CASE 6.4

Beech-Nut's Imitation Apple Juice

Thomas I. White

In 1988, the Beech-Nut Nutrition Corporation and two of its top executives admitted that they had knowingly sold adulterated apple juice. In fact, the baby food, although described on the label as "100% fruit juice," contained little if any apple juice. The company agreed to pay a $2 million fine, but the ultimate cost to Beech-Nut was closer to $25 million when the settlement of a class action suit, legal fees, and lost sales are included. The two executives, Neils L. Hoyvald, the firm's former president and CEO, and John F. Lavery, former vice-president of manufacturing, were fined $100,000 each and sentenced to jail terms of a year and a day. (A major part of the conviction and Hoyvald's imprisonment were dismissed when an appeals court ruled that the trial had taken place in the wrong court.)

This example of corporate wrongdoing combines fraud with a coverup and was apparently driven by ongoing and intense financial pressure at Beech-Nut. In 1977, Beech-Nut changed suppliers of the concentrate used to produce its apple juice when it was offered the product at 20 percent below market rates by Interjuice Trading Corporation. This resulted in an annual savings of $250,000—no small amount for a company that was financially strapped. Despite misgivings about the juice by Jerome LiCari, Beech-Nut's director of research and development, laboratory tests could not prove that the juice was counterfeit. By 1981, however, LiCari believed that there was enough circumstantial evidence to suggest that the concentrate was a blend of synthetic ingredients, and he claims that he notified senior management of his belief. By that time, however, Hoyvald had apparently promised Nestlé, the Swiss food concern that had bought Beech-Nut, that the company would turn around financially in 1982. Beech-Nut had been sold to Nestlé in 1979 and had lost $2.5 million in fiscal 1981. But Hoyvald pledged a profit of $700,000 for the following year, and the parent company apparently communicated to him that he must deliver. As Hoyvald put it, "The pressure was on." Changing suppliers and buying a more expensive concentrate would have made a profit impossible to achieve. Also, some Beech-Nut officials still pointed to the fact that there was no absolute proof that the apple juice was adulterated. (It is worth noting, however, that although Beech-Nut's policy was to stay with the concentrate as long as it could not be proven that it was counterfeit, other companies reversed the burden of proof and terminated a supplier if it could not prove that its product was genuine.) Some Beech-Nut officials also claimed that even if the juice were fake, it was not doing anyone any harm. The juice in the bottles might not be apple juice, but it was not a health hazard.

By mid-1982, however, a private detective hired by an industry association found proof that the concentrate was synthetic and presented it to Beech-Nut. The company did stop buying the concentrate at that time. But instead of publicly admitting the error, destroying or relabeling the inventory, and paying a fine, Hoyvald chose a strategy that would buy enough time to sell the $3.5 million worth of juice sitting in warehouses. The company refused to cooperate with an investigation against the suppliers and waited a few month. The product then was offered at large discounts to offshore distributors. To keep one step ahead of state law enforcement officials, inventory was even moved from one state to another. Hoyvald apparently believed that Beech-Nut's very existence was at stake. When asked by one of the prosecutors why the juice had simply not been destroyed, he replied, "And I could have called up Switzerland and told them I had closed the company down. Because that is what would have been the result of it."

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"What Led Beech-Nut Down the Road to Disgrace," *Business Week*, February 22, 1988, 124–128.

QUESTIONS

1. How seriously unethical is what Beech-Nut did? How seriously wrong is what Hoyvald and Lavery did?
2. How do you distinguish corporate from personal responsibility? Should the parent company, Nestlé, be held responsible for anything that happened?
3. Is the company's difficult financial condition an extenuating circumstance?
4. How relevant is the claim that the counterfeit juice did not hurt any babies who drank it?
5. If you were the judge in this case, what punishments would you assign the corporation and the individual executives?
6. What would the punishments look like if you used French's Hester Prynne Sanction, Shipp's modified vendetta, or Rafalko's beheading proposal?

CASE 6.5

Sentencing a Corporation to Prison

Thomas I. White

In 1988, Federal Judge Robert G. Doumar handed down an extremely unusual punishment for a corporation convicted of wrongdoing—he sentenced it to three years in prison. The Maryland-based Allegheny Bottling Company was found guilty of three years of price-fixing, and Judge Doumar wanted a penalty that would be sterner than the typical fine. "The corporation," explained the jurist, "could come in here, profit to the tune of $10 million and walk away with a $1 million fine." The punishment he chose, on top of such a fine, was [illegible] unexpected.

Judge Doumar later suspended the sentence and [illegible] of the fine, but he placed the company on [illegible]. The judge explained that in the case of a corporation, imprisonment amounted to placing [illegible] on the company's ability to operate. He [illegible] that four of the company's senior executives [illegible] two years of full-time community service. And he threatened that if the company failed to do so, he would close down its operations.

Allegheny Bottling, a Pepsi bottling franchise, was accused of collaborating with the Mid-Atlantic Coca-Cola Bottling Company to set wholesale prices. Before Allegheny's sentencing, the price-fixing scheme had already led to convictions of Morton Lapides, former chairman of Allegheny, and James Harford, former president of Mid-Atlantic Coca-Cola. Both men were sentenced to three years in prison, with all but six months suspended. Harford was also sentenced to three years of community service. In his order that four of Allegheny's executives perform community service, Judge Doumar specified that their positions and salaries must be similar to those of the executives already sentenced.

Attorneys for the company objected, pointing out that there was no precedent for imprisoning a corporation.

REFERENCE

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QUESTIONS

1. It is obviously difficult to punish a corporation, and one of the most frustrating aspects of trying to do so is that a fine can ultimately be passed along to stockholders, employees, or consumers—that is, people who had no hand in the wrongdoing pay the penalty. Is the Allegheny case a model of how to address this particular problem?

2. Two specific top executives were sentenced to prison and community service, Allegheny was ordered to have four other senior managers perform community service, and the company was ordered to pay a fine. How does this serve justice, broadly understood? Is such a model appropriately retributive for the crime? Would it deter other corporations? Most important, does it make any sense to sentence a corporation to imprisonment?

CASE 6.6

The Debate Over Doing Good

Brian Grow, Steve Hamm, and Louise Lee

Grow, Hamm, and Lee regularly report on current financial and corporate issues.

It's 8:30 a.m. on a Friday in July, and Carol B. Tomé is starting to sweat. The chief financial officer of Home Depot Inc. isn't getting ready to face a firing squad of investors or unveil troubled accounting at the home-improvement giant. Instead, she and 200 other Home Depot employees are helping to build a playground replete with swings, slides, and a jungle gym at a local girls' club in a hardscrabble neighborhood of Marietta, Georgia. Dressed in a white Home Depot T-shirt, a baseball cap, and blue capri jeans, Tomé tightens bolts, while others dump wood chips, mix concrete, and sink posts. The company, together with nonprofit playground specialist KaBOOM!, plans to build 1,000 more such kiddie parks in the next three years—and spend $25 million doing it.

Is this any way to build shareholder value at Home Depot, where the stock has been stuck near $43, down 35 percent from its all-time high? Chief Executive Robert L. Nardelli and his troops think so. Last year about 50,000 of Home Depot's 325,000 employees donated 2 million hours to communi service. Now, Nardelli is trying to encourage mo companies to volunteer at Home Depot's pace. A his invitation, executives from twenty-four comp nies and foundations gathered for five hours at Ho Depot's Atlanta headquarters in May to disc community service. Attendees included Lawren R. Johnston of Albertson's, F. Duane Ackerm of BellSouth, Gerald Grinstein of Delta Air Lin and William R. McDermott of SAP America. September 1st these CEOs and others will kick "A Month of Service," an ambitious plan, develo with community group the Hands-On Network deploy corporate volunteers on 2,000 projects acr the country, and raise the total number of volun by 10 percent, or 6.4 million, in two years. "We l at this activity with the same eye that we look at b ness," Nardelli says.

Yes, companies have long paid lots of mon and lip service—to philanthropy and public se But as Nardelli's confab indicates, managers all parts of American business are increasingl ing social responsibility as a strategic imper