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BUSINESS

U.S. Food Firm OSI Challenges Chinese Verdict in Meat Scandal

Chinese court statement says OSI Group, a supplier to major U.S. fast-food chains, violated China's food safety law by selling substandard food

A McDonald's outlet in Beijing. China had been a key growth market for meat supplier OSI. *PHOTO: JIWEI HAN/ZUMA PRESS*

By LAURIE BURKITT

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BEIJING—In an unusual move, American food-processing company OSI Group LLC vehemently disputed a Chinese court's ruling that it had sold "inferior products" to fast-food chains in China including McDonald's Corp. and KFC parent Yum Brands Inc. and claimed it had been the subject of a smear campaign.

Challenging a Chinese court verdict is rare for a company trying to regain ground in the country. China had been OSI's key growth market but its business there was decimated after a 2014 television report purported to show workers in its Shanghai plant doctoring the production dates of meat to resell chicken nuggets and patties that had passed their sell-by dates.

The Shanghai Jiading People's Court said in a statement on its microblog Monday that it fined two of OSI's units—one in Shanghai and another in Hebei province—2.4 million yuan ($365,000) and sentenced 10 people to prison, including Australian Yang Liqun, a general manager at OSI in China, who was sentenced to three years, followed by deportation. Mr. Yang wasn't reachable to comment. The Australian Embassy in Beijing didn't immediately respond to requests for comment.

Mr. Yang, a naturalized Australian citizen from China, was the only non-Chinese citizen among the 10 sentenced.

The other nine defendants face sentences from 19 months to 32 months, the statement said.

Shortly after the ruling, the Aurora, Ill., company said it planned to appeal: "The verdict is inconsistent with the facts and evidence that were presented in the court proceedings." It said the Chinese authorities unjustly held OSI employees for 17 months and barred OSI's senior leaders and reporters from attending the trial. Prosecutors weren't immediately available to comment.

OSI also said it planned to take legal action against Dragon TV, the state-run broadcaster that aired the 2014 report, saying it "made false and incomplete accusations that ignored facts and Chinese law," the statement said.

Dragon TV didn't respond to requests for comment on OSI's statement.

OSI's business in China collapsed after the Dragon TV report aired in July 2014. Shortly afterward, Chinese authorities arrested six employees of the company's Shanghai unit and launched a probe.

The company's initial response to the allegations in the report was swift and remorseful. Within days, Sheldon Lavin, OSI's chief executive, apologized for "completely unacceptable" missteps at the company.

Since then, however, OSI has attempted to question the veracity of the allegations.

Internal OSI documents reviewed by The Wall Street Journal indicate that a review the company conducted after the scandal found that a disgruntled former employee and two journalists staged the report by Dragon TV.

The reporters used fake identifications and the TV station worked in concert with food-safety watchdogs, the document said, adding that before the report finished airing in 2014, authorities closed the plant where the reporters worked and ordered an investigation.

The document said Dragon TV aired the report without judicial review and confirmation. Asked about the assertions in OSI's internal report, Dragon TV earlier declined to comment.

Companies that have invested millions in the Chinese market rarely push back against government decisions or openly dispute legal setbacks. The long tally of businesses that have issued public apologies in China includes McDonald's, French grocer Carrefour SA and Apple Inc.

In its statement on Monday, OSI said it "can no longer accept injustices against our people and our reputation." The company said it saw itself "forced to consider an appeal through all legal channels in order to eventually be granted a just, evidence-based verdict."

OSI had poured capital into China to build up chicken farms and meat-processing units to supply fast-food chains—foreign and domestic—across the country. In 2013, it opened its ninth and 10th plants in China, part of a $750 million investment. The plants had been processing 50,000 tons of food a year.

But after state media showered criticism on OSI in the wake of the television report, fast-food chains including McDonald's, Burger King and Yum Brands, which runs KFC and Pizza Hut chains in China, cut ties with the company. OSI had been one of the biggest suppliers by volume in China.

As a result of the report, McDonald's, which relied heavily on OSI's supplies, faced a shortage of hamburgers for months, leading to sales losses.

It isn't clear how much OSI is currently processing. People within the industry say OSI lost more than $1 billion after the food-safety allegations paralyzed its operations across China. The company laid off 340 employees from its Shanghai plant in September 2014.

Business groups said a pattern of increased scrutiny of foreign firms by government officials and state media has contributed to a cooling of foreign business sentiment about operating in China.

Monday's ruling reflects a tough stance that leaders are taking on food-safety issues in China, where scandals have caused many deaths and undermined trust. Leaders laid out new food-safety laws this year that set harsher punishments and stronger oversight. The government frequently acts against foreign companies, making high-profile examples of them to teach lessons to domestic firms.

Authorities haven't released findings of their investigation into OSI's practices. They destroyed batches of the meat that had been recalled in the incident. Several people briefed on the situation said tests haven't revealed any safety problems.

The court statement said OSI violated China's food-safety law by selling substandard food.

—Jacob Bunge and Lilian Lin contributed to this article.

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