

**IN THE CROWN COURT AT SOUTHWARK**

**BETWEEN**

**Regina**

**-v-**

**BAE Systems PLC**

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**Note for Opening**

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**Background and Summary Overview**

1. BAE Systems Plc ('BAE' or 'the company') has pleaded guilty to one count of breaching its duty to keep accounting records contrary to section 221 of the Companies Act 1985 ('the 1985 act'). The particulars of the offence are as follows:

*“(i) BAE Systems Plc, between 1<sup>st</sup> January 1999 and 31<sup>st</sup> December 2005 knowingly procured the failure of British Aerospace Defence Systems Limited to comply with the provisions of section 221 of the Companies Act 1985 and thereby aided and abetted, counselled and procured the commission of the offence contrary to section 221 (5) of the Companies Act 1985 by the officers of British Aerospace Defence Systems Limited.*

*(ii) The failure to comply with the provisions of section 221 of the Companies Act 1985 was the failure of British Aerospace Defence Systems Limited to keep*

*accounting records which were sufficient to show and explain payments made pursuant to (a) a contract between Red Diamond Trading Limited and Envers Trading Corporation (b) a further contract between British Aerospace (Operations) Limited and Merlin International Limited.”*

2. The Company has pleaded guilty to this offence on an agreed factual basis pursuant to a written settlement (‘the settlement agreement’) between the Company and the Serious Fraud Office (‘SFO’) dated 16<sup>th</sup> February 2010. This settlement agreement was reached having regard to the Attorney General’s Guidelines on Plea Discussions in Cases of Serious or Complex Fraud.
  
3. During that time the Company was also involved in plea negotiations with prosecuting authorities in the United States of America (‘United States’). On 5<sup>th</sup> February 2010, BAE entered into a plea agreement with the Criminal Division and the National Security Division of the U.S. Department of Justice. Pursuant to that plea agreement, on 1<sup>st</sup> March 2010, BAE pleaded guilty to one offence of conspiring to commit offences against the United States, in violation of 18 U.S.C. Section 371, in that it conspired to impair and impede the lawful government functions of the United States, to make false statements in violation of 18 U.S.C. Section 1001 and to violate the Arms Export Control Act and the International Traffic in Arms Regulations. In summary, the specific facts pleaded to in the United States Information to which BAE pleaded guilty related to its operations and business dealings in the Czech Republic, Hungary and Saudi Arabia and elsewhere. The Company was fined US\$400 million.

## **BAE**

4. BAE, one of the world’s largest defence businesses, is a publicly-owned company engaged in the development, delivery and support of advanced defence and

aerospace systems for air, land and naval forces. The Company's headquarters are located in Farnborough.

5. BAE has a long history of mergers and acquisitions from its early days as a nationalised company to its current entity. The Company history may be summarised as follows.

(1) In 1977, British Aerospace was formed as a nationalised corporation by the merger of a number of aviation companies

(2) In 1981, British Aerospace became a public limited company, acquiring the assets and business of the nationalised corporation.

(3) In about April 1998, British Aerospace completed the acquisition of Siemens Plessey Systems ('SPS') (a subsidiary of Siemens AG). The new company was named BAEDS.

(4) In January 1999, British Aerospace and GEC agreed to create a global aerospace and defence company by merging British Aerospace with GEC's Marconi Electronics Systems. The merger was completed in November 1999 and the new company was called BAE Systems Plc

### **The Offence**

6. The offence concerns how the accounting for a contract for the provision of a Radar Defence System to the Government of Tanzania was dealt with by the BAE group of companies.

### **The Tanzania Radar Contract**

7. In November 1992 the Government of Tanzania invited tenders to supply a new air traffic control system at Dar-es-Salaam International Airport. Four companies, including SPS, bid for the tender. SPS won the tender in November 1993.
8. However, there followed years of negotiation, and it was not until September 1997 that SPS (which was still not then a BAE company) and the Government entered into a contract for the supply of radar equipment. The contract price was \$88 million. In the event the contract did not become effective because certain conditions precedent were not satisfied. Instead negotiations continued between the parties.
9. In October-November 1997, BAE acquired SPS. The acquisition was completed in the spring of 1998. As noted, in April 1998, SPS was renamed BAEDS.
10. On 10<sup>th</sup> September 1999, a new contract was signed between BAEDS and the Government. The contract price was \$39.97 million.

### **Marketing Advisers**

11. It was commonly the case that BAE, in support of its overseas sales, would employ advisers to assist in the marketing of its products. The Company referred to these advisers as either 'overt', that is advisers who conducted their work openly as BAE's in-country representatives, or 'covert', that is those whose relationship was regarded as highly confidential. In the case of 'covert' advisers, the need for confidentiality was explained in a note dated 24<sup>th</sup> April 1995 prepared by the then head of Headquarters Marketing Services ('HQMS'):

- “1. Rules or regulations in the relevant country (including clauses in Government sales contracts) forbidding the appointment of intermediaries, agents etc
  2. Tax implications when the adviser wishes to pass on money to a third party but cannot declare this to his authorities
  3. General embarrassment or possible press interest due to a large fee or a sensitive subject.”
12. This was a legitimate commercial aim.
  13. For these reasons, between September 1995 and September 1996 BAE executives were actively looking for ways to achieve maximum confidentiality with regard to the names of, and payments to, advisers; Vithlani being one such adviser.
  14. These considerations led to the incorporation of Red Diamond Trading Limited in February 1998. Red Diamond was a B.V.I. company, so structured that it would be extremely difficult for an enquiring outsider to pierce its veil. Its existence was known only to a small group of executives. Red Diamond was controlled by BAE Plc.

**Shailesh Vithlani**

15. From an early stage in the negotiations between SPS and the Government of Tanzania, Shailesh Vithlani, a local businessman based in Dar-es-Salaam, acted as a marketing adviser for SPS. He was recruited by Christopher Naqvi, at that time SPS's in-house sales representative, and entered into an adviser agreement on 21<sup>st</sup> June 1993 (that is, before SPS had won the tender for the radar contract).

16. Vithlani's fee was calculated as a percentage of the price of the proposed radar contract. During the early negotiations between SPS and the Government this fee was amended at various times, fluctuating between 31% and 40%. This was a particularly high rate of commission, by comparison with other contracts.
17. The contract between SPS and Vithlani was due to expire at the end of 1998.
18. On 17<sup>th</sup> November 1998, a committee, which included Michael Turner (then a member of BAE's Board), agreed an extension of the Vithlani adviser agreement for a further 12 months. Under the terms of the extension, Vithlani's fee was to be 31% of the price of the radar contract. Because this exceeded the maximum fee (20%) that that committee was ordinarily authorised to approve, Vithlani's re-appointment was personally approved by Sir Richard Evans and on 17<sup>th</sup> November 1998, Sir Richard Evans signed a memorandum approving Vithlani's re-appointment.
19. At the beginning of September 1999, about a week before the radar contract was concluded, the legal structure of the BAEDS-Vithlani relationship changed with two separate adviser contracts being concluded:
  - (1) On 2<sup>nd</sup> September 1999, a written agreement was made between Red Diamond Trading Limited and Envers Trading Corporation ('Envers'), a company incorporated in Panama and controlled by Vithlani. The agreement was signed by the parties on 4<sup>th</sup> October 1999, although the effective date was 1<sup>st</sup> September 1999, Hugh Dickinson signing on behalf of Red Diamond. Under the terms of the contract Envers was identified as the '*Consultant*' by whom services were to be provided and the fee for providing the services was not more than 30.025% of the radar contract price. The services to be provided were described as follows: 'The provision of certain advice and various services as required by [Red Diamond] to support [Red Diamond] with regard to its activities in the

Territory [i.e. Tanzania] including (if required) advice on financial and commercial aspects of doing such business in the Territory’.

(2) On 3<sup>rd</sup> September 1999 (again signed on 4<sup>th</sup> October 1999, but with an effective date of 3<sup>rd</sup> September) a parallel agreement was concluded between British Aerospace (Operations) Limited (‘BAEOL’) and Merlin International Limited (‘Merlin’) a Tanzanian entity controlled by Vithlani. This time Merlin was described as the ‘Consultant’; but the fee for the provision of the services was 1% of the radar contract price. The services to be provided under this contract were described in the same terms as in the Envers contract save that in Merlin’s case the services were to be provided to BAEOL, not to Red Diamond.

20. Acting through Merlin, Vithlani was referred to by the Company as an ‘overt’ adviser while acting through Envers, he was referred to by the Company as a ‘covert’ adviser.

21. The liability to make payments to Envers and Merlin arose on the receipt by BAEDS of the payments from the Government of Tanzania under the radar contract.

22. The Envers Contract was renewed on 22<sup>nd</sup> May 2000. The Merlin contract was renewed on 22<sup>nd</sup> September 2000. Both renewals were approved by BAE.

23. From January 2000 to December 2005 approximately \$12.4 million (about £7.7 million) was paid pursuant to the Envers and Merlin contracts. The payments were as follows

<b>Date</b>	<b>Contract</b>	<b>Amount</b>
7 January 2000	Envers	\$40,000
7 January 2000	Merlin	\$ 40,000
23 June 2000	Envers	\$95,000
23 June 2000	Merlin	\$25,000
18 July 2000	Envers	\$1,774,968
18 July 2000	Merlin	\$25,000
12 January 2001	Envers	\$1,486,460
12 January 2001	Merlin	\$ 63,540
16 January 2002	Envers	\$2,748,490
16 January 2002	Merlin	\$167,510
18 October 2002	Envers	\$790,540
18 October 2002	Merlin	\$ 23,460
24 January 2003	Envers	\$93,490
24 January 2003	Merlin	\$2,964.50
25 February 2004	Envers	\$344,500
25 February 2004	Merlin	\$5,500
24 March 2004	Envers	\$ 272,250
24 March 2004	Merlin	\$ 2,750
7 December 2004	Envers	\$272,250
7 December 2004	Merlin	\$2,750
8 April 2005	Envers	\$272,250
8 April 2005	Merlin	\$2,750
12 December 2005	Merlin	\$2,750
13 December 2005	Envers	\$272,250
14 December 2005	Envers	GBP 1,899,576.27
14 December 2005	Merlin	\$34,000

24. BAE has accepted in the basis of plea that, “There was a high probability that part of the \$12.4 million would be used in the negotiation process to favour British Aerospace Defence Systems Limited” (Basis of plea paragraph 4.5)
25. Accordingly, BAE has accepted that there was a high probability that the payments to Vithlani were intended to compensate him for work done in seeking to persuade relevant persons to favour BAEDS in respect of the radar project. It is not now possible to establish precisely what Vithlani did with the money which was paid to him.
26. However it is no part of the Crown’s case that any part of those payments were in fact improperly used in the negotiation process to favour BAEDS, nor is it any part of the Crown’s case that BAE was party to an agreement to corrupt. To lobby is one thing, to corrupt another. The SFO’s investigation ended with the plea agreement and the SFO has decided not to charge the Company with any such offences. Further the SFO readily acknowledges that the Company has gone to very considerable lengths to ensure that the conduct giving rise to the section 221(5) offence is never again repeated and has instituted appropriate standards of compliance.

### **Recording the payments**

27. The payments set out in the above table were effected as follows.
28. Under the terms of the radar contract, BAEDS received periodic ‘*milestone*’ payments from the customer (the Government of Tanzania). BAEDS notified International Business Support (IBS), part of the head office operation of BAE, that the milestone payment had been received, and requested IBS to make the payments due pursuant to the Envers and Merlin contracts. (IBS replaced HQMS

- in 2001. Prior to 2001 the role of IBS in the payment process was performed by HQMS.)
29. IBS calculated the amounts due to Envers and Merlin, and issued an internal instruction for the payment to be made. Importantly, the instruction documents generated by IBS referred, by way of an internal reference and the contract date, to the contract under which the payment in question was to be made: TAN/007 in the case of the Envers contract, and TAN/008 in the case of the Merlin contract.
  30. The instructions were directed to BAE's treasury department and required it to provide the sums required to IBS. (A single request by IBS to the treasury department may have covered both sums due under the Merlin and Envers agreements, and also sums due to other marketing advisers. Thus the total amount requested on any specific occasion does not necessarily correspond to the amount payable to Envers and Merlin, respectively.)
  31. The treasury department transferred funds to IBS's USD Account, which was known as the B Account.
  32. The payments to Merlin were made direct from the B Account. The payments to Envers were made from the B Account to Red Diamond's USD Account, known as the D Account, and then from the D Account to Envers. (Save for the final payment to Envers, dated 14 December 2005, which was made from Red Diamond's sterling account, known as the C Account.)
  33. The payments made from the B and D accounts were recorded in account ledgers maintained by BAE. The payments made to Envers and Merlin from the B and D accounts were also recorded in the Lloyds Link Freeze Batch reports and bank statements. These documents recorded the payments under the relevant contract reference (that is, TAN/007 or TAN/008). IBS maintained contract statements in respect of payments made under the Envers and Merlin contracts. These documents recorded the payments made, and described them as '*commission*'.

34. The value of the transactions was then recharged to BAEDS by the following steps. BAE's Head Office Finance (HOF) (on behalf of IBS), raised invoices representing an aggregate of all sums paid by IBS due for recharge. The invoice was supported by Backcharge Details papers, which broke down the amount recharged contract by contract. In the case of Envers and Merlin, these papers recorded the value of the individual recharges against the contract reference, the name of the consultant (that is, Envers and Merlin), and the products to which the contract related (that is, the Tanzanian radar equipment). BAEDS paid the recharge amounts into a HOF account. These payments were recorded by HOF in an account ledger.
35. BAEDS also kept monthly Project Finance Statements (re-named Contract Status Reports as of November 2000), in respect of the radar contract. These were documents forming part of the accounting process which recorded a breakdown of the costs of the radar project (a) as accepted at the time of entering into the radar contract, (b) as incurred at the date of the statement and (c) as estimated at completion. The statements did not refer to the Envers and Merlin contracts, but the contracts were, until August 2002, described as being for the provision of '*Technical Services*'. Thereafter, the description changed, and payments were described as '*Commissions*'. Another monthly accounting document kept by BAEDS in respect of the radar contract was the 'EAC Variances' document. Until May 2003, the EAC Variances also recorded the value of the liability under the Envers and Merlin contracts (without specifically referring to those contracts) as being for '*Technical Services*'. Thereafter, the EAC Variances contained in their breakdown of costs entries for both '*Technical Services*' and '*Commissions*', but no cost value was recorded against either entry. (The phrase '*Technical Services*' had previously been used by SPS to describe Vithlani's role.) Vithlani was not providing technical services: he had no knowledge of any technical matters concerned with the radar project.

### **The position in this case**

36. BAEDS bore the cost of making payments to Envers and Merlin pursuant to the agreements. The payments were made in furtherance of BAEDS's management of the radar project, and fell due as a result of the receipt by BAEDS of payment from its customer, the Government of Tanzania. BAE acted as paying agent (and the recharges made against BAEDS ensured that BAEDS bore the cost of each payment). BAEDS was therefore required by section 221 to keep accounting records sufficient to show and explain the payments, and identifying the matters in respect of which the expenditure took place.
37. Records concerning these payments were created and maintained by BAE, for and on behalf of BAEDS. These records were insufficient to show and explain the nature and purpose of the expenditure. Instead, the documents referred to above, described the services, incorrectly, as 'technical services' and the Envers and Merlin contracts did not particularise the reason for the payment. The terms of the contracts referred to the '*provision of certain advice and various services as required by [Red Diamond/BAEOL] to support [Red Diamond/BAEOL] with regard to its activities in the Territory [i.e. Tanzania] including (if required) advice on financial and commercial aspects of doing such business in the Territory*'. Moreover, the contract stated that the services being provided were being provided for Red Diamond and BAEOL, when in fact they were being provided for BAEDS. Furthermore, given what was known about the payments to Vithlani, as set out in paragraphs 24 and 25 above, describing the payments to him simply by the cross-reference to the contract (and the 'description' in those terms of the provision of '*certain advice and various services*' and '*advice on financial and commercial aspects*') obscured any explanation of the transaction.
38. As the basis of plea makes clear (paragraph 4.6) "the financial position of [BAEDS] was not stated with reasonable accuracy since it was not possible for

any person considering the accounts to investigate and determine whether the payments were properly accounted for and were lawful. The failure to record the services accurately was the result of a deliberate decision by one or more officers of BAEDS.”

### **Summary**

39. BAEDS was in default of the obligation under section 221, with the consequence that its officers committed the offence contrary to section 221(5).
40. BAEDS’s default was the result of a deliberate decision by one or more of its officers. The default flowed from the parent company’s decision to keep the true reason for such payments hidden.
41. The failure to state the true position in the accounting records was therefore the intended consequence of the actions of one or more of the officers of BAE and the subsidiaries’ breach of section 221 of the Companies Act 1985 was procured by the parent. It is accepted by the company that one or more of the officers of BAE: (a) approved the contractual arrangements under which Vithlani provided his services; (b) approved the terms of the Envers and Merlin contracts, including the descriptions on the face of the contract; (c) caused the payments to Envers and Merlin to be administered in accordance with the contracts; (d) approved the form in which the accounting records in respect of these payments were maintained on behalf of BAEDS, and the content of those records. By these means one or more of the officers of BAE sought to ensure that any inquiry into the payments would have failed to identify the proper explanation of the transactions. The procurement by BAE amounted to a deliberate abuse of an otherwise legitimate confidential structure.

42. It should be made plain by the SFO that it is not suggested that any of the individuals who have been named in this document were personally responsible for the commission of the section 221 offence. No allegation of criminal conduct is made against any named officer of BAE.

43. The appropriate penalty for BAE's admitted criminality is now entirely a matter for the Court and guidance on the principles to be applied is contained in the joint submission on sentence.

Victor Temple QC

Timothy Cray

Louis Mably

22 November 2010