

House Committee on Small Business
Subcommittee on Investigations and Oversight
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Re: The Consumer Product Safety Improvement Act and Small Business

Statement of
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STATEMENT OF RICHARD M. WOLDENBERG
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Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to provide testimony on the impact of the Consumer Product Safety Improvement Act (CPSIA) on small businesses. My name is Richard Woldenberg and I am Chairman of Learning Resources, Inc. of Vernon Hills, Illinois, a manufacturer and distributor of educational materials and educational toys. We employ 150 people and sell our products in over 80 countries.

As a manager of a small business, I am concerned about the impact of the CPSIA on small businesses serving the children's products market. We have begun to see the destructive economic impact of this precautionary law on small business without providing significant offsetting consumer safety benefits. The CPSIA has the potential to make running an American small business so difficult that many businesses will elect to close or exit segments of the children's product market. In addition, the specialty markets that we serve, like the school market and specialty retail, will become greatly weakened.

The most significant problems caused by the CPSIA for the small business community are (a) burdensome compliance costs, (b) increased regulatory and business complexity, and (c) virtually uncontrollable liability risk. These issues are particularly severe for small businesses, as they have so little infrastructure to manage these challenges, and are often ill-prepared to surmount the complexities created by the law or bear the risk to their invested capital.

I. Burdensome Compliance Costs:

A. Retroactive Effect. The first heavy financial blow dealt by the CPSIA was the retroactive application of the new safety standards to existing inventory. By allowing only six months to sell-off merchandise that was “safe” one day and “unsafe” the next, Congress imposed terrible losses on many small businesses and incited a trade war between retailers and manufacturers over who would be “stuck” with the un-saleable inventory. [Notably, the advanced notice of the retroactive effect of the phthalates ban was even worse – just two business days (see <http://cpsc.gov/about/cpsia/nrdcopinion.pdf>).] The short sell-off period for the newly illicit inventory is FAR SHORTER than was offered by the Eighteenth Amendment and Volstead Act in 1919 when alcohol was banned in the Prohibition, the culmination of a nearly 100 year anti-alcohol campaign. Retroactivity has virtually no precedence in CPSC history. Industry-wide losses are estimated at billions of dollars. See <http://online.wsj.com/article/SB123872361943185291.html>. No reparations have been offered to small businesses harmed by this dramatic change in law. New inventory losses may occur on August 14, 2009 as the law requires a further drop in the lead and lead-in-paint standards which will also be given retroactive effect.

B. Testing Costs. The precautionary regulatory approach of the CPSIA imposes testing costs on small business out of proportion to its stated objective of improved safety. The new law attempts to resolve perceived “gaps” in regulation by considering every product intended for children “hazardous” until proven otherwise. Under the CPSIA, the definition of a “children’s

product” subject to regulation was widened to encompass ALL products designed or intended primarily for a child 12 years of age or younger (15 U.S.C. §2052(a)(2)). Thus, the new restrictions encompass library books, ballpoint pens, dissection specimens, shoes, sweaters, ATVs, used children’s bicycles, etc. The CPSIA requires that manufacturers test all “children’s products” for compliance using a certified independent laboratory prior to importation or sale (15 USC §2063(2)). The heavy testing burden will crush small businesses of all types. For instance, we have submitted written quotes to Congressional leaders for as much as \$24,050 to test a single telescope under the CPSIA. Even allowing for new test specifications recently announced by the CPSC, the cost for a typical complete suite of CPSIA tests is likely to exceed \$1,500 per average product. At our company, we have about 2,000 catalog items. Even with all conceivable efficiencies, the prospective testing cost for our inventory is staggering.

The testing regime under the CPSIA was not designed with small businesses in mind. The low sales volume typical of small business products makes the cost of testing prohibitive and creates an unfair competitive advantage for businesses serving mass markets. Because small businesses bear disproportionately higher production costs from testing, many items will become uncompetitive in specialty markets. The structural advantage of mass markets under the CPSIA will depress the competitiveness and viability of niche markets and niche companies.

The solution to the testing dilemma is not clear cut without a major change in law. The CPSIA eliminates risk assessment as the basis for safety administration and as a result, each product must be individually tested. Small businesses do not have the option to use supply chain management techniques or testing focused on specific risks to achieve safety goals. Repetitive testing of like products for like risks will raise costs significantly for little safety payoff. Even component-level testing offers only limited relief, mainly for the simplest products with few components (assuming component suppliers will cooperate and provide the expensive test reports at all). Notably, Customs inspection of test reports at the time of importation will likely

create delays for companies relying on bundles of component test reports. It won't take long for component testing to be exposed as unworkable for imported children's products. This will adversely affect many small importers.

C. Tracking Label Costs. CPSIA tracking label requirements will drive up costs for small businesses. The tracking label provision (15 USC §2063(a)) requires that every item be marked with source and production lot data ostensibly to improve recall effectiveness. The cost of tracking labels is FAR in excess of purported benefits. For instance, we estimate that our company will spend more than 50,000 times the expected cost of recalls EVERY YEAR to apply tracking labels to our products (based on our 25-year recall rate of 0.00001%). In fact, far less than 1% of all children's products are EVER recalled. With the market comprised of many millions of items, the tracking labels requirement punishes the many for the sins of the few.

In light of the purpose of the new law, the tracking labels provision seems particularly misconceived. The CPSIA is intended to reduce recalls of children's products significantly – so why are tracking labels still necessary? As Wayne Gretzky once explained: "I skate to where the puck is going to be, not where the puck has been." The expected lower rate of recalls will only magnify the damage inflicted on small businesses by the tracking label requirement. We also expect certain high quality factories to stop serving small business customers to avoid the challenge and expense of tracking labels on small production runs of children's products. The loss of these manufacturing resources may curtail many small business activities.

D. No Way to Avoid the New Burdens. Obtaining an exception to the law will be nearly impossible for small businesses. The CPSIA (essentially) prohibits exceptions allowing the sale of materials or items that exceed the new standards (see <http://cpsc.gov/about/cpsia/101lead.pdf>). Thus, the sale of materials or products with phthalates and/or lead in excess of standards is now a *per se* violation of the CPSIA, whether or not there is any evidence of risk or danger associated with the use of such materials or products. While the recent exercise of "enforcement discretion"

by the CPSC in granting a two year enforcement stay on ATVs is a possible sign of broader relief to come, it was notably preceded by a lengthy campaign by the ATV industry for relief. The exemption process (<http://cpsc.gov/library/foia/foia09/brief/leadexclusion.pdf>) is so expensive that few if any small businesses can entertain it. The ATV industry effort to obtain relief under the CPSIA for its narrow class of goods may exceed \$5-10 million in cost over more than four years. For small businesses, this exemption door is effectively closed.

E. Reduced Incentive to Innovate. The increased cost to bring a product to market will make many viable – and valuable – products uneconomic. To cover the cost of developing, testing and safety-managing new products, the prospective sales of new items will need to be much higher than before. This means that low volume items can't be produced profitably and new market entrants may find themselves priced out of the market. The blizzard of new legal requirements will reduce the number of new children's product business start-ups. We think that increasingly companies will be forced to abandon specialty and niche markets to concentrate on the mass market. Over time, only high volume items will be cost-effective enough to survive the Darwinian action of the market under the CPSIA. This will hurt many important, but small, markets like educational products for the blind or the deaf. Our company, with its 2,000 catalog items, is probably now a dinosaur under the CPSIA – the law provides a strong incentive to reduce our product line to 50-150 items, a manageable undertaking under the new rules, and focus on high volume customers only. The efficiencies of selling only in large runs to large customers will drive many enterprises to abandon business models involving large product lines.

II. Regulatory and Business Complexity:

The complexity of compliance with the CPSIA is excessive for most businesses, large or small, but is particularly unmanageable for small businesses. Even for the tiniest companies, specialized systems will be needed to manage the chore of continually changing lot markings and retaining the data necessary to make tracking labels useful. For most small businesses,

specialized staff and expensive specialized software will be necessary to administer the labeling process. The scale of the chore is mindboggling. We estimate for our company that we will face as much as 30,000 label changes per annum. In our group of companies, annual label changes may exceed 75,000 (about 1,500 changes per week). In addition, supply chains will need new manufacturing protocols by product type, material type, packaging type, component type, assembly strategy, factory location, and so on. Many items produced by small businesses will be challenging to label properly (e.g., items with multiple production dates, multiple sources, many components, small parts, designed for aesthetics or special functionality, etc.). Many small businesses will be defeated by such a tedious bureaucratic undertaking, all to improve on recalls that may never occur.

Small businesses don't have the resources to manage compliance with ultra-complex laws, and will throw up their hands in frustration. Our company has already lost customers for our entire category on the grounds that selling toys is too confusing or too much of a "hassle". This is our new market reality. We know of businesses that employ retail managers who earn \$8.50 per hour. Other stores might have an owner/manager supported by 4-5 hourly workers, often local high school kids. Small businesses like these cannot manage demanding legal compliance schemes among their other burdens. It is unrealistic to assume that a precautionary law will not adversely affect the economics of small businesses ill-equipped to deal with it.

Administering the law is made more difficult by the emerging gap between the law itself and the implementation of the CPSIA by the CPSC. Unfortunately, implementation of the law has become so pockmarked by CPSC exceptions, FAQs, clarifications, letter opinions and stays that the CPSIA itself no longer describes the way it is being enforced. As a consequence, well-intentioned companies may implement the law against themselves at great expense. The apparent insistence of Congress that the CPSC interpret the law with "common sense", rather than amend

the law itself to conform to common sense, will hurt small companies ill-equipped to navigate these complicated legal waters.

III. **Significant Liability Risk:**

A knowing violation of the CPSA, FHSA and other applicable consumer rules enforced by the CPSC can result in civil or even criminal liability under the CPSIA (15 USC §2069-70). Small businesses know about the potential for liability under the CPSIA and are shying away from behavior they consider “risky”. This is why some thrift stores have begun to discontinue the sale of the children’s merchandise. See www.boston.com/community/moms/articles/2009/02/27/lead_law_puts_thrift_stores_in_lurch.

Risk of liability will cause small business markets to shrink.

Even following the implementation rules of the CPSC is no assurance of avoiding liability under the new law. The CPSIA provides that the State Attorneys General may independently enforce the new law (15 USC §2073). In other words, the actions and views of the CPSC are not enforceable against the State Attorneys General who may enforce their own interpretations of the law. Small businesses have no capacity to monitor the activities of 50 different State Attorneys General and the CPSC, or maintain relations with each of them. This rule introduces uncontrollable random risk and political risk to small American businesses.

Because all violations of the CPSA and FHSA must be self-reported to the CPSC within 24 hours (15 USC §2064(b)), the CPSIA renders all violations of the law an “emergency”, irrespective of risk of injury (if any). The significance of the violation is not a consideration in the self-reporting requirement. As a manufacturer with a product of about 2,000 items, we are fearful of being in a constant state of crisis under this provision. The odds of regularly uncovering technical violations (missing warning label on our website, etc.) is high with so many products in our product line. Each such incidence might constitute a “knowing violation” giving

rise to criminal liability unless immediately acted upon. The wear and tear, not to mention the expense, of constant crisis will be a major problem under the new regulatory scheme.

The prospect of liability (civil and criminal) under the CPSIA is driving a refocus of children's product businesses away from product development, marketing, sales and infrastructure investment toward bureaucratic excellence. The diversion of resources toward unproductive, liability-minimizing activities certainly violates the Pareto Principle (80/20), which dictates that a properly organized business will allocate its resources to the activity which produces the greatest economic return. The precautionary CPSIA creates inefficient incentives which favor heavy investment in unproductive, non-revenue producing overhead – and passing along these inefficiencies in the form of higher prices to an unsuspecting public. The illusion of improved safety cannot overcome the reality of dollars that won't go as far, buy as much or provide as high a standard of living as prior generations enjoyed.

Recommendations and Conclusion:

The dangers of a precautionary approach to legislation are clearly demonstrated by the impact of the CPSIA on the small business community serving children's markets. The solution to the dilemma is to restore the authority of the CPSC to administer safety using risk assessment as its guiding principle. This will allow the agency to refocus its attention on risks that present a danger of actual injury, and avoid wasting resources on pens, library books, bicycles, educational materials, sweaters and shoes, unless they present a quantifiable risk of injury. For the small business community, a more rational system of regulation, with fewer hair trigger liability rules, will also allow productive commerce to resume. Reasonable protection for thrift stores in this proposed common sense safety regime would naturally follow.

To ensure better compliance in the future, the reconstituted CPSC should put more resources into market education and a commercial liaison function. The CPSC in its early days had more "outreach" resources to help companies solve their safety issues without threat or

coercion. Improved industrial relations will return a higher dividend than implementation of a penal, restrictive regulatory scheme. I urge the Subcommittee to carefully consider these issues and to encourage the House Committee on Energy and Commerce to reopen this problematic law and fix it once and for all.

Thank you for considering my views on this important subject.