

## Counting the costs of corporate misconduct: Analyzing a lethal product-harm crisis

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### ABSTRACT

This teaching case provides students with an opportunity to examine a real-world instance of corporate misconduct using Peloton Interactive's mishandling of their Tread+ product safety problem and recall. Senior leaders have historically struggled with strategic decisions relating to product safety problems as they pose a challenge owing to the costly financial, reputational, and legal damages that frequently ensue from well-publicized product recalls. Peloton's Tread+ product safety problem is a tragic example of these decision-making challenges where students can analyze the reasonableness of the actual penalty and corrective action imposed by a regulatory agency, which, in this case, was the Consumer Product Safety Commission. The Consumer Product Safety Commission is a government agency in the United States that protects consumers and enforces penalties for Commission-directed statutes and regulations. The case develops students' critical thinking and analytical skill set through four discussion questions. These discussion questions enable students to provide hypothetical advice or counsel to the Consumer Product Safety Commission as well as evaluate the Commission's actual consequences, including the likelihood it will successfully deter future misconduct. Analyzing the Consumer Product Safety Commission's settlement agreement with Peloton allows students to not only identify salient features that contributed to the Commission's decision-making process but also develop alternative courses of action that could have been pursued. The case is appropriate for undergraduate and graduate students in management courses with curriculum featuring strategic or ethical decision-making as well as corporate misconduct.

Keywords: Corporate misconduct, organizational wrongdoing, corrective actions, ethics, product recalls, strategic decision-making

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## INTRODUCTION

Corporate misconduct encompasses a diverse array of business events and occurs when organizations cross the line between right and wrong (Greve et al., 2010). Product safety problems represent one type of corporate misconduct that has garnered increased attention (e.g., Mayo et al., 2022; Muralidharan et al., 2022). For product safety problems to rise to the level of misconduct, they must threaten consumer safety as companies either negligently or deliberately allow dangerous or defective products to circulate in the open market (Hersel et al., 2019).

In the United States, several government agencies oversee product safety problems and recalls with the most well-researched being the Consumer Product Safety Commission, Food and Drug Administration, and National Highway Traffic Safety Administration (Cleeren et al., 2017; Li et al., 2022). While each government agency has unique processes for managing product recalls, this case specifically focuses on Peloton's Tread+ product safety problem and eventual recall, which the Consumer Product Safety Commission oversaw.

## PELOTON INTERACTIVE

On January 5, 2023, the Consumer Product Safety Commission announced a settlement agreement with Peloton for corporate misconduct. The misconduct arose from Peloton's recall-related actions of its Tread+ treadmill, and the settlement agreement contained two primary elements. First, the settlement agreement included corrective actions, which sought to shield consumers from future injury. These corrective actions required Peloton to develop an enhanced compliance program, file annual reports, and detail any updates to its internal controls and procedures. Second, the settlement agreement acknowledged the seriousness of the misconduct as Peloton agreed to pay a civil penalty totaling \$19.065 million – one of the highest civil penalties in recent record. The misconduct and resultant civil penalty centered around two chief claims (a) failure to report a product safety problem in a timely manner, which resulted in civil penalties of \$16.025 million and (b) unlawful distribution of recalled products, which resulted in additional penalties of \$3.040 million<sup>1</sup>. Each claim is reviewed next.

Regarding Peloton's failure-to-report claim, the Consumer Product Safety Commission asserts (2023a) that starting in December 2018, and progressing into 2019, Peloton became aware of the entrapment hazard caused by its Tread+ treadmill. The entrapment hazard arose because the Tread+ could pull children, adults, and pets underneath the treadmill's back end, creating the possibility of consumer harm or death (Consumer Product Safety Commission, 2021b). While crisis communication experts recommend for companies to proactively announce a swift recall as part of a customer-focused strategy, Peloton implemented a reactive strategy that delayed the recall announcement (Claeys, 2017). The Consumer Product Safety Commission (2023a) found that during the delay Peloton internally reviewed the product safety problem where the company sought to change the location of the Tread+ warning label and investigate the practicality of a design update to stop future entrapments. Yet, Peloton did not contact the Commission about the entrapment hazard; that is, until tragedy struck over two years later.

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<sup>1</sup> The settlement agreement with Peloton was published in the Federal Register. All references to the settlement refer to this published agreement, unless otherwise noted. The case used this settlement to review the Consumer Product Safety Commission's and Peloton's claims.

On March 3, 2021, Peloton learned that a six-year-old child had been fatally injured after becoming entrapped under the Tread+ treadmill. One day later, on March 4, 2021, Peloton notified the Consumer Product Safety Commission of the Tread+ safety concern and a product recall announcement followed about one month later on May 5, 2021. The product recall announcement from May 5, 2021, stated that Peloton had received some 72 incident reports prior to the child's death – including 29 reports of injuries to minors ranging from second- and third-degree abrasions to lacerations and broken bones (Consumer Product Safety Commission, 2021b). However, subsequent releases from the Consumer Product Safety Commission (2022) place the number of incident reports closer to 150 then increasing to 335.

The Consumer Product Safety Commission purports the incident reports prior to the six-year-old's death suggest that Peloton had ample warning of the entrapment hazard and deliberately neglected its mandated reporting duty. As Commissioner Rich Trumka Jr. (2023) commented, "It took tragedy striking for Peloton to act [...] Had Peloton reported incidents on time, this child might still be alive today" (p. 1). Thus, the Commission asserts that despite Peloton's a priori knowledge of the safety issue the company neglected its duty to inform the agency immediately about the entrapment risk, which is mandated in the Consumer Product Safety Act.

On April 17, 2021, before Peloton's recall announcement, the Consumer Product Safety Commission took the unusual measure and individually released a Health and Safety Notice warning that asked consumers to discontinue use of the Tread+. The Consumer Product Safety Commission (2021a) notes that this "urgent warning" was released about 30 days after Peloton confirmed the six-year-old's fatality in a note to Tread+ consumers. John Foley, who then served as Peloton's CEO, wrote to consumers about "a tragic accident involving a child and the Tread+, resulting in, unthinkably, a death" (Peloton, 2021a, paragraph 1). Although Peloton acknowledged the tragedy, the company did not issue a voluntary product recall immediately and instead took a defensive posture by calling the Commission's warning "inaccurate" and "misleading" (Peloton, 2021b). It took almost three weeks for Peloton to change their position and acknowledge their mistake. While some applauded Peloton's public apology, it followed staunch criticism and likely represented an attempt to repair the brand's severely damaged reputation and relationship with consumers.

Regarding Peloton's unlawful distribution claim, the Consumer Product Safety Commission (2023a) asserts that between May 5, 2021, and August 2021, Peloton intended to distribute 38 recalled Tread+ treadmills to consumers. Distributing a recalled product is unlawful under the Consumer Product Safety Act, however, Peloton appears to dispute this unlawful distribution claim in the settlement agreement, saying they have a program specifically for product safety compliance, which would have barred the transport and distribution of recalled products such as the Tread+. As further support, Peloton states it had specifically asked its distributors to pause deliveries before the Tread+ recall. Peloton's statement that they paused deliveries appears to directly conflict with the Commission's claims, but, in an interesting disclosure in the settlement agreement, the firm indicates that an internal review revealed the "post-recall distribution of Tread+ units" – news which Peloton emphasizes they voluntarily offered to the Commission (Consumer Product Safety Commission, 2023a, p. 1195).

As a more omnibus statement, Peloton responded to the Consumer Product Safety Commission's (2023a) claims and confirmed they entered in the settlement agreement to resolve the Tread+ treadmills product-harm crisis and to prevent the expense, interruption, and ambiguity of prolonged court cases and legal proceedings. Peloton indicated in their response that the

settlement agreement was not an admission of guilt nor an indication the firm had violated any laws. However, Peloton's (2021c) public messaging unsurprisingly communicated a much different approach – one where the company expressed regret and admitted that they should have cooperated and acted in tandem with the Consumer Product Safety Commission from the start.

Although this was Peloton's initial offense, the Consumer Product Safety Commission emphasized the importance of implementing penalties that will serve as deterrents to executives who disregard the Commission's mandatory reporting requirement and threaten consumer safety. Commission Chair, Alexander D. Hoehn-Saric (2023), indicated that the settlement agreement with Peloton illustrated the agency's dedication to holding transgressing companies accountable for their wrongdoings and mission to creating a safer environment for all.

In conclusion, the Consumer Product Safety Commission believes Peloton endangered consumers by declining to report that the Tread+ treadmill posed a risk of injury to consumers plus knowingly distributed recalled treadmills. Peloton agreed to pay a civil penalty and the firm's then-CEO and cofounder called their initial response a mistake. Nevertheless, Peloton did not freely admit guilt in the settlement agreement reached with the Commission.

However, Peloton's recall woes appear to be far from over. On May 11, 2023, Peloton issued a different recall for approximately 2.2 million Model PL01 Bikes due to a fall and injury hazard after receiving 35 incident reports, resulting in 13 injuries (Consumer Product Safety Commission, 2023b). Peloton seems to have learned its lesson from the Tread+ recall as the firm collaborated with the Consumer Product Safety Commission on the Model PL01 Bike recall. Still, Peloton used a reactive strategy because the recall was announced only after consumers were injured – not before. The news of the Model PL01 Bike recall was ill timed as it coincided with a 9% stock price drop from Peloton's poor third quarter earnings (Piñon, 2023). Peloton's fiscal performance and successive recalls have increased shareholders' concerns, suggesting their new CEO, Barry McCarthy, will face an uphill battle to successfully turnaround the company.

## DISCUSSION QUESTIONS

1. Do you believe Peloton's civil penalty of \$19.065 million was an appropriate amount? Explain your position.
2. If you were advising a member of the Consumer Product Safety Commission, what consequence(s) would you have recommended given Peloton's handling of the Tread+ recall and severity of the product safety problem?
3. What counsel would you offer the Consumer Product Safety Commission regarding the primary elements of Peloton's enhanced compliance program? As an advisor, what internal controls would you require Peloton to implement, and what content would you mandate Peloton to provide in its annual report to the Commission?
4. Do you think the Consumer Product Safety Commission's consequences for Peloton will serve as a deterrent, which thwarts future incidents of corporate misconduct and makes consumer products safer? If so, provide a justification. If not, provide one or more alternative consequences that you believe would have been more effective.

## TEACHER'S NOTE

### Learning Outcomes

This case provides students with an opportunity to analyze the Consumer Product Safety Commission's decision regarding the consequences imposed for Peloton's mishandling of the Tread+ safety problem. At the conclusion of this case, students will have gained practice with:

- Analyzing a real-life business situation featuring allegations of corporate misconduct,
- Assessing the effectiveness of punitive actions designed to prevent future incidents of misconduct, and
- Recognizing the strategic principles required to render managerial decisions and formulate alternatives.

### Intended Audience and Instructional Design

This case is well suited for either undergraduate or graduate management courses that have a curricular focus on ethical dilemmas, corporate misconduct as well as strategic decision-making. Students are not required to have extensive knowledge of corporate wrongdoing nor product recalls; however, faculty are encouraged to assign this case when they are covering ethical problems or real-life quandaries that managers face and the practices commonly available for evaluating and solving them.

This case is best covered during two class sessions. During class session one, faculty should begin by assigning students the case to read and then asking them to conduct their own research on the Consumer Product Safety Commission's handling of the Tread+ safety problem and recall as well as Peloton's communications and actions surrounding the actual event. Next, students should work independently or in groups to answer the four discussion questions, which allows for ample preparation before the classroom discussion. Case preparation is important because it allows students to deeply engage with the content and develop their own managerial approach and strategic stance prior to class.

During class session two, the classroom discussion occurs. Faculty should take on the role of facilitator during the classroom discussion where they are moderating peer-to-peer dialogue, creating a safe space for intellectual curiosity and growth amongst students. Such discussion allows students to examine their assumptions, introspectively reflect, and build on their peers' contributions to gain a more fulsome understanding of the Peloton case. Faculty should use the four questions provided in the case to guide the classroom discussion, and, to bolster engagement, below are pedagogical considerations for each question.

## PEDAGOGICAL CONSIDERATIONS

### Question 1: Pedagogical Considerations

Discussion Question 1 asks students to evaluate the Consumer Product Safety Commission's decision regarding Peloton's civil penalty. The objective is to develop students' analytical skills by examining the appropriateness of the amount.

Faculty can enhance their students' analysis by asking them to review the Commission's (insufficient) procedures for civil penalties and adding a comparative case – Vornado Air. In

Commissioner Peter Feldman's (2023) press release about Peloton, he communicated concern that the Consumer Product Safety Commission lacked a consistent enforcement policy regarding civil penalties for product safety concerns. For illustration, Commissioner Feldman (2022a) offered the case against Vornado Air from July 7, 2022. The Consumer Product Safety Commission and Vornado Air reached a settlement where the company would pay a penalty of \$7.5 million. Peloton's civil penalty is over two times larger than Vornado Air's charged amount. Similar to Peloton, Commissioner Feldman (2022a) states that Vornado Air failed to report a known product safety issue that led to consumer injuries and a fatality of an elderly veteran. However, unlike Peloton, Vornado Air was a repeat offender, and, of equal concern, Commissioner Feldman's statement (2022a) indicated there was evidence that Vornado's senior management was aware of the product defect by 2014, at the earliest, and might have willfully hidden this from the agency. Commissioner Feldman (2022a) asserts Vornado Air allowed their defective product to circulate within the open market for nine years – between 2009 and 2018.

Further Commissioner Feldman (2023) goes on to comment in his press release about Peloton that he still is unsure “how to explain the discrepancy in settlement amounts,” saying that “no one at the Commission has articulated a coherent underlying doctrine or principle.” It is likely for this reason that Commissioner Feldman remains “concerned” that the Commission does not have a “coherent enforcement policy when it comes to civil penalties” (p. 1)

Finally, in Commissioner Feldman's (2022a) press release about Vornado Air, he specifically notes the importance of penalizing wrongdoing, saying that failure to do so “will embolden companies to continue to ignore their reporting obligations and jeopardize our ability as a Commission to fulfill our mission to keep consumers safe” (p. 2).

The discrepancy between Peloton and Vornado Air's civil penalties offers an opportunity for classroom debate – was either Peloton or Vornado Air's civil penalty reasonable? Faculty are encouraged to ask their students about the lack of consistency regarding the Commission's civil penalties and how this impacts their evaluation. For example, how can the reasonableness of a civil penalty amount be determined without consistent procedures? Could the class offer any mitigating factors that could justify the differences between Peloton and Vornado Air's penalties?

## **Question 2: Pedagogical Considerations**

Discussion Question 2 asks students to formulate their own consequences for Peloton, which may, or may not, align with the Consumer Product Safety Commission's decision. The aim is to expand students' problem-solving skills as they develop their own recommendation regarding Peloton's penalty. One way faculty can help in the evaluative process is to assist students in their analysis of ‘why’ Peloton's conduct occurred.

There are many product safety factors that may have contributed to Peloton's conduct, but prior research suggests that the severity of the hazard as well as the speed with which firms notify the appropriate regulatory agency and consumers are especially salient to the recall process (Eilert et al., 2017; Hora et al., 2011). The severity of the recall hazard, unsurprisingly, influences consumer reactions to product recalls where highly hazardous products garner the most negative consumer responses. Firms that announce a recall swiftly after learning of a product safety problem – or even the potential for one – prioritize consumer wellbeing by decreasing the amount of time the dangerous product is available for purchase. From a consumer welfare standpoint, it is apparent that low-hazard products that are recalled quickly save lives. So, the obvious question is: Why did Peloton delay contacting the Commission regarding a

historically hazardous product until after the tragic death of a six-year-old and many incidents were reported? What factors may have contributed to Peloton's delay of the Tread+ recall?

The 'true' logic that drove Peloton to delay the Tread+ recall admittedly rests with their senior leadership team, but empirical evidence indicates that product-recall decisions are difficult because when companies act to promote consumer wellbeing it can result in stock price declines, financial costs, and heightened shareholder concerns (Chen et al., 2009). Questions remain regarding whether senior leaders are fiscally rewarded for prioritizing consumer safety, and, of equal concern, empirical evidence suggests that CEOs may 'throw caution to the wind' as incentive systems may tempt them to act according to their personal interests (Liu et al., 2016; Wowak et al., 2015). Thus, product-recall decisions and the factors influencing the process are exceedingly complex, which explains why some executives are dubious of acting proactively and following expert advice by announcing a decisive, immediate recall (Claeys & Coombs, 2020; Coombs, 2018; Siomkos, 1999).

Faculty may find it beneficial to inquire whether the class believes Peloton's leaders delayed the Tread+ recall to promote the firm's interests over those of their consumers, asking, for example, whether students think the leadership team sought to shield their firm from post-recall backlash or simply wanted to contain the recall in an attempt to keep the product safety problem hidden from the public. Promoting a classroom discussion about (a) how the severity of the entrapment hazard and (b) the extent to which Peloton delayed the recall affects students' recommendation about Peloton's penalty offers robust opportunity for peer-to-peer debate.

### **Question 3: Pedagogical Considerations**

Discussion Question 3 presents students with an opportunity to design their own guidance about Peloton's enhanced compliance program, annual reports, as well as updated internal controls and procedures. The intent is for students to provide their own analysis, which is evaluated vis-à-vis the Commission's actual description after working through the case questions. The Consumer Product Safety Commission (2023a) explicitly outlines the requirements in its settlement agreement with Peloton. Thus, students can be shown the Commission's official decision, and these requirements are provided in point 34, 35, and 36 of the settlement available through the Federal Register.

During the case analysis, faculty may consider asking students whether they believe the Commission should have mandated a third-party compliance monitor as part of its agreement with Peloton. The Seventh Federal Circuit Court of Appeals asserted the Commission's ability to mandate third-party monitoring to further compliance from the charged company. (For more details see the *United States v. Spectrum Brands, Inc.*, No. 18-1785 [7th Cir. 2019])

Commissioner Peter Feldman's (2023) press release discusses third-party compliance monitors and notes that, "Until recently, the Commission has used its injunctive authority to require third-party monitors in cases where there was a reasonable likelihood of future violations" (p. 1). In a recounted commentary from August 2, Commissioner Feldman (2022b) discusses that the requirement of third-party monitors is not unprecedented, stating that since 2010 he is aware of the Commission using its authority at least four times. However, with respect to Peloton, Commissioner Feldman (2023) was "comfortable accepting this penalty without a monitor," indicating that his analysis of Peloton's misconduct seemed to result from a "loss of control of its product distribution during unique pandemic circumstances" (p. 1).

Faculty are encouraged to ask students to assess the positives and negatives of the Commission's enhanced compliance program plus identify areas for further development. Including a discussion that centers on the necessity of a third-party monitor may illuminate other points for analysis especially if students are asked whether they agree with Commissioner Feldman's assessment and would have accepted Peloton's penalty without a monitor.

#### **Question 4: Pedagogical Considerations**

Discussion Question 4 asks students to evaluate the effectiveness of the Consumer Product Safety Commission's consequences in deterring future incidents of misconduct. Then, Discussion Question 4 has students justify their answer, including the chance to propose new and potentially more effective deterrents. The goal is for students to assess the soundness of an established decision plus consider whether they would have selected an alternative approach. Faculty may find the following two elements enhance their students' decision-making process.

First, the Consumer Product Safety Commission also has the authority to bring both civil and criminal penalties. Thus, in addition to the civil penalty already charged against Peloton, the Commission could also bring criminal penalties, too. Does the class feel that utilizing criminal penalties in addition to civil penalties would reduce future misconduct incidents? Are criminal penalties warranted for Peloton's conduct?

Second, a monetary comparison of the Commission's civil penalty against Peloton's losses provides an interesting context to qualify the effectiveness of the deterrent. In May 2021, Peloton projected the Tread+ recall would reduce the firm's revenue by some \$165 million, resulting in a \$16 million profit decrease (Isidore, 2021). Two years later, Peloton's (2023) shareholder letter for the third quarter indicates that product recall related matters are still impacting its financial health. Based on these financials, do students believe that the Consumer Product Safety Commission's civil penalty will be an effective deterrent? Would they have recommended a lower or higher civil penalty based on Peloton's losses.

Faculty may encourage debate over the Consumer Product Safety Commission's consequences, having some students defend the deterrents (i.e., explain why they will reduce future incidents of misconduct) while other students critique the deterrents (i.e., explain why they will not reduce future incidents of misconduct). Having students on each side of the debate sets the stage for a comprehensive discussion. Then, afterward, faculty may ask students from both sides to come together and contribute their own proposals about developing effective deterrents.

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