Honeygate II Highlights Supply Chain Risks For U.S. Buyers Of Imported Goods

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Kelley Drye & Warren LLP

Michael J. Coursey

Still buying imports of dubious foreign origin from unrelated U.S. importers? Consider the case of Groeb Farms, Inc., which recently accepted criminal responsibility for fraudulently entered Chinese honey that had avoided $79 million in duties – despite not being directly involved in the honey’s importation.

The takeaway: Not being the importer of record for fraudulently entered goods does not insulate a “knowing” downstream buyer from criminal liability for that fraud.

Fraud Schemes For Importing Chinese Honey

In 2001, the government determined that Chinese honey was being dumped in the United States at below-cost prices and was economically injuring domestic honey producers. Since then, the government has imposed antidumping duties on imports of Chinese honey equal to twice their value. The following year, the Food and Drug Administration (“FDA”) began subjecting Chinese honey imports to heightened inspection for chloramphenicol, a banned animal antibiotic that is highly dangerous for humans.

With the imposition of dumping duties and heightened FDA inspection, Chinese honey imports shrank briefly but soon surged again when dishonest Chinese exporters and their U.S.-based accomplices implemented fraud-based schemes to evade – or “circumvent” – those restrictions.

In one scheme, the importer would falsely report to U.S. Customs and Border Protection (“CBP”) that the Chinese honey being entered had been produced in a foreign country other than China that was not subject to dumping duties or heightened FDA inspection. In another, the importer would falsely tell CBP that while the imported product was made in China, it consisted of a sweetener other than honey that was not subject to the restrictions on Chinese honey.

Honeygate I

By 2007, large volumes of low-priced Chinese honey were being illegally imported through the two evasion schemes and had driven U.S. honey prices back to below-cost levels. One suspected importer was Alfred L. Wolff USA – the Chicago-based subsidiary of Alfred L. Wolff GmbH (“Wolff”), which then was the world’s largest honey trader, with headquarters in Germany and subsidiaries in five countries, including China and Hong Kong. Public trade-tracking sources showed that since 2004, Wolff USA had imported thousands of tons of honey from Asian countries other than China that were not significant honey producers.
In March 2008, agents from U.S. Immigrations and Customs Enforcement ("ICE") launched what became known as Honeygate I by raiding Wolff's Chicago office and confiscating its hard and electronic records. Two months later, ICE agents arrested two senior Wolff executives as they attempted to flee to Germany, their home country. When these two agreed to cooperate with the government – a task that required them to remain in Chicago wearing ankle bracelets for several years – Wolff fired them.

In October 2010, the Office for the U.S. Attorney for the Northern District of Illinois (the "OUSA") indicted the Wolff companies in Germany, the United States and China, and ten Wolff executives, for fraudulently importing substantial volumes of Chinese honey as having been made in a country other than China or as a sweetener made in China that was other than honey. The government claimed that through these actions, the defendants avoided $80 million in dumping duties and entered a significant amount of Chinese honey tainted with chloramphenicol.

Wolff's German owners immediately dissolved the existing Wolff enterprise and reconstituted it in another food company they controlled, which so far has foiled further prosecution of the Wolff corporate enterprise. The two cooperating Wolff executives ultimately pled to reduced charges and received sentences that included substantial fines and, for one, an additional year in prison. To date, the other Wolff executives have avoided prosecution by remaining in Germany, though they are still listed as international criminal fugitives on Interpol's website.

Despite removing Wolff from the U.S. honey market, Honeygate I did not stop the flow of illegal Chinese honey because Wolff's customers – which included some of America's biggest honey buyers – started purchasing circumvented Chinese honey from shady new no-asset importers that filled the void left by Wolff. To complete its work in Honeygate I, the government had to deter those large honey buyers from continuing to purchase Chinese honey they knew had been fraudulently imported. The largest of these was Groeb Farms, which became one of the government's two main targets in Honeygate II.

**Honeygate II**

Groeb Farms had long been America's largest supplier of processed honey, accounting for almost a third of all processed honey sold in this country. Such suppliers – referred to as honey "packers" – purchase unprocessed "raw" honey in bulk from both domestic beekeepers and U.S. importers, process that honey to remove impurities, and sell it to retail stores, food service companies and food processors.

For years Groeb Farms was managed as a family-owned company by two Groeb brothers, Ernest and Troy. In March 2007, the family sold a controlling interest in the company to an outside investor, which – while establishing its own board of directors – retained the Groeb brothers as the company's two highest executives.

In February 2008, and unbeknownst to the board, the Groeb brothers began purchasing from U.S. importers and honey brokers substantial amounts of Chinese honey that the brothers knew had been fraudulently entered as having been made in a country other than China or as a Chinese sweetener other than honey. Over the next four years, the Groeb brothers purchased 1,578 shipment containers of fraudulently entered Chinese honey – about 50 to 60 million pounds – all of which Groeb Farms processed and sold to its customers as honey from Asian countries other than China, or as Chinese honey, depending on which entry scheme had been used. Those imports avoided $79 million in dumping duties, which gave Groeb Farms a substantial price advantage over honey packers that refused to buy circumvented Chinese...
honey. Throughout this period, the Groeb brothers concealed the fraudulent nature of their purchases from Groeb Farm’s new owner and board.

At some point in 2008 – and perhaps as a result of the publicity for Honeygate I – Groeb Farms’ board directed the Groeb brothers to put in place first-party supply chain audit and inspection (A&I) procedures to enable the company to verify the chain of custody of all its ongoing purchases of raw honey inputs. While the brothers in fact implemented such procedures, they ignored and covered up the many red flags raised during the subsequent audits and inspections that indicated that the “non-China” honey Groeb Farms was buying had actually been made in China.

In early 2012, Groeb Farms was served with subpoenas from a federal grand jury in Chicago concerning the country of origin for its purchases of imported honey. Duly alarmed, the board conducted an internal investigation that revealed the Groeb brothers’ purchases of fraudulently entered Chinese honey. The brothers were promptly terminated, and Groeb Farms’ purchases of such honey finally stopped in April 2012.

**Groeb Farms’ Deferred Prosecution Agreement**

In its plea negotiations with the OUSA, Groeb Farms likely learned that, in the government’s view, the Chinese honey the company had purchased had been unlawfully entered through the presentation of “false statements” at entry, in violation of 18 U.S.C. §542. Because Groeb Farms was not directly involved in the entry process, it couldn’t be charged with violating Section 542.

The company could, however, be charged for each purchase with violating 18 U.S.C. § 545, which makes it illegal for anyone to receive, buy or sell imported goods “knowing” they were imported “contrary to law” – which includes Section 542. Section 545 subjects individuals to per-incident sentences of up to 20 years, and companies and individuals to substantial monetary penalties. Given the large number of purchases at issue and the $79 million in avoided duties, Groeb Farms faced an enormous amount of potential fines.

The OUSA, however, did not indict the company. Instead, in February it asked a federal judge in Chicago to approve a deferred prosecution agreement (“DPA”) between the OUSA and Groeb Farms that proposed penalties that were a fraction of those the government could have sought. Under the DPA, the OUSA agreed

- to limit its charge against the company to one count under Section 545, for knowingly receiving 22 containers of fraudulently entered Chinese honey;
- to defer prosecuting that charge for two years, pending the company’s fulfillment of its commitments under the agreement; and
- to ask the court in two years to dismiss that charge if the company had met its commitments.

For its part, Groeb Farms agreed

- to accept responsibility for the conduct of its employees (i.e., the Groeb brothers) with regard to the company’s purchase of fraudulently entered Chinese honey;
- to immediately pay a $2 million fine;
- to give the OUSA its full cooperation in connection with the government’s other investigations and prosecutions involving the illegal importation of Chinese honey; and
• to implement additional rigorous and detailed supply chain A&I procedures designed by ICE and FDA to eliminate/minimize Groeb Farms’ future violations of U.S. import laws and regulations.

The OUSA’s DPA with Groeb Farms is by no means toothless, for it essentially requires Groeb Farms to meet the OUSA’s “cooperation” expectations while operating under the government’s close scrutiny for at least the next two years, or be subject to full indictment. Yet, the DPA struck many domestic beekeepers – the real economic victims of the company’s four-year duty evasion scheme – as being too lenient.

What convinced the government to settle with Groeb Farms under the DPA’s terms? According to Groeb Farms’ counsel, it was these points:

• Before approaching the OUSA, the company took substantial remedial action by firing the culpable employees and implementing enhanced supply chain A&I procedures, including thorough and ongoing training of all employees.
• The company’s financial statements showed that an indictment seeking the maximum monetary penalties would immediately bankrupt the company, leaving its many employees jobless.
• A $2 million penalty was all the company could pay and continue as a viable enterprise.
• Groeb Farms’ immediate felony indictment would disqualify it as a supplier under many of its customers’ bank credit agreements.
• Given Groeb Farms’ 30 percent share of the domestic processed honey market and the continued presence of dishonest importers and packers, the government and the domestic honey industry were better off with a “compliant” Groeb Farms than without it.[1]

As it turns out, the company now has other worries besides complying with the DPA. In April, several large commercial beekeepers filed two RICO-based class action lawsuits against Groeb Farms, the Groeb brothers and a second major honey packer with which the OUSA had also signed a DPA. Those lawsuits seek treble damages related to the beekeepers’ lost revenue caused by the defendant honey packers’ purchase and sale of the circumvented Chinese honey, and have now been consolidated in federal court in Chicago.[2]

Honeygate II underscores that a U.S. user or distributor of imported goods of dubious origin risks being prosecuted for customs fraud if the circumstances indicate that it purchased the goods “knowing” they had been fraudulently imported. Honeygate II also suggests that, given the prominence in the DPA of Groeb Farms’ obligation to adopt rigorous supply chain A&I procedures, the government now expects that all U.S. users and distributors of imports have already implemented and are maintaining such procedures as a matter of course. Thus, companies that haven’t done so face a heightened risk.


Michael J. Coursey is a Partner in the International Trade and Customs Law Practice Group at Kelley Drye & Warren LLP, which has represented the American Honey Producers
Association and Sioux Honey Association in connection with the antidumping duty order on honey imports from China.

Please email the author at mcoursey@kelleydrye.com with questions about this article.