

**UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLUMBIA**

**UNITED STATES OF AMERICA,**

**Plaintiff**

**v.**

**BAE SYSTEMS PLC,**

**Defendant**

**CRIMINAL NO.: 1:10-cr-035 (JDB)**

**UNITED STATES' SENTENCING MEMORANDUM**

The United States of America, by and through its counsel, the United States Department of Justice, Criminal Division, Fraud Section, and the National Security Division, Counterespionage Section (collectively, the "Department"), hereby submits the Department's Sentencing Memorandum in this matter. For the reasons set forth below, the Department respectfully submits that the Court should accept the guilty plea of BAE Systems plc ("BAES") to the Criminal Information in 1:10-cr-035, and sentence it in accordance with the parties' plea agreement, filed simultaneously.

**I. Background**

BAES is a multinational corporation headquartered in Farnborough, England, in the United Kingdom of Great Britain and Northern Ireland, with offices and operations in various countries, including the United States. BAES is the world's second largest defense contractor, and the fifth largest provider of defense materials to the United States government. BAES

employs over 100,000 people, has customers in over 100 countries, and has annual sales in excess of £18.5 billion in 2008.

BAES's business practices are or were the subject of numerous ongoing investigations by different foreign governments. As noted specifically in the plea agreement between BAES and the Department, the plea agreement only binds the Department and not any foreign authority. Similarly, the recommended sentence here relates only to the offense charged in the criminal Information to which BAES is pleading guilty, and not to any matters under investigation by any authorities other than the Department, including any foreign authorities.

## **II. Summary of Facts**

As part of its investigation, since 2005 the Department has examined a variety of suspicious payments by BAES in numerous jurisdictions across the world, including in the Kingdom of Saudi Arabia ("KSA"), the Czech Republic, Hungary and other countries. Certain of these payments serve as the factual predicate for the conspiracy charge in the criminal Information here. That conspiracy charge has as its objects: (a) impairing and impeding the lawful functions of the Department of Defense and the Department of State, thus defrauding the United States, in violation of Title 18 U.S.C. Section 371; (b) committing the following offenses against the United States: (i) making false statements to the United States, in violation of Title 18 U.S.C. Section 1001; and (ii) violating the Arms Export Control Act ("AECA"), Title 22 U.S.C. Section 2751, *et seq.*, and the International Traffic in Arms Regulations ("ITAR"), 22 C.F.R. Section 120, *et seq.*

**A. Representations to the United States Regarding Compliance Mechanisms**

In 2000, BAES was undertaking a significant expansion into the United States market. In connection with U.S. government scrutiny of BAES's expansion plans, on November 16, 2000, BAES represented in writing to the U.S. government, including the Department of Defense and the Department of Justice, that BAES would create compliance mechanisms sufficient to ensure that its U.S. and non-U.S. businesses alike would operate as if they were subject to the anti-bribery provisions of the Foreign Corrupt Practices Act, Title 15 U.S.C. Sections 78dd-1, *et seq.* BAES committed that these compliance mechanisms would be established within six months (by May 2001) and no later than within 12 months (by November 2001).

In 2002, BAES was rumored to have won tenders to supply several Eastern European countries with fighter jets by bribing various Eastern European public officials. As a result, the U.S. Department of Defense asked BAES for assurances that BAES had lived up to its November 2000 anti-corruption commitments. In May and June 2002, in letters and presentations to the Department of Defense, BAES stated that it had reformed its business practices and had implemented sufficient mechanisms to ensure that all its businesses were operating in compliance with the anti-bribery provisions of the FCPA. Such representations were false. As detailed in the Information and Statement of Offense,<sup>1</sup> BAES had made payments that it had not subjected to the level of scrutiny to which BAES had assured the U.S. government they would be subjected.

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<sup>1</sup> Please note that while the Statement of Offense, attached as Appendix B to the Plea Agreement, and the Information contain substantively identical factual allegations, the relevant paragraph numbers differ slightly between documents.

**B. Requirements to Disclose Commissions Used in Sales of Defense Articles**

As part of the U.S. regulatory scheme to control the distribution of U.S. military technology, under the AECA and ITAR the Department of State has the power to approve or deny applications to transfer controlled U.S. technology identified on the United States Munitions List (“USML”). Part of the licensing scheme requires the applicant to identify commissions paid to anyone who helps secure the sales of defense articles and services. Commissions must be identified to the Department of State in a filing called an ITAR Part 130 statement, whether they are legitimate commissions or bribes. In particular, the license applicant must identify the person or entity receiving the commission and the amounts paid. In addition, every applicant must obtain from each vendor a “full disclosure” of all fees or commissions paid. 22 C.F.R. § 130.12. Moreover, supplementary reports are required to be filed to ensure that the licensing authority has complete information. 22 C.F.R. § 130.11.

During the relevant time period, BAES was involved in thousands of applications for the transfer or retransfer of defense articles. BAES, however, consistently failed to identify commissions paid to third parties to assist in securing the sales of defense articles that were the subject of export licenses. As detailed in the Information and Statement of Offense, BAES had established an elaborate system to conceal its relationships with its marketing advisors and to pay them secretly. In paying commissions to some of its third-party marketing advisors, BAES was aware that some or part of those payments would be passed on to others to influence government procurement processes for the benefit of BAES.

**C. Payments Evidencing the Falsity of BAES’s Statements**

In contrast to BAES’s multiple representations to the U.S. government that its non-U.S. businesses would comply with the anti-bribery provisions of the FCPA, and in violation of

BAES's legal disclosure obligations under the AECA and ITAR, BAES had created numerous structures for making covert payments in connection with the sales of defense articles. As detailed in the Information and Statement of Offense, BAES made some third-party payments while aware that there was a high probability that part of the funds would be passed on to a foreign government official to influence a decision in favor of BAES. BAES made other payments aware that there was a high probability that the payments would be used to influence government decision makers in the purchase of defense materials. Regardless of the true identities of the ultimate recipients of the funds, BAES intentionally failed to create mechanisms to ensure its compliance with the FCPA and failed properly to identify and disclose to the State Department commission payments as required by the AECA and ITAR in connection with the sales and exports of defense articles and services.

### **III. Prosecution of BAE**

#### **A. Summary of Criminal Charges**

The Department and BAES propose to resolve this matter through a guilty plea by BAES, pursuant to a plea agreement. Criminal Information 1:10-cr-035 charges BAES with conspiracy in violation of 18 U.S.C. § 371. The objects of the charged conspiracy are: (a) defrauding the United States, in violation of 18 U.S.C. § 371; and (b) committing the two following offenses against the United States: (1) making false statements to the United States, in violation of 18 U.S.C. § 1001; and (2) violating the AECA, 22 U.S.C. §§ 2751, *et seq.* and ITAR, 22 C.F.R. Section 120, *et seq.*

**B. Summary of Core Terms of the Plea Agreement**

The proposed plea agreement contain the following core terms: (a) BAES agrees to plead guilty to the charge in criminal Information 1:10-cr-035 in the District of Columbia, and in connection with that charge to admit and adopt the Statement of Offense attached to the plea agreement; (b) BAES shall pay a criminal penalty of \$400,000,000 to the United States; (c) BAES will cooperate with the Department as described in the plea agreement; (d) BAES will implement an effective compliance system, including periodic testing of same; and (e) BAE will retain an independent compliance monitor, as described in the plea agreement, who will, over a three-year term, conduct a review of BAES’s anti-corruption and export controls compliance systems, internal controls, and related issues, and will provide the Department periodic reports on his or her reviews.

**IV. Sentencing Guidelines Calculation and Criminal Penalties**

**A. BAES’s Sentencing Guidelines Calculation**

As set forth in paragraph 4 of the plea agreement, the parties agree that the following Sentencing Guidelines provisions, using the 2009 Sentencing Guidelines Manual, apply based on the facts of this case, for purposes of determining an advisory guideline range:

1. Calculation of Offense Level:

§ 2C1.1(a)(2)	Base Offense Level	12
§ 2C1.1(b)(2) & § 2B1.1(b)(1)(O)	Benefit Received Over \$200 million	+28
§ 2C1.1(b)(3)	High-Level Decision Maker	<u>+ 4</u>
	<b>TOTAL</b>	<b>44</b>

2. Calculation of Culpability Score:

§ 8C2.5(a) Base Score	5
§ 8C2.5(b)(1)(a)(i) and (ii) 5,000 or More Employees; High-Level Personnel Involvement; and Pervasive Tolerance	+ 5
§ 8C2.5(g)(3) Acceptance of Responsibility	<u>- 1</u>
<b>TOTAL</b>	<b>9</b>

3. Calculation of Preliminary Fine Range

Base Fine: Greater of the amount from table in § 8C2.4(a)(1) & (d) corresponding to or Offense Level of 44 (\$72,500,000), or the pecuniary loss/gain from the offense (\$200,000,000) (described below)	\$72,500,000 \$200,000,000
Multipliers, culpability score of 9 § 8C2.6	1.8 to 3.6
Fine Range: § 8C2.7 – greater of Using Offense Level 44 (\$72,500,000)	\$130,500,000 to \$261,000,000
OR	
Using pecuniary gain/loss (\$200,000,000)	\$360,000,000 to \$720,000,000
4. Statutory Maximum Fine (18 U.S.C. § 3571) Twice the gross gain/loss of \$200,000,000	\$400,000,000
5. <i>Final Effective Fine Range</i>	<i>\$360,000,000 to \$400,000,000</i>

**B. BAES's Loss or Gain Figure**

Pursuant to *United States v. Booker*, 543 U.S. 220 (2005), the Court must determine an advisory sentencing guideline range pursuant to the United States Sentencing Guidelines. The

Court should then determine a reasonable sentence within the statutory range after considering the advisory sentencing guideline range and the factors listed in 18 U.S.C. § 3553(a).

The advisory guideline range calculated above, and agreed to by the parties, is based on U.S.S.G. § 2C1.1, which is the sentencing guidelines range for a conspiracy to defraud by impairing and impeding the lawful functions of the United States government. See U.S.S.C. § 2C1.1 Commentary, Statutory Provisions; Appendix A. U.S.S.G. § 2C1.1(b)(2) contains a cross-reference to § 2B1.1, in order to determine the amount of the “loss” or “gain.”

For purposes of calculating “loss” or “gain” under U.S.S.G. § 2B1.1(b)(1), the Department and BAES have determined and agreed that \$200,000,000 is the appropriate “gain” to be used in this circumstance. The basis for using this figure is that a traditional calculation of loss or gain in a case of this magnitude and complexity is overly burdensome, if not impossible. The commentary to U.S.S.G. § 2B1.1 specifically provides that where loss cannot reasonably be determined, gain is an acceptable alternative measure of loss.

Before determining that \$200,000,000 was the appropriate gain figure under the circumstances here, the Department considered several possible alternative methods of calculating BAES’s potential “gain” from the false statements, including examining what might have happened if the appropriate U.S. government entities had known of BAES’s false statements. In particular, the Department considered the following potential alternative approaches:

- (A) calculating the potential profits obtained by BAES from its acquisitions of U.S. companies as part of its efforts to expand into the U.S. market, where such acquisitions could have been blocked if the underlying factual predicate were known to the appropriate U.S. government entities;



- (B) calculating the potential profits from the sales of defense articles and services requiring State Department export licenses based on false arms export applications;
- (C) calculating the potential increased costs, and thus reduced profits, to BAES if they did not have access to U.S. technology; and
- (D) calculating the potential lost profits if the appropriate U.S. suspension and debarment authorities had determined that BAES was not a responsible contractor and thus had suspended or debarred BAES from future U.S. government contracting.

It is the Department's view that each of these approaches to calculating profits is highly speculative and insufficiently reliable for sentencing purposes.

In sum, after considering the various methods described above, the Department has determined that it cannot reasonably calculate the "gain" to BAES. Notably, the false statements and the export license applications referenced in the Information and Statement of Offense relate to hundreds of projects involving numerous BAES subsidiaries over a long time period. In addition, BAES has represented to the Department that BAES and its relevant non U.S. subsidiaries have not maintained sufficient records to identify which defense projects, and therefore which export license applications, were linked to specific undisclosed payments to third parties. Moreover, because BAES is not itself a U.S. entity, BAES was not, and could not be, the "applicant" for the arms export licenses containing material false statements and material omissions. Instead, BAES, or its relevant non U.S. subsidiary, was typically the "licensee," and the actual applicant in such cases was a foreign government or a U.S. entity also involved in the transaction. Consequently, identifying the full scope of false export applications involving BAES would be complicated by first having to identify which companies or governments had applied for a license on BAES's behalf. Similarly, calculating the loss or gain on a project-by-

project basis would take an unreasonable amount of time and resources and would only produce speculative results.

Under these circumstances, the commentary to U.S.S.G. § 2B1.1 relating to “Government Benefits” is instructive. It provides that in cases involving government benefits, “loss shall be considered to be not less than the value of the benefits obtained by unintended recipients or diverted to unintended uses, as the case may be.” Although the commentary is intended to apply to cases involving government grants, loans, and entitlement programs, its rationale applies here as well. Here, by analogy, the “unintended recipients” are third parties to whom BAES made undisclosed payments, including those who received payments from BAES under circumstances in which BAES was aware of a high probability that part of the payments would be used to influence government decisions to favor BAES. Accordingly, it is rational to conclude that the “gain” should not be less than those total undisclosed third-party payments.

Consequently, the Department and BAES agreed to use the total payments identified in the Statement of Facts to determine the approximate amount of payments “obtained by unintended recipients or diverted to unintended uses.” Those total approximate payments are as follows:

- Statement of Offense Paragraph 29: £135,000,000 plus more than \$14,000,000
- Statement of Offense Paragraph 42: \$5,000,000
- Statement of Offense Paragraph 44: £10,000,000 plus more than \$9,000,000

**Total: £145,000,000 plus more than \$24,000,000**

Using a historical exchange rate of \$1.50 to £1, the maximum amount of payments “obtained by unintended recipients or diverted to unintended uses” is therefore approximately \$240,000,000.

The Department, however, recognizes that some of the undisclosed commission payments were (1) used to secure defense projects that did not require licenses from the Department of State, and (2) likely not improper in light of BAES's commitment to create mechanisms so that its non-U.S. businesses would operate as if they were U.S. businesses in compliance with the anti-bribery provisions of the FCPA. Given the difficulties in identifying with specificity the scope of such legitimate payments given the dearth of documentation retained by BAES related to the undisclosed payments, the parties have estimated, and therefore stipulated, that this category of non-covered payments totals approximately \$40,000,000. Using the amount of payments identified in the Statement of Offense (\$240,000,000) and subtracting the non-covered payments (\$40,000,000), the result is \$200,000,000.

As a result, the parties agree that for sentencing purposes, the total "gain" for BAES from the actions described in the Statement of Offense is at least \$200,000,000.

**C. BAES's Remediation Efforts**

Since the beginning of the Department's criminal investigation in 2005, BAES's remediation efforts have been modest in scope, have improved over time and have been significant in their impact. First, BAES has now replaced nearly all of its top leadership, including its Chief Executive Officer and Chairman of the Board. Notably, BAES has retained a new chief legal officer, with the title Group General Counsel, since early 2007. In addition, the Company no longer employs various members of BAES's senior management who were implicated in the criminal misconduct uncovered by the investigation, although it does continue financial and advisory relationships with at least one individual involved in the criminal conduct and undisclosed payments.

BAES also overhauled and expanded its compliance organization and Corporate Responsibility efforts. New positions include Chief Counsel, Compliance and Regulation, that include global responsibility over this field, and the Managing Director of Corporate Responsibility, who reports directly to the Chief Executive officer.

In addition to these efforts, during the investigation, BAES imposed a moratorium on entering into new marketing advisor agreements or making payments under existing business marketing advisor agreements until a complete collection and review was undertaken of all such agreements. In 2007, BAES also initiated a review of all third-party advisors with whom it had agreements, and terminated the majority of pre-existing agreements with advisors. Going forward, BAES enhanced its review and approval procedures for marketing advisors, in light of the past problems and created an External Review Panel (the "Panel") composed of U.S. and U.K. lawyers with experience in the FCPA and other anti-corruption laws. The new advisor review process requires any BAES employee who wishes to engage an advisor to formally propose the advisor to the Panel, which then examines corruption risk and potential reputational risk arising from hiring that advisor before making a recommendation to BAES's Group General Counsel.

In June 2007, well before entering plea negotiations with the Department, BAES commissioned a respected U.K. jurist to evaluate BAES's ethics and business conduct policies and processes. While this review expressly was not an examination of BAES's past business practices, some of which are described in the Criminal Information and Statement of Offense, the review did identify numerous areas for improvement, including twenty-three (23) specific recommendations described in a May 2008 report. BAES committed to implement all twenty-three recommendations, and, as part of those efforts, hired Deloitte LLP ("Deloitte") to evaluate

BAES's efforts in implementing these compliance enhancements as part of a larger Corporate Responsibility audit. As part of its plea agreement with the Department, BAES has agreed to continue employing Deloitte to conduct such audits on an ongoing basis.

The remediation measures described above, in conjunction with BAES's agreement to retain an independent compliance monitor, who will have access to the External Review Panel and the Deloitte Corporate Responsibility Review, are viewed by the Department as evidence supporting BAES's stated commitment to ensure that it operates in a transparent, honest, and responsible manner going forward. Most importantly, BAES has, again, committed itself to operating consistent with the principles outlined in its November 16, 2000 letter: *that BAES will ensure that its non-U.S. businesses, like its U.S. businesses, comply with the anti-bribery provisions of the FCPA as if they were all U.S. businesses.*

**D. The Department's Principles of Federal Prosecution of Business Organizations**

In accordance with the Department's Principles of Federal Prosecution of Business Organizations, the Department considered a number of factors in its decisions regarding the overall disposition in this case, including but not limited to the following factors, applied as noted:

- Nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities:
  - Impairing and impeding the lawful functions of the Defense Department and the Department of State, and thereby defrauding the United States, is a serious offense.
  - The conduct by BAES implicates the Department's priorities, including protecting the integrity of our free economic and capital markets, and protecting consumers, investors and business entities that compete only through lawful means.

- Pervasiveness of wrongdoing within the corporation, including the complicity in, or the condoning of, the wrongdoing by corporate management:
  - Corporate leadership knowingly and willfully failed to adopt an anti-corruption compliance system after making representations to the U.S. government that such mechanisms would be or had been created.
  - The undisclosed payments that form the underlying factual predicate for the charged offense was a major and longstanding business strategy replete with corruption risk.
  - The undisclosed payments were pervasive across the Company, covered numerous markets, and lasted for decades.
  - The undisclosed payments were tolerated or condoned up to the highest corporate levels.
  - Corporate leadership created the structures for the payment of undisclosed commissions in order to frustrate investigations and avoid identification of those payments to and through marketing advisors.
  
- The corporation's history of similar misconduct, including prior civil, criminal, and regulatory actions against it:
  - The Company had a history of making undisclosed payments prior to its representations to the U.S. government in 2000.
  
- The corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents:
  - No voluntary disclosure was made, except for a limited disclosure in late 2009 related to potential export control violations, which are not specifically described in the Statement of Offense.
  - No substantive cooperation was provided by BAES to the Department's investigation after 2006, but BAES did provide limited cooperation on procedural aspects of the investigation.
  - BAES's U.S. subsidiary, BAE Systems Inc., generally cooperated with the Department during the entirety of the investigation.
  
- The existence and effectiveness of the corporation's pre-existing compliance program:
  - BAES's anti-corruption and export control compliance programs in effect at time of offense were clearly inadequate.
  - Early anti-corruption compliance program was designed to be inadequate in order to conceal payments to third parties.
  
- The corporation's remedial actions, including efforts to implement an effective corporate compliance program or improve existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution, and to cooperate with relevant government agencies:
  - Prior Company management has been replaced by individuals committed to compliance with anti-corruption and export control laws.

- Company compliance and audit functions centralized and enhanced to avoid prior problems.
- The Company implemented company-wide training, enhanced audit and due diligence tools to prevent future violations of law.
- The External Review Panel was established to review proposed new advisors, a primary source of historical business conduct problems.
- Deloitte has been commissioned to conduct a periodic audit of BAES's corporate responsibility, including the effectiveness of the External Review Panel.
- The Company's undisclosed payments continued even after earlier government corruption investigations had been commenced.
- Culpable employees were not effectively or timely disciplined for wrongdoing.
- Even after BAES was informed of material omissions on U.S. arms export applications, BAES took no substantive steps to correct those omissions in previously filed ITAR Part 130 statements. Because of the complexity of the process required to correct previous applications, as described above, BAES is not required by the plea agreement with the Department of Justice to correct these prior applications.
  
- Collateral consequences, including whether there is disproportionate harm to the shareholders, pension holders, employees, and other persons not proven personally culpable, as well as impact on the public arising from the prosecution:
  - European Union Directive 2004/18/EC, which has recently been enacted in all EU countries through implementing legislation, provides that companies convicted of corruption offenses *shall* be mandatorily excluded from government contracts.
  - BAES's business is primarily from government contracts, including with several EU customers.
  - Mandatory exclusion under EU debarment regulations is unlikely in light of the nature of the charge to which BAES is pleading. Discretionary debarment will presumably be considered and determined by various suspension and debarment officials.
  - The Department will communicate with U.S. debarment and regulatory authorities, and relevant foreign authorities, if requested to do so, regarding the nature of the offense of which BAES has been convicted, the conduct engaged in by BAES, its remediation efforts, and the facts relevant to an assessment of whether BAES is presently a responsible government contractor.
  
- The adequacy of prosecution of individuals responsible for the corporation's malfeasance:
  - Individuals responsible for criminal activities may be beyond reach of U.S. authorities based on U.S. statute of limitations or jurisdictional limitations.

- U.K. authorities announced on February 5, 2010, that in light of BAES's agreement to plead guilty to certain charges in the U.S. and the U.K., it is no longer in the public interest to continue the U.K.'s investigation into the conduct of individuals. Consequently, the Serious Fraud Office has at this time withdrawn criminal charges previously brought against one individual and closed the investigation into other individuals.
- Corporate charge necessary for deterrence purposes.
- The adequacy of remedies such as civil or regulatory enforcement actions:
  - Regulatory remedies are inadequate here to address widespread and serious violations of law.

**E. Agreed Fine: \$400,000,000**

Pursuant to Fed. R. Crim. P. 11(c)(1)(c), the Department and BAES agree that the appropriate criminal fine in this case, after consideration of (a) the appropriate application of the Sentencing Guidelines, (b) its compliance and remediation efforts, and (c) the factors set forth in 18 U.S.C. § 3553(a), is \$400,000,000. This fine amount represents a number within the recommended guidelines range, and is the maximum allowed under Title 18, United States Code, Section 3571.

**V. Waiver of the Pre-Sentence Report and Scheduling of the Plea**

In accordance with Paragraph Seven of the Plea Agreement, the Department requests the Court waive the requirement for a pre-sentence report pursuant to Federal Rule of Criminal Procedure 32(c)(1)(A), based on a finding by the Court that the record contains information sufficient to enable the Court to meaningfully exercise its sentencing power. The Department further requests the Court combine the entry of the plea and sentencing into one proceeding, and that the proceeding be scheduled as quickly as possible, preferably on March 1, 2010.




**CONCLUSION**

For the foregoing reasons, the Department respectfully recommends that the Court sentence BAES to a fine in the amount of \$400,000,000 and a special assessment of \$400, and a term of three years of organizational probation.

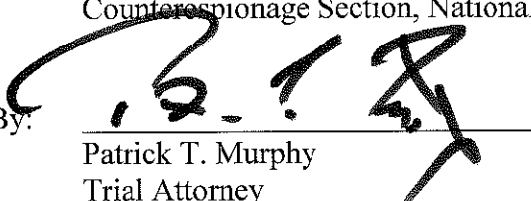
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**CERTIFICATE OF SERVICE**

I hereby certify that on February 22, 2010, I served a copy of the above Sentencing Memorandum on Lawrence Byrne, Esq., counsel for defendant BAE Systems plc, via filing electronically on ECF and electronic mail.

/s/ Nathaniel B. Edmonds  
Senior Litigation Counsel