

Costco Settlement Shows CPSC Still Imposing Big Penalties

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On Oct. 5, 2018, the U.S. Consumer Product Safety Commission announced that Costco Wholesale Corp. entered into a settlement agreement with the CPSC to pay a \$3.85 million civil penalty for its alleged failure to timely report defective trash cans.[1] This latest penalty agreement was accepted unanimously (4-0) by the commission.

Notably, this is the first multimillion dollar civil penalty in the post-Consumer Product Safety Improvement Act era where there was not a Democratic majority at the CPSC — indicating that penalty actions are far from moribund under the current Republican leadership. This follows the large penalty levied against Polaris Industries Inc. in March 2018 for its alleged failure to timely report defective off-road vehicles.

The CPSC’s power to seek penalties such as the ones described here derives from the Consumer Product Safety Act, which Congress enacted to “protect the public against unreasonable risks of injury associated with consumer products.”[2] To achieve that goal, CPSA Section 15(b) mandates manufacturers, retailers and distributors of consumer products report “immediately” to the CPSC “information which reasonably supports the conclusion that [a] product contains a defect which could create a substantial product hazard ... [or] creates an unreasonable risk of serious injury or death[.]”[3]

In other words, while the CPSA does not require companies to report all defects, it does require companies to report defects that potentially create substantial product hazards. Indeed, whether such hazards end up being determined to exist is not conclusive in the context of the reporting requirement. This is a lower threshold than the threshold the CPSC employs when determining whether a corrective action — such as a recall or a repair program — is necessary. In order to require a recall, the defect must result in a substantial product hazard.

As the Western District of Wisconsin explained in the 2016 case *United States v. Spectrum Brands Inc.*, the lower reporting threshold “expressly requires a company



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to report even when no substantial product hazard may actually exist.”[4] The Third Circuit, in the 2004 case *United States v. Mirama Enterprises Inc.*, described the justification for this rule thusly:

It makes sense ... to ... impose 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.[5]

If a company knowingly violates the CPSA’s reporting requirement, it will “be subject to a civil penalty not to exceed \$110,000 for each such violation,” with a statutory maximum of \$16.025 million for any related series of violations.[6] The CPSC considers a whole range factors, including the nature of the product defect and the severity of the risk of injury, when determining the penalty amount.[7]

In its settlement agreement with Costco, the commission alleged that between December 2013 and May 2015, Costco sold approximately 367,000 EKO Sensible Eco Living Trash Cans at its stores. The trash cans had a black plastic protective collar in the opening on the back of the can that, according to the Commission, could become dislodged and expose a sharp metal edge, leading to a laceration hazard to consumers.

The commission concluded Costco, after receiving 92 complaints about the trash can in the two years it sold it, including 60 complaints from consumers who alleged injuries, had information which reasonably supported the conclusion the trash can was defective. Ultimately, Costco voluntarily notified the CPSC in May 2015 about the defective trash can, and it was recalled on July 17, 2015.

In its response to the allegations and civil penalty in the agreement, Costco stated that in December 2014, its Product Safety Committee examined an exemplar product provided by its supplier, and determined the black plastic protective collar could not be removed easily. Then, in May 2015, after receiving additional reported incidents, it learned the supplier had made a design change to prevent the black plastic protective collar around the opening from coming loose. Costco also learned the exemplar that it had received and tested in 2014 had already incorporated the modified protective collar, unbeknownst to the company. Consequently, Costco asserted it did not knowingly violate the CPSA as that term is defined in the statute.

Costco’s dilemma is illustrative of the well-known issues consumer product manufacturers and retailers face with suppliers, particularly those in the Asia region. It is not uncommon for manufacturers to encounter suppliers who provide “golden samples” for testing, and make design changes without disclosing them to their customers. This problem can bedevil even the largest companies with robust safety programs and evaluative procedures, as is the case here. For smaller companies with less economic leverage, supply chain management and oversight is a daunting endeavor.

Of course, there are thousands of excellent manufacturers, component suppliers and laboratories throughout Asia, but it behooves consumer product actors in the U.S. to know as best they can who they are dealing with in the supply chain, and develop trusted relationships as much as reasonably possible. Even with best efforts by companies like Costco that have well-established product safety committees and are dedicated to product safety there can be issues.

Along with paying the \$3.85 million civil penalty, Costco has agreed to maintain a product safety

compliance program to ensure that the company complies with product safety standards and regulations enforced by the commission. The compliance program must include the following elements:

- Written standards, policies and procedures designed to ensure information relevant to CPSA compliance is promptly conveyed to employees responsible for compliance;
- A confidential employee reporting system whereby employees can submit compliance-related questions or concerns to either a compliance officer or a senior manager with authority to report it;
- Effective communication of CPSA compliance-related policies to all appropriate employees;
- Costco's senior management participation in a CPSA compliance committee, which should provide review and oversight of compliance matters;
- Retention of CPSA compliance-related records for at least five years; and
- Procedures that ensure information required to be disclosed to the CPSC is recorded, processed and reported in accordance with applicable law.

As the Costco civil penalty demonstrates, companies in the consumer products arena should remain mindful of their mandatory reporting obligations under the Consumer Product Safety Act. No matter who has the majority on the commission, all are sworn to follow and uphold the law. Multimillion dollar civil penalties appear as if they will remain an option — perhaps the new normal.

We'll see.

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[1] https://cpsc.gov/s3fs-public/19_C0001_Costco_CivilPenalty_100318.pdf?qWFKr9OHcWsEcORJSvSfN1vLmLI3xhqm.

[2] 15 U.S.C. § 2051.

[3] 15 U.S.C. § 2064(b). Companies must also immediately report to the CPSC when a product fails to comply with an applicable consumer product safety rule or with any other regulation under the CPSA.

[4] *United States v. Spectrum Brands Inc.*, 218 F. Supp. 3d 794, 813 (W.D. Wis. 2016).

[5] *United States v. Mirama Enterprises Inc.*, 387 F.3d 983, 988-89 (3rd Cir. 2004)

[6] 15 U.S.C. § 2069.

[7] *Id.*