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**CIVIL PENALTIES****CONSUMER PRODUCT SAFETY COMMISSION**

A recent statement by Consumer Product Safety Commission Chairman Inez M. Tenenbaum appears to signal a shift in the civil penalty amounts the commission may seek for untimely safety reports, say attorneys Christie Grymes Thompson and Bridget M. Richardson in this BNA Insight. The authors offer practical advice on how product manufacturers and sellers can minimize the risk of civil penalties.

**Buckle Up! Course Set for Higher CPSC Civil Penalties**

BY CHRISTIE GRYMES THOMPSON  
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**C**ompanies manufacturing or selling consumer products should proceed with caution when evaluating whether to report potential safety issues to the Consumer Product Safety Commission. Now more

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than ever, companies should consider the CPSC's mantra of "when in doubt, report." In a statement regarding the settlement between the CPSC and Hewlett-Packard Company (HP) for \$450,000, CPSC Chairman Inez Tenenbaum signaled a shift in the civil penalty amounts the Commission would seek for untimely reports:

While this settlement with HP was negotiated under the pre-CPSIA statutory scheme, it is my strong hope and expectation that future enforcement actions, particularly those that arise under our enhanced authorities, will (as Congress intended) include civil penalty amounts that maximize the likelihood of deterring violations, providing just punishment, and promoting respect for and compliance with the law, reflecting the seriousness of the violation, and ultimately protecting the public from unreasonable risks of injury and death.<sup>1</sup>

The Consumer Product Safety Improvement Act (CPSIA) authorizes CPSC to obtain civil penalties of up to \$15 million for failure to report safety hazards to CPSC in a timely manner, increasing the previous civil penalty cap by more than \$13 million. As the Commission staff begins to negotiate settlements under its new authority, companies can expect more aggressive positions from the CPSC. Recent consent agreements give insights for the road ahead and turns companies should avoid taking when navigating product safety issues.

<sup>1</sup> Statement of The Honorable Inez M. Tenenbaum on the Vote to Approve Provisionally a Civil Penalty Settlement With Hewlett-Packard Company (Jan. 19, 2012), available at <http://www.cpsc.gov/pr/tenenbaum01192012.pdf>.

## CPSIA Penalty Changes

Before CPSIA, civil penalties were capped at \$8,000 for each knowing violation under the Consumer Product Safety Act (CPSA), Federal Hazardous Substances Act (FHSA) and Flammable Fabrics Act (FFA), with a maximum penalty for any related series of violations of \$1.825 million. In assessing penalties, the CPSC considered the nature of the product defect, the severity of the risk of injury, the occurrence of absence of injury, the number of defective products distributed or the substance distributed, and the appropriateness of the penalty in relation to the size of the business of the person charged. The CPSC considered the same factors as compromising or mitigating factors that reduce the amount of a penalty.

CPSIA increased civil penalty amounts to \$100,000 for each knowing violation under CPSA, FHSA and FFA, and increased the maximum penalty for any related series of violations to \$15 million. The increased penalties apply to failures since August 4, 2009.

CPSIA also expanded the factors the CPSC could consider when determining penalty amounts and gave CPSC the option to consider additional factors as appropriate. In a rule promulgated in March 2010, CPSC elaborated on the CPSIA factors and described additional factors it would consider:

- *A safety/compliance program and/or system related to a violation.* The Commission may consider whether a company had a reasonable and effective program or system for collecting and analyzing information related to safety issues at the time the alleged violation occurred.

- *History of noncompliance.* The Commission may consider whether or not a company's history of non-compliance with the laws and regulations that the CPSC enforces should increase the amount of the penalty. The regulation does not state whether the CPSC will consider a company's history of compliance as a factor to decrease the penalty amount.

- *Economic gain from noncompliance.* The Commission may consider whether a company benefited economically from a failure to comply, including a delay in complying.

- *Failure to respond to CPSC in a complete and timely fashion.* The Commission may consider whether a company's failure to respond in a timely and complete fashion to Commission requests for information or for remedial action should increase a penalty.<sup>2</sup>

In addition to civil penalties, CPSC may seek injunctive relief. In the past, CPSC has used this authority rarely. As shown below, however, recent consent agreements demonstrate that CPSC will seek injunctive relief if civil penalties do not sufficiently address a company's allegedly violative conduct.

## Avoiding Bumps in the Road

The CPSC has applied the civil penalty factors in recent cases—companies can learn from those actions and take steps to minimize civil penalty exposure.

<sup>2</sup> 16 C.F.R. § 119.4(b); see also Civil Penalty Factors, 75 Fed. Reg. 15,993 (March 31, 2010).

## 1) Develop a Strong Compliance Program

Daiso Holding USA Inc. paid the largest penalty since CPSIA was enacted, \$2.05 million, in March 2010. To date, Daiso's is the only penalty imposed for alleged violations of the CPSIA. As part of its border control efforts, the CPSC staff collected and tested Daiso's products and found them in violation of the federal ban on phthalates, lead paint, and lead content. In addition, the CPSC staff alleged that Daiso failed to comply with the small parts ban on toys and other articles intended for use by children under three years of age, or to include required warnings for choking hazards from toys or games intended for children who are three to six years of age. Likely due to the breadth of Daiso's violations, CPSC staff sought injunctive relief in addition to the civil penalty. Daiso agreed to stop importing or selling any product that failed to comply with federal law or CPSC regulations and to implement a comprehensive product safety program.

Daiso agreed to retain a Product Safety Coordinator to help the company perform a product audit and develop a safety program that must:

- 1) include a product testing program for any consumer product subject to CPSC regulations;
- 2) ensure that Daiso issues certificates of conformance for any consumer product subject to CPSC regulations;
- 3) establish procedures ensure that Daiso applies all cautionary labeling required by CPSC;
- 4) establish systems to ensure that the safety program's standard operating procedures are consistently followed;
- 5) include procedures for corrective action in the event of any violation cited by a CPSC inspection, and to respond to CPSC letters of advice at the time specified in the letter, and
- 6) establish systems to investigate any incidents involving a CPSC regulated product.

Those provisions of the settlement provide for other companies a roadmap of the Commission's expectations. Implementing such a program would help companies eliminate problems during production and quickly identify issues that appear once a product is in distribution. Although the CPSC could still seek to impose civil penalties against a company with a compliance program, the company would be well positioned when the Commission applies the CPSIA factors to determine a penalty amount.

## 2) Ensure Product Testing Conforms With Protocols, and Incident Reports Don't Contradict Results

In October 2011, Spin Master, Inc. paid a penalty of \$1.3 million to resolve allegations that the distributor knowingly imported and sold a product containing a toxic and banned hazardous substance, and knowingly failed to report a defect associated with the Aqua Dots craft kit. The craft kits included beads containing a substance which, upon ingestion, metabolizes to the date rape drug. Spin Master allegedly received reports in mid-October 2007 of children becoming ill, but did not file a Section 15(b) Report with the CPSC at that time. After receiving two reports of children ingesting the product and becoming ill, on November 5, 2007, the

CPSC notified Spin Master of the reports, and two days later the parties announced a voluntary recall of 4.2 million units. Just a few weeks lapsed from the time Spin Master allegedly received the reports of illness and the time CPSC contacted Spin Master. Nonetheless, the staff alleged that Spin Master had not reported in a timely manner.

Spin Master responded to the CPSC staff's allegations by noting that the company had no involvement in the production of Aqua Dots and had no information about the product's chemical composition because such information was "a closely guarded trade secret [of] the manufacturer." In addition, Spin Master relied on results from a toxicological risk assessment conducted by a board-certified toxicologist stating that the product was safe. The CPSC staff alleged that the testing was inadequate, but did not explain why, and stated that the actual illnesses reported to Spin Master were sufficient to trigger the company's reporting obligation regardless of what the product testing results showed.

This settlement demonstrates that the use of overseas contract manufacturers complicates the task of testing for safety and compliance, but does not change the importer's or distributor's legal responsibilities. In addition, companies should note that even if product testing indicates a low risk of product hazard, actual reports of illness or injury often trigger reporting obligations to CPSC.

### 3) Execute Agreements With Third-Party Suppliers

Although they will not likely provide a safe harbor from a CPSC penalty action, contracts with third-party suppliers can often provide indemnification and other commercial options if the CPSC does seek a penalty. The recent settlement with Build-A-Bear Workshop, Inc., however, indicates a CPSC initiative to hold companies directly responsible and a new involvement in a company's commercial dealings with its vendors.

In December 2011, Build-A-Bear Workshop, Inc., paid \$600,000 to settle allegations that the company failed to immediately report chairs with sharp edges that could pinch, lacerate, or amputate a child's fingertip. Build-A-Bear allegedly first received reports of injuries in July 2007, but did not report to CPSC until March 2009. In addition to the penalty, the civil penalty settlement enjoins Build-A-Bear from seeking indemnification or insurance for the civil penalty:

Build-A-Bear agrees that it will not seek or accept, directly or indirectly, indemnification, reimbursement, insurance, or any other form of compensation or payment, including, but not limited to, cash, account credit, or setoff, from any manufacturer, importer or retail store, or from any other firm or person, for the civil penalty that Build-A-Bear agrees to pay pursuant to this Agreement and Order.

Orders since Build-A-Bear have not included the same language, so the circumstances in that case may have been unique. Nonetheless, companies should closely watch this issue in future civil penalty announcements.

### 4) Call the CPSC Before the CPSC Calls the Company

Henry Gordy International, Inc. paid \$1.1 million in October 2011 to settle charges that the company knowingly failed to immediately report a risk of asphyxiation

from the soft, pliable, plastic toy darts included in its Auto Fire Target Set. Henry Gordy allegedly knew of at least three deaths between March 2006 and October 2007, but did not report to CPSC until after the CPSC staff asked for a report in May 2009. In the report, Henry Gordy did not include the death that occurred in March 2006 or a packaging design change made in May 2006 in response to the death. In June 2009, CPSC informed Henry Gordy that a recall of the target sets was necessary. Henry Gordy refused to conduct a recall, so CPSC announced a recall conducted with Family Dollar Stores, the exclusive retailer of the target sets. A few days after the recall with Family Dollar Stores was announced, a fourth death occurred.

The staff likely considered Henry Gordy's alleged failure to provide complete information in response to the staff's request and failure to conduct a voluntary recall when determining the civil penalty amount. Although companies should assert defenses when appropriate, they should do so in a reasonable way that does not appear as roadblocking.

### 5) Don't View Penalties as Cost of Doing Business

In January 2012, HP entered into a consent agreement with CPSC to resolve allegations that HP knowingly failed to immediately report a fire and burn hazard that resulted from overheating of certain lithium-ion battery packs. The CPSC staff alleged that HP knew of around 22 incidents of overheating by September 2007, including two injuries to consumers, 10 months before reporting to the CPSC. Because the alleged failure to report occurred before the CPSIA's civil penalty cap increase, the pre-CPSIA cap of \$1.85 million applied. Under that penalty structure, HP agreed to pay a \$425,000 penalty to settle the allegations.

HP's penalty was less than a quarter of the \$1,850,000 pre-CPSIA statutory limit, and two Commissioners thought the penalty was too low. Commissioner Robert Adler voted against the settlement, opining that, given HP's size, a \$425,000 penalty would not deter future violations.<sup>3</sup> More interestingly, Chairman Tenenbaum shared Commissioner Adler's concerns, but voted in favor of the settlement because it was negotiated under pre-CPSIA limits.<sup>4</sup> Even under the pre-CPSIA penalty scheme, however, the Commission could factor the size of the company into a penalty amount determination. With the addition of the CPSIA factors, the Commission might have also determined that the company benefited economically from its alleged failure to report.

The statements issued with this settlement amplify the Commission's intention to seek higher civil penalties against larger companies. Companies should watch closely as the CPSC begins to announce civil penalties under the \$15 million CPSIA limit.

<sup>3</sup> Dissenting Opinion of Commissioner Robert S. Adler Regarding a Civil Penalty Settlement Agreement With The Hewlett-Packard Company (Jan. 19, 2012), available at <http://www.cpsc.gov/pr/adler01192012.pdf>.

<sup>4</sup> Statement of The Honorable Inez M. Tenenbaum on the Vote to Approve Provisionally a Civil Penalty Settlement With Hewlett-Packard Company (Jan. 19, 2012), available at <http://www.cpsc.gov/pr/tenenbaum01192012.pdf>.