Panel Discussion: Corporate Governance and the Impact of Sarbanes-Oxley

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JAIME CORTÉS ROCHA: I would like to comment on Don José García Mata’s remarks about the Comisario. Although I acknowledge and appreciate the high responsibilities which the post carries, I think the Comisario plays a very important role in the protection of shareholders before and against the acts of management, the administration, and against controlling shareholders. I think its protections are especially beneficial to non-public companies. Public companies already have some protections for minorities and have implemented some corporate governance rules. However, if you look at the general companies that constitute approximately 99% of the businesses in Mexico, they need some sort of protection from management that is not currently given by the law.

Also, the work of the comisarios is not the same as the role of the auditors. Comisarios respond to the shareholders and not to the board. In cases where there is an auditing committee, the board appoints the auditor based on the recommendation of the audit committee. The responsibilities of the comisario, in terms of reporting financial information, include assisting the shareholders by calling for shareholder meetings. The comisarios have a general role of inspection and reporting which is not given to the auditors. Although the post of comisario originated with the Law of General Corporations more than sixty years ago, it is still a valid role and should perhaps be revised. It could be looked upon differently in its application to public companies that are currently subject to corporate governance rules. In general terms, I think this is a role that should continue in Mexican corporations.

STEPHENSON: Does anyone on the panel want to respond?

JOSÉ O. GARCÍA MATA: In my prior comments I tried to emphasize that, as presently written, the law imposes significant personal responsibility on a person who serves as comisario, or statutory examiner. I just cannot see how someone who does not participate in or has the support of an audit can render a report that states that the information presented by management to shareholders reflects in a true and sufficient form the financial position and results of operations of the corporation. That, to me, is a statement that implies a great deal of responsibility. I am no longer the comisario of any company and that is a personal decision. I do not get involved with any audit in particular. I agree that the comisario function is particularly for non-public, or private companies. For instance, it can be a very useful tool for overseeing the interests of minority shareholders and of family members. I think it is a valid role. I do, however, think that the law and its requirements should be

* The views expressed here are those of the panelists, and should not be taken to represent the views of their employers or other organizations with whom they may be affiliated.
* A summary of the panelists’ background appears on the last page of the panel discussion.
1. Jaime Cortés is a partner in the firm of Mijares, Angoitia, Cortés y Fuentes S.C. in Mexico City.
3. Id.
revised. Comisarios should not be required to make such a broad statement as they must under current law.

CORTÉS: The comisarios usually rely on the work of an auditing firm. Customarily, the comisario is a partner of the same auditing firm, but that does not mean that it has to be in the same auditing firm. However, I do not understand anyone accepting the responsibility of comisario if there is no auditing firm making the financial audit. Likewise, the comisario could ask to be staffed and the company would pay those expenses. In my experience, most instances where comisarios have been sued for responsibility are due to the comisarios taking sides with one of the groups of the company.

STEPHENSON: I had a firm tell me that it no longer acts as comisario. They will act only as an accountant and perform an audit for the firm, but neither they nor any of their partners are permitted to act as comisarios. I was informed of this practice about a year ago.

THOMAS HEATHER: It is interesting. I think very valid points are being made here. The comment that has been made by your client is based on the fact that we have disputes that can go wrong, especially with shareholders. The comisario has a valid function, a very important function, to try to get the parties together, to call shareholders meetings, and to assure the formalities are kept.

Unfortunately in Mexico we are seeing that when the comisario brings the parties together, mercantile and commercial matters are turned into criminal affairs. First, litigators cause arrest warrants to be issued, comisarios are placed in jail, and then they ask you whether the convocatoria or agenda was correct or not. We find this tendency to file criminal charges as a means of pressure to be a problem, especially with the smaller companies. People do not want to take that role anymore, so now we are seeing that many non-accountants, or friends of management, end up in that role.

MICHAEL OWEN: I’m going to agree with and challenge some comments that both Jaime and José have made. José’s partner got squeezed not because he took sides but because, under Mexican law, he was required to call a shareholders meeting. That company had not called a shareholders meeting in two years, and a valid shareholder was insisting that the comisario call a shareholders meeting. I do not think that is taking sides, and yet that partner was threatened with criminal action and had to take a very long vacation outside of Mexico. But I do take issue with José’s comments to a large extent with respect to the comisario. In fact, I have often felt that one of the very valuable elements of Mexican corporate law as compared to U.S. law is precisely the institution of the comisario. It is especially valuable in Mexico, where certain families control many companies. These families give little or no importance to the rights of the minority shareholders. In that scenario, the comisario can play a very valuable role. I do happen to agree with

4. Michael Owen is a partner in the firm of Paul, Hastings, Janofsky & Walker L.L.P. in Los Angeles, California.
José’s comment with respect to certification on the accounting side. If the comisario is not an accountant or the accountant is not competent the comisario should not be required to make that certification. The comisario’s responsibilities with respect to calling shareholders meeting and assuring that corporate formalities are followed on behalf of the shareholders are extremely valuable ones.

CARLOS RAMOS: I wanted to comment on the fact that the statutory auditor or the comisario is not the only one held personally liable under the commercial companies law. There are also several provisions affecting direct liability and personal liability for directors. We have to revisit the actual corporate culture in Mexico. Some companies appoint a statutory auditor and appoint directors, but neither the statutory auditor nor the directors take their office seriously. We have to revisit our practices and then we have to learn to be liable and responsible for our actions. If we agree to be on a board, we must act as board members as required by law. Thus we will have to spend money to pay real professionals for undertaking those jobs, even though corporate governance is going to be much more expensive and we all have to take a step toward being more responsible for our actions.

JOHN ROGERS: Regarding the comisario’s legal liability, we already talked about the criminal liability. What about civil liability for damages caused to creditors of a company that has either borrowed money or issued securities and the financial condition of the company has rapidly deteriorated in a manner that would suggest that the comisario should have known and should have taken more aggressive action to make the real condition of the company known?

My second question involves the reporting-up obligation for lawyers in the U.S. under section 307 of Sarbanes-Oxley and its applicability to foreign attorneys. In this case foreign attorneys can include Mexican issuers in the U.S. capital market. As I understand it, the exemption for foreign attorneys is not a blanket exemption. It is only an exemption to the extent that the foreign attorney does not hold himself or herself out as practicing and does not give legal advice regarding U.S. federal or state securities or other laws. The question I raise is, for a Mexican attorney who is advising a Mexican issuer in the U.S. capital markets, how easy is it to draw the line and say you’re not advising on U.S. securities laws?

HEATHER: You are right. It’s not a blanket exemption and perhaps I am not well qualified to address the questions from the U.S. perspective, since I do not practice law in the U.S. In any event, I believe there is an implied duty of care by the Mexican lawyer. He renders advice in those areas where he is competent, and he should be very careful to know when to rely on U.S. counsel. There are certain matters that do have a consequence and it is important to document whatever the lawyer relies on when rendering advice in regard to U.S. placements.

5. Carlos Ramos is a partner in the firm of Barrera, Siqueros y Torres Landa S.C. in Mexico City.
6. John Rogers is a partner in the firm of Strasburger & Price, L.L.P. in Mexico City.
As far as the *comisario* is concerned, we must refer to the 1934 Mexican Statute on Corporations Law or the *Ley General de Sociedades Mercantiles*. It is possible for a shareholder, or in some circumstances a creditor, to sustain the auditor or declare that the *comisario* approved securities certifications improperly or erroneously, causing damage. The certifications could also be plainly false. The problem is that the standards of evidence are extremely high, and furthermore you have to establish the direct causal link for damages in our Mexican legal system. The possibility of actually recouping damages or lost profits, *perjuicios*, is a very difficult task. It is probably not worthwhile to attempt to recoup damages unless it is something absolutely blatant, and that is never the case.

There have been instances under U.S. securities laws of alleged violations of SEC Rule 10-B-5 where an auditor or officer of an issuer knowingly omits a material fact or should have known of actions or discussions of relevance which were omitted in disclosure. Any time you have a situation where civil liability is predicated exclusively on a violation of U.S. securities law, even if a judgment is obtained and is subsequently brought to Mexico for enforcement through the Mexican judiciary, the case will be severely questioned and probably will not get past first base.

KIMBERLY WARNKE: I know this was a tangential sort of issue raised by Lic. Heather, but I wanted to pursue it because it interests or troubles me. With regard to the Foreign Corrupt Practices Act (FCPA), the Facilitating Payment Concept, or "grease payment" as they're otherwise called, I understand that those are an exception under the FCPA. I also understand that "grease payments" are limited to the extent that local law prohibits them. Further, it is my understanding that in Mexico, local law does in fact prohibit them. It is also my understanding that we are dealing with a climate where we may believe, or suspect, that they are more common in practice, whether or not they are legally prohibited. How do you suggest advising clients with regard to that discrepancy, if you will, between reality and legal obligations?

HEATHER: Basically you are correct. Many of these payments to a government official or employee to carry out their function are considered to be a felony. Mexico, in order to be in compliance with the Organization for Economic Cooperation and Development (OECD) Convention on the Prevention of Bribery in Foreign Officials, reformed an article in the Federal Criminal Code, Article 222 (*Código Penal Federal*). You would probably have as a general rule, that some of the conduct does violate Mexican law. Nevertheless, there are certain exceptions, and some could be administrative violations. There are limitations as to amounts,

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10. Kimberly Warnke is a partner in the firm of Strasburger & Price, LLP in Mexico City.
there are limitations as to gifts; allowable, legal gifts may be fairly small. But the FCPA, under the light of Sarbanes-Oxley, has caused a major problem. Consider the situation in regard to resolving an issue with intellectual property piracy, either with software or other consumer products, or counterfeit products and stolen parts. You have an administrative party that is the IMPI, the Mexican Institute of Intellectual Property, and then you have the PGR, which is the Attorney General’s Office that prosecutes criminal felonies for contraband and piracy. In order to file and make either one of these entities move and actually carry out raids, they may not have the budget or the equipment available to carry out surveillance or to even transport the agents to a remote location. However, if the company provides resources and pays for some of the agency’s expenses and this agreement is strictly documented, is that a violation? I would say probably not. Yet certain colleagues in the states may say “No, that is the violation.”

Consider an Agencia Federal de Investigación (AFI) raid. AFI is the Mexican equivalent of the FBI. I believe they are doing a marvelous job and they are honest and young, well-trained people. Sometimes when they have to travel they might ask you, “Could you cover my lunch?” Some people may charge you up to, U.S. $20 a day. Is that a violation of a statute? I would say probably not. But it is something that is recurring and we have to take a look at the specific circumstances. This is not a problem unique to Mexico.

Yet, I do not think I quite answered your question sufficiently, but hopefully, I have given you a few points for further thought. I believe you have to look at FCPA questions on a case-by-case basis. Any type of bribery always poses serious issues.

STEPHENSON: Additional questions?

CHARLES BELL: Extrapolating this further down, from the attorney-reporting-up perspective, I speak from the perspective of an in-house lawyer who has a Mexican subsidiary. I would certainly want local counsel reporting those kinds of issues up through the general counsel’s office of the parent company. I realize that may create some confidentiality issues that I know our company would be more than happy to help you resolve with respect to our subsidiaries. I was just wondering about your thoughts on that in terms of the question that another gentleman asked, “Who is your client?,” when representing multi-national corporations, and you’re primarily representing the local subsidiary?

HEATHER: Who is your client? Your client could be the Mexican subsidiary—usually the case—or it could be the multi-national. It also depends on how you establish the contact and who pays you. Often reports from external counsel go directly to the general counsel’s office in the foreign company or the assistant general counsel in charge of the region or in charge of Mexico. That is up at the parent level. In general, Mexican practitioners in serious corporate firms are very careful in establishing the formality of who is the actual client.

In general, we have well established practices in Mexico to determine who the client is and when it may be appropriate to report or not with respect to a situation.

13. Mr. Bell is an employee of Perot Systems Corporation in Plano, Texas.
Sometimes it is appropriate to report even though the local persons in the legal department are your friends. You have a duty first to carry out your engagement on the agreed terms. In most cases, the client is the multinational, and the attorney reports to the head office.

One thing that is happening is that many of these multi-nationals go outside their established relationship of many years when these issues come up. They go to another law firm so that you do not cause the attorney, or law firm in question, to have to address these issues or cause a conflict unnecessarily. These issues are handled very confidentially, and I think we are seeing more clients consulting other firms and vice versa.

BELL: I think that applies not only when you have specific violations of law but also of the materiality standards under the securities regulations for public companies, particularly for smaller public companies. Relatively modest amounts of money could create a reporting issue for the parent, so it is probably incumbent upon all counsel to really understand materiality standards so that a local problem doesn’t end up being a material violation at the securities law level.

HEATHER: One very interesting point that came out of WorldCom specifically was this Breeden Report. I do not know if you have read it, but it is comprehensive and it does not allow anybody to do anything. And basically I really doubt that the Pope would qualify as an external, as the comisario. Is this going way beyond Sarbanes-Oxley as a reaction regarding fiduciary duties?

In Mexico we have concepts of fiduciary duties similar to those of the SEC and those imposed by Sarbanes-Oxley. First of all, directors in Mexican corporations are bound by a general duty of care and loyalty. The Civil Code applies supplementary to the Mercantile Code, and is an obligation of prudence to keep the business or take care of it as if it were one’s own (negocios propios). That basic concept is imbedded in the Civil Code, and also there are standards within other provisions of Mexican law.

Second, we are finding that more public companies in Mexico are implementing principles and internal policies basically dealing with conflicts of interest and business opportunities. Nevertheless, it is a fact that in Mexico we have a very heavy concentration of wealth, and few persons on many boards, like the one fellow that is on ten boards and has access to significant business opportunities. It would be an issue if policies were violated or if there was an obvious conflict of interest or violation of this duty of care and prudence. I believe you would have standing to report it, but to whom? You report it to the board and you would say, “There’s been a breach of this internal policy.” You report it to the audit committee. The audit committee should and must give the proper follow-through on these policies to make sure they are being implemented, and not just prescribed on paper.

If an opportunity is lost it is possible for the audit committee to recover damages. However, my principal comment on the issue of damages, is that in theory you can

recover damages and lost profits. However, in most cases, whatever is recouped is for the benefit of the corporation, not for the benefit of who ever is suing, which does away with "derivative"-type suits. The technical problem is one of substantiating the evidence and establishing very clearly a direct cause and effect. In the courts that is a real problem. In fact, I'm not aware of any major lawsuit whatsoever that has been successful using this theory.

**ROGERS:** I would like to take issue with the suggestion in the situations where there is a foreign parent company and a Mexican subsidiary, that lawyers should treat both as our clients. I think that creates a potential problem in blurring responsibility. There are some cases where the U.S. parent does not wholly own the subsidiary; there may be local shareholders. Even if there are not significant local shareholders, it may create a suggestion that there is some duty where there is a conflict to side with maybe one of the parties or get a conflict waiver from the two. I am not sure that is necessarily a good thing to do.

**HEATHER:** I agree with what you say; that should be the case. You have to know who your client is and what you were hired for. You have to be very careful with your letter of engagement. There could be a situation where you are hired for a project and that project involved the participation of the parent and of the subsidiary, and there could be a conflict. I believe in that situation, you are ethically obligated to not represent either one and to withdraw from the matter.
**BIографical Summaries**

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**José O. García Mata** CPA is a managing partner of the Mexico City office of Deloitte & Touche. Mr. García Mata has held several leadership positions at the Deloitte & Touche firm including: National Director of Professional Practice, Managing Partner of the Chihuahua and Guadalajara offices and Managing Partner for national audit operations. He is a member of the firm’s Executive Committee and was a member of its Board of Directors. Mr. García Mata has been the lead client service partner and engagement partner on some of the largest multinational companies operating in Mexico. Prior to joining Deloitte & Touche, he was a partner at one of the Big Eight accounting firms and worked as V.P. of Finance and Administration at a large U.S. multinational company. Mr. García Mata is a member of the American Institute of Certified Public Accountants and has been active in the Mexican Institute of Financial Executives. He received his Bachelor of Business Administration Degree from Woodbury University, Los Angeles and is a New York Certified Public Accountant.

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