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**Recent SEC Action Reinforces Principles of Compliance with the Foreign Corrupt Practices Act**

On August 27, 2008, the Securities and Exchange Commission filed a settled enforcement action against a California-based freight transportation company for violation of the books and records and internal controls provisions of the Foreign Corrupt Practices Act ("FCPA"). Con-way, Inc., a publicly-traded company, agreed to pay \$300,000 to settle claims brought in the U.S. District Court for the District of Columbia. This enforcement action reinforces principles of FCPA compliance and can provide guidance to domestic companies' efforts to educate employees concerning FCPA compliance issues.

**Alleged Conduct**

According to the complaint filed by the SEC, Con-way controlled (through a wholly-owned subsidiary) a 55% voting interest in Emery Transnational, a shipping company operating in the Philippines. The SEC alleged that, between 2000 and 2003, Emery Transnational made "hundreds of small payments totaling at least \$417,000" to foreign officials. The improper payments were made to two types of recipients:

- **Payments to Customs Officials:** The SEC alleged that payments were made to Philippine customs officials to (a) induce them to violate customs regulations to permit Emery Transnational to store shipments longer than otherwise permitted (thus saving transportation costs), (b) improperly settle customs disputes, or (c) reduce or otherwise decline to enforce legitimate fines. During the three years covered by the SEC enforcement action, the total amount of improper payments to customs officials was at least \$244,000.
- **Payments to Airline Employees:** Payments were also alleged to have been paid to employees of fourteen state-owned airlines. The payments were made (a) to encourage airline officials to improperly reserve space for the company's shipments (termed "weight shipped" payments), and (b) to induce airline officials to falsely under-weigh shipments and consolidate separate shipments into one shipment, thus saving shipping costs (termed "gain shares" payments). Emery Transnational paid airline officials 90% of the reduced shipping costs. Improper payments to airline officials totaled at least \$173,000 between 2000 and 2003. According to an administrative cease-and-desist order entered by the SEC contemporaneously with the civil action, payments were made to employees of the following majority state-owned airlines: Air France, Alitalia (Italy), China Airlines, EgyptAir, Emirates (Dubai), Gulf Air (Bahrain, Abu Dhabi, Oman), Kuwait Airways, Malaysian Airlines, Pakistan International Airlines, Royal Brunei Airlines, Saudi Arabian Airlines, SilkAir (Singapore), Singapore Airlines, and Thai Airways International.

Emery Transnational used its employees as conduits for improper payments. Company employees submitted reports to the finance department requesting cash advances to complete customs processing. The company issued checks made payable to the employees, who then cashed the checks and paid money to customs and airline officials. Unlike legitimate customs charges, the improper customs payments were not supported by receipts from the customs bureau or the Philippine Economic Zone Area.

During the relevant period, Emery Transnational was not required to report detailed financial information to Con-way or its wholly-owned subsidiary, Menlo Forwarding. Instead, Emery Transnational was only obligated to report its net profits, from which Menlo calculated its 55% dividend. This dividend was incorporated into Menlo's financial statements, which were rolled up and consolidated into the financial statements of Con-way.

The improper conduct came to light in 2003, when Menlo Forwarding increased Emery Transnational's internal reporting requirements, adding requirements that it begin reporting income and expenses. As a result of the more detailed reporting, Menlo Forwarding noted unusually high expenditures related to customs and airline expenses. An internal investigation conducted by Con-way uncovered potential violations of the FCPA, which were disclosed to the SEC. As a result of the investigation, Con-way imposed heightened financial reporting and compliance requirements on Emery Transnational. Several Emery Transnational employees were terminated, and Con-way provided additional FCPA training to its employees.

Under terms of the settlement, Con-way must pay a \$300,000 civil penalty within ten days of the entry of a judgment. Neither Con-way nor the Department of Justice has disclosed the existence of a corresponding criminal investigation.

### **Illustration of FCPA Compliance Principles**

1. **Supervision of Affiliated Enterprises:** The Con-way enforcement action reminds issuers of their responsibility to adequately supervise the conduct of affiliated companies under their control. The government will not likely consider supervision to be adequate if it does not include review of basic financial information that should reveal the existence of improper payments.

In its complaint, the SEC noted that Con-way and its subsidiary, Menlo Forwarding, provided little supervision or oversight of Emery Transnational. According to the SEC, "Neither Con-way nor Menlo Forwarding took steps to devise or maintain internal accounting controls concerning Emery Transnational, to ensure that it acted in accordance with Con-way's FCPA policies, or to make certain that its books and records were detailed or accurate." Emery Transnational was only obligated to report its net profits, from which Menlo Forwarding's dividend was calculated. Neither Con-way nor Menlo Forwarding requested more detailed information about the affiliate's income and expenses, records that, according to the SEC, should have revealed the improper payments to foreign officials. The SEC's view that such a review would surface improper payments is corroborated by the fact that the conduct was subsequently discovered as a result of increased financial reporting requirements imposed on Emery Transnational.

2. No Free Pass for Foreign Affiliates: The Con-way case illustrates that U.S. companies are not insulated from liability under the FCPA for illicit payments made by foreign employees of foreign affiliates. The improper payments in this case were made by employees of a Philippine company. However, under the FCPA, Con-way was required to maintain adequate internal controls to ensure that Emery Transnational complied with the FCPA and to provide that payments were properly recorded in its records.
3. “Foreign Officials” Lurk in “Private” Places: This case also reminds companies that foreign officials can be found in roles commonly associated with private enterprises. In the FCPA context, the term “foreign official” reaches far beyond the traditional notions of government agencies or elected officials. The FCPA defines “foreign official” to include “any officer or employee of a foreign government or any department, agency, or instrumentality thereof . . . or any person acting in an official capacity for or on behalf of any such government department, agency, or instrumentality . . . .” 15 U.S.C. § 78dd-1(f)(1)(A). Therefore, employees of foreign government-owned enterprises are considered foreign officials under the FCPA. Compliance programs, therefore, should address corporate contact with these “covert” officials, including employees of state-owned airlines.
4. Small Payments ≠ Facilitating Payments: The Con-way case reinforces the fact that a bribe payment for a small amount is nonetheless an impermissible bribe payment. The FCPA provides an exception for facilitating payments made to foreign officials “to expedite or to secure the performance of a routine governmental action.” 15 U.S.C. § 78dd-2(b). Facilitating payments are commonly considered to be small payments to a low-level government employee. But the Con-way case demonstrates that not all nominal payments to low-level government workers are permissible facilitating payments. Although the exact amount or range of payments was not disclosed by the SEC or Con-way, the SEC acknowledges that the individual payments were “small.” The payments, however, were made for the purpose of inducing officials to violate customs regulations, improperly settle disputes, refrain from enforcing administrative penalties, improperly reserve space for the company’s shipments, under-weigh shipments, and improperly consolidate multiple shipments. None of these actions can be considered a “routine government action” that can be secured by a facilitating payment. The Con-way matter illustrates that the purpose of the payment is more important than the amount when assessing whether it is a permissible facilitating payment under the FCPA.

Haynes and Boone, LLP has extensive experience in FCPA matters. If you would like advice on the matters mentioned in this Foreign Corrupt Practices Act Alert, or more information, please contact one of the Haynes and Boone attorneys listed below.

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