



## \$975,000 CIVIL PENALTY HIGHLIGHTS CPSC'S AGGRESSIVE ENFORCEMENT OF REPORTING REQUIREMENTS

On March 9, 2007, the U.S. Consumer Product Safety Commission (CPSC) announced a \$975,000 civil penalty settlement with Fisher-Price. The settlement resolves allegations that the company was late in notifying the agency that ringed nail fasteners could disengage from a toy—Little People® Animal Sounds Farms—posing a choking or aspiration hazard. The settlement highlights the risk to companies of being second-guessed in deciding when to notify CPSC, and sheds light on the staff's interpretation of the statutory reporting requirements under the Consumer Product Safety Act (CPSA).

Section 15(b) of the CPSA requires manufacturers, importers, and retailers to notify the CPSC “immediately” upon receiving information that “reasonably supports the conclusion” that a product (a) “contains a defect which could create a substantial product hazard,” or (b) “creates an unreasonable risk of serious injury or death.” Companies are at risk of civil penalties of up to \$1.8 million if CPSC questions decisions not to notify the agency of a potential safety issue (even if made in good faith) or the timing of such notification.

To understand the potential implications of this case, it is helpful to have a sense of the relevant timeline, as alleged by CPSC:

- During September 2002, Fisher-Price first learned of an incident in which a nail fastener disengaged from one of the toys.
- By mid-November 2002, Fisher-Price had learned of nine reports of nail fasteners coming loose from the toy, including one report from a consumer that her child placed a nail fastener in her mouth.
- By early February 2003, Fisher-Price had received two telephone calls in which consumers expressed concern that this problem posed a choking hazard to children.
- On February 14, 2003, Fisher-Price learned that a 14-month-old child aspirated a nail fastener from the toy into his lung, requiring emergency surgery to remove the fastener. The consumer told Fisher-Price that she had notified CPSC of the incident.

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**Washington, DC**  
+1 202.942.5000

**New York**  
+1 212.715.1000

**London**  
+44 (0)20 7786 6100

**Brussels**  
+32 (0)2 517 6600

**Los Angeles**  
+1 213.243.4000

**San Francisco**  
+1 415.356.3000

**Northern Virginia**  
+1 703.720.7000

**Denver**  
+1 303.863.1000

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- On March 14, 2003, Fisher-Price filed a Full Report with the CPSC notifying the Commission of the potential hazard. By that time, Fisher-Price knew of 33 reports that the nail fastener had come loose from the toy, including four reports that children put a fastener in their mouths (one of whom cut the inside of her mouth).
- On April 23, 2003, Fisher-Price announced a voluntary recall under CPSC's Fast Track program.

CPSC alleged that "[a]lthough Fisher-Price had obtained sufficient information to reasonably support the conclusion that the [toy] contained a defect which could create a substantial product hazard, or created an unreasonable risk of serious injury or death, **it failed to immediately inform** the Commission of such defect or risk..." (emphasis added). Although Fisher-Price denied that the toy contained any such defect, denied that it violated any reporting requirements, and believed that the toy complied with the applicable CPSC regulations regarding small parts, Fisher-Price chose to settle CPSC's allegations for the substantial sum of \$975,000 in civil penalties.

The CPSC directs the Commission to consider the following factors in evaluating the amount of a civil penalty: (a) the nature of the product defect; (b) the severity of the risk of injury; (c) the number of defective products distributed; (d) the occurrence or absence of injury; and (e) the appropriateness of the

penalty to the size of the business. Companies have long complained that those statutory factors fail to provide any meaningful guidance as to when CPSC will seek penalties and the amount of any such fines. During July 2006, CPSC proposed a new interpretive rule outlining additional factors the Commission considers in deciding the "appropriateness and amount" of civil penalties for late reporting.<sup>1</sup> It is instructive to review these factors in light of the allegations against Fisher-Price:

- (1) **The firm's previous record of compliance with CPSC requirements:** During June 2001—about 15 to 18 months before the CPSC staff claims that Fisher-Price should have notified the Commission in this case—the company paid a \$1.1 million penalty for allegedly failing to notify CPSC about a fire hazard associated with Power Wheels® ride-on toys.
- (2) **Timeliness of a firm's response to relevant information:** Fisher-Price notified CPSC six months after receiving the first report of a product failure, four months after Fisher-Price had learned of nine product failures, and four weeks after learning of the only serious injury. While not discussed in the settlement agreement, the staff may have believed that if Fisher-Price had notified CPSC sooner and conducted a recall before the end of 2002, the injury could have been avoided.<sup>2</sup>

- (3) **Safety and compliance monitoring:** Although the settlement agreement does not mention Fisher-Price's internal controls, in announcing the 2001 penalty then Chairman Ann Brown "applaud[ed]" the company for strengthening its "product integrity organization."
- (4) **Cooperation and good faith:** There is no suggestion that Fisher-Price failed to cooperate with CPSC. To the contrary, Fisher-Price notified CPSC without the staff first opening an investigation, and announced a voluntary Fast Track recall within about five weeks after submitting its Full Report to CPSC.
- (5) **Economic gain from any delay or non-compliance:** Fisher-Price imported and sold a total of 67,000 units of the product. According to the press release announcing the corrective action, retail sales of recalled units ended in December 2002. Thus, even assuming that Fisher-Price should have notified CPSC and stopped sale during the Fall of 2002, the company cannot have made a significant profit through the alleged delay in notifying CPSC.
- (6) **The product's failure rate:** The product failure rate was 0.049%—33 reports out of 67,000 units. It is unclear how that rate compares with other toys.

**(7) Any other pertinent factors:**

Although we do not know what other factors, if any, were considered here, two merit discussion:

— When is CPSC adequately notified of a risk? A company's duty to notify CPSC under Section 15 of the CPSA is excused if the company has "actual knowledge that the Commission has been adequately informed" of the potential safety hazard.<sup>3</sup> In this case, the consumer who notified Fisher-Price of the only serious injury also told the company that she had already reported the incident to CPSC. Yet, as in prior cases, the staff likely took the position that CPSC had not been "adequately informed" because it did not know how many reports Fisher-Price had received that the product had broken.

— What is the significance of compliance with applicable safety standards? Fisher-Price asserted that the toy complied with applicable safety standards, presumably including mandatory and voluntary standards that bar toys for children under three years of age from having small parts even after use and abuse testing. However, CPSC has asserted that

compliance with mandatory or voluntary standards—even those that address the risk in question—does not "relieve a firm of the requirement to report when a substantial product hazard may exist" or "provide a safe harbor for the failure to report."<sup>4</sup>

In conclusion, the penalty is a stark reminder of CPSC's position that a duty to notify can arise even absent any reported injuries, that CPSC may second-guess reporting decisions, and of the difficulty in avoiding late reporting allegations without erring on the side of over-reporting. Indeed, at least in part to reduce the risk of civil penalties, leading retailers Wal-Mart and Sears Holdings (Sears and Kmart) as well as some manufacturers have begun participating in the staff's trigger reporting program through which they notify CPSC on an ongoing basis of specified categories of incident data to satisfy the statutory reporting requirement.<sup>5</sup> In exchange, participating companies get a safe harbor from civil penalties for the data they report. While trigger reporting may not be the best approach for all companies, CPSC's aggressive enforcement of the Section 15 notification requirements highlights the importance of having internal controls in place to collect, assess and address information with potential safety consequences, and to ensure that those procedures are being followed.

**Notes**

- 1 71 Fed. Reg. 39248 (July 12, 2006).
- 2 However, such an argument would be highly speculative. Even if Fisher-Price had notified CPSC in September 2002, upon receiving the first report that the toy had broken, it is unlikely that a recall would have been announced by mid-December unless Fisher-Price had opted to participate in CPSC's Fast Track program. Otherwise, it often takes CPSC months to conduct a technical analysis of a product and to issue a preliminary determination requesting that a company recall a product. And, given that the Fast Track program is voluntary, it would be unfair to penalize a company for not utilizing the program (or, in this case, not using the program sooner).
- 3 15 U.S.C. § 2064(b).
- 4 71 Fed. Reg. 42029, 42030 (July 25, 2006). This is not the first time that CPSC has penalized a company for failing to notify CPSC of a risk of injury (choking or aspiration) despite the fact that the product complied with mandatory and voluntary standards that addressed that same risk. See 69 Fed. Reg. 56202 (Sept. 20, 2004) (announcing a \$125,000 civil penalty settlement with Battat Inc. for alleged late reporting: Battat had received 330 reports, none with injuries, that small parts had broken off toy drum sticks, yet neither CPSC nor an outside lab could replicate the failure in testing pursuant to CPSC's small parts regulation).
- 5 See A&P Client Advisory, "CPSC Announces 'Working Model' for Section 15 Reporting" (Feb. 2005), [http://www.arnoldporter.com/pubs/files/Advisory-CPSC\\_Section15Reporting\(0205\).pdf](http://www.arnoldporter.com/pubs/files/Advisory-CPSC_Section15Reporting(0205).pdf)

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*If you would like more information, please contact your Arnold & Porter attorney or:*

**Eric A. Rubel**  
+1 202.942.5749  
[Eric.Rubel@aporter.com](mailto:Eric.Rubel@aporter.com)