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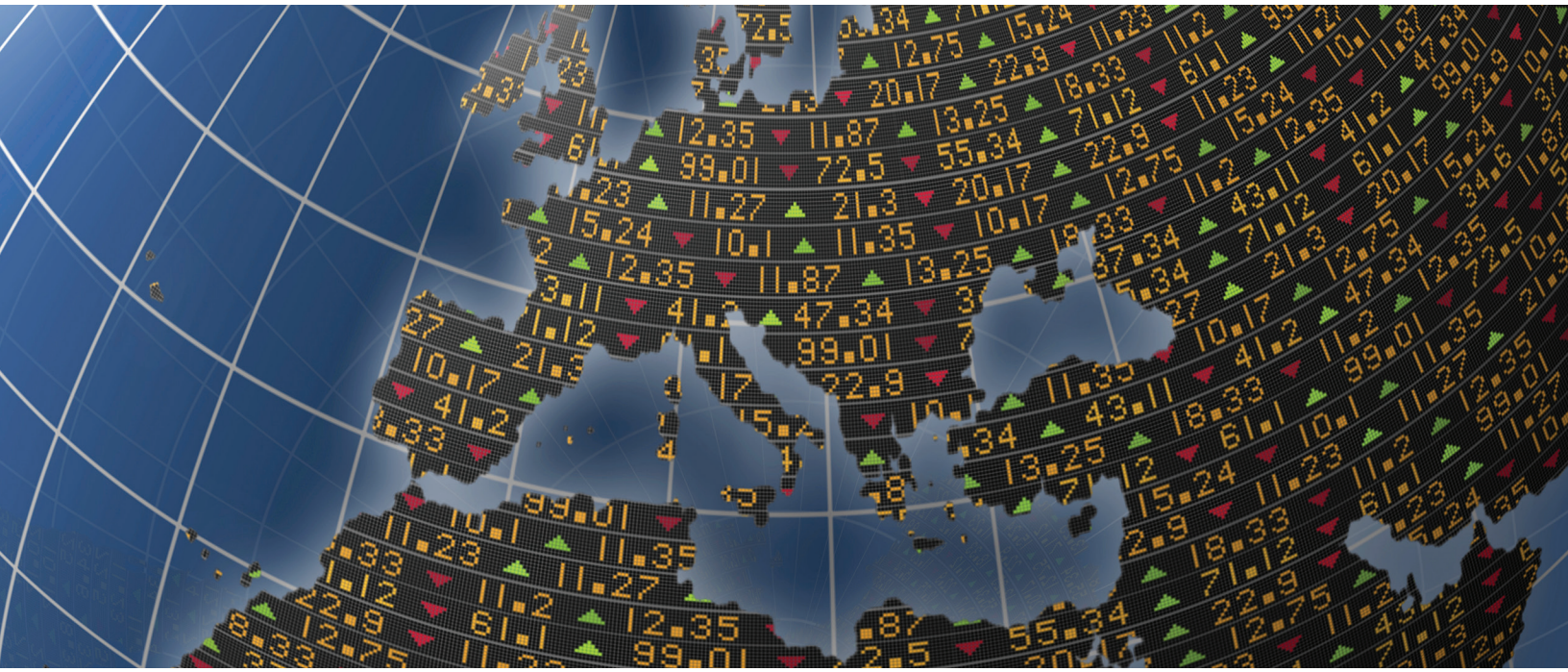

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Walmart and U.S. Authorities Reach Long-Awaited FCPA Settlements

After more than seven years and a reported $900 million in investigative and remediation costs, Walmart Inc. finally has settled its longstanding DOJ and SEC FCPA investigations. The Company paid a combined total of over $282 million in disgorgement, forfeiture, and penalties to the SEC and DOJ, and agreed with DOJ to a two-year monitorship. In doing so, the Company settled alleged violations of the FCPA's books and records and internal controls provisions relating to its subsidiaries in Mexico, Brazil, India, and China. Walmart's Brazilian subsidiary also pled guilty to one count of causing Walmart's books and records violations.[1]

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1. Order, *In the Matter of Walmart, Inc.*, Securities Exchange Act Rel. No. 86159 (June 20, 2019) *available at* https://www.sec.gov/litigation/admin/2019/34-86159.pdf [hereinafter "Walmart Order"]; Non-Prosecution Agreement, *Walmart, Inc.* (June 20, 2019) [hereinafter "Walmart NPA"]; Plea Agreement, *United States v. Walmart, Inc.* (June 20, 2019) [hereinafter "Walmart Plea Agreement"].

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The resolutions announced on June 20, 2019 marked the end of an unusually long period of scrutiny for Walmart, even by FCPA standards. Walmart first announced it was under investigation in late 2011,[2] after which it was the subject of a series of *New York Times* exposés starting in April 2012.[3] The Company conducted an internal investigation that began in Mexico and expanded to Brazil, India, and China. Even the settlements themselves were apparently the subject of drawn out and time-consuming negotiations, as Walmart had set aside $283 million to pay the U.S. Treasury almost one-and-a-half years ago.[4]

We view several aspects of these resolutions as particularly noteworthy:

- Neither DOJ nor the SEC brought any anti-bribery charges. Even the Brazilian subsidiary pled guilty only to violations of the FCPA's books and records provision.
- The majority of the allegations – and the most egregious examples of improper payments – date from the mid-2000s, ten to fifteen years ago, and some from much longer ago than that.
- Despite awarding credit for the Company's "substantial" remediation, DOJ still imposed a two-year corporate monitor. In an unusual break from past practice, the SEC did not impose a monitor and instead required the Company to self-monitor for a two-year period.
- The Company received only partial cooperation credit relating to its issue in Mexico, due in part to the Company's apparent failure to agree to a DOJ de-confliction request regarding a witness, which appears to be the first time DOJ ever has expressly highlighted such a consequence.
- DOJ provided the Company a 25%-reduction off the bottom of the U.S. Sentencing Guidelines range for the conduct in Brazil, India, and China, but only a 20%-reduction for Mexico.
- This matter is one of the largest anti-corruption enforcement actions ever brought in the area of licensing and permitting.

For good reason, many articles about this settlement likely will focus on Walmart's use of third parties ("*gestores*") in Mexico, fifteen years ago, especially since those

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2. Walmart, Inc., Quarterly Report (Form 10-Q) (Dec. 8, 2011).
3. David Barstow, "Wal-Mart Hushed Up a Vast Mexican Bribery Case," *New York Times* (Apr. 21, 2012), https://www.nytimes.com/2012/04/22/business/at-wal-mart-in-mexico-a-bribe-inquiry-silenced.html.
4. Walmart, Inc., Current Report (Form 8-K) (Nov. 16, 2017).

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allegations received the most press attention. However, other significant elements of this settlement warrant fresh scrutiny, including:

- The government has continued its aggressive use of the FCPA's internal controls provisions to penalize companies, in this case for what is now a long-ago failure to implement effective anti-corruption controls in its overseas subsidiaries, despite indications of risk.
- In what surely will be of interest to the retail sector and others, this settlement appears to be the first time that a franchisor has been found liable under the FCPA for the actions of its franchisee. However, there were two operations in India (the retail business, which was operated as a franchise, and the wholesale business, which was operated as a joint venture with an Indian partner), and it is not entirely clear from the settlement documents how much of the conduct involved the franchise business or whether the franchise business operated as a traditional franchise, given that the franchisee was also the Indian joint venture partner.

"The government has continued its aggressive use of the FCPA's internal controls provisions to penalize companies, in this case for what is now a long-ago failure to implement effective anti-corruption controls in its overseas subsidiaries, despite indications of risk."

- This is another example of the government penalizing a company in connection with charitable donations. In this case, unlike prior matters, at least some of the donations were not in cash, but were in-kind (computers, cars, other items), and the government did not allege that the donations were in fact improperly converted to personal use.[5]
- Once again, DOJ declined to give self-reporting credit for voluntarily disclosing information about new jurisdictions as Walmart's investigation expanded. This serves as a stark reminder of the challenges companies face when trying to receive full self-disclosure credit under DOJ's Corporate Enforcement Policy.
- And finally, as if any further indication was needed, this resolution underscores the difficultly of establishing the statutory "facilitation payment" defense.

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5. *See* Colby A. Smith, Andrew M. Levine & Philip Rohlik, "Charitable Donations as FCPA Violations: SEC Settles with Nu Skin Over Donations by Chinese Subsidiary," FCPA Update, Vol. 8, No. 2 (Sept. 2016), https://www.debevoise.com/~/media/files/insights/publications/2016/09/fcpa_update_september_2016.pdf.

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Settlement Details

On June 20, 2019, Walmart, Inc., an Arkansas-headquartered retailor and issuer, entered into a NPA (the "NPA") with DOJ[6] and settled a Cease-and-Desist Order (the "Order") with the SEC.[7] Walmart's Brazilian subsidiary, WMT Brasilia S.a.r.l ("Walmart Brazil") also pleaded guilty to one count of causing Walmart to violate the books and records provisions of the FCPA (the "Plea").[8] Notwithstanding the age of the allegations (with the most recent dating from 2012 and the majority of the allegations dating from long before that), Walmart disgorged more than $144 million to the SEC[9] and paid a penalty exceeding $138 million to DOJ,[10] totaling more than $282 million.

Notably absent from the facts underlying the Walmart enforcement action is any real attempt to quantify the amount of improper payments made. With the exception of some references to relatively small payments in Brazil and India, as well as pre-2005 practices in Mexico (which fall outside the statute of limitations), there is little discussion of bribe payments and almost no effort to assign monetary value to them. In Brazil and India, the government expressly specifies that the payments were made without the knowledge of the Walmart subsidiary's employees. However, there are certainly indications that the Brazilian subsidiary was willfully blind by hiring the third-party intermediary through a contractor, hiding evidence of using the intermediary because of the concern that she might be or have been a government official, and referring to the intermediary as the "sorceress" for her ability to obtain permits no one else could.

Fundamentally, the Company is being faulted for failing to adopt and implement an adequate anti-corruption program as it expanded its overseas operations. In the resolution, DOJ and the SEC provide at least some guidance regarding expectations in terms of third-party due diligence and monitoring.

The Allegations

It appears from the facts asserted in the settlement documents that Walmart had only minimal internal controls in its riskiest markets as it expanded its overseas business. These facts are tempered somewhat by the sheer age of the allegations, however the compliance program inadequacies and repeated failures to respond to various red flags appear to be the driving forces behind the enforcement actions.

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6. *See* Walmart NPA.
7. *See* Walmart Order.
8. *See* Walmart Plea Agreement.
9. Walmart Order at 13.
10. Walmart NPA at 6.

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Mexico

In December 2005, a former lawyer of Walmart's Mexican subsidiary reported to Walmart allegations that, while at the subsidiary, he had used third-party *gestores* – professional third-party "fixers" – to interact with local officials to facilitate obtaining permits.[11] His allegations described an elaborate scheme using code words ("claves") to hide the purpose of the payments. The various codes were used to identify the reason the Mexican subsidiary had made the improper payment, including: (1) to avoid a requirement; (2) to influence, control, or gain knowledge of privileged information known by a government official; and (3) to eliminate fines.[12]

It appears these payments ended in 2004 when the former lawyer left the Mexican subsidiary. Walmart investigated the allegations, but did not follow up on the remediation, and, according to the government, eventually turned the investigation over to an executive in Mexico who had himself been implicated in the scheme. According to the government, although the payments through gestores ended in 2004, the Mexican subsidiary's use of donations in the form of checks, cash, and merchandise to Mexican municipalities and local government entities increased. Both the SEC and DOJ criticized the Company for allowing the donations without ensuring that the donations could not be converted to personal use, but do not cite any evidence that such conversion actually occurred. In the end, the government appears to fault Walmart for not having investigated the issue more thoroughly and for failing to implement stronger anti-corruption controls in Mexico until 2011.[13]

DOJ ultimately awarded the Company partial cooperation credit for its investigation into conduct in Mexico for its 2011 disclosure, factual presentations, and generally aiding in facilitating witness interviews and associated document translations.[14]

Brazil

The allegations relating to Brazil form the basis for the guilty plea taken by Walmart Brazil. According to the Plea Agreement, DOJ and Walmart Brazil agreed to a criminal fine of $724,898 and criminal forfeiture of $3,624,490.[15] The books and records violation is predicated on Walmart Brazil's false recording of $527,000 as payments to certain Brazil construction companies, despite employees of Walmart Brazil knowing that the payments were actually being funneled through the construction company

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11. Walmart Order ¶ 29.
12. Walmart NPA at A-9.
13. *Id.* ¶ 25.
14. *Id.* at 1.
15. Walmart Plea Agreement at 15-16.

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to a Brazilian intermediary whom they believed might be a government official and was known as 'the sorceress' for her ability to get permits when no one else could.[16] Walmart Brazil earned approximately $3,624,490 in profits from these stores.[17] The false records were subsequently consolidated into Walmart's financial records and used to support Walmart's own financial reporting.

According to the government, Walmart Brazil engaged a construction company with a reputation for corruption and paid that company $52 million to build eight stores between 2008 and 2012.[18] Even after the construction company failed multiple rounds of vendor due diligence, and Walmart Brazil's Ethics and Compliance Department informed the Construction and Indirect Sourcing Departments that "no further contracts were to be signed with the company,"[19] Walmart Brazil continued to use the intermediary.

India

In 2005, while exploring long-term business opportunities in India, Walmart hired a consulting firm to assess corruption risks in the jurisdiction.[20] The consulting firm's report to Walmart indicated that it would "be targeted by corrupt individuals and organizations seeking bribes or kickbacks in exchange for favorable business relationships or the easing of bureaucratic restrictions" and that it would likely face "delays in the processing of permits, licenses and other paperwork" due to corruption.[21]

According to the government, several red flags were raised, but ultimately ignored by Walmart regarding its business in India:

- ***First***, Walmart allegedly learned of specific potential corruption concerns related to its Indian JV Partner before operations commenced.[22] Despite these concerns, Walmart moved forward.[23]
- ***Second***, between 2008 and 2011, Walmart's India-based audit team conducted at least six reviews of the India Wholesale Business. Each review apparently "identified weaknesses in anti-corruption related internal accounting controls."[24]

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16. Walmart NPA ¶ 58.
17. Walmart Plea Agreement Ex 2-1 ¶ 6.
18. Walmart NPA ¶ 56.
19. In 2009, the Walmart Brazil Ethics and Compliance Department did not have a mechanism in place to ensure that third parties failing preliminary due diligence were to be suspended pending final due diligence. *See id.* ¶ 56.
20. Walmart NPA at A-13.
21. *Id.*
22. *Id.*
23. *Id.* at A-14.
24. *Id.*

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Walmart did not seek to implement and maintain a system of sufficient internal accounting controls to address them.[25]

- ***Finally***, the government makes broad, but very general allegations that both the wholesale and retail businesses retained third parties that made improper payments to government officials in exchange for store operating permits and licenses.[26] The NPA points to only one specific instance where a third party communicated with an India Retail Employee about payment.[27]

"Walmart has paid a substantial fine because it had not set up a sufficient anti-corruption program, in light of red flags at certain of its foreign subsidiaries, but not as a result of the government establishing large or numerous improper payments."

China

Neither the SEC nor DOJ alleged improper payments by the China subsidiary within the relevant time period. But both agencies identified failures by Walmart to provide FCPA training to employees of the China subsidiary, even in response to a request for such training (and a policy for third parties) from the China subsidiary in 2003.[28] FCPA training was not provided to China subsidiary personnel until "years later."[29]

The payments alleged fall well outside of the statute of limitations, including one from 1999[30] and various small payments to Chinese officials, each less than $20, identified by internal audit in 2003.[31] The China subsidiary suggested remedial actions, which Walmart did not "promptly implement."[32]

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25. *Id.* at A-15.
26. The allegedly improper payments were recorded in the JV's books and records with vague descriptions, including: "misc fees," "miscellaneous," "professional fees," "incidental," and "government fee." *See id.*
27. *Id.* at A-15 to A-16.
28. Walmart Order ¶ 23.
29. Walmart NPA at A-19 to A-20.
30. Walmart Order ¶ 39.
31. Walmart NPA at A-6.
32. Walmart Order ¶ 25.

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The Importance of Adequate Internal Controls

Given the size of the settlement – $282 million – this resolution represents an expansion from prior cases involving primarily a failure to implement internal controls. Other recent actions limited to violations of the accounting provisions without meaningful significant improper payments garnered much smaller recoveries.[33] Historically, this provision been used essentially to shift the burden of proof to a company that is believed to have engaged in improper conduct, in order to establish that it had adequate controls in place. Here, though, Walmart has paid a substantial fine because it had not set up a sufficient anti-corruption program, in light of red flags at certain of its foreign subsidiaries, but not as a result of the government establishing large or numerous improper payments.

FCPA settlements are heavily negotiated, and it could be that there are facts omitted from the settlement documents that would establish more than the small number of payments suggested by the papers, including the very few payments in Brazil assigned dollar amounts. Indeed, the precise amount of disgorgement ($119,647,735) suggests there was some basis for the calculation. However, based on the facts presented, it is difficult to see the specific nature of any improper payments, including their scope and magnitude as well as how they may have formed the basis for these enforcement actions.

What comes through clearly from both sets of settlement documents is that, in each of the jurisdictions addressed, Walmart (including executives in the United States) was aware of past practices or risks, including from numerous audit reports identifying deficiencies. The settlement documents note at least one anti-corruption audit undertaken in each jurisdiction, with six having been conducted in India alone between 2008 and 2011.[34]

While Walmart had an apparently commendable internal audit function, each of these reports identified some anti-corruption related weaknesses that were not addressed. The internal China audit report was the only one that reports an actual finding of misconduct and that related to subsidiary employees providing gifts worth less than $20 to government officials to maintain relationships and obtain approvals.[35] Although the other reports only identified weaknesses, DOJ and the SEC make it clear that companies would do well not only to test their compliance program, but to act quickly and thoroughly in remediating weaknesses that are identified.

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33. *See, e.g.*, Order, *In the Matter of Elbit Imaging Ltd.*, Securities Exchange Act Rel. No. 82849, (Mar. 9, 2018), https://www.sec.gov/enforce/34-82849-s ($500,000 fine); Order, *In the Matter of Telefônica Brasil S.A*, Securities Exchange Act Rel. No. 4046 (May 9, 2019), https://www.sec.gov/litigation/admin/2019/34-85819.pdf ($4 million fine).
34. Walmart NPA ¶ 45.
35. *Id.* ¶ 60.

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In addition to the audit reports, there were three whistleblower complaints in India between July and September 2011, allegedly from the same individual, none of which were investigated.[36] And, as discussed above, the allegations in Mexico raised by a former lawyer of the Mexican subsidiary were not investigated thoroughly.[37]

This case stands as a cautionary tale for subsidiaries' use of third parties. In fact, the settlement documents are clearest when setting out specific deficiencies regarding third-party relationships:

- India: vendors operated without contracts, third-party contracts lacked standard FCPA provisions, vendors did not complete anti-corruption certifications, disbursements lacked supporting documentation, training was incomplete, and there was no formal third-party due diligence process.[38]
- Brazil: contracts were not kept to ensure accurate books and records, there was no formal third-party due diligence process, and the subsidiary lacked the ability to ensure third parties flagged for corruption risks were not used in the future.[39]
- China: third-party contracts lacked anti-corruption provisions, some third parties lacked due diligence documentation and certifications, payments were made without required documentation and approvals, and there was no formal FCPA training.[40]

Some of the red flags are clearly more severe than others, but it is difficult to tell how the importance of each red flag was weighted or if they simply were considered cumulatively. At least some included in the SEC and DOJ papers seem relatively trivial and are likely to cause confusion for compliance officers. For example:

- The NPA and Order both mention multiple gifts in China, each under $20. It is hard to imagine such a *de minimis* amount warranting government scrutiny. However, they are presented as yet another example of the Company failing to respond to and implement changes in light of internal audit findings.
- The NPA and Order could be read as taking issue with the Company's de-centralized approach to compliance and suggesting that such an approach is an internal controls failure.[41] However, DOJ and the SEC have both recognized

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36. *Id.* ¶ 47.
37. *Id.* ¶¶ 27, 41, 47.
38. *Id.* ¶ 46.
39. *Id.* ¶ 55.
40. Walmart Order ¶ 39.
41. Walmart NPA ¶ 23; Walmart Order ¶ 54.

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previously that a tailored, risk-based approach to compliance programs is the most beneficial.[42] Thus, it seems more likely that what the SEC and DOJ have taken issue with is the Company's consistent failure to follow up when audit reports showed local policies had not been adopted and/or were not working in practice.

- The NPA suggests that bribe solicitations, not alleged to have been paid, required an investigation by the Company.[43] Again, taken by itself, it is hard to see how this forms the basis of FCPA liability, but it appears to have been included as an additional example of the Company not responding to information received.

Franchisors and Franchisees

The settlements appear to hold Walmart liable for both the actions of its wholesale joint venture, which has been done before, and for the actions of its retail franchisee, which would be a new expansion of FCPA liability. It may be that there were facts here indicating that the franchisee relationship operated in practice like the JV (since the franchisee was the JV partner), but it is unclear based on the very cursory discussion in the settlement documents.

"The Walmart enforcement actions' treatment of its Indian subsidiaries is an example of a difficult question – in this case franchise liability – under-developed in the context of a non-judicial resolution."

While non-judicial resolutions of corruption cases like NPAs or SEC Orders are often preferred by companies and have much to recommend them, a serious drawback of absenting the judiciary is that the government is not held to its burden of proof, and complicated legal issues are not fully fleshed out. The Walmart enforcement actions' treatment of its Indian subsidiaries is an example of a difficult question – in this case franchise liability – under-developed in the context of a non-judicial resolution.

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42. *See* Matthew L. Biben et al., *DOJ Updates Guidance on Evaluating Corporate Compliance Programs*, Debevoise Update (May 3, 2019), https://www.debevoise.com/-/media/files/insights/publications/2019/05/20190502_doj_updates_guidance.pdf.

43. Walmart NPA ¶ 41.

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Facilitation Payments

The FCPA provides an explicit exception for facilitation payments, stating that the anti-bribery provisions' prohibition "shall not apply to any facilitating or expediting payment to a foreign official, political party, or party official the purpose of which is to expedite or to secure the performance of a routine governmental action by a foreign official, political party, or party official."[44] Relying on the statute's legislative history, DOJ and the SEC have taken a narrower view of this exception requiring that it be a payment made only to further "routine governmental action" that "involves non-discretionary acts."[45]

With the exception of some of the older payments linked to the "claves" (codes) in Mexico, the payments described in the Order and NPA relate to obtaining licenses and permits, as well as the $20 gifts in China — all of which raise the possibility that they might fall under the facilitation payments exception. However, the settlement papers do not address this issue or describe the payments in sufficient detail for us to assess whether they would fall within the exception, demonstrating yet again that companies generally would do well not to rely on this exception, even though it is explicitly carved out in the statute.[46]

In-Kind Donations

The SEC and DOJ specifically criticized the Mexican subsidiary's practice of donations in the form of checks, cash, and merchandise to Mexican municipalities and local government entities. However the only allegation regarding this practice is that some of the gifts (such as computers and cars) "were capable of being converted into personal use."

Of course, a payment to a governmental entity – rather than an official – is not prohibited by the FCPA's anti-bribery provisions. And there is no assertion here of specific facts that were consciously avoided; the Order merely states that this practice created a risk. In-kind donations are not uncommon, and donations of basic goods to charity serve both a social responsibility goal and to enhance a company's reputation. While possible that there are facts known to the SEC and DOJ that have

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44. 15 U.S.C. § 78dd-1(b).

45. U.S. Dep't of Justice & U.S. Securities & Exchange Comm'n, A Resource Guide to the U.S. Foreign Corrupt Practices Act (2012) at 25, *available at* https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2015/01/16/guide.pdf; *id.* n. 160 ("In exempting facilitating payments, Congress sought to distinguish them as 'payments which merely move a particular matter toward an eventual act or decision or which do not involve any discretionary action,' giving the examples of 'a gratuity paid to a customs official to speed the processing of a customs document' or 'payments made to secure permits, licenses, or the expeditious performance of similar duties of an essentially ministerial or clerical nature which must of necessity be performed in any event.'" Quoting H.R. Rep. No. 95-640, at 8.).

46. *See SEC v. Jackson*, 908 F. Supp. 2d 834, 855 (S.D. Tex. 2012) ("[T]he SEC must bear the burden of negating the "facilitating" payments exception. The facilitating payments exception is best understood as a threshold requirement to pleading that a defendant acted 'corruptly.'").

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not been asserted in the papers, by including the in-kind donations as they have, without specifying what controls would be appropriate, they provide little guidance to companies grappling with this issue. Thus, it becomes much more likely that used computers will end up in a landfill instead of in a poor school district's library.

Self-Reporting Credit under the Corporate Enforcement Program

Interestingly, Walmart received informal self-reporting credit from the SEC,[47] but not from DOJ.[48] We have seen this dynamic before, where DOJ is less willing to give self-reporting credit for additional jurisdictions identified once an investigation has begun.

The problem this might create for companies is that when an initial investigation expands to countries beyond the subject of an original self-report, it appears they may not receive credit for any subsequently shared information. The government has made clear that it still expects companies to share this information if they are in a cooperative posture, but it seems an unfair catch-22 for companies and significantly reduces the value of any initial self-report.

Key Takeaways

- When expanding operations into high-risk jurisdictions, it is important to implement thorough-going anti-corruption programs as soon as possible;
- It remains essential to address third-party risk and due diligence, an issue in each of the jurisdictions at issue in Walmart;
- Franchisors should examine FCPA risk involving franchisees;
- Companies rely the facilitation payments exception at their peril;
- Know what your third parties are doing and pay attention to red flags. In two of the countries here, the government specified that the improper payments were made without the knowledge of the Walmart subsidiary's employees, though there were certainly indications of willful blindness.
- In-kind donations to government entities are potentially risky, and companies, at the very least, should obtain an agreement from such entities that donations will not be converted into personal use.

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47. Walmart Order ¶ 61.
48. Walmart NPA ¶ 1.

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Anti-Corruption Enforcement in Mexico: A Possible Turning Point?

In recent years, anti-corruption enforcement has become increasingly globalized. New anti-corruption laws have proliferated, along with deepening commitments to enforcing such laws. Sometimes, like in Brazil, active enforcement has followed promptly after the adoption of new laws. Other times, as in the case of Mexico, the journey from enactment to enforcement has proven more challenging.

Amidst much fanfare, Mexico adopted its new National Anti-Corruption System in mid-2016. Many hoped Mexico would seize the opportunity and shortly thereafter pursue significant anti-corruption enforcement. But key posts within the anti-corruption system remained unfilled, and no significant enforcement ensued.

After two years of relative inaction, Andrés Manuel López Obrador campaigned successfully for President of Mexico in significant part based on a promise to eliminate the cancer of corruption. He took office in December 2018 and filled a number of significant positions, including appointing Mexico's first-ever independent Attorney General, who in turn appointed a Special Anti-Corruption Prosecutor. At the same time, notwithstanding lofty campaign promises, an absence of immediate enforcement along with some of President López Obrador's public statements tempered expectations about full implementation of the new regime.

Over the last few weeks – especially given the arrest warrant issued for the former head of Petróleos Mexicanos ("Pemex") – new questions have arisen and expectations again have been piqued regarding the potential vigor of Mexican anti-corruption enforcement. In relatively short order, differing viewpoints have emerged. Some believe that Pandora's box has opened and that Mexican enforcement authorities will have no choice at this point but to scrutinize past acts of corruption, in addition to future ones. Others believe that these developments ultimately may be isolated in nature and perhaps the by-products of short-term political considerations. A recent address by President López Obrador's chief legal advisor suggests a middle position: the Attorney General's Office will pursue vigorously acts of potential corruption already within that office's investigative pipeline, but otherwise will focus its investigative efforts on future misconduct.

In any event, critical questions persist regarding how and to what extent the Mexican government will enforce its new anti-corruption regime. This article puts those questions into context by considering developments relating to Mexico's fledgling anti-corruption system, relatively new administration, and recent enforcement developments.

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I. Mexico's New Anti-Corruption System

On July 18, 2016, Mexico's former President Peña Nieto ratified and published new legislation amending Mexico's anti-corruption framework.[1] This sweeping reform created four new laws: the General Law of Administrative Liabilities, the General Law of the National Anti-Corruption System, the Organic Law of the Administrative Justice Federal Court, and the Federal Accounting and Accountability Law. It also amended the Federal Criminal Code, the Organic Law of the Attorney General's Office, and the Organic Law of the Federal Public Administration by the Mexican Federal Congress. Relevant changes included broadening the range of chargeable anti-corruption offenses and facilitating more meaningful prosecution of such crimes.

These new laws, known together as the National Anti-Corruption System, also: institute disclosure requirements for public servants; impose severe penalties for corruption-related offenses; incentivize the implementation of corporate compliance programs and cooperation with authorities; and provide for coordination among federal, state, and local government institutions fighting corruption. The laws also create critical new governmental posts for ferreting out and prosecuting corruption, including the position of a Special Anti-Corruption Prosecutor.

In late 2018, as a supplement to these domestic enhancements, Mexico became a signatory to the United States-Mexico-Canada Agreement, a tripartite treaty that contains an entire chapter on anti-corruption enforcement and compliance.[2] The treaty imposes a broad range of obligations on the signatory countries, including an affirmative duty to enforce or enact legislation in support of specific anti-corruption measures. It addresses both the payment and receipt of bribes and underscores the importance of international cooperation among anti-corruption law enforcement agencies. Although these obligations are not binding until the treaty is fully ratified and specific legislation is passed to implement the anti-corruption provisions, the agreement represents a potentially meaningful commitment to cooperate in pursuing anti-corruption efforts.

II. AMLO's Government

A. A Platform of Enforcement

Combating corruption figured prominently in the campaign platform of Mexico's current president. During the campaign, for example, now-President López Obrador

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1. Sean Hecker, Andrew M. Levine, & Eileen Zelek, "Mexico Adopts New Anti-Corruption Legislation," FCPA Update, Vol. 8, No. 2 (Sept. 2016), https://www.debevoise.com/insights/publications/2016/09/fcpa-update-september-2016.
2. Kara Brockmeyer, Andrew M. Levine, Marisa R. Taney, & Victoria L. Recalde, "NAFTA Replacement Adds Anti-Corruption Provisions," FCPA Update, Vol. 10, No. 4 (Nov. 2018), https://www.debevoise.com/insights/publications/2018/11/fcpa-update-november-2018.

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proposed establishing stricter penalties for conflicts of interest and corruption violations and promoting greater transparency in government contracting. In doing so, he called for "pull[ing] this corrupt regime out by its roots"[3] and "clean[ing] out corruption in government from top to bottom, like you clean the stairs."[4] He also vowed to amend an article in the Mexican constitution that prevents Mexican presidents from being tried for corruption.[5] Other campaign promises included cutting government spending, selling the presidential plane, slashing presidential pensions and reducing his own salary, and driving to work in his Volkswagen Jetta.[6]

"Some believe that Pandora's box has opened and that Mexican enforcement authorities will have no choice at this point but to scrutinize past acts of corruption, in addition to future ones. Others believe that these developments ultimately may be isolated in nature and perhaps the by-products of short-term political considerations."

During his first months in office, President López Obrador's track record on implementing his campaign promises has been mixed. The new administration has worked with Congress to alter the Mexican Constitution to make corruption, fuel theft, and electoral fraud more serious felonies.[7] Additionally, the President implemented some of his more populist promises, such as opening the presidential complex to the public and selling the presidential airplane.[8] He also reduced significantly the salaries for some of the highest-paid public employees and raised salaries for lower-earning employees.[9]

Other campaign promises remain unfulfilled, though the new President admittedly is only about six months into his six-year term. As an example, despite purported efforts to improve transparency in government contracting,

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3. Jon Lee Anderson, "A New Revolution in Mexico," *The New Yorker* (June 18, 2018), https://www.newyorker.com/magazine/2018/06/25/a-new-revolution-in-mexico.
4. Jude Webber, "López Obrador vows to clean out corruption 'from top to bottom,'" *The Financial Times* (Nov. 20, 2019), https://www.ft.com/content/74c53fdc-ce1f-11e7-b781-794ce08b24dc.
5. Anderson, n. 3, *supra*.
6. David Agren, "Mexican president Amlo reveals $23,000 in savings – and no credit card," *The Guardian* (Jan. 4, 2019), https://www.theguardian.com/world/2019/jan/04/mexico-amlo-president-savings-money.
7. *Id.*; *see also* Emily Casswell, "Mexico to tackle corruption with 'all the strength' of the state," *Global Investigations Review* (June 7, 2019), https://globalinvestigationsreview.com/article/1193803/mexico-to-tackle-corruption-with-all-the-strength"-of-the-state.
8. Azam Ahmed & Kirk Semple, "A New Revolution? Mexico Still Waiting as López Obrador Nears Half-Year Mark," *New York Times* (May 10, 2019), https://www.nytimes.com/2019/05/10/world/americas/amlo-mexico-lopez-obrador.html.
9. *Id.*; *see also* Casswell, n. 7, *supra*.

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over seventy percent of the contracts awarded in the first three months of López Obrador's presidency have taken place without competitive bids.[10] Just before taking office, the President canceled the construction of a new and partially-built airport in Texcoco, a municipality near Mexico City. He then announced, after assuming the presidency, the construction under the military's oversight of a different commercial airport in Santa Lucía, another area on the outskirts of Mexico City.[11] Since the beginning of June 2019, several non-governmental organizations have obtained injunctions ordering the López Obrador administration to suspend the Santa Lucía project and preserve the Texcoco partially-built airport.

B. Willingness to Scrutinize Past Misconduct

Questions persist about President López Obrador's commitment to investigating corruption and holding culpable individuals to account. Although the President has opined steadfastly that corruption is an enormous problem for the country, he has vacillated between whether his enforcement approach would be backward or forward looking. Upon taking office, he declared an end to the cycle of prosecuting previous administrations once out of power and announced that his administration would focus on prosecuting future corrupt acts: "I propose to the people of Mexico that we draw a final line under this horrible history and make a new start: In other words, that there be no prosecution of former officials."[12]

However, recent statements by the President's chief legal advisor, Julio Scherer Ibarra, suggest the President may be softening that stance.[13] On June 6, 2019, at the *Latin Lawyer – GIR Live Anti-Corruption and Investigations Conference Mexico* ("Mexico Conference"), Scherer Ibarra clarified in a keynote address that "[w]hatever investigations were already ongoing under the Attorney General's office prior to the new government will be pursued with all the strength of the Mexican state."

The arrest warrant recently issued for the former head of Pemex, as detailed below, likewise evidences such a potential shift. In discussing this particular prosecution, the government has distanced itself somewhat, emphasizing the Attorney General's independence in making such decisions. More broadly, based on Scherer Ibarra's comments, it appears that – aside from independent prosecutions arguably already in progress to some degree – the administration wishes to focus prospectively its anti-corruption enforcement efforts.

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10. *See* Ahmed & Semple, n. 8, *supra*.
11. Sharay Angulo, "Mexican President Says New Airport Construction to Start Next Week," *Reuters* (Apr. 24, 2019), https://www.reuters.com/article/us-mexico-airport/mexican-president-says-new-airport-construction-to-start-next-week-idUSKCN1S02FT.
12. Luis Pérez de Acha, "Por qué AMLO no puede poner 'punto final' a la historia de corrupción," *New York Times* (Dec. 10, 2018), https://www.nytimes.com/es/2018/12/10/opinion-corrupcion-amlo.
13. *See* Casswell, n. 7, *supra*.

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III. Recent Steps Towards Implementing the Anti-Corruption Framework

A. The National Anti-Corruption System

Following the passage and entry into force of Mexico's new National Anti-Corruption System, there was only limited progress in its implementation, undoubtedly challenged in part by entrenched norms regarding corruption in the public and private sectors. Important governmental posts remained vacant. And enforcement had not materialized in a substantial way, though multinational and local companies began registering the increasing need to address corruption risk.

Since taking office, President López Obrador has filled a number of important posts. In particular, he nominated three individuals for the newly independent position of Attorney General, one of whom, Alejandro Gertz Manero, the Senate then selected. Gertz Manero then appointed a Special Anti-Corruption Prosecutor, María de la Luz Mijangos Borja, who is tasked specifically with investigating and prosecuting corruption-related misconduct in Mexico.[14]

Beyond efforts of the government, the Citizen's Participation Committee ("CPC"), currently led by José Octavio López Presa, plays a vital role in Mexico's National Anti-Corruption System. At the Mexico Conference, López Presa explained in a special address how the CPC has taken concrete steps towards eliminating corruption in Mexico. This includes advocating for whistleblower protections from the government, opining on appointments to key government posts, and seeking greater autonomy for institutions involved in monitoring and identifying potential misconduct.

As López Presa explained, the CPC also has launched two notable initiatives aimed at changing the culture and mindset of how business is conducted in Mexico:

- ***First***, the CPC developed an app called "Ética CPC." It will ask lawyers and compliance professionals to pledge to abide by a shared ethical standard in conducting business. Although there are no formal consequences for non-compliance, the app seeks to encourage mutual accountability within the legal and compliance community, with the objective of then having a broader cultural impact.[15]
- ***Second***, the CPC is developing an index for rating the independence of various institutions at the federal level, which will score each from 0 to 10 based on twelve key indicators of autonomy.

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14. Elías Camhaji, "Alejandro Gertz Manero: el fiscal que supo esperar," *El País* (Jan. 19, 2019), https://elpais.com/internacional/2019/01/18/mexico/1547826190_621298.html; Juan Arvizu, "Nombran a los fiscales electoral y anticorrupción," *El Universal* (Feb. 9, 2019), https://www.eluniversal.com.mx/nacion/politica/nombran-los-fiscales-electoral-y-anticorrupcion.

15. Ética CPC was launched on June 20, 2019 at the *Instituto de Investigaciones Jurídicas* of the *Universidad Nacional Autónoma de México* and is available at http://etica.firmamex.com.

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The CPC intends these efforts to help counter cultural acceptance of corruption-related misconduct and hold public officials and institutions, as well as private Mexican businesses, accountable for corrupt acts.

B. Enforcement Efforts

On May 28, 2019, the Fiscalía General de la República Mexicana issued an arrest warrant for Emilio Lozoya, the former director of Pemex.[16] The arrest was based on Lozoya's alleged receipt of improper payments "facilitated by" Odebrecht, a Brazilian construction firm involved in Operation *Lava Jato*.[17] More specifically, the arrest warrant charged Lozoya with offenses including bribery, fraud, and money laundering, relating to Pemex's purchase in 2014 of Agronitrogenados, a fertilizer plant, from Altos Hornos de Mexico ("AHMSA"). Pemex paid $475 million for the plant, which the Mexican government now claims was worth less than $50 million.[18] Mexican investigators also identified a series of transfers connected with the purchase, including a $3.6 million payment to AHMSA, later transferred to a Swiss shell company connected to Lozoya.[19]

On May 28, 2019, Alonso Ancira Elizondo, the owner of AHMSA, was arrested in Mallorca, Spain in connection with these charges.[20] The Mexican Financial Intelligence Unit has investigated Ancira Elizondo for bank transfers to an Odebrecht affiliate that allegedly were destined for Lozoya.[21]

Notwithstanding the flurry of attention following issuance of Lozoya's arrest warrant, subsequent events suggest that the government may face an uphill battle in pursuing this prosecution. A week later, on June 5, 2019, a judge in Mexico City suspended the warrant, concluding that at least three of the criminal charges – involving fraud, money laundering, and bribery – do not justify pretrial detention.[22]

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16. *El País*, "La policía desmiente haber detenido al ex CEO de Pemex Emilio Lozoya," (May 29, 2019), https://cincodias.elpais.com/cincodias/2019/05/29/companias/1559114217_832985.html.
17. Anthony Harrup & Juan Montes, "Mexican Investigators File Corruption Charges Against Pemex Ex-CEO,' *Wall Street Journal* (May 27, 2019), https://www.wsj.com/articles/mexican-investigators-file-corruption-charges-against-pemex-ex-ceo-11559016009.
18. David Luhnow & J uan Montes, "Steel Executive Seized in Spain in Mexican Corruption Case Tied to Pemex," *Wall Street Journal* (May 28, 2019), https://www.wsj.com/articles/steel-executive-seized-in-spain-in-mexican-corruption-case-tied-to-pemex-11559089071.
19. Kirk Semple & Azam Ahmed, "Mexico Charges Former Oil Official With bribery in Anticorruption Drive," *New York Times* (May 28, 2019), https://www.nytimes.com/2019/05/28/world/americas/mexico-corruption-prosecution-oil-company.html.
20. "Comunicado FGR 258/19, La Fiscalía General de la República Informa de la detención de Alonso 'N' en España" (May 28, 2019), https://www.gob.mx/fgr/prensa/comunicado-fgr-258-19-la-fiscalia-general-de-la-republica-informa-de-la-detencion-de-alonso-n-en-espana?idiom=es.
21. Luhnow & Montes, n. 18, *supra*.
22. Diana Lastri, "Emilio Lozoya, former Pemex director, won't be arrested," *El Universal* (June 6, 2019), https://www.eluniversal.com.mx/english/emilio-lozoya-former-pemex-director-wont-be-arrested; *Mexico News Daily*, "Judge issues injunction, halts move to arrest former Pemex CEO," (June 5, 2019), https://mexiconewsdaily.com/news/judge-issues-injunction-halts-move-to-arrest-former-pemex-ceo.

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Following this ruling, Lozoya stated on Twitter that he would not appear in court as required, and he in fact failed to appear for the next hearing. On June 17, 2019, the judge revoked the prior order, finding that Lozoya had violated the terms of his arrest warrant's suspension.[23]

Thus far, the government has been unable to locate and arrest Lozoya, despite President López Obrador's apparent insistence that Lozoya be in custody within 30 days.[24] Compounding this difficulty, Lozoya's attorney, Javier Coello Trejo, stated publicly that the authorities would be unable to find and arrest Lozoya, even though he is supposedly in Mexico City.[25] Such actions and statements by Lozoya and his counsel make an already challenging enforcement environment even more difficult to navigate.

"[O]nly time will tell whether recent anti-corruption developments in Mexico represent a watershed moment or outliers unlikely to be replicated."

IV. Conclusion

As recounted above, there has been recent progress in implementing Mexico's National Anti-Corruption System, though challenges remain. For example, the position of the Special Anti-Corruption Prosecutor is now filled. However, that prosecutor has a relatively small staff and therefore must be extremely selective in the cases she pursues, absent an allocation of additional resources. Likewise, the Pemex-related developments suggest that the Mexican government is willing to investigate and prosecute at least some past conduct that it views as corrupt. But the attendant delays and complications foreshadow that the road ahead may be a difficult one, particularly because nothing motivates compliance quite like enforcement.

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23. Diana Lastri, "Quitan suspensión a Emilio Lozoya; ya podrá ser detenido por lavado," *El Universal* (June 17, 2019), https://www.eluniversal.com.mx/nacion/quitan-suspension-emilio-lozoya-ya-podra-ser-detenido-por-lavado.
24. *El Universal*, "30 days to find Emilio Lozoya" (June 20, 2019), https://www.eluniversal.com.mx/english/30-days-find-emilio-lozoya.
25. *Mexico News Daily*, "Ex-Pemex chief loses protection from arrest but he won't be found: lawyer" (June 18, 2019), https://mexiconewsdaily.com/news/ex-pemex-chief-loses-protection-for-arrest.

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In the coming months, we may get a better sense of how actively the administration of President López Obrador will remain committed to his core campaign promise of fighting corruption. Relatedly, only time will tell whether recent anti-corruption developments in Mexico represent a watershed moment or outliers unlikely to be replicated. Of course, regardless of how aggressively the Mexican authorities enforce their own anti-corruption laws, there remains the looming threat of U.S. or other foreign enforcement involving misconduct in Mexico, as the recent Walmart resolution demonstrates.

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German Court Finds That GDPR Access Rights May Trump Confidentiality of Internal Investigations

A recent decision of a German mid-level State Appellate Court[1] concludes that data protection rights under the EU General Data Protection Regulation (the "GDPR") may extend to personal information gathered in internal investigations or similar proceedings on a private level. Counsel for a European company therefore should exercise particular care in crafting a defense of the company, to protect the confidentiality of the investigation and the identity of whistleblowers to the extent possible.

1. The Case

A German company had implemented a whistleblower system that invited confidential reporting. Any reported information on an employee was meant to be kept separate from that employee's personnel files and out of the hands of the human resources department, to be housed instead in a business practices office that the company had installed specifically to handle compliance investigations.

The plaintiff employee sought to obtain from the company access to, and a copy of, "personal information relating to performance and behavior," including information on an already closed investigation of the plaintiff employee's alleged compliance violations, which had been revealed by a whistleblower. The plaintiff employee's requests were based on special German employment law remedies and GDPR access rights.

The company resisted the requests, arguing that the information would reveal the identity of a whistleblower that the company had promised to keep confidential. A duty of care vis-a-vis persons who report violations would require the company to keep the requested information confidential. The company, however, did not specify to the court the whistleblower's allegations or submit details about the information that could not be disclosed without affecting the whistleblower's interests.

The German State Appellate Court therefore granted the plaintiff employee access to the requested information, including the investigation files. It considered the results of an internal investigation into an employee's compliance violations, irrespective of the location, to be information that must be included in the employee's personnel files and is not automatically exempted from access.

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1. Landesarbeitsgericht Baden-Württemberg, Dec. 20, 2018, 17 Sa 11/18, available at http://lrbw.juris.de/cgi-bin/laender_rechtsprechung/document.py?Gericht=bw&GerichtAuswahl=Arbeitsgerichte&Art=en&Datum=2018-12&nr=27411&pos=0&anz=4.

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The court did affirm a potential overriding interest of the company in the confidentiality of a whistleblowing system, except in cases of wrong allegations made deliberately or with gross negligence. The court also recognized German data protection law provisions restricting GDPR access rights. However, in order to balance the interest of the plaintiff against the interest of the company, the company had to present facts that would permit the court to conduct such a test. In this case, the company made only unspecific references to the confidentiality of its whistleblower system, which the court found to be insufficient as a defense against the employee's access request. Without the required submission of the concrete allegations made by the whistleblower, the court held against the company.

2. What are EU GDPR Subject Access Rights?

The GDPR is a uniform law across the European Union that applies to the processing of information relating to individuals (the "data subjects") in the EU. For example, in an internal investigation, the collection, assessment, transfer, or other use of information about the custodian within the EU triggers the GDPR.[2]

The GDPR provides the data subject with various rights vis-a-vis the user (the "controller") of its data. These rights include the right to information about the used data and a right to access the data to verify the proper use, including a right to receive a copy.[2]

The European subject access right is not an absolute right, and the GDPR balances this right against other fundamental rights, including the freedom to conduct a business or the right to an effective remedy and to a fair trial. In addition, the Regulation permits EU Member States to restrict data protection rights in certain instances to promote other rights and interests, including public interests or the rights and freedoms of others. Accordingly, Germany has chosen to make the access right subject to a balancing test, weighing the interest of the data subject, the controller, or affected third persons.

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2. The GDPR access right permits the data subject to request from the controller confirmation as to whether it processes personal data relating to him, access to that data, and information as to, for example, the purposes of the data processing, the categories of data used, or any available information as to their source. The data subject may further request a copy of its data. The controller has to provide the information or a copy free of charge and without undue delay, at the latest within one month. This tight deadline may be extended to two additional months in exceptional cases only.

   The controller can refuse to act on the request if it demonstrates that it cannot identify the requesting person or the request is manifestly unfounded or excessive. If a controller processes a large quantity of personal information relating to the requesting person, it is further permitted to ask the data subject to specify the information or process activities to which the request relates.

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In more detail, the GDPR provides that the right to a copy may not adversely affect the rights and freedoms of others, including their rights to the protection of their trade secrets or intellectual property. The Regulation makes it clear that these considerations must not be used to justify an outright refusal to deliver the requested information, but rather require a balancing of the interests involved and the use of other measures, such as a redaction of protected information, if they may also be adequate to comply with the request while protecting opposing interests. In any case in which the controller refuses to comply with a request, the controller has to disclose his reasons to the data subject, thereby making the decision "reviewable."

"There is a risk that custodians may try to use their GDPR access rights in internal investigations to better understand the scope and status of the investigation and adjust their cooperation accordingly."

Germany restricts GDPR access rights if such access would require disclosure of statutorily protected information, including information that by its very nature has to be kept secret, in particular because of overriding legitimate interests of third parties. As an example, a German lawyer can rely on the statutory professional secrecy duty in refusing a data access request of a non-client.

3. EU GDPR Subject Access Rights and Whistleblowing

In the European Union, whistleblower protection is fragmented across Member States and uneven across policy areas. Only ten EU countries, including the UK and France, provide comprehensive legal protection. In the remaining countries, including Germany, protection is only partial or applies to specific sectors or categories of employees.

The EU is in the process of releasing a Directive for whistleblowers which will address reporting on, or disclosing, breaches of certain EU law through secure reporting channels and effective protection from retaliation. The Directive aims to enhance the enforcement of EU law and policies in specific areas by providing minimum standards for protection of persons reporting breaches of EU law.

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The adoption of the Directive is expected in fall 2019, and Member States will be required to implement the Directive into national law by 2021.[3]

The Directive reflects that effective protection of the confidentiality of the identities of reporting persons is necessary for the protection of the rights and freedoms of others. The Directive calls on the Member States to ensure the effectiveness of the Directive, including, where necessary, by restricting, through legislative measures, the exercise of certain data protection rights by concerned persons. Such restrictions must only be implemented, however, to the extent necessary to prevent and address attempts to hinder reporting, attempts to impede follow-up to reports (particularly through investigations), or attempts to uncover the identity of the reporting persons. The Directive invites the Member States to ground such legislation in the public interest, particularly the interest in functioning whistleblower protections to enhance the enforcement of EU law and policies in specific areas where breaches can cause serious harm. Further, the Directive suggests that the effective protection of the confidentiality of the identity of the reporting persons is necessary for the protection of the rights and freedoms of others and thus suggests that national legislators can build exceptions to the GDPR access rights on this rationale.

In a November 2018 guidance document,[4] German data protection authorities assessed GDPR access rights in the context of whistleblowing and held that both the whistleblower and the accused person have access rights to their respective personal data, including rights to know the source and the recipients of the personal information. With regard to the conflicting interests between the access right of the concerned person and the anonymity of the whistleblower, the authorities confirm that access rights may not be exercised where doing so would reveal information about the identity of the whistleblower. As previously stated, in such a case the whistleblower's interest in anonymity overrides the data subject's interest in the information.

The Baden-Württemberg court recently considered the application of this restriction to an access request. The defendant company could indeed have resisted the access request if it had shown specifically the overriding interest of the whistleblower to remain confidential, but it failed to do so.

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3. For further information, see the European Parliament press release, available at http://www.europarl.europa.eu/news/en/press-room/20190410IPR37529/protecting-whistle-blowers-new-eu-wide-rules-approved.

4. The guidance is available at https://datenschutz.saarland.de/fileadmin/datenschutz/dsk_entschliessungen/95/Orientierungshilfe-Whistleblowing-Hotlines.pdf.

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4. Conclusion

The GDPR covers information gathered in internal investigations of a European company and grants access rights to data subjects. These access rights not only may allow data subjects to learn the categories of data and the purposes of its processing, but also may grant data subjects access to any available information as to the source of the data, including information about a whistleblower.

The Regulation provides for several defenses, in particular in cases of unfounded, excessive, or unspecific requests. There is no guidance as to the degree of specificity required, and the Baden-Württemberg decision shows that a court may also accept a very broad request as sufficiently specific. Further defenses may result from Member State legislation that shapes the access rights to reflect the protection of public interests or the rights and freedoms of third parties.

There is a risk that custodians may try to use their GDPR access rights in internal investigations to better understand the scope and the status of the investigation and adjust their cooperation accordingly. They may also seek to get evidence for litigation that would otherwise not be available to them.

As a consequence, the planning of an internal investigation should not only include preparation for a timely response to access requests but also consider potential defenses under the GDPR or Member State legislation from the outset.

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