

Recent DOJ Intervention Highlights FCA Use Against Customs Fraud

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With the Trump administration's new tariffs, some companies may be looking for ways to compensate for increased costs of imports. Companies operating in the international supply chain must be aware that any attempts to circumvent heightened duties may draw unwanted attention from the Department of Justice (DOJ) and/or whistleblowers through False Claims Act (FCA) enforcement. A recent complaint the DOJ filed in the Eastern District of California demonstrates how the DOJ and/or whistleblowers can use the FCA to pursue customs fraud.

On April 11, the DOJ filed a complaint in intervention against Barco Uniforms, Inc. (Barco), David Chan, Kenny Chan, and multiple companies controlled by David and Kenny Chan (the Chan companies, together with David and Kenny Chan, the Chan defendants). The complaint alleges that the defendants violated the FCA by knowingly and improperly underpaying customs duties on imported apparel. The case, initially a *qui tam* whistleblower action, is *United States, ex rel. Lee v. Barco Uniforms Inc.*, No. 2:1-cv-1805, pending in the U.S. District Court for the Eastern District of California.

Defendant Barco sells commercial uniforms to restaurants and health care providers, among other customers. For decades, the Chan companies operated as the manufacturers and direct suppliers of the uniforms Barco sold to its customers in the U.S. Most of the uniforms the Chan companies sold to Barco were manufactured in China.

The DOJ alleges that Barco and the Chan defendants caused material, false representations to be presented to the U.S. through the information submitted to U.S. Customs and Border Protection (CBP) on the required Entry Summary/Form 7501. The Entry Summary/Form 7501 requires a party making an entry of goods into the U.S. to disclose, among other information, a description of the goods, the quantity of the goods, the value of each item, as well as the duty rates and duties owed for the goods. The DOJ views each piece of information provided with the Entry Summary/Form 7501 as a material representation to the U.S.

According to the DOJ's complaint, Barco and the Chan defendants schemed to underpay customs duties owed to the U.S. on the uniforms the Chan companies sold to Barco. By scheming to underpay customs duties, the Chan companies were able to offer Barco lower prices for the uniforms Barco purchased, which allowed Barco to win lucrative contracts from customers.

The DOJ alleges that Barco documented the scheme on internal "cost sheets" that would reflect falsified duties. Barco often would provide these cost sheets to the Chan companies to identify target costs for the uniforms, including artificially low target duties.

The DOJ also alleges that the Chan companies created two invoices for the uniforms Barco purchased. One invoice would reflect the actual price that Barco agreed to pay the Chan companies. A second invoice would have a falsified, lower price for the same items to justify the artificially low duties. The second invoice, with the lower price, was provided to a customs broker who relied upon that falsified price when submitting the Entry Summary/Form 7501 to CBP.

Based on these alleged efforts to avoid paying full custom duties on the goods Barco purchased from the Chan companies, the DOJ has asserted three counts of reverse false claims FCA violations against Barco and the Chan defendants.

Key Takeaways

In light of the Trump administration's imposition of sweeping tariffs, companies that import goods, particularly from China and other countries facing increased tariffs, should prepare for an increase in investigative scrutiny under the FCA based on any actual or perceived attempts to evade the heightened duties and their associated costs.

Companies need to ensure that they have effective compliance programs and that their own import policies and procedures are consistent with all applicable laws. Given the increased risk with tariffs imposed on imports from targeted countries, now is the time that companies may want to consider internal audits of their compliance controls. Similarly, companies may want to review and revise their policies that enable them to maintain visibility into all stages of their supply chain. Moreover, because *qui tam* whistleblowers often initiate FCA actions, companies should ensure that they have confidential reporting mechanisms for potential FCA violations to be raised internally, and subsequently investigated and appropriately addressed.

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