
LESSONS LEARNED FROM THE WAL-MART DE MEXICO SCANDAL: HOW NOT TO LET THIS HAPPEN TO YOU

April 2012
By: Anja Manuel

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Introduction

On Saturday, April 21, 2012 the *New York Times* broke a story alleging that Wal-Mart had hushed up a bribery scandal involving \$24 million of suspect payments from Wal-Mart de México, the company's largest foreign subsidiary.¹

In this article, we summarize the facts as the *New York Times* reported them, and then draw some important conclusions from the case for corporate FCPA compliance efforts.

Factual Background²

In September 2005, Sergio Cicero, a former executive of Wal-Mart de México who had resigned in 2004, emailed the then general counsel of Wal-Mart International about information on bribes paid for permits to expedite the company's expansion in Mexico, largely through intermediaries. According to the *New York Times*, Cicero implicated Wal-Mart de México's board chairman, general counsel, chief auditor, and top real estate executive. Cicero said that bribery had increased when Eduardo Castro-Wright became Wal-Mart de México's chief executive in 2002. Cicero also said that he himself had recruited Mexican gestores (fixers, some of whom operate legitimately) and approved payments to them.

The Wal-Mart International general counsel shared Cicero's allegations with a number of Wal-Mart's senior executives including: the company's general counsel, executive vice president and corporate secretary, top internal auditor, Latin America chief executive, and the chief administrative officer of Wal-Mart International. Wal-Mart's CEO was also reportedly given a "detailed description" of Cicero's allegations.

An internal Wal-Mart team (rather than independent outside counsel) assumed control of the investigation. The investigative team found evidence of more than 400 payments to fixers between 2003 and 2005 and concluded that \$8.5 million went to two Mexico City lawyers, who then made payments to various government officials. Cicero claimed that he had given these men "envelopes of cash" for government officials such as mayors, city council members, and low-level bureaucrats to expedite licenses. The *Times* reports that the investigators confirmed that Castro-Wright and other top Wal-Mart de México executives were aware of the payments. The investigators also found that Wal-Mart de México had made \$16 million of direct "contributions" and "donations" to local Mexican governments.

In December 2005, the investigators reported to Wal-Mart's top executives, "there is reasonable suspicion to believe that Mexican and USA laws have been violated."

Wal-Mart did **not** notify American or Mexican law enforcement authorities about any of these allegations.

According to the *Times*, instead of punishing employees allegedly involved in the payments, Wal-Mart subsequently placed Wal-Mart de México General Counsel José Luis Rodríguezmacedo -- himself the target of some of the accusations -- in charge of the next step of the investigation. Rodríguezmacedo's final report found no evidence that wrongful bribes were paid to Mexican government authorities.

¹ "Vast Mexico Bribery Case Hushed Up by Wal-Mart After Top-Level Struggle," David Barstow, *New York Times*, April 21, 2011.

² This factual summary is based entirely on the allegations in this article. Although the *Times* article is very detailed and appears comprehensively researched, journalists can get some facts wrong. No matter what, the facts provide an excellent case study for compliance officials, and should be required reading.

In a December 2011 Securities and Exchange Commission filing, Wal-Mart disclosed that it was reviewing its anti-corruption policies and had begun an investigation into “whether certain matters, including permitting, licensing and inspections, were in compliance with the U.S. Foreign Corrupt Practices Act.”³ The *Times* claims that Wal-Mart approached the Justice Department about this issue only after learning about the *Times*’ reporting.

On Saturday, Wal-Mart’s spokesman said Wal-Mart was meeting with the Department of Justice (DoJ) and the Securities and Exchange Commission (SEC).⁴

Key Conclusions

The allegations outlined in the *New York Times* article read like a case study in “what not to do” in corporate compliance. This piece will highlight just a few important lessons that compliance executives can learn from the facts:

1) *Intermediary Payments Often Get Companies in FCPA Trouble.*

According to the *Times*, many of the payments allegedly made by Wal-Mart de México were not made by company representatives themselves, but through intermediaries (called, in this case, “gestores”). Agents are one of the most common channels for illegal payments.

Under the FCPA, a company can be liable for the activities of its agents, consultants, advisers, joint venture partners, and other relevant third parties (“Agents”). Therefore, it is important that a policy on selection, appointment, monitoring, and audit of Agents is included as part of an effective compliance program.

Even if the Mexican payments through intermediaries do not meet the elements of an FCPA anti-bribery violation, the enforcement agencies are likely to assert that such payments violate the FCPA books and records and internal control provisions. For instance, *The Times* article suggests that the Mexican payments were routed through Mexican gestores who were told to submit invoices full of secret code words.

Lessons Learned:

Any third parties that interact with foreign governments on the company’s behalf (as sales agents, by obtaining licenses such as attorneys, filing taxes such as accountants, etc.) should:

- go through a comprehensive due diligence process before the intermediary is retained,
- sign a statement saying they understand the key provisions of the FCPA and will abide by them (which should be renewed annually)
- both the due diligence and acknowledgement should be updated periodically to remind third parties of their obligations.

³ “Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended October 31, 2011,” Walmart Stores, Inc. <http://www.sec.gov/Archives/edgar/data/104169/000119312511335177/d233066d10q.htm>.

⁴ “Walmart Statement in Response to Recent New York Times Article About Compliance with the U.S. Foreign Corrupt Practices Act,” David Tovar, April 21, 2012.

All relevant company employees should be trained repeatedly to understand that payments through intermediaries can create FCPA liability for the company and for them personally.

2) Cover-ups or Complicity by High-Level Company Executives Will Likely Result in High Penalties.

The most dramatic allegations in the *Times* article are not related to the size of the bribes, but to the high level involvement in the cover up that allegedly occurred after the whistleblower came forward.

Looking at the largest FCPA settlements in recent years reveals an interesting pattern: the sizes of the bribes do not appear to correlate directly with the ultimate sizes of the settlement. Most of the cases in the top ten largest settlements are there because senior management was involved in the conduct, or did not act appropriately when they learned of the conduct, by either covering it up and/or not cooperating with the government.

For example, at the top end, Siemens paid bribes of \$1.4 billion and settled for \$800 million. The illegal activity there started at the top of the organization (and many senior executives ultimately lost their jobs). KBR paid \$182 million in bribes and settled for \$579 million. Allegations against KBR state that the CEO was directly involved in trying to circumvent the FCPA.⁵

Lessons Learned:

Top management must set the ethical tone in the company.

When whistleblower allegations are investigated internally and there is some “fire” under the smoke, it is critical for senior management to ensure that all further steps are taken by impartial outsiders and well documented.

Otherwise the company – and possibly individual managers as well – will be disproportionately punished by the authorities. More on this below.

3) Consideration on How to Conduct an Effective FCPA Investigation.

According to the *Times*, Wal-Mart Stores Inc. initially did everything right: in-house lawyers relayed the whistleblower’s allegations of bribery up the chain of command and an outside law firm was brought in and recommended a more extensive investigation. But then, instead of having the outside firm proceed, the company sent the investigation back down the line, and ultimately placed one of the executives allegedly involved in the wrongdoing in charge of it. Ouch. Wal-Mart apparently also failed to disclose the issue to shareholders in its SEC filings.

⁵ Further down the list, Daimler paid \$56 million in bribes and settled for \$185 million. Alcatel-Lucent’s bribes amounted to just \$9.8 million but it settled for \$137 million. Magyar Telekom paid \$15 million in bribes and settled for \$95 million. Panalpina paid \$49 million in bribes and settled for \$81.8 million. <http://www.fcpablog.com/blog/2012/4/24/weighing-walmart-what-makes-a-big-case.html>

This could have dire consequences. Some commentators speculate that this could be the first time the government employs the controversial gatekeeper provisions of the Sarbanes-Oxley Act (“SOX certification”), which require individuals such as corporate attorneys to report company wrongdoing up the chain of command to the audit committee.

The SEC will likely analyze every SEC filing since 2005 by executives regarding Wal-Mart México, when executives apparently became aware of the payments at issue. The company could also face harmful and expensive shareholder derivative actions as a result.

Lessons Learned:

Outside counsel may be expensive, but it almost always makes sense to engage them when allegations are as serious as the ones made by the Wal-Mart whistleblower, because they are more likely to be viewed as impartial.

The company should make clear in advance who has authority over the investigation, and make sure that person (if internal to the company, not an outside board member, which may be warranted for substantial allegations), is impartial and not involved in the alleged misconduct.

The company should carefully document all investigatory steps and preserve all documents to ensure that it retains legal privilege.

Finally, if the investigation does reveal wrongdoing, the company should implement effective remedial measures, including by (a) disciplining and terminating culpable employees,⁶ and (b) implementing an effective corporate compliance program or improving an existing one.⁷

4) Consideration on When to Disclose Alleged Wrongdoing to the SEC and DoJ.

The *Times* reported that Wal-Mart only began discussions with the government in late 2011, after Wal-Mart learned that the *New York Times* was reporting on the issue.

While the FCPA does not contain any affirmative disclosure obligation, most companies the size and stature of Wal-Mart tend to disclose conduct that could implicate the FCPA in any substantial way. Self-disclosure and cooperation often results in more lenient treatment.

Under the DOJ’s [Principles of Federal Prosecution of Business Organizations](#) a factor the DOJ will consider in arriving at its enforcement decision is “the corporation’s timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents.”⁸

⁶ *The Times* investigation concludes that Eduardo Castro-Wright (at the critical time period the CEO of Wal-Mart México) was known by others at Wal-Mart to be involved in the Mexican payments, but was nevertheless continuously thereafter promoted by Wal-Mart.

⁷ See DoJ Principles of Prosecution, available at http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/28mcrm.htm. (“In determining whether or not to prosecute a corporation, the government may consider whether the corporation has taken meaningful remedial measures...”)

⁸ http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/28mcrm.htm

Additionally, since the passage of Sarbanes Oxley in 2002, CEOs and CFOs must certify that their companies' financial filings are correct. Bribes, because they have to be hidden, are generally an indicator that at least something in a company's books has been faked. So under Sarbanes Oxley it's effectively a violation of securities law not to disclose knowledge of potential bribes.

Looking at the ten largest FCPA settlements, many of them involve companies that were slow to react such as Siemens, Daimler, and BAE, who all stonewalled before coming clean, and several others who waited to be caught.

Lessons Learned:

If an internal investigation concludes as Wal-Mart's did, that several million dollars in bribes were allegedly paid, it is very hard to justify NOT disclosing that to the government.

5) Prosecutions Against Individuals Are on the Rise, Especially Where Cover-ups Are Alleged.

Considering the substantial involvement of high-level Wal-mart executives in the misconduct and cover-up, it is likely that several Wal-Mart executives will be prosecuted as individuals. Both DOJ and the SEC have recently made the prosecution of individuals for FCPA violations an enforcement priority. For example, in October 2011, Tracy Price, Assistant Director of the SEC's FCPA Unit, said, "You're going to see a lot more cases against individuals.... We are continuing to increase our efforts to bring charges against corrupt individuals who have a role in the accounting and control violations that occur."⁹

Lesson Learned:

When training employees (especially executives) on FCPA issues, the company should stress that misconduct can result in personal liability for anyone who was involved, not just liability for the corporation.

⁹ http://www.wilmerhale.com/files/Publication/7399b366-ef46-4d9f-b147-3e0349ebb307/Presentation/PublicationAttachment/fda0568a-f996-48ff-9f98-570cb6f963b3/Anti-Corruption%20Enforcement%20Developments_2011%20Year-in-Review%20and%202012%20Preview.pdf