAHILL: That is a little different under the NAFTA rules. The NAFTA rules are called "tariff shift rules." That is the concept of which Peter speaks concerning importing a strip of leather and putting a buckle on it. I would probably argue against him on that point and say that adding the buckle may only constitute an assembly. If one took raw leather and shipped it to Mexico and then made the belts, the tariff shift rule would apply, assuming that the leather, upon arrival into Mexico, was classified under the non-originating materials chapter of the tariff schedule. The manufacturing activity transforms the leather into another tariff classification, namely a belt.

Then one could be in compliance with the law. There is no judgment involved in the tariff shift rules. The tariff shift rules were written for NAFTA and they are established.

Essentially, under the tariff shift rules you must classify the goods twice: once on arrival and again on departure. For instance, bovine leather from Argentina is shipped to Mexico where someone makes handbags out of it. That would qualify because the leather was the non-originating material from another chapter and the tariff shift rule says that the handbag qualifies as a good of the NAFTA country, and is, therefore, entitled to the special Mexican rate of duty.

AUDIENCE PARTICIPANT: Does the tariff shift have to be for one that is from the last chapter?

JAMES CAHILL: The tariff shift rules run the gamut. There is no particular set of numbers that I am aware of, however, because the rules go through the headings, the sub-headings, and the tariff items in order. There is a broad spectrum of classifications. You must first look at the goods as they are, then classify the non-originating goods, then classify the product that will be shipped to another country, and the goods either qualify or they do not. Each rule is set out opposite the chapter headings or sub-headings in the tariff, each is set out separately. These rules are different from what Peter called substantial transformation rules, under which an exporter must substantially transform the goods to establish a different country of origin. For substantial transformation to apply, a new and different article of commerce must emerge, with a new name, character, and use.

There are conflicts in NAFTA's rules of country origin with regard to textiles, assembly, etc. There was one rule, stating that if fabric was cut in the United States, then the United States was designated as the fabric's country of origin. That rule has recently changed, and now the country where the fabric is cut is considered the country of assembly. The rules are becoming increasingly complicated as demonstrated in a ruling on a tee shirt that resulted in eight pages of a ruling from three different divisions in the United States Customs Service.

### VIII. HARMONIZED TARIFF SCHEDULES

PETER QUINTER: I would like to add two things to make sure that we all understand these concepts. I have talked about the tariff

schedule and the harmony of the tariff schedule. This schedule contains descriptions of all possible goods. The schedule also lists the percentage of duty to be collected by the Customs Service for the good, whether it is the United States Customs Service, for merchandise that arrives in the U.S., or another country's customs service. Other countries' tariff schedules are similar to the tariff schedule of the United States.

ROBERT SCHRADER: The reason countries have harmonized their tariff schedules is to ensure uniform classification in each country. There are ten digit codes in the United States Harmonized Tariff Schedule while some other countries' schedules use eight. The first six digits are uniform in all countries. What the United States calls a pencil might be a "non-ink writing instrument" in another country. Without uniform codes it was very difficult to determine what a particular country's description meant. Now it is simpler since the first six digits are the same. The last four digits are left to the individual countries to use for their own purposes. Usually, the last two digits are used for statistical purposes. For instance, the United States uses the last two digits to track import and export figures. When one refers to a classification shift they usually mean that the first six digits of classification have changed based on some manufacturing or process. For example, the first six digits may indicate that you have a writing instrument; the seventh and eighth digits might indicate whether the item is a writing instrument with permanent ink, washable ink, lead, or magic marker. The latter digits provide further classifications.

#### IX. COMMERCIAL RULING REQUESTS

PETER QUINTER: Any importer can make a commercial ruling request to the United States Customs Service. Usually, the importer makes the request to the Customs Service's headquarters in Washington, D.C., the New York Seaport, or local ports. We have a port here in Miami, for instance. A rule request may concern valuation of merchandise. In the rule request, the importer can indicate what the expected value should be and request a correction. The importer can also ask for a country of origin ruling. When a product is manufactured and assembled in different countries, a company may ask Customs to determine the country of origin prior to importation. What

other questions can be asked?

ROBERT SCHRADER: Whether a process is an assembly or manufacturing.

PETER QUINTER: Before you import something into the United States, you should obtain a commercial ruling request from Customs. Hopefully, Customs will issue the ruling within thirty to sixty days, detailing the country of origin or product value. That is what you specify when you file with the Customs Service. Your approach should be to take all the guesswork out of it before you even begin.

JAMES CAHILL: This latter point is extremely important because I have been involved with three or four companies in the past year that want to locate operations offshore in the Caribbean. If I were to do all of the customs research for these companies, it would cost these companies a fortune. Things are not always what they seem to be with Customs. It is, therefore, wise to have these companies request a binding ruling from Customs to begin with because many times Customs changes its own rulings. So, if you are going to make a large capital investment in a foreign country and want at least some certainty, you should obtain a binding ruling from Customs as to what it is you intend to do in that country and whether you qualify for special benefits, such as under the Caribbean Basin Initiative. If you do not qualify, there may be little reason to relocate there in the first place.

## MINIMIZING DUTY LIABILITY AND ISSUES OF EXPORT CONTROLS

PRESENTATION BY ROBERT G. SCHRADER, ESQ.  
RUDEN MCCLOSKEY SMITH SCHUSTER & RUSSELL, P.A.

### INTRODUCTION

I am going to cover two different areas. First, I am going to talk a little bit about structuring the transaction so that you pay a smaller amount of duty, if any at all, on imported merchandise. Then I will discuss some issues in the area of export controls.

## I. MINIMIZING DUTY LIABILITY

### *A. Re-Classification Via Customs Ruling*

Obtaining a Customs ruling is a good lead into my topic. As attorneys, you can research the existing rulings—I believe they are online on Westlaw now and there are some other services on the Internet—to see if your client's issue has been ruled on before. Customs may not have answered the question, or you may not like the answer Customs gave. If you want to reduce the duty rate when importing merchandise, one of the first things that you can attempt is to obtain a new classification ruling. You can always request a new ruling. Look at how the merchandise is classified now, and try to change the classification to something else with a lower duty rate.

When you write the ruling requests, do not take the attitude, "Here is what we have; what is your advice?" The Government's job is to collect money. Accordingly, Customs will attempt to place you in the highest possible category. As the lawyer, you should instead argue, "This is what we think the proper duty rate is, and this is why." You need to give them every rule, every basis you can find in order to make it easy for them to agree with your position. If you provide a basis for a ruling that is favorable to your client, then Customs is more likely to give you a favorable ruling.

### *B. Preference Programs and Duty Free Treatment*

Beyond requesting a new ruling, part of what a lawyer can do is become very involved with the client in planning the manufacturing. Perhaps your client is currently manufacturing something on which they are paying a particular amount of duty, and the client wants to move its operations to a different country. They may come to you for advice on which country will result in the lowest rate of duty.

There are a number of preference programs for particular countries. Some countries qualify for what is called the Generalized System of Preference, or GSP. Most developing countries qualify for GSP, and, therefore, much of their merchandise will qualify as duty free or at a reduced duty rate.

The Caribbean Economic Basin Recovery Act ("CEBRA") or Caribbean Basin Initiative ("CBI") and CBI-II also contain duty pref-

erence programs. Under the CBI, if you can establish enough change to the imported product, you will qualify for certain benefits. This change, "substantial transformation," is generally required for eligibility under GSP, CBI, and other duty preference programs.

There are also preference programs under various trade agreements, such as the United States-Israel Free Trade Agreement and NAFTA, that use the substantial transformation requirements we just discussed. These preference programs usually have a local content requirement. In other words, in addition to changing the product in the eligible country, you must add some mandated percentage of locally sourced materials to the value of the finished product. The mandated change in value is usually thirty-five percent. However, even the thirty-five percent requirement is flexible. For instance, under the CBI, United States materials can account for up to fifteen percent of the thirty-five percent required value added, so you would only be required to add twenty percent of local materials. That twenty-percent in turn may include overhead or certain labor costs; you would then perhaps only need to source ten percent of local raw materials.

If your client structures the manufacturing properly, they might find it advantageous to build a facility in one of these areas. By shifting the manufacturing from one place to another or sourcing materials from a different place, your client can end up with a product that he or she can import duty free or duty reduced, resulting in substantial savings sufficient to justify the restructuring and your fees.

For example, I had a client who manufactures candied breath mints in Italy. They then shipped the mints to a packaging plant in Puerto Rico before sending them to the United States. We reviewed the situation and were able to obtain a ruling from Customs that, if manufactured in Puerto Rico, which is considered both a United States territory and part of the CBI, Puerto Rico was the source country so that they qualified there. Customs also has special rules for manufacturing bonded warehouses, which I will discuss later. We were able to structure the manufacturing process so that the company shifted their operations to Puerto Rico and saved hundreds of thousands of dollars a year in duties. Through proper structuring of the manufacturing process and obtaining binding rulings, the merchan-

dise was able to enter the United States duty free. In two years they saved enough in Customs duties to pay for a new factory as well as the entire cost of relocating. Keep in mind, however, that relocation and reclassification are complex processes.

Sometimes you research the issue and determine that there is nothing that you can do. For awhile, the only thing the manufacturer could add locally in Puerto Rico was sugar. While the most valuable component was their housing formulas, every other ingredient was from the United States or other countries, and none of these source materials were made in Puerto Rico. In addition, there was an initial concern that if the manufacturer could not find enough sugar in Puerto Rico, then the relocation would fall apart. There were also different problems obtaining sugar on the global market versus the United States, which has price controls on sugar. Nonetheless, moving the manufacturing process abroad is one thing you can do to lower or eliminate duty payments.

### *C. Foreign Trade Zones*

A second way to reduce duty or delay its assessment is by utilizing a foreign trade zone. A foreign trade zone is an area in the United States that is not considered a part of the Customs territory of the United States. A foreign trade zone is physically in the United States. For Customs purposes, however, it is not considered part of the United States for most enforcement issues. You can bring merchandise into the zone without paying duty, do a minimal amount of manufacturing, assembling, testing, painting, or packaging, and ship it back out again. For duty purposes, you never entered the merchandise into the United States. Not only do you avoid dealing with Customs to a great extent, but you also do not have to worry about paying duty on the entry.

#### *1. Subzones*

There are some real benefits to using foreign trade zones in the manufacturing process. Foreign trade zones used for this purpose are called subzones. Most of the major automobile manufacturers have subzones in the United States, as do most of the drug manufacturers. When you bring merchandise into a subzone, there are two options in setting the duty: either the duty applies to the components at the time



they are brought into the subzone, or the duty is assessed after the final product is finished and leaves the subzone. If you take the merchandise out in a different condition, the final product might have a different duty rate. If the initial duty is less than what it will be when the product is fully manufactured, you might want to set value when you bring the product into the subzone. If the initial duty is greater than the duty would be after the product leaves the subzone, you will opt to set the duty at the end.

With cars, I think the average duty on the finished automobile is approximately 2.5 percent. If you look at all of the parts of the car, however, you have parts that probably come in duty free and parts that come in at up to twenty percent duty. Added together, the duty is much higher for the parts than the 2.5 percent for the finished car. Thus, manufacturers choose to bring in the parts under what is called foreign status. Therefore, when the car is removed from the zone, the duty is based on the fully assembled value. It may come in as a part, but it is being taken out as a car.

If manufacturers also use United States parts, they will only pay the duty on the foreign parts. You do not pay duty on the value of the United States parts. Obviously, a company may manufacture something in the United States at its factories in Ohio. It may ship everything to Ohio and then put the car together. The company will pay duty on all of those parts. If the finished product has a lower duty rate, it might be worthwhile to structure that manufacturing facility as a subzone in order to take advantage of the lower duty rates.

## *2. Privileged & Zone Restricted Status*

Similarly, if the product's duty rate is lower when it is brought in, you can bring it in under what is called "privileged status." Under privileged status, you pay duty based on the product's value when it is brought in and not on the value when it is taken out. Obviously, the duty rate is lower.

Another useful status in foreign trade zones is what is called "zone restricted status." You can place either foreign merchandise or United States merchandise, which has to be exported, into zone restricted status. It is then considered "exported" from the United States. In the United States, liquor manufacturers and cigarette manufacturers pay substantial domestic taxes that they do not have to pay

when they export. When they export, however, they must go through bonded facilities—bonded warehouses that are actually bonded by the Bureau of Alcohol Tobacco and Firearms. Merchandise required to be exported can be transferred to a foreign trade zone or subzone in zone restricted status so the merchandise is then considered exported, even though the company may not at that time have a foreign purchaser or designated export port.

#### *D. Bonded Warehouses*

##### *1. Deferred Duty*

In addition to foreign trade zones, you can also use bonded warehouses to take advantage of what is called “deferred duty.” This can be very significant to a client who imports televisions, for instance. Suppose they import a container of televisions per month and pay all the duty and taxes at the time the container arrives. However, they sell only ten televisions a week. It takes them ten weeks to recoup all the money they have paid out in duty alone.

If they use a bonded warehouse instead, they can bring the televisions to that bonded warehouse and store them without having to pay the duty up front. A bonded warehouse means that the importer posts a bond to protect Customs on the duty that is supposed to be paid. If the importer sells ten televisions a week, ten televisions are removed from the bonded warehouse and duty is paid only on those ten televisions. Instead of paying duty on one hundred televisions all at once, the importer only pays duty when they make a sale and withdraw a unit from the bonded warehouse. The difference in cash flow can mean a lot to the bottom line of the company.

##### *2. Time Limitations*

You must be aware of time limitations with bonded warehouses. You can store merchandise in a bonded warehouse for five years. If it remains beyond five years, it is forfeited to the United States Government. For example, if unsold merchandise is stored in a warehouse and remains there for four years and three hundred-fifty days, then it must be exported or entered for consumption before it reaches the five-year anniversary of importation. Perhaps a customer intends to purchase the merchandise within the next month (but beyond the

five-year limit). The manufacturer simply cannot continue to warehouse in a bonded warehouse. You could, however, transfer the merchandise to a foreign trade zone in zone restricted status, and it would be considered exported. This allows the owner to avoid having to export the goods before a sale. However, the problem with zone restricted status is that the merchandise still must be exported. Exported means taken to another country, separated from U.S. commerce and entered into the commerce of another country. You cannot simply take it out on a ship and turn around and come back in. This demonstrates the importance of knowing and complying with Customs time requirements.

### *3. Trademark Issues*

There are other benefits to the use of a bonded warehouse. We discussed trademark violations. Sometimes you might bring something into the United States that is legal in its own right, perhaps with a legal trademark. However, if someone else has the exclusive license for that trademark in the United States and has registered it with Customs, you are prohibited from bringing that item in without permission of the licensee. Customs will seize the importation of the merchandise because the only person allowed to import the merchandise is the trademark owner or licensee. When Customs detains the shipment, two things can happen. Customs may contact the person who registered the trademark, and that person may "greenmail" the company attempting importation by requiring payment of a royalty fee. The other scenario is that the trademark holder does not let the company enter the merchandise, and the importing company is penalized or Customs seizes the merchandise and destroys it. In seizure cases, however, the importing company may reduce the penalty by petitioning for re-export of the merchandise.

### *4. Labeling, Marking, Packaging*

Bonded warehouses can also serve as a facility to deal with unlabeled merchandise. In a bonded warehouse, you can perform minor assembly operations such as testing, labeling, and so forth. You may bring in a product that it is not properly labeled, marked, or packaged with the country of origin. For instance, if it has been packaged under the metric system and is labeled in milliliters instead of ounces, you

can bring it into a bonded warehouse and re-label it or otherwise bring it into compliance with U.S. law before importation. This strategy avoids seizure by Customs.

#### 5. *Manufacturing & Other Bonded Warehouses*

Manufacturing bonded warehouses are bonded warehouses in the United States where something is manufactured. To qualify, there must be more than assembly; it must be actual manufacturing. This raises the issue of substantial transformation. Manufacturing may involve both United States components and foreign components. Under normal circumstances, in a typical manufacturing operation, you would pay duty on the imported parts used during the manufacturing process even if the finished product is exported. Alternatively, you could seek drawback on the existing value of the manufactured product—a long process.

On the other hand, if you have a manufacturing bonded warehouse, you can use United States parts with foreign parts imported under bond, which allows you to avoid any duty. After you manufacture the product, you do not have to pay any duty. The key element of a manufacturing bonded warehouse is that whatever is manufactured can only be exported—it cannot be brought into the United States. If the company makes something that it sells both in the U.S. and abroad, the company will have to bond a portion of the facility, depending on how the manufacturing process works. The ideal situation is when everything that is manufactured is exported. In that case, there will be no duty.

Getting back to my earlier example of the mints. In that case, we used a loophole in the Customs laws. I mentioned the advantages of using Puerto Rico along with the rules under the CBI, but there is also an exception in Customs law that says that if something is manufactured in a bonded manufacturing warehouse *in Puerto Rico*, it *can* be exported to the United States. If you manufacture something in a manufacturing bonded warehouse in the continental United States, it must be exported from the United States. If you manufacture it in Puerto Rico, even though it is in a manufacturing bonded warehouse, by utilizing the CBI and several other structural elements, the merchandise (1) can be imported into the United States, and (2) it enters duty free under the CBI. Thus, you can combine a number of

different rules to reduce the cost of duty to your client.

There are a number of other types of warehouses that are divided under Customs regulations into nine classes. These include general warehouses; public warehouses, where the owner stores goods for other people; private warehouses, where the company that uses the warehouse also owns it; and class 8 warehouses that only allow the "manipulation" of merchandise, which includes cleaning, sorting, re-packing, etc. You can also combine the classes of warehouses to allow greater flexibility in what the importer can do with the goods.

The importer of container loads of merchandise can also benefit from the use of bonded warehouses. They might sell half of the container load here and half of it overseas. They could enter the merchandise into the bonded warehouse, unpack the container here, pay duty on what is brought into the United States, and then export the rest to its final destination without having to pay duty in the United States on the exported merchandise. Container freight stations also allow you to bring in a container, break it down, keep part of it here, and ship the rest out. These can only be utilized when the merchandise is to remain there for a limited period of time.

#### *6. Bonded Warehouse Considerations*

Something else to keep in mind when considering a bonded warehouse is that the burden of record keeping is on either the operator of the warehouse or the company itself. Very detailed records must be kept for each entry filed. In particular, certain documents must be retained in a special folder for Customs inspection. Each entry must be tracked with an entry number. Warehouse withdrawals and duty payments must be tracked as well. Customs will periodically conduct audits and spot checks. Customs will inspect the folder to ascertain how many containers have come in, how many have been withdrawn, and how many should remain. If the warehouse does not contain the proper number of containers, Customs will issue penalties. Penalties for bonded warehouses, even paperwork violations, can be very large.

Penalties can also arise from technical violations, including penalties for improper record keeping, missing forms, or forms not filed on time. There are very strict schedules for the filing of forms. Certain forms have to be filed within two days, some within ten days,

and certain yearly submissions have forty-five day deadlines. If you miss a deadline, each day late is usually a separate violation, and there is a one thousand dollar penalty for each day. The fines are compounded, meaning that the total penalty for some warehouse owners could amount to hundreds of thousands of dollars. For example, the total penalty for filing ten forms thirty days late could be three hundred thousand dollars. Often the penalties can be mitigated or cancelled, but the risk of a large fine is always present. Consequently, it is very important that the individuals operating the warehouses know and understand the record keeping requirements.

### *E. Drawback*

Jim mentioned the procedure for drawback, which can be an alternative to using bonded warehouses or special trade zones. Suppose you did not use a bonded warehouse, brought in ten container loads of televisions, and paid ten thousand dollars in duty on each container for a total of one hundred thousand dollars. Now, suppose you end up sending half of those televisions to Latin America. You would have paid one hundred thousand dollars in duty to ship out half of the merchandise. You can file for a drawback of fifty thousand dollars in duty, actually you receive ninety-nine percent of the amount. The government keeps one percent for administrative costs. However, it will probably take six months to one year to actually receive the refund. The process may be quicker now with the recent procedural changes.

**JAMES CAHILL:** You can get drawback in three weeks if you get Customs approval for accelerated payment.

**ROBERT SCHRADER:** But the first time you apply for drawback, you cannot receive accelerated consideration. To obtain accelerated consideration, you must have established an accelerated drawback status. You must also prove that the merchandise you shipped is the same merchandise on which you paid duty. A better alternative for someone using a point in the United States as a distribution point, is to use a bonded facility as I have discussed. You can bring in all of the merchandise and pay duty only on what you actually use in the United States. You can ship the rest out without having to pay duty on it.

## II. EXPORT CONTROLS

Let me shift to the issue of export controls. The United States maintains a number of export controls and several embargoes. Many argue that our export laws are unjustly applied extraterritorially when they are enforced against companies that do not have facilities in the United States and have never sold anything directly to the United States. You may wonder how the United States Government can apply its export laws to a company that has never even dealt with the United States. It happens through a number of different mechanisms.

### *A. Licensing*

Export controls are primarily administered by the Department of Commerce, Bureau of Export Administration (“BXA”); and the Department of State, Office of Munitions Controls (“OMC”). In addition, the Department of Treasury, Office of Foreign Assets Control (“OFAC”) may also become involved in exports to particular countries under sanction or embargo by the United States. These agencies are currently attempting to coordinate their efforts because, for one reason, they sometimes both claim jurisdiction over an article, especially when something can be classified as either military or commercial. Military exports are licensed by the Department of State. The products covered are generally weapons, i.e., tanks, jet fighters, missiles, and biochemical or chemical weapons.

On the commercial side, almost everything exported from the United States requires a license. Prior to 1996, if an item did not require any special license, it received what was called a general license, which used to be known as a G-DEST license. The terminology changed in 1996. Currently, products that do not require a license are designated as NLR, which means “no license required.” Some things by their nature do not require a license, such as pencils or glasses. However, there are still restrictions on where you can send even those items. The Department of Commerce classifies merchandise for export regulation by what are called ECCN numbers. The ECCN number determines whether the item requires a license. If an item does not fall under the Export Administration Regulations (“EAR”), then no license is required. If it does fall under the EAR, then you must follow the regulations to determine if the item falls within a license exception. If not, it will require a license.

There are ten general prohibitions for export licensing. There are generally no special restrictions on exporting to Western World countries unless the particular item requires a special license. Exports to some restricted countries require a license no matter what the item. For example, an exporter would have to obtain an export license—theoretically there are licenses available—to export items to Cuba or Vietnam or other embargoed countries. I deal a lot with the Treasury Department's Office of Foreign Assets Control. This agency reviews licenses for exports to embargoed countries. In my discussions with the general counsel in a number of different cases, they have stated that their general policy is that while they are permitted to issue licenses, they generally do not, unless the exporter can show some very extenuating circumstances or some specific need, i.e. humanitarian reasons.

### *B. Embargoed Countries*

In addition to export licensing, there are also special export restrictions relating to embargoes. The United States maintains embargoes against several countries. The Office of Foreign Assets Control enforces these embargoes. An embargo essentially means that you cannot import from or export to that particular country or engage in transactions with nationals, including companies, of that country.

I had an interesting case that indirectly implicated an embargo issue. I had a client that wanted to purchase several 727 jet engines made by Pratt & Whitney in the 1970s in the United States. He was going to buy the jet engines from a European company. In dealing with the European company, the whole licensing issue came up because the U.S. purchaser requested a "DOS license." I said, at the time, that there was no need for a license to import these jet engines from Europe, but the company's customer in the United States insisted. I thought something was strange about that because you normally do not need a license for imports. I learned that for aircraft engines there are log books that track the engine's location from the time the engine is made to its present location. Well, it turned out that the European company had purchased the engines from an Algerian company. That raised flags because Algeria is a country that a number of Libyan companies use as a front for business. Back in the mid-seventies, *before* the embargo against Libya, the jet engines



were sold to the Libyan Airlines. Later the engines broke down and were never repaired (because of a lack of parts due to the embargo). *After* the embargo went into effect, the engines were sold to the unrelated Algerian company in an arms-length transaction. The European company was able to show that the Algerian company had no ties to the Libyan company, so it was not a front. It was a good faith commercial transaction. The Algerian company later sold the engines to the European company in a completely arms-length, unrelated transaction. And the European company was now selling to our client, a broker selling the engines to another U.S. company.

I compiled this information and sent a letter to the Office of Foreign Assets Control in which I asserted that looking at this situation, it appeared that these jet engines did not fall under the embargo restrictions because my client was not buying from the Libyan government or any Libyan-controlled company. The Office of Foreign Assets Control sent a letter back that basically said, "You are right; no problem; you can continue with the transaction." Two or three weeks later we received a phone call from OFAC and another letter saying, "You cannot do the transaction." Thank goodness my client had not yet done the deal because if they had, they could have been prosecuted. It does not matter that they followed OFAC's initial opinion, they still would have been liable for violating the embargo.

The problem was not in dealing with a Libyan party. The interpretation of the Office of Foreign Assets Control, which we were not able to overcome, basically said that when the U.S.-made jet engines were sold to the Libyan Airlines, they became products of that embargoed country. OFAC said that once those jet engines were put on a plane of the Libyan Airlines back in the 70s, they entered into the commerce of Libya and, therefore, "became products of Libya." So, we could not deal with these jet engines. Other than the fact that the customer happened to ask for a license, the Office of Foreign Assets Control would not have blocked the deal. Asking for the license sort of triggered being asked whether something was wrong with the transaction. If the customer had never asked for the license, we would have never known OFAC's unique interpretation of "a product of," and the transaction would have been completed. The enforcement of import/export laws on embargoed countries is very strict; my client would have been prosecuted. These laws afford little mitigation.

### *C. List of Denied Persons*

The Bureau of Export Administration maintains what it calls a list of denied persons or Temporary Denial Order (“TDO”) list. The list is on the Internet at the BXA web page ([http://www.bxa.doc.gov/\\_2denial.htm](http://www.bxa.doc.gov/_2denial.htm)). Anybody in the United States that exports, whether they are exporting pencils or tanks, should have some type of export management system to ensure that they are not dealing with people on TDO, or OFAC, or DOS “bad guy” lists. It is not simply a product that requires licensing, you must also know who your customer is and where he is located. The exporter has the responsibility of knowing the ultimate destination, who the end user is, and making sure the product is not going someplace where it is not allowed to go, directly or by re-export.

The denied persons list is one way the BXA enforces its laws. Whenever they catch somebody violating the EAR, BXA can place them on the denied persons list. Individuals on the denied persons list could remain on the list for thirty days, or permanently. Once you are on the list, nobody is allowed to do business with you. If you do business with a person or company that happens to be on the list, even in a domestic transaction, you could lose your export privileges in the United States. I would venture to guess that the vast majority of companies do not even know that the list exists or that they should check it. It is, however, very important that you check the denied persons list.

### *D. Specially Designated Nationals and Blocked Persons*

Aside from the denied persons list, a number of other lists have been established recently. One list is maintained by the Office of Foreign Assets Control and is called Specially Designated Nationals and Blocked Persons. Basically, the list contains terrorists as well as known drug dealers and money launderers. The list also contains the companies that do business with these people. The list is now online on the Internet at the OFAC web site (<http://www.ustreas.gov/treasury/services/fac/fac.html>).

Several large commercial banks in Colombia are on the list because of suspected drug money laundering. If you do business with these banks, you could lose your export privileges or be subject to sanctions. The list of Specially Designated Nationals and Blocked

Persons has a few thousand names on it. Peter talked about people switching their names around—the lists have the names followed by all the known aliases. The names are listed by individuals and by companies. A person's listing could just be their company. Therefore, you would have to look at their address to make sure the address of the person you are dealing with is not the same. There also are vessels on the list, with their vessel numbers.

### *E. Client Export Management System*

There are several lists out there and people may have no idea that these lists exist, but if you do business with these individuals or companies, you could be subject to sanctions. Fortunately, these lists are now on the Internet. Once a company understands that these lists exist, they should have a system set up so that as orders come in or purchases go out, they know what steps to take to determine that they are not dealing with somebody on one of these lists, and thereby subjecting themselves to sanctions. Looking at that list, you may see a company in Miami or elsewhere in the United States. These businesses still operate, but have lost their exporting privileges. Nonetheless, if you have to do business with these companies, you might lose your exporting privilege even though it is a completely domestic transaction.

I had a client from a large public company call me up and say, "We have this deal and it is a really important transaction for us, a ten to twenty million dollar sale. It is supposed to be going to a company in Panama, but we are pretty sure it is going to go to, for example, Cuba." I forget which country it was exactly. I said to the general counsel, "You cannot do it." He said, "I thought so, but our sales department, they really want to sell it, and this is really going to effect our bottom line. The company's stock is down. Is there anyway we can do it?" I said, "No, I am sorry you have to tell them no."

Very often, even if your clients are larger companies that may have a legal department, people out in the field doing the sales do not know of the export requirements. They just want to make a sale, which may be a condition for their promotion. That was the problem in this case. Fortunately, this company is in the process of setting up an export management system so that the salespersons understand that before they conclude a transaction they have to check with the

legal department, which checks the various lists.

Implementing an export management system helps protect the client if there is a problem later on. The company can show that it did everything it could, and the illegal sale was simply the action of an overzealous sales person who has been fired or disciplined. Or, perhaps it was just a clerical error that has now been corrected. Having an export management system in place weighs heavily in the client's favor if there are future problems.

#### *F. Increased Customs Scrutiny*

JAMES CAHILL: I just want to add one quick note to what Bob just said. Just this week, Customs proposed greater use of the centralized examination stations ("CES"), which is where they send all the imports that they want intensively inspected. This week, Customs proposed sending export shipments to CESs in more locations than just those where there is a port of exit. That proposal just came out in the *Customs Bulletin*. Consequently, I anticipate stepped-up efforts in the physical inspection of exports by Customs because they will be sending them to these stations.

ROBERT SCHRADER: That obviously has a high priority with all of these new listings being generated because of new sanctions. For example, there are a lot of people that know we have the Helms-Burton Act, which has been suspended. I do not know what is going to come of that.

AUDIENCE PARTICIPANT: What is the effect on a company and the individuals of being on one of the lists?

ROBERT SCHRADER: That is why they list the company name and will usually list the principals under the company to cover the individuals too. But if the person gets his brother-in-law with a different name and sets up another company, then they will continue to operate until they get caught again.

Some of these people are obviously being more closely scrutinized. For example, it is a minor export violation to export without a license, and Customs may not catch this violation. However, in the case of known narcotics traffickers or something of that sort, you know that Customs will be on the lookout.

On one occasion Customs agents entered a client's office in Miami

with their guns drawn, took all the computers, all the hard drives, separated all of the employees, and started questioning them one by one. The client called us, and two hours later I was on a plane to London because they had a subsidiary there, and the transactions were going back and forth between London and Miami. The client had no idea what was going on or what Customs was looking for. Since the indictment was sealed, there was only one way to find out—by looking at the other side of the transaction.

So, I spent three weeks going over every transaction for the past several years. It turns out that they sold parts to their U.K. subsidiary, then the parts were sold to Aer Lingus, and finally they were sold to Iran. Five parts were involved, five things called klystron tubes. They are little tubes, like an old television tube, and are used to operate remote runways. They install the tubes in a desert, and use them as an electronic signal, rather than lights, for planes to land. These tubes obviously have a military application. The problem was that they are made in the United States by 3M. 3M did the right thing by stamping "This Commodity Requires Export Licensing by the Department of Commerce" on the package and invoices for the tubes. 3M would have had problems if they knew who the end user was. But a person in the sales department of my client took the part from 3M, whited-out the warning on the invoice, took off the sticker, and then exported the tubes without the license. This salesman just listed them as "Miscellaneous Aircraft Parts." The client was a public company. It was shut down, even though the parts were only worth maybe one or two thousand dollars apiece. I mean, we are talking five parts. I do not know how much the markup was, but for a relatively small amount of money, this whole company was shut down and nearly went out of business because somebody was overzealous in trying to sell the part. So companies do not always understand that they are liable for the activities of their sales people, and they also must know the law.

After Customs seizes all of that information, it now has all of the invoices of that company whether Customs wins the case or loses the case. Customs, therefore, knows everybody that company bought from and everybody that company sold to. Customs may start watching the other company's transactions and put their names in its computer. That is frequently how a company is placed onto one of the computer lists even though they may not have committed any

Customs violations. Nevertheless, Customs may start detaining their shipments because, according to the invoices, they bought from somebody else who has violated the law. They are now in the system. This happens a lot. You may find out after a FOIA request that the company has a problem with prior deals with people who broke the law. You can argue that they were just a customer, that they never violated the law and should not be in the Customs computer.

AUDIENCE PARTICIPANT: How far does the list go? I am thinking of a company in Chile accused of selling to Iran. He does business with everyone in Chile.

ROBERT SCHRADER: That was a huge case here in Miami.

JAMES CAHILL: Customs has systems to deal with importers and manufacturers like that. Customs has identification codes, which are used to track people in the import/export trade all over the world, similar to the IRS numbers in the United States.

ROBERT SCHRADER: It is kind of frightening. Big brother is here. Customs knows what is going on and what is coming in and going out. Customs may not know with whom he deals locally because that depends on whether Customs is actively investigating or merely watching. Customs may be watching him to see whom he deals with. Customs would certainly check any company he dealt with in the United States. Let us say ABC Exporters dealt with the Chilean company. When Customs found out that ABC Exporters dealt with this Chilean company, Customs would likely start watching ABC Exporters.

## AUDIENCE QUESTIONS

### I. CAREERS IN CUSTOMS LAW

AUDIENCE PARTICIPANT: Law schools do not really offer courses in customs law. For those of us interested in breaking into the customs field, what are your recommendations?

ROBERT SCHRADER: Actually, Peter, Jim, and I all got into customs law in different ways. I began learning about customs law when I joined a firm. I was fresh out of law school, and I went to a nationwide firm that specialized in customs law. My situation was unique

because I think that just about every attorney at the firm had worked at Customs at some point in time. I was the only partner who had never worked at Customs, but I knew that was the area in which I wanted to practice. In law school, I studied international business transactions, regulation and trade, and learned about GATT and the WTO. You are right though, you do not learn about valuation and export controls in law school. As I said, I was the only one in the firm that did not come to the firm with some sort of customs law background.

PETER QUINTER: I started with the United States Customs Service upon graduation from law school and worked there as an attorney for five years. I think working at the Customs Service is the best way to learn customs law because there really are no law school offerings in customs law, although Bob and I are now teaching some courses in that area. The Customs Service has attorneys in a number of its departments and in most of its offices. There are offices in Miami, Washington, and all the major cities in the country. There is also an office called the Office of Regulations and Rulings, where there are approximately one hundred attorneys in Washington, D.C. alone.

If you are not going to work for the Customs Service, an alternative way to learn about customs law, or international trade law generally, is to work for a large corporation in its general counsel's office. They usually have an international law department or an international law attorney within that department. I do work for several Fortune 500 companies and usually deal with their general counsel's office. Working for a corporation's legal department is a good introduction to customs law. If you are still in law school, another option is to intern for one of the federal agencies, such as Customs, Commerce, the State Department, or even the Justice Department.

JAMES CAHILL: There are other ways to learn customs law. I have spent over twenty years as a certified Treasury Department instructor. I teach a customhouse brokers course, which is now a forty to forty-five hour program, and I average at least one attorney per class now. I have also been asked to teach this program at the Florida Atlantic University in their business, law, and accounting department. It will probably be the first of its kind, and we intend to inaugurate it in January.

I also teach several courses in Miami for the Florida Foreign Trade

Association and in Ft. Lauderdale at the World Trade Center. This course has proven very successful for people who want to become licensed customhouse brokers. I think it serves a similar purpose for attorneys who are attracted to the training program in order to receive their brokers' licenses. It offers a broad-based understanding of the procedural aspects of Customs.

I have also taught courses for large corporations. For example, I conducted a course for eleven executives of one of the largest international courier companies. These executives wanted to understand more about Customs rules because they are getting into the brokerage business in a big way. Another courier also has a huge customs center, reportedly with one hundred inspectors in Memphis, Tennessee.

Working in one of the district offices of Customs is another way to get experience in customs law. I was Regional Director of Inspection and Control for the Southeastern U.S. for six years and District Director for five years. District Directors function in a quasi-judicial administrative law type fashion, with the power to conduct hearings and, therefore, get a broad experience in customs law and the interpretation of customs law.

There are increasingly more avenues for people to get involved in customs work. I am glad to see lawyers, in general, becoming more interested in customs because I think the area has a great need for more practitioners. The Customs Service is imposing a number of new responsibilities on brokers. As a result, brokers are hard-pressed to keep up with all of the legal aspects of what they are doing; the case studies support this.

ROBERT SCHRADER: Customs is a fascinating area of law. In my opinion, it is much better than divorce or real estate, for example. This practice gives you the opportunity to learn about different countries, products, and manufacturing processes. In addition, when you travel, you often have the opportunity to offer your clients some business advice as well, such as advising a company about how to structure its manufacturing and where to locate its facilities. That is not really legal work, it is more like strategic business planning, but it is a nice change of pace.

The other point that I want to make is that the practice itself is all federal administrative law. Therefore, an administrative law background is very good to have. Even if you do not work at Customs,



working in any of the administrative agencies of the federal government can give you a good background. In the Office of Regulations and Rulings, the attorneys review the rulings and give the legal opinions on Customs law. They also draft and interpret the regulations, which requires a good knowledge of administrative law.

JAMES CAHILL: A good investment that may whet your appetite for customs law is a subscription to the *Customs Bulletin*. It is published once a week and contains some fascinating cases. I think the *Customs Bulletin* was one of the things that led me toward working on classification issues. I would pick up the bulletins and read the classification cases and was very impressed how some brilliant lawyers and judges interpreted the most minute details of imported items and broke things down to narrow issues and terminology to arrive at a correct classification. I have succeeded in many protests—an excellent record when you consider the level of intelligence Customs has in the area of classifications.

ROBERT SCHRADER: Another place you could work is the Court of International Trade in New York, if you can arrange a clerkship or internship with one of the judges. If you enjoy litigation, there is Customs litigation before the CIT and other federal courts.

## II. CUSTOMS LITIGATION

AUDIENCE PARTICIPANT: I was wondering how much of your work here in Miami involves the Court of International Trade, and if it does, do you use counsel in New York?

ROBERT SCHRADER: I have had a couple of cases pending at the Court of International Trade, but most of the cases that end up there are test cases and cases that are similar to a class action. For example, currently pending is a harbor maintenance fee case.

The harbor maintenance fee case concerns a fee that the U.S. imposed on imports and exports to pay for the maintenance and rebuilding of harbors. The litigants claim that the fee is a tax on exports, which is unconstitutional. The Constitution specifically says that there shall be no tax on exports. This case was initiated by one particular company, United States Shoe, but thousands of other companies have since joined the protest. When the case got up to the CIT it was designated a test case, meaning that every case that followed the same fact scenario would be controlled by the decision. I person-

ally dislike litigation, so if I ever had a case like that, I would bring in somebody that specializes in federal litigation.

AUDIENCE PARTICIPANT: Do you find that some of the disputes involving classification, valuation, or Customs violations are utilizing alternative dispute resolution?

MICHELLE SALEM: All of the valuation cases that I have worked on have either concluded at the Customs rulings level or terminated when the client decided that it would be too costly to pursue the case further.

ROBERT SCHRADER: I had a case in federal court that dealt with counterfeit watch faces. We lost on summary judgment, but we felt the judge was wrong on the law. There is a whole body of special Customs law that he simply did not address. He looked at it as a regular case. We were ninety-nine percent confident that if we appealed, we would have won, but the client decided that our bill was going to be more than the value of the merchandise, so the client conceded the case. Most of your clients are businesses, and, usually, they are not going to fight for principle. They will often simply change the product, write it off, or start shipping the product to another country.

MICHELLE SALEM: In the area of classification, the client may continue to pursue a case because the differential in a duty rate between two classifications can be so substantial that it can benefit a company to continue to pursue the lower duty rate. In valuation cases, the law is sometimes vague. If you seek a Customs ruling, you will get an answer to your question. Sometimes the process is lengthy, but it really is useful in the end.

ROBERT SCHRADER: In drafting your contracts you should include a clause that allocates responsibility for compliance with Customs laws. For example, if the contract stipulates that a product must be labeled a certain way and the overseas supplier does not correctly label the product, you want the burden to be on the supplier to pay for any remedy, or you want to provide a way for your client to get out of the contract.

In contracts that involve export controls issues, I first seek the advice of my intellectual property rights and copyright partners when it is a contract that involves a licensing agreement. After they have

looked at the contract, I add about another half page of clauses to cover the special lists and other issues that I discussed earlier. I always include a clause that says the exporter bears the burden of compliance on these issues. If there are no problems with the transaction, that is great. However, if down the road one of the governments gets involved, then you can have some major problems.

AUDIENCE PARTICIPANT: Do you anticipate that the Helms-Burton provisions will be implemented and enforced?

ROBERT SCHRADER: I do not see how they could be enforced. There would be so many complaints from all of the other countries. Everybody I know is going overseas. They are all going to Cuba. In Miami, it is an especially sensitive issue, but I do not see how it could be enforced. The United States is alone on this issue. The President postponed implementation of the provisions, and I think the postponement is about to run out sometime in September. It will probably be postponed again. I just do not see how the United States can enforce those provisions.