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Into the Mouths of Babes

By JAMES TRAUB; JAMES TRAUB WRITES FREQUENTLY ON LEGAL ISSUES.
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LEAD: IT IS WELL WITHIN THE REACH of most white-collar criminals to assume an air of irreproachable virtue, especially when they're about to be sentenced. But there was something unusually compelling about the bearing of Niels L. Hoyvald and John F. Lavery as they stood before Judge Thomas C. Platt of the United States District Court in Brooklyn last month - especially in light of what they were being sentenced for.

IT IS WELL WITHIN THE REACH of most white-collar criminals to assume an air of irreproachable virtue, especially when they're about to be sentenced. But there was something unusually compelling about the bearing of Niels L. Hoyvald and John F. Lavery as they stood before Judge Thomas C. Platt of the United States District Court in Brooklyn last month - especially in light of what they were being sentenced for. As president and vice president of the Beech-Nut Nutrition Corporation, Hoyvald and Lavery had sold millions of bottles of "apple juice" that they knew to contain little or no apple juice at all - only sugars, water, flavoring and coloring. The consumers of this bogus product were babies.

One prosecutor of the case, Thomas H. Roche, had summed up Beech-Nut's behavior as "a classic picture of corporate greed and irresponsibility." The company itself had pleaded guilty the previous fall to 215 counts of violating Federal food and drug laws, and had agreed to pay a \$2 million fine, by far the largest ever imposed in the 50-year history of the Food, Drug and Cosmetic Act. Beech-Nut had confessed in a press release that it had broken a "sacred trust."

Yet here was Niels Hoyvald, 54 years old, tall, silver-haired, immaculately dressed, standing before Judge Platt with head bowed, as his attorney, Brendan V. Sullivan Jr., described him as "a person we would be proud to have in our family." When it was Hoyvald's turn to address the judge, he spoke firmly, but then his voice cracked as he spoke of his wife and mother: "I can hardly bear to look at them or speak to them," he said. "I ask for them and myself, please don't send me to jail."

Judge Platt was clearly troubled. He spoke in a semiaudible mutter that had the crowd in the courtroom craning forward. Though it was "unusual for a corporate executive to do time for consumer fraud," he said, he had "no alternative" but to sentence Hoyvald to a prison term of a year and a day, plus fines totaling \$100,000. He then meted out the same punishment to the 56-year-old Lavery, who declined to speak on his own behalf. He received his sentence with no show of emotion.

The combination of babies, apple juice and a well-known name like Beech-Nut makes for a potent symbol. In fact, apple juice is not especially nutritious (bottlers often fortify it with extra vitamin C), but babies love it and find it easy to digest. Parents are pleased to buy a product that says "no sugar added" and "100% fruit juice" - as Beech-Nut advertised - and seem to regard it as almost as pure and natural as mother's milk. That, of course, was the sacred trust Beech-Nut broke, and is now struggling to repair. The company's share of the \$760 million United States baby-food market has dropped from a high of 20 percent in 1986, when Beech-Nut and the two executives were indicted, to 17 percent this year. Its losses in the fruit-juice market have been even more dramatic. Richard C. Theuer, the company's president since 1986, still gets a stream of letters from outraged parents "who don't realize that it was a long time ago." Some of them, he says, are "almost obscene."

If parents are outraged by Beech-Nut's actions, many people are also baffled. Even after the trial and the verdict, the question of motive lingers: why would two men with impeccable records carry out so cynical and reckless a fraud? Except for Theuer, no current Beech-Nut employee who was involved in the events of the trial agreed to be interviewed for this article, nor did Hoyvald or Lavery. But a vivid picture of the economic and psychological concerns that impelled the company along its ruinous course emerges from court documents and a wide range of interviews. The Beech-Nut baby-food scandal is a case study in the warping effects of blind corporate loyalty.

FOR THREE-QUARTERS OF A century after its founding in 1891 as a meat-packing company, Beech-Nut expanded steadily into a large, diversified food concern, eventually including Life Savers, Table Talk pies, Tetley tea, Martinson's coffee, chewing gum and, of course, baby food. The company had an image straight from Norman Rockwell - pure, simple, healthful. In 1969, Beech-Nut was taken over by the Squibb Corporation. Only four years later, a remnant of the old company was spun off and taken private by a group led by a lawyer, Frank C. Nicholas. The company that emerged from the Squibb umbrella sold only baby food, and, as in earlier years, regularly divided with Heinz the third or so of the market not controlled by Gerber. It was a completely new world for Beech-Nut's newly independent owners, and an extremely precarious one. Beech-Nut was in a continuous financial bind. After an expensive and unsuccessful effort in the mid-1970's to market Beech-Nut as the "natural" baby food, the imperative to reduce costs became overwhelming. In 1977, when a Bronx-based supplier, who would later take the name Universal Juice, offered Beech-Nut a less-expensive apple-juice concentrate, the company abandoned its longtime supplier for the new source. The savings would never amount to much more than \$250,000 a year, out of a \$50 million-plus manufacturing budget, but Beech-Nut was under the gun.

At the time, the decision may have seemed insignificant. Ira Knickerbocker, head of agricultural purchasing at the main Beech-Nut plant, in Canajoharie, N.Y., who has since retired, says that in 1977 the new concentrate was only slightly less expensive than the competition's. "There was never a question about the quality or anything else," he insists. Yet no other baby-food company, and no large apple-juice manufacturer, ever bought significant quantities of concentrate from Universal. In early 1981, Heinz would

return the product to Universal after samples had failed to pass conventional laboratory tests and the supplier refused to let company officials visit the plant.

Another Federal prosecutor, John R. Fleder, contends that the low price of the Universal concentrate, which eventually reached 25 percent below the market, "should have been enough in itself to tip off anybody" that the concentrate was diluted or adulterated. Jack B. Hartog, a supplier who had sold Beech-Nut much of its apple concentrate until 1977, agrees with Fleder: "There was no question about it in the trade."

John Lavery, Beech-Nut's vice president of operations and manager of the plant in Canajoharie, did not question the authenticity of the concentrate. After spending his entire career at Beech-Nut, Lavery had risen to a position in which he managed almost 1,000 employees. In the small hamlets around Canajoharie, a company town in rural Montgomery County, northwest of Albany, Lavery was known as a figure of propriety and rectitude. "He was as straight and narrow as anything you could come up with," says Ed Gros, an engineer who worked with Lavery at Beech-Nut. Lavery was a fixture in the Methodist church, on the school board and in community organizations.

In 1978, after initial testing indicated the presence of impurities in the new concentrate, Lavery agreed to send two employees to inspect the "blending facility" that Universal's owner, Zeev Kaplansky, claimed to operate in New Jersey. The two reported that all they could find was a warehouse containing a few 55-gallon drums. The bizarre field trip aroused further suspicions among executives at the Canajoharie plant, but only one, Jerome J. LiCari, head of research and development, chose to act on them.

LiCari sent samples of the concentrate to an outside laboratory. The tests, he reported to Lavery, indicated that the juice was adulterated, probably with corn syrup. Rather than return the concentrate, or demand proof of its authenticity, as Heinz would do three years later, Lavery sent down the order that Kaplansky sign a "hold-harmless agreement," indemnifying Beech-Nut against damages arising from consumer and other complaints. (Ironically, in May 1987 Beech-Nut settled a class-action suit against it totaling \$7.5 million.) LiCari, however, was scarcely satisfied by Lavery's legalistic approach. Like Lavery, LiCari was also every bit the local boy. Born and raised in neighboring Herkimer County, he had worked in the Beech-Nut plant during summers home from college, and, after 14 years with Beech-Nut, he had achieved his greatest ambitions. Yet it was LiCari who accepted the solitary role of institutional conscience. In April 1979, and again in July, he sent samples of the concentrate to a second laboratory, in California. The April test again found signs of adulteration, but the July test did not. LiCari concluded that Kaplansky had switched from corn syrup to beet sugar, an adulterant that current technology could not detect. Once again he approached Lavery, suggesting that Beech-Nut require Kaplansky to repurchase the concentrate. This time, Lavery instructed that the concentrate be blended into mixed juices, where adulteration is far harder to detect. Lavery's attorney, Steven Kimelman, says that his client does not recall his rationale for the decision, but argues that on this matter, as on others, he acted in concert with other executives, including LiCari.

Lavery and LiCari were locked in a hopeless conflict of roles, values, and personality. Steven Kimelman characterizes Lavery as "more like a general. He's the kind of guy who gives orders, and he has no trouble making up his mind; LiCari was too much of a scientist type to him, and not practical enough." LiCari had become consumed by the issue of the concentrate. By the spring of 1981 he was working almost full time on tests to determine its purity. Finally, on Aug. 5, LiCari circulated a memo to executives, including Lavery. "A tremendous amount of circumstantial evidence," he wrote, makes for "a grave case against the current supplier" of apple concentrate. No matter what the cost, LiCari concluded, a new supplier should be found.

Several days later, LiCari was summoned to Lavery's office, where, as he told the jury, "I was threatened that I wasn't a team player, I wasn't working for the company, threatened to be fired." The choice could not have been more stark: capitulate, or leave.

Many of those who know Lavery find this picture of him simply unbelievable. The Canajoharie view is that Lavery was victimized. Ed Gros, Lavery's former colleague, speculates that LiCari "had a personal vendetta" against Lavery. Ira Knickerbocker blames the Government. Yet even Lavery's friends admit to a kind of moral bafflement. "I've lost a lot of sleep over this," says a former company vice president, Bill Johnsey.

Steven Kimelman denies that Lavery threatened LiCari, but concedes that his client made a "mistake in judgment." The mistake was in not kicking the matter up to Hoyvald when he received the Aug. 5 memo. Kimelman insists that Lavery "thought that LiCari tended to overreact," and in any case felt that there was no other concentrate whose purity he could entirely trust. In fact, LiCari's tests showed no signs of adulteration in several other, more expensive, concentrates. A harsher view is that Lavery acted quite consciously. "He just didn't care," says Thomas Roche, one of the prosecutors. "He showed an extraordinary amount of arrogance. I think his sole objective was to show Beech-Nut and Nestle [since 1979, the corporate parent] that he could do well."

Or perhaps Lavery had simply blinded himself to the consequences of his acts. The apple juice had become merely a commodity and the babies merely customers. One exchange between another prosecutor, Kenneth L. Jost, and an executive at the Canajoharie plant, Robert J. Belvin, seemed to sum up Lavery's state of mind:

"Mr. Belvin, what did you do when you found that Beech-Nut had been using a product in what it called apple juice that was not in fact apple juice?" "I - I became very upset."
"Why were you very upset?"

"Because we feed babies. . . ."

"Did you ever hear Mr. Lavery express a sentiment similar to that you have just described to the jury?"

"No."

BY 1979, BEECH-NUT'S financial condition had become so parlous that Frank Nicholas admitted failure and sold the company to Nestle S.A., the Swiss food giant. Nestle arrived with \$60 million in working capital and a commitment to restore a hallowed brand name to health. The view in the food industry was that Beech-Nut had been rescued from the brink. Yet evidence presented at the trial gives the exact opposite impression - of a Procrustean bed being prepared for nervous managers. Hoyvald, who chose to testify on his own behalf, admitted that in 1981, his first year as chief executive, he had grandiosely promised Nestle that Beech-Nut would earn \$700,000 the following year, though there would be a negative cash flow of \$1.7 million. Hoyvald had arrived at Nestle only a year before, but he was a seasoned executive in the food business. The answer nevertheless shot back from Switzerland: the cash flow for Beech-Nut, as for all other Nestle subsidiaries, would have to be zero or better. "The pressure," as he conceded, "was on."

Hoyvald testified that he knew nothing about adulterated concentrate until the summer of 1982. In January 1981, however, LiCari had sent to both Lavery and Hoyvald a copy of an article in a trade magazine discussing signs of adulteration in apple juice, and had written and attached a memo noting, among other things, that "Beech-Nut has been concerned over the authenticity of fruit juice products." LiCari also told the jury that in August of that same year, several weeks after his disastrous confrontation with Lavery, he went to Beech-Nut's corporate headquarters in Fort Washington, Pa., to appeal to Hoyvald - an uncharacteristic suspension of his faith in the chain of command. Hoyvald had been appointed president only four months earlier, and LiCari testified that he liked and trusted his new boss, whom he felt had a mandate from Nestle to restore Beech-Nut's prestige. The meeting in Fort Washington persuaded LiCari that he had finally found an ally. Hoyvald, LiCari testified, "appeared shocked and surprised" at LiCari's report, and left him feeling "that something was going to be done and they would stop using it."

Then, month after month, nothing happened. Finally, at a late-fall company retreat at a ski resort in Vermont, LiCari raised the issue with Hoyvald one last time. Hoyvald told him, he testified, that he was unwilling to fire Lavery. (In his own testimony, Hoyvald denied that either meeting had taken place.) LiCari was now convinced that the company was bent on lawbreaking, as he later testified, and rather than acquiesce, he quit, in January 1982. His allies concerned with quality control remained behind, but evidently none was stubborn or reckless enough to press his point.

Hoyvald, like Lavery, was a man with an exemplary background, though one that was a good deal more varied and sophisticated than his subordinate's. Born and raised in a provincial town in Denmark, he had relocated to the United States and received his Master of Business Administration degree from the University of Wisconsin in 1960. An ambitious man, Hoyvald had hopped across five companies before joining Beech-Nut as head of marketing in 1980, with the promise that he would be promoted to president within a year. Throughout his career, Hoyvald's watchword had been "aggressively marketing top quality products," as he wrote in a three-page "Career Path" addendum to a 1979 resume. He had turned around the faltering Plumrose Inc., a large food company, by emphasizing quality, and he viewed the job at Beech-Nut as a chance to do just that.

In June 1982, Hoyvald's principles were abruptly tested when the quality of his own product was decisively challenged. A trade association, the Processed Apples Institute, had initiated an investigation into longstanding charges of adulteration throughout the apple-concentrate business. By April 1982, an investigator working for the institute, a former New York City narcotics detective named Andrew Rosenzweig (who is now chief investigator for the Manhattan District Attorney's office), was prowling around the Woodside, Queens, warehouse of a company called Food Complex, which was Universal's manufacturing arm. By diligent questioning, and searching by flashlight through a dumpster in the middle of many nights, Rosenzweig discovered that Food Complex omitted apples from its recipe altogether, and that its biggest customer was Beech-Nut. On June 25, Rosenzweig tracked a tanker truck full of sugar water out of the Food Complex loading dock and up the New York State Thruway to Canajoharie, where he planned to confront management with his findings. He was hoping to persuade the company to join a civil suit being prepared against Universal and Food Complex; but, expecting the worst, he secretly tape-recorded the ensuing conversation.

At the trial, the tape proved to be a damning piece of evidence. In the course of the discussion, Lavery and two other executives, instead of disputing Rosenzweig's claim that Beech-Nut was making juice from suspect concentrate, unleashed a cascade of tortuous rationalizations. When Rosenzweig explained that the trade association had made new strides in lab testing, Lavery, obviously panicking, suddenly announced: "At this point, we've made our last order from" Universal. But despite considerable pressure, Lavery refused to give Rosenzweig samples of the concentrate, and declined to join the suit. The one anxiety he expressed was over the possibility of bad publicity.

On June 28, Paul E. Hillabush, the head of quality assurance at Canajoharie, called Hoyvald to tell him of Rosenzweig's visit. Hillabush testified that he suggested Beech-Nut recall the product. But Beech-Nut would not only have had to switch to a new and more expensive concentrate, it would have had to admit publicly that the product it had been selling since 1978 was bogus. The cover-up, which Lavery had begun three years earlier with the order to blend the concentrate in mixed juices, was attaining an irresistible momentum.

Hoyvald made the fateful decision to reject Hillabush's advice, and to devote the next eight weeks to moving the tainted products as fast as possible. It would be aggressive marketing, though not of a quality product.

THE APPLE INSTITUTE'S suit, as it turned out, was only the first wave to hit the beach. Federal and state authorities had been investigating suppliers of adulterated concentrate since the spring, and the trail led them, too, to Canajoharie. On July 29, an inspector from the United States Food and Drug Administration arrived at the plant, announced that samples taken from supermarket shelves had proved to be adulterated, and took away cases of apple juice ready to be shipped. On Aug. 11, Paul Hillabush received a call from an old friend, Maurice Guerrette, an assistant director with the New York State Department of Agriculture and Markets, who reported much the same conclusion. Guerrette recalls receiving one of the great shocks of his life when Hillabush tried to

laugh the whole thing off. It was only then that he realized - as would each investigator in his turn - that Beech-Nut was not the victim of a crime, but its conscious perpetrator.

Guerrette's phone call persuaded Lavery and others - incorrectly, as it turned out - that a seizure action was imminent. After consulting with Hoyvald, executives in Canajoharie decided to move the entire inventory of tainted juice out of the state's jurisdiction. And so, on the night of Aug. 12, nine tractor-trailers from Beech-Nut's trucking company were loaded with 26,000 cases of juice and taken in a ghostly caravan to a warehouse in Secaucus, N.J. One of America's most venerable food companies was fleeing the law like a bootlegger.

By the late summer of 1982, Beech-Nut was racing to unload its stock before regulators initiated a seizure action. On Sept. 1, Hoyvald managed to unload thousands of cases of juice from the Secaucus warehouse to Puerto Rico, despite the fact that the Puerto Rican distributor was already overstocked. Two weeks later, Hoyvald overruled his own lawyers and colleagues, who again suggested a recall, and ordered a feverish "foreign promotion"; under certain circumstances, American law does not prohibit the selling abroad of products banned at home. Within days, 23,000 cases were trucked at great expense from the company's San Jose, Calif., plant to Galveston, Tex., where they were off-loaded onto the first boat bound for the Dominican Republic, where they were sold at a 50 percent discount.

While Beech-Nut's sales staff shipped the evidence out to sea, its lawyers were holding Federal and state agencies at bay. On Sept. 24, lawyers scheduled a meeting with F.D.A. officials that was designed to placate their adversaries. It worked. Three more weeks passed before the F.D.A. Administrator, Taylor M. Quinn, threatened to seize the juice, and thus finally wrung from the company a pledge to begin a nationwide recall. New York State authorities, less patient, threatened a seizure before Beech-Nut hurriedly agreed to a state recall. But the delay allowed Niels Hoyvald to virtually complete his master plan.

By the middle of November Hoyvald could boast, in a report to his superior at Nestle: "The recall has now been completed, and due to our many delays, we were only faced with having to destroy approximately 20,000 cases. We received adverse publicity in only one magazine." As it turned out, of course, Hoyvald's self-congratulation was premature.

Further Federal and state investigations exposed details of the cover-up, as well as the fact that Beech-Nut had continued to sell the juice in its mixed-juice product for six months after the recall. New York State sued Beech-Nut for selling an adulterated and misbranded product, and imposed a \$250,000 fine, by far the largest such penalty ever assessed in the state for consumer violations. In November 1986, the United States Attorney obtained indictments of Hoyvald, Lavery, Beech-Nut, Zeev Kaplansky and Kaplansky's colleague Raymond H. Wells, the owner of Food Complex. Beech-Nut eventually settled by agreeing to pay a \$2 million fine. Kaplansky and Wells, who had earlier settled the apple-institute suit with a financial agreement and by ceasing

production of their concentrate, also pleaded guilty, and await sentencing. The F.D.A. referred the case to the Justice Department for criminal prosecution.

THE CASE AGAINST Hoyvald and Lavery seemed overwhelming - so overwhelming that Lavery's first attorney suggested he plead guilty. Why did Lavery and Hoyvald insist on standing trial? Because both men, by most reports, are still convinced that they committed nothing graver than a mistake in judgment.

Hoyvald and Lavery seem to think of themselves as corporate patriots. Asked by one of the prosecutors why the entire inventory of concentrate was not destroyed once it came under suspicion, Hoyvald shot back testily: "And I could have called up Switzerland and told them I had just closed the company down. Because that is what would have been the result of it."

The question of what Nestle would have said, or did say, was not resolved by the trial. Jerome LiCari testified that in 1980 and 1981 he had expressed his concerns to six different Nestle officials, including Richard Theuer, who was then a vice president of Nestle and would become Beech-Nut's president in 1986. In an extraordinary effort to clear its reputation, Nestle brought all six officials to court, mostly from Switzerland, and each one either contradicted LiCari's account or stated he had no memory of the alleged conversation. Nestle is acutely sensitive to its public image, which was tarnished in the 1970's and early 80's when it aggressively promoted infant formula in third-world countries despite public health concerns, sparking international controversy and boycott campaigns.

Nestle has defended its subsidiary's acts as vigorously as it defended its own in the past. The company has spent what sources close to the case estimate as several million dollars in defending the two executives, and has agreed to keep both men on the payroll - at annual salaries of \$120,000 and \$70,000 - until their current appeals are exhausted.

In a memo sent to Canajoharie employees after the verdict, James M. Biggar, president of Nestle's American operations, claimed that LiCari had confused "what he wished he had said" with "what he actually said or did," and faulted management only for failing to keep an "open door."

Richard Theuer, the man Nestle chose to replace Hoyvald, promises to keep that door open. He hopes to convince the public that at "the new Beech-Nut" decisions will be taken, as he says, "on behalf of the babies."