

ADVISORY

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CPSC ISSUES FINAL REGULATION ON CIVIL PENALTY FACTORS

The Consumer Product Safety Improvement Act of 2008 (CPSIA) dramatically raised the maximum civil penalties the Consumer Product Safety Commission (CPSC) may seek for knowing violations of the laws CPSC enforces—the Consumer Product Safety Act (CPSA), the Federal Hazardous Substances Act (FHSA), and the Flammable Fabrics Act (FFA). The penalties increased from US\$8,000 to US\$100,000 per violation, and from US\$1.825 million to US\$15 million for a related series of violations. Because CPSC treats each unit of a consumer product as a separate violation, the potential penalty for a related series of violations can easily reach the statutory maximum of US\$15 million.

Given the significant increase in potential penalties, as well as new substantive requirements imposed by the CPSIA, it is important for companies to understand the factors CPSC will consider in determining the amount of a penalty. The statutory factors include (1) the nature of the product defect; (2) the severity of the risk of injury; (3) the number of defective products distributed; (4) the occurrence or absence of injury; (5) the appropriateness of the penalty to the size of the business; and (6) other factors as appropriate. Congress recognized in enacting the CPSIA that, without more, these factors provide little guidance, and Congress thus mandated that CPSC issue a final rule to elaborate on their meaning. As CPSC later explained, such a final rule serves to provide “transparency to the regulatory community about the framework the Commission will use to guide its penalty calculations in the enforcement process” which, in turn, could create “incentives for greater compliance.”

On March 10, 2010, CPSC issued a final rule interpreting the civil penalty factors, adopting in large measure an interim rule CPSC published on September 1, 2009.¹ The final rule interprets the six statutory factors listed above, and also identifies a non-exhaustive list of additional factors that CPSC may consider on a case-by-case basis. Consistent with its desire to retain flexibility in penalty decisions, CPSC’s final rule eschewed comments that would have required CPSC to adopt a “formulaic” approach to civil penalties. Specifically, CPSC declined to commit to seek the highest penalties only in situations involving actual knowledge and serious injury or death, or to seek low or no penalties

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¹ See 74 Fed. Reg. 45,101 (Sept. 1, 2009).

in situations involving only presumed knowledge and minor or no injury. CPSC explained that all of the laws it enforces allow civil penalties only for “knowing violations,” and those laws define “knowingly” as having either actual knowledge or the presumed knowledge possessed by a “reasonable man” acting in the circumstances. “[T]o follow the commenter’s position,” CPSC concluded, “would treat the ‘presumed knowledge’ element differently than it is treated in the statute.”²

Instead of following a formulaic approach in assessing penalties, the preamble to the final rule makes clear that CPSC will review the “facts and circumstances” against the enumerated factors on a case-by-case basis, and use its civil penalty power “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.”³

STATUTORY FACTORS

Against this backdrop, the final rule and accompanying preamble provide the following interpretation of the factors relevant to CPSC’s assessment of civil penalties:

1. *Nature, circumstances, extent, and gravity of the violation.* As in the interim rule, the final rule states that CPSC will consider “the totality of the circumstances surrounding a violation while recognizing that depending upon the case, the significance and importance of each factor may vary.” CPSC treats this factor as a catchall, which allows it to assess the “seriousness and extent of a particular violation that may not otherwise be considered with respect to the other enumerated statutory factors.”
2. *Nature of the product defect.* Under this factor, CPSC will consider “the nature of the product defect associated with a CPSA violation” and “the nature of

the substance associated with an FHSA violation.” For clarity, CPSC modified the definition of “product defect” that appeared in the interim rule to make it consistent with the definition of that term in the CPSA and existing CPSC regulations at 16 C.F.R. § 1115.4. In addition, the final rule acknowledges that a “product defect” may not be relevant for certain violations of the CPSA (for example, failing to supply a required certificate that a product complies with an applicable product safety rule), and that other factors would be considered in that circumstance.

3. *Severity of the risk of injury.* Like the interim rule, the final rule interprets this factor as “the potential for serious injury, illness, or death (and whether any injury or illness required medical treatment including hospitalization or surgery).” In doing so, CPSC rejected the suggestion that it forego penalties “where the products presented risks of minor or moderate injuries.” As part of this factor, CPSC also will consider “the likelihood of injury; the intended or reasonably foreseeable use or misuse of the product; and the population at risk (including vulnerable populations such as children, the elderly, or those with disabilities).”
4. *The occurrence or absence of injury.* CPSC will consider whether injuries, illness, or death have or have not occurred. However, as stated in the preamble to the final rule, CPSC may seek penalties even absent an injury: “a violative product, a product about which a person did not report as required, or another type of violation, may present a serious risk to consumers even though no injuries have occurred.”
5. *The number of defective products distributed.* Under this factor, CPSC will consider “the number of defective products or amount of substance distributed in commerce.” As in the interim rule, CPSC recognized that “the number of defective products in consumers’ hands may be different from the number of defective products distributed,” but concluded that

² In the preamble to its interim final rule, CPSC noted that it received comments opposed to a formulaic approach, including on the ground that the companies would then be able to calculate the cost of noncompliance.

³ The final rule further clarifies the broad purposes of civil penalties: “detering violations; providing just punishment; promoting respect for the law; promoting full compliance with the law; reflecting the seriousness of the violation; and protecting the public.”

“the statutory language makes no distinction” between the two, and both could be considered in relevant case. Importantly, however, the final rule clarifies that the factor “will not be used to penalize a person’s decision to conduct a wider-than-necessary recall out of an abundance of caution.” This includes situations “where such a recall is conducted due to a person’s uncertainty concerning how many or which products may need to be recalled.”

6. *The appropriateness of such penalty in relation to the size of the business of the person charged, including how to mitigate undue adverse economic impacts on small businesses.* The preamble accompanying the final rule explains that this “factor reflects the relationship between the size of the business of the person charged and the deterrent effect of, and other policies underlying, civil penalties.” In evaluating a company’s size, CPSC will consider the “number of employees, net worth, and annual sales” and may also be guided “by any relevant financial factors to help determine a person’s ability to pay.” Like the interim rule, the final rule notes that CPSC is required to mitigate only “undue” impacts on small businesses. However, the final rule modified the interim rule to explain that the burden rests on the business to present clear, reliable, relevant, and sufficient evidence relating to a business’s size and ability to pay.

ADDITIONAL FACTORS

The final rule identifies the following non-exclusive list of additional factors that CPSC may consider on a case-by-case basis. These factors also appeared in the interim rule.

1. *Safety and compliance program or system.* CPSC may consider whether, “at the time of the violation,” the company had “a reasonable and effective program or system for collecting and analyzing information relating to safety issues.” Examples include “incident reports, lawsuits, warranty claims, and safety-related

issues related to repairs or returns.” CPSC may also consider whether “a person conducted adequate and relevant premarket and production testing of the product at issue.” Unlike the interim rule, the final rule makes explicit that the burden to present “clear, reliable, relevant, and sufficient evidence of any such program and its relevance is on the person seeking consideration of this factor.” Also unlike the interim rule, the final rule clarifies that the program must specifically relate to the violation and be reasonable and effective. CPSC’s emphasis of the internal controls in place at the time of an alleged violation highlights CPSC’s belief that enhancements to internal controls in response to an alleged violation are less important in assessing a civil penalty than the adequacy of internal controls in place at the time of the alleged violation.

2. *History of noncompliance.* CPSC may consider whether “a history of noncompliance” with the laws CPSC enforces warrants increasing the amount of the penalty. The preamble to the final rule explains that CPSC declined to add “compliance” in the final rule “because the factor by its nature is intended to address repeat violations.” However, the final rule clarifies that repeat violations of the same law or regulation, or prior violations of a different law or regulation enforced by CPSC, and the number of violations, will be considerations.
3. *Economic gain from noncompliance.* CPSC may consider “whether a person benefitted economically from a failure to comply, including a delay in complying, with the CPSA, FHSA, FFA, and other laws that CPSC enforces, and the regulations thereunder.”
4. *Failure of the violator to respond in a timely and complete fashion to CPSC’s requests for information or remedial action.* CPSC may consider “whether a person’s failure to respond in a timely and complete fashion to requests from the Commission for information or for remedial action should increase

a penalty.” Unlike the interim rule, CPSC clarified that the factor “is intended to address a person’s dilatory and egregious conduct in responding to requests for information or remedial action sought by the Commission, but not to impede any person’s lawful rights” such as the right to decline to respond or act voluntarily, and the legal right to seek advice on information and remedial action requests from the agency.

CPSC declined to include other factors urged by some commenters, including “previous record of compliance, good faith, efforts taken to respond to the violation,” and duration of the violation. CPSC reasoned that CPSC already would evaluate these factors in connection with the enumerated statutory factors. In addition, as in the interim rule, the final rule leaves open the question of which of the factors above CPSC may consider in a particular case, and further states that “the Commission and a person may raise any factors they believe are relevant in determining an appropriate penalty amount.” CPSC will notify a person of any factor—beyond those enumerated in the statutes—that CPSC relies on as an aggravating factor for determining a civil penalty amount.

Commissioner Anne M. Northup, the only one of five Commissioners who voted against the final rule, expressed concern about the final rule’s “overly punitive” approach.⁴ She felt that CPSC had preserved flexibility for itself at the expense of predictability for good faith actors in the industry. She noted that the fear of civil penalties, added to the burden of complying with CPSIA requirements, could drive smaller producers out of the market and discourage innovation by large companies. Commissioner Nancy Nord indicated that she shared many of Commissioner Northup’s concerns about lack of certainty, but ultimately declared the final rule an improvement over the interim rule.⁵ In a joint

statement, Commissioners Tenenbaum, Moore, and Adler predicted that the final rule would not change the way the statutory factors have been applied by CPSC in years past, and concluded that “additional factors that are discussed should come as no surprise to the industries over which we have jurisdiction.”⁶

The takeaway from both the civil penalty factors and the Commissioners’ statements is clear: CPSC will continue to determine penalty amounts based on a case-by-case assessment of the facts and, not surprisingly, has sought to avoid surrendering any discretion to seek severe penalties where the Commission believes they are warranted. What is less clear is whether CPSC will apply these factors in a fair and consistent manner. In all events, given the severity of the potential penalties and the risk that CPSC will feel compelled to use its enhanced authority, it is more important than ever for companies to reduce the risk of being subject to penalties for alleged violations of CPSC-enforced statutes.

We hope that you have found this advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:

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⁴ See Statement of Commissioner Anne M. Northup on the Final Rule Interpreting Civil Penalty Factors, March 10, 2010, available at <http://www.cpsc.gov/PR/northup03102010.pdf>.

⁵ See Statement of Commissioner Nancy Nord on the CPSC Civil Penalty Factors Final Rule, March 10, 2010, available at <http://www.cpsc.gov/PR/nord03102010.pdf>.

⁶ See Statement of the Honorable Thomas H. Moore, the Honorable Robert S. Adler and the Honorable Inez Tenenbaum on the Final Interpretive Rule on Civil Penalty Factors, March 10, 2010, available at <http://www.cpsc.gov/PR/civpen03102010.pdf>.