

Companies May See More Compliance Rules After Kolcraft

The recent highly publicized settlement agreement between the U.S. Consumer Product Safety Commission and Kolcraft Enterprises Inc. has generated concerns within the business and legal communities over the CPSC's future intentions regarding civil penalty settlements with companies that allegedly failed to file timely substantial product hazard reports with the CPSC. Traditionally, these penalty settlements have involved only the imposition of monetary penalties.

The Kolcraft agreement, however, contains a wide-ranging set of requirements purportedly designed to ensure the company's future compliance not only with the CPSC's reporting requirements but with substantive safety statutes and regulations as well. These additional compliance-related requirements in the settlement prompted a split among the three CPSC commissioners and the issuance of statements supporting and criticizing the provisions.

The CPSC's Reporting Obligations

Section 15(b) of the Consumer Product Safety Act is a key element of the CPSC's enforcement scheme. This section requires manufacturers, distributors or retailers to report "immediately" (i.e., within 24 hours) to the CPSC if they obtain information that "reasonably supports the conclusion" that a product they sell: fails to comply with an applicable CPSC safety rule; contains a defect that could create a substantial product hazard; or creates an unreasonable risk of death or serious injury to the public. 15 U.S.C. § 2064(b).

Section 15(b) is the principal mechanism by which companies notify the CPSC of potentially hazardous products and applies to all companies in the distribution chain.

Failure to comply with the reporting requirements of section 15(b) is a prohibited act subject to civil penalties. 15 U.S.C. §§ 2068, 2069. Each individual product may be considered the subject of a separate offense.

Prior to enactment of the Consumer Product Safety Improvement Act of 2008, the maximum penalty was \$8,000 per violation, with a maximum of \$1.825 million for any related series of violations. 15 U.S.C. § 2069(a). The CPSIA dramatically increased these penalties to \$100,000 per violation, up to a maximum of \$15 million, for violations occurring after the effective date of the revised penalty provisions.

Historically, monetary penalty settlements involving reporting violations have ranged from approximately \$50,000 to \$1.5 million, with some higher-amount exceptions, although most settlements to date have involved alleged violations occurring before the CPSIA-enhanced penalty provisions took effect. In CPSC fiscal year 2012, the agency entered into eight civil penalty settlements with penalties ranging from \$214,000 to \$1.5 million.

The CPSC has long taken the position that because the defect-related reporting obligation in Section 15(b) is triggered by a defect that "could create" a substantial product hazard, a product need not actually create such a hazard to trigger reporting requirements. The CPSC has asserted that the reporting threshold under Section 15(b) is low and that firms should err on the side of over-reporting rather than under-reporting. See *United States v. Mirama Enter. Inc.*, 185 F. Supp. 2d 1148, 1158 (S.D. Cal. 2002).

Moreover, since the CPSC's reporting requirements apply to all firms in the distribution chain, downstream distributors or retailers cannot assume that any reporting obligations, and resulting penalties for reporting violations, will fall only on the product manufacturer or importer.

The Kolcraft Settlement

From 2000 to 2009, Kolcraft sold various models of play yards that the CPSC alleged had a side rail that failed to latch properly or was subject to unexpected unlatching. According to the CPSC, during this time

period, Kolcraft received approximately 350 reports of play yards collapsing, with 21 reported incidents involving injuries (scrapes, bruises and one concussion) to children.

The settlement alleged that in 2006, Kolcraft made various changes to the side-rail latch, warning labels and instructions to address the false latching problem for future production but took no action with respect to the more than 880,000 units already sold. The company reported the problem to the CPSC in January 2009 and, in July 2009, announced in conjunction with the CPSC a voluntary recall of 1 million play yards. In agreeing to the settlement, Kolcraft denied that it had committed reporting violations or that its products contained a defect which could create a substantial product hazard.

The \$400,000 amount in the settlement is not itself particularly unusual in light of the penalty ranges discussed above. The penalty statute requires the commission to take into account a wide range of factors, including the appropriateness of the penalty in relation to the size of the business, with consideration to be given to undue adverse impacts on small businesses. The settlement noted that Kolcraft is a small business.

The attention and concerns generated by the Kolcraft settlement, however, have focused on the compliance-related requirements to which the company agreed in the settlement. In addition to maintaining and enforcing a set of internal controls and procedures to ensure compliance with the CPSC's reporting requirements, the settlement required the company to establish an effective program to ensure compliance with the substantive statutes and regulations enforced by the CPSC.

The program must include written standards and policies; a mechanism for employee internal reporting of compliance-related questions or concerns; effective communication of company compliance policies to all employees through training or other means; senior management responsibility for compliance; board oversight of compliance (if applicable); and retention of compliance-related records for at least five years.

It was this unusual expansion of penalty settlement provisions that traditionally have required only monetary penalties that provoked the conflicting votes and statements of the commissioners.

Chairman Inez Tenenbaum and Commissioner Robert Adler, the two commissioners voting to approve the settlement, noted that since 1989, the company had conducted more than a dozen recalls involving various children's products. In their view, this history suggested that the company did not have an effective compliance program and internal controls in place and that "further action" by the commission clearly was warranted.

Commissioner Nancy Nord, however, protested the majority's position, noting that the company's violations involved only reporting — the CPSC had never alleged that the company had violated any underlying safety standard. In the absence of a history of violations of safety standards, Nord regarded the imposition by the federal government of compliance-related requirements relating to the company's manufacturing as inappropriate.

The full implications of the Kolcraft settlement remain to be seen. Various aspects of the settlement, however, are troubling because of their scope and stated rationale and also because of the uncertainty regarding the factors the commission may consider in future penalty actions.

Remedial provisions imposing restrictions or obligations on companies in settlement agreements are not uncommon. Typically, however, these provisions relate specifically to the type of conduct that was the subject of the violation that led to the enforcement action. The obvious objective of such remedial measures is to prevent recurrences of the violation.

Here, however, the commission used a penalty proceeding for reporting violations to impose substantive compliance requirements that go far beyond reporting obligations and extend to potentially all CPSC-enforced requirements.

Second, reliance on a history of recalls as the basis for imposing such expanded, compliance-related provisions is additionally troubling. The number of recalls a company may conduct over any time period — much less a span of more than 20 years — may be based on a number of factors: among others, the variety of products involved, the complexity of the products, the number of products sold, the nature of their intended use, the degree of consumer interaction with the products and so forth.

Moreover, the use of a recall history as grounds for enhanced penalty provisions is particularly suspect where the recalls do not involve repeated violations of CPSC safety standards or bans but rather are defect-based recalls.

The latter often involves situations where there may be no accepted design or manufacturing standards governing the specific product or component and thus no measure to serve as a generally accepted quality control benchmark. Often, the alleged defect may appear in the product only after substantial use by consumers and is not easily traceable back to any evident manufacturing or quality control deficiency.

In the CPSIA, Congress imposed a form of quality control systematically on manufacturers and importers by requiring that products subject to CPSC safety standards or bans must be tested and certified for compliance prior to their distribution in commerce. With respect to children's products subject to CPSC safety standards or bans, these preventive controls are more stringent as these products must be tested for compliance by independent third-party labs accredited by the CPSC.

These uniform requirements, however, were imposed as a result of legislative action. The compliance program in the Kolcraft settlement may be viewed as an administrative “warning shot” that the CPSC intends to impose compliance-related measures on a case-by-case basis as a defect quality control measure.

The language of the majority statement on this point seems clear. The statement asserts that if companies do not voluntarily implement effective compliance programs and internal controls, the commission “will insist that they do so.”

And the potential penalty consequences are stated equally clearly in the statement's emphasis that both the penalty amounts and the compliance provisions should be viewed as “independently robust as called for under the circumstances.”

Conclusion

The inclusion of compliance-related provisions in the Kolcraft civil penalty settlement marks a significant departure from long-standing CPSC practice in penalty proceedings involving reporting violations. In light of these provisions and the majority commissioners supporting statements, consumer product manufacturers and importers would be well-advised to review their existing internal procedures for compliance with CPSC reporting requirements as well as their internal design, manufacturing and quality control programs and practices.

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