

Understand the risks

Companies operating in Mexico face significant corruption risks. Recognising them can help minimise any damage

What is the likelihood that an employee at one of your companies will be asked to pay a bribe in Mexico this year? Or if a rogue employee pays a bribe, will you catch him?

These are two questions that haunt companies in the current international business and regulatory environment. Recent corruption prosecutions and legislative changes relating to business in Mexico reflect an increased emphasis on combating corruption risks.

Given the overlapping jurisdiction of the United States Foreign Corrupt Practices Act (FCPA), the UK's Bribery Act, and analogous Mexican laws, companies need to understand their exposure to such risks to evaluate the effectiveness of their internal controls and to ensure that they are designed to protect the company from potential criminal and civil liability.

The US sentencing guidelines, which govern the standards by which corporations prosecuted for US federal law violations will be evaluated, state that an "organisation shall periodically assess the risk of criminal conduct and shall take appropriate steps to design, implement, or modify each" of the elements of an effective compliance programme specified in the guidelines to "reduce the risk of criminal conduct identified through this process."

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Risk assessment is an important factor in both the guidelines and the US Department of Justice's Federal Prosecution Principles for determining whether a company has established an effective ethics and compliance programme.

How bad is it?

Although Mexico remains one of the US's three largest trading partners and a popular destination for foreign direct investments, corruption risks there are pervasive and worsening. In 2011, the country ranked 100th out of 178 countries on Transparency International's Corruption Perceptions Index. It had fallen twenty-eight places since 2008.

US regulators have brought enforcement actions against eight companies for bribery in Mexico in the last 10 years (Syncor in 2002; Paradigm in 2007; Siemens in 2008; ABB and Pride International in 2010; and Bridgestone, Lindsey Manufacturing and Tyson Foods in 2011). Avon Products is under investigation by the US Securities and Exchange Commission (SEC) for "questionable payments", some of which pertain to Mexico, and a large California-based energy company is under investigation by both the Department of Justice (DOJ) and SEC for possible bribery of Mexican officials.

Five non-Mexican executives have been individually charged with FCPA violations for bribery in Mexico, including Bobby Benton, Pride International's former vice-president of Western Hemisphere Operations for Pride International; Misao Hioki, former general manager of Bridgestone's Japanese marine hose business; John J O'Shea, former general manager of ABB's Texas-based subsidiary; and Keith E Lindsey and Steve K Lee, CEO and CFO of Lindsey Manufacturing. (Lee, Lindsey, and O'Shea were acquitted after their trials.)

A number of third-party intermediaries interfacing with government officials also have been targeted by the DOJ under conspiracy or money laundering charges, and in one recent investigation, US

regulators directed that the company's external counsel scrutinise any relationships with sales agents and consultants.

With Mexico's proximity to the US and the regular cooperation between law enforcement officials on drug interdiction, there are some indications that US regulators may find prosecuting FCPA violations occurring in Mexico preferable (for logistical and political reasons) to pursuing those occurring in distant, unfriendly jurisdictions.

The investigative cost to the US government of pursuing an action in Mexico can often be lower, and the level of cooperation can be higher. This can make prosecutions more likely. For example, the DOJ acknowledged assistance from Mexican authorities in the prosecution of Lindsey Manufacturing and its executives in May 2011.

The risks

Corruption risks are, of course, not isolated to one segment or agency of the Mexican government. Allegations of corruption have implicated employees at various levels, from local law enforcement (police forces) and city governments to elected federal officials and employees at state-owned agencies and entities. The bribe recipients in recent US enforcement actions involving Mexico have included customs officials, veterinary inspectors and doctors at public hospitals.

Companies with any presence in Mexico may be subject to demands for extortion payments for basic police protection and access to public services. Companies have reported that police in some regions in Mexico demand small cash payments or gifts to convince them to patrol their property and protect it from local criminal enterprises. Refusals to meet extortion demands from criminal gangs can have serious consequences, as demonstrated tragically by media reports indicating that Mexican police officers reportedly controlled by the gangs stood watch on August 25 2011, while criminal groups set fire to an occupied casino that had refused to make extortion payments to the gang. More than 50 people died.

Companies that transport goods internally within Mexico – or through customs – may be exposed to requests for improper payments to expedite customs clearance or overlook motor vehicle infractions, such as when company vehicles exceed weight, hours and other traffic restrictions. Companies that require special licences or permits may be asked for bribes to expedite their issuance or overlook compliance issues.

Companies that participate in public contracting are exposed to unique risks given their dependency on officials of state-owned enterprises to win contracts. *Petróleos Mexicanos* and the *Comisión Federal de Electricidad* have been especially associated with suspected incidents of corruption in the past. Alleged bribes to their employees underlie five US enforcement actions (*Paradigm*, *Siemens*, *ABB*, *Bridgestone*, and *Lindsey Manufacturing*), and there have been follow-on investigations of the bribe-takers in Mexico. These issues most acutely affect companies in the energy and manufacturing industries.

Companies that participate in public works projects also may be exposed to corruption in local and municipal governments when bidding for projects, and they may have financial incentives to pay bribes to induce government customers to overlook missed deadlines and other instances of non-compliance with their contractual obligations.

Although not specific to Mexico, several recent US enforcement actions have arisen from improper payments made by companies in order to keep lucrative contracts. *Alcatel-Lucent* allegedly paid Honduran officials not to rescind contracts after the company missed delivery deadlines for state-owned telecommunications company *Empresa Hondureña de Telecomunicaciones*, in violation of the FCPA's prohibition on bribery to obtain or retain business.

The legal framework

Aside from the FCPA and other extra-territorial laws that may reach it, corrupt activity in Mexico may run afoul of local anti-corruption laws.

The country is a signatory to the OECD's Anti-Bribery Convention, the UN Convention Against Corruption, and the Inter-American Convention Against Corruption, which require it to criminalise bribery of public officials.

Corruption is prohibited under Mexican criminal law. Like the United States, Mexico has a two-tiered penal code. The federal penal code governs bribery of federal employees, such as federal police, and each Mexican state has a penal code that governs conduct within the state. Although Mexican state penal code provisions vary, many have adopted the federal provisions on bribery.

The anti-bribery provisions of the federal penal code are two-sided, in that they prohibit bribing government employees and they also prohibit government

employees from soliciting or accepting bribes. Article 222 of the Mexican Federal Penal Code prohibits bribery of public servants.

Under the first provision of Article 222, a public servant violates the law if he, directly or through an intermediary, solicits or improperly receives money or something of value to do, or refrain from doing, something just or unjust related to his

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official duties.

Under the second provision, an individual violates the law if he spontaneously gives or offers money or another thing of value to any person mentioned in the previous provision so that the public servant improperly does, or refrains from doing, a just or unjust act related to his official duties.

The law does not carve out an exception for facilitating payments, but it does carve out a narrow exception for some extortion payments. Although demanding extortion payments is unlawful, in some cases making them may not be: the Federal Code, as well as some state criminal codes, includes the element that a bribe payment be offered to a public servant “spontaneously.” This narrow exception of the criminal code has been interpreted to exclude payments that are given “because of a demand by a public servant” because the element of “spontaneity,” requiring that the payment be made voluntarily or of one's own will, is not satisfied.

Penalties for violations depend on the size of the bribe. Small bribes, measured as those equal to or less than 500-times the daily minimum wage (approximately \$2,300), are punishable by anywhere from three months to two years in prison, a fine equal to between 30- and 300-times the daily net income of the individual or entity sentenced, and suspension from holding public sector employment or office for

three months to two years. Penalties for larger bribes are punishable by anywhere from two to 14 years in prison, a fine equal to between 300- and 1000-times the daily net income of the individual or entity sentenced, and suspension from public employment or office from two to 14 years.

Article 222 bis of the federal penal code is the Mexican analogue to the FCPA. It makes it a crime to, for the purpose of obtaining or retaining undue advantages in the development or conduct of international commercial transactions, offer, promise, or, give, directly or through another person, money or any other thing of value, to a foreign public servant to improperly influence his official conduct.

In addition to the penalties for violations of Article 222 discussed above, when a corporation or other legal entity violates Article 222 bis, judges may impose fines up to 1000 days' net income. They also have the discretion to order the dissolution of the corporation, taking into consideration the degree of knowledge about the bribery, the harm it caused, the benefit the entity received and, under Article 11 of the federal code, whether such dissolution is necessary for public security.

Unlike the FCPA, the Mexican criminal anti-bribery provisions do not include an exception for facilitating payments that are made to a foreign official for routine government action, such as issuing permits or processing paperwork, to expedite performance of non-discretionary duties, and there is no de minimis threshold for bribe payments.

The domestic climate

There are several domestic initiatives intended to improve the business climate in Mexico and deter business-related corruption. Referring to the casino fire mentioned above, President Felipe Calderon said in his September 2011 State of the Union address: “[L]ike all Mexicans, I'm outraged at the level of opacity and corruption that the Monterrey tragedy has brought to light”. He lamented that, without more successful law enforcement, organised crime and the government could become “practically the same thing.”

In its October 2011 assessment of Mexico's enforcement of foreign bribery and domestic anti-corruption laws, the OECD recommended “that Mexico give greater priority to the criminal enforcement of its bribery laws”. This was based on a finding that the agencies tasked with prosecuting bribery were understaffed and few, if any, successful prosecutions were completed in recent years. The Mexican

government reportedly has shown a willingness to investigate possible improper payments in Mexico. In 2010, for example, the President ordered an investigation into suspected corruption by a large international pharmaceutical company to obtain a \$6.5 million contract with the Mexican Social Security Institute, and employment action was taken against at least one Mexican government official for his involvement. Former Comisión Federal de Electricidad official Néstor Moreno Díaz was arrested in September 2011 under a Mexican court order for accepting improper payments from ABB. Moreno is being prosecuted by the Mexican Federal Attorney General's Office.

Mexico's government is also taking steps to fill gaps in its legal framework. Although the regulatory regime creates administrative penalties for some misconduct in federal contracting, international organisations such as the OECD have identified gaps in how the laws address corruption. Under the laws of Acquisitions, Leases and Services in the Public Sector, and Public Works and Services Related to the Same, companies can be penalised for failing to meet their contractual obligations and federal employees can be penalised for engaging in corruption.

These laws do not, however, include penalties for an individual or corporation that bribes public officials, and the penalties for corporations that fail to meet their contractual obligations which are capped at MXN\$2 million (approximately \$150,000) have been criticised by Transparency International and the OECD as being too low to be a significant deterrent to unlawful conduct.

A new proposed law, which is backed by President Felipe Calderón, is designed to fill the gaps in Mexico's anti-corruption legal framework by making bribery a civil offence as well as a crime. The Federal Anti-Corruption Law in Public Contracting has passed the senate and is awaiting approval by the lower house. Its primary goal is to reduce corruption in federal contracting. In the legislation's preamble, the Mexican government asserts that corruption hurts the country's development and the well-being of its society and it laments the significant cost of corruption to Mexico's economy, ranging from 7% to 9% of Mexico's GDP.

The proposed legislation would penalise companies and their agents for actions intended to improperly influence federal employees. In addition to prohibiting bribery, the law would prohibit other dishonest contracting practices including

“New business partners should be vetted thoroughly”

providing false information in bids, participating in tenders in which an entity is not legally entitled to participate, and using one's influence over a government official to obtain a benefit, including obtaining or destroying documentation to which the entity is not entitled. Public contracting is defined broadly to include obtaining licences and permits from government agencies.

The law, which is intended to supplement the existing contracting laws, would be enforced by the same agency, the Secretariat of Civil Service, and violations would be punishable with debarment for three months to five years and fines up to 35% of the value of the contract or 50,000-times the daily minimum wage for individuals. For corporations, punishment would be debarment for three months to eight years and fines up to 35% of the value of the contract or 2 million-times the daily minimum wage.

The pending anti-corruption law would also prohibit Mexican nationals (individuals or companies) from engaging in overseas corruption involving foreign governments under a provision similar to the FCPA's anti-bribery clause. This provision also would be enforced by the administrative agency and is designed to complement the existing criminal laws on bribery. Penalties for violations of this provision are the same as listed above and there is no exception for facilitating payments.

How to respond

Companies should use a general understanding of Mexico's corruption risk profile – and a detailed analysis of their exposure to risks in Mexico, including risks specific to particular industries like energy and manufacturing, based on their operations in the country – to evaluate how effectively the company's controls protect it and make improvements where they are needed. There are five critical areas to check.

The first is the tone from the top. Management should send a clear message to employees working in foreign jurisdictions (including in Mexico) that the company is committed to complying with all applicable laws and standards of business ethics, and transgressions will not be permitted notwithstanding local norms or challenges.

Second is training: employees who interface with government officials should be trained on the FCPA, Mexican anti-corruption statutes, and business ethics. Company policies should be tailored to clearly prohibit the payment of bribes to Mexican officials with whom employees may interact.

Next is dealings with third parties. Companies should evaluate whether any third parties are authorised to interact with government officials on their behalf, and ensure that such agents and intermediaries do not engage in corrupt activities through contractual provisions, trainings, and other tailored control mechanisms.

The fourth area concerns auditing and controls. Accounts from which payments could be made to Mexican government authorities or third parties should be closely monitored for irregularities and audited to detect improper or inaccurately recorded payments.

The final consideration is reporting and investigating: senior managers should promptly escalate potential issues to the legal or compliance department, which should initiate investigations by the appropriate internal or external counsel.

The company's operational risks and the effectiveness of its internal controls programme should be evaluated periodically and any time there is a significant change in the country's risk profile or the company's operations there.

Targeted due diligence should be conducted before mergers with (or acquisitions of) entities with Mexican operations to avoid successor liability for prior bad acts. New business partners should be vetted thoroughly.

An effective compliance programme and system of internal controls can prevent most violations of anti-corruption laws even in challenging jurisdictions such as Mexico.

If rogue employees circumvent the company's rules and controls, internal controls can help the company swiftly detect transgressions, discipline bad actors, and remediate control weaknesses before the company incurs significant liability.

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