

CLIENT ALERT

Silence Isn't Golden: Failure to Report Consumer Product Safety Issues Results in Rare \$91 Million Criminal Penalty

November 5, 2021

In one of the most significant developments in product safety law over the past decade, Gree Electric Appliances Inc. of Zhuhai, Hong Kong Gree Electric Appliances Sales Co. Ltd., and Gree USA Inc. (the “Gree Companies”), an appliance manufacturer and two of its subsidiaries, have pled guilty to willfully failing to report to the Consumer Product Safety Commission (CPSC) under Section 15(b) of the Consumer Product Safety Act (CPSA). According to the U.S. Department of Justice (DOJ) and the CPSC, the Gree Companies knew their dehumidifiers were defective, failed to meet applicable safety standards, and could catch fire, but failed to timely report that information to the CPSC. Section 19 of the CPSA makes it unlawful to fail to furnish information required by Section 15(b), and such failures are subject to both civil *and criminal* penalties. While CPSC civil penalties have become fairly routine—the Gree Companies also paid a then-record \$15.45 million civil penalty in 2016—this is the first corporate criminal enforcement action brought under the CPSA, according to the DOJ.

Importantly, the DOJ alleges egregious conduct by the Gree Companies, with accusations beyond failing to report, including willfully selling products known to be defective, using falsified UL certifications, and otherwise lying to the public about the safety of their products. The facts adduced in related product liability trials also suggest that the Gree Companies did not inform retailers of the full scope of affected products and delayed their recall announcement so that products that should not have been sold could be, and were, distributed to unsuspecting consumers.

The DOJ reported that the Gree Companies entered into agreements^[1]¹ to resolve the one felony count of willfully failing to report consumer product safety information as required by the CPSA alleged against each in a criminal information^[2]² filed in the U.S. District Court for the Central District of California. Collectively, the Gree Companies will pay a \$91 million penalty and restitution for any uncompensated victims of fires caused by the defective dehumidifiers. Two Gree USA executives have also been charged criminally by the DOJ and await trial.

Enforcement Under the CPSA

Under the CPSA, manufacturers, distributors, and retailers of a consumer product who obtain information which reasonably supports the conclusion that their product contains a defect which would create a substantial product hazard, or that creates an unreasonable risk of serious injury or death, must immediately inform the CPSC of the defect.^[3]³ “Substantial product hazard” has two meanings under the CPSA. The first is a failure to comply with an applicable consumer product safety rule, or similar regulation enforced by the CPSC that creates a substantial risk of injury to the public.^[4]⁴ The second is any product defect

which—because of a pattern of defect, the number of defective products distributed in commerce, the severity of the risk, or otherwise—creates a substantial risk of injury to the public.^[5]⁵

Failure to report information about a substantial product hazard (within 24 hours of obtaining reportable information) is considered an unlawful prohibited act under Section 19 of the CPSA.^[6]⁶ Knowing violations of Section 19 may result in civil and criminal penalties, including monetary fines, imprisonment, and forfeiture of assets associated with the violation.^[7]⁷ Moreover, individual directors, officers, and agents of a corporation who knowingly and willfully authorize, order, or perform any act constituting a violation can be subject to criminal penalties separate from the corporation.^[8]⁸

Although the CPSC uses civil penalties as an enforcement tool on a fairly regular basis, use of criminal penalties has been much less common. For example, the CPSC has issued at least one civil penalty every year (except 2020) for the past decade—often issuing five or more civil penalties in a year. The two civil penalties issued already in 2021 totaled approximately \$12 million and \$8 million, respectively. Although the DOJ states that this is the first corporate criminal enforcement action under the CPSA, we are aware of one other instance in which the CPSC has sought criminal penalties within the past ten years. That criminal penalty was levied in 2013, when the President of a corporation was sentenced to 22 months in prison and assessed a \$10,000 fine after pleading guilty to conspiracy to traffic and smuggle banned children’s products containing excessive lead and small parts in violation of the CPSA and Federal Hazardous Substances Act (FHSA). Prior to the case against the Gree Companies, criminal penalties were typically sought against individuals for violations of the FHSA, and no fine associated with a criminal penalty had exceeded \$400,000.

Recall History of the Dehumidifiers

The Gree Companies manufactured, imported, and sold approximately 2.5 million allegedly defective dehumidifiers from 2007 to 2013. The dehumidifiers were first recalled on September 12, 2013 in conjunction with the CPSC. The recall covered twelve brand names, citing the products’ tendency to overheat, smoke, and catch fire. The recall announcement was updated on October 30, 2013 with additional models to account for additional incident reports. At the time, the Gree Companies had received 325 incident reports, including 71 fires and \$2.7 million in property damage.

The recall was expanded again on January 30, 2014 to include additional dehumidifiers. The Gree Companies received sixteen incident reports involving those appliances, including five reports of fires associated with \$430,000 in property damage. By May 2014, the Gree Companies had received a total of 471 incident reports, including 121 reported fires and \$4.5 million in associated property damage. By November 2016, those figures jumped to more than 2,000 incident reports, including 450 fires resulting in more than \$19 million in property damage.

Civil Proceedings at the CPSC

In 2016, the CPSC announced that it obtained a \$15.45 million civil penalty in a settlement agreement with the Gree Companies.^[9]⁹ The CPSC alleged that the Gree Companies: (1) knowingly failed to timely report to the CPSC a defect and

unreasonable risk of serious injury with dehumidifiers sold under thirteen brand names; (2) knowingly made material misrepresentations to the CPSC; and (3) sold dehumidifiers bearing the UL safety certification mark knowing that the products did not meet UL flammability standards.

The Gree Companies did not admit to the CPSC's allegations, and instead reiterated that they voluntarily notified the Commission about concerns with the dehumidifiers, carried out a voluntary recall in cooperation with the Commission, and acted to reduce the potential risk of injury to consumers. In addition to paying the civil penalty, the Gree Companies agreed to implement a stringent compliance program. Such compliance programs have become common elements in civil penalty settlement agreements with the CPSC.

Criminal Proceedings

Under the terms of the plea and deferred prosecution agreements, the Gree Companies admitted to selling more than two million dehumidifiers in the U.S. from 2007 to 2013 and that, in the fall of 2012, high-level Gree executives learned about the defects through consumer reports of fires and subsequent testing. Indeed, Gree USA had the dehumidifiers tested multiple times during the fall of 2012, which resulted in findings that the appliances were made with material that did not conform to the applicable UL safety standards for fire resistance and could, therefore, catch fire. The Gree Companies also admitted that those same high-level executives knew that dangerous consumer products must be reported to the CPSC, but continued to import and sell the appliances (still containing labels that touted compliance with UL standards) in the U.S. for at least six months before finally reporting to the CPSC. And despite receiving multiple test reports indicating non-compliance, the Gree Companies' initial report to the CPSC in March 2013 did not mention the specific defects that caused the dehumidifiers to burn. The follow up report submitted in April 2013 also failed to identify the defects, stating that the Gree Companies did not believe the dehumidifiers posed a substantial product hazard or needed to be recalled.

As part of the criminal resolutions, the Gree Companies have agreed, among other things, to continue to: cooperate in any ongoing or future investigations and prosecutions; strengthen their compliance programs; enhanced reporting requirements; and submit annual reports to the DOJ on their compliance and internal controls with an aim of improving product safety and detecting violations of the CPSA. The Gree Companies will also be required to retain an independent "Compliance Expert" at their own expense to advise on product safety and regulatory compliance issues under the CPSA. The Compliance Expert must begin the process of auditing and advising the Gree Companies on written policies and procedures to ensure that relevant information gets to appropriate internal compliance personnel, mechanisms for confidential employee reporting of compliance-related concerns, effective communication and training on CPSA compliance-related policies and procedures for all applicable employees, and retention of CPSA-compliance related records, within six months and also periodically report out to government officials.

The U.S. Attorneys' Office for the Central District of California also indicted Charley Loh, the chief executive officer of Gree USA, and Simon Chu, the subsidiary's chief administrative officer, with felony conspiracy, wire fraud, and CPSA-related charges in March 2019 for their alleged roles in the company's failure to report the defects, use of false UL certifications, and other material misrepresentations. Both individuals are awaiting trial, which is currently scheduled for March 2022.

Lessons Learned

This case provides several key takeaways for companies to heed as they implement internal and external reporting processes and develop their compliance frameworks. The record of the Gree Companies' interactions with the CPSC has been extensively discovered in products liability litigation, and the allegations behind their delayed engagement with the CPSC played an important role in those cases. To avoid similar pitfalls, companies that manufacture, import, distribute, or sell consumer products should:

- Develop compliance processes to ensure that all consumer products sold to U.S. consumers are tested and certified to the applicable federal product safety rules and voluntary safety standards, as well as retest existing products when there is a change in vendors or material suppliers to ensure continuous compliance with the standards.
- Validate that all certifications on products are accurate and supported by legitimate testing.
- Retain testing and compliance documentation for all products for at least five years.
- Develop compliance processes to ensure that customer feedback is regularly monitored for signs of potential safety hazards and trends, and if any are discovered, conduct further investigation.
- Be prepared to explain to regulators the need for an extended investigation after receipt of concerning customer reviews, if applicable.
- Notify the CPSC as soon as possible after obtaining information that suggests a product may present a substantial product hazard or could create a risk of serious injury or death, and work with the Commission to find an appropriate resolution.
- In conducting a recall, ensure that all retailers are fully and immediately informed about the scope of affected products and work diligently to inform all purchasers by direct mail immediately upon announcing the recall.

The DOJ has promised to continue to work closely with the CPSC to ensure consumers' safety.^[10] This case is a harsh example of the increasingly aggressive actions taken by the CPSC, and now the DOJ, in an effort to protect consumers from repeat offenders and bad actors in the marketplace. Perhaps most importantly, companies should look inward to ensure processes and policies are in place so that they can timely comply with reporting requirements.

[1] Gree USA's plea agreement and Gree Zhuhai and Gree Hong Kong's deferred prosecution agreement (DPA) were filed on October 28, 2021.

[2] The Criminal Information was filed on October 26, 2021.

[3] 15 U.S.C. § 2064(b); also known as Section 15(b) of the CPSA.

[4] 15 U.S.C. § 2064(a)(1).

[5] 15 U.S.C. 2064(a)(2).

[6] 15 U.S.C. § 2068(a)(4).

[7] 15 U.S.C. § 2069(a) (civil penalties); 15 U.S.C. § 2070(a), (c) (criminal penalties).

[8] 15 U.S.C. § 2070(b).

[9] See Civil Penalty Announcement (Mar. 25, 2016); Settlement Agreement (Mar. 25, 2016).

[10] DOJ Press Release regarding resolution of criminal charges, dated October 29, 2021.

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