



BNA, INC.

PRODUCT SAFETY & LIABILITY



REPORTER

Reproduced with permission from Product Safety & Liability Reporter, 38 PSLR 693, 07/05/2010. Copyright © 2010 by The Bureau of National Affairs, Inc. (800-372-1033) <http://www.bna.com>

CONSUMER PRODUCT SAFETY COMMISSION

ENFORCEMENT

The costs and frequency of civil penalty investigations by the Consumer Product Safety Commission is rising, say attorneys Christie L. Grymes and Mark L. Austrian in this BNA Insight. Focusing on a March consent decree between the CPSC and Daiso Holding USA Inc. that resulted in a \$2 million civil penalty and extensive injunctive relief, the authors scrutinize a new final rule on civil penalty factors, and offer guidance to companies on how these developments may affect future civil penalty investigations.

With Signs Pointing to Rising Civil Penalties by the Consumer Product Safety Commission, Companies Should Prepare Now for Future Enforcement

BY CHRISTIE L. GRYMES AND MARK L. AUSTRIAN

Christie L. Grymes and Mark L. Austrian are partners at Kelley Drye & Warren LLP in Washington, D.C. Grymes is the chair of the firm's Consumer Product Safety practice group. Austrian's practice concentrates on litigation and consumer product safety. Grymes can be reached at cgrymes@kelleydrye.com. Austrian can be reached at maustrian@kelleydrye.com

Recent Consumer Product Safety Commission activity indicates that the costs and frequency of civil penalty investigations and amounts are on the rise.

On March 2, 2010, the CPSC announced a consent decree with Daiso Holding USA Inc., Daiso Seattle LLC, Daiso California LLC, and one of the companies' officers (collectively, "Daiso") that includes a \$2.05 million civil penalty and extensive injunctive relief governing product safety compliance.

In addition, the CPSC approved a Final Rule that identifies and interprets factors the CPSC will consider when seeking civil penalties for knowing violations of

the Consumer Product Safety Act (“CPSA”), Federal Hazardous Substances Act (“FHSA”), and Flammable Fabrics Act (“FFA”).¹ The Consumer Product Safety Improvement Act (“CPSIA”) increased the maximum civil penalty amounts from \$8,000 to \$100,000 for each “knowing” violation² and from \$1.825 million to \$15 million for any related series of violations.³ In its annual Report to the President and Congress,⁴ the Commission stated that, in 2009, CPSC negotiated out of court settlements in which 38 companies voluntarily agreed to pay \$9.8 million in civil penalties. Both the number of firms and the dollar amount are the largest in CPSC history. The Commission noted that, with the CPSIA’s increase in maximum civil penalty amounts, the actual penalty amounts will continue to rise.

This article examines the Daiso complaint and consent decree and the Final Rule on civil penalty factors, then provides guidance to companies on how these developments could affect future civil penalty investigations.

I. Consent Decree Signals Aggressive Use of Enforcement Authority, Provides Road Map for Model Compliance Programs

The CPSC alleged that Daiso violated the CPSA, the FHSA, and the CPSIA by importing, distributing, and selling toys with illegal levels of lead, lead paint, and phthalates—toys that had small parts intended for children younger than three years old, and products that lacked the required warning labels.⁵ Unlike typical civil penalty settlements, which are handled administratively and involve only a penalty payment, the Daiso consent decree was filed in federal court and includes requirements to establish an extensive product safety program.⁶

A. CPSC Allegations

The CPSC began investigating Daiso in 2006 when, from November 2006 to November 2008, the CPSC collected Daiso product samples from imports into the United States. The CPSC determined that many of these products violated federal statutes and CPSC regulations. In May 2009, the CPSC conducted a full investigation of Daiso’s California warehouse facilities and discovered dozens of children’s products with similar defects. Further, in November and December 2009, the

CPSC collected additional samples of Daiso imports and found similar violations. The CPSC issued Letters of Advice (LOA) for all the violations it found since commencing the investigation in 2006.

In its complaint, the CPSC alleged that Daiso:

- violated the CPSA by importing and selling children’s products and toys that contained excess phthalates.
- sold children’s toys and products containing lead-containing paint and other lead substances that are banned hazardous products under the CPSA, FHSA, and CPSC regulations. The CPSIA increased the lead paint ban to include “lead-containing paint” that contains lead “in excess of 0.009 percent of the weight of the total nonvolatile content of the paint or the weight of the dried paint film.” Under the FHSA, as amended in August 2009, a children’s product may not contain more than 0.003 percent, or 300 parts per million, of lead.
- failed to ensure that its children’s toys and products complied with CPSC children’s product safety rules, as tested by an independent third-party assessment body.
- failed to furnish information to the CPSC that its children’s products failed to comply with applicable consumer product safety rules, even despite receipt of the LOAs.
- failed to comply with FHSA regulations prohibiting children’s products with small parts, and,
- failed to include required cautionary statements regarding small parts, latex balloons, marbles, and art materials.

In late 2009, the CPSC and Daiso had announced the recall of numerous products that are the subject of the consent decree, including wooden toys, purses and pen cases, stuffed toys, and children’s jewelry.

B. Consent Decree

The consent decree requires Daiso to pay a \$2.05 million civil penalty.⁷ Although the dollar amount of the penalty may seem relatively low in light of the extensive allegations, the most significant costs will be incurred in complying with the extensive injunctive relief. In addition to the civil penalty, the consent decree requires Daiso to satisfy numerous product safety evaluation and review procedures before it can import, sell, or distribute products.

- Among the consent decree requirements, Daiso must retain an independent product safety coordinator, who is approved by the CPSC, to: (1) create a comprehensive product safety program, (2) conduct a product audit of all Daiso’s merchandise to determine testing and certification requirements, (3) create guidance manuals for managers and employees regarding product safety compliance, (4) develop procedures for CPSC compliance and reporting, and (5) establish procedures to conduct product recalls.

⁷ At least some of the alleged violations occurred before the civil penalty cap increased to \$15 million.

¹ Civil Penalty Factors, 74 Fed. Reg. 45,101 (Sept. 1, 2009).

² The CPSA defines “knowingly” as actual knowledge based on knowledge attributed to a reasonable person acting in the circumstances, including knowledge obtainable upon the exercise of due care to ascertain the truth of representation. The knowledge requirements in the CPSA, FHSA, and FFA include presumed knowledge, as well as actual knowledge.

³ Pub. L. No. 110-314, § 217, 122 Stat. 3016, 3058.

⁴ U.S. Consumer Product Safety Commission Annual Report to the President and the Congress (2009), available at <http://www.cpsc.gov/CPSCPUB/PUBS/REPORTS/2009rpt.pdf>.

⁵ Complaint for Civil Penalties and Permanent Injunction, *United States v. Daiso Holding USA Inc.*, No. 4:10-CV-00797 (N.D. Cal. Feb. 25, 2010).

⁶ See Consent Decree for Permanent Injunction and Payment of Civil Penalty, *United States v. Daiso Holding USA Inc.*, No. 4:10-cv-00795 (N.D. Cal. Mar. 4, 2010) available at <http://www.cpsc.gov/CPSCPUB/PREREL/prhtml110/10151.pdf>.

- Daiso's comprehensive product safety program must include: (1) reasonable testing procedures that ensure compliance with CPSC regulations, (2) procedures that ensure Daiso complies with all cautionary labeling requirements, (3) assurance that Daiso has adequately corrected product violations cited by the CPSC, and (4) systems to investigate all reports of consumer incidents, property, damage, injuries, warranty claims, insurance claims, and court complaints regarding products under the CPSC's jurisdiction.
- Daiso must also recall, at least to the retail level, all defective and non-complying products that they have distributed after January 1, 2010. The recalled items must be destroyed in accordance with all applicable environmental regulations.
- The consent decree restrains the company from directly or indirectly importing or distributing children's toys or products that violate any laws, standards, or bans enforced by the CPSC.

In agreeing to the Consent Decree, Daiso did not admit any violation of the law.

II. Final Rule on Civil Penalty Factors Confirms Importance of Compliance Program, Cooperation With CPSC Staff

With the civil penalty cap having increased to \$15 million, on March 31, 2010, the CPSC published its final interpretative rule that identifies and interprets factors the CPSC will consider when seeking civil penalties for knowing violations of the CPSA, FHSA, and FFA.⁸ As required by section 217(b)(2) of the CPSIA, this rule "provides the Commission's interpretation of the civil penalty factors found in" section 20(b) of the CPSA, section 5(c)(3) of the FHSA, and section 5(e)(2) of the FFA. The Commission voted 4-1 to approve the Final Rule as amended. Chairman Tenenbaum and Commissioners Nord, Adler, and Moore voted to approve the Final Rule as amended, and Commissioner Northup voted not to approve the Final Rule.

The statutory factors the Commission must consider include: the nature, circumstances, extent and gravity of the violation, including the nature of the product defect or of the substance; the severity of the risk of injury; the occurrence or absence of injury; the number of defective products distributed or the amount of substance distributed; the appropriateness of the penalty in relation to the size of the business, including how to mitigate undue adverse economic impacts on small businesses; and such other factors as appropriate. The Final Rule provides the Commission's interpretation of those statutory factors.

A. Interim Final Rule

In August 2009, the Commission had announced an interim final rule that provided immediate guidance to industry and allowed for a comment period for interested parties, prior to the Commission's adoption of the

final rule.⁹ The interim rule provided only four additional factors for consideration:

- Safety or compliance program.
- Compliance history.
- Economic gain from noncompliance.
- Failure of the company to respond to requests.

B. Final Rule

In its Final Rule, the Commission elaborated on the statutory factors as follows:

- **The nature, circumstances, extent and gravity of the violation, including the nature of the product defect or of the substance.** The CPSC will consider, for example, whether the defect arises from the product's design, composition, contents, construction, manufacture, packaging, warnings, or instructions, and will consider conditions or circumstances in which the defect arises. According to the statement issued by Chairman Tenenbaum and Commissioners Adler and Moore, the Commission will also consider the duration of the violation.¹⁰
- **The severity of the risk of injury.** The Commission will consider, among other factors, the potential for serious injury, illness, or death (and whether any injury or illness required medical treatment including hospitalization or surgery); the likelihood of injury; the intended or reasonably foreseeable use or misuse of the product; and the population at risk.
- **The occurrence or absence of injury.** This factor will include a review of whether injuries, illnesses, or deaths have or have not occurred and, if so, the number and nature of injuries, illnesses, or deaths.
- **The number of defective products distributed or the amount of substance distributed.** The CPSC will make no distinction for those defective products distributed in commerce that consumers never received, although a company will not be penalized for conducting a wider-than-necessary recall out of an abundance of caution.
- **The appropriateness of the penalty in relation to the size of the business, including how to mitigate undue adverse economic impacts on small businesses.** The Commission will consider several factors such as the number of employees, net worth, and annual sales. For small businesses, the Commission will also consider liquidity, solvency, and profitability.

The Commission retained the four *other factors* as appropriate from the Interim Final Rule:

- (1) **Safety/compliance program and/or system relating to a violation:** If a safety/compliance program and/or system as established is relevant to a violation, the CPSC may consider whether the company had at the time of the violation a reasonable and effective program or system for collecting

⁸ Civil Penalty Factors, 75 Fed. Reg. 15,993 (Mar. 31, 2010) (to be codified at 16 C.F.R. pt. 1119).

⁹ See Civil Penalty Factors, 74 Fed. Reg. 45,101 (Sept. 1, 2009).

¹⁰ Statement of the Honorable Thomas H. Moore, The Honorable Robert S. Adler, and the Honorable Inez M. Tenenbaum on the Final Interpretative Rule on Civil Penalty Factors at 1 (Mar. 10, 2010), available at <http://www.cpsc.gov/cpscpub/prerel/prhtml10/10168.html>.

and analyzing information such as incident reports, lawsuits, warranty claims, and safety-related issues related to repairs or returns. The Commission may also consider whether the company conducted adequate and relevant premarket and production testing and had a program for continued compliance with all relevant mandatory and voluntary safety standards. Although comments on the Interim Final Rule suggested that companies should receive credit for having a previous record of good compliance, Chairman Tenenbaum and Commissioners Adler and Moore stated that a record of good compliance may not be very probative of good behavior because it could simply mean that the Commission has not discovered previous violations.¹¹

(2) **History of noncompliance:** Past violations of the CPSA, FHSA, FFA, and other laws that the CPSC enforces could lead to an increase in the amount of a civil penalty. The Commission could consider the number of previous violations or how recently a previous violation occurred.

(3) **Economic gain from noncompliance:** The CPSC may consider whether a company benefited economically from a failure to comply, including a delay in complying, but did not elaborate on how it would calculate any economic benefit.

(4) **Failure to respond in a timely and complete fashion to the Commission's request for information or remedial action:** A company's failure to respond in a timely and complete fashion to information requests or for remedial action could increase the amount of the penalty. The Commission did not provide detail on what might be considered "untimely" or "incomplete."

The Commission declined to consider the relative complexity of identifying and confirming the presence of a defect in a product. In support of that decision, Chairman Tenenbaum and Commissioners Adler and Moore cited the *Mirama* case, in which the court found:

It makes sense for Congress to have imposed fines for reporting failures even *when a product turns out not to be defective*. Information about a possible defect triggers the duty to report, which in turn allows the Commission either to conclude that no defect exists or to require appropriate corrective action. Congress's decision to impose penalties for reporting violations without requiring proof of a product defect encourages companies to provide necessary information to the Commission.¹²

The Commission will continue to consider previous violations as it has in the past when determining the amount of penalties to seek or compromise. "We voted to delete the examples of violations that the Commission would consider as we saw no need to try to capture all of the types of violations that the Commission has traditionally recognized, fearing that if we inadvertently left something off the list it would take on unintended significance."

C. Criticisms of the Final Rule

Commissioner Anne Northup, who abstained from voting on the Interim Final Rule, voted against the Final

Rule and released a statement on March 10, 2010, criticizing the rule and the CPSIA as a whole. She stated in part:

The CPSIA imposes so many new requirements all at once – including arbitrary lead and phthalates limits (not based on risk), third-party testing, certification, tracking labels, etc. – that it challenges the capacity of both small and large consumer product companies to comply. Even the largest entities . . . have indicated how difficult it is to decipher the law's requirements.¹³

Others have criticized that the Final Rule fails to treat technical violations differently enough; gives limited credit for good faith and good effort; and uses language that is too vague and noncommittal to reassure good actors. In an economic environment where many companies are feeling the need to cut back on employees, products and diversification, Northup and others fear that markets will continue to shrink and thus, jobs and product innovation will suffer, in the face of more severe civil penalties and increased regulation.

III. Preparing Now for Future Enforcement

In the CPSC's press release announcing the Daiso settlement, Chairman Tenenbaum, noted, "This landmark agreement for an injunction [including extensive requirements for a product safety program] sets a precedent for any firm attempting to distribute hazardous products to our nation's children." The assistant attorney general for the Justice Department echoed her warning stating, "Companies that manufacture and distribute toys should be put on notice by the government action today." The Commission's Final Rule raises the volume on the warnings from the Daiso case, emphasizing the need for a comprehensive product safety program and confirming an aggressive approach to civil penalties going forward.

With those warnings in mind, companies should consider the following going forward:

(1) The Commission expects companies to have a comprehensive product safety program.

- The Daiso injunctive relief might be used as a road map of the CPSC's expectations for manufacturers, distributors, and retailers of consumer products, particularly children's products. For example, Chairman Tenenbaum stated in the CPSC's press release announcing the settlement: "This consent decree is an agreement by Daiso to follow best industry practices."
- A product safety program certainly should incorporate foreign manufacturing and the importation of those products. U.S. Customs and Border Protection in San Francisco and Seattle area ports assisted in the Daiso action, demonstrating the increased role that Customs is expected to take in CPSC enforcement.
- A comprehensive program can identify safety issues during manufacture and, if the products have already been distributed, the program can help fa-

¹¹ Statement of the Honorable Thomas H. Moore, The Honorable Robert S. Adler, and the Honorable Inez M. Tenenbaum on the Final Interpretative Rule on Civil Penalty Factors at 2 (Mar. 10, 2010), available at <http://www.cpsc.gov/cpscpub/prerel/prhtml10/10168.html>.

¹² Statement of the Honorable Thomas H. Moore, the Honorable Robert S. Adler, and the Honorable Inez M. Tenenbaum on the Final Interpretative Rule on Civil Penalty Factors at 2 (Mar. 10, 2010), available at <http://www.cpsc.gov/cpscpub/prerel/prhtml10/10168.html> (citing *United States v. Mirama Enterprises, Inc.*, 987 F.3d 983 (9th Cir. __) (emphasis added)).

¹³ Statement of Commissioner Anne M. Northup on the Final Rule Interpreting Civil Penalty Factors at 1 (Mar. 10, 2010), available at <http://www.cpsc.gov/PR/northup03102010.pdf>.

cilitate prompt reporting to the CPSC and implementation of any corrective action. With such a program in place, even if an aberrational safety issue occurs, the company will be in a much better position in any related civil penalty investigation.

(2) Obligations associated with a civil penalty could extend beyond writing the check.

- With a few exceptions, historically the CPSC imposed civil penalties without injunctive relief, particularly when the penalty was not preceded by the filing of a lawsuit. In the Daiso matter, the CPSC obtained extensive injunctive relief in the absence of litigation. This could indicate the Commission's intent to begin locking companies into future conduct rather than just paying a penalty in an administrative proceeding.

(3) Companies should not expect leniency from the CPSC for "technical" violations of statutory requirements.

- For example, in the Daiso case, the Commission alleged that Daiso failed to issue or obtain third-party conformity certificates, which could be considered a technical requirement under the CPSIA. This is the first enforcement action regarding those certificates. Although the CPSC has issued a stay for certain certificate requirements, companies should ensure that they are in compliance for products not covered by the stay.
- In addition, some commenters to the CPSC's Interim Final Rule suggested that technical violations should not involve a penalty at all. The Commission dismissed the suggestion in an effort to

avoid a formulaic approach to penalties, although it did note that it "intends to use its civil penalty authority in a manner best designed to promote the underlying goals of the CPSA – specifically that of protecting the public against unreasonable risks of injury associated with consumer products. In so doing, the Commission may reserve the highest civil penalty for more serious or extensive violations."¹⁴

(4) The CPSC may go after company officers more aggressively.

- An officer of the company was a named defendant in the Daiso case. Historically, the CPSC named only the company for civil, rather than criminal, penalty proceedings.

(5) Companies should establish procedures to respond to correspondence from the CPSC.

- In the Daiso matter, the CPSC had previously issued Letters of Advice to Daiso after examinations at ports and inspections revealed violations. If the company had reacted to those Letters of Advice by responding to the CPSC and implementing any appropriate changes, it may have avoided some of the relief dictated in the consent decree.
- Pursuant to the Final Rule, a company could mitigate the amount of civil penalties by responding promptly and completely to Commission requests. Internal procedures facilitate that process.

¹⁴ 75 Fed. Reg. at 15,996.