Legal Backgrounder

WLF Washington Legal Foundation
Advocate for freedom and justice®
2009 Massachusetts Avenue, NW
Washington, DC 20036
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Vol. 28 No. 11 August 23, 2013

CPSC's MISUSE OF RCO DOCTRINE BODES ILL FOR CEOs AND CONSUMERS

by
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On June 19, 2013, an Administrative Law Judge (ALJ) denied a request by the National Association of Manufacturers (NAM), Retail Industry Leaders Association, and National Retail Federation to intervene in the Consumer Product Safety Commission's (CPSC) case of *In re Maxfield and Oberton Holdings, LLC, et al*. Industry members had hoped to help challenge the Agency's unprecedented decisions to (1) name a dissolved corporation's former CEO individually as a respondent in the recall case; and (2) apply the responsible corporate officer (RCO) doctrine outside the criminal context. Although the ALJ denied this request, CPSC's effort to expand the Agency's enforcement powers raises broad public policy concerns, including whether its actions will chill reasonable objections to CPSC's future recall demands, unduly expand the definition of children's products, jeopardize expected legal protections of incorporation, and extend the RCO doctrine into uncharted territory.

Background. The case of Maxfield and Oberton (M&O) began in 2011, when the company's Buckyballs® magnet novelty item for adults came under CPSC scrutiny following reports of ingestion injuries. M&O initially worked with CPSC to develop more robust warnings on the top, side, and carrying case, updating packaging and labeling to specify that the products were for "adult use only," including strong warnings about risks from accidental ingestion, and voluntarily recalling all magnets without the new warning. M&O then obtained a letter from CPSC's General Counsel indicating that the product could be legally sold. However, CPSC later decided that the new warnings were insufficient, and in July, 2012 the agency filed an administrative complaint seeking to force M&O to recall the product and refund the purchase price to customers. Because the agency sought to completely stop M&O from selling its only product line, this became a bet-the-company case.

M&O strongly objected to CPSC's decision and launched a public relations campaign to tell the company's side of the story. As part of the campaign, M&O CEO Craig Zucker appeared on radio and television shows, criticizing CPSC's attempt to ban the product and claiming that the agency was employing "bullying" tactics to put an American small business out of business. For example, the agency reportedly pressured retailers to stop carrying Buckyballs®, and it issued a notice of proposed rulemaking to effectively ban the product in September, 2012.[1] On December 27, 2012, M&O filed a Certificate of Cancellation with the state of Delaware, and dissolved as a corporation. It established a Liquidating Trust to settle any outstanding claims. Even though this development meant that Buckyballs® would no longer be available for sale anywhere, even on the company's website, CPSC continued to pursue its complaint against the company.[2]

In response to the notice of M&O's dissolution, CPSC filed a second amended complaint in February 2013 seeking to add Mr. Zucker, both individually and as an officer of the former corporation, as a

[1] 77 Fed. Reg. 53781 (Sept. 4, 2012).

[2] In the Matter of Maxfield and Oberton Holdings, LLC, CPSC Docket 12-1 (2013).

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respondent. CPSC argued that Mr. Zucker should be held individually liable for conducting a recall and refunding the purchase price to customers. Despite Mr. Zucker's objections, an Administrative Law Judge granted CPSC's motion on May 3, 2013. Oddly, the Agency did not seek to add the Liquidating Trust as a respondent, nor did it seek to add Mr. Zucker's co-owner (who had not personally criticized the CPSC in public). In the meantime, in April, 2013, a number of retailers did announce recalls of the products "in cooperation with CPSC."

If CPSC's efforts to hold Mr. Zucker personally liable succeed, this case will set a disturbing precedent, giving CPSC added leverage in negotiating recalls and penalties with product manufacturers, especially small businesses and owner-operated businesses.

CPSA's Recognition of the Corporate Form. Although the Consumer Product Safety Act (CPSA) establishes criminal and civil penalties against individuals for statutory violations, it does not confer authority on CPSC to compel an individual to carry out a recall. In opposing CPSC's motion to name him individually, Mr. Zucker argued that the plain wording of CPSA Section 15 only authorizes the "manufacturer, distributor or retailer" to conduct a recall. In some cases, the manufacturer, distributor or retailer could be an individual who conducted business without forming a corporation or partnership, but that was not the situation here. Mr. Zucker argued that because manufacture and distribution were handled by a legitimate corporate entity, not personally, he could not be subject to personal liability under Section 15.

Mr. Zucker further argued that under U.S. corporate law, an officer, director, or shareholder of a corporation is not responsible for the debts or obligations of the corporation.[3] Indeed, the general presumption is that individuals are not responsible for the actions and liabilities of their corporate employers except in rare instances where Congress has decided to supersede this protection by statute.[4] Courts will "pierce the corporate veil" to hold shareholders or officers liable for the actions of a corporation under "exceptional circumstances," such as where the corporation is a "mere shell, serving no legitimate purpose, and used primarily as an intermediary to perpetuate fraud or promote injustice."[5] Mr. Zucker's actions do not justify disregard of the corporate form.

The* Park *Doctrine and CPSC. Despite these arguments, the ALJ agreed with CPSC and held that the responsible corporate officer doctrine permitted Mr. Zucker to be added individually as a respondent. The RCO doctrine, also known as the *Park* doctrine, began as a legal mechanism to hold high-ranking corporate executives criminally liable for violations of the Food, Drug, and Cosmetic Act (FDCA), even absent knowledge of or participation in the violation. Supreme Court cases *United States v. Dotterweich* and *United States v. Park* (reaffirming *Dotterweich*) held that a corporate agent who stands in a "responsible relation" to a misdemeanor may be held *criminally* liable for FDCA violations, even if the corporate officer did not play a direct role in the misconduct.[6] Although the *Park* doctrine originated in the food and drug context, it also has been applied in the context of other public health and welfare statutes. Most notably, the Clean Air Act and the Clean Water Act expressly provide that a "responsible corporate officer" may be held liable for violations of those statutes.[7]

In its recent ruling, the ALJ held that it must only determine whether, under the RCO doctrine, Mr. Zucker could "be held individually responsible for the alleged CPSA transgressions" of the corporation. Because the CPSA relates to the public's health and safety, the ALJ reasoned that *Dotterweich* and *Park* controlled in this case. The ALJ found the complaint sufficiently alleged liability under the RCO doctrine, citing CPSC's argument that "Mr. Zucker was responsible for ensuring Maxfield's compliance with applicable statutes and regulations . . . . [and] personally controlled the acts and practices of Maxfield,

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[3] *See Citizens Elec. Corp. v. Bituminous Fire & Marine Ins. Co*., 68 F.3d 1016, 1021 (7th Cir. 1995).

[4] The Model Business Corporations Act states: "[A] shareholder … is not personally liable for the acts or debts of the corporation except that he may become personally liable by reason of his own acts or conduct." Model Bus. Corp. Act § 6.22(b) (1984).

[5] *SFA Folio Collections, Inc. v. Bannon*, 585 A.2d 666, 672 (Conn. 1991) (*quoting Angelo Tomasso, Inc. v. Armor Constr. & Paving Inc*., 447 A.2d 406, 412 (Conn. 1982)).

[6] 320 U.S. 277 (1943); 421 U.S. 658 (1975).

[7] *See* 42 U.S.C. § 7413 (c)(6); 33 U.S.C. § 1319(c)(6).

including the importation of Buckyballs and Buckycubes."[8]

This interpretation misapplies the *Dotterweich* and *Park* precedents and positions the case to expand CPSC's authority significantly beyond the scope of its governing statutes. Mr. Zucker's conduct in refusing to agree to a *voluntary* recall—instead insisting that the Agency meet its statutory obligation to first prove that the product posed a "substantial product hazard"—does not even rise to the level of a regulatory violation, let alone criminal conduct that might implicate the traditional RCO doctrine.

Section 21 of CPSA states that any individual director, officer, or agent of a corporation who "knowingly and willfully violates Section 19 of the Act shall be subject to criminal penalties."[9] Section 19 violations include the sale and distribution of a product that is explicitly banned or otherwise prohibited under a CSPC regulation. A suit against a corporate officer who violated Section 19 would look a lot more like a *Park* doctrine type case by holding a corporate executive responsible for *violations* of a statute or regulation on his or her watch.

However, in pursuing this case, CPSC is seeking an administrative determination that Buckyballs® adult magnet sets do in fact present a "substantial product hazard" within the meaning of Section 15(a)(2) of CPSA. If this finding is made, CPSC further seeks an order compelling a recall of the product and a refund of the purchase price to consumers. Crucially, the sale and distribution of the product do not violate the statute *unless and until* Buckyballs® are classified as a substantial product hazard. Hence, given the present posture of the matter before the ALJ, the equitable policy served by the RCO doctrine could not possibly have been satisfied in this case, much less merit application in a civil matter.

CPSC argued that the addition of Mr. Zucker was appropriate, saying it "simply allows the court to identify a responsible corporate official who can carry out an Order in this proceeding."[10] The CPSC further alleged that the liquidating trust contains "woefully insufficient" funds to provide compensation to consumers and that "justice requires" the court to require Mr. Zucker to provide the requested relief.[11] This policy argument has far-reaching implications, as it breaches the most basic protection from personal liability ostensibly offered by the corporate form. Compelling a former officer of a dissolved corporation to personally refund consumers for products which have not yet been determined to pose a substantial product hazard misreads consumer product safety law, but imposing personal liability absent any showing of undercapitalization or other fraud—even if a substantial product hazard determination had been made—undermines the business community's ability to rely on the protection of the corporate form.

Public Policy Considerations in Applying the Responsible Corporate Officer Doctrine. Product manufacturers, distributors, and retailers—and individuals managing these companies—have a legal right to challenge a government agency's determination that a product recall is warranted based on legitimate, but different, interpretations of applicable statutes as applied to specific facts. Individuals do not check their free speech rights at the door when they disagree with agency actions and exercise their rights to object.

Although CPSC plays a valuable role in protecting the public, it has not been granted absolute power to halt commerce without demonstrating a need to protect consumers from danger, consistent with its statutory authority. Those circumstances do not appear to be present in this case. Instead, CPSC is seeking to disregard the valid corporate form, raising questions about whether other individuals involved in product safety decisions—especially those who disagree publicly with initial Commission decisions—could face exposure to personal liability if they resist a voluntary recall request.

Beyond the clear economic danger to companies and corporate officers, this precedent could harm the cooperative relationship between corporations and the CPSC. This action creates a perverse incentive for corporate officers to avoid reporting product hazards to the CPSC, out of fear that their personal finances and

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[8] Order Granting Complaint Counsel's Motion for Leave to File Second Amended Complaints in Docket Nos. 12-1 and 12-2 at 14, CPSC Docket 12-1 and 12-2 (2013).

[9] 15 U.S.C. § 2070(b) (2011).

[10] Reply in Support of the Complaint Counsel's Motion for Leave to File Second Amended Complaints in Docket Nos. 12-1 and 12-2 at 2, CPSC Docket 12-1 and 12-2 (2013).

[11] CPSC's claim that the liquidating trust lacked sufficient funds also ignores the fact that the vast majority of consumers in a product recall like this do not return the product.

family's welfare could be put at risk. Such a disincentive is contrary to the general interests of the CPSC and the public, who depend upon corporate cooperation to monitor and report potential product hazards.

Another concern is whether the Commission is improperly seeking to re-categorize an adult product as a children's product. Defining "children's products" was a seminal issue during discussions of the Consumer Product Safety Improvement Act (CPSIA) in 2008. Suggestions that children's products be defined by their "appeal" to children were rejected in favor of defining children's products as those "*designed or intended primarily for children 12 years of age or younger*."[12] A statement by a manufacturer about intended use, including a label if such statement is reasonable, representations in packaging, display, or advertising about whether the product is appropriate for use by children, whether the product is commonly recognized as being intended for use by a child, and the Commission's Age Determination Guidelines are factors to consider.

Here, the warnings and distribution mode illustrate that the primary intended users were adults. Warnings are a commonly accepted tool to help adults make sure children are not exposed to unsuitable products, and there is no legal duty to manufacture products that are always safe for children—thus the "Keep Away from Children" warning found on many household products. From matches, lighters, and fireworks to butcher knives, chainsaws, and superglues, numerous dangerous but useful legal products are sold intended solely for use by adults. Hence, the decision to pursue a Buckyballs® recall against M&O and Mr. Zucker raises troubling questions about the ability of any manufacturer to make good-faith decisions about the intended user demographic (adults) and to utilize strong warnings about hazards if a product attracts unwanted attention from under-age consumers.

Another immediate implication of this lawsuit, if successful, is that that the corporate form would no longer protect former officers after dissolution if CPSC seeks a recall of a product. NAM *et al.* outlined just some of the questions about how this doctrine would be applied within the context of CPSC rules regarding reports of potential product hazards and recall negotiations, saying, in their motion to intervene:

> The equities do not support setting aside all the protections of the business entity where there has not been alleged or pleaded any arguable 'wrongdoing' on the part of the individual. In this case, Mr. Zucker directed the actions of a limited liability corporation that marketed a legal product. Further, he relied repeatedly on CPSC guidance about marketing and labeling of the product in doing so. Then CPSC staff changed its mind. To now suggest that Mr. Zucker should be exposed to potential personal liability, and the attendant costs of defending himself, as a result, is inequitable in the extreme …[13]

Not only does this decision attack the essential nature of the corporate form, whose very purpose is to shield individuals from liability for corporate acts, but it utterly misconstrues the RCO doctrine. Using that doctrine to find a CEO personally liable for conduct that was not even a regulatory violation, let alone criminal, risks creating a new standard: strict personal liability for merely failing to agree to an agency's request. Such a precedent would eviscerate the voluntary nature of the recall process, empower the CPSC to engage in backdoor rulemaking, and leave business owners unable to rely on clear rules known in advance. Supplanting standard rulemaking processes legislated in CPSC's organic statutes through this action undermines principles of administrative law.

Conclusion. In an increasingly regulated marketplace, business owners should not have to fear personal and financial ruin for alleged offenses that are decided retroactively, such as substantial hazard findings under the CPSA. Accountability for wrongdoing adds to our confidence in product safety; however, government shakes that confidence when it takes actions that are perceived as unfair. Allowing the Agency's pursuit of an individual corporate employee personally under *Park* and its progeny to move forward under these facts is just such an example.

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[12] 15 U.S.C. § 2052 (a)(2).

[13] Memorandum in Support of Zucker's Request for Interlocutory Determination of Status as Proper Party to Proceeding at 2, CPSC Docket 12-1 and 12-2 (2013).