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**Abstract**

This Article is an attempt to describe the current state of the evolving law on liquidated damages and to focus attention on several of the emerging areas that are likely to require administrative, congressional, or judicial action.

# LIQUIDATED DAMAGES: MAKING SENSE OF THE RELATIONS BETWEEN THE U.S. CUSTOMS SERVICE, BOND PRINCIPALS, AND SURETIES†

*Gilbert Lee Sandler**

## *INTRODUCTION*

The substantive and procedural law governing liquidated damage cases has changed dramatically in recent years without the benefit of any comprehensive review or plan. The U.S. Congress did not adopt an omnibus liquidated damage simplification act, nor has the U.S. Customs Service (the "Customs Service" or "Customs") adopted a comprehensive regulatory scheme designed to harmonize the voluminous flow of notices, demands, bills, protests, petitions, and court cases involved in the joint and several liabilities of bond principals and their sureties. Instead, the last decade has been punctuated by fundamental changes developed in an intermittent and piece-meal fashion. Occasional Customs Service rulings and regulatory changes, supplemented or inspired by decisions issued by the courts in the handful of cases that received judicial review, have left us with a patchwork of procedural and substantive law. Whether the pieces neatly fit, or whether they have left gaps or holes to be patched over, should be a cause for concern among all three parties to the bond: Customs, bond principals, and sureties.

This Article is limited in scope. It is not a comprehensive review of liquidated damage developments. It is an attempt to describe the current state of the evolving law on liquidated damages and to focus attention on several of the emerging ar-

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eas that are likely to require administrative, congressional, or judicial action.

## I. *THE CHANGING LIQUIDATED DAMAGE ENVIRONMENT*

Customs has relied upon bonds to secure the obligations of private citizens since the turn of the nineteenth century. In 1799, the U.S. Congress adopted legislation that remains a part of title nineteen of the U.S. Code: the right to assess six percent interest on any duties recovered in a law suit brought by Customs upon a bond.[1] Despite the ancient reliance by Customs on surety bonds, the last decade has witnessed an awesome array of developments defining for the first time the basic procedures for dealing with surety bonds and their related liquidated damages. The new developments are so basic as to suggest that virtually no procedures were established during the preceding 180 years.

### A. *The Surety's Right to Protest*

The right of the surety to file a protest against liquidation had been recognized by the courts, but not by any Customs Service regulation or directive.[2] In 1979, Congress for the first time established a realistic opportunity for sureties to exercise their protest right. In recognition of the fact that sureties are unlikely to receive notice of a liquidation and the required information to protest within ninety days of liquidation, Congress extended the time period for surety protests to ninety days following the demand on surety.[3]

### B. *The Surety's Right to Information*

The surety's right to obtain access to entry documents was denied by Customs as late as 1981, two years after the adoption of the statute extending the due date for surety protests. This was more than a decade after *St. Paul Fire and Marine Insurance Company v. United States*.[4] A Customs Service telex stated

1. 19 U.S.C. § 580 (1988).

2. *See* St. Paul Fire & Marine Ins. Co. v. United States, 370 F.2d 870, 873-74 (5th Cir. 1967).

3. Trade Agreements Act of 1979, 19 U.S.C. § 1514(c)(2) (1988) [hereinafter 1979 Trade Act].

4. 370 F.2d 870 (5th Cir. 1967).

that "[u]ntil such time as Customs Headquarters formulates a definite national policy respecting the release to and/or copying of such information by a surety filing a protest, the [regional office] will not allow such inspection or copying."[5] Later in 1981, however, Customs Service headquarters advised, by telex, all of its field offices to permit sureties access to such information, stating that "sureties have attained the status of a party-in-interest, and as such . . . are entitled to request and receive copies of the bond and the entry, as well as any documents submitted by and for the importer in support of the entry."[6]

In 1988, the Customs Service published its first, and as yet only, official standard on surety information access. That notice reaffirmed the right of sureties to obtain basic information at the time of a bond's issue, but limited the sureties' access to much of the information flowing from the importer prior to a breach of the bond.[7]

### C. *The Right to Petition and Protest Liquidated Damage Claims*

The right of both importers and other bond principals to file petitions against liquidated damage claims has been well established in Customs regulations for many years. The right of the surety to petition, however, was not clearly established until 1981.[8]

The right of both importers and sureties to protest liquidated damage assessments, meanwhile, is still a matter of debate and controversy. In 1982, the U.S. government argued that liquidated damage assessments are not protestable.[9] In 1988, the Customs Service argued that legal issues may only be raised against liquidated damage assessments by the filing of a ninety-day protest.[10] This unresolved issue is specifically ad-

5. Letter of Regional Office of Classification and Value of U.S. Customs Service at Miami, Florida of Jan. 28, 1981 (File PRO-1-0:C MMM) (copy on file at the *Fordham International Law Journal* office).

6. Telex from Headquarters of U.S. Customs Service of Feb. 19, 1981 (copy on file at the *Fordham International Law Journal* office).

7. Customs Service Notice, 53 Fed. Reg. 6,216 (Mar. 1, 1988).

8. C.S.D. 81-3, 15 Cust. B. & Dec. 752 (1981).

9. United States v. Bavarian Motors, Inc., 4 CIT 83 (1982).

10. United States v. Utex Int'l, Inc., 659 F. Supp. 250, 252 (Ct. Int'l Trade 1987), *rev'd*, 857 F.2d 1408 (Fed. Cir. 1988).

dressed in a subsequent section of this Article.[11]

How have the administrative procedures developed so as to avoid the potential confusion and unnecessary burden in handling the competing information requests, protests, petitions, and demands for payment to both the surety and its principal? The regulations and language of the bonds have never established a strict priority for seeking payment from the principal and its surety. The liquidated damage notice regulation, however, states only that a courtesy copy of the initial notice should be provided to the surety.[12] Traditionally, Customs has dealt exclusively with the bond principal for a period of time and only thereafter made demand on the surety.[13] Generally, Customs has merely stated that the obligations of the principal and the surety are "joint and several" without further elaboration.[14]

With regard to protests by "different authorized persons," Congress long ago provided that Customs should treat the separate filings as "part of a single protest."[15] It appears, however, that Customs has never treated such protests together. Regarding liquidated damages, there is no statute or Customs Service regulation establishing a unified procedure for the handling of multiple petitions.

Thus, almost 200 years after Congress first established a procedure utilizing bonds for import transactions, we are for the first time dealing with some of the most fundamental rights and procedures concerning those bonds: the rights of importers and sureties to protest, the rights of sureties both to petition and gain access to the documentary evidence concerning breaches of their bond, the obligations of Customs under the bond, and the orderly handling of the relative obligations of importers and sureties. The evolution of these issues is far from complete. The following sections of this Article will discuss some of the issues likely to emerge in the future, and will suggest possible resolutions.

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11. *See infra* notes 16-44 and accompanying text.

12. 19 C.F.R. § 172.1(a) (1990).

13. S. REP. No. 249, 96th Cong., 1st Sess. 254 (1979), *reprinted in* 1979 U.S. CODE CONG. & ADMIN. NEWS 381; T.D. 87-151, 52 Fed. Reg. 12,149 (Apr. 15, 1987).

14. *See, e.g.*, T.D. 88-72, 22 Cust. B. & Dec., No. 48 (Nov. 30, 1988).

15. 19 U.S.C. § 1514(c)(1) (1988).

## II. *ACCESS TO JUDICIAL REVIEW OF LIQUIDATED DAMAGE CLAIMS: COPING WITH THE LITIGATION/MITIGATION OPTION*

Liquidated damage notices may be contested immediately by filing a petition within thirty days.[16] At the conclusion of the administrative process, however, a mitigation decision issued by Customs is not protestable or subject to judicial review.[17] It is now settled that the courts will review the legality of the liquidated damage claim when the principal or surety raises a legal defense in response to a collection action.[18] The question remains unresolved as to whether the importer and surety have an option to initiate litigation by protesting the liquidated damage notice under section 1514 of title nineteen of the U.S. Code and filing a summons against a denial.

It has been said that judicial review may be affirmatively sought by protesting and filing a summons after payment of the full liquidated damages. Presumably, this opinion is based upon a conclusion that recent cases which have held that a protest is not *required* by importers and sureties have left undecided whether they have an *option* to protest. It is the opinion of the Author, however, that the section 1514 protest and subsequent summons filed in the U.S. Court of International Trade (the "CIT") is not an alternative available under statute to either the importer or its surety. The filing of a protest may serve the legitimate purpose of inviting administrative review of legal issues prior to filing a collection action, but it cannot confer jurisdiction on the CIT in an action by the protestor against a denied "protest."

### A. *The Authority For Protesting Liquidated Damage Claims*

Courts have held that an importer or surety who fails to protest a liquidated damage notice may nonetheless raise legal defenses to the government's collection action.[19] Because the protest statute is actually a statute of limitations for the raising

16. 19 C.F.R. § 171.12(b) (1990).

17. *See* United States v. Borge Int'l, 9 CIT 484 (1985).

18. *See, e.g.*, United States v. Utex Int'l, Inc., 659 F. Supp. 250, 253 (Ct. Int'l Trade 1987), *rev'd*, 857 F.2d 1408 (Fed. Cir. 1988).

19. *See, e.g., id.*; United States v. Toshoku Am., Inc., 670 F. Supp. 1006 (Ct. Int'l Trade 1987), *rev'd*, 879 F.2d 815 (Fed. Cir. 1989).

of legal issues, the courts could not logically have issued these decisions unless they had concluded that liquidated damage decisions are not protestable decisions under section 1514. Section 1514(a) states that the protestable decision "shall be final and conclusive upon all persons . . . unless a protest is filed in accordance with this section."[20] If no protest is filed, the legality of the assessment is final and unchallengeable by a defendant in a collection action.

Consistent with this logic, courts have specifically stated that "an assessment of liquidated damages is not [a] 'charge or exaction' that must be challenged by protest under 19 U.S.C. § 1514 (1982)."[21]

This is not unmindful of the decision in *United States v. Bavarian Motors, Inc.*[22] dismissing the government's collection action on the ground that it was premature; a surety protest was pending administratively.[23] The CIT did not consider the matters before the appellate courts in *United States v. Utex International, Inc.*[24] and *United States v. Toshoku America, Inc.*.[25] In any event, the result in *Bavarian Motors* was correct because the CIT need not accept jurisdiction prior to completion of the administrative process.

Regardless of whether the "protest" in *Bavarian Motors* was properly fileable under section 1514, the surety and the importer have the right to advise the government of any defense which might be raised in future litigation. The govern-

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20. 19 U.S.C. § 1514(a) (1988). One decision of the CIT issued after this Article was originally written rejected the U.S. government's claim that liquidated damage notices must be protested under section 1514. Halperin Shipping Co. v. United States, 742 F. Supp. 1163 (Ct. Int'l Trade 1990). Prior to holding that a Department of Treasury decision rejecting an offer-in-compromise and making a "demand for payment" is not a protestable "charge or exaction," the trial judge noted that two prior decisions of the U.S. Court of Appeals for the Federal Circuit had "squarely rejected" the government's claim that notices of liquidated damages are protestable. *Id.* (citing *Toshoku* and *Utex*).

21. *Toshoku*, 879 F.2d at 818 (explaining holding in United States v. Utex Int'l Inc., 857 F.2d 1408 (Fed. Cir. 1988)).

22. 4 CIT 83 (1982).

23. *Id.*

24. 659 F. Supp. 250 (Ct. Int'l Trade 1987), *rev'd*, 857 F.2d 1408 (Fed. Cir. 1988).

25. 670 F. Supp. 1006 (Ct. Int'l Trade), *rev'd*, 879 F.2d 815 (Fed. Cir. 1989). *Compare Bavarian Motors*, 4 CIT 83 *with supra* notes 18-19 and accompanying text (discussing *Utex* and *Toshoku* decisions).

ment has an interest (if not an obligation) in reviewing such issues so as to avoid such litigation. The CIT, meanwhile, has an interest in encouraging such submissions so that it can avoid entertaining unnecessary litigation, or at least has the benefit of complete administrative records where it must entertain litigation.

There are many reasons why the courts are correct in their conclusion that liquidated damages are not "protestable" decisions. The liquidated damage notice advises the recipient that it has thirty days to file a petition; it does not advise that there are ninety days to file a protest. The absence of this notice (or of any other notice required by statute, regulation, or long-standing administrative practice) advising of the requirement or option to file a protest is so fundamentally inconsistent with the principles of due process that no court should imply the existence of such an obligation or option. In similar circumstances, the CIT has dismissed a government characterization of a fee as a protestable "charge or exaction," referring to this instead as a "post-litigation rationalization."[26]

Sureties have historically been permitted to raise all legal defenses to a collection action even when no protest has been filed. Neither Congress nor the Customs Service has passed legislation or regulations to modify this practice. As the U.S. Court of Appeals for the Federal Circuit concluded in *Utex*: "[i]t is not characteristic of either the law of surety or the law of contracts that a defendant must routinely pay the amount demanded prior to judicial determination of contractual liability. Absent statutory directive or clear Congressional intent to the contrary, we do not impose it."[27]

It would be particularly inappropriate to imply such a unique requirement for full payment of liquidated damages in light of the large disparity between the full bond amount and the amount that Customs will reasonably accept in full satisfaction of the contract or bond violation under its mitigation guidelines and compromise procedures. Liquidated damages are normally assessed by Customs in large amounts set by Customs regulations, subject to mitigation by the agency under its

26. National Bonded Warehouse Ass'n v. United States, 706 F. Supp. 904, 906 (Ct. Int'l Trade 1989).

27. United States v. Utex Int'l Inc., 857 F.2d 1408, 1414 (Fed. Cir. 1988).

administrative guidelines.[28]

Examination of the recently published mitigation (*i.e.*, Bond Cancellation) guidelines demonstrates the dramatic difference in the bond amount and the amount Customs reasonably expects to collect upon filing of a petition.[29] Both repeat and aggravated violators of the country-of-origin marking laws can expect mitigation to an amount between twenty-five and fifty percent of the bond.[30] Documentary late-filing cases, under regulation and mitigation guidelines, are demanded in full bond amounts and mitigated to nominal sums.[31]

To seek judicial review of a liquidated damage case, therefore, an importer or surety typically must reject an offer or opportunity for substantial mitigation. Payment of a large sum as a precondition to litigation would have an unreasonable chilling effect on judicial review and should not be imposed unless expressly required by statute.

Furthermore, liquidated damages assessed for violation of the bond's contractual obligations can be described in the same manner as the annual warehouse fees which were held to be nonprotestable:

> As this court acknowledged in its previous opinion, both *Puget Sound Freight Lines* and *Atlantic Transport Co. v. United States*, 5 Ct. Cust. App. 373 (1914), though distinguishable from the case at hand, indicated that fees, exactions or charges which bear no relation to the importation of merchandise and the rate of duty resulting from such classification, do not fall within the meaning of "charges or exactions of whatever character" as used in 19 U.S.C. § 1514(a)(3).[32]

Thus, it must be concluded that liquidated damages are not protestable.[33] However, that conclusion raises a new issue

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28. *See generally* DEPARTMENT OF TREASURY (UNITED STATES CUSTOMS SERVICE), CUSTOMS FINES, PENALTIES & FORFEITURES HANDBOOK (HB 4400-01) at pp. LDS-1 — LDS-47 (Apr. 1986 revision).

29. T.D. No. 89-48, 23 Cust. B. & Dec. No. 18, § IV(E)(3), at 8 (May 3, 1989).

30. *Id.* Lesser violations are routinely reduced to amounts ranging from one percent to five percent, but are never lessened below US$100. *Id.* § IV(D)(2), at 8.

31. *Id.* § I, at 2-4 (regarding 19 C.F.R. § 142.15 (1990)); *id.* § V at 10-11 (regarding 19 C.F.R. § 113.42 (1990)).

32. National Bonded Warehouse Ass'n v. United States, 706 F. Supp. 904, 906 (Ct. Int'l Trade 1989).

33. This conclusion raises the question whether there is any possibility that an importer or surety may bring an affirmative action in court to control a liquidated

of considerable concern: what is the effect of the many "protests" that have been filed against liquidated damage assessments?

### B. *The Effects of Protesting Liquidated Damage Claims*

Customs has invited the filing of protests against liquidated damage assessments by installing a computerized procedure that issues "notices of liquidated damages" advising the recipient it must file its petition within thirty days. At the same time, Customs headquarters has directed its field offices to accept petitions within ninety days because the principal and surety are regarded as having the right to file a ninety-day protest. The Customs computer has been programmed to postpone issuing bills until expiration of the ninety-day period without the filing of a petition or protest.[34]

As a practical matter, some parties have responded to demands after the thirty-day petition period, but prior to the ninety-first day, by filing "protests" so as to give notice to the government of their objections to the assessment. Under Customs procedures, the pendency of such a protest prevents the government from treating the assessment as "delinquent."

The filing of such a "protest" is appropriate because it is the only existing regulatory procedure recognized by Customs for contesting a liquidated damage notice more than thirty days after its issuance. A petition filed at that late date is likely to be rejected as untimely; Customs does not freely grant extensions of the petition period.[35] Customs will accept the "protest" during the ninety-day period and will issue a decision in response to the protest.

What happens if Customs denies the protest? Having

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damage case suit. If the protest procedure does not apply, then the only jurisdiction in the CIT exists where Customs files a collection action. *See* 28 U.S.C. §§ 1581-1585 (1988) (denoting jurisdictional powers of CIT). It is doubtful that the CIT has jurisdiction under its residual authority under 28 U.S.C. § 1581 (1988). The Court of Claims recently ruled it is without authority because the government is not a "party" to the surety contract. Washington Int'l Ins. Co. v. United States, 16 Cl. Ct. 663, *aff'd*, 889 F.2d 1101 (Fed. Cir. 1989).

34. While this procedure is not the subject of any published notice, it is the current procedure as repeatedly described by officials at Customs Service Headquarters in public meetings with the surety industry, and is consistent with the experience of the Author and his clients.

35. *See* 19 C.F.R. § 172.12 (1990).

elected to file a section 1514 "protest," has the "protestant" subjected the decision to finality and waived any right to defend against a collection action? It appears not. If the liquidated damage claim is not final by operation of section 1514 when no protest is filed,[36] it also cannot become final by virtue of a protest denial. No language within the statute supports an interpretation that would apply the statute in one instance but not in the other.

Furthermore, the fact that the document filed with Customs is designated as a section 1514 protest—or even filed on Customs Form 19 for such protests—does not make it a protest if that is inconsistent with the law. Courts have long recognized that the failure to use the term "protest" or refer to section 1514 in a letter contesting a Customs Service liquidation is still a proper protest if it complies in other respects.[37] Consistent with those decisions, the erroneous designation of a document as a "protest" does not convert it into a protest.

Finally, since Customs regulations do not provide for any procedure to contest liquidated damages beyond the thirtieth day, the courts should be pleased by efforts to induce Customs to consider the validity of its assessment under the protest procedures. Adoption of this method is helpful in avoiding litigation and in developing a meaningful administrative record should litigation become necessary. In fact, Customs regulations should be revised to provide for the filing of administrative petitions contesting the legality of liquidated damage cases until such time as the government files a collection action. Such petitions should be acceptable since the same issues may be raised in any subsequent collection case. By developing regulations, Customs can crystallize the procedures and make certain that issues are presented to the proper persons and handled efficiently. In the absence of Customs regulations, we will continue to operate in an environment where *ad hoc*, extralegal procedures are adopted to get the attention of Customs officials on legitimate issues by parties hoping to avoid unnecessary litigation.

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36. *See supra* notes 18-19 and accompanying text (discussing *Utex* and *Toshoku* cases).

37. *See, e.g.*, Mattel, Inc. v. United States, 377 F. Supp. 955, 958-60 (Cust. Ct. 1974).

### C. *Jurisdictional Issues: The Timeliness of Protests*

If liquidated damage notices and demands are protestable for only a ninety-day period, courts can anticipate disputes over whether a notice or demand was mailed within ninety days before receipt of a protest. Protests, by statute, must be filed within ninety days of the date of the protested decision or of the posted bulletin notice of liquidation.[38] The one exception to this rule is that protests by a surety may be filed within ninety days of the date that a demand is mailed to the surety.[39] Similarly, Customs ordinarily mails liquidated damage notices (or demands) to the surety in the form of a "notice of penalty and/or liquidated damages."[40]

In at least two cases where a protestor has demonstrated non-receipt of a Customs Service notice, courts have placed an exceptionally heavy burden upon Customs to prove that it mailed the notice in question.[41] In considering the surety protest statute, the CIT has relied upon those decisions in holding protests to be timely which had been filed as late as thirteen months after the date on which Customs claimed it had commenced mailing demands on a monthly basis.[42]

There is at least one other instance in which Customs has a statutory requirement to mail a notice: the date a protest decision is mailed commences the 180-day period for the filing of a summons.[43] Customs has avoided litigation over when it mailed the decision by adopting a regulation which provides that the decision date recorded on the protest is deemed to be the date it was mailed.[44] No such regulation has been adopted with respect to surety protests, however, nor has Customs adopted any other procedure that would avoid future litigation.

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38. 19 U.S.C. § 1514(c)(2) (1988).

39. *Id.*

40. Customs Form 5955A; *see, e.g.*, American Motorists Ins. Co. v. Villanueva, 706 F. Supp. 923, 930 (Ct. Int'l Trade), *aff'd*, 880 F.2d 409 (Fed. Cir. 1989) (referring to Customs Form 5955A).

41. *See* Clayton Chem. and Packaging Co. v. United States, 150 F. Supp. 628, 630 (Cust. Ct. 1957); Alfred Dunhill of London, Inc., v. United States, 22 Cust. Ct. 209 (1949).

42. *See, e.g.*, Peerless Ins. Co. v. United States, slip op., No. 81-5-00652 (Ct. Int'l Trade June 3, 1982).

43. 28 U.S.C. § 2636 (1988).

44. 19 C.F.R. § 174.30(a) (1990).

## III. *FUTURE ADMINISTRATIVE AND JUDICIAL ISSUES*

The loosely defined relationship of Customs, importers, and sureties will continue to create new administrative and judicial issues with respect to contesting (and collecting) claims for liquidated damages.

### A. *Customs' Failure to Follow Its Regulations*

Legal challenges to liquidated damage claims are often based on claims that the Customs Service failed to follow a regulation that allegedly established a precondition to collecting under the bond. Courts have held that the failure of Customs to follow its regulations, however, does not give rise to a defense of equitable estoppel.[45] Alternatively, it has now been held by an appellate court, as a matter of law, that the government has no cause of action under a bond where Customs has failed to follow certain of its regulations.[46] Earlier, the CIT had held that a failure to issue a notice of liquidation extension to the surety would only prevent Customs from collecting from the surety if it were proven that non-delivery was prejudicial to the surety.[47] The absence of the need to demonstrate prejudice in both the *Utex* and *Toshoku* cases appears to arise from a determination that the regulations violated in those cases were mandatory, whereas the regulation violated in *Old Republic Insurance Co., Inc. v. United States*[48] was directory and not required by statute.[49]

Future litigants no doubt will raise such Customs Service omissions in defense of collection actions. The need to determine whether the violated regulation or statute is directory or mandatory, and whether or not there is a need to establish prejudice, are likely to be critical issues.

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45. *See* United States v. Federal Ins. Co., 805 F.2d 1012, 1013-14 (Fed. Cir. 1986), *cert. denied*, 481 U.S. 1048 (1987).

46. For example, when Customs has failed to issue a re-delivery notice prior to liquidation. *See, e.g.*, United States v. Utex Int'l, Inc., 659 F. Supp. 250 (Ct. Int'l Trade 1987), *aff'd*, 857 F.2d 1408 (Fed. Cir. 1988).

47. Old Republic Ins. Co. v. United States, 645 F. Supp. 943, 947 (Ct. Int'l Trade 1986).

48. *Id.*

49. *Compare supra* notes 18-19 and accompanying text (discussing *Utex* and *Toshoku* cases) *with supra* notes 47-48 and accompanying text (discussing *Old Republic* case).

Earlier cases often involved a threshold issue as to whether or not the regulation in question was an implied part of the bond. If not, the surety then had no reason to complain about the government's failure to follow the regulations. In *Old Republic*, the CIT held that the regulation would be implied so long as it was for the benefit of the surety.[50] In that case, the regulation provided notice to the surety (in addition to statutory notice to the importer) and was therefore held to be for the benefit of the surety and implied into the bond. In contrast, the government has argued in more recent litigation that the regulatory provision under which courtesy copies of liquidated damage notices are supplied to the surety is not a regulation "for the benefit of the surety" and is not an implied part of the bond.[51] Thus, it appears that this issue will be raised in future cases unless the courts devise a definitive standard that is clear and dispositive enough so as to eliminate all ambiguity.

Any regulation that requires Customs to provide a notice to the surety should unquestionably be regarded as a part of the bond. The government has argued unconvincingly that such notices are for its benefit in that they protect revenue. In fact, the benefits to the government are minimal in comparison to those for the surety. The notice enables the surety to make intelligent underwriting decisions, including refusals to write future bonds. It also enables it to post sufficient reserves to protect itself against future liabilities. In contrast, Customs gains no advantage because the notice will not enable it to collect any more than the face amount of the bond. It cannot change its position in any respect.

Finally, it is worth noting that the bonds established by Customs under its uniform bond procedure actually have no substantive text other than the Customs regulations.[52] Thus, while the courts may have previously interpreted the meaning of various paragraphs of Customs bonds, future cases will deal almost exclusively with interpretations of Customs regulations.

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50. *Old Republic*, 645 F. Supp. at 954.

51. *See* Washington Int'l Ins. Co. v. United States, 16 Cl. Ct. 663 (involving requirement that Customs "immediately" issue liquidated damages where estimated duties are unpaid), *aff'd*, 889 F.2d 1101 (Fed. Cir. 1989); 19 C.F.R. §§ 142.15 & 172.1 (1990).

52. T.D. 84-213, 18 Cust. B. & Dec. 597 (1984).

### B. *The Burden of Proof In Liquidated Damage Cases: Who Is the Recordkeeper?*

Evidentiary issues can be expected to be raised in future liquidated damage cases regarding which party has the ultimate burden of persuasion on critical issues, despite the fact that such evidentiary issues have not been crucial in recent decisions. In both *Toshoku* and *Utex*, the government readily conceded the facts with respect to the issuance of re-delivery notices.[53] Moreover, the CIT in *American Motorists Insurance Co. v. Villanueva*[54] concluded that the surety could not require Customs to produce copies of bonds covering over one hundred entries after the surety had failed to raise such questions in response to four prior notices.[55]

Thus far, it has been traditional to assume that the government's position will prevail for at least two reasons when incomplete or imperfect information is available to the parties and the court. First, its actions are protected by the so-called "presumption of correctness."[56] Second, the party most likely to challenge the Customs decision—the "owner, importer, consignee, or agent thereof"—should have most of the evidence available to it because it is subject to a statutory requirement to maintain all pertinent records.[57] Specifically, Judge Tsoucalas of the CIT has observed with respect to the surety that "Customs is not plaintiff's private recordkeeper."[58]

Nonetheless, ongoing developments suggest that future cases will call upon the courts to determine whether the government position must fail for lack of evidentiary support. These developments include the increasing movement toward a "paperless environment" in which the government will become increasingly reliant upon information key-punched into a computer and not upon retained original documents, and the

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53. *See supra* notes 18-19 and accompanying text (discussing *Toshoku* and *Utex* cases).

54. 706 F. Supp. 923 (Ct. Int'l Trade), *aff'd*, 880 F.2d 409 (Fed. Cir. 1989).

55. *Id.* at 931.

56. Jarvis Clark Co. v. United States, 733 F.2d 873, 876 (Fed. Cir. 1984). Courts have imposed a dual burden of proof on importers in such instances. The importer must first prove that the government's classification is incorrect, and must then also prove that the importer's classification is correct. *Id.*

57. 19 U.S.C. § 1508 (1988).

58. *American Motorists*, 706 F. Supp. at 930.

absence of requirements that many critical evidentiary documents (or communications) be provided to all potential litigants. In fact, the surety is not routinely permitted to receive many crucial documents. Two examples will illustrate the emerging problem.

*Illustration 1*: Proving the existence of the bond.

Will proof of the following circumstances be sufficient for a surety to defend a claim brought against it by Customs? Neither the surety nor the broker has any record of the existence of a bond covering a particular entry on which Customs issued a liquidated damage notice. The importer is bankrupt, uncooperative, or otherwise unable or unwilling to provide records. The only Customs Service record is the entry of a three-digit code for a particular surety in its computerized data base.

*Illustration 2*: Proving issuance of a redelivery notice.

The broker and the importer have no record of receiving a redelivery notice from Customs. The surety is not provided with such a notice under existing regulations. Customs has no copies of an actual redelivery notice, but its computerized data base indicates that a notice was issued prior to the date of liquidation. The importer might not be able to defend against that collection action, but the surety should be able to.

In these and similar illustrations, it is the Author's opinion that the burden must be borne by the government. Proof of the terms and conditions of the bond is the basic element of the affirmative case to be established by the government in a collection action: it must prove the existence of the debt, the amount of the debt, and the responsibility of the defendant (importer or surety) for the debt. Moreover, while the government has complete and specific information available to it, the surety is forced to rely upon intermediate sources where it has not received original documents. Except for the initial bond itself, the surety has no reliable source of information other than the government.

On the other hand, the surety does not receive the critical notices that flow between Customs, the importer, and its broker during the course of government decision-making. The surety is not entitled to receive notices of detention, refusal, or

redelivery, requests for information, or notices of change or reports of investigation or audit. While Customs has recently agreed to provide computerized information identifying entries, importers, and certain other related information regarded as covered by a surety's bond, the significant information that forms the basis of a protest or petition is not provided to the surety until after a breach occurs.[59]

Additionally, the importer is not a reliable source of information for the surety. It is the party in default. It is threatened by both Customs and the surety. Thus, it is illogical to assume that the importer would cooperate with the surety. The custom-house broker (in the event the importer used one) might be a logical source of information. The broker's files, however, are generally not as complete as those maintained by Customs. Furthermore, Customs regulations do not require the broker to share information with the surety.

Thus, future cases are likely to raise the evidentiary question in a far different context because the Customs Service has moved toward a "paperless" environment. The records that remain available to Customs to establish its claims in the future will be computerized, less reliable, and far less probative. Importers and brokers able to demonstrate that their files do not include duplicate originals confirming the computerized Customs information are likely to have thereby rebutted any presumption of regularity attaching to the government's computerized records. In these circumstances, the burden of persuasion would shift to the government.

Sureties—when they are entitled to receive records as part of the regulatory process—should have the same limited burden of proof. Where the sureties are not provided documents during the administrative proceeding (*e.g.*, notices of redelivery or refusal of admission), however, the burden of proof may rest entirely with the government.

### C. *Sanction Procedures: The Next Generation of Cases*

It is now a clear matter of law that Customs may sanction sureties if they are substantially delinquent in their obliga-

59. Customs Service Notice, 53 Fed. Reg. 6,216 (Mar. 1, 1988).

tions.[60] The lower court in the *American Motorists* case, however, implicitly recognized that another plaintiff in another case might raise issues that the courts could view differently:

> the Court is of the opinion that 113 claims against which plaintiff neither made a concerted effort to rebut nor file timely petitions constitute significant delinquency. Under the facts of this case, plaintiff "cannot complain of the vagueness of the law as applied to the conduct of others."[61]

Two general observations should be made regarding the sanction procedure's general vulnerability to attack. First, the sanction procedure is erroneously modeled after the "immediate-delivery suspension" procedure. Second, liquidated damages are not subject to clear and inflexible rules governing the amount and due date for payment.

The surety sanction procedure was established by the Customs Service in order to collect debts under a threat which would be taken seriously by the debtor. Customs first attempted this procedure in 1981 to collect increased duty bills. This action was preliminarily enjoined in *Old Republic Insurance Company v. Pitman*,[62] primarily because no regulation authorized such a procedure. Customs then re-established the procedure through a regulation adopted in 1984.[63]

The procedure involved in the *Pitman* case, as well as the procedure subsequently adopted in regulations, was modeled after the authority of the Customs Service to "sanction" delinquent importers by suspending their immediate delivery privileges.[64] While both procedures are effective tools for collecting debts, they are not analogous. The suspension of immediate delivery privileges merely places the importer on a cash basis; it cannot postpone deposit of estimated duty for ten days after release of the goods, and the importer must deposit the duty prior to release of the goods. Suspension of this privilege merely places an additional financial and logistical burden upon the importer. In sharp contrast, surety sanctions actually

60. *See* American Motorists Ins. Co. v. Villanueva, 706 F. Supp. 923 (Ct. Int'l Trade), *aff'd*, 880 F.2d 409 (Fed. Cir. 1989).

61. *Id.* at 931 (citation omitted).

62. 520 F. Supp. 1225 (Ct. Int'l Trade 1981).

63. T.D. 84-213, 18 Cust. B. & Dec. 597 (1984).

64. *See* 19 C.F.R. § 142.25 (1990).

put the surety out of the business of writing single transaction bonds for a period of five days. Moreover, such sanctions may inflict long-standing if not irreparable damage upon the surety's ability to write bonds even after they are lifted. The severe nature of the surety sanction was described by the court in *Pitman*:

> Nothing can disturb the confidence of an importing public faster or with more certainty than the knowledge, or even a mere suggestion that a surety on the public's bonds lacks the financial stability that the public was led to believe it possessed when engaged. Obviously, therefore, it was to guard against such an event that the Secretary [referring to the Treasury regulations governing revocation of the certification of a surety to do government business, found at 31 C.F.R. § 223.17-21] chose to preside over events influencing the exercise of such devastating power, and then only after shepherding these events through carefully detailed procedure designed to accord the surety protection of a valuable property right safeguarded by constitutional due process.[65]

Thus, surety sanctions raise a far greater need for strict adherence to due process standards than does the immediate delivery suspension procedure. It is also significant that Customs now has applied the surety sanction procedures to liquidated damage cases as opposed to duty assessment cases. The *Pitman* case, for example, involved increased duties whereas the *American Motorists* case involved liquidated damages.

Increased duty assessments are sums certain and final. There is no question about the amount of an increased duty bill and there is no question about the procedures under which it can be contested. The time limits provided in the protest statute unquestionably apply. Whatever question might have existed with regard to the date on which the increased duty bills become due and owing (or delinquent) was settled both by the CIT[66] and in subsequently adopted legislation and regulations.[67]

Liquidated damage claims do not involve such certain and

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65. *Pitman*, 520 F. Supp. at 1229.

66. *See* Heraeus-Amersil, Inc. v. United States, 515 F. Supp. 770, 774 (Ct. Int'l Trade 1981), *aff'd*, 671 F.2d 1356 (C.C.P.A. 1982).

67. *See, e.g.*, Trade and Tariff Act of 1984, codified in scattered sections of 28

final amounts and due dates. The applicability of the time limits in the protest statute and the right to raise legal defenses in a collection action are still subject to debate. Furthermore, liquidated damages historically have been subject to mitigation and/or compromise even after the filing of a collection action. In contrast, the Customs Service historically has not shown such flexibility with respect to duty assessments. The full amount of the revenue (duty as opposed to liquidated damages) is traditionally protected.

With respect to existing regulations and procedures, the following issues are likely to arise in the courts:

1. *Where the government makes demand on surety for damages that were neither petitioned nor protested by a solvent principal, the surety can be expected to demand that Customs impose sanctions against the principal first.*

Under existing Customs regulations and practices, the delinquency of the principal will occur prior to the date the surety becomes eligible for its own sanctions. Customs is less likely to sanction the principal, however, than it is to pursue collection and sanctions against its surety.

As a practical matter, a surety discovering that its principal is solvent is less likely to protect itself from potential sanctions by filing a petition or protest against the Customs Service demand. Principals are expected to take care of their obligations and, in most instances, they do. Customs normally does not wish to be burdened with additional petitions from sureties in such cases, preferring to work exclusively with the principal.

The Customs Service is capable of easily and routinely sanctioning such importers through their computerized notice, collections, and selectivity system. Ultimately, the omission may give rise to a challenge through the sanction procedure itself.

2. *Sureties will insist that they be given the same mitigation offer previously extended to their principals.*

Sureties are not provided with copies of mitigation decisions offered to principals, nor are they notified of the amount of any such offer. Yet, if a principal defaults on such an offer

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U.S.C. (1988); T.D. 85-93, 19 Cust. B. & Dec. 209 (1985): T.D. 86-178, 20 Cust. B. & Dec. 500 (1986); 19 C.F.R. § 24.3a(b)(2) (1990).

or refuses to accept it, the surety has historically been subjected to a demand for payment of the full liquidated damages.

Customs Service headquarters has indicated it will reprogram its computers to incorporate mitigation offers into the first demand on surety; however, that has not happened as of this writing. Such action is not required by the regulations, nor does it appear to be the practice of district penalty offices. As an example, the Author's office received a decision from Customs addressed to a client/importer that included the following language: "Payment of US$1,547.90 should be made to the District Director of Customs, Miami, Florida within thirty days from the date of this letter or demand will be made on the surety for US$77,395.00, the full amount of the liquidated damages assessed."[68]

3. *When Customs determines that it will discharge a principal, sureties will urge that they also be discharged.*

The liability of the surety and its principal is joint and several. This concept is appropriate where Customs elects to sue one party as opposed to another on the basis of their respective solvency or ability to be sued. In at least two instances, however, the concept of joint and several liability is likely to be challenged.

The first occurs when Customs enters into a compromise settlement with the principal and does not include the surety in that settlement. This changes the obligations of the bond. It is a change, therefore, to which the surety is entitled to receive notice and an opportunity to acquiesce.[69] Under the general law of suretyship, the new compromise settlement constitutes a new contract or novation which substitutes for the bond.[70]

In the second situation, the Customs Service issues a decision to a bond principal stating that it will not be pursued because Customs has determined that the principal on the bond was not actually a party to the import transaction. If this finding is true, the bond was never valid and no claim should be made against the importer or the surety. Whether true or not,

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68. Customs Service Letter of Dec. 22, 1988 (File 87-0935:KBT) from the Miami Customs Regional Counsel's Office (copy on file at the *Fordham International Law Journal* office).

69. *See* 19 C.F.R. § 113.23 (1990).

70. A. STEARNS & J. ELDER, THE LAW OF SURETYSHIP § 6.6 (5th ed. 1972).

the finding by the Customs Service prejudices the right of the surety to seek reimbursement from its principal and may therefore constitute grounds for relieving it from further responsibility under the bond.

4. *The procedures under which Customs sanctions sureties are vague and vulnerable to attack.*

The *American Motorists* court alluded to the vague Customs sanctioning procedures by implying that a different party in a different context might be viewed more favorably.[71] The regulations invite litigation on the following issues:

a. *What constitutes "significantly delinquent"?*

In sharp contrast to the number of cases and amount in dispute in *American Motorists*, the Customs Service has published a standard which is far less substantial:

> District level: ten cases and/or US$25,000.00 for consideration of show cause letter.
> Regional level: forty cases and/or US$100,000.00 for consideration of show cause letter.[72]

Since liquidated damages are typically set in amounts equal to the value of a single importation, the US$100,000 mark is often exceeded; the US$25,000 mark is exceeded in virtually every case. Furthermore, it is unlikely that either amount would be regarded as substantial in comparison to the financial stability of surety companies listed on the Treasury Certification List.

b. *What constitutes "just cause" for withholding payment*[73] *or "a substantial question of law as to whether a breach of bond obligation has occurred"?*[74]

The Customs Service and the U.S. Department of Justice might agree that the surety has raised a legal issue justifying its non-payment, even though it is a legal opinion contrary to the official position of the Customs Service. In other words, it may be an issue to which the surety is entitled to have its day in court. However, local Customs officials are left to their complete discretion as to whether a legal issue is sufficient to merit

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71. American Motorists Ins. Co. v. Villanueva, 706 F. Supp. 923, 931 (Ct. Int'l Trade), *aff'd*, 880 F.2d 409 (Fed. Cir. 1989).

72. T.D. 89-57, 23 Cust. B. & Dec. No. 21 (May 4, 1989).

73. 19 C.F.R. § 113.38 (c)(1)-(3) (1990).

74. *Id.* § 113.38(c)(1).

referral to headquarters under internal advice procedures.[75] There are no standards or criteria as to what type of legal issue may be raised in defense of a collection action or in response to a threat or sanctions. Moreover, there is no requirement that the person deciding the validity of the surety's response to a show cause letter be a person different from either the official who issued the show cause letter or the person who handled the liquidated damage cases. The circumstances suggest that the broad authority vested in local officials has not been placed into a regulatory framework that will withstand scrutiny.

c. *"Last chance" to make payment without sanctions.*

The current regulations require that the surety be sanctioned a minimum of five days where its response to the show cause letter is found to be inadequate. The surety should be provided an option to make payment without suffering sanctions in the event that its good-faith, written response to the show cause letter is rejected. In this regard, it is interesting that when Customs proposed the surety sanction procedures, it also proposed a show cause letter that would routinely provide the surety with a three-day period to make payment without sanctions.[76] This "last chance" provision was not incorporated into the letter issued to the surety in *American Motorists*, nor has it surfaced in most of the letters viewed by the Author.

## *CONCLUSION*

A review of the rapidly evolving judicial and regulatory developments with respect to liquidated damages reveals that there are many important areas which have not been the subject of any comprehensive scheme or plan. The right to protest liquidated damage claims remains open to debate. The right of sureties to gain access to basic documentary evidence concerning breaches of their bonds is still evolving. The identification of the obligations and rights of Customs bond principals and sureties is incomplete, as is the development of lawful procedures under which those parties may act responsibly as liquidated damage claims progress from notice and demand through cancellation, payment, sanctions or litigation. The ju-

75. *Id.* § 177.11.

76. *See* 48 Fed. Reg. 11,073 (Appendix F, 1983).

risdictional prerequisite and, once in court, the evidentiary burdens also involve unanswered questions. The courts are likely to be called upon to fill such voids with their interpretations unless Customs and the U.S. Congress adopt the specific regulations and legislation needed to define a more comprehensive system.