

CASE 2-4 Ethics and Airbus

One September, a fraud squad, led by Jean-Claude Van Espen, a Belgian magistrate, raided Airbus's headquarters in Toulouse. "They wanted to check whether there was possible falsification of documents, bribery or other infractions as part of the sale of Airbus aircraft to Sabena," says Van Espen's spokesman. The team of 20 Belgian and French investigators interviewed several Airbus employees during its three-day stay in Toulouse and carted away boxes of documents.

In November 1997, Sabena had approved an order for 17 Airbus A320s (narrow-bodied aircraft), which it did not need. Even more oddly, it had doubled the order at the last minute to 34, a move that helped trigger the airline's collapse four years later.

Although nominally controlled by the Belgian government, Sabena was run by the parent company of Swissair, SAirGroup, which had owned a stake of 49.5 percent since 1995 and which also went bust in 2001. A former Sabena manager, who arrived after the Airbus order was placed, says that the planes were not needed: "It was a fatal business decision." A Belgian parliamentary commission's recent report confirms that the Airbus order was a big cause of Sabena's collapse.

Van Espen's separate criminal investigation is continuing. According to the report, it started in October 2001 after Philippe Doyen, then a Sabena employee, lodged a complaint. Among other things, he suggested to Van Espen that he interview Peter Gysel, a former Swissair employee now working at Airbus, who put together Sabena's deal with Airbus. Gysel denies any impropriety. The former Sabena manager says: "I never got the slightest whiff that the decision was driven by kickbacks, side-payments, and so on. But I cannot rule anything out." Neither does Van Espen.

Today airlines are ordering about 400 aircraft a year. But in good times, 800 planes, worth around \$60 billion, are sold a year. In the past ten years Airbus (originally a consortium, now owned 80 percent by EADS and 20 percent by BAE Systems) has caught up with Boeing, which had enjoyed two-thirds of the market since its 747 jumbo-jet entered commercial service in 1970.

Many aircraft are no doubt bought and sold in entirely conventional ways. But many are not. After all, lots of airlines are still state-owned and not subject to normal business rules. Commission payments (licit or illicit) on multimillion-dollar aircraft deals increase the capital cost of aircraft, which are therefore subject to higher depreciation or operating-lease charges, or both. But these extra costs are barely discernible in the pool of red ink created by the carriers' perennial losses.

Aircraft purchases drag on for years, as airlines play Boeing and Airbus off against each other. Especially in a buyer's market, deep discounts are common, performance guarantees are demanding, and manufacturers have to offer all sorts of sweeteners (e.g., aircraft trade-ins, unusual guarantees) to persuade an airline to switch to their aircraft.

Unsurprisingly, given the regulated nature of international air travel, politics plays a part. For instance, no sooner had Air Mauritius bought Airbus A340s in 1994 than it obtained an upgrade from

Paris Orly to Charles de Gaulle airport, which is Air France's main base with better onward connections.

Aircraft purchases have long been associated with controversy. In the 1970s, when Lockheed was still making civil jets, it was caught bribing Japanese officials to buy its L1011 wide-bodied airliner. A Japanese prime minister was later charged and convicted in 1983 for taking a bribe. Prince Bernhard of the Netherlands was also disgraced for his involvement with Lockheed. This scandal led in 1977 to Congress passing the Foreign Corrupt Practices Act (FCPA), which forbids American companies, their officers, or their representatives from bribing foreign officials.

Critics have often pointed out that American firms can sidestep the FCPA by using foreign subsidiaries and nationals to pay bribes. Boeing says that its policy is to adhere to the spirit and letter of the FCPA, that its systems of controls ensure employees comply with this policy, and that no Boeing employee has been charged under the FCPA. In 1982 Boeing pleaded guilty to false statements about commissions on the sale of commercial aircraft prior to 1977. Boeing also says that there have been public hearings in the Bahamas over allegations of bribery in the 1990 sale of deHavilland aircraft to Bahamas Air, during Boeing's ownership of deHavilland.

Airbus has not been subject to such constraints. France ratified an OECD convention to outlaw bribery of foreign public officials in 2000. Until then the government even permitted French companies tax deductions for giving bribes.

For years, as they steadily lost market share to the European challenger, the Americans have been outspokenly critical of Airbus. In the 1980s the beef was the huge subsidies that European governments poured into the industry. Now that Airbus repays such launch aid, that is less relevant, especially as Boeing receives indirect subsidies through America's defense budget and space program.

But the American government has also spoken out on the subject of bribery. Grant Aldonas, an undersecretary for international trade, told a congressional committee: "Unfortunately this [aircraft manufacturing] is an industry where foreign corruption has a real impact . . . this sector has been especially vulnerable to trade distortions involving bribery of foreign public officials."

According to a European Parliament report, published in 2001, America's National Security Agency (NSA) intercepted faxes and phone calls between Airbus, Saudi Arabian Airlines, and the Saudi government in early 1994. The NSA found that Airbus agents were offering bribes to a Saudi official to secure a lion's share for Airbus in modernizing Saudi Arabian Airlines' fleet. The planes were in a \$6 billion deal that Edouard Balladur, France's then prime minister, had hoped to clinch on a visit to see King Fahd in January 1994. He went home empty-handed.

James Woolsey, then director of the Central Intelligence Agency, recounted in a newspaper article in 2000 how the American government typically reacted to intelligence of this sort. "When we have caught you [Europeans] . . . we go to the government you're bribing and tell its officials that we don't take kindly

to such corruption,” he wrote. Apparently this (and a direct sales pitch from Bill Clinton to King Fahd) swung the aircraft part of the deal Boeing’s and McDonnell Douglas’s way.

KUWAIT KICKBACKS?

Not even the NSA, however, knows about everything in the aircraft-manufacturing industry as it actually happens. Consider the history of an Airbus order placed by Kuwait Airways Corporation (KAC), another state-owned airline.

In November 1995, Reuters reported that Kuwaiti prosecutors had questioned Bader Mallalah, KAC’s then chief financial officer, over allegations of embezzlement made against him by KAC. The firm’s chairman, Ahmed al Mishari, had suspended Mallalah from his job the previous month. But KAC had trumped up the allegations against Mallalah to put the lid on a story of corruption in which its then chairman was himself involved.

That story began exactly five years earlier in Cairo, where KAC had set up temporary headquarters after Iraq’s invasion of Kuwait in August 1990. Most of its planes would inevitably be lost or damaged, so al Mishari was planning a shiny new postwar fleet. Naturally, both Boeing and Airbus were asked to tender. Both firms expected politics to play a part in KAC’s choice, especially after an American-led coalition had liberated Kuwait.

Shortly after the liberation of Kuwait, Boeing and KAC met in London. One person present says al Mishari gave the impression that the order would be Boeing’s. After all, until then, American companies had won most of the large reconstruction contracts from a grateful government.

Airbus hoped otherwise. In 1991, shortly before the Paris Air Show, Jean Pierson, the then-boss of Airbus, met al Mishari at the Churchill Hotel in London. The two talked in private for part of the time, so what they discussed is not known. Two clear inferences can, however, be drawn from subsequent events: al Mishari promised the order to Airbus, and Pierson pressed for an announcement at the imminent air show.

As substantial public funds were involved, KAC was supposed to follow the formal process in Kuwait before placing the order. This process included approvals from the Ministry of Finance and the public-spending watchdog. None of these approvals was sought before the air show. In June 1991, at the show, al Mishari stunned Kuwaiti officials and Boeing when he announced a firm order for 15 Airbus aircraft, worth \$1.1 billion, and options for nine more, worth up to \$900 million. A delighted Pierson trumpeted the deal as Airbus’s first single order for all its aircraft types.

Most unusually, Boeing was not asked for its “best and final” offer, according to a former KAC employee. Boeing’s response to the announcement was to offer generous discounts to KAC—so that its package was around \$100 million cheaper than its rival’s—but it was too late. The upshot of a meeting in the summer of 1991 between the boss of Boeing Commercial, furious American officials, and the Crown Prince of Kuwait was a messy compromise. KAC would order the engines for the Airbuses from General Electric; Boeing would receive an order for two wide-bodied planes as a sop; and the firm order for 15 Airbus aircraft would go ahead provided that KAC bought from Boeing in future.

This compromise left al Mishari in a rather awkward spot. KAC had an option to buy nine more aircraft from Airbus. An airline is usually able to walk away from an option deal if it forfeits the modest deposit paid. But this case was far from normal. The company that was to take up the option was not KAC itself but

a subsidiary, Aviation Lease and Finance Company (ALAFCO), which al Mishari had set up in Bermuda in September 1992. ALAFCO was to buy the aircraft and lease them to KAC. In late 1992 al Mishari confirmed to Pierson that ALAFCO would buy the nine planes and sent off a \$2.5 million deposit. By buying the planes through ALAFCO, al Mishari intended to bypass formal governmental approval.

There was more to the deal. Airbus chipped in a total of \$450,000 between 1992 and 1994 to help with the costs of setting up and running ALAFCO. On December 15, 1992, ALAFCO appointed a part-time commercial adviser, Mohamed Habib El Fekih, a Tunisian national. His day job was then as head of sales in the Middle East—for Airbus. Under his ALAFCO contract of employment, a copy of which *The Economist* has and which was to run for three years from January 1993, El Fekih received \$5,000 a month and \$80,000 in back pay for “services” rendered to ALAFCO from February 1, 1990—31 months before ALAFCO’s incorporation—to December 31, 1992. The \$5,000 was paid each month from ALAFCO’s account number 201-901-04 at the Commercial Bank of Kuwait in New York to El Fekih’s personal account at Cr dit Lyonnais’s branch in Blagnac, France, where Airbus is based on the outskirts of Toulouse.

By 1993 three of the nine aircraft under option, all cargo planes, were nearly ready for delivery. However, Mallalah, who was also ALAFCO’s chief executive, insisted that the transaction be subject to formal procedure in Kuwait. This meant competitive tenders from Airbus and Boeing. Unsurprisingly, Airbus, with inside knowledge from its two-hatted vice president, El Fekih, was able to match exactly offers from Boeing, after Boeing came in over \$50 million cheaper. With nothing to choose between the offers, ALAFCO selected Airbus, on the grounds that KAC’s fleet now comprised predominantly Airbus aircraft.

The deal sailed through KAC’s board and the Ministry of Finance. However, Mallalah provided Kuwait’s public spending watchdog with full details of ALAFCO’s order for the cargo planes. It refused to sanction the deal. Consultants concluded in early 1995 that the purchase of the cargo aircraft was not justified. The Ministry of Finance told KAC not to proceed. After Mallalah submitted a report to KAC’s board on the affair, El Fekih resigned from ALAFCO in March 1995.

El Fekih says that he acted in an honest way; Pierson approved his ALAFCO contract, as did the boards of KAC and ALAFCO; his ALAFCO contract had nothing to do with the sale of Airbus to KAC; KAC canceled its option; ALAFCO never bought any Airbus aircraft; he acted as a consultant to help set up ALAFCO as an aircraft-financing company; and he declared his earnings to the tax man. Airbus says that it offers this sort of support to customers, when asked. The present owners of the ALAFCO business confirm that ALAFCO bought three Airbus aircraft.

Of the other six aircraft under option, three were not converted into firm orders. Two Airbus A320s were leased to Shorouk Air in Egypt. This joint-venture between KAC and EgyptAir was specifically set up to find a home for them but is being liquidated because of massive losses. Kuwait’s Ministry of Finance leased another.

Al Mishari, sacked as the chairman of KAC in 1999 after spending almost his entire career with the airline, owns a shopping complex in the Salmiya district of Kuwait, which local wags have dubbed the “Airbus Centre.” Al Mishari, whose family is wealthy, suffered financial problems when the Kuwaiti stock market collapsed in the early 1980s. Al Mishari declines to comment, as does KAC.

It is not irrelevant to ask if the price of the Airbus aircraft was inflated to allow for kickbacks. No evidence of graft has ever come to light. However, no policeman, in Kuwait (or elsewhere), has looked for any.

INDIA INK

What about cases where police have carried out investigations? In March 1990 India's Central Bureau of Investigation (CBI) filed a first information report (FIR). It was investigating allegations that Airbus had bribed highly placed public servants and others to induce Indian Airlines (IA) to order its aircraft.

In March 1986 state-owned IA had ordered 19 Airbus A320s, worth \$952 million, with an option for 12 more, later exercised. This order was despite the fact that, when IA set up a committee in 1983 to recommend replacement aircraft for its aging Boeing fleet, the A320 was not considered—it had not then been launched or flown. With approval from the Indian government, IA had in July 1984 paid Boeing a deposit for 12 Boeing 757s, large narrow-bodied aircraft.

Several civil servants and IA officials were named in the FIR. One name not on the list was that of Rajiv Gandhi, India's prime minister in 1984–89, who was killed in a bomb explosion in May 1991.

How has the CBI's investigation progressed in the intervening 13 years? Hardly at all, despite the hounding on public-interest grounds of the CBI in Delhi's High Court since 1998 by B. L. Wadehra, an anti-corruption lawyer based in Delhi. *The Economist* has examined the publicly available court documents—the CBI's status reports on its investigation are secret—from Wadehra's litigation.

These papers allege, first, that in October 1984, weeks before Gandhi, a former pilot, succeeded his mother, IA received an offer from Airbus for A320 aircraft, a smaller and less expensive plane than Boeing's 757. It required urgent attention. Second, in November, the aviation ministry gave IA just three days to appraise the offer for Gandhi's office.

Much later, in 1990, *Indian Express*, an Indian newspaper, reported a leaked manuscript note which showed that Gandhi had decided at a meeting on August 2, 1985, that IA "should go in for Airbus A320 aircraft."

Gandhi's correspondence file on the deal mysteriously vanished. The court papers show that civil servants reconstructed 29 pages of the missing file for the CBI by obtaining copy correspondence from government departments. Remarkably, this task took seven years—and even then the reconstruction was only partial.

After the green light from Gandhi, approvals from IA and government bodies were a formality. For instance, the IA board approved the Airbus order at a meeting on August 30, 1985, which started at noon. The quality of the analysis presented to the board on the competing offers was pitiful. The board considered only one criterion—comparative fuel efficiency. Even for that, the data were incomplete. The A320 with the engine chosen by IA had yet to be tried and tested anywhere; provisional data only were included in the report for Boeing 737s "since no technical data were supplied by the company."

But Boeing had not been asked for any, because two hours before the board meeting, at 9:50 a.m. IA's managing director, who is named in the FIR as an alleged recipient of kickbacks, received a letter from Richard Elliott, then Boeing's regional sales director. Boeing offered to supply up to 35 of its 737 aircraft, its

narrow-bodied rival to the A320, with a discount of \$5 million per plane. This offer would reduce IA's investment in new planes by \$140 million, stated Elliott. IA's board brushed the offer aside on the grounds that "if Boeing was [sic] too serious . . . they [sic] could have made the offer earlier."

The Delhi court has a withering opinion of the help Airbus has given the CBI. It allowed Wadehra to add Airbus's Indian subsidiary to his action on the grounds that Airbus in France was not cooperating. Airbus told Wadehra that French law forbade it from answering his questions. "[Airbus] sells its aircraft on their merits," the firm insisted.

The court has castigated the CBI for its dilatory approach. It took the Indian authorities until 1995 to contact Airbus for information, only to be told that such requests should be routed through the French government. The CBI told Wadehra, despite trying Interpol and diplomatic channels, it was not getting any help from the French government. The French embassy in Delhi in effect told Wadehra to get lost when he wrote to ask why France was not cooperating.

Wadehra's case is now topical, because in March last year, IA's board approved an order for 43 Airbus planes, worth around \$2 billion. The order now needs government approval. However, in September 2000, the Delhi court ruled that the Indian government should not approve further purchases from Airbus until the CBI had obtained the information it wanted from the French.

The upshot of the IA story is that no serious attempt has been made to establish whether or not Airbus paid kickbacks to Gandhi and associates. The CBI has not answered written questions.

MOUNTIES AND BANKS

But there are police forces that have shown rather more resolve and initiative than the CBI. One important case establishes that Airbus has paid "commissions" to individuals hiding behind shell companies in jurisdictions where ownership of companies is not a matter of public record, and where strict bank secrecy applies.

Airbus's first big sale in North America was a \$1.5 billion deal, signed in 1988, to sell 34 aircraft to the then state-owned Air Canada. The middleman was Karlheinz Schreiber, a German-Canadian with connections to politicians in Germany and Canada. Schreiber emerged as a figure in the financing scandal that engulfed Germany's Christian Democrat party and its top politician, Helmut Kohl, a former chancellor, in the late 1990s.

In August 1999 the Royal Canadian Mounted Police, acting on a German arrest warrant, nabbed Schreiber. In 2000, Schreiber was charged in Germany with tax evasion on money he had received for the Airbus transaction and other deals. The *Süddeutsche Zeitung*, a German daily, supplied a copy of Schreiber's indictment to *The Economist*. According to this document, Airbus signed a consultancy contract (amended four times) with International Aircraft Leasing (IAL) in March 1985. IAL, which was to help with the Air Canada deal, was a shell company based in Vaduz, Liechtenstein, and a subsidiary of another Liechtenstein-registered shell, Kensington Anstalt.

According to the indictment, between September 30, 1988, and October 21, 1993 (i.e., as Air Canada took delivery of Airbus planes), Airbus paid a total of \$22,540,000 in "commissions" to IAL. Then \$10,867,000 was paid into IAL's account at the Verwaltungs-und Privat-Bank in Vaduz and \$11,673,000 into IAL's account number at Swiss Bank Corporation (SBC) in Zurich. During extradition proceedings against Schreiber in 1999, Airbus

admitted to these payments. In October 2000, Schreiber won a suspension of execution of his case.

The court ruled that IAL belonged to Schreiber, but also that, to the extent that Schreiber had paid out the Airbus “commissions” as *Schmiergelder* (“grease monies”), these payments could be tax deductible. Schreiber’s German tax lawyer later told the court: “*Schmiergelder* were not openly paid to the ‘greased’ person by [Airbus]. It was through third persons to make reception anonymous and the *Schmiergelder* unrecognizable as such.”

So who got the commissions? After years of police investigations in at least five jurisdictions, it is still not clear. According to *The Last Amigo*, a well-researched book on the affair by Harvey Cashore and Stevie Cameron, both Canadian journalists, a lot was withdrawn in cash. Cashore, a producer on “The Fifth Estate,” the Canadian Broadcasting Corporation’s main investigative program, says that Schreiber’s bank records and diaries showed that he usually followed a simple formula for dividing up the money: half for Canadians and half for Europeans.

The book alleges that there may have been a smaller scam within the bigger scam: an Airbus employee may have got some of the money. Some of the money was transferred into subaccounts at SBC in Zurich. One of the subaccounts, code-named “Stewardess,” received as much as one-eighth of the commissions. The book suggests that this account was intended for Stuart Iddles, Airbus’s senior vice president from 1986 to 1994.

Iddles’s wife bought Casa Las Estacas, a luxurious beachfront villa in Puerto Vallarta, Mexico, in September 1992. Documents in *The Economist*’s possession show the price was \$1.5 million. According to a person involved in the deal, the money was wired from an account in the name of the Ciclon Foundation at the Zurich branch of Lloyds, a British bank. Mrs. Iddles confirms that she bought the villa in 1992 but says she has not the “foggiest idea” how much it cost, or which bank the money came from. Mr. Iddles has denied any impropriety. Airbus says it has not been indicted in any jurisdiction over the Air Canada deal, or over any other sales. It adds that no investigator has found unethical behavior on its part.

SYRIAN SCANDALS

Only one case of Airbus’s colluding with a middleman apparently to bribe officials to buy its aircraft has led to convictions. According to Syria’s state news agency, three people were sentenced in Syria in October 2001 to 22 years imprisonment each (later reduced to 10 years) for “serious irregularities” in connection with state-owned Syrianair’s order for six Airbus A320s in 1996. The court also imposed a fine on the three of \$268 million. They were a former minister for economic affairs, a former transport minister, and Munir Abu Khaddur, the middleman. Khaddur was sentenced in absentia and is reportedly living in Spain. The court found that the men had forced the airline to buy the planes, worth \$240 million, and as a result Syrianair had incurred “big financial losses.”

The only inferences to be drawn are either that there was a miscarriage of justice or that bribes were paid. If the latter, the news agency did not release details of how much the men embezzled. Quite why bribes would have been necessary is puzzling. Because America deems Syria to be a sponsor of terrorism, Boeing has long been prohibited from exporting there. The Syrian government declines to comment.

The result of investigations into instances of corruption or alleged corruption by Airbus suggests that Van Espen will have a

very long haul as he tries to establish whether “commissions” influenced Sabena’s decision to buy Airbuses. The order for the 34 A320s could be viewed as incompetence. But nobody can predict the results of Van Espen’s inquiry.

The parliamentary report says Sabena’s board received some lacunary information that was misleading. The choice of Airbus supposedly meant Sabena was confident of strong sales growth. Yet a month after the order was placed, SAirGroup’s chief executive, who also sat on Sabena’s board, said: “We’re now in the last year or years of the boom in air travel.” (We do not mean to imply by inference that the chief executive was corrupt.)

Most of what is recounted in this case happened before Airbus’s present top management team arrived, before it was established as a proper company, and before France adopted the OECD convention on bribery.

No one doubts the company’s ability to compete across the whole product range with Boeing. By the time the Paris Air Show is over, Airbus will probably be well ahead of its rival in market share, thanks to an attractive range of planes. But if charges of corruption involving Airbus were to emerge from Van Espen’s investigation of Sabena, that would deal the company’s reputation a severe blow.

AIRBUS LOBBIES TO RELAX ANTI-BRIBERY RULES

Newly released documents have revealed how companies used their lobbying power to loosen official rules designed to stop corruption. In behind-the-scenes maneuvers, Rolls-Royce, BAE Systems, and the aircraft giant Airbus persuaded trade secretary Patricia Hewitt to allow them to keep secret details of the middlemen used to secure international contracts.

She brushed aside the advice of U.K. government officials who argued that these middlemen are often used to channel bribes to foreign politicians and officials to win contracts. The government’s Export Credits Guarantee Department (ECGD) had proposed that exporters had to disclose the identities of middlemen when they applied for financial support from the taxpayer. The government required the details as part of tougher measures to stop the payment of bribes overseas by British companies.

The documents were released by the ECGD following a freedom of information request from *The Guardian* (a British newspaper) and a recent court case. Minutes of a meeting on August 9, 2004, show that the three companies told the ECGD that information about these middlemen was “very commercially sensitive.” The minutes continued: “The network of agents/intermediaries was a valuable asset built up over a number of years and offered important commercial advantages such as being able to open doors . . . The intermediaries themselves may have valid and justifiable reasons for wanting to remain anonymous.”

The companies claimed that the names of the agents would leak from the ECGD, enabling competitors to poach them. Hewitt agreed that the companies did not have to give the names or addresses of these middlemen, provided the firms gave an explanation.

At a meeting on October 7, the companies wanted “confirmation that commercial confidentiality would be accepted as a valid reason for not identifying its agents.” Hewitt has been forced to rethink the anti-bribery rules because of a legal victory by anti-corruption campaigners, the Corner House group. Susan Hawley,

for the group, said: “Knowing who is the middleman is crucial to stopping corruption, otherwise the taxpayer will end up directly supporting bribery.” BAE is alleged to have made corrupt payments through middlemen in Saudi Arabia, Qatar, and India. Rolls-Royce is accused of paying £15 million to win a contract in India.

QUESTIONS

1. In each of the cases described, who benefits and who suffers from the alleged ethical and legal lapses of Airbus?
2. How should the public relations staff at Airbus respond to the articles appearing in *The Economist*, *The Guardian*, and Reuters News?

3. What steps might Boeing take to defend itself from this sort of competition?
4. Do you think that Boeing and Airbus behave differently in marketing their aircraft around the globe? How and why?
5. Had France adopted the OECD convention on bribery ahead of these transactions, would the firm’s behavior have differed? Why?

Sources: “Airbus’ Secret Past—Aircraft and Bribery,” *The Economist*, June 14, 2003, pp. 55–58; Rob Evans and David Leigh, “Firms Can Keep Secret Agents: Minister Persuaded to Ease Anti-bribery Rules,” *The Guardian*, January 25, 2005, p. 18; “EADS Says Airbus Audit Shows No Wrongdoing,” Reuters News, April 3, 2007.