

Winning the Unwinnable Case

Government

Litigation and Dispute Resolution


ST REGIS



CHEAT SHEET

- ***Power of attorney.*** A power of attorney was provided to the plant manager as part of the normal course of managing a maquiladora, but the language provided the manager with a great deal of discretion. US companies operating in Mexico should carefully word powers of authority to include a system of checks and balances.
- ***A failed mediation.*** In Mexico, the law does not provide for discovery. Mexican lawyers are often reluctant to begin a settlement negotiation, as no one wants to be the first to settle.
- ***The verdict.*** The court ultimately issued a judgment against the factory for US$17 million, including 20 percent taxation. In preparing to appeal the decision, the team retained outside counsel with extensive appellate court experience.
- ***The appeal.*** Under the first appeal, the judgment was modified to award the plaintiff only US$100,000 dollars in damages plus US$40,000 in prior invoices due. However, after the final appeal, the lower court ruled that the contracts were simulated and fraudulent — and modified the decision again — obligating the plaintiff to pay 20 percent of US$17 million or US$3.4 million.

San Luis Potosí, Mexico is home to many maquiladoras — factories owned by foreign (non-Mexican) entities — to take advantage of the financial incentives associated with the North American Free Trade Agreement (NAFTA). One such maquiladora made generators and alternators for automobiles. The maquiladora employed approximately 3,000 workers over various shifts. Its manager was a Mexican native to Queretaro, a state that borders San Luis Potosí. The maquiladora had been in existence for more than 20 years. Things seemed to be going well…

That is until it was discovered that the plant manager was corrupt and engaged in many illegal side deals, such as authorizing the payment of a ransom to recover stolen inventory against the instructions of senior management. The local Mexican vendor was also corrupt. It provided temporary assembly line workers, quality control workers, and warehousing for parts. It was discovered that the local Mexican vendor used forged social security documents for temporary maquiladora workers. The social security numbers belonged to deceased individuals, thereby enabling the vendor to pocket more money. After the fraudulent social security documents were discovered, management made the decision to sever ties with the Mexican vendor — having already terminated the plant manager. While management was negotiating the payment of the Mexican vendor's final invoices, the maquiladora was served with the lawsuit claiming US$20 million dollars in damages for breach of contract. The contract contained no termination clause. This is where the drama begins. No one at the maquiladora knew about the contract until the petition was served.

The maquiladora had a 17-year relationship with a corporate lawyer from a well-established Mexican firm. Upon the receipt of the summons, the maquiladora's Mexican lawyer advised the maquiladora's in-house US-based corporate lawyer that the petition had to be answered within 30 calendar days. This was incorrect. The factory's answer had to be filed within 15 days. By the time the corporate lawyer at the home office learned about the error, there were only three days left to file an answer.

In the United States, this is not an issue because it is not uncommon for an extension to be granted

to enable the defendant when requested. The court will usually grant more time to file an answer or to conduct another responsive pleading. In the United States, an answer usually consists of a denial, an affirmative defense, or a counter-claim. Once the responsive pleadings are filed, discovery begins.

Under Mexican law, the period in which to answer a petition cannot be extended because the court does not have the subject-matter jurisdiction to do so. In addition, Mexican law requires that the answer must filed with all documents that will be introduced at the hearing, including a list of witnesses, as well as any cross claims. Only newly discovered evidence can be filed at a later time. The only exception to this rule is in situations where the evidence to be produced is known but for reasons outside the control of the lawyer cannot be filed. The unavailable evidence must still be mentioned in the pleading and seek leave of court to file when received. A Mexican court usually grants leave.

The US corporate counsel and a Mexican lawyer named José Antonio Vázquez Cobo, with the help of numerous associates, worked around the clock to file the answer with the necessary documents and witness list in time. José Antonio was retained because the maquiladora's previous Mexican lawyer told the US counsel that its firm did not handle litigation outside of Mexico City. This was not true. The law firm was handling a number of cases for the parent company outside of Mexico City.

The parties

The plaintiff was a local corporation that provided services to the factory. The principal of that corporation was the nephew from a "prominent" local family. He ingratiated himself with the plant manager and convinced him, or they colluded together, to prepare the simulated contract. The plaintiff 's lawyer is a local attorney who is known for preparing these types of agreements. According to one local counsel, this plaintiff 's lawyer seeks out former employees of foreign companies to sign contracts binding the company. It is my understanding that his fees are generally 50 percent of any recovery.

A simulated contract is an agreement that seems to be valid and bona fide but is actually invalid. In civil law jurisdictions, it is a contract that does not express the true intent of the parties.

Retaining a lawyer

Retaining a Mexican lawyer was also a challenge. US lawyers usually charge corporate clients an hourly rate. In San Luis Potosí, one firm asked for a US$500,000 retainer plus 20 percent of any amount between the full amount of the demand and what might be awarded by the court. For example, a complete win would result in a fee of US$4,500,000 based on the US$20 million demand. Other local lawyers asked for similar amounts. Jose Antonio's firm was retained at an hourly rate.

As in-house counsel for the parent company, the GC asked me to manage the litigation for the company. The answer had already been filed. Jose Antonio, the lawyer retained by the company, is now a partner at Jones Day in Mexico City. He assumed during our first meeting that we would likely terminate his services. The thought crossed my mind. After the meeting, corporate counsel and I agreed that he should continue. He did a great job under the circumstances. He and his partners were able to file the answer within the short window of three days, which prevented a default judgment against the factory. Under Mexican law, the court has the authority to set it aside.

Power of attorney

The concept of apparent authority does not exist in civil law jurisdictions as it does in the United States. In all aspects of Mexican law, individuals can only act for the benefit of another if he or she has a power of attorney authorizing that person to act. The manager of business is usually given power of attorney to manage the daily affairs of a company. This also applies to a Mexican lawyer representing a client. He or she cannot do so without the formal signed power of attorney. This differs significantly in the United States. A US lawyer is retained through a retainer agreement, depending on the firm. A power of attorney agreement is never used.

The power of attorney must specifically describe what the agent can do. He or she can only do what has been specified. Any documents signed or actions taken without a power of attorney are voidable. In this case, the power of attorney was provided to the plant manager as part of the normal course of managing a maquiladora. He needed the power of attorney to manage the day-to-day affairs of the maquiladora. The problem is that the power of attorney was broad and allowed the plant manager a significant amount of discretion. According to one Mexican lawyer, the plant manager could have sold the maquiladora without management knowing.

The authority granted under a power of attorney is almost absolute. If the employee acts in bad faith with a properly executed power of attorney, it is next to impossible to set action taken by the employee aside. This was our dilemma. We contacted a local general counsel in the area and were informed that it is highly unlikely the factory would prevail. This was not encouraging news. US companies operating in Mexico should carefully word powers of attorney and have a system of checks and balances to prevent dishonest employees from using the powers of attorney to the detriment of the company.

Preparing witnesses

All witnesses employed by the factory were ordered to appear for an interview conducted by José Antonio and me. There were approximately 11 employees and one former employee who agreed to appear. This process started in the morning and went well into the evening. The first 11 said that they had never seen the agreement and that it was highly unusual for the plant manager to sign such an agreement with a vendor.

The factory has an established vendor management process. The origination of any contract begins with a procurement request based on input from plant supervisors who knew the workflow and can accurately forecast the needs for future services. The request would move up the chain of command.

The contract at issue bypassed all established company procedures. As we were waiting for the last witness to arrive at the plant, José Antonio indicated that it might be a waste of time to interview this person because his signature was on the contract and he was probably complicit with the plant manager. I knew it was important to know what information this person had, whether good or bad. To our surprise, the witness stated that he did sign the agreement but did not actually witness the agreement. He stated that he was ordered to sign the agreement by the plant manager. The vendor and the other witnesses were not present. He also stated that the purported date of the contract was Sunday, January 1 — when the plant was closed. He was our best witness and extremely cooperative. At the first hearing, the witness testified that the plant manager and the vendor attempted to coerce him into testifying on the plaintiff ’s behalf just a few days prior.

Retaining Mexican counsel

1. Exercise caution in retaining Mexican counsel. The Mexican bar has no authority to discipline attorneys for unethical conduct.
2. Obtain references where possible.
3. Have an upfront understanding of the fees.
4. Negotiate in good faith but be aggressive.
5. Interview several attorneys.
6. Include language in the agreement where the attorney agrees not to violate the FCPA.

Mexican legal process

There is a sharp distinction between trials in the United States and Mexico. Except for pretrial matters and motions, trials in the United States are conducted before a judge and/or a jury. Once the trial begins, the parties present the evidence on consecutive days until the end. In Mexico, hearings are set in one or two-hour increments.

Pleadings

When a plaintiff files a complaint in a civil proceeding, the plaintiff must include all the causes of action against a defendant. He or she must include a copy of any documents that will be submitted as evidence and list all the testifying witnesses. The court will exclude as evidence any document not attached to the complaint as well as the testimony of any witness not listed. The plaintiff cannot amend the complaint after the court files it. The same applies to the defendant when the answer is filed. There is an exception for evidence that was not known at the time the pleadings are filed. If the evidence is known to a party but cannot be filed for reasons not within the control of a party, the court will allow a leave to introduce the evidence later. The party's pleading must mention the evidence.

Once the parties are served, it is the obligation of the plaintiff to move the case forward. Failure to do so could result in a dismissal for failure to prosecute and subject the plaintiff to costs. In most cases, the plaintiff can refile the petition if the statute of limitations has not lapsed.

Hearings

There is a significant contrast between a trial in the United States and Mexico. In civil law jurisdictions, there is no discovery, and pretrial motions are allowed only in limited circumstances. Evidence is presented piecemeal in one or two-hour increments. The Mexican code requires that all of the evidence be presented by a certain date. A continuance is seldom granted. There is no remedy if a witness fails to appear. In one of my other cases in Mexico, the defendant was 20 minutes late. The judge did not allow him to testify.

Questions to party witnesses are submitted to the court prior to the hearing in a sealed envelope. The attorney law clerk opens the envelope and reads the questions to the witness. A secretary types a transcript of the testimony, which is signed by the witness and all attorneys. Defense counsel cannot be present during the testimony of his client. Opposing counsel as well as members of the public can be present. Attorneys for both parties can be present during the testimony of non-party witnesses. The submission of written questions is not required for nonparty witnesses.

There is typically no courtroom. The evidence is presented in a cramped room before the attorney law clerk. There is a secretary who types the witness testimony and, once signed, places it in the file. There was one chair for the witness. All other parties must stand.

Once the evidentiary phase has concluded, the attorneys have three days to file written closing arguments that become part of the record. The magistrate will then review the court file and make a decision based upon the evidence contained in the file. Many US lawyers are perplexed by the fact that the court, with few exceptions, does not hear the evidence. Mexican judges believe that, for some reason documentary evidence prepared under oath is more reliable than eyewitness testimony.

Beware of powers of attorney in Mexico

1. Only give the employee that authority that is necessary to carry out his day-to-day responsibilities.
2. Place a dollar limit on purchases.
3. Require secondary approvals.
4. Revoke the power of attorney when the employee is terminated.
5. Do a yearly audit of who has authority to act on behalf of the company and the extent of that authority.

Failed attempt at mediation

After the first hearing, José Antonio and I asked to meet with the plaintiff and his attorney. Two of his associates were also present. The experience was surreal. At the beginning, each party expresses its gratitude to the other for graciously attending the meeting. The lead attorney refused to provide a settlement amount. I made an offer of US$100,000. His only statement was “We are still far apart.” Without company authority, I offered US$500,000. He again said, “We are still far apart.” The plaintiff seemed anxious to settle but the lead attorney gave him a stare, which obviously meant, “Do not say a word.” I politely said thank you and we left.

It is difficult to mediate cases in Mexico. In the United States, the pretrial discovery makes the process more transparent because each side is required to disclose most of the evidence (but not all) to be presented. Each side knows the other’s strengths and weaknesses. Mexican law does not provide for discovery. Mexican lawyers are often reluctant to begin a settlement negotiation. No one wants to be the first. It is considered a sign of weakness — that the lawyer does not have confidence in his case — otherwise, why settle? I received demand letters on other matters in Mexico. A number of the Mexican lawyers advised me not to respond. If the plaintiff is serious about his case, he will file a lawsuit. This is diametrically opposed to the view in the United States where it is usually prudent to respond to a demand letter.

Strategy

We knew that winning this case was an uphill battle. A broad power of attorney is usually the kiss of death. In most cases, the only remedy is to sue the employee or press criminal charges. Notwithstanding, all evidence that would prove that the contract is a simulated contact would be submitted. In an effort to prove there was collusion between the former plant manager and the

vendor, we introduced testimony from multiple witnesses showing that no one else at the factory knew about the contract until the lawsuit was filed. José Antonio submitted testimony from witnesses explaining that auto parts manufacture can only predict the level of future services six months in advance at the most. The services needed are totally contingent on the orders received by the factory. The truth, veracity, and credibility of the plant manager was also attacked. Management terminated the plant manager because of his illegal activities that put the factory in jeopardy.

The verdict

The attorney law clerk for the court hinted during a conversation that an adverse ruling was probable. She stated after the close of the evidence that we will have all of the remedies available under Mexican law. I then notified management of the probable loss. It was no surprise when the court issued a judgment against the factory for US$17 million. In San Luis Potosí, the costs are taxed at 20 percent of the amount of the demand. In other parts of Mexico, costs are taxed at eight percent. The judgment also included cost, which is 20 percent of the US$17 million. The loser usually pays cost. Advising upper management of the verdict was a difficult call to make despite the fact that management received reports after each hearing.

Because José Antonio is based in Mexico City we decided to seek local counsel who could assist with the appeal. One local lawyer suggested that we not appeal. His advice was to create other entities and transfer the factory assets to those entitles to avoid paying the judgment. Knowing the answer to the question, I asked if Mexico law prohibited fraudulent transfers. He said, yes, but that would not be an issue here. I said thank you and left. It is important to note that this attorney comes from a purportedly prominent local law firm. We ultimately retained Angel Candida, who is a well-established attorney in San Luis Potosí with a stellar reputation, to assist with the appeal.

I have encountered lawyers who will tell you that they can handle anything and are reluctant to bring in other counsel. I was impressed when José Antonio suggested that we also retain one of his colleagues, Luis Asali Harfuch, who has extensive appellate experience and is well respected by the appellate court judges throughout Mexico.

The trial

The case was tried before the Juzgado Cuarto Del Estado de San Luis Potosí (The Fourth Court of the State of San Luis Potosí.) There were two opportunities to appeal. First, before the Tribunal Unitario del Noveno Ciruito (The first Unitarian Court of the Ninth Circuit), where only the magistrate judge decides the appeal. The final appeal took place before the Segundo Tribunal Colegiado del Noveno Ciruito (the Collegial Court of the Ninth Circuit also known as the Constitutional Court), where three magistrate judges decide the appeal.

First appeal

We expected that the first appellate court would affirm the adverse decision of the lower court. Only one judge was deciding our fate and we were not certain if this judge would be fair and impartial. To our surprise, the court ruled that the penalties provided for in the simulated contract violated Mexican law. The judgment was modified, awarding the plaintiff only US$100,000 in damages plus US$40,000 on prior invoices that were owed. The court did not rule on the validity of the simulated contracts. This was unexpected. We would have been happy to pay that amount but the plaintiff appealed. Therefore, we also appealed.

Final appeal

The constitutional court remanded the matter to the first appellate court with instructions to rule on the validity of the contract. The constitutional court did not instruct the lower court as to how to rule but to simply make a determination based on the evidence presented. At first, the lower court did not modify the opinion and sent it back to the constitutional court without any changes. We learned later that no changes were made because the magistrate did not have time to work on the file so he sent it back without changes. The constitutional court remanded the matter again.

The lower court ruled that the contracts were in fact simulated and fraudulent, thereby declaring them to be invalid and the factory owed no money. The amended decision was then sent back to the constitutional court, which later affirmed the lower appellate court's decision. Not only did the plaintiff not get any money under the contract, but because it lost the matter, it was obligated to pay 20 percent of US$17 million or US$3.4 million.

Conclusion

At the end of the day, justice prevailed in Mexico, but not without a lot of hard work, worrying, and luck. We were lucky to find good lawyers who were meticulous, persistent, and tenacious. No stone was left unturned. Notwithstanding, all of this could had been avoided if a robust system of checks and balances would have been in place. Powers of attorney should not be so broad. They should be reviewed every year by management and local counsel. Attending the significant court hearings gave me the opportunity to evaluate the performance of Mexican counsel. Outside counsel always seem to be at their best when working in front of the client. This is why US management should not be just a passive observer but rather be actively involved in the matter.

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