Cooley

The Jury Has Spoken: Two Executives Convicted in Groundbreaking Consumer Product Safety Prosecution

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Editor's note: Authored by Daniel Grooms, Matt Howsare and Shawn Skolky, this article was originally published in Law360.

In November 2023, a jury convicted two corporate executives of conspiracy and failure to report information about defective residential dehumidifiers, as required by the Consumer Product Safety Act.

The jury verdict in U.S. v. Chu is groundbreaking because it is the first-ever criminal conviction of corporate executives for failure to report under the CPSA.

The judge's decision on sentencing for the two defendants will likely put an end to the yearslong series of civil and criminal enforcement actions involving multiple Gree companies relating to the recalled dehumidifiers.

The numerous actions over prior years were related to the companies' recalls of multiple dehumidifiers linked to over "450 reported fires and millions of dollars in property damage."

Under Section 15(b) of the CPSA, manufacturers, importers and distributors of consumer products are required to immediately report information that "reasonably supports the conclusion that the product contains a defect which could create a substantial product hazard" or "creates an unreasonable risk of serious injury or death."

Though companies are required to immediately report to the U.S. Consumer Product Safety Commission when Section 15(b) reporting thresholds are met, the government alleged that the Gree companies were aware of numerous incidents and significant property damage, but chose not to submit a Section 15(b) report to the CPSC.

The government alleged that the information in Gree's possession should have given rise to a reporting obligation sooner than when the company eventually reported.

In 2016, following a recall, the Gree companies agreed to pay a nearly $15.5 million civil penalty to settle CPSC staff charges of knowingly violating the CPSA's reporting requirement, using a false UL product certification mark and making material misrepresentations to the federal government.

But that did not end the saga for the Gree companies. In 2021, Gree USA Inc. agreed to plead guilty to a felony — knowingly and willfully failing to report to the CPSC — and the other companies entered into a deferred prosecution agreement related to the same charge.

The companies' criminal resolution included a $91 million penalty and represented the first corporate criminal enforcement actions ever brought for failure to report a product safety issue as required by the CPSA.

At the same time the corporate prosecution was pending, the U.S. Department of Justice also individually indicted Gree USA's former chief administrative officer, Simon Chu, and former CEO, Charley Loh.

The March 2019 indictment, which was sought and filed during the Trump administration, alleged that the two executives had "received multiple reports that were defective, dangerous and could catch fire," but failed to disclose these hazards to the CPSC for at least six months while they continued to sell the defective products — all while allegedly knowing that they were required to report this information.

Following a six-day trial in November 2023, a jury in the U.S. District Court for the Central District of California found both executives guilty of conspiracy and failure to immediately report required information under the CPSA.

This first-of-its-kind prosecution and guilty verdict against corporate officers reflects the CPSC's and the DOJ's increasingly aggressive approach to enforcing the CPSA and holding corporate executives accountable for misconduct.

Companies making or selling products subject to the CPSA should be mindful of the increased enforcement focus and potential for corporate and individual criminal exposure that, regardless of administration, appears poised to continue.

Read on for more about criminal enforcement under the CPSA.

Reporting Requirement Under the CPSA

The CPSA was enacted in 1972 to protect the public from unreasonable risks of injury from consumer products. It imposes an affirmative reporting requirement on manufacturers, importers and distributors of consumer products, which also applies to the directors, officers and agents of those companies.

Information must be reported when it “reasonably supports the conclusion that the product contains a defect which could create a substantial product hazard” or “creates an unreasonable risk of serious injury or death.” In practice, the CPSC advises, “when in doubt, report.”

Given the interplay with consumer product safety, Congress purposefully set a tight deadline for this reporting obligation in the CPSA. Such information must be reported “immediately” — meaning “within 24 hours of obtaining reportable information,” though CPSC’s implementing regulations also allow companies time to conduct a reasonable investigation, not to exceed 10 working days.

Failure to timely report the information required under the CPSA can result in civil penalties, which are currently capped at $120,000 per violation and about $17 million “for any related series of violations.”

With respect to civil penalties, companies may be subject to monetary penalties if they knowingly violate the law, which is not a particularly high bar because “knowledge” includes information that a reasonable company should have had while exercising due care.

The CPSA also provides for criminal penalties — and imprisonment of up to five years — for not only knowing, but also willful, violations, i.e., where a company knew of its legal obligation to report but voluntarily and intentionally chose not to do so.

For individual officers or directors of a company, the CPSA provides for criminal penalties for knowing and willful authorization of the violation of law.

This provision of the CPSA had never been utilized by the DOJ for the CPSA’s Section 15(b) reporting violations before — until now.

The Road Ahead: Increased Focus on Criminal Enforcement

While the CPSC has not historically pursued criminal enforcement for violations of the CPSA, signs point to this being the leading edge of a potential sea change at the commission.

For example, the CPSC’s fiscal year 2023 operating plan reflected an intention to review “all civil penalty cases for potential criminal referral to the Department of Justice” — a sentiment repeated within the fiscal year 2024 operating plan.

And a unanimous and bipartisan contingent of current CPSC commissioners have strongly voiced their intention to place more emphasis on the role of criminal penalties.

Chair Alex Hoehn-Saric, for example, noted that “ailure to report in a timely fashion will result in an investigation and CPSC will pursue significant civil and potentially criminal penalties.”

Commissioner Richard Trumka also made clear that “this Commission is serious about deterring corporate misconduct using every tool at our disposal, including the appropriate use of civil penalties and, where warranted, criminal referrals.”

Commissioner Peter Feldman similarly noted in the wake of Chu and Loh’s convictions that “CPSC and its federal partners will use all available tools to keep consumers safe.”

And finally, Commissioner Mary Boyle stated that “ivil — and potentially criminal — penalties are essential to ensure that the interests of consumers are given their due.”

While Gree is the first case involving corporate and individual criminal exposure for a violation of the CPSA, it assuredly will not be the last. The DOJ Consumer Protection Branch, working alongside the U.S. attorney's offices, appears to have the appetite to pursue additional criminal investigations and prosecutions under the CPSA.

In fact, Generac Power Systems Inc. recently disclosed that in July 2023 it received a grand jury subpoena related to its failure to timely submit a report about defective portable generators.

This criminal investigation follows Generac's May 2023 settlement with the CPSC, under which it agreed to pay a civil fine of $15.8 million and implement and maintain a compliance program and certain internal controls to ensure compliance with the CPSA.

As Hoehn-Saric cautioned last year, "companies should be on notice that the agency will be even more aggressive in the future."

And, in the words of Deputy Assistant Attorney General for the DOJ's Consumer Protection Branch Arun Rao, "holding corporations and those who act on their behalf (such as managers who attempt to conceal potentially dangerous problems from customers …) responsible for criminal wrongdoing has been, and remains, an important priority of the department."

The writing appears to be on the wall that, where there are indications of a willful violation, CPSC already is, and will continue, closely scrutinizing a company's behavior through both a lens of civil penalty enforcement and referral to the DOJ for criminal prosecution.

What This Means for Companies

Given the CPSC's increased focus on criminal referrals, companies should assess criminal exposure risk as part of regulatory investigations related to potential violations of the CPSA.

Corporate executives should also have it in the back of their mind when acting on recommendations of whether a product safety issue warrants a Section 15(b) report to the CPSC.

A realistic scenario in which a corporate executive should strongly consider the risk of potential criminal investigation is when an internal recommendation has been made to submit a Section 15(b) report, but the executive or a group of senior leaders chooses not to submit a report and instead takes other action.

In this situation, or in any situation in which a decision is made to forego a Section 15(b) report, strong consideration should be given to creating a contemporaneous record that documents the reasonable and good faith basis for choosing not to report at that time based on the factors outlined in CPSC's reporting regulations.

To ensure recommendations on product safety issues are timely identified and escalated to senior managers, companies should take proactive steps to enhance their regulatory compliance and Section 15(b) reporting programs.

This includes establishing clear policies and procedures for handling sources of potential product safety issues, regardless of whether those originate from customer service calls, online reviews, warranty claims, safety-related design changes, concerns raised within the company or other sources.

Companies should also train responsible employees on Section 15(b) reporting obligations and the appropriate identification and internal handling of product safety-related information.

Beyond the regulatory compliance and Section 15(b) reporting components, companies should have robust internal compliance mechanisms that focus on both risk mitigation and accountability.

As only one example, to promote robust compliance and accountability for employees at every level, companies should have policies in place governing employee communications.

Companies should also ensure those communications are appropriately preserved and maintained in accordance with internal document retention policies.

In the context of a government investigation or litigation, these communications will be produced and form the basis for reconstructing what happened during the time period being investigated.

This includes managing the usage of ephemeral messaging tools that might not be captured by company systems and having policies regarding the appropriate use of personal devices, such as mobile phones.

Compliance is an ongoing process. Effective compliance programs should be tested and modified over time. Periodic audits should focus on areas of greatest compliance risk and look for opportunities to improve on existing policies and procedures.

Compliance also should be evaluated in real time, including immediate review of significant product safety issues that have recently concluded for any lessons learned prior to memories fading or key personnel departing.

Finally, compliance is a cultural issue. Companies should establish a culture that expects compliance, and reinforce that expectation through the tone from the top and through all levels of the organization.

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