
Case 6-2

Con-way Inc.

Summary of Findings

Con-way is a Delaware corporation headquartered in San Mateo, California. It is an international freight transportation and logistics services company that conducts operations in a number of foreign jurisdictions. During the relevant period, the company was named CNF, Inc.; it changed its name to Con-way in April 2006. Con-way's common stock is registered with the SEC pursuant to Section 12(b) of the Exchange Act and is listed on the NYSE.¹

Menlo Worldwide Forwarding, Inc. (Menlo Forwarding), was a wholly owned U.S.-based subsidiary of Con-way that Con-way purchased in 1989. During the relevant period, Menlo Forwarding was headquartered in Redwood City, California, and had a 55 percent voting interest in Emery Transnational (Emery). Con-way sold Menlo Forwarding to United Parcel Service of America, Inc. (UPS), in December 2004.

California-based Con-way Inc., a global freight forwarder, was charged by the SEC with making payments that violated the FCPA. The company paid a \$300,000 penalty and accepted a cease-and-desist order to settle the FCPA enforcement action. Con-way's FCPA violations were caused by a Philippines-based subsidiary, Emery Transnational. It made about \$244,000 in improper payments between 2000 and 2003 to officials at the Philippines Bureau of Customs and the Philippine Economic Zone Area, and \$173,000 in improper payments to officials at 14 state-owned airlines. In connection with the improper payments, Con-way failed to record these payments accurately on the company's books and records and knowingly failed to implement or maintain a system of effective internal accounting controls.

Lack of Oversight over Emery Transnational

During the relevant period, Con-way and Menlo Forwarding engaged in little supervision or oversight over Emery. Neither Con-way nor Menlo Forwarding took steps to devise or maintain internal accounting controls concerning Emery, 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.

During the relevant period, Con-way and Menlo Forwarding required only that Emery periodically report back to Menlo its net profits, from which Emery then paid Menlo a yearly 55 percent dividend. Menlo incorporated the yearly 55 percent

dividend into its financial results, which were then consolidated in Con-way's financial statements. Neither Con-way nor Menlo asked for or received any other financial information from Emery. Accordingly, neither Con-way nor Menlo maintained or reviewed any of the books and records of Emery—including the records of operating expenses, which should have reflected the illicit payments made to foreign officials.

Payments to Philippine Customs Officials

Emery made hundreds of small payments to foreign officials at the Philippines Bureau of Customs and the Philippine Economic Zone Area between 2000 and 2003 in order to obtain or retain business. These payments were made to influence the acts and decisions of these foreign officials and to secure a business advantage or economic benefit. By these payments, foreign officials were induced to (1) violate customs regulations by allowing Emery to store shipments longer than otherwise permitted, thus saving the company transportation costs related to its inbound shipments; (2) improperly settle Emery's disputes with the Philippines Bureau of Customs, or (3) reduce or not enforce otherwise legitimate fines for administrative violations.

To generate funding for these payments, Emery employees submitted a *Shipment Processing and Clearance Expense Report* to Emery's finance department. These reports requested cash advances to complete customs processing. The cash advances were then issued via checks made payable to Emery employees, who cashed the checks and paid the money to designated foreign officials. Unlike legitimate customs payments, the payments at issue were not supported by receipts from the Philippines Bureau of Customs and the Philippine Economic Zone Area. Emery did not identify the true nature of these payments in its books and records. From 2000 to 2003, these payments totaled at least \$244,000.

Payments to Officials of Majority State-Owned Airlines

To obtain or retain business, Emery also made numerous payments to foreign officials at 14 state-owned airlines that did business in the Philippines between 2000 and 2003. These payments were made with the intent of improperly influencing the acts and decisions of these foreign officials and to secure a business advantage or economic benefit. Emery Transnational made two types of payments. The first type was known as "weight-shipped" payments, which were made to induce airline officials to reserve space for Emery on the airplanes improperly. These payments were valued

¹Securities and Exchange Commission, *In the Matter of Con-way Inc.*, Accounting and Auditing Enforcement Release No. 2867, August 27, 2008, www.sec.gov/litigation/admin/2008/34-58433.pdf.

based on the volume of the shipments the airlines carried for Emery. The second type were known as “gain shares” payments, which were paid to induce airline officials to falsely underweigh shipments and to consolidate multiple shipments into a single shipment, resulting in lower shipping charges. Emery paid the foreign officials 90 percent of the reduced shipping costs.

Both types of payments to foreign airline officials were paid in cash by members of Emery’s management team. Checks reflecting the amount of the weight-shipped and gain shares payments were issued to these managers, who cashed the checks and personally distributed the cash payments to the foreign airline officials. Emery Transnational did not characterize these payments in its books and records as bribes. During the 2000–2003 period, these payments totaled at least \$173,000. Neither Con-way nor Menlo requested or received any records of these payments or any of Emery’s expenses during this period.

Discovery of Improper Payments and Internal Investigation

Con-way discovered potential FCPA issues in early 2003. Starting in January 2003, Menlo initiated steps to increase Emery’s internal reporting requirements, including requiring Emery to begin reporting its income and expenses, in addition to its net profits. As a result, in reviewing Emery’s records, Menlo employees noticed unusually high customs and airline-related expenditures.

Menlo conducted an internal investigation of the suspicious payments at Emery and determined that Emery employees had been making regular cash payments to customs officials and employees of majority state-owned airlines. Based on Menlo’s investigation, Con-way conducted a broader review of all of Menlo foreign businesses and voluntarily disclosed the existence of possible FCPA violations to the staff. After completing its internal investigation, Con-way imposed heightened financial reporting and compliance requirements on Emery. Menlo terminated a number of the Emery employees involved in the misconduct, and Con-way provided additional FCPA training and education to its employees and strengthened its regulatory compliance program. In December 2004, Con-way sold Emery to UPS.

Legal Analysis

The FCPA, enacted in 1977, added Exchange Act Section 13(b)(2)(A) to require public companies to make and keep books, records, and accounts that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer, and added Exchange Act Section 13(b)(2)(B) to require such companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that (1) transactions are executed in accordance with management’s general or

specific authorization; and (2) transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and to maintain accountability for assets.

As already detailed, Con-way’s books, records, and accounts did not properly reflect the illicit payments made by Emery to Philippine customs officials and to officials of majority state-owned airlines. As a result, Con-way violated SEC Exchange Act Section 13(b)(2)(A). Con-way also failed to devise or maintain sufficient internal controls to ensure that Emery Transnational complied with the FCPA and to ensure that the payments it made to foreign officials were accurately reflected on its books and records. As a result, Con-way violated Section 13(b)(2)(B) of the Act.

Securities Exchange Act Section 13(b)(5) prohibits any person or company from knowingly circumventing or knowingly failing to implement a system of internal accounting controls as described in Section 13(b)(2)(B), or knowingly falsifying any book, record, or account as described in Section 13(b)(2)(A). By knowingly failing to implement a system of internal accounting controls concerning Emery Transnational, Con-way also violated Exchange Act Section 13(b)(5).

According to the SEC’s complaint, none of Emery’s improper payments were reflected accurately in Con-way’s books and records. Also, Con-way knowingly failed to implement a system of internal accounting controls concerning Emery that would both ensure that Emery complied with the FCPA and require that the payments that it made to foreign officials were reflected accurately on its books and records.

Questions

1. The FCPA distinguishes between so-called facilitating payments and more serious activities. Do you think such a distinction and the related penalties for violations under the Act make sense from an ethical perspective? Use the utilitarian analysis of harms and benefits of facilitating payments to support your position.
2. Securities Exchange Act Section 13(b)(5), 15 U.S.C. §78m(b)(5) prohibits any person or company from knowingly circumventing or knowingly failing to implement a system of internal accounting controls or knowingly falsifying any book, record, or account. What is the purpose of the accounting provisions in the SEC laws and FCPA? Assume the auditors of Con-way knew about the accounting for FCPA payments in the books and records of the company. Do you think the auditors would be guilty of: (1) ordinary negligence; (2) gross negligence; or (3) fraud? Explain.
3. Given that the FCPA permits facilitating payments, do you believe it is ethically appropriate for companies to deduct such payments from their income taxes? Why or why not? What about outright bribery payments? What does the law require in each instance with respect to tax deductibility?