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Mexico Bribery Scandal Two Years Ago Continues to Have Negative Repercussions on Walmart

by Carlos Navarro
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A bribery scandal that surfaced more than two years ago involving Wal-Mart de México (Walmex) continues to have major repercussions on the US-based parent company. Walmex executives allegedly paid bribes to officials, particularly at the municipal level, during the early 2000s to facilitate rapid expansion of the retail chain in the country. By obtaining quick permits, Walmex attempted to gain an advantage against potential competing retailers. Walmart officials in the US have sought to quash a class-action lawsuit in the US resulting from the scandal, but a US judge recommended in May of this year the legal action be allowed to proceed.

At the time, the scandal received mixed reactions in Mexico and met outrage in the US (SourceMex, April 25, 2012). In a special investigative report in April of that year, The New York Times alleged that high-level Walmart officials attempted to conceal a campaign to bribe Mexican officials and win contracts. The report prompted investigations by the US Department of Justice (DOJ), the US Securities and Exchange Commission (SEC), and the Mexican attorney general's office (Procuraduría General de la República, PGR). The news of the investigations led to a drop in Walmart stock that resulted in a loss of about US$17 billion in market value. Walmart's stock price fell 8.2% in the three days following the release of the Times report.

The loss in value hurt investors and pension funds, which led the City of Pontiac General Employees' Retirement System to file a class-action suit against the company and former chief executive officer Mike Duke. The suit is just one of nearly a dozen legal actions filed against Walmart in the US as a result of the Mexico bribery scandal. At least 11 derivative suits against Walmart have already been filed over the matter, including one by the California State Teachers' Retirement System (CalSTERS) and New York City's pension funds.

The suit filed by the Pontiac pension fund alleges that Duke and other Walmart officials knew as early as 2005 that Walmex might have been bribing local officials to open stores faster but did not investigate the matter adequately in 2005 and 2006. Furthermore, the suit alleges that Walmart should have "come clean" in a quarterly report filed on Dec. 8, 2011, soon after it had learned of the Times' investigation. Instead, plaintiffs said, the report, known as a 10-Q, was a "phony demonstration of vigilance and virtue" that made it appear that Walmart learned of suspected corruption in 2011, addressed it appropriately, and reported its findings to the DOJ and the SEC.

Arkansas judge upholds class-action suit

Walmart sought to have a US court dismiss the suit, but the move has failed for now. On May 8, US Magistrate Judge Erin Setser recommended denying Walmart's request to dismiss the lawsuit against the company and Duke.

"Plaintiff has sufficiently alleged that defendants knew the omission in the December 2011 Form 10-Q of the 2005 revelation of the suspected corruption and defendants' 2005 and 2006 investigation was materially misleading," Setser wrote.
Setser's ruling is not definitive, however, as her recommendation is still subject to review by US District Judge Susan Hickey.

The plaintiffs, however, are confident that Hickey will accept Setser's decision. "We're very encouraged, and hopefully Judge Hickey agrees with the findings," said Jason Forge, a Robbins Geller Rudman & Dowd partner representing the plaintiffs. "Once Walmart knew the Times was hot on its trail, and that there was enough substance to the allegations that it needed to tell the DOJ and the SEC, it needed to tell investors."

"We respectfully disagree with the magistrate judge's opinion," a Walmart spokesperson told Reuters after the judge dismissed its request, "and continue to believe that the complaint does not meet the standard necessary to move the case forward."

The bribery scandal in Mexico has had other effects on Walmart's global operations. In a report released in December 2013, the company estimated the cost of investigation and global-compliance programs would have surpassed US$400 million by the end of its fiscal year in 2014. The price tag does not include expenditures for legal costs and settlements because of the bribery scandal.

**Bribery a common practice in Mexico**

Some observers noted, however, that Walmart is hardly the only company that has used bribery to advance its business interests in Mexico. A report published by CNNExpansión named officials from seven other companies recently alleged to have been involved in bribery scandals. The list includes two Mexico-based enterprises: the public electric utility Comisión Federal de Electricidad (CFE) and Oceanografía, a private contractor hired by the state-run oil company PEMEX.

"Nestor Moreno, the former director of operations for the CFE, was arrested in 2011 on charges of using his position to gain wealth illicitly," said CNNExpansión. "He obtained 33 million pesos (US $2.5 million) allegedly by soliciting bribes from foreign companies."

In the case of Oceanografía, a company based in Ciudad del Carmen in Campeche state, the company is alleged to have fraudulently obtained millions of dollars in loans from Mexico's largest bank Grupo Financiero Banamex (SourceMex, March 19, 2014). The company provided offshore oil services to PEMEX subsidiary Exploración y Producción (PEP) for more than four decades. "Just yesterday, it was revealed that the company allegedly bribed former PEP director Carlos Morales Gil," CNNExpansión said in its April 10 report.

The report mention several recent cases in which US or other foreign companies were exposed for engaging in bribery, including Hewlett-Packard México, which paid more than US$1 billion in bribes to obtain a software contract from PEMEX.

The list also included the German engineering company Siemens, which allegedly paid bribes to PEMEX officials in 2004 to win the contract for the modernization of the Cadereyta refinery. PEMEX filed a lawsuit in US District court accusing Siemens of bribing officials from the company to approve overrun and expense payments. A US judge dismissed the case, not because of its merits but because of questions of jurisdiction. Reuters said the bribery allegations in the suit were part of a scheme that has dogged the German conglomerate for years. Siemens paid a record US$1.6 billion to US and European authorities in 2008 to resolve allegations of bribery involving several countries.
Another case involved a subsidiary of French company Alstom International, which was sanctioned in 2004 for bribing executives from the now defunct utility company Luz y Fuerza del Centro (LFC) to win several contracts for the company during an auction held in 1999.

In 2002, Texas-based Orthofix, manufacturer of bone-repair and sports-medicine products, had to pay a fine of about US$5.2 million for violations of the Foreign Corrupt Practices Act (FCPA). Orthofix’s Mexican subsidiary Promeca S.A. de C.V. bribed officials at the state-run Instituto Mexicano del Seguro Social (IMSS) to obtain contracts to place its products at IMSS hospitals.

Cosmetics company Avon Products is another US-based company accused of violating the FCPA. Company officials allegedly bribed officials in Mexico, as well as other Latin American and Asian countries, between 2004 and 2010. There are reports the company might end up spending as much as US$132 million to resolve criminal and civil inquiries.

Walmart continues to expand in Mexico, Central America

Walmart’s affiliate in Mexico has faced other legal tussles in Mexico in recent years, including a dispute with the municipality of San Pedro Garza García in Nuevo León state. The retailer apparently reneged on a commitment to leave 30 trees intact in the Parque Rufino Tamayo during construction of a local store.

"Walmart has been levied a fine of 12.5 million pesos (US$970,000), which it has not only refused to pay but has challenged in court," said Eduardo Martínez, environment director for San Pedro Garza García, a community just outside Monterrey. "Under an agreement, the company said it would leave 30 trees alone, but it did not do so." Martínez said Walmart has replanted trees in the park but has refused to pay the fine.

Despite the scandals, the company has continued to prosper in Mexico and Central America in recent years. In the first quarter of this year, Walmex announced the opening of eight outlets in Mexico and seven in Central America, which adds up to 2,867 Walmart-owned stores in the region. The total includes warehouse outlets like Bodega Aurrera and Sam’s Club as well as the Walmart Supercenter, Farmacia Walmart Superama, and Suburbia outlets.

The company’s earnings have generally been influenced by economic trends in the region, including in five Central American countries: Guatemala, El Salvador, Costa Rica, Nicaragua, and Honduras. In data filed with the Mexican stock exchange (Bolsa Mexicana de Valores, BMV), Walmex reported a 2.2% increase in earnings during the first quarter of 2014, but a decline of about 4.4% in profits. The company said this was because of an increase in expenditures, which were about 7% higher than sales revenues.

Sales in Mexico were limited by reduced consumer confidence, which plunged 15.5% in January and 11.4% in February but rose by 4.7% in March, the company said.

Another factor in Mexico was the implementation of the tax-reform laws at the beginning of 2014, particularly a special tax (Impuesto Especial sobre Producción y Servicios, IEPS) on soft drinks and junk food and other items such as pet food (SourceMex, Oct. 23, 2013). Food and soft-drink manufacturers, including Ferrero de México, Sabritas, Productos Rochín, Gélita México, Bebidas Mundiales, Arca Continental, Chedraui, and Grupo Herdez protested the IEPS on junk food and soft drinks. Walmex’s protest centered on the new tax on pet food and on soft drinks. [Peso-dollar
conversions in this article are based on the Interbank rate in effect on May 14, 2014, reported at 12.90 pesos per US$1.00.]

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