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'Honey Laundering' Signals A New Enforcement Era

Law360, New York (February 21, 2013, 11:06 PM ET) -- In the world of white collar crime, Chicago is clearly shedding its "Second City" moniker. On Feb. 20, 2013, the government announced headline-grabbing charges against two heavyweight domestic honey-processing companies and five individuals in connection with the government's global "honey laundering" sting. The detailed charges allege not only the record-breaking illegal importation of honey from China without paying anti-dumping import duties, but the introduction into commerce of adulterated honey.

The allegations are startling: Not only did the defendants mislabel honey to avoid more than $180 million in anti-dumping duties, but they also imported and sold honey adulterated with unapproved antibiotics.

This pioneering case is double-billed as the largest anti-dumping case in U.S. history and the nation's largest food-fraud case, shattering the prior record of about $80 million set two years earlier by the same enforcement team. But the real story may be what this case signals about the governmental enforcer's amplified focus on supply chain compliance — and the lengths they will go to in their effort to make their charges stick.

Why Have Import Duties on Chinese Honey?

In 2001, the U.S. Department of Commerce determined that honey from China was being sold in the U.S. at less than fair market value. In response, the government implemented anti-dumping laws imposing hefty duties on Chinese-origin honey.

So how well did these standard protectionist regulations work? Industry insiders had long speculated that companies illegally worked around these anti-dumping laws using one or more of three separate strategies: (1) mislabeling honey as sugar, molasses, or another similar product, (2) mislabeling honey coming directly from China as coming from another country, and (3) transshipping honey from China through another country and claiming it as the country of origin. (Notably, Texas-based Honey Holdings, doing business as Honey Solutions, and Michigan-based Groeb Farms are, in fact, charged with knowingly buying honey that illegally entered the country in avoidance of applicable anti-dumping duties under all three of these strategies.).

Meanwhile, in 2002, the U.S. Food and Drug Administration issued an alert for honey containing the antibiotic Chloramphenicol, which is used to treat serious infection in humans, but is not approved for use in honey. Honey containing the antibiotic is considered to be "adulterated." (And Honey Holdings is charged with knowingly importing and distributing such adulterated honey from Poland.)

Honey Laundering Sting Highlights

Supply Chain Audits Were Performed ... And Executives' Handling of the Results Gave Rise to Criminal Liability

The two charged companies — Groeb Farms and Honey Solutions — rank among the world's largest honey processors, selling honey to the industrial, retail and foodservice sectors. The individual defendants, in turn, are executive-level food brokers and distributors. The government alleges that from 2008 through 2012, Groeb Farms implemented first-party onsite supply chain audits and inspections of manufacturers and suppliers to insure compliance with all laws, including honey import laws. As luck would have it, the government says these detailed audits raised substantial concerns that honey from overseas suppliers was illegally transshipped and misdeclared. One supplier even refused auditors access to facilities (a classic supply chain "red flag").

Despite these clear warning signs signaling significant supply chain problems, Groeb Farms continued to buy honey sourced from these suppliers. Executives, indeed, even went so far as to knowingly provide false information to their board of directors, and to market and promote the company's business practices as compliant with applicable laws.

The company's failure to conduct meaningful supply chain due diligence, its executives' willful blindness toward evidence of illegality, and the resulting cover-up, led to the current charges.

The Government Used an Undercover Agent Inside an Operating Company

In 2011, Honey Holdings began cooperating with the government in its efforts to identify others engaged in illegal importing. This included the placement of an undercover law enforcement officer in Honey Holdings as its "director of procurement." But unlike other cases, this undercover was not inserted in a government-created undercover company. Rather, the undercover was, rather exceptionally, placed into a real operating company unaffiliated with the government.

This style of sophisticated, aggressive and proactive investigation was once the sole province of agents and prosecutors working narcotics and other organized crime cases. If the apparent success in Honey Holdings is any indication, this may well be a sign of things to come in this area.

The Corporate Defendants' Mandatory Corporate Compliance Programs Parallel SEC Conflict Mineral Rules

In addition to other significant concessions in a white collar case — such as promising to cooperate fully with the federal government, produce all documents requested, make employees available for testimony, voluntarily dispose of the illegal honey, and pay a millions of dollars in fines — Groeb Farms and Honey Holding, as part of their respective deferred prosecution agreements (DPAs), agreed to implement effective corporate compliance programs.

More specifically, under the agreed-to compliance programs, the companies must conduct "reasonable country-of-origin and supply chain inquiries" for their honey — thereby adopting a standard similar to the U.S. Securities and Exchange Commission's recently released final conflict minerals rules. Significantly, as part of its risk assessment — and in what appears to be a first-of-its-kind provision — the companies are required to proactively diligence their suppliers by conducting supply chain audits; key criteria include "the willingness and extent of access granted [by the suppliers] for the audits; thoroughness, scope, and frequency of the audits; and the training, expertise, and credibility of the auditor."

The mandated compliance program also requires the companies to educate their customers regarding (1) their policies on traceability and (2) food laws. These requirements are perhaps not coincidentally evocative of the disclosures required by other "hot topic" supply chain compliance laws and regulations, including the president's Sept. 25, 2012, Executive Order on Trafficking in Federal Contracting; the California's Transparency and Supply Chains Act; and the pending Business Transparency on Trafficking and Slavery Act (H.R. 2759).

Industrywide Sweep: Record-Setting Case

In a rare move, the government entered into the two above-referenced DPAs with Groeb Farms and Honey Holdings (but only assessed $2 million and $1 million, respectively, in fines based on both companies' ability to pay), while simultaneously criminally charging five individuals (one of whom is a Canadian citizen). This case, therefore, stands in stark relief to the oft-criticized U.S. Department of Justice practice of entering into DPAs with companies while leaving the individuals who actually engaged in the underlying illegal conduct uncharged.

Defendant Douglas Murphy of Early FCPA Fame Convicted Again

Also charged was former Honey Holding executive, Douglas Murphy. Murphy, indeed, is no stranger to federal court. In June 2005, a federal judge in Texas handed the former American Rice Inc. president and CEO the then-longest sentence for violating the Foreign Corrupt Practices Act. Murphy at his 2004 trial was convicted of bribing Haitian customs officials and obstructing justice. Although his 63-month sentence was later eclipsed by Joel Esquenazi's 2012 180-month sentence (which is being appealed by co-author Funk and his colleague Michael Sink), the case drew wide attention and in a sense signaled the start of today's ramped-up FCPA enforcement.

This appears to be the first time in U.S. history in which the government has brought new charges against a previously convicted FCPA defendant. (In fact, based on the government's allegations and Murphy's plea agreement, Murphy may have committed the food fraud offense while on release from custody during his appeal in the Fifth Circuit in United States v. Kay.)

The Lesson: Supply Chain Compliance is Serious Business — and the Government is Starting to Treat it as Such

Even setting aside the eye-catching numbers and other historic aspects of this noteworthy case, what stands out is the government's aggressive stance toward (1) investigating the case and (2) negotiating both DPAs with the companies and plea agreements with some of the key defendants.

This case provides companies with complex supply chains an even greater incentive to conduct appropriate due diligence and ensure that their audit results are taken seriously. The government has put companies on notice that supply chain audits originally intended as corporate shields to liability may now serve as the government's sword to convict the corporation if the audit results are ignored or not taken seriously.

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