



corporate officers becoming liable for negligent acts is reconsidered

MSK Client Alert

March 26, 2014

In July 2013, the decision of the Court of Appeals for the Federal Circuit (CAFC) was announced in *United States v. Trek Leather, Inc. and Harish Shadadpuri*, Case No. 2011-1527 (July 30, 2013). Harish Shadadpuri (Shadadpuri) was the President and sole shareholder of Trek Leather, Inc. (Trek). The question before the appellate court was whether, in the absence of any specific allegations against him personally, Shadadpuri could be held liable for the gross negligence of Trek. The appellate court held no, but both the CAFC and Shadadpuri conceded there were other legal bases on which he could be held liable, even as the government declined to pursue those other options. The CAFC has now granted an en banc hearing to reconsider that decision, which is generating significant concern on many fronts.

The underlying facts are uncontested. Trek imported men's suits. When the entries were filed, the cost of the fabric (considered an "assist") was not included as part of the dutiable value. Shadadpuri was previously associated with another company and two (2) years earlier had a similar problem with that other company. In the earlier case, Customs and Border Protection (CBP) decided to forgo any penalty action, but received \$46,156.89 in unpaid duties.

With Trek, Shadadpuri conceded from the outset the fabric assist should have been declared. [An assist is anything the importer provides to the manufacturer that is used in production that the manufacturer received at a reduced cost or at no cost.] CBP identified the assist and issued a penalty. In assessing the penalty, CBP named both Trek and Shadadpuri as jointly and severally liable in its claim for \$2,392,307 based on fraudulently, knowingly, and intentionally understating the dutiable value of the imported men's suits. As frequently occurs in such situations, the government also alleged gross negligence and negligence and sought payment of \$45,245.39 in underpaid duty.

The Court of International Trade (CIT) found Shadadpuri liable for gross negligence, and, as a result, the other two counts (the ones for negligence and fraud) were dismissed. The CAFC overturned that decision. It held Shadadpuri

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could have been liable for fraud, or as an aider or abettor, or if the government had pierced the corporate veil, but since none of those theories were pursued, the government lost on appeal.

What the trade community is trying to figure out is what does this mean? Based on CAFC's decision in *United States v. Hitachi America, Ltd.*, 172 F.3d 1319 (Fed. Cir. 1999), a person cannot "aid and abet" negligent conduct, so under the CBP penalty regime, that would mean an individual corporate officer (or even a director or manager) could not be liable for the culpability of his corporate employer unless there is fraud present or there are allegations recited against him individually. At the same time, if fraud is alleged, that means the government has been able to assert specific acts against the individual. So, does the fact the CAFC granted the rehearing mean we will see a reversal of the Hitachi decision? Will there be clarity about personal liability in the negligence context?

As international traders know, 19 U.S.C. § 1592 requires importers to exercise reasonable care when filing their entry declarations with CBP. A violation occurs when there is a material false statement or material omission in those declarations, which is the case when a value component, such as a fabric assist, is not included in the dutiable value declared at time of entry. In imposing liability, § 1592 (a)(1) talks in terms of "no person" may make entry by fraud, gross negligence, or negligence. § 1592 (a)(1)(B) includes a prohibition for aiding or abetting such misdeclarations.

During oral argument at the CIT, Trek conceded it had been grossly negligent, while Shadadpuri continued to deny liability. Shadadpuri went on to argue he could only be personally liable if the government pierced Trek's corporate veil or established he had committed fraud or aided and abetted Trek's fraud. He also argued he could not be liable for aiding and abetting in the case of negligence or gross negligence; see *United States vs. Hitachi America, Ltd.*, 172 F.3d 1319 (Fed. Cir. 1999). Surprisingly, the government abandoned any attempt to claim fraud, declined the invitation to proceed on any other theory, and instead stuck to the position Shadadpuri is a "person" as defined in § 1592 and so is liable. The CIT agreed and entered judgment for \$534,420.32 based on gross negligence, holding Shadadpuri jointly and severally liable. The CIT was undoubtedly influenced by the fact Shadadpuri is the one who was responsible to examine the relevant documentation before submitting it to the customs broker to prepare entry. Put another way, Trek could not have been grossly negligent but for the actions of Shadadpuri. While Shadadpuri appealed, the government did not appeal the dismissal of the fraud claim.

In reaching its decision, the CAFC analyzed the issue by first conceding the obvious – Shadadpuri was a person within the meaning of the statute – but questioned whether the government proceeded on the correct legal grounds. For example, a § 1592 penalty arises in conjunction with material false statements or omissions made during the entry process by the importer. As such, to establish direct liability, the government had to establish the elements of negligence – a duty, a breach of that duty, and then harm. The duties set out in §§ 1484 and 1485, and so in § 1592, relate to entry declarations by importers. In its penalty action, the government failed to assert any duty on Shadadpuri's part, so there could be no negligence or gross negligence by him and so no penalty liability.

Typically, a corporate officer is insulated from claims by creditors by virtue of there being a corporate entity. There is a long-standing limited liability principle holding that, so long as the corporate officer is acting on behalf of the corporation, he is not liable for what follows. Obviously, there are other contexts where individual liability



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can arise, but in this case, because of how the government chose to plead its case, it lost.

In terms of the en banc request, the judges who heard the case referred it to the other judges on that court, who agreed to entertain the rehearing. As a result, the July 2013 decision is vacated. The parties were directed to brief the following issues:

1. 19 U.S.C. § 1592(a) imposes liability on any "person" who "enter[s], introduce[s], or attempt[s] to enter or introduce" merchandise into United States commerce by means of fraud, gross negligence, or negligence by the means described in § 1592(a). What is the meaning of "person" within this statutory provision? How do other statutory provisions of Title 19 affect this inquiry?
2. If corporate officers or shareholders qualify as "persons" under § 1592(a), can they be held personally liable for duties and penalties imposed under §§ 1592(c)(2) and (3) when, while acting within the course and scope of their employment on behalf of the corporation by which they are employed, they provide inaccurate information relating to the entry or introduction of merchandise into the United States by their corporation? If so, under what circumstances?
3. What is the scope of "gross negligence" and "negligence" in 19 U.S.C. § 1592(a) and what is the relevant duty? How do other statutory provisions in Title 19 affect this inquiry?

Shadadpuri's brief is due April 19; the government's response, May 19; and any reply, June 3. Thereafter the court will designate the oral argument date.

The question this case presents on rehearing is whether there are circumstances under which an individual may be held liable for the tort actions of the company simply by virtue of being an officer or director, or even a manager or employee? Obviously, if the answer of the CAFC turns out to be yes, this result could well turn long-standing corporate immunity principles upside down! There is no question an individual in the employ of the company in whatever capacity is an individual as defined in the statute, but does the legislative history of that statute allow it to have the far reaching impact of making individuals liable in the circumstance of the employer being negligent or grossly negligent without anything more?

Given the potential impact of the court's decision, it is not surprising that many trade associations are filing amicus briefs, but all those interested in corporate governance issues should be just as concerned. It is impossible at this point to guess what will be the CAFC's decision, but clearly the outcome could have far-reaching effects, not just on corporations, but also on limited liability companies and perhaps even limited liability partnerships. It is also reasonable to expect that, while the case is pending, many companies will be considering indemnity agreements with key employees.