



## **BAE Systems – Saudi Arabia: A daunting decision to be made**

C28-10-013

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The case in question related to allegations that the British defense contractor BAE Systems plc, along with full knowledge of the British government, had acted as a conduit for improper payments totaling more than \$2 billion US to Prince Bandar Bin Sultan of Saudi Arabia. The payments, which were said to have taken place over a period of twenty years, were for commissions related to an ongoing \$86 billion US aircraft and arms deal known as al-Yamamah.<sup>1</sup>

Since the signing of al-Yamamah in 1988 its operations had been under scrutiny by various public watchdog committees including the British Serious Fraud Office (SFO); but by the end of 2006 the situation had come to a head. Tony Blair, the British prime minister at the time, was faced with a dilemma. As a result of commercial and diplomatic pressure from the Saudi government he was being called upon to halt the SFO investigations. A call had to be made but it was a daunting prospect.

### **The company: BAE Systems plc**

#### ***Background***

BAE Systems plc was a British defense and aerospace company, headquartered in Farnborough, UK with additional worldwide interests in Australia, South Africa, Sweden, Saudi Arabia and the USA. BAE Systems was Europe's largest, and the world's third largest, defense contractor with annual sales above \$13 billion US, customers in over 100 countries, and a workforce of around 90,000 employees worldwide.<sup>2</sup>

The company was created in November 1999 by the merger of two British companies: Marconi Electronics Systems, the defense electronics and naval shipbuilding subsidiary of

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<sup>1</sup> Allegations had been made in various newspapers related to BAE Systems plc involvement in supposedly corrupt business practices but the scale of the activities, related to deals with Saudi Arabia was first highlighted by the British newspaper, The Guardian in 2004 [www.guardian.co.uk/world/bae](http://www.guardian.co.uk/world/bae)

<sup>2</sup> BAE Systems plc company propaganda web page [www.baesystems.com](http://www.baesystems.com) consulted 2006

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*This case was written by Professor Brian Hutt. It was prepared solely to provide material for class discussion.*

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The General Electric Company; and British Aerospace, an aircraft, munitions and naval systems manufacturer.

As a result of the merger the newly formed company brought to the market a rich heritage of aircraft, defense, electronics and naval expertise. Included in the company's curriculum were former names such as the Comet, the first civilian passenger jet aircraft; Concorde, the world's first supersonic passenger aircraft, produced in a combined project with Aérospatiale; and numerous military hardware projects such as the Harrier, the first vertical takeoff and landing aircraft.

From its inception, BAE Systems was at the forefront of a range of acquisition and consortium ventures, finally emerging as a defense industry leader. In 2006 the company dominated in major defense projects such as the F-35 Lightning II, the Eurofighter Typhoon, and the Royal Navy Queen Elizabeth class aircraft carriers. (See **Annex 1**).

### **BAE Systems as a source of employment and technological innovation in the UK**

BAE Systems was the major strategic defense contractor to the British government, receiving \$1 billion US annually; and in turn, was a principle source of employment and technical training in the United Kingdom. In 2006 the company employed around 35,000 direct workers throughout its different business operational units, in addition to supply churning with over 7,000 other British companies.<sup>3</sup> Significant for the British government was that BAE Systems was a major employer in industrial areas of the country that had recently experienced high levels of unemployment.<sup>4</sup> With the decline in the traditional shipbuilding industries of Scotland and the North West of England, BAE Systems, with its installations in Glasgow, Bristol and Barrow in Furness had been a welcome source of employment and a catalyst for regional economic development.

### **Expansion into the USA**

BAE System's North American subsidiary, BAE Systems Inc., was initiated in 1999 as a response to falling sales of armaments in the UK and Europe, and the rapidly growing market in the USA. At this time, the USA accounted for 45% of the world expenditure on arms. Since 1999 BAE Systems Inc. had spent \$6 billion US buying up American companies, and became the seventh largest arms company in the country. In 2006, the US accounted for 40% of BAE Systems total company sales and employed around 40,000 workers in 34 different states.<sup>5</sup>

The most recent BAE Systems activity in the US was the proposed acquisition of Florida-based armored vehicle maker Armor Holdings Inc. This was to tap into heavy demand from the American military for vehicles in Iraq and other war zones. (see **Figure 1**)

After consideration by the U.S. Treasury Department, it was concluded that the takeover did not pose any security threats. BAE Systems Inc. which hoped to conclude the deal in

<sup>3</sup> ibid

<sup>4</sup> Reference UK unemployment trends 1982-2000.

<http://www.nuffield.ox.ac.uk/users/nickell/papers/TheRecentPerformanceoftheUKLabourMarket.pdf> . Also see British Shipbuilding and the state since 1918 by Lewis Johnman and Hugh Murphy

<http://www.jmr.nmm.ac.uk/server/show/conJmrBookReview.30> . See also "BAE in Lancashire" June 2004 [http://www.lancashire.gov.uk/office\\_of\\_the\\_chief\\_executive/lancashireprofile/aero/baesystems.asp](http://www.lancashire.gov.uk/office_of_the_chief_executive/lancashireprofile/aero/baesystems.asp)

<sup>5</sup> Company propaganda BAE Systems Inc. [www.baesystems.com/WorldwideLocations/UnitedStates/](http://www.baesystems.com/WorldwideLocations/UnitedStates/) consulted 2006

late 2006 was waiting for the Justice Department to finish its probe of possible antitrust issues.

**Figure 1.** Armor Holdings Tank



### **The chain of events**

#### ***Britain enters the arms business***

Throughout recent history, the United Kingdom had been an active expansionist country, and in particular had supported a large and powerfully equipped military. Changes in present day geopolitics had diluted UK expansionism but had not diluted its strong heritage in the armaments industry, nor its presence as a major world player in the somewhat sinister international arms trade, (see Annex 2).

During the 1960's the UK was facing particular pressure as a result of its continued intervention in upholding the Cold War with the Soviets. Funding an expensive military machine was a drain on the local economy and the government was continuously being criticized as living beyond its means. During this period only 30% of its GDP was being derived from exports; a solution had to be found and it didn't take long for the newly elected government to come up with one.

Weapons were a key commodity at the time, and one that the UK could easily sell abroad. Valuable foreign currency could be earned to balance the country's finances and in addition, provide the foreign exchange for the purchase of much needed oil imports to continue the country's energy and industrial transformation.

Economically the scenario made sense, however, to be successful it was recognized that one had to play the game and so, for the next 40 years, the UK government was said to have secretly tolerated the practice and even participated in bribery and other corrupt practices.<sup>6</sup>

At the outset of British participation in the international arms trade it was recognized that a certain amount of "greasing of palms" was accepted business practice. Top government officials were on board with the idea and a network of government officials, agents, and

<sup>6</sup> "Web of state corruption dates back 40 years" The Guardian, June 13, 2003 (see also annex 2)

middlemen gradually developed. In addition, an organization was set up under the control of the British Ministry of Defense (MoD) entitled the Defense Export Services Organization (Deso). Its function was to promote and supervise the sale of arms.

### *Early British arms deals*

During the late 1960's the UK began to develop its overseas arms trade with a series of lucrative deals. One such deal was with the Shah of Iran who was desperately in need of military muscle to maintain his falling popularity and control conflicts with the country's religious insurgents. Aided by the newly developing network of arms dealers and the backing of the government, numerous sales of tanks, armored vehicles and warplanes were made. During the 1970's it had been estimated that these deals topped \$400 million US with bribes in excess of \$5 million US.<sup>7</sup> Arms dealings with Iran ceased in 1979 when the Shah regime was toppled by the Ayatollahs, but arms dealing did not cease there; there were plenty more customers to be nurtured, and in particular, the Saudi Arabians.

British arms dealings with Saudi Arabia also began in the 1960's and carried on through to the end of the 1970's in a reasonable controlled manner, as compared to what was later to come.

During the 60's and 70's British Aerospace (later to become part of BAE Systems) was the UK government sponsored supplier of military hardware to the Saudis. Net sales totaled \$7 billion US and an associated \$750 million US in commissions were said to have been paid to agents, middlemen and Saudi royals. The Saudi project alone was said to have kept the British warplane factories profitable during these two decades with the resultant preservation of thousands of jobs.<sup>8</sup>

But this was only the beginning. The series of contracts between the Saudis and BAE Systems, known as al-Yamamah, would eventually dwarf these initial dealings.

### *The al-Yamamah deal*

Al-Yamamah, (translated into English means "The Dove") was an arms deal first negotiated in 1986 between Margaret Thatcher, the British prime minister, and Prince Bandar Bin Sultan son of Prince Sultan, crown prince of the Saudi kingdom and heir to the throne (see **Figure 2**). Beating rivals from the US and France, the deal was referred to as the "deal of the century".<sup>9</sup>

In essence, it consisted of a complete rearmament of the Saudi military in response to growing tension in the Middle East at the time. Internal pressure was being felt from Islamic traditionalists and externally there was a fear that the Saudis might be drawn into the Iran – Iraq war, having declared themselves to be on the side of Saddam Hussein.

The signing of the first al-Yamamah contract took place in 1988 and included the sale of 72 Tornado warplanes, 30 Hawk trainer jets, and 30 other trainer planes (see **Annex 1**). This was then followed up in 1993 with the sale of a further 48 Tornados. In 2005, a third stage

<sup>7</sup> "The Iranian Deals" by David Leigh and Rob Evans. The Guardian Unlimited [www.guardian.co.uk/baefiles/page/0,,2095222,00.html](http://www.guardian.co.uk/baefiles/page/0,,2095222,00.html) consulted 2006

<sup>8</sup> "The Unlovable Saudis" by David Leigh and Rob Evans The Guardian [www.guardian.co.uk/baefiles/page/0,,2095803,00.html](http://www.guardian.co.uk/baefiles/page/0,,2095803,00.html) consulted 2006

<sup>9</sup> "The arms deal they called the dove: how Britain grasped the biggest prize" by David Pallister. The Guardian December, 2006

was initiated to buy a new fleet of 72 Eurofighter Typhoon warplanes (see **Annex 1**) with a projected cost of \$19 billion US.

In all, the first two stages of the deal realized sales in excess of \$60 billion US, and represented the UK's biggest arms deal ever. Over these two decades of al-Yamamah, BAE Systems, as the UK official contractor, serviced the project providing essential maintenance and training services. The company were said to have 4,500 employees based in Saudi Arabia.

**Figure 2** Margaret Thatcher, the British Prime minister, and Prince Bandar Bin Sultan in 1986 at the signing of the first al-Yamamah arms deal



### *Al-Yamamah under scrutiny*

Al-Yamamah was a deal negotiated at a government to government level and contemplated a counter trade of 600,000 barrels of oil per day for arms.<sup>10</sup> BAE Systems, as the UK's major defense contractor, was the company assigned to the project by the Ministry of Defense (MoD), the government agency responsible for the deal. All monies from the transactions were to be paid directly into MoD dedicated bank accounts.

At the outset al-Yamamah came under immediate criticism from campaigners against arms dealing and human rights both from the British public and also from the Muslim world. But then gradually, further suspicion arose of a more delicate nature. Bribery and corruption in arms dealing had been recognized on previous dealings with the Saudis but with the size of this present deal, the situation was reported as being serious.<sup>11</sup>

According to disclosures made by the Guardian Newspaper in 2004, the National Audit Office of the British government, in 1994, produced a report that alleged that members of Saudi royal family and middlemen were secretly paid hundreds of millions of pounds in kickbacks related to al-Yamamah. The report was subsequently suppressed amongst fears that it would anger the Saudis.

In essence the mechanics of these payments were to inflate the price of the hardware being supplied and this increase was in turn filtered back to Saudi Arabia as "commissions". The Guardian newspaper disclosures had indicated that these inflations were as much as 32% on

<sup>10</sup> *ibid*

<sup>11</sup> Disclosures made in "Millions in secret commissions paid out for Saudi arms deal" by Richard Norton and David Pallister. The Guardian June 23 1997

the price of the Tornado warplanes.<sup>12</sup> In all, the same disclosures indicate that as much as \$2 billion US had been paid as “commissions” to date (2004). BAE Systems, although denying any wrong doings, was accused of participating as a conduit for these commission payments.<sup>13</sup>

### ***SFO investigations***

The Serious Fraud Office (SFO) was a government department and part of the UK criminal justice system. In the words of its mission statement its “... aim is to investigate and prosecute serious and complex fraud and so deter fraud and maintain confidence in the probity of business and financial services in the United Kingdom”.<sup>14</sup>

Despite the political connections of BAE Systems, by the year 2000 their network was beginning to show signs of weakness. Under the auspices of the SFO, several investigations were under way but only to be quashed by high ranking officials. One particular case was the discovery of a hidden sum of money, \$11 million US, in an offshore Jersey bank account. This money was later transferred to Qatar as “commission” payments; but in terms of any legal action, nothing happened.<sup>15</sup>

A year later, in 2001, further complaints reached the SFO. This time there were accusations that BAE Systems was running a “slush fund” of \$110 million US as support funding for al-Yamamah “expenses”.<sup>16</sup> And in addition, Prince Bandar bin Sultan, a former Saudi ambassador to the USA, had been the direct recipient of \$200 million US a year. These sums were said to have been paid quarterly, over a period of 10 years, into Riggs Bank in Washington, with full knowledge and authorization of the British Ministry of Defense. Although the SFO wanted to take legal action on its findings, its personnel came into conflict with high ranking Ministry of Defense (MoD) civil servants, and it was not until the Guardian newspaper exposed the case publically in 2004 that the events had to be taken seriously.

As a result of the Guardian newspaper’s declarations and public outcry, a swift action was rallied on behalf of the government; particularly from the MoD and the Foreign Secretary and on up until the British Prime Minister, Tony Blair, was involved. By 2006 a series of declarations were being made in defense of the importance of al-Yamamah. Principle citations were the possible loss of the important defense contract with the Saudis; the implications on British foreign and strategic policy in the Middle East; the economy; and local job losses.

### ***Saudi pressures to halt the investigations***

Reaction from the Saudi royal family to the SFO investigations, and the series of events that followed the Guardian newspaper disclosure was one of infuriation. There were

<sup>12</sup> Disclosures made in “The secret Whitehall telegram that reveals truth behind controversial Saudi arms deal: Document shows Riyadh paid £600m extra for jets” by David Leigh and Rob Evans. The Guardian Unlimited October 2006 [www.guardian.co.uk/world/2006/oct/28/bae.whitehall](http://www.guardian.co.uk/world/2006/oct/28/bae.whitehall)

<sup>13</sup> *ibid*

<sup>14</sup> Serious Fraud Office [www.sfo.gov.uk/](http://www.sfo.gov.uk/) consulted 2006

<sup>15</sup> Disclosures made in “Secret £1bn deal to insure Saudi arms contract” The Guardian December 2004

<sup>16</sup> Disclosures made in “BAE accused of arms deal slush fund” The Guardian September 2003

particular security concerns that resentment against the Saudi royals would grow and be exploited by militants and fundamentalist enemies both within Saudi Arabia and throughout the Muslim world. Immediate calls were issued to halt the SFO investigations along with threats and ultimatums to cancel the latest pending arms deal, the biggest to date, with a price tag in excess of \$19 billion US.

## **Relationships UK / Saudi Arabia**

### ***Saudi Arabia Profile***

The kingdom of Saudi Arabia was founded in 1932, by Abd Al-Aziz bin Abd al-Rahman Al Saud after a 30-year campaign to unify the Arabian Peninsula. In 2006 King Abdullah, a direct descendent of Al Saud was the ruling monarch.

Saudi Arabia was largely desert and of little economic value other than its huge oil reserve. Discovered by accident in 1938, Saudi Arabia possessed 25% of the world proven oil reserve which in turn had given huge wealth and power to its ruling families.

Saudi Arabia was the birthplace of Islam, and home to Islam's two holiest shrines in Mecca and Medina and although the country was devout Muslim and the king's official title was the Custodian of the Two Holy Mosques, there were frictions within the nation. The Royal family was traditionally the ruling class in charge of managing the country's wealth and foreign policy but the ordinary citizens were more subject to the Wahhabis, a traditionalist fundamentalist ruling theocracy. The Wahhabis were present in everyday Saudi life as guardians of a strict moral code and education that attempted to maintain the country firmly in the grip of traditionalism.

Between the royal leaders and the religious leaders a fragile status quo had been maintained. The royals had been tolerated in their opulent behavior and had been largely allowed to keep their wealth whilst the Wahhabis had maintained control of the people; however such a system had been to the detriment of basic human rights. Organizations defending human rights had abounded with their criticisms of lack of freedom of speech; suppression of political opposition; the daily occurrence of torture and floggings; and the dire plight of women.

Culturally, local customs of bribery and corruption were commonplace at all levels within society. According to the Bribe Payers Index of 30 countries Saudi Arabia occupied the 22<sup>nd</sup> position, the first position being the least susceptible to accepting a bribe.<sup>17</sup> Recent international disclosures in relation to al-Yamamah however had now caused concern for the fragile status quo.<sup>18</sup> There was increasing unrest within the Saudi population that could have come to a head in the form of a more extremist fundamentalism boarding on terrorism and its consequences on regional stability. Saudi money was said to have funded al-Qaeda and although the Saudi royals had denied Islamic insurgency activity within the country, other sources indicate the jihadists had been responsible for numerous attacks. Particular disgust was felt by fundamentalist Muslims at seeing their royals mixing

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<sup>17</sup> Bribe Payers Index taken from Transparency International  
[www.transparency.org/news\\_room/in\\_focus/bpi\\_2006](http://www.transparency.org/news_room/in_focus/bpi_2006)

<sup>18</sup> "The secret Whitehall telegram that reveals truth behind controversial Saudi arms deal" by Davis Leigh and Rob Evans The Guardian October 2006

with the infidel. There was no doubt also that Saudis formed a strong nucleus of the “9/11” terrorist attacks<sup>19</sup> and that Osama bin Laden came from a prominent Saudi family. Implications of these current trends within Saudi Arabia were now becoming of concern to western powers in the context of the wider global security issues and terrorist threats<sup>20</sup>.

### ***Economic ties***

Outside of arms trade, oil was the basis of Saudi Arabia's economic relationship with the UK. Britain required a consistent and dependable oil supply and seemed prepared to go to great lengths to secure it. Particularly, the UK was conscious of the strategic aspects of their economic dependency and as a result, their foreign policy was orientated towards maintaining cordial relations. In turn, it could be understood that in all probability, the British government would have been prepared to turn a blind eye to overly harsh criticism leveled at their trading partner.<sup>21</sup> Moreover, an integral part of al-Yamamah was the delivery of 600,000 barrel of oil per day.

### ***Key allies in the balance of Middle East peace and security***

Post 9/11 geopolitics had resulted in a significant change in the activities of western actors, principally the USA and the UK, and their search for Middle Eastern allies in the Islamic world. Central to these activities had been a combination of economic and strategic considerations focused particularly on Saudi Arabia. Being the source of 25% of the world known oil supply, the economic importance of the country was unquestionable. For both the USA and the UK the supply of petroleum was critical, but in addition, the strategic implications were now taking on new dimensions. Saudi Arabia was a split country between its extensive ruling Royal family and its highly traditional and fundamentalist Islamic rulers of its “people”, the Wahhabis. The Wahhabis were known to have sympathies with jihadist principles and the concept of ummah<sup>22</sup>. Additionally, Saudi Arabia was one of only a few countries to have recognized the Taliban regime in Afghanistan.

Key to both American and British intelligence related to the potential terrorist threat was to have contact and a “welcome” presence in countries which had influence or were close to the source of the problem. It was well known that countries that have developed trade and economic ties do not go to war. With reference to the nuclear crisis between India and Pakistan, the depth and pressure from business and commercial activity in India related to its role as a global player of outsourcing effectively defused the situation. It was noteworthy that India had the world’s second largest Muslim population but no Indian Muslim was incriminated in the 9/11 terrorist attacks.<sup>23</sup>

It was clear that the UK as a close ally of the US had an enormous interest in the affairs of the Middle East. There was a realization that there must be close involvement in intelligence sharing and regional relationship building with the Saudis in order to minimize

<sup>19</sup> “9/11” refers to the September 11, 2001 terrorist attacks on the World Trade Center.

<sup>20</sup> “The secret Whitehall telegram that reveals truth behind controversial Saudi arms deal” by Davis Leigh and Rob Evans The Guardian October 2006.

<sup>21</sup> “Blind eye’ to bribes by UK firms abroad” The Guardian March 2005

<sup>22</sup> Ummah The concept of a “Nation of Muslims”

<sup>23</sup> This case is further explained in “The World is Flat” by Thomas Friedman. *Farrar, Straus and Giroux*, 2005. Chapter 12 “The Dell Theory of Conflict Prevention”.

potential reprisals of the nature of 9/11 and “7/7”<sup>24</sup>. The UK has had a long and mixed fortunes existence within the Middle East but was still an old friend and respected ally of many of its communities. As an overall national security strategy the UK could feasibly see this status quo worthy of protection.<sup>25</sup>

### **International Implications**

#### ***UK – OECD. UK signatory to the convention against bribing foreign officials***

The OECD (Organization for Economic Cooperation and Development) was a grouping of countries pledged to helping governments tackle the economic, social and governance challenges of a globalised economy. Established in 1961 in Paris, France, the group numbered 30 countries including not only the most developed nations such as the USA, Japan, and the UK but also some of the newly industrialized countries such as Mexico, Turkey and Korea. Saudi Arabia was not a member.<sup>26</sup>

The principle activity of the OECD was data collection, through which it then aimed to provide governments with the information they needed to formulate policy, particularly in the area of competitiveness through economic growth and financial stability. Through the work of committees, information was reviewed and evaluated to draw up action plans between members. On occasion such actions or co-operation may have result in the countries coming to formal agreements. Such was the case with the agreement to combat bribery which culminated in the OECD Convention on Combating Bribery of Foreign Officials in International Business Transactions. Signed in 1997 the treaty had 36 signatories, including the USA and the UK, pledging to prosecute business executives who paid bribes to overseas officials and politicians to win contracts abroad. In 2002 the UK reinforced their commitment to the convention by writing it into the country’s laws.

At the outset of the OECD initiatives Britain was a reluctant player, but due to pressure from the USA, it finally succumbed to joining. Indicating that bribery and corruption were “common place business practices in certain parts of the world”, the British DESO (Defense Export Services Organization) on the other hand, defended the practice to the extent that it was said to have authorized the payment of special commissions, under the full knowledge and consent of the Ministry of Defense.<sup>27</sup>

As of 2002, according to the new law, all acts of bribery to obtain foreign business were illegal and were criminal acts punishable by law. Government officials had claimed to be tightening controls and committed to upholding the legislation but to date there had not been any prosecutions. This state of affairs was echoed by an OECD international inspection team who, on a visit to the UK in 2005, reported “particular concern over political interference in bribery investigations” and later went on to declare that ““The very large number of investigative bodies has resulted in excessive fragmentation of efforts, lack of specialized expertise, lack of transparency ... and problems in achieving coherent

<sup>24</sup> “7/7” refers to a series of coordinated Islamist terrorist bomb attacks on London’s public transport system that took place on July 7, 2005. The bombings killed 52 commuters, 4 suicide bombers and injured 700 people.

<sup>25</sup> “Saudi–European relations 1902–2001: a pragmatic quest for relative autonomy” International Affairs Volume 77 Issue 3 Page 631-661, July 2001

<sup>26</sup> OECD [www.oecd.org/home/0,2987,en\\_2649\\_201185\\_1\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/home/0,2987,en_2649_201185_1_1_1_1_1,00.html)

<sup>27</sup> “Web of state corruption dates back 40 years” The Guardian June 13 2003 (see also annex 2)

action." Praise was however forthcoming from the OECD inspectors with regard to the SFO's (Serious Fraud Office) work in pursuing corruption cases; although doubt was cast over the political willpower to continue to support it in all its functions.<sup>28</sup>

Finally, in retaliation to the OECD initiative an unnamed government official was quoted as saying "Bribery in international business transactions was inevitable, and that disallowing it could be dangerous, as companies would then not be able to compete on a level-playing field".

### *UK - USA Relations in the arms trade*

Post World War II UK-US relations have been, on the surface, close and amenable in all aspects of the political spectrum. However there have been some notable undercurrents in agreements and policies and the issue of bribery and corrupt practices in the arms trade has been one of them. As revealed in the negotiations leading up the OECD initiative on combating bribery of foreign officials in international business, the USA was constantly seen to be as the press at the time termed it "browbeating" to ensure the UK's compliance and support.<sup>29</sup>

To understand the possible reason for the US's concern for the good behavior of the UK, one can refer back to US involvement on numerous "scandals" surrounding arms deals during the Reagan and Clinton administrations. Of particular significance on the political stage of the day were the Iran-Cobra affair; US dealings with Turkey over the Kurdish issue; and the sale of US arms to Taiwan and its implications for Sino-American relationships, all of which left a legacy of "we need to clean up our act".<sup>30</sup>

British compliance to American pressure finally came in the wake of the 9/11 terrorist attacks. At this moment both countries were under attack and the whole question of bribery, corruption and money laundering with possible connections to terrorism was top of the agenda. Britain's signing into law of the bill that made it illegal for companies to offer bribes to foreign officials to further their business interests appeased the Americans.

The situation seemed to calm down; however, in 2003 the Guardian newspaper revealed that the US government accused BAE Systems of "corrupt practices" in a \$1.8 billion US deal to sell Gripen warplanes (See **Fig. 3**), to the Czech government. The accusations, which were based on reports from the CIA and other American firms also competing for the project, were immediately denied by British Ministry of Defense; after all these kinds of practice were now illegal under the new British law.<sup>31</sup>

The four other companies bidding for the contract, two of them American, finally withdrew their participation in protest to the "rigging" of the deal. The project was subsequently shelved but not before what was later to be revealed; that British Prime Minister, Tony Blair had personally visited the Czech Republic to lobby on behalf of BAE System's participation.

<sup>28</sup> 'Blind eye' to bribes by UK firms abroad by David Leigh and Rob Evans The Guardian March 2005  
[www.guardian.co.uk/world/2005/mar/19/bae.foreignpolicy](http://www.guardian.co.uk/world/2005/mar/19/bae.foreignpolicy)

<sup>29</sup> "US accuses British over arms deal bribery bid" by Rob Evans and Ian Traynor. The Guardian June 12, 2003

<sup>30</sup> "US weapons secrets exposed" The Guardian October 29, 2002

<sup>31</sup> "BAE faces corruption claims around world: Disclosures on Czech deal to be referred to police" The Guardian June 2003

**Figure 3** Gripen Warplane

These accusations came at a sensitive moment, putting strain on both UK-US relations and internally in the US regarding the Iraqi war and the need to maintain the supply of military equipment to its deployed forces. In the pipeline was the proposed takeover of the armored vehicle and tank manufacturer Armor Holdings by BAE Systems Inc. The deal, which was being evaluated by the Justice Department for any antitrust issues, had wider economic implications as BAE Systems Inc. was a major regional economic driver and job provider. Additionally, the potential to disrupt Pentagon plans for needed armament for Iraqi and Afghanistan war zones was a further issue to be considered.

### **British Government Stance**

#### ***The British Government actors***

The arms industry had been typically one with a high government involvement. In the case of the UK, the industry before Margret Thatcher (prime minister from 1979-1990) was totally government owned. With a long tradition in shipbuilding, aircraft manufacturing and the Royal Ordnance Factory, the British government plied its arms negotiations throughout the world on a government to government basis relatively undisturbed. The Ministry of Defense (MoD) was the principle government ministry responsible for its workings although the direct dealings were delegated to a special branch created for the promotion of arms sales, the Defense Export Service Organization (Deso).

With the coming of the Thatcher era, and subsequent wave of privatizations, the industry gained some new players, the eventual formation of BAE Systems being one of them. Still closely related to government however, these new companies relied heavily on the preference of government, seeking that exclusive status of “Official Defense Contractor”. Economies of scale was all important within the industry which in turn lead to a series of mergers and acquisitions rendering all but an exclusive club of companies, amongst which BAE Systems emerged as by far the most important.

Since the creation of BAE Systems, the British government had taken a somewhat back seat role but nevertheless maintained a firm presence. Because of the lucrative nature of the industry and its national importance in terms of prestige and employment, it could hardly do otherwise.

In the case of al-Yamamah the position of the British government was critical. Initially BAE Systems was the front player but the basis of the deal was a government to government project. Under the auspices of the MoD and Deso, BAE Systems was the official contractor providing the service, in “all its implications” as later accusations led to show.

All monies collected from al-Yamamah were said to have passed through the MoD and associated Bank of England accounts however, as later accusations indicated, the role of BAE Systems as intermediaries in the diversion of funds to the payment of commissions and the operation of “slush funds” seemed to have clearly taken place with government knowledge.

### *Tony Blair Trajectories*

Tony Blair took office as the British Prime Minister in 1997 as the leader of the “New Socialist” party and ending a long reign of Conservatism dating from the Thatcher era. Essentially, Tony Blair abandoned many of the former socialist policies but was able to maintain a trend of economic development and prosperity. There were no major swings in the structure of the industrial base of the country and companies were allowed to prosper. On numerous occasions Tony Blair was active in promoting British commercial activity abroad and sought to take an active role in world politics to maintain peace and stability. Britain’s close involvement in the events following the 9/11 terrorist attacks was very much driven by Tony Blair; including the coming together of the UK with the US in the fight against terrorism.

In terms of the arms trade and in the name of promoting British industry abroad to serve the prosperity and security at home, Tony Blair made a number of lobbying trips. Two documented trips of note to this case were firstly, a trip made to the Czech Republic related to the sale Gripen warplanes, and a second trip made in July of 2005 to Riyadh to promote al-Yamamah. This second trip to Riyadh was particularly important as it was in support of the most lucrative arms deal ever for the British government. It involved the latest negotiations of al-Yamamah which included the sale of a new fleet of 72 Eurofighter Typhoon warplanes at a price of \$19 billion US., lucrative in terms of net sales but also lucrative in terms of jobs for the British workforce.<sup>32</sup>

### *Leaving office*

Tony Blair had given various hints that his intention was to step down from the position of Prime Minister. Speculation in the country was rife and the resignation was expected for the middle of 2007. Given a mid 2007 departure he would have completed a ten year tenure and become the longest serving labour prime minister in history.<sup>33</sup> But al-Yamamah was an issue that was still outstanding.

The moment of decision: Tony Blair through his government had now to take the above factors into consideration in making a decision as to whether to allow the SFO to continue with its investigations or to bow down to Saudi pressures and halt them. The decision was a daunting one given the complexity of the situation. On the one hand the importance of al-Yamamah in the context of Anglo-Saudi relations and the fight against terrorism, the future

<sup>32</sup> “Blair in secret Saudi Mission: Expulsions link to £40bn arms deal” The Guardian September 27 2005

<sup>33</sup> “Blair Says He Plans to Resign in Next Year” New York Times September 7, 2006

balance of power in the Middle East, and the undoubted economic advantages; but on the other hand, the delicacy of the ethical implications of appearing to turn a blind eye to bribery and corruption.

At the end of the day the decision had to be ethically convincing (see **Annex 3**), not only for the British public but also for a wider audience, particularly that of the OECD member countries; if Blair was to exit from office with dignity.<sup>34</sup>

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<sup>34</sup> Leaked memo outlines Blair's "farewell tour" The Times Online, September 5 2006  
<http://www.timesonline.co.uk/tol/news/politics/article628537.ece>

### Annex 1. BAE Systems plc: Principle Products and Services

BAE Systems products and services were related to the development, delivery and support of advanced defense and aerospace systems. Principle divisions included:

#### *Military air solutions*

This division of the company offered extensive capabilities in manufacturing, maintenance and training in the areas of military air products. Key air solutions were combat aircraft, jet trainers, reconnaissance aircraft and unmanned aerial vehicles (UAV). The division had eight locations within the United Kingdom which in turn provided employment for 14,000 workers.<sup>35</sup>

The F-35, the Eurofighter Typhoon jet and the Tornado (See **Figures. 1-3**) were the company's principle combat aircraft offerings. In the area of jet training BAE Systems offered the Hawk advanced Jet Trainer (See **Figure 4**) along with the Hawk synthetic training facility for fast jet training. This installation although located at the RAF's Hawk training facility at RAF Valley in Wales was BAE System designed, built and owned. In the area of marine reconnaissance, BAE Systems signed in July 1996, a £2bn contract with the British Ministry of Defense to build 18 Nimrod MR2 aircraft along with their respective training and support packages. Finally, in the area of UAVs, BAE Systems took a leading role in the development of new technologies and poised itself to take a leading role in the market segment. This initiative was in response to a stated British Ministry of Defense Industrial Strategy that indicated that an essential part of future combat air capability would be between manned and unmanned aerial vehicles.<sup>36</sup>

**Figure 1.** F-35 Joint Strike Fighter



**Figure 2.** Eurofighter Typhoon Jet



**Figure 3.** Tornado Multi-role aircraft



**Figure 4.** Hawk Trainer Jet



<sup>35</sup> BAE Systems plc web page company propaganda [www.baesystems.com](http://www.baesystems.com) consulted 2006

<sup>36</sup> *ibid*

### *Surface Fleet Solutions*

BAE Systems Surface Fleet division, was involved in all stages of the maritime capability lifecycle including concept design, manufacturing, in-service support, regeneration and disposal of surface warships. Located at three different sites in the United Kingdom; Glasgow, Bristol and Portsmouth, BAE Systems employed over 4,300 workers and apprentices.<sup>37</sup> Key products and services included destroyers, Queen Elizabeth class aircraft carriers (See **Figure 5**), frigates and landing ships.

As well as being the major supplier to the British Navy, BAE Surface Fleet Solutions had also been active in the international arena at government level. Recently completed projects had included the sale and refurbishment of three Royal Navy frigates to the Chilean Navy and a crew training project for a former sale of two ex Royal Navy frigates to the Romanian Government

**Figure 5.** Queen Elizabeth class aircraft carriers



### *Submarine Solutions*

BAE Systems plc Submarine Solutions division, was focused on the design and manufacture of a new class of submarine, the Nuclear Class Astute (See **Figure 6**). Employing state of the art technology and a heritage of having come from a long line of over 330 previously built submarines, the Astute amassed impressive capabilities. Designed to require “no refueling” throughout its full service life, expected to be in excess of 25 years, the vessel could patrol for 90 days without surfacing. It was the largest and most powerful attack submarine ever commissioned by the Royal Navy.<sup>38</sup>

The main production facilities of submarine solutions were located at the Barrow-in-Furness shipyard in the northwestern part of the UK. The division employed a total of 3,500 workers.<sup>39</sup>

<sup>37</sup> ibid

<sup>38</sup> ibid

<sup>39</sup> ibid

**Figure 6.** Astute Class Submarine***Integrated Systems Technologies***

BAE Systems Integrated Systems Technologies was a division of the company that focuses on the needs of the homeland security and defense market. Its principle products included NATO Class land based air defense radar systems, and advanced multi-function maritime radar. The division employed 3,500 workers, the majority of them high skilled graduate engineers specializing in software and systems design.<sup>40</sup>

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<sup>40</sup> ibid

## **Annex 2.** Article about corruption in UK

This article appeared in the Guardian, on Friday June 13, 2003; written by Rob Evans, Ian Traynor in Prague, Luke Harding in New Delhi and Rory Carroll in Johannesburg. Accessed through <http://www.guardian.co.uk/world/2003/jun/13/bae.armstrade>

### **Web of state corruption dates back 40 years**

Shielded by secrecy law - the system of special commissions' still flourishing today.

The government's own arms sales department is directly implicated in bribery abroad, according to documents obtained by the Guardian. Such bribery has supposedly been outlawed since 2001.

Current Ministry of Defence files show that DESO, the defence exports services organisation, officially authorises what it calls "special commissions" paid by arms firms.

Payment arrangements are even written by civil servants into the secret contracts on government-to-government arms deals.

Firms which pay the bribes, described as "commonplace in certain parts of the world", are, it is explained, exempt from normal MoD rules banning corruption.

The Guardian disclosed yesterday that Britain has failed to investigate bribery accusations by the US over a recent Czech arms deal.

The discovery of evidence that the UK secretly connives at such payments explains why the allegations placed Britain in such a difficult position.

DESO, a secretive organisation headed by an arms industry businessman, has 600 staff with privileged ability to influence policy, and far-flung salespeople in Saudi Arabia, Qatar, Singapore, Kuala Lumpur, Johannesburg, Kuwait and Abu Dhabi.

But it now appears on the face of it that DESO is conspiring to break Britain's own laws.

Our discoveries go even further. We have uncovered a series of damning Whitehall files detailing graphically how bribery has been at the heart of DESO's mission from the day the unit was launched nearly 40 years ago.

The then Labour defence secretary, Denis Healey, hired a tough businessman, Sir Donald Stokes, to tell him how to compete with the Americans on arms sales. But civil servants were dismayed by what Sir Donald then advised. As Healey's top official, Sir Henry Hardman, noted in July 1965: "Sir Donald Stokes had indicated that it was often necessary to offer bribes to make sales."

Behind the shroud of Whitehall secrecy, Stokes went on to spell out with brutal clarity how arms sales actually worked. "The commercial technique was to gather intelligence on the right people who controlled sales and purchases (these were by no means the top people in governments and organisations).

"When the right person was found effort would be concentrated on him and in time a sale would be effected. Sir Donald stressed that a great many arms sales were made not because anyone wanted the arms, but because of the commission involved en route."

He recommended importing a businessman who could disregard Whitehall ethics. He wrote: "It may well be necessary to provide other financial aids and incentives for certain possible eventualities... It must be recognised that certain business is obtained in unorthodox ways... Our competitors in this field are determined and ruthless. We must be even more so."

As one civil servant primly minuted: "He suggested, for example, that it is very good business... to make someone the gift of a motor car or to provide his wife with a free holiday in Bermuda! We made it clear it would be very difficult to provide for this sort of thing from moneys voted by parliament."

One solution, Stokes suggested, was for the government to work hand in glove with local "fixers", who could dish out the more hefty bribes: "Good commercial agents... are better placed than an official to dispense the less orthodox inducements".

The whole business would be kept dark, behind the screen of the Official Secrets Act.

"It would defeat the whole object if potential recipients of 'gifts' had reason to fear that the transactions would in due course become public property and the object of critical comments in the British parliament and press," observed JE Herbecq of the Treasury.

Officials swallowed their qualms. Herbecq recorded: "There would be little sense in paying the market's price for the market's skills if we are too squeamish to use them".

Ray Brown, former boss of military radio firm Racal, became the first head of the Wilson government's defence sales organisation. This unusual implant flourishes to this day as DESO, with salesmen from the big arms firms taking it in turns to manage it. DESO's current head is Alan Garwood, formerly a top Middle East missile salesman for BAE Systems, the country's largest arms firm.

He is paid a six-figure permanent secretary's salary plus a large, secret cash top-up by the arms firms themselves.

The documents defining DESO's true purpose remained official secrets for 30 years, until they were eventually deposited in obscurity at the Public Record Office, where the Guardian found them.

DESO's role in bribery appears never to have ceased over the years. In 1977, for example, DESO's then head, Sir Lester Suffield, was called at an Old Bailey corruption trial and asked about £2m bribes paid to the Shah of Iran and his "fixer" to persuade Iran to buy Chieftain tanks. Under questioning, he replied: "Yes. I approved it." The MoD's current official Guidelines to Industry appear to be stern. They say: "Undisclosed commissions (ie payment to a third party)... are undesirable distortions of the procurement process and will usually be deemed to be corrupt in law."

But the internal DESO document obtained by the Guardian says the exact opposite. Part of the MoD's contracts manual, it is headed Special Commissions and addressed to commercial managers. Dated 1999, it is still current.

"In certain parts of the world it has become commonplace for special commissions to be required. This is a matter for DESO, to whom all requests for special commissions should be referred."

DESO will, says the MoD, "confirm that such payments can be made. [MoD] Contracts staff may need to provide the means for payment in the contract".

Provided that the arms firm comes clean to DESO, the bribes will remain a secret between the two organisations, the document says. Companies will be exempt from the normal ministry rules which forbid what they term "corrupt gifts and payment of commission".

Whitehall's direct implication in corrupt payments explains another political mystery. For years, the US pressed a curiously reluctant Britain to outlaw foreign bribery, as the US itself has done since its own huge arms sales scandals in the 1970s.

Commerce secretary William Daley complained to the then trade secretary, Margaret Beckett, in 1997. She professed herself "surprised" by her officials' inaction.

But subsequently, the Home Office set out to block a private member's bill. Arms companies had been lobbying against it.

In March 2001, at a Washington meeting, Anthony Wayne, the state department official in charge of anti-bribery efforts, and his boss Alan Larson continued to pressurise the British trade minister, Richard Caborn, about UK foot-dragging.

Only after the September 11 terrorist attacks did British ministers bow to passionate US pressure to stop all forms of money laundering which might fund terrorism.

The emergency law then passed contains a section outlawing corrupt payments to foreign public officials. Yet, as we revealed yesterday, the MoD now faces renewed allegations from the US that bribery has continued on BAE's would-be Czech Gripen deal.

We asked the MoD on which of Britain's recent government-to-government arms shipments these "special commissions" had been paid. It said it could trace no records of any such payments, despite their being described internally as "commonplace". The MoD said no definition of special commission as against legitimate commission appeared to exist, but it believed it was "intended to cover payments for legitimate services".

BAE said last night: "Any commercial practices in any of the instances mentioned would have been in compliance with the laws in effect at the time." Other arms companies could give no information last night.

### Annex 3. Ethical issues in international business negotiations

Summary of the four commonly cited ethical criteria used to evaluate international business decisions.<sup>41</sup>

The four commonly used ethical criteria in international business and negotiations are:

1. *The Golden Rule*. The explanation of ethical behavior as a function of personnel values. “Do unto others as you would have them do unto you” is often cited as the “Golden Rule”. In essence requires participants to apply the same standards of fairness and equity to their own actions that they would demand from others.
2. *Universalism*. Requires the prejudgment of an action to determine, before the action is carried out, its rightness or wrongness. Based on the work of the philosopher Immanuel Kant, human beings are incapable of foreseeing the results of all their decisions and actions and thus need a moral code to guide them. For a decision or action to be considered ethical under universalism it must meet the following criteria:
  - People must not be used as a means to an end. There must be a basic respect of for the individuals inherent worth and dignity
  - Under similar circumstances all people must be treated equally
  - Consistent with all universal moral principles
3. *Utilitarianism*. In contrast to universalism, argues that human beings ought to foresee the results of their actions. They should act according to the principle of seeking alternatives that provide the greatest amount of good for the greatest number of people, therefore maximizing the total amount of good. Implicit in this ethical criterion is that all people will be affected by the set of alternatives and the array of outcomes and that there will be some winners and some losers.
4. *Distributive Justice*. Based on the work of John Rawls, implies that justice occurs when individuals get what they deserve and the opposite, injustice occurs when individuals are deprived of that to which they have a legitimate right. Additionally, the concept then asks if everyone (in the group) is better off as a result of the action

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<sup>41</sup> Taken from *Ethics in Negotiation: Oil and Water or Good Lubrication?*. H. Joseph Reitz, James A. Wall, Jr. Mary Sue Love. Business Horizons, May-June 1998. Indiana University, Kelly School of Business.