BAE Settles Protracted, Controversial Bribery Case with U.S. and U.K. Authorities

International Alert

02.11.10

On February 5, 2010, the U.S. Department of Justice ("DOJ") and the U.K.'s Serious Fraud Office ("SFO") announced settlements of long-standing bribery investigations of U.K. defense giant BAE Systems plc ("BAE"). While the case would be noteworthy solely because the joint penalties imposed make this the third largest foreign bribery case to date, it also raises a host of significant legal and policy questions that are only partly explained in the public documents.

The combined penalty of over $445 million -- most of which ($400 million) was imposed by the DOJ -- is among the highest anticorruption-related penalties assessed to date. However, it is the differences in the factual allegations in the two settlements, the oblique nature of the violations charged, the negotiated terms of the settlements, and the allegations that are not made in the public settlement documents that provide a glimpse of the political undercurrents, legal maneuvering, and policy objectives that underlie this settlement and that raise potentially far-reaching precedential issues.

The Investigations. Both the SFO and the DOJ have conducted anti-bribery investigations of BAE for several years. The SFO investigations have focused on alleged bribery in numerous countries. As reported in our past FCPA reviews, the SFO began investigating BAE in July 2004 for alleged large-scale corruption involving payments to members of the Saudi royal family. In particular, BAE allegedly deposited £1 billion ($1.97 billion) into the Washington bank account of Saudi Prince Bandar bin Sultan (who was at the time the Saudi Ambassador to the United States) in exchange for his help in brokering the sale of Typhoon jet fighters to the Saudi government, in a deal known as the "al-Yamamah" arms sale. As was widely reported at the time, in 2006, former Prime Minister Tony Blair directed the SFO to shut down the probe on national security grounds, and his controversial, widely-criticized decision was upheld on appeal to the House of Lords.

In 2007, following the discontinuation of the U.K.'s al-Yamamah investigation, the DOJ began its own investigation of BAE, issuing subpoenas to several BAE executives. Also, following the resignation of SFO head Robert Wardle, the SFO, under the leadership of Wardle's successor, Richard Alderman, resumed investigating BAE for activities unrelated to the al-Yamamah deal, including alleged bribery of officials in Austria, the Czech Republic, Romania, South Africa, and Tanzania, among other countries. According to press accounts, a previous effort by the SFO and BAE to reach a settlement collapsed in September 2009, with BAE reportedly rejecting an offer by the SFO to settle bribery charges for £300 million. Soon thereafter, the SFO announced plans to prosecute BAE.

The Alleged Underlying Facts. Releases by the SFO and the DOJ, together with press reports, chronicle a series of large payments made by BAE to third parties in order to obtain business. Press accounts report that BAE paid third parties $12 million to secure a $40 million contract to provide Tanzania with a new military-grade air-traffic control system. In conjunction with the SFO announcement, BAE issued a statement admitting that the company made commission payments to a "marketing adviser" in connection with the sale of a radar system to Tanzania in 1999 and failed to accurately record such payments in its accounting records.

The criminal information filed by the DOJ recites efforts by BAE to obtain military contracts in the Czech Republic, Hungary, and Saudi Arabia. It asserts that BAE made substantial payments through offshore shell companies to third parties referred to as "marketing advisers" and that it made such payments under circumstances suggesting that there was a high probability that part of the payments would be used to gain an advantage for BAE in seeking defense contracts with foreign governments. It further alleges that BAE took various steps to conceal its arrangements with third parties from enforcement authorities by, for example, avoiding communicating with third parties in writing and maintaining materials with information about third parties in secretive legal trusts in offshore locations.

With respect to Saudi Arabia, the DOJ also alleged that BAE made payments to an unnamed Saudi official who had influence over a contract for military aircraft and related items between BAE and the Saudi government. DOJ documents state that BAE allegedly disguised the payments to the Saudi official as "support services" provided under an agreement between the Saudi government and BAE. These "support services" were allegedly made through third parties (including travel agents), and included the purchase of travel and accommodations,
security services, real estate, automobiles and personal items. Invoices for “support services” provided between 2001 and 2002 allegedly totaled over $5 million. Additionally, in connection with the same contract, BAE allegedly agreed to transfer over $24 million to an intermediary’s Swiss bank account while BAE was aware that part of the payment would be passed on to the Saudi official.

The DOJ information also states that BAE provided marketing services to the government of Sweden in connection with the lease of Swedish fighter jets to the governments of the Czech Republic and Hungary. For assistance in securing the lease of the jets by the Czech and Hungarian governments, BAE allegedly made payments totaling over $29 million to an unnamed third party. Because the jets contained U.S.-controlled defense materials, Sweden was required to obtain U.S. re-export licenses from the Department of State for these leases. The DOJ documents state that BAE failed to disclose to Sweden the existence of the commission payments it paid, which caused Sweden to omit this information in the license applications submitted to the Department of State. Overall, the DOJ information claims that BAE gained over $200 million from these transactions involving the Czech and Hungarian governments.

The Plea Agreements. The plea agreements issued in each country set out facts alleging that BAE made corrupt payments to government officials directly or through third party intermediaries. However, although the case has been widely characterized in press reports as a bribery case, the plea agreements do not charge BAE with actually paying or authorizing the payment of unlawful bribes to government officials. Instead, they charge BAE with accounting violations and a conspiracy charge. In the United Kingdom, BAE will plead guilty to one count related to accounting violations, for which it will pay a fine of £30 million. The DOJ information charges BAE with one count of conspiring to defraud the U.S. government, make false statements to the U.S. government, and omit material facts required to be stated in applications for export licenses.

The DOJ’s charge of conspiracy to defraud and make false statements was based in part on a letter sent by the company to the then-Secretary of Defense in November 2000 (that letter is the sole exhibit to the information) in which BAE proclaimed its commitment to comply with the FCPA and stated that it would within one year adopt a compliance program to ensure that the company and its affiliates met the standards set forth in the FCPA, U.K. anti-bribery laws, and the OECD Anti-Bribery Convention. The information further alleges that subsequently, in May 2002, BAE stated in correspondence with the then-U.S. Under Secretary of Defense that it had complied with the spirit and letter of its statements in the November 2000 letter.

The information alleges that despite introducing enhanced compliance policies and procedures in 2001, BAE failed to create or implement sufficient anti-corruption mechanisms to make the statements in the correspondence truthful and to satisfy its commitments made in the correspondence. While not directly stated in the relevant DOJ documents, that failure presumably relates in the first instance to the series of payments made to intermediaries in the business deals described in the information. In addition, the information specifically asserts that BAE neglected to conduct due diligence on third parties it retained. Finally, the information further alleges that BAE failed to maintain a system of internal controls that complied with the requirements of the FCPA, a failure that is presumably demonstrated by the large questionable payments that BAE made.

Beyond these FCPA-related allegations, the information also alleges that BAE conspired to make false statements to the U.S. Department of State and to omit a material fact required to be stated in export license applications by failing to identify on export license applications commissions paid to third parties for assistance in the lease of certain defense articles.

Factors Shaping These Dispositions. The first observation about these settlement agreements is that, as is the case with all plea agreements, the terms were negotiated. In such negotiations, parties can seek to achieve their respective objectives through a process of give-and-take that may affect the language of the agreements, the nature and amount of the penalties imposed, and the charges to which a company will agree to plead guilty or otherwise accept responsibility. These highly controversial and, at least in the United Kingdom, politicized negotiations were undoubtedly even more complex than usual. Some early press commentaries, notwithstanding the final terms of settlement, credit both the DOJ and SFO with perseverance and forcing a final disposition of this long-standing investigation.

Nonetheless, the settlements invite a series of questions about what factors drove the parties to the final terms reached:

- Were the settlements crafted to avoid substantive anti-bribery charges in order to avert debarment of BAE from pursuing military contracts in the European Union and the United States? If so, it would be another example of automatic debarment under E.U. rules having a fundamental impact on the enforcement of anti-corruption laws. It could also reflect considerations of national security, so that BAE’s position as a major defense contractor in both the United Kingdom and the United States would not be jeopardized. If so, this would be an ironic footnote to a case that, in the United Kingdom, was subject to harsh and widespread criticism because the original investigation was aborted at high political levels for fear of adverse national security (and employment) consequences.
Was the statute of limitations a factor around which these plea agreements were shaped? Did BAE have a statute of limitations defense to anti-bribery charges in either country? Did the conspiracy charge arise out of statute of limitations concerns, as a conspiracy may continue well beyond overt acts and thus be prosecutable after charges on the underlying conduct are no longer possible? Conspiracy charges may also be a preferred course by prosecutors when evidence of a substantive violation is incomplete or subject to challenge.

Were U.S. authorities constrained by jurisdictional limitations? The U.S. settlement was with BAE, which is the parent company of an important U.S. defense contractor physically based in the United States. In a curious jurisdictional twist, the pleadings prominently state that the criminal information does not "relate to or represent any conduct of" BAE’s U.S. affiliate, which underscores questions about jurisdiction over the U.K. parent. Additionally, the pleadings do not specifically state the jurisdictional basis for the charges. Did the DOJ choose to bring the unusual charge of conspiracy for defrauding and making false statements to the U.S. government and misrepresentations in export license applications because BAE’s letter representations to Defense Department officials and its alleged export licensing violations are subject to fewer jurisdictional restrictions than FCPA charges?

If not disclosed in due course by participants to the settlement processes, the answers to these questions will undoubtedly be the subject of continuing curiosity and speculation.

Individuals. No individuals were charged in this round of settlements. The SFO has indicated that the matter is now closed and has announced that it does not seek to prosecute any individuals for involvement in BAE’s misconduct. On the same day as the settlements were announced, the SFO withdrew charges against an Austrian, Count Alfons Mensdorff-Pouilly, who was allegedly involved in BAE’s misconduct in the Czech Republic and Hungary (see our Spring 2009 FCPA Review), and announced that "[the Director of the SFO] decided that it is no longer in the public interest to continue the investigation into the conduct of individuals."

As noted, U.S. authorities subpoenaed several executives in the course of the DOJ investigation, but they have not definitely stated whether they will seek the prosecution of individuals (for which there could be additional jurisdictional and other considerations). Under the expansive provisions of the FCPA, individuals who serve as intermediaries could be subject to prosecution, even if they are neither U.S. nationals nor U.S. residents. Although U.S. enforcement officials have acted under that provision in the past, doing so in this case would be quite aggressive.

Issues in the United Kingdom. The SFO’s plea agreement with BAE punctuates a highly contentious and highly politicized controversy in the United Kingdom. By this settlement, one of the SFO’s goals may have been to be perceived as persevering, with a view to attempting to modify its reputation in the press and with international bodies (especially the OECD) as toothless in enforcing laws against foreign bribery. The SFO’s action can be seen as a clear indication that it has embraced U.S.-style plea agreements, a step that could significantly facilitate future prosecution of U.K. anti-bribery laws.

At the same time, U.K. NGOs that had pressed for the prosecution of BAE have harshly criticized the relatively small penalty and the fact that settlement precluded the disclosure of facts that would have resulted from a public trial. Directors of the U.K. organization Corruption Watch described the SFO’s settlement with BAE as “a slap in the face for the people of the countries BAE has allegedly corrupted, the British taxpayer and the British justice system” because it failed to elicit an admission of guilt from BAE regarding bribery and because the SFO has decided not to prosecute any individuals, among other cited shortcomings. The Financial Times applauded the overall amount of the combined penalty, but described the outcome in the United Kingdom as “half a victory for anti-corruption,” noting that it fell far short of the outcome forecast by the U.K.’s Attorney General.

Issues in Other Countries. The settlement may have further reverberations, and cause some considerable embarrassment, in the Czech Republic, Hungary, Tanzania, Sweden, and Saudi Arabia. The settlement documents plainly imply that the transactions described in Hungary, the Czech Republic, and Tanzania may well have involved corrupt payments to government officials.

In Saudi Arabia, repercussions could be more profound. Though unnamed in the DOJ information, the Saudi intermediary is widely reported to have been Prince Bandar. Two years ago, the U.S. television program Frontline re-broadcast an earlier interview with Prince Bandar in which he shrugged off $50 billion of corrupt payments in a hypothetical $400 billion transaction with a “so what?”, adding that this was, in his view, “human nature.”

How Might BAE Be Seen as a Precedent in Future Cases? Because of the dearth of adjudicated court decisions related to the FCPA, settlement agreements containing compromises that may be acceptable to both sides are also frequently cited as precedents, including by U.S. enforcement agencies. As a result, terms accepted as conditions of settlement become part of FCPA “jurisprudence,” but may not always reflect how a court or jury would have decided the same issue. This case may be particularly inapt to cite in this manner, as there is the possibility that assumed or unstated, but otherwise egregious, conduct is driving

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The DOJ documents state that BAE was held liable because it failed, contrary to representations it had made to U.S. government officials, to maintain an FCPA compliance program that would prevent future violations. Does this result imply that any company that has made similar commitments could be held liable for conspiring to make false statements to the U.S. government should it have subsequent FCPA violations? Or is it the product of the combination of specific facts and considerations presented by BAE?

In a related consideration, would a company that has entered into a settlement with the DOJ pursuant to which it agreed to establish an effective compliance program be subject to a similar charge in the event of a later violation? Would companies that agreed to the terms of a cease and desist order be similarly at risk? And what of a company that persuades an independent compliance monitor that it had established an "effective compliance program," and the monitor so certifies to the government? Would good faith on the part of the company be a defense?

The DOJ cites BAE's failure to conduct due diligence on third party intermediaries or special advisors. Due diligence on third parties has long been viewed as an element of an effective compliance program and a best practice. The specific attention given to due diligence in the DOJ documents confirms that such reviews of third parties remain a critical component of FCPA compliance, including in the eyes of the enforcement agencies.

This is not the only case in which a company has been faulted for a failure to know, or seek to know, the ultimate disposition of funds -- especially large commission payments -- paid to a third party consultant or agent. What are the contours of this potential liability? When is an inability to track or confirm the ultimate disposition of funds paid to a third party a failure of internal controls? As a practical matter, will this ever be an issue in the absence of facts indicating a corrupt payment to a government official by the third party?

The information in the U.S. pleadings suggests that the DOJ received cooperation from witnesses, and earlier press accounts reported that U.S. authorities served subpoenas on non-U.S. nationals of BAE when they traveled to the United States. Issues of individual liability remain unresolved. Even when they are resolved, however, it may be difficult to determine what factors influenced decisions to prosecute or not prosecute, whether the government conferred immunity on any individuals, and what favorable consideration individual witnesses may have earned for cooperating voluntarily, or voluntarily after being requested to cooperate.

The U.S. pleadings detail significant issues with BAE's compliance program and internal controls, yet the pleadings did not allege substantive violations of the FCPA's accounting provisions, and the Securities and Exchange Commission ("SEC") has yet to bring an action against BAE. The absence of SEC charges may reflect a lack of SEC jurisdiction because BAE was not subject to the registration and reporting requirements of the Securities and Exchange Act during the relevant time period, which is required for FCPA accounting provision jurisdiction. According to press accounts, however, the SEC may have investigated BAE in connection with the al-Yamamah arms sale. The status of this possible investigation remains unclear.

In resorting to export controls laws to impose penalties in this case, the DOJ also raised issues with respect to the application and enforcement of those laws. The International Traffic in Arms Regulations ("ITAR") requirement (in Part 130) that applicants for licenses or re-export authorizations must report certain fees and commissions incurred in the sale of defense articles and services applies to payments that are both lawful and unlawful under the FCPA. In this case, the re-exporter (the government of Sweden) failed to make disclosures with respect to fees and commissions, but it was BAE, presumably an agent of Sweden, that failed to disclose fees that it had paid. Thus, this enforcement action looked past the re-exporter from whom disclosure was required and directly prosecuted the re-exporter's agent for its failure to disclose to the re-exporter. This case is not the first example of the relationship between the ITAR obligation to report commissions and fees and the potential risks that such fees can create under the FCPA. The Titan case is a prime example. The standard of care implied by the BAE settlement also implicates the level of due diligence appropriate for mergers and acquisitions, given successor liability under the FCPA and export control laws.

Stepping back from the details and from the specific legal issues, a lesson that can fairly be extracted from these settlements is that if faced with bad facts and evidence of payment of substantial bribes to foreign government officials, the DOJ will go to considerable lengths to find jurisdictional grounds and defensible legal theories to prosecute or penalize the corporations involved.

These settlements may also indicate that the SFO and the United Kingdom are now using investigation and prosecution techniques similar to those employed by their counterparts in the United States. Notwithstanding the arguably modest fine, in reaching a final disposition, the SFO pursued BAE in the wake of heavy political pressure not to do so; it employed the bottom line disposition, including penalties. While not precedential, these settlements do raise a number of issues not presented by previous FCPA cases, which raise compliance questions and considerations for other companies:

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American-style plea bargaining; and it threatened to prosecute BAE in court. The SFO’s charging a European individual intermediary shortly before the settlement also suggests that the SFO used the threat of a case against an individual to pressure the company into settling, a technique commonly used in U.S. enforcement actions. Although these steps may not satisfy critics in the United Kingdom who object to what they see as deficiencies in process, in context, this is a significant change in the SFO’s prosecutorial philosophy.

- What repercussions, if any, these cases will have in other countries that were involved remains to be seen. U.S. and U.K. enforcement authorities are undoubtedly prepared to share investigative findings with their counterparts in other countries. Whether that results in the prosecution of any current or former government officials, or in any other responses, remains to be seen. If nothing further happens, it will not be for lack of publicity for a case that ranks with Siemens and Halliburton/KBR in the developing annals of anti-corruption enforcement.

For more information, please contact:

John Davis, jdavis@milchev.com, 202-626-5913
Homer Moyer, hmoyer@milchev.com, 202-626-6020
James Tillen, jtillen@milchev.com, 202-626-6068
Larry Christensen, lchristensen@milchev.com, 202-626-1469
Nathan Lankford, nlankford@milchev.com, 202-626-5978

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