

## RACING TO THE TOP?: ACQUISITIONS AS A VEHICLE FOR IMPROVED ENVIRONMENTAL PERFORMANCE IN MEXICO

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**ABSTRACT.** *This article presents evidence which suggests that a “race to the top” is happening, as opposed to a “race to the bottom” with regard to environmental protection in the globalized world. The article analyses how environmental compliance influences mergers and acquisitions in Mexico. It presents new data on environmental compliance in relation to foreign investment in Mexico and asks whether the nationality of businesses affects the level of compliance. The evidence found suggests that as a consequence of the North American Free Trade Agreement, environmental legislation and compliance has improved. In addition, the evaluation of the level of soil contamination has proven to be an important factor in the acquisition of Mexican companies or subsidiaries of companies settled in Mexico.*

**KEY WORDS:** *Race to the top, race to the bottom, pollution haven, globalization, environment, NAFTA.*

**RESUMEN.** *Este artículo presenta evidencia que sugiere que una “carrera hacia la cima” está sucediendo, al contrario de una “carrera hacia el fondo”, en materia ambiental. La autora obtuvo datos de abogados que se dedican a derecho ambiental y fusiones y adquisiciones sobre la forma en que las fusiones y adquisiciones funcionan en México en la práctica y cómo influye esto en el cumplimiento de la legislación ambiental. El presente artículo contiene información nueva sobre el cumplimiento de las obligaciones ambientales en relación con la inversión extranjera y si la nacionalidad influye en reverdecer los negocios. La evidencia presentada sugiere que como consecuencia del Tratado de Libre Comercio, la legislación ambiental y el cumplimiento de ésta ha mejorado. Adicionalmente, la evaluación del nivel de contaminación de suelos ha probado ser un factor importante en la adquisición de compañías mexicanas o subsidiarias establecidas en México.*

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PALABRAS CLAVE: *Paraíso ambiental, cumplimiento ambiental, globalización, ambiente, TLC.*

TABLE OF CONTENTS

I. INTRODUCTION . . . . . 66

II. GLOBALIZATION AS DETONATOR FOR EITHER A “RACE TO THE TOP” OR A “RACE TO THE BOTTOM”. . . . . 67

    1. The “Race to the Bottom” . . . . . 68

    2. The “Race to the Top” . . . . . 70

    3. Foreign Direct Investment . . . . . 72

    4. The North American Free Trade Agreement as a Means for the Development of Mexico’s National Environmental Regulation . . . . . 73

    5. Environmental Audit Program. . . . . 75

III. METHODOLOGY . . . . . 79

IV. RESULTS AND DISCUSSION . . . . . 81

    1. Support for Vogel’s Environment vs. Labor Competition. . . . . 81

    2. Deal-Breakers: Environmental vs. Labor. . . . . 82

    3. Environmental Management Systems: Who Joins the Club? . . . . . 84

    4. Green Nationality. . . . . 85

    5. Following National or Foreign Environmental Laws?. . . . . 86

V. CONCLUSIONS. . . . . 87

I. INTRODUCTION

Globalization is said by some to give rise to a “race to the top” where cross-border acquisitions play an important part.<sup>1</sup> Others categorically dispute this perspective.<sup>2</sup> Mexico has opened its economy and it is important to know whether in addition to promoting economic growth this also has had a positive influence on environmental performance. This article uses new survey evidence to analyze the effects of cross-border acquisitions on environmental compliance in Mexico. The data demonstrates that there is a clear tendency towards a “race to the top”.

The phenomenon under study is acquisitions taking place in Mexico. Only companies incorporated in Mexico (hereinafter referred to as the *Ac-*

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<sup>1</sup> David Vogel, *Trading up and Governing Across: Transnational Governance and Environmental Protection*, 4 JOURNAL OF EUROPEAN PUBLIC POLICY 556-571 (1997).

<sup>2</sup> Herman Daly, *The Perils of Free Trade*, 269 SCIENTIFIC AMERICAN 24 (1993).

*quired*) which are being or have been acquired by companies directly or indirectly controlled by foreigners (hereinafter known as the *Acquirer*) were part of the study. The results suggest that Acquiring companies are interested in knowing the environmental conditions of the *Acquired*. In some cases the *Acquired* is registered in an Environmental Management Program with the purpose of bringing it to full compliance with environmental laws, although the evidence for this last proposition was not strong.

Surprisingly, Mexico is particularly concerned with one specific environmental obligation: soil contamination. The prohibition on transferring contaminated sites, as well as the obligation to clean-up contaminated facilities prior to closing them down, has gotten the attention of merger and acquisition (“*M&A*”) lawyers. According to the results obtained from my questionnaire, this topic alone has proven to be strong enough to cancel multi-million dollar acquisitions.

This article will try to answer the following questions:

1. Whether *Acquirers* are interested in acquiring companies whose environmental compliance record is high or whether this is irrelevant;
2. What are the reasons *Acquirers* want to find out the *Acquired* companies’ level of compliance with environmental laws; and
3. Whether *Acquired* companies comply with local environmental standards or foreign standards.

The structure of this paper is as follows: Section II contains a discussion of the “race to the top” and the “race to the bottom” hypotheses and argues in favor of the former. It also analyzes Mexico’s position with respect to foreign direct investment over the years and the issue on whether joining the North American Free Trade Agreement (*NAFTA*) has showed positive influence on Mexican environmental legislation and institutions. Finally, the design of the Environmental Audit Program will be studied in terms of its achievements with environmental compliance. Section III provides information on the methodology used in the preparation of this paper. The fourth section presents the results obtained from surveys completed by lawyers working for top Mexican law firms who specialize in mergers & acquisitions, environmental law or both specialties. This provides the basis for assessing whether cross-border acquisitions bring a “race to the top” with respect to compliance with environmental laws.

## II. GLOBALIZATION AS DETONATOR FOR EITHER A “RACE TO THE TOP” OR A “RACE TO THE BOTTOM”

The “race to the top” and “race to the bottom” theses arose from the competitive advantage theory, which is the basis for free trade. According

to this theory each country would manufacture only the products in which it had a competitive advantage. As a consequence, each country would be more efficient in the use of its resources. Some authors criticized this much-debated idea.<sup>3</sup> An example of competitive advantage is discussed in Abel and Phillips,<sup>4</sup> who describe one competitive advantage that appeared in Mexico after the execution of *NAFTA*. The stonewash industry was originally set up in El Paso, Texas, but was relocated to Mexico, which offered lower wages than the United States and has a strategic geographical location. This was determinant when choosing between Asia and Mexico, as transportation costs were lower.

Daly<sup>5</sup> supports the argument that globalization would result in weaker environmental standards or lax enforcement thereof, that is, a “race to the bottom.” The other position, the “race to the top,”<sup>6</sup> argues that free trade would have the opposite result. This paper argues that since the negotiation of *NAFTA*, Mexico has pursued a “race to the top” both in environmental legislation and compliance. To support the argument, the results section provides evidence obtained from experienced lawyers specializing in cross-border acquisitions.

Another debate is related to the power foreign companies could hold in a country and whether allowing foreign direct investment (*FDI*) would be beneficial. Mexico is one of the countries that chose to open its economy and allow *FDI* with certain limitations, such as the provision of electricity, as a public service, which is restricted to Mexico’s federal government.<sup>7</sup> The reasons behind the decision to open up to *FDI* will be explored, and the article will also analyze whether Mexico should aim to attract more *FDI* in the future in view of possible favorable outcomes in environmental compliance, as well as on the grounds of economic growth.

### 1. *The “Race to the Bottom”*

The “race to the bottom” thesis is based on the assumption that, in a free trade scenario, a country’s decision to enact more stringent environmental

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<sup>3</sup> See generally Daly, *supra* note 2.

<sup>4</sup> Andrea Abel & Travis Phillips, *The Relocation of El Paso’s Stonewashing Industry and its Implications for Trade and the Environment in Commission for Environmental Cooperation of North America*, in *THE ENVIRONMENTAL EFFECTS OF FREE TRADE, PAPERS PRESENTED AT THE NORTH AMERICAN SYMPOSIUM ON ASSESSING THE LINKAGES BETWEEN TRADE AND ENVIRONMENT* 263-291 (2002).

<sup>5</sup> Daly, *supra* note 2.

<sup>6</sup> Vogel, *supra* note 1; Sebastian Princen, *Trading up in the Transatlantic Relationship*, 24 *JOURNAL OF PUBLIC POLICY* 127-144 (2004).

<sup>7</sup> Cámara de Diputados del Honorable Congreso de la Unión [Congressional Chamber of Deputies], *Constitución Política de los Estados Unidos Mexicanos* [Political Constitution of the United Mexican States], available at: [www.cddhcu.gob.mx](http://www.cddhcu.gob.mx), February 22, 2010.

legislation would increase the cost of industry compliance. Under this assumption, companies' options for establishing industrial facilities would be based on countries with the least stringent environmental laws and standards, and thus the lowest costs in environmental compliance. Along the same line, countries would compete to attract foreign investment by lowering their environmental standards and/or the enforcement of instruments of compliance, thus creating "pollution havens."<sup>8</sup>

The "pollution haven" theory has been difficult to prove in practice because it involves lowering environmental requirements and exporting pollution to a specific country. Exporting pollution has been analyzed by several authors. For instance, Mark T. Heil and Thomas M. Selden<sup>9</sup> find that when income increased in developed countries, the amount of carbon emissions decreased as it increased in developing countries. Matthew Cole and Eric Neumayer<sup>10</sup> analyze the percentage of consumption of imports from developing countries and found that there was an increase in pollution-intensive imports from developing countries. Vivek Suri and Duane Chapman<sup>11</sup> study the rate of consumption of products manufactured domestically compared to those produced by a foreign country and imported. The results show that domestic production is replaced by exports. Although these studies provide evidence on the export of manufacturing activities from developed countries to developing ones, there is no evidence of "pollution havens."

Vogel<sup>12</sup> disagrees with the "race to the bottom" thesis and adds that when companies choose where to set up an industrial facility, the choice is based more on labor regulations as opposed to environmental regulations. Kumar<sup>13</sup> found that one of the characteristics that will drive general *FDI* away from a country is cheap labor. The reason for this is because investors need qualified workers for certain types of industries, as opposed to un-educated cheap labor. However, cheap labor may attract more investment from companies with the purpose of exporting the goods produced, Mexico's competitive advantage under the *NAFTA*.<sup>14</sup>

<sup>8</sup> Princen, *supra* note 6.

<sup>9</sup> Mark T. Heil & Thomas Selden, *International Trade Intensity and Carbon Emissions: A Cross Country Econometric Analysis*, 10 *JOURNAL OF ENVIRONMENT AND DEVELOPMENT* 35-49.

<sup>10</sup> Matthew Cole & Eric Neumayer, *Environmental Policy and the Environmental Kuznets Curve: Can Developing Countries Escape the Detrimental Consequences of Economic Growth?*, in *HANDBOOK OF GLOBAL ENVIRONMENTAL ECONOMICS* 298-318 (Peter Dauvergne ed., Wiley-Blackwell, 2005).

<sup>11</sup> Vivek Suri & Duane Chapman, *Economic Growth, Trade and Energy: Implications for the Environmental Kuznets Curve*, 25 *ECOLOGICAL ECONOMICS* 195-208 (1998).

<sup>12</sup> David Vogel, *Environmental Regulation and Economic Integration*, Vol. 3 No. 2 *JOURNAL OF INTERNATIONAL ECONOMIC LAW* 265-279 (2000).

<sup>13</sup> KUMAR NAJES, *GLOBALIZATION AND THE QUALITY OF FOREIGN DIRECT INVESTMENT* (Oxford University Press, 2002).

<sup>14</sup> Supporting Vogel's assumption, my own evidence shows that cheaper labor in for-

When *NAFTA* was being negotiated, there was fear that relocation to Mexico would become a method of escaping compliance with the U.S. and/or Canadian environmental standards, thus turning it into a “pollution haven.”<sup>15</sup> The evidence, however, is that both Mexican environmental legislation and compliance have improved since *NAFTA*’s passage.<sup>16</sup> In terms of free trade and *NAFTA*, Schatan<sup>17</sup> concluded that Mexico has shifted towards the export and manufacture of technological products, as opposed to primary goods and that since 1994, it has not turned to more polluting sectors. Thus, it has not become a “pollution haven.”

In fact, there is at least one example of Canada as a “pollution haven,” in terms of its environmental protection standards on transboundary movement of hazardous waste. Jacott *et al.*<sup>18</sup> study data on transboundary movements of hazardous waste between Canada, the United States and Mexico and found that after *NAFTA*, there was an increase of U.S. hazardous waste exports to Canada for its disposal, accompanied by weaker environmental protection standards. Unlike Canada, Mexico decided to ban the import of hazardous waste, and its environmental performance has been improving continuously.

## 2. *The “Race to the Top”*

According to Vogel and Johnson,<sup>19</sup> the “race to the top” theory has reflected the current outcomes of globalization and free trade, disqualifying

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eign countries is a more frequent cause of relocation of industrial facilities to Mexico than the difference in environmental requirements. Labor is clearly an important factor investors take into consideration when selecting where to set up an industrial facility. However, there is a difference in the type of *FDIs* attracted by cheap labor. Although the type of *FDI* that a country attracts and its possible spillovers are interesting, it is not part of this research.

<sup>15</sup> Bryan Husted & Jeanne M. Logsdon, *The Impact of NAFTA on Mexico’s Environmental Policy*, 28 *GROWTH AND CHANGE* 24-48 (1997).

<sup>16</sup> P. S. Wisner & M. J. Epstein, “Push” and “pull” impacts of *NAFTA* on Environmental Responsiveness and Performance in Mexican Industry, in PAPER PRESENTED AT THE THIRD NORTH AMERICAN SYMPOSIUM ON ASSESSING THE ENVIRONMENTAL EFFECTS OF TRADE (2005).

<sup>17</sup> Claudia Schatan, *Mexico’s Manufacturing Exports and the Environment under NAFTA*, in PAPERS PRESENTED AT THE NORTH AMERICAN SYMPOSIUM ON ASSESSING THE LINKAGES BETWEEN TRADE AND ENVIRONMENT, TORONTO, CANADA, 335-354 (2000).

<sup>18</sup> Marisa Jacott, *The Generation and Management of Hazardous Wastes and Transboundary Hazardous Waste Shipments between Mexico, Canada and the United States, 1990-2000*, in THE ENVIRONMENTAL EFFECTS OF FREE TRADE. PAPERS PRESENTED AT THE NORTH AMERICAN SYMPOSIUM ON ASSESSING THE LINKAGES BETWEEN TRADE AND ENVIRONMENT 161-212 (2002).

<sup>19</sup> Vogel, *supra* note 6; Pierre Marc, *The Environmental Effects of Free Trade*, in PAPERS

the “race to the bottom” thesis. This line of thought suggests that interdependency brings higher environmental standards and more resources invested in environmental protection. Using the “tuna dolphin” case, Vogel<sup>20</sup> shows how more stringent U.S. environmental protection requirements raised the tuna production standards in Costa Rica, France, Mexico, Spain and Venezuela by way of the Panama Declaration.

This case is an example of the “California effect.”<sup>21</sup> Although principally used for production standards, the “California effect” takes place when one party has stricter environmental standards than its commercial activity partners. Following these standards becomes a requirement of continued commercial activity between the parties. Hence, the commercial partners in the less regulated country adopt the more stringent environmental standards of the more regulated one.

Other examples of the “California effect” include: (i) Europe’s eco-labeling based on life-cycle assessment which has made Brazil re-think the way its leather goods are produced, which in turn has influenced Argentina and Uruguay, Brazil’s trading partners; and (ii) the European Union’s warning to Canada about the possibility of its exclusion from European Union markets if baby seals continued to be slaughtered.<sup>22</sup>

The “California effect” has yet to be a proven rule. Although there are examples of successful “contagion” of higher environmental standards between trading partners, there are also cases in which environmental standards have not been raised. In the “beef and hormone” case, the European Union imposed higher standards on meat imports, but the United States and Canada have not attempted to meet them.<sup>23</sup> Although this is an exception to the “California effect” theory, it does not by itself support the “race to the bottom” thesis. As we will see below, the best example to illustrate a “race to the top” in Mexico is the negotiation and enactment of the *NAFTA* between Canada, the United States and Mexico.

Apart from the “California effect,” the other possible effect which has been discussed in the literature is the concept of “regulatory chill.”<sup>24</sup> A “regulatory chill” would occur if Mexico decided not to enact stricter environmental laws out of fear that investors would leave the country or choose to invest elsewhere. Guerrero *et al.*<sup>25</sup> suggest one potential case in which

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PRESENTED AT THE NORTH AMERICAN SYMPOSIUM ON ASSESSING THE LINKAGES BETWEEN TRADE AND ENVIRONMENT (2002).

<sup>20</sup> Vogel, *supra* note 12.

<sup>21</sup> Vogel, *supra* note 1.

<sup>22</sup> *Id.*

<sup>23</sup> Princen, *supra* note 6.

<sup>24</sup> Jennifer Clapp, *What the Pollution Haven Debate Overlooks*, 2 GLOBAL ENVIRONMENTAL POLITICS 11-19 (MIT, 2002).

<sup>25</sup> María Teresa Guerrero, *The Forestry Industry in the State of Chihuahua: Economic, Ecological and Social Impacts Post-NAFTA*, in THE ENVIRONMENTAL EFFECTS OF FREE TRADE.



“regulatory chill” could occur in Mexico, namely in the forestry industry. As a result of *NAFTA*, import tariffs for wood were reduced from 15% to 0%. Although the forestry industry in Chihuahua alleged they could still remain competitive, the authors believed that the forestry industry would strongly oppose an increase in environmental quality standards, giving birth to a “regulatory chill.”

### 3. Foreign Direct Investment

Mexico did not open its markets until the 1980s. It was not until the negotiation of *NAFTA* and its execution that Mexico’s environmental legislation and institutions were formally and materially created and began to evolve. Just as *NAFTA* helped Mexico build more stringent environmental policies, cross-border acquisitions have also contributed to higher compliance levels with Mexican legislation.

In the 1950s, 1960s and 1970s, Mexico lived through a phase of “national import substitution.” This economic model promoted Mexico’s national industries providing tax benefits and easy loans to private industries. During the “national import substitution” phase, Mexico opposed free trade as “...numerous writers from developing countries worried that the market power of multinational firms would lead to these firms dominating their economies, such that prosperity, if it came, would be clouded by foreign control over these economies. This led, in many countries, to the adoption of policies to regulate or even, for some sectors at least, to ban foreign direct investment.”<sup>26</sup> This was the case of Mexico, which for obvious reasons was particularly worried about its northern neighbor.

To fund the activities that would promote Mexican industry, loans were obtained from foreign countries. This economic system worked for some time, but in the 1970s and 1980s Mexico became increasingly indebted, which led to a severe economic crisis. However, during the José López Portillo administration (1977-1982), sources of petroleum were found in Mexico. Confident of having oil as a source of income, Mexico continued with high spending rates and increasing debts. This had tragic consequences and eventually led Mexico to reconsider opening its economy to international markets after 1982.<sup>27</sup> The Mexican economy shifted towards greater inte-

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PAPERS PRESENTED AT THE NORTH AMERICAN SYMPOSIUM ON ASSESSING THE LINKAGES BETWEEN TRADE AND ENVIRONMENT 29-77 (2002).

<sup>26</sup> Edward Graham, *Introduction: Foreign Direct Investment in Developing Countries – Where Do We Now Stand?*, in *MULTINATIONALS AND FOREIGN INVESTMENT IN ECONOMIC DEVELOPMENT* 9 (Edward M. Graham ed., Palgrave Macmillan, 2005).

<sup>27</sup> RONIE GARCIA-JOHNSON, *EXPORTING ENVIRONMENTALISM. U.S. MULTINATIONAL CHEMICAL CORPORATIONS IN BRAZIL AND MEXICO* (MIT, 2000).



gration with the international economy: Mexico joined the General Agreement on Trade and Tariffs in 1986 and the *NAFTA* in 1992<sup>28</sup> (which entered into force in 1994).

Every rule has its exception, and while Mexican legislation today allows foreign investment, it also contains exceptions. The Foreign Investment Law<sup>29</sup> restricts the following activities that only the State can control: petroleum, basic chemistry, the generation, conduction, transformation, distribution and supply of electricity as part of the power public utility service,<sup>30</sup> nuclear energy generation; radioactive minerals; telegraphs, radiotelegraphs and mail; the issuance of Mexican notes and coins; and the control, supervision and inspection of ports, airports and heliports. Only Mexican companies or individuals are allowed to operate: land passenger transportation, tourism and freight (excluding courier services), gasoline commercialization and distribution of liquefied gas, credit unions, development bank institutions and certain professions.

#### 4. *The North American Free Trade Agreement as a Means for the Development of Mexico's National Environmental Regulation*

Environmentalism in Mexico grew in the 1990s.<sup>31</sup> During the *NAFTA* negotiation years, the number of air emission permits requested increased dramatically. Before 1992, only 50 air emission permits had been granted. Between 1992 and 1994, the number grew to 22,021. Today, there have been 35,500 air emission permits given.<sup>32</sup> The Secretariat of the Environment and Natural Resources (*SEMARNAT*) explains this increase in the number of permits as the result of the establishment of the Federal Prosecutor for the Protection of the Environment (*PROFEPA*) in 1992, and the commencement of their inspection program. *PROFEPA* was created on account of pressure to raise Mexico's environmental legislation and standards

<sup>28</sup> Juan Pablo Zorrilla Salgado, *La historia económica de México (Un resumen bajo la óptica sobre riesgo)* [Mexico's Economic History (A Summary under a Risk Perspective)], May 2004, available at: <http://www.gestiopolis.com/canales2/economia/histomex.htm>; Dale Colyer, *Foreign Direct Investment in the Primary Sector of Mexico*, in *FOREIGN INVESTMENT IN DEVELOPING COUNTRIES* 223-237 (H. S. Kehal ed., 2004).

<sup>29</sup> Cámara de Diputados del Honorable Congreso de la Unión, *Ley de Inversión Extranjera* [Law on Foreign Investment], Mexico City, February 22, 2010. Available at: [www.cddhcu.gob.mx](http://www.cddhcu.gob.mx), February 22, 2010.

<sup>30</sup> Dirección General de Compilación y Consulta del Orden Jurídico Nacional, *Ley del Servicio Público de Energía Eléctrica* [Electric Power Public Utility Law], Mexico City, February 22, 2010. Available at: [www.ordenjuridico.gob.mx](http://www.ordenjuridico.gob.mx), February 22, 2010.

<sup>31</sup> Susmita Dasgupta, *What Improves Environmental Compliance? Evidence from Mexican Industry*, 39 *JOURNAL OF ENVIRONMENTAL ECONOMICS AND MANAGEMENT* 39-66 (2000).

<sup>32</sup> JOSÉ LUIS LUEGE TAMARGO ET AL., *LA GESTIÓN AMBIENTAL EN MÉXICO* 372 (2006).

pertaining to *NAFTA*.<sup>33</sup> After *PROFEPA* began inspections, companies began to work on their environmental obligations, obtaining the proper documentation for their operations.<sup>34</sup>

Husted and Logsdon<sup>35</sup> study whether *NAFTA* negotiations were an example of a “race to the top,” and if so, whether that trend would be maintained in the long run or if Mexico would be “stuck in the mud.” After a thorough analysis of Mexican environmental legislation and regulatory enforcement, they concluded that Mexico had in fact raised its environmental standards as of the 1990s, and had spent increasing amounts of money on regulatory enforcement.

Wisner and Epstein<sup>36</sup> also analyze whether *NAFTA* brought higher environmental standards to Mexico and increased levels of compliance. Their findings are that both Mexican environmental legislation and environmental performance have been strengthened. The most important finding is that the most relevant driving force for compliance is not the regulation itself, but market forces. Fredriksson and Millimet<sup>37</sup> study whether U.S. states bordering Mexico and Canada changed their environmental standards, knowing that some facilities could leave the United States and establish themselves in Canada or Mexico. They found that environmental quality in the United States did not lower as a consequence of the *NAFTA*, and thus concluded that a “race to the bottom” did not take place.

Mexico’s first environmental law was enacted in 1971, however, “...for the major part of the 1970s, the Underministry of Environmental Improvement (SMA) did not enforce Mexican policy. While some facilities were temporarily closed, and minor fines imposed in Mexico City, regulation was not enforced.”<sup>38</sup> The Secretariat of the Environment, Natural Resources and Fisheries was created in 1994, and changed its name to the Secretariat of Environment and Natural Resources (*SEMARNAT*) in 2000. *PROFEPA* was created in 1992, and is responsible for inspection and evaluation of compliance with environmental legislation. The creation of both authorities coincides with Mexico’s entering *NAFTA*.

Mexico uses two instruments to verify or guarantee compliance with environmental legislation: environmental audits and environmental inspections. Environmental audits are voluntary and preventive while inspection

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<sup>33</sup> Wisner & Epstein, *supra* note 16.

<sup>34</sup> Luege Tamargo, *supra* note 32

<sup>35</sup> Husted & Logsdon, *supra* note 15.

<sup>36</sup> Wisner & Epstein, *supra* note 16.

<sup>37</sup> G. Fredriksson & Daniel Millimet, *Is there a Race to the Bottom in Environmental Policies? The Effects of NAFTA in Commission for Environmental Cooperation of North America*, in *THE ENVIRONMENTAL EFFECTS OF FREE TRADE. PAPERS PRESENTED AT THE NORTH AMERICAN SYMPOSIUM ON ASSESSING THE LINKAGES BETWEEN TRADE AND ENVIRONMENT* 241-261 (2002).

<sup>38</sup> Garcia-Johnson, *supra* note 27, at 117.

visits are obligatory and corrective. Both instruments are responsibility of *PROFEPA*. Although positive outcomes were found in terms of developing environmental legislation in Mexico in the 1990s by Husted and Logsdon,<sup>39</sup> they also found that there was only a limited capacity to inspect companies' compliance with environmental laws.

This situation prevails today. The strategy does not center on visiting a larger number of industries, but on visiting the most contaminating industries and devoting more time to each.<sup>40</sup> At the time, there was probably small capacity to keep up with inspections of every establishment in Mexico. While that still applies today, Mexico is now shifting from a command-and-control environmental policy system to a voluntary one. The environmental audit program thus plays a very relevant role. Dasgupta *et al.*<sup>41</sup> assure that although monitoring and enforcement of environmental legislation is poor in Mexico, there are still high levels of compliance. This fact shows that firms have reasons to comply besides the possible direct legal outcomes (economic fines, closure of facilities, etc.).

A previous analysis was undertaken by Dasgupta *et al.*<sup>42</sup> regarding compliance with environmental legislation in Mexico and what triggers it. They found that publicly-traded companies have higher compliance levels than other companies, and firms with ISO-14001 certification were more compliant than non-certified companies. As Dasgupta *et al.*<sup>43</sup> assert, "A number of studies in North America, Latin America, and Asia have shown that bad environmental performance lowers the market valuation of firms and reduces banks' willingness to extend credit..."

Garcia-Johnson<sup>44</sup> studies the export of environmentalism to Mexico from the United States, focusing on chemical industries. Interviews were carried out with officers working for both the chemical industry and Mexico's environmental authorities. She concludes that environmentalism was imported to Mexico with the help of "Responsible Care," an environmental management program for the chemical industry. Free trade plays an important part, given that chemical companies in Mexico adopted it to facilitate trade with foreign countries.

### 5. *Environmental Audit Program*

A successful environmental policy system consists not only of reliable environmental legislation, but also of the right enforcement mechanisms. Mex-

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<sup>39</sup> Husted & Logsdon, *supra* note 15.

<sup>40</sup> Luege Tamargo, *supra* note 32.

<sup>41</sup> Dasgupta, *supra* note 31.

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> Garcia-Johnson, *supra* note 27.

ico's Environmental Audit is an instrument for sustainable development that was created in 1988 as a voluntary compliance mechanism. This instrument aims at attracting companies that wish to be in full compliance with Mexican environmental legislation, and also want to comply with foreign and international applicable laws. After a company goes through the process, it is granted a "Clean Industry Award" which certifies that the entity is in full compliance with Mexican environmental legislation and that it will be for the following two years. The certificate may be renewed, provided that the entity demonstrates that its activities are in full compliance with all the environmental laws.<sup>45</sup>

This is one of the most important instruments in Mexican environmental policy as it is now shifting from an adversarial system based on command-and-control rules to a cooperative one based on voluntary compliance.<sup>46</sup> After a thorough analysis, Mexico discovered that as efforts and resources increased in terms of inspection visits performed by *PROFEPA*, environmental outcomes were decreasing. Surprisingly, there was also an increase in companies registering in *PROFEPA*'s environmental audit program. According to Luege Tamargo *et al.*<sup>47</sup> (former Special Attorney General for Environmental Protection, former Minister of the Environment and Natural Resources and currently head of the National Water Commission), it seems that the reputation gained by a company for voluntarily obtaining a certificate is one of the most important reasons for firms to join the program.<sup>48</sup>

Weiß<sup>49</sup> finds that the external reasons for a firm to join an environmental management program were: (i) competitive behavior, (ii) government requirements, (iii) environmental interest groups, and (iv) the firm's stakeholders. According to *SEMARNAT*, "exporting companies, companies that provide goods to the Mexican government, the ones that have a large amount of capital, the ones that belong to the construction, electricity, water, gas, manufacture, mining and other services are more prone to join the program."<sup>50</sup> A thorough review of the incentives of the manufacturing in-

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<sup>45</sup> Dirección General de Compilación y Consulta del Orden Jurídico Nacional, (1) *Ley General del Equilibrio Ecológico y la Protección al Ambiente* [General Law of Ecological Balance and Environmental Protection]. Available at: <http://www.ordenjuridico.gob.mx/Federal/Combo/L-158.pdf>, February 23, 2010; and Dirección General de Compilación y Consulta del Orden Jurídico Nacional, (2) *Reglamento de la Ley General del Equilibrio Ecológico y la Protección al Ambiente en Materia de Auditoría Ambiental* [Regulations for the General Law of Ecological Balance and on Environmental Audits]. Available at: <http://www.ordenjuridico.gob.mx/Documentos/Federal/wo44397.doc>, February 23, 2010.

<sup>46</sup> Luege Tamargo, *supra* note 32.

<sup>47</sup> *Id.*

<sup>48</sup> *Id.*

<sup>49</sup> P. WEIß ET AL., ENVIRONMENTAL MANAGEMENT SYSTEMS AND CERTIFICATION (2006).

<sup>50</sup> Luege Tamargo, *supra* note 32, at 397.

dustry for joining the program was not included in the study, but the results give some guidance as to the reasons companies might consider joining the program.

According to Husted and Logsdon,<sup>51</sup> the Mexican environmental audit became an important instrument to correct environmental problems. They list two incentives to register in the program: (a) no fines can be imposed under the program; and (b) industrial plants cannot be closed while the Clean Industry Award is valid. It is possible that these incentives were granted by *PROFEPA* on a case-by-case basis since the General Law on Ecological Balance and Environmental Protection (*GLEBP*),<sup>52</sup> the Regulations for the *GLEBP* on Environmental Audits<sup>53</sup> and the format of the contract to be entered into by the audited company and *PROFEPA*<sup>54</sup> do not specify any incentives given to those who join the program related to fines or closures. Aside from the fact that the audited company can use the Clean Industry Certificate logo, there would seem to be a lack of incentives to join.

*SEMARNAT* considers the strategy and the achievements to date successful. So far, 4,757 facilities form part of the program; only 1,934 of them obtained the Clean Industry Certificate.<sup>55</sup> Recently, *PROFEPA* launched an upgrade of the program, called the "Award of Excellence." Although this proceeding is free of charge, the only incentives provided by *SEMARNAT* are allowing the relevant company to use the Excellence logo, and being recognized as a leader in environmental protection. In order to receive the award, a company must: (i) hold a valid Clean Industry Award, (ii) have an on-going environmental management program, (iii) not be the subject of any administrative proceedings, and (iv) not have any continuing environmental claims against it. Only 16 companies were granted this award in the year 2005. Although efforts are being made to get more companies to join the program, they have proven unsuccessful.<sup>56</sup>

When compared to other environmental management systems or certificates, the Clean Industry Award certificate holds certain prestige. It requires compliance with the environmental legislation in force at the moment of the audit, as well as compliance with applicable foreign laws (in specific cases

<sup>51</sup> Husted & Logsdon, *supra* note 15.

<sup>52</sup> Secretaría de Medio Ambiente y Recursos Naturales (1), *supra* note 45.

<sup>53</sup> Secretaría de Medio Ambiente y Recursos Naturales (2), *supra* note 45.

<sup>54</sup> The format of the agreement to be entered into by the audited company and *PROFEPA* is publicly available at: <http://www.profepa.gob.mx/NR/rdonlyres/CA24B72A-164E-4284-AEBA-B04EE01EB1CE/4732/ConvenioAA1.pdf>, February 22, 2010.

<sup>55</sup> Luege Tamargo, *supra* note 32.

<sup>56</sup> Procuraduría Federal de Protección al Ambiente, *Boletín de prensa. Recibirán 16 empresas el reconocimiento de excelencia ambiental 2005: PROFEPA* [Press Release. 16 Companies to Receive the 2005 Environmental Excellent Award] available at: <http://www.profepa.gob.mx/PROFEPA/ComunicacionSocial/BoletinesdeMedios/CP-160-06.htm>.

where legislation is not available in Mexico, such as in soil contamination standards or when foreign laws are more stringent than local legislation), similar to the European Eco-Management and Audit Scheme (*EMAS*).<sup>57</sup> It could not be compared to the content of ISO-14001, which provides a choice of laws with which the facility can comply,<sup>58</sup> and there is no involvement with the authorities.<sup>59</sup> The Clean Industry Award involves the expert opinion of an environmental consultant whose capability has been certified by an independent organization (the Mexican Entity of Certification). The certificate may be renewed, provided that the firm is still in compliance, the status of which is confirmed by an independent environmental consultant. This is an opportunity to update any new environmental obligations that may have been incorporated into the relevant legislation and changes in the production process or new activities undertaken. In support of this fact, Watzold *et al.*<sup>60</sup> argue that companies which are part of an environmental management system are more up-to-date with environmental legislation.

On the other hand, there is a problem related to administrative fragmentation. *PROFEPA* is the entity responsible for carrying out Environmental Audits and issuing Clean Industry Award certificates. Legally speaking, however, it has no authority to perform an audit related to matters of either water extraction or waste water discharges (unless water was polluted as a result) or fisheries (unless as a result of such action environmental damages were caused), which are under the jurisdiction of the National Water Commission and the Ministry of Agriculture, Cattling, Rural Development, Fisheries and Food, respectively. In the opinion of the author, this diminishes the instrument's reliability. There is also the issue of the scope of the certificate, as the Clean Industry Award only certifies compliance with federal laws, leaving out state and municipal ones (for example, the handling of urban solid wastes and waste water discharges into municipal infrastructure are under municipal jurisdiction; and environmental impact and risky activities could be under state jurisdiction depending on the activity). Therefore, it certifies compliance with environmental administrative laws and standards and leaves out environmental taxes. As is the case with an ISO-14001, having the Clean Industry Award does not guarantee any improvements in environmental performance. It does at least, however, show that registered firms are motivated to comply, organized and informed.<sup>61</sup> It is recognized locally, as opposed to ISO-14001, which is recognized worldwide.<sup>62</sup>

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<sup>57</sup> Franz Watzold, *EMAS and Regulatory Relief in Europe: Lessons from National Experience*, 11 EUROPEAN ENVIRONMENT 37-48 (2008).

<sup>58</sup> P. Weiß *et al.*, *supra* note 49.

<sup>59</sup> Watzold, *supra* note 57.

<sup>60</sup> *Id.*

<sup>61</sup> Dasgupta, *supra* note 31; P. Weiß *et al.*, *supra* note 49.

<sup>62</sup> Watzold, *supra* note 57.

The Clean Industry Award has proven to be a useful tool with the potential to achieve positive environmental performance. It meets Mexico's requirements because it is a strategy that is less costly than inspection visits. However, the incentives to get facilities and/or companies to register have been insufficient so far and thus *PROFEPA* should focus on improving them if it wishes to focus environmental compliance through this instrument.

### III. METHODOLOGY

A survey was designed and conducted by the author of this paper, using the "Tailored Design Method" created by Don Dillman<sup>63</sup> for web-based surveys. It was carried out via SurveyMonkey, a web-based survey tool. According to the literature,<sup>64</sup> more honest responses are obtained in written questionnaires as opposed to interviews, given that they are self-administered. To avoid bias on this basis, respondents were assured that their responses and identities would be kept confidential.

The cluster sampling method and stratified random sample were used.<sup>65</sup> The names of the top ten law firms were found<sup>66</sup> and the population was selected from these firms. The relevant subgroups were (a) Mergers & Acquisitions; (b) Environmental Law; or (c) Both.

Cross-border acquisitions<sup>67</sup> generally take place within a short period of time, require a large team of multidisciplinary lawyers to perform a legal

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<sup>63</sup> DON A. DILLMAN, *MAIL AND INTERNET SURVEYS: THE TAILORED DESIGN METHOD* (Wiley, 2002).

<sup>64</sup> John C. Whitehead, *A Practitioner's Primer on the Contingent Valuation Method*, in *HANDBOOK OF CONTINGENT VALUATION* 66-91 (Anna Alberini & James R. Kahn eds., 2000).

<sup>65</sup> BRETT MARTIN DAVIES, *DOING A SUCCESSFUL RESEARCH PROJECT: USING QUALITATIVE OR QUANTITATIVE METHODS* (McMillan, 2007).

<sup>66</sup> Although the Mexican Bar for lawyers exists, it does not have the function of certifying the quality of lawyers, as is the case with Bar Associations in the United States. A complete list of lawyers and their specializations is thus not publicly available from it or from any other institution. To overcome this obstacle, the author of this paper consulted *LatinLawyer*, a magazine which, among other things, researches and ranks the quality of legal services provided to foreign clients by firms located in Latin America. It also provides the names and specializations of thousands of Mexican lawyers. The top ten Mexican law firms were picked from *LatinLawyer's* 9th edition of the "250 Most Authoritative Latin America Leading Business Law Firms." A law firm specializing in environmental law, which was amongst the top fifteen law firms, was also included in the law firms surveyed. Six of the ten law firms were also listed as the top ten law firms in Mexico by *Martindale.com*, one of the most recognized web-based lawyer location and ranking tools.

<sup>67</sup> This paper deals principally with the issue of acquisitions. Mergers are the act of combining two companies to create a larger company. Acquisitions, on the other hand, happen when a company decides to buy either shares or assets of another company, and thereby takes control of them. The surveys completed by lawyers made reference only to



audit and find any non-compliance, and are carried out in English because the *Acquirer* is a foreign company. Prior to the design of the survey, lawyers that had been previously selected with the desired specializations were contacted randomly via phone to find out how acquisitions usually worked.

Law firms are often contacted by either a foreign law firm or a foreign company wishing to acquire a Mexican company. In most cases, the Mexican law firm will assist in acquisition transactions and will not follow up on the *Acquired* company, unless an issue arises. This is the reason why most of the questions are related to information provided during the acquisition and not information that would have emerged at a later date.

Using Martindale's Internet Lawyer Locator, a search was conducted to find each of the lawyers working for the above firms that specialized in Mergers & Acquisitions, Environmental Law or Both. Although the Web page contained current information for most of the possible recipients, some information was unfortunately out of date. In the search for updated information, each law firm's website was checked against the lists. However, there is still the possibility that personnel who were recently hired and/or who had recently left the law firms were not contacted.<sup>68</sup>

The request for completion of the survey was sent individually, via e-mail, to 165 lawyers. Of those 165 lawyers: (i) 77% specialized in Mergers & Acquisitions; (ii) 18% specialized in Environmental Law; and (iii) 3% specialized in Both. The numbers reflect the number of people working at each of the specialties in the top ten law firms. The questionnaire was completed by 49 lawyers (29% of responses)<sup>69</sup> of which: (i) 65% specialized in *M&A*; (ii) 28%, in Environmental Law; and (iii) 6%, in *Both*. The questionnaire contained mainly closed, but also some open-ended, questions, and asked for detailed information about each lawyer's experiences with: (a) the type of industries that receive foreign direct investment; (b) the most common way of acquiring a company established in Mexico (either by means of acquiring assets or shares); (c) whether transactions were cancelled due to environmental or labor issues; (d) to what extent environmental certifications play an important role in cross-border acquisitions; (e) if environmentalism has a

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"acquisitions." It is possible that if they had been asked about mergers as well, the responses would have been similar to those obtained for this paper.

<sup>68</sup> The contact details for each lawyer were obtained from each law firm's webpage. One of the eleven law firms to be surveyed did not have their personnel's contact details publicly available. Although personnel at the law firm were contacted via telephone and e-mail for the purpose of obtaining the relevant contact details, they were not provided and therefore that law firm was not surveyed.

<sup>69</sup> Although a request to complete the survey was sent individually to each lawyer, in two cases, the relevant law firms completed only one survey on behalf of the law firm. The action taken was an obstacle to obtain a higher number of responses; however in both cases, it was an experienced partner who answered the questionnaire; therefore valuable information was provided.

nationality; (f) whether a foreign legal framework is used by foreign companies to bring the *Acquired* company to full environmental compliance, and (g) why foreign companies find out the environmental performance of the company to be *Acquired*.

#### IV. RESULTS AND DISCUSSION

There are significant differences between responses given by environmental lawyers and *M&A* lawyers. In most cases, environmental lawyers are only involved in acquisitions where the company has industrial facilities capable of polluting (air, water, hazardous waste, etc.). *M&A* lawyers are always involved regardless of the type of company. The responses given by each lawyer enhances the outcome of the research given that they show how they think and what their experience is with respect to certain topics. Most of the discrepancies have an explanation, which is always based on a legal requirement applied to real-life cases.

##### 1. *Support for Vogel's Environment vs. Labor Competition*

The questionnaire included a question designed to explore Vogel's hypothesis that wages were more important than environmental requirements when investing in another country. Lawyers were asked whether they had experienced any closures of industrial facilities during the past year in which the owner had the intention of setting it up elsewhere (in a foreign country). Only 16% responded they had. When computed separately based on the area of legal specialty, there is only a 10% difference in the responses; hence trends do not substantially differ between the respondents.

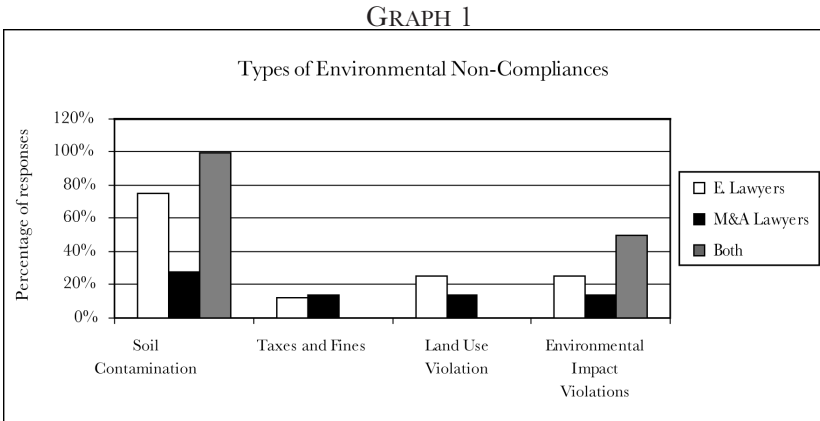
Of those reported closures, the results suggest that only 2% of the cases were related to environmental requirements being too strict in Mexico compared to other countries, while 14% were due to lower wages in foreign countries. In terms of environmental-related closures, when computed separately, results show that 50% of the environmental lawyers have experienced it and only 18% of *M&A* lawyers have done so. Lawyers with specialties in *Both* reflect the overall trend (30%).

As to closing down an industrial facility to set it up elsewhere due to lower wages, when computed separately none of the environmental lawyers had come across this situation while 15% of the *M&A* lawyers had. In conclusion, Vogel's hypothesis is supported by the overall results. We should not forget that "*maquiladoras* are designed to be able to relocate geographically according to different comparative advantages offered by different coun-

tries, regions.”<sup>70</sup> We observe a much stronger relationship for the hypothesis that where an industrial facility is closed down to be set up in other country, it is because of lower wages rather than lower environmental requirements.

## 2. Deal-Breakers: Environmental vs. Labor

When asked whether the lawyers had any experiences with an acquisition that was cancelled due to environmental non-compliance, only 30% responded they had. When asked for the reason(s) the acquisition was rescinded, 73% answered that it was for reasons of soil contamination. When computed separately, 75% of environmental lawyers made reference to soil contamination while only 28% of the *M&A* lawyers responded the same. With respect to the lawyers with both specialties, 100% responded that it was related to soil contamination. Graph 1, below, contains the environmental non-compliances that gave rise to the suspension of an acquisition, which include: (i) land use violation; (ii) environmental impact violation; (iii) taxes and fines; and (iv) soil contamination.



Soil contamination has the strongest potential impact when acquisitions are undertaken. In the event that a contaminated site was transferred during an acquisition, not only would authorization need to be obtained from *SEMARNAT* and/or *PROFEPA*, but the *Acquirer* would also become responsible for its clean-up (unless an agreement was reached for the previous

<sup>70</sup> Claudia Schata & Liliana Castilleja, *The Maquiladora Electronics Industry on Mexico's Northern Border and the Environment*, in *THIRD NORTH AMERICAN SYMPOSIUM ON ASSESSING THE ENVIRONMENTAL EFFECTS OF TRADE: INVESTMENT, GROWTH AND THE ENVIRONMENT*, Montreal, 30 November and 1 December, 2005, slide 10. Available at: <http://www.cec.org/symposium/documents.cfm?varlan=espanol>, July 10, 2009.

owner to arrange clean-up). Fines<sup>71</sup> for soil contamination may range from approximately US\$90 dollars to US\$225,000 dollars.<sup>72</sup> It is difficult to estimate the cost of the remediation of a site with contaminated soil given that it varies depending on: (a) the amount of contaminated soil and (b) type of contaminants. In *PROFEPA's* experience, approximate costs incurred by the authority in the remediation of 15 contaminated sites ranged from US\$2,148 to US\$21'485,000.<sup>73</sup> The price paid for cleaning up contaminated soil is always significantly higher than a fine. This explains why such a high percentage of transactions are cancelled due to soil contamination. Cross-border acquisitions can therefore be expected to play an important role in the nature and extent of contaminated site clean-up over the next several years, hence increasing environmental compliance levels.

Results show that environmental non-compliance is a more frequent deal-breaker than labor issues. Again, soil contamination plays an important role. As mentioned above, in addition to soil contamination remediation's being expensive, it is time-consuming and a potential future liability. Relevant standards for clean-up exist for some heavy metals, hydrocarbons and polychlorinated biphenyls. However, Mexico is in the process of developing all of the standards needed and thus buying a potentially-contaminated site raises concerns about future liabilities which might arise as the law on contaminated lands continues to develop.

Mexico has had contaminated sites since the colonial era as a result of mining activities. Recently, the number of contaminated sites has increased due to petroleum and industrial activities. No actions had been taken on this issue until six years ago when the General Law on the Prevention of Integral Management of Waste (*LGPGIR*) was published, and subsequently enacted in January 2004.<sup>74</sup> After the *LGPGIR* was published, sites with soils contaminated with hazardous waste could only be transferred if authorization was given by *SEMARNAT*. Owners and/or possessors of contaminated sites would be jointly responsible for the site clean-up. According to *SEMARNAT's* web site, since the *LGPGIR* was enacted, and until today, only 12 applications were filed with *SEMARNAT* to obtain an authorization to transfer a site whose soil is contaminated. In contrast, there were 118 applications for the approval of the proposals to remediate contaminated soil. We may conclude that parties who own a contaminated site clean it up instead of transferring such site as an environmental liability.

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<sup>71</sup> Cámara de Diputados del Honorable Congreso de la Unión, *Ley General del Equilibrio Ecológico y la Protección al Ambiente*, Mexico City, 2007. Available at: [www.cddhcu.gob.mx](http://www.cddhcu.gob.mx), February 22, 2010.

<sup>72</sup> The exchange rate used is the one published in *Diario Oficial de la Federación* on February 23, 2010.

<sup>73</sup> The exchange rate used is the one published in *Diario Oficial de la Federación* on February 23, 2010.

<sup>74</sup> Luege Tamargo, *supra* note 32.

Evidence supporting the argument that fines create an incentive for compliance if set high enough<sup>75</sup> was obtained from the questionnaire. *PROFEPA* may impose fines for environmental non-compliance ranging from US\$90 dollars to US\$225,000 dollars.<sup>76</sup> The National Water Commission may impose fines related to water non-compliances ranging from US\$4,500 dollars to US\$90,000 dollars.<sup>77</sup> According to *PROFEPA*'s annual report, 5,325 administrative proceedings were undertaken during 2006. The total amount of fines imposed in those proceedings was 112 million pesos (approximately US\$8,750,000 dollars). When divided, it shows that each administrative proceeding imposed a fine of approximately US\$1,643 dollars. Cross-border acquisitions are never below several millions of dollars, making fines irrelevant to the transaction. These issues are often dealt with by reducing the price paid for the *Acquired* company.

### 3. *Environmental Management Systems: Who Joins the Club?*

It has already been suggested in this paper that Mexico has not become a "pollution haven." It has also been argued that Mexico is shifting from a command-and-control system towards a voluntary and cooperative one. Following this line of thought, lawyers were asked whether acquiring companies had the intention of registering the *Acquired* company in one of the programs designed to improve their environmental compliance and management (only applicable to the cases in which the *Acquired* was not certified or in the process of obtaining certification). In the majority of the cases (55%), the acquiring company did not involve the *Acquired* in an environmental management program. In some cases (35%), the *Acquired* company was already registered in one of these programs and the acquiring company was certified or in the process of obtaining certification in 46% of the cases. When computed separately, both results are exactly the same for environmental lawyers and *M&A* lawyers (57% and 35%, respectively).

The results show that the most popular program chosen by the acquiring companies is the Clean Industry Award run by *PROFEPA*. Although most of the evidence would point to a positive effect of cross-border acquisitions in an increase in the number of companies registered in the Environmental Audit program, the evidence is not conclusive. There is only a small contribution from cross-border acquisitions to the development of Mexico's voluntary compliance strategy and *PROFEPA* needs to work harder to offer in-

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<sup>75</sup> Dasgupta, *supra* note 31.

<sup>76</sup> The exchange rate used is the one published in *Diario Oficial de la Federación* on February 23, 2010.

<sup>77</sup> The exchange rate used is the one published in *Diario Oficial de la Federación* on February 23, 2010.

centives to companies that join the program and obtain the Clean Industry Award.

The evidence presented here is not able to address the reasons the acquiring companies chose one environmental management program over another. However, it is clear that the acquiring companies wish to know the *Acquired* company's compliance status and bring it to full compliance with the applicable Mexican environmental legislation, which is clearly the purpose of the Environmental Audit Program.

#### 4. *Green Nationality*

In general, when we make reference to green nationalities we mostly think of either Germans or Swedes. Due to the controversial position of the United States towards the Kyoto agreement, it has not achieved a reputation for its clean ideology. Also controversial is the U.S. performance as both a part of and a defendant of the World Trade Organization on environmental matters.

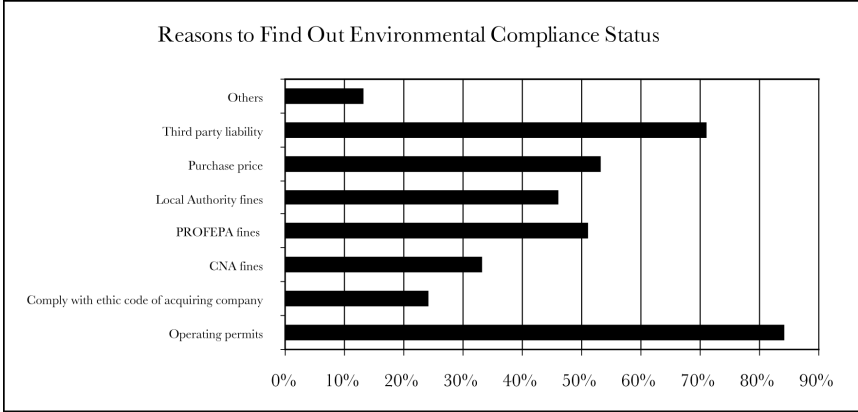
Mexico's Federal Secretariat of Economy provides a list of the nations that invest most money in Mexico. This is based upon the data collected by Mexico's Federal Foreign Investment Registry. According to this document, the nations with the most investment in Mexico are: the United States, Spain, Germany, Canada, Holland, Korea, France, Japan, Italy, United Kingdom, Panama, Belgium, Colombia, Brazil, Switzerland, Cayman Islands, Barbados, Virgin Islands, Argentina, Uruguay, Sweden and China. Based on this information, lawyers were asked which nationality in their experience was more interested in learning about environmental compliance of the company to be *Acquired*. The results show that 95% of the respondents answer the United States. The complete results are contained in Table 3 below. Only those countries ranking above 0% are included in the list.

TABLE 1. GREEN NATIONALITIES

<i>Country</i>	<i>Percentage</i>	<i>Country</i>	<i>Percentage</i>
United States	95%	Brazil	4%
Germany	31%	Sweden	4%
Canada	21%	Belgium	2%
United Kingdom	21%	Holland	2%
Japan	11%	Switzerland	2%
Spain	9%	China	2%
France	7%	Others	2%

Following up on this topic, the reasons an acquiring company would be interested in finding out the *Acquired* company’s compliance status with environmental laws are shown in Graph 2:

GRAPH 2. REASONS TO FIND OUT ENVIRONMENTAL COMPLIANCE STATUS



The effect of fines imposed by *PROFEPA*, the National Water Commission or local authorities on the acquisition of a company is positive, as expected, but not particularly strong. Having the relevant permits for operating the facility as soon as the acquisition takes place, third party liability and the purchase price remain the three most important reasons an acquiring company wants to find out the *Acquired* company’s environmental compliance status. Again, these reasons are directed at the possible costs to be incurred by the *Acquirer* if everything is not in good conditions, all of which are substantially higher than any of the fines that could be imposed.

5. *Following National or Foreign Environmental Laws?*

The only legal framework applicable to a company established in Mexico is Mexico’s federal, state and municipal environmental legislation. However, in practice, multinationals sometimes follow the laws of their home country. Mexico accepts compliance with foreign environmental laws, as long as they are stricter than Mexican standards. This is only applicable to cases in which legislation is not readily available.

An example of this is the standards for soil contamination. Mexico has enacted the following Mexican Official Standards for soil contamination: (a) NOM-138-SEMARNAT/SS-2003, which sets forth maximum permitted limits for hydrocarbons in soils and specifications for its characteriza-



tion and remediation, and (b) NOM-147-SEMARNAT/SSA1-2004, which sets forth criteria for determining remediation, concentrations for soil contaminated with arsenic, barium, beryllium, cadmium, hexavalent chromium, mercury, nickel, silver, lead, selenium, thallium and vanadium. In addition, the Mexican Official Standard for polychlorinated biphenyls contains limits for such material in soil. These standards are only some of the parameters which should be published for soil contamination concentrations (*i.e.*, there are no parameters for fertilizers in soil). Therefore, to date, Mexico has not enacted the complete framework that would allow a party to define its site as a contaminated one. To comply with the law (*LGPGIR*) already in force, *PROFEPA* and *SEMARNAT* encouraged the use of either: (a) unpublished criteria developed by a group of experts in the *PROFEPA*; or (b) the U.S. Environmental Protection Agency's Region IX Soil Contamination Standards.<sup>78</sup>

Survey results show that in 91% of the cases, companies are brought to comply with Mexican environmental legislation. Only in 8% of the cases do companies choose to comply with foreign laws. We did not find any evidence of instances in which companies did not comply with either national or foreign environmental legislation.

## V. CONCLUSIONS

According to the literature, Mexico's performance in environmental matters has advanced since entering *NAFTA*.<sup>79</sup> Generally speaking, Mexico has witnessed improvements in its environmental legislation as globalization progresses. This article contributes to the debate on the consequences of economic globalization by creating data on cross-border acquisitions and its effects on compliance levels with environmental laws in Mexico which were not previously available. Our results suggest that foreign Acquiring companies are interested in finding out the level of environmental compliance of *Acquired* companies. Below are the conclusions gathered from the findings of the paper.

- 1) Given the results obtained from green nationality, Mexico should not only promote foreign direct investment, but also encourage it from the United States, Germany, United Kingdom and Canada, which have shown an interest in environmental compliance. Moreover, if any more activities are open to foreign investment (such as energy), the green nationality factor should be taken into consideration when revising companies interested in investing in Mexico.

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<sup>78</sup> This information was obtained via e-mail from the Soil Contamination Offices of *PROFEPA* and *SEMARNAT* on August 17, 2007.

<sup>79</sup> Husted & Logsdon, *supra* note 15; Wisner & Epstein, *supra* note 16.

- 2) Mexico should increase the amount imposed for economic fines for environmental or water violations in order to increase compliance levels. As discussed in this paper, the amounts that can be legally imposed, as well as the amounts actually imposed in cases to date, are irrelevant when compared to the purchase prices paid in cross-border acquisitions. The responses of lawyers interviewed for this paper have suggested that soil contamination has been an obstacle in acquiring a Mexican company. This was explained by the fact that site clean-up is both expensive and time consuming. This tends to support, although in a different setting, the theory that if fines are set high enough, they will encourage compliance instead of making non-compliance part of a company's budget.
- 3) *PROFEPA* should increase incentives for companies in order to achieve higher compliance levels with environmental legislation via voluntary compliance. This strategy fits Mexico's profile given that voluntary programs are less resource-intensive for environmental authorities, which is the case of Mexico's budget for environmental matters. Today, being part of the program provides the incentive of being able to use the Clean Industry logo and the possible promise of not closing its facilities or being fined while part of the program.
- 4) Regulatory chill and soil contamination: evidence from the surveys suggests that the link between soil contamination and its relevance in cross-border acquisitions has strengthened environmental compliance. The results also show that it is possible to create environmental legislation that establishes higher environmental liabilities, which can result in increased costs. These violations have been dealt with by either reducing the purchase price of a transaction, agreeing on the clean-up of the contaminated site before the acquisition takes place, or canceling the transaction.
- 5) We found little statistical evidence of companies in Mexico being shut down for the purpose of setting them up in a foreign country with either lower wages or less stringent environmental standards. We find stronger evidence for the lower wages hypothesis as opposed to the less stringent environmental requirements.