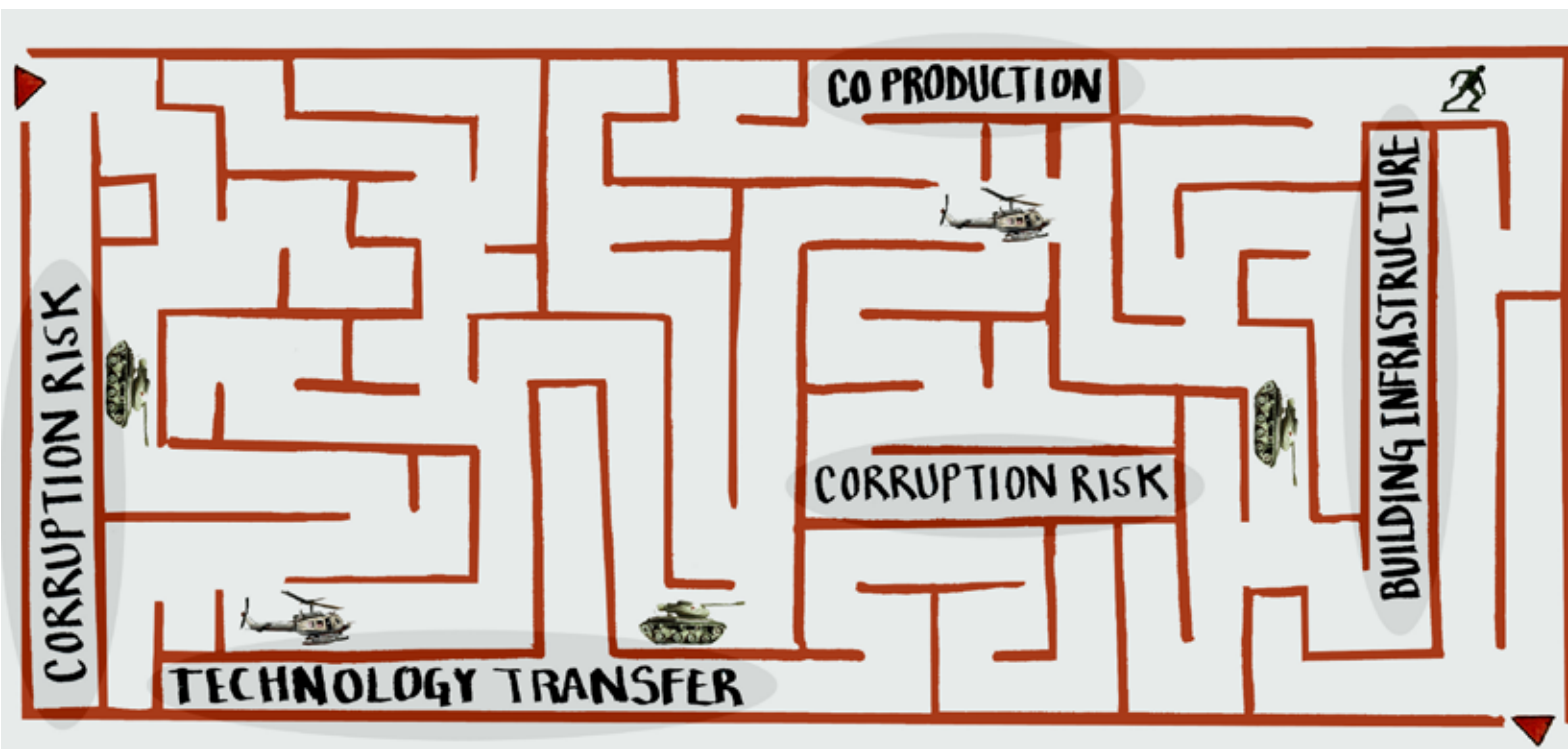


Due diligence and corruption risk in defence industry offset programmes



Transparency International (TI) is the civil society organisation leading the global fight against corruption. Through more than 90 chapters worldwide and an international secretariat in Berlin, Germany, TI raises awareness of the damaging effects of corruption, and works with partners in government, business and civil society to develop and implement effective measures to tackle it. For more information on TI, please visit www.transparency.org.

The Defence and Security Programme works with governments, defence companies, multilateral organisations and civil society to build integrity and reduce corruption in defence establishments worldwide. The London-based Defence and Security Programme is led by Transparency International UK. Information on Transparency International's work in the defence and security sector to date, including background, overviews of current and past projects, and publications, is available at the TI-UK Defence and Security Programme website: www.ti-defence.org.

While acknowledging the debt TI-UK owes to all those who have contributed to and collaborated in the preparation of this publication, we wish to make it clear that Transparency International UK alone is responsible for its content. Although believed to be accurate at this time, this publication should not be relied on as a full or detailed statement of the subject matter.

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Due diligence and corruption risk in defence industry offset programmes

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Preface

This report reviews a particular area of risk: the corruption risk associated with defence offset programmes, a large but opaque part of the defence industrial landscape. We undertook this review because we found that there was very limited awareness in the defence sector of these risks, particularly the risk associated with using an offset transaction as a bribery mechanism to influence improperly the award of the main defence contract. The review enquires into the depth and quality of current due diligence practices in offset programmes by defence companies, and by the brokers who put forward such programmes to government and industry customers. Our objective is to illuminate current practice in this area and to encourage improvement across the industry.

We intend this review to be read by defence companies, by staff of government ministries responsible for defence offset programmes, by offset brokers, by lawyers and other service providers to the industry, and by all those keen to see improvements in transparency and integrity in the defence industry.

Lord Robertson, the former NATO Secretary General, wrote earlier this year that “to the despair of many trustworthy people in the sector, many defence and security institutions have maintained a reputation for dishonesty and corruption. In too many countries across both government and industry, bribery is too often justified as merely ‘doing business’.”

However, the environment is changing rapidly, as many participants in this review confirmed. Societies and markets are less ready to tolerate corruption. Particularly at a time of economic crisis, governments are more resistant to accept the waste—and public anger—that comes with corruption.



ACKNOWLEDGEMENTS

This work has required active cooperation from defence companies officers and other practitioners in the industry. We thank them for their participation. We particularly thank the Global Offset and Countertrade Association (GOCA), which was proactive and helpful in encouraging its members to participate, and the Defence Industry Offset Association (DIOA) for inviting us to present the project to its members at its Spring 2011 meeting. Such participation is conducive to constructive dialogue and improvement across the industry. The review is, however, entirely the work and responsibility of Transparency International UK's Defence and Security Programme.

We hope you find this report to be useful, and we welcome all feedback and discussion of our findings.

A handwritten signature in black ink that reads "Mark Pyman". The signature is written in a cursive, flowing style.

Mark Pyman
Director, International Defence and Security
Programme
Transparency International UK
London, February 2012

Summary

Transparency UK's International Defence and Security Programme (TI-DSP) invited 150 organisations to share their current views and practices in doing due diligence as part of setting up defence offset programmes. Twenty-seven organisations agreed to participate, mostly international defence companies. The review consisted of detailed one-to-one interviews between the organisations' person responsible for, or heavily engaged in, offsets, and an experienced lawyer on the TI team. The interviews were non-attributable, so as to maximise the chance of an open discussion. The study's purpose was to shed light on the depth and extent of due diligence in the establishment of defence offset programmes internationally, and to identify areas of good practice and areas for improvement.

The study has limitations. Whilst the sample size is reasonable, we were disappointed that a significant number of companies declined to participate. Consequentially, there will be a bias in the sample towards respondents with good practices. Further, though we have tried to ensure maximum candour by holding non-attributable interviews, it is still likely that respondents are putting forward the most positive view on current practice.

Noting these limitations, the main findings are as follows:

1. Offset due diligence practice is improving.

It is clear that at least for most of the companies interviewed in this survey, substantial improvement has been occurring over the last two to four years in due diligence on offset programmes.

2. Substantial variations in practice exist.

Substantial variations in due diligence practices persist between the companies, even in this sample, which is likely to over-represent companies with good practices. At one end of the range, there is a block of companies with strong, well established due diligence practices or who fully outsource it. At the other,

there are many other companies who have either rudimentary processes or who have very recently established processes that are still in their infancy. Even among those companies with established processes, practices vary considerably.

The responses to the interviews and questionnaires in respect of current practice—for companies and for brokers—are described in Chapter 4, "Findings".

3. There are many examples of good practice.

The companies that we think represent good practice distinguish themselves because they have a clear list of red flags¹ that indicate potential corruption for which their staff and advisers must look out for, and have mandatory processes to be followed when a red flag is identified. The most distinguishing fact of all is that they invest in on-the-ground investigators to verify information and investigate red flags. They also have robust sign-off procedures: for example, the committees that review and approve the offset programmes have external representation.

Good practice was also seen in their due diligence on offset partners, with brokers or sub-contractors being treated as an integral part of the formal risk assessment process. Companies regularly refresh the vetting process on offset partners, such as brokers and intermediaries, and also provide guidance and clarity on what constitutes a 'deal breaker': for example, the presence of a government official in any part of the offset programme.

4. Verification is the most troublesome area.

This topic came up repeatedly as the most difficult issue for companies. Not just on account of the expense and the difficulty of verifying information in many countries, but because it goes to the heart of when, whether and how companies will raise concerns. One of the vulnerable points in due diligence procedures emerging from the interviews is that the process for some companies is mere

¹ Red flag: issues which would suggest there is a risk of corruption.

'box ticking' so that difficult issues and red flags can be ignored. Over-reliance on self-certification by a potential partner with a vested interest was also found, as well as not tracking down answers for the following key questions:

- Who has authority in decisions on the main and offset contracts?
- Who is the contractor dealing with as a potential partner/sub-contractor?
- Are any of the potential partners and subcontractors connected with those involved in letting the main contract?
- Is there a recognisable network of relevant people who are connected with each other?
- Who is the real beneficial owner of any partner/sub-contractor?
- What is the offset broker's fee or commission and is it proportionate to the services actually provided?
- How does the money flow throughout the offset deal?
- What are the reputations of the people involved?

5. Scrutiny of offset corruption risk needs to be integrated into normal business conduct and compliance practice.

Companies need to incorporate offsets into their normal business conduct requirements, business

ethics practices and training programmes. This is often not the case at present.

6. Governments should require more stringency and transparency in offset programmes.

Given the strong current challenges to the existence of offsets, notably in the EU, offsets practices need to be much more transparent than at present if they are to have government and regulatory support. We found support from companies for governments to issue guidance that required all companies to have similar standards of high levels of transparency and audit requirements in order to 'level the playing field'.

7. Industry associations need to be more proactive.

Industry associations such as ASD, AIA, ADS and IFBEC have a strong role to play in facilitating higher standards across the industry. GOCA has taken a proactive stance by supporting this study. Assistance from industry or trade associations in providing common verification checklists and sources of information, as well as sharing intelligence (where this is permitted and without legal or confidentiality issues) would help. Apart from GOCA, however, associations are not active in guiding their members on this topic.



Industry associations need to be more proactive. Assistance from industry or trade associations in providing common verification checklists and sources of information, as well as sharing intelligence (where this is permitted and without legal or confidentiality issues) would help. Credit: istockphoto

Recommendations

For defence companies:

Recommendation 1: Defence companies should review their own offset due diligence practices against the status described in this review, particularly in relation to the more difficult issues of verification and red flags discussed in Chapter 5. They should update practices, policies and procedures where they find scope for improvement.

In particular this means gaining greater clarity about what are deal breakers, what issues are red flag issues, and what happens if one arises. Signing off a transaction especially where red flags have been identified must not be viewed as a formality. In addition, there must be a robust process of challenging reports which have supposedly resolved red flags without clear evidence supporting that conclusion.

Recommendation 2: Companies should ensure that contracts are clear in allocating responsibility for conducting due diligence.

Recommendation 3: Sub-contractors, brokers and other intermediaries and advisers should be required in their contracts to disclose to the obligor all information material to the offset programme, specifically including potential corruption related observations or concerns.

Recommendation 4: Companies should ensure that their corporate compliance and business conduct policies explicitly include reference to responsibility and requirements for offset arrangements.

For service providers:

Recommendation 5: Service providers who provide due diligence services, especially those who provide verification on red flag issues and on-the-ground investigators, should be encouraged to develop lower-cost services for smaller companies.

For industry associations:

Recommendation 6: Industry associations such as ASD, AIA, IFBEC, GOCA and DIOA should advise their members to review their offset due diligence practices, and provide them with guidance on good practice. Such guidance to members could usefully comprise the following:

1. A guidance document on reasonable due diligence practice to all its members, including guidance for smaller companies.
2. Separate minimum due diligence standards for their company and broker members.

Recommendation 7: Industry associations should find ways to encourage governments to strengthen their transparency and public reporting requirements. They might consider providing a checklist that government officials could use, specifying transparency, reporting and audit requirements. This checklist would set a good template that governments could follow. Or, they could facilitate an international forum that brings together company experts and government offset officers.

For governments:

Recommendation 8: Governments could have a major impact in reducing corruption risk in offset programmes. They should review their policies and procedures so as to make their offset institutional frameworks more robust, more transparent and with greater public reporting.

Government officials could consider the proposals made in Transparency International UK's 2010 'Defence Offsets' report, reproduced on page 21.

1. Introduction

Transparency International (TI) is the civil society organisation leading the global fight against corruption. Through more than 90 national chapters worldwide and an international secretariat in Berlin, Germany, TI raises awareness of the damaging effects of corruption, and works with partners in government, business and civil society to develop and implement effective measures to tackle it.

The Defence and Security Programme (TI-DSP) is Transparency International UK's programme dedicated to addressing corruption in the defence and security sector globally. The Programme works with all stakeholders in the defence sector—defence companies, governments, multilateral organisations, civil society and media—to minimise defence and security corruption through enhanced transparency, accountability and good practice.

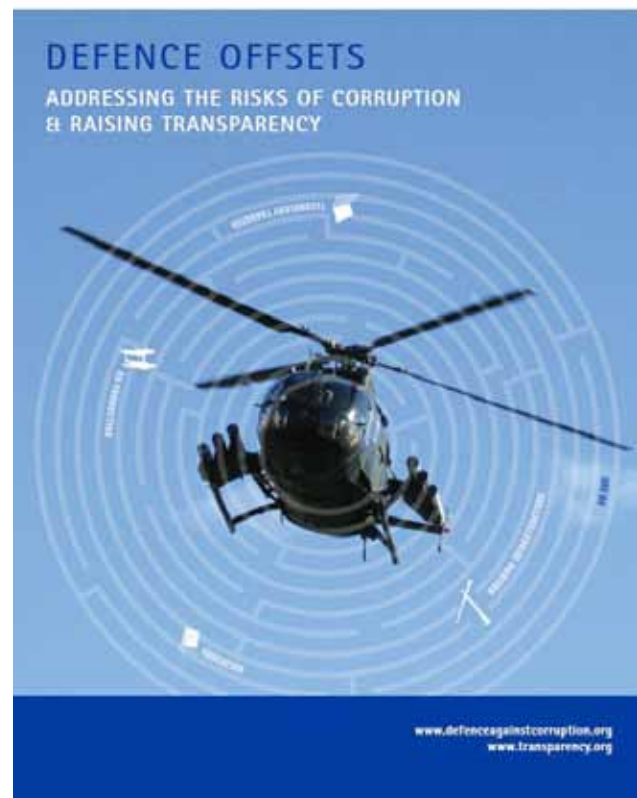
TI-DSP has been active in working with industry to address potential corruption in international arms sales for several years. We have encouraged the defence industry to develop a forum for raising anti-corruption standards,² out of which has come the International Forum for Business and Ethical Conduct (IFBEC) for the defence and aerospace industry,³ and have facilitated the European defence industry to develop common standards for tackling bribery.⁴

TI-DSP has been advocating for stronger controls on the corruption risks in offset programmes since 2008.

The complex nature of offset programmes and their lower visibility in comparison with the main defence deal means that corruption risk is neither discussed nor analysed in many cases. We published a report

on this in April 2010, and presented our analysis and proposals at forums across the industry. It contains recommendations for governments, companies and international regulators on ways to raise the transparency of these programmes and to reduce the corruption risk related to offsets.⁵

One of our 2010 offsets report main findings was that the typical levels of due diligence in relation to possible corruption in offset transactions seems to be insufficient.



One of the report's main findings was that the typical levels of due diligence in relation to possible corruption in offset transactions seems to be insufficient, often being more of a 'box ticking' exercise rather than proper due diligence.

² S Pfeifer, "Ex-NATO Chief Urges Ethics Code", *Financial Times*, 14 April 2008, retrieved September 2011, <http://www.ft.com/cms/s/0/b4c11a76-09bb-11dd-81bf-0000779fd2ac.html#axzz1YOEcvUTm>.

³ For more information, please see <http://www.ifbec.info/>.

⁴ UK Aerospace, Defence and Security Industries (ADS) *Common Industry Standards*, 19 November 2010, retrieved September 2011, http://www.adsgroup.org.uk/pages/83675783.asp#aGroup_2.

⁵ F Vilhena da Cunha, M Pyman & B Magahy, *Defence Offsets: Addressing the Risks of Corruption and Raising Transparency*, April 2010, retrieved September 2011, <http://www.ti-defence.org/publications/153-defence-offsets-report/>.

In subsequent discussions with practitioners in the industry, we concluded that it would be useful to do a review of current practice in offset due diligence. However, many in the offset world are quite reclusive about their practices, and we were concerned that we may not be able to gather anything other than highly generic information. We discussed our ideas for this survey with one of the major defence industry associations that represents those in the offset business.

We were pleased to find that the Global Offsets and Countertrade Association (GOCA), one of the principal industry bodies in this area of business, was ready to support the idea of our review. (GOCA does not 'endorse' it—it is fully our work and our responsibility. See box below for GOCA's letter to their members). We are grateful for GOCA's support and thank them sincerely for it. Despite this support, we were still disappointed that a significant proportion of companies and advisers chose not to participate.

The objective of this review is to collate the international defence industry's current practices on due diligence regarding corruption risks of offset transactions. The research reviews what due diligence defence companies normally carry out on offset partners and/or beneficiaries when acting as principal contractors. The project seeks to highlight what is current "good practice" in due diligence and to make recommendations for improvement as appropriate. Coupled with the recent developments in offsets legislation, notably in the EU and the UK, as well as the increased application of the US Foreign Corrupt Practices Act (FCPA), we hope that this report will stimulate continued improvement in defence industry integrity practices worldwide.

BOX 1 | GOCA LETTER TO MEMBERS

The offset world seems to be under attack from many sources. The USG has for many years embarked on a course of action to "eliminate the harmful effects of offset", while making it clear that, in its mind offset is anti-competitive in itself. The EC now seems to agree and is attacking offset as anti-competitive behaviour also. Transparency International recently published a booklet on corruption in offset and has presented its views at our recent conferences. A further attack, this time from an academic, Shana Williams, who has written at least one article entitled "The Modernization of Bribery". She has completed her thesis on how offset is used to allow bribery in the Middle East, arguing that offset is used to support the various regimes there. It is quite academic and, in my view full of errors and/or misunderstandings. One of her arguments about why offset is arguably being used for the purposes of corruption is the secrecy surrounding it.

While there are important competitive reasons for confidentiality in any commercial transaction, a greater openness to answering the criticisms would serve our industry well, in my view. Showing that we understand and are in fact dealing with the issue is the best weapon we have against further attacks. One example of the defense industry's concern is the amount of due diligence the industry actually performs to avoid corruption. Transparency International (TI) is undertaking a survey of the policies and procedures of the industry and asked GOCA whether GOCA supported this exercise. The Executive Committee agreed that it did and we also agreed to circulate the TI letter seeking input to our members. Enclosed is that letter. We encourage you to forward this letter to the appropriate department in your company and respond to the survey. By doing so we should allow TI and the concerned world to realize the steps the industry does take to avoid corruption in its business.

Cary Viktor,
Chairman and CEO
GOCA

Neil Rutter,
Legal Counsel,
Chair of Legal Committee
GOCA

2. Background

OFFSETS

Defence offsets are a counter-trade mechanism agreed between purchasing governments and supplying companies requiring them to put in place a number of additional investments, often unconnected to the main contract, as a condition of undertaking it. They are frequently used as industrial (sometimes even economic or social) policy tools aimed at improving balance of payments accounts and compensating the purchaser's economy for a public investment that will not have an immediate direct impact on the well-being of the nation.

Offsets programmes consist of a package of contracts valued to a percentage of the main acquisition contract. The value of offsets programmes as a percentage of the main contract is high, often exceeding 100 per cent. The large size of offset programmes is one of the reasons for raising concerns about corruption—they are not 'marginal' additional investments.

Offsets may take many forms, for example, agreements for co-production, licensed production, subcontracting, training, technology transfer, or other investments in the purchasing country's economy. They fall under one of two headings: **direct offsets**, in which the investment is directly related to the subject of the acquisition; and **indirect offsets**, which can be defence or civil, and are not related to the subject of the acquisition. The approaches to offsets vary from country to country, in particular regarding the choice between direct or indirect offsets and the amount (percentage of the total offsets package) of direct offsets that a country requires. Increasingly, indirect offsets are more common than direct offsets.

It is important to note that offsets value is denominated not in actual currency but in offset credits. These credit values essentially reflect the degree of importance assigned by the purchasing government to the offset project, and can refer to the potential impact of the

offsets in the purchasing country or even be unrelated to any type of economic indicator. Problematically, the multipliers used to calculate offset credits and offset commitment volumes are in most cases determined confidentially during the negotiation stage on an ad hoc basis, which is subjective and arbitrary. The relationship between the actual investment in an offset project and the offsets' value associated with it thus can vary considerably. All this further exacerbates the lack of clear information and understanding of offsets true costs, benefits and obligations. The actual cost to the defence company supplier, and hence the additional cost to the purchasing government, is not discussed publicly at all, or—astonishingly—between government and supplier. The most common estimates given to us in anecdotal discussions for the actual cost of the offset programmes range from 8 per cent of the main contract value up to 33 per cent.

The offsets business model involves several key actors. Importing governments demand the offsets package along with the equipment or service they purchase. Their national offset authorities define the offsets guidelines and framework. The suppliers of the equipment or service become offset 'obligors', who can and do engage the services of other entities to define, negotiate and deliver the offset programme. Such third parties are often brokers who are usually knowledgeable of the local realities and can engage with local partners for the projects and even interact with the offset authority. Consultants are also frequently used, and tend to be specialists in the local industries, providing technical advice, project definition and development. Finally, third party offset executors that can be companies or R&D centres are engaged in the process by the obligor to provide orders, technology or training to offset beneficiaries.

The value of offset contracts related to defence industry contracts is high. In 2009, 13 US defence contractors reported to Congress that they entered into 56 new offset agreements with 21 countries valued at USD 6.69 billion.⁶ The value of these agreements equaled 62.65 per cent of the USD 10.68 billion in reported contracts for sales of defence articles and services to foreign entities with associated offset agreements. During the period 1993-2009, 49 US companies undertook offset obligations for 46 countries, with the offsets' value amounting to USD 75.9 billion versus USD 108.22 billion value of associated acquisition contracts.

Estimates for European contractors are much more difficult to ascertain. As part of the Code of Conduct on Offsets introduced by the European Defence Agency (EDA) in 2008, participating member states have reported entering into 45 offset projects, to the value of EUR 1.6 billion in the first reporting period of 1 July 2009 – 31 December 2010. The percentage value relative to the main contract varied from 50 per cent to 260 per cent, with 99 per cent being the average percentage value. The majority of the programmes were signed with non-EU offset obligors.⁷

The global value of offset contracts currently in force is very high—estimated to be between USD 75 billion and USD 100 billion.⁸ The value of offset agreements as a percentage of the contract value is continuing to increase. Austria, notably, required offset commitments totalling 300 per cent of the main contract,⁹ though the EDA Code of Conduct guidance¹⁰ has since brought the norm closer to 100%.

RISKS

Offsets transactions carry potentially high risks of corruption, not only due to the high level of secrecy within defence procurement as a whole, but because they usually lack the scrutiny and monitoring of the corresponding acquisition contract. Additionally, most offset transactions have few, if any, transparency and public accountability requirements.

Besides the risk of bribery in offsets contracts, there is an additional risk that main supplier companies may be using the offsets package as a vehicle to offer benefits to individuals in return for undue influence or access to defence contracts. In short, offsets may influence the acquisition decision rather than the quality of the good or service offered. Agents, offsets brokers and intermediaries negotiating offsets packages may also be offering benefits to officials to secure undue advantage for the main supplier company or create a demand for offsets in defence contracting. Box 2 gives a brief overview of a current corruption case involving the purchase of submarines by Portugal.

Additionally, governments and companies have conducted patchy monitoring of performance on offsets contracts, inadequate audits of what was delivered compared to the pledges, and very limited publication of offset results, benefits or performance. One respondent referred to the potential for performance bonds being used as a corruption route. There are no publicly available audits of offsets contract performance or integrity that we are aware of.

RECENT LEGISLATIVE CHANGES

There are major changes underway in the regulatory landscape relating to offsets. Recent changes in legal frameworks in the European Union and the passage of the UK's Bribery Act in April 2010, as well as the increasing application of the FCPA in the United States, have concentrated companies' minds on what constitutes due diligence and broader offsets transparency.

With the publication of the Defence Procurement Directive (2009/81/EC), the European Commission

6 US Dept of Commerce Bureau of Industry and Security *Offsets in Defense Trade Fifteenth Study*, December 2010, retrieved September 2011, http://www.bis.doc.gov/news/2011/15th_offsets_defense_trade_report.pdf.

7 European Defence Agency (EDA) Presentation at DIOA Spring Conference 2011, Newport, Rhode Island, May 17-19 2011.

8 Pfeiffer, op.cit.

9 N Amies, 'Probe into German-Greek Arms Deals Reveals Murky Side of Defense Sales', *Deutsche Welle*, 12 August 2010, retrieved September 2011, <http://www.dw-world.de/dw/article/0,,5890375,00.html>.

10 European Defence Agency (EDA), *Code of Conduct on Offsets*, retrieved September 2011, <http://www.eda.europa.eu/Otheractivities/CoCOffsets>.

BOX 2 | PORTUGUESE SUBMARINES

- In 2004, Portugal finalised the purchase of two submarines constructed by the German Submarine Consortium (GSC). As one of the Consortium members, the German industry giant Ferrostaal AG was also responsible for the majority of the EUR 1.2 billion offset deal.
- In July 2006 Portuguese authorities opened criminal investigations into the contract when, stemming from a different investigation's findings, questions arose over payments of EUR 30 million to the intermediary company for brokering the deal and the offsets contract.
- Offsets, in particular, were also targeted by a spin-off investigation that led to a formal prosecution in autumn 2009. Portuguese prosecutors have indicted three German executives and seven Portuguese executives on allegations of fraud and document forgery in relation to automotive offset projects included in the submarines package.
- The prosecution targeted projects worth approximately EUR 86 million, claiming that the obligor and the Portuguese consortium benefiting from the offsets colluded to include projects lacking causality, that is, masked existing investments and those developed solely by the consortium members, in the offset programme, in exchange for a EUR 1 million fee.
- The prosecution quoted EUR 34 million as the damage to the state from these actions and is demanding compensation in the same value from the defendants.
- The case progressed to the trial stage; however, it has faced a number of delays, not least due to the German defendants alleging that the court documents were not translated into German, as is required by formal procedure.
- There is speculation that the defendants might be able to fulfil their offset obligations, due to a loophole in the contract, thus reducing the damage to the state, and absolving themselves of fraud charges.

(EC) aims to achieve a more harmonised and efficient procurement framework for defence, reducing the need for member states to diverge from EU law in defence procurement processes.

Even though the Directive does not refer to offsets by name, its provisions (e.g. on sub-contracting) have the effect of proscribing civilian indirect offsets in defence transactions. The Directive required governments to implement it into national law by 21 August 2011. Accordingly, the Directive provides alternative ways for EU countries to attract investment rather than rely on offsets. While countries may still declare offsets as vital to a country's national security under Article 346 of the Lisbon Treaty, the Directive restricts the conditions under which offsets may be demanded.

More importantly, the Guidance Note on Offsets issued by the Commission prohibits offsets from impacting competition in civil markets and requires a sound justification from member states that the offsets they demand are necessary for their "essential security interests" and are not used as economic tools. The European Commission has started several infringement procedures regarding unjustified use of the Article 346 derogation.¹¹ The Commission has

¹¹ For information on infringement procedures related to public procurement, please visit http://ec.europa.eu/internal_market/publicprocurement/infringements_en.htm.

also challenged Greece's 2009 purchase of submarine battery kits involving a 35 per cent local production requirement on the basis that the derogation was not justified on the ground of security interests.¹² In December 2010, MEP Ana Gomes (Portugal) filed a complaint regarding the Portuguese government's acquisition of submarines (see Box 2), specifically mentioning that the offset programme included several projects aimed at providing benefits to companies competing solely in civil markets, giving them unfair competitive advantages.¹³

Partly as a result of such high profile cases and subsequent pressure (both from the US and domestic sources) to update ancient bribery laws, the UK's Bribery Act 2010 came into operation on 1 July 2011. This has compelled major defence companies and foreign companies that trade in the UK to review and update their policies and procedures. One reason for this is that the Bribery Act is not only extra-territorial like the FCPA but is broader than the FCPA since it does not permit the use of facilitation payments.

¹² Europa 2010, 'Public Procurement: Commission calls on Greece to amend procedure for awarding supply contract for submarine battery kits', retrieved September 2011, <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/1558&format=HTML&aged=0&language=en&guiLanguage=en>.

¹³ For information on infringement procedures related to public procurement, please visit http://ec.europa.eu/internal_market/publicprocurement/infringements_en.htm.

3. Approach

SCOPE

This review has a specialised and narrow scope: to review companies' and intermediaries' due diligence practices in relation to corruption risks within offset programmes attached to international defence deals.

APPROACH

We have carried out the review mostly through detailed interviews with defence companies and offset practitioners in the industry, supported by completed questionnaires from a number of other companies. This interview approach was chosen because this is a specialist area, and one that does not yet have well-known, widely established practices. As a result, we decided to work principally through one-to-one "expert" interviews, rather than relying only on completed questionnaires. TI-DSP's principal

Interviews were conducted on a non-attributable basis in order to maximise potential for a candid picture of current practices.

interviewer is a senior lawyer with an extensive legal background, having until recently been General Counsel of a major international company working with over 150 countries.

Interviews were conducted on a non-attributable basis in order to maximise potential for a candid picture of current practices.

Interviews and information gathering were conducted in three stages. The first stage was a familiarisation phase, comprising conversations with individuals closely familiar with or working in the offsets sphere, including representatives from the legal profession and offset brokers. This step was taken in order to gauge the industry's readiness to speak to TI-DSP about this sensitive subject, to obtain an initial understanding of current practices, and to formulate questions that would be used as the starting point for subsequent detailed interviews.

The second stage was aimed at expanding the number and range of interviewees, primarily the defence industry, but supplemented with insights from lawyers, offsets experts and offset brokers. For this stage, TI-DSP made contact with all GOCA members and invited them to participate. GOCA had encouraged its members to consider taking part in the overview (See Box 1). At the time the letter was sent, GOCA comprised 57 regular members, consisting of defence offset obligors, and also 44 associate members who are made up of entities or individuals who do not provide offsets but are interested or employed in the field, such as offset brokers, law firms, universities and individual members. Among the regular members at the time, 22 were headquartered in the EU and EEA, 31 were based in North America, and the remainder in the Middle East, sub-Saharan Africa, Latin America, and East Asia.

In parallel, TI-DSP sought interviews with lawyers, offset experts, and due diligence experts and officers of its own acquaintance, which in a couple of instances also coincided with GOCA membership.

For the third stage, TI sought to widen the participation in the project. A questionnaire was sent to a wider range of 48 companies (27 Europe, 21 North America)¹⁴—many of them large, but also including medium and smaller companies. Questionnaires were also solicited from companies who had attended the 2011 Spring meeting of the Defence Industry Offsets Association (DIOA), at which TI-DSP was represented.

SAMPLE SIZE

A total of 150 organisations were contacted across the world; 142 of these were companies, including associate GOCA members, and eight were offset practitioners and lawyers. Of these, 27 responded

¹⁴ Nine of these were also GOCA members, four were parent companies of GOCA members, and one a subsidiary of a GOCA member.

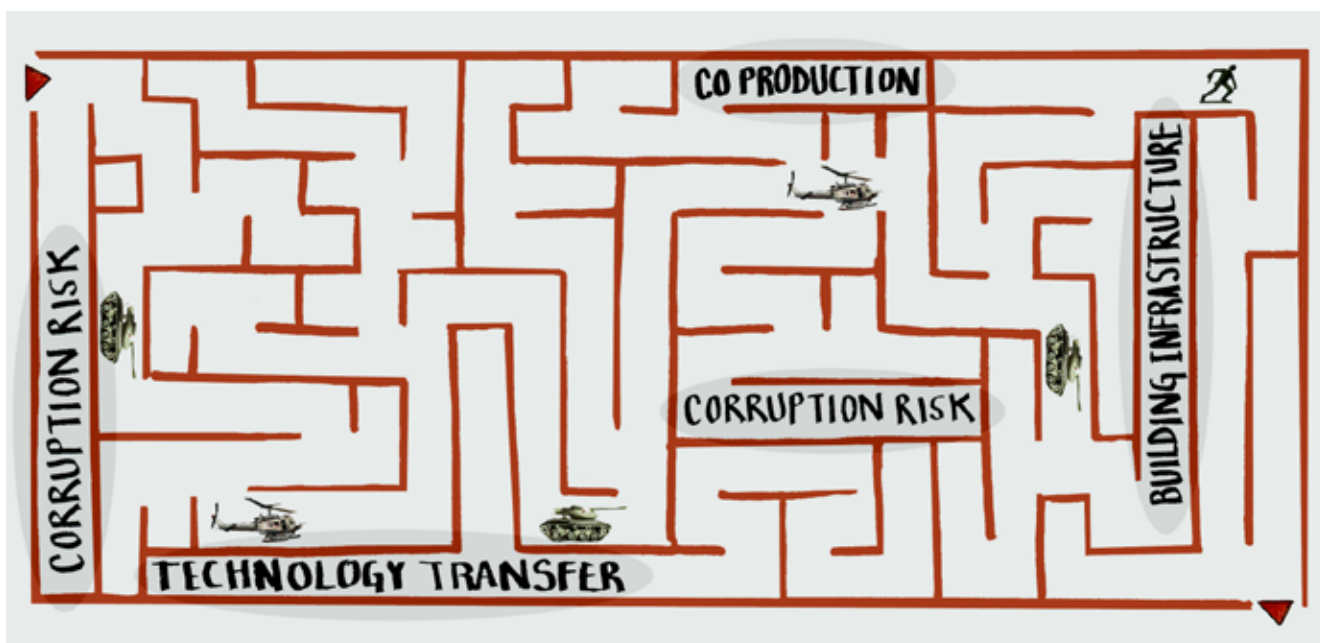
positively. Twenty-three interviews were conducted either in person or on the telephone. Twelve interviews were held with defence contractors (five were European companies, six were US companies; one was an industry association).

Three were offset brokers, two were lawyers and three were practitioners in the due diligence or offset industry.

In addition, four questionnaires were returned (three from US companies, one from a European company). At the time of writing this report, TI-DSP had also received interested responses from a further six companies.

CAVEATS

Two caveats are necessary. First, the study is not representative of the industry at large as it is based on responses from a limited sample of 27 organisations. Second, and consequentially, there will be a bias in the responses towards those companies that do have decent due diligence processes: the companies that respond to these studies may do so because they believe they have good due diligence processes.



This review has a specialised and narrow scope: to review companies' and intermediaries' due diligence practices in relation to corruption risks within offset programmes attached to international defence deals.

4. Findings

All the respondents were keen to point out that there was awareness of the risks involved in offset transactions, and that companies did have processes in place for carrying out due diligence.

None of the respondents had direct experience of a bribery situation in working with offsets, though several had declined possible transactions on the basis of suspicion of corruption. At the same time, many commented that they “heard rumours” of bribery within the industry.

Both companies and brokers emphasised that a scandal resulting from corruption would cause major damage to their firm’s reputation, quite apart from criminal sanctions or share price impact, and thus it was clearly in their interest to minimise this risk.

There were many comments reflecting the belief that offsets practices had been improving over the last three or four years, especially in relation to the quality and scope of the due diligence required. There was scepticism whether this was the case in countries that did not have a vigorous enforcement culture. However, others commented that there had been, and still was, a culture of ‘box ticking’ in offsets due diligence.

The responses to the interviews and questionnaires in respect of current practice—for companies and for brokers—are described in this chapter under the following headings:

- i. Initial due diligence process
- ii. Corporate responsibility for due diligence
- iii. Responsibility of sub-contractors and brokers
- iv. Questionnaire for prospective partners
- v. Verification
- vi. Representations and warranties
- vii. Sign-off
- viii. Brokers

Good practice examples in each area are noted.

I) INITIAL DUE DILIGENCE PROCESS

All the defence contractors had a formal due diligence process whereby the business unit wishing to enter into a contract involving offsets was obliged to justify its business proposition. Apart from financial justification, this would involve providing information and rationale about the use of any proposed third parties. Large companies also have sign off processes involving senior executives once the due diligence has been completed.

II) CORPORATE RESPONSIBILITY FOR DUE DILIGENCE

In most companies surveyed, a central unit is responsible for carrying out due diligence. Usually this is under the control of the General Counsel or a deputy and separate from the business unit for the obvious reason of avoiding a conflict of interest with the business unit, which was keen on the prospective deal. A minority of the companies surveyed outsourced the due diligence to independent law firms.

The main variations between large companies were whether they undertook the due diligence themselves or whether they outsourced to third parties such as lawyers, investigative companies or accountants. Another variation resulted in how robustly they then verified information provided by means of a self-certification questionnaire and followed up on any issues raised. In this regard, some companies insist on conducting face-to-face interviews with new partners, others on re-vetting periodically, while still others take the view that they

All the defence contractors had a formal due diligence process whereby the business unit wishing to enter into a contract involving offsets was obliged to justify its business proposition.



Many of the biggest companies impose very specific obligations on their contractors, such as complying with the principal contractor's code of ethics and specific policies about anti-bribery and disclosure.

have sufficient resources and can do the job better than external firms. Lastly, some companies use a combination of these resources.

A surprising number of companies did not include offsets in their main corporate ethics programmes. Offsets should be included within business conduct policy, risk assessment and training.

III) RESPONSIBILITY OF SUB-CONTRACTORS AND BROKERS

Several respondents commented that responsibility for due diligence lay entirely with the obligor or with the group assembling the offset programme. This extended to it 'not being my job' to verify red flag issues, and possibly not passing on information about a doubtful deal. At the same time, companies are likely to have a general duty in their contractual obligations not to do anything that would bring the company into disrepute.

Many of the bigger companies impose very specific obligations on their contractors, such as complying with the principal contractor's code of ethics and specific policies about anti-bribery and disclosure.

IV) QUESTIONNAIRE FOR PROSPECTIVE PARTNERS

Since defence contractors viewed offset contractors as part of the supply chain and brokers as third party intermediaries, they thought that both should be treated as such. All the contractors attested to performing their own due diligence: they would not accept what a third party, such as a broker, had submitted without verifying it themselves.

The starting point of the due diligence process is a questionnaire, which the prospective third party is required to complete. Typically this requires the third party to provide the following types of information:

- business and technical information;
- audited and/or management accounts;
- business plans;
- corporate structure showing holding (and ultimate holding company) and subsidiary companies;
- details of the company, its subsidiaries and holding companies and the ultimate shareholders (i.e. individuals) and/or anyone with a controlling interest;
- details of any affiliate companies;

- details about the company's directors (including shadow directors) key staff and their curricula vitae;
- if the entity is a partnership, equivalent details about the partners and key employees would have to be provided;
- bank and business references;
- details of key suppliers and customers;
- self-reporting details (such as whether it has ever been investigated by law enforcement authorities, been barred or disqualified from participating in a government tender or had an administrator or receiver appointed or filed for bankruptcy—e.g. Chapter 11 in the US or similar in other jurisdictions);
- dealings with government by company or group;
- whether any of owners, directors or key employees are currently or have been in the past employed by or in a relationship with any government department or entity;
- whether any of the owners, directors or key employees are currently or have been in the past members of a political party;
- details of the company's anti-corruption policies (e.g. general ethics/ hospitality/specific anti-bribery).

Smaller companies have fewer resources than larger ones and are more likely to rely on third parties to provide the basic due diligence information.

V) VERIFICATION

Once initial due diligence information has been obtained, subsequent verification practices vary from company to company. Some do their own verification via the relevant corporate department.

At the least, it would involve checking references and checking publicly available information. Others will also use organisations such as TRACE, which provides various services to its corporate members, including due diligence reports and TRACE Check for lower risk

intermediaries.¹⁵ Some companies will use services provided by government organisations such as the US Department of Commerce for verification purposes. See Chapter 5 'Challenges' for more details on the challenges presented in verifying information.

The greatest changes are taking place in verification standards, driven in part by the recent UK Bribery Act and the tough application of the FCPA. Whereas previously having a corporate policy and minimal due diligence via a questionnaire would have been sufficient corporate

protection, it now will no longer be sufficient under the new UK law. Companies will need to demonstrate that they have tested the information and considered whether any "red flags" apply. If

red flags have been raised, companies will need to demonstrate that they have investigated them further and resolved any problematic issues before deciding whether or not to proceed.

Verification challenges and red flags are discussed further in Chapter 5.

The greatest changes are taking place in verification standards, driven in part by the recent UK Bribery Act and the tough application of the FCPA.

VI) REPRESENTATIONS AND WARRANTIES

Third parties, such as sales intermediaries or brokers, and sub-contractors would typically also be asked to confirm that they will comply with the policies and procedures of the prime offsets obligor. In many cases they are required to re-certify that they have complied. The reason for this is to incorporate warranties into the contract, which would enable the primary obligor to terminate the contract if such representations turn out to be untrue. As with many complex contracts, there is a chain of representations and warranties flowing from the principal defence contractor to its sales representatives (including offset brokers) and its contractors and sub-contractors.

¹⁵ For more information, please check TRACE International's website: <http://www.traceinternational.org/>.

VII) SIGN-OFF

Companies have sign-off processes to authorise proceeding with a particular project including partners or subcontractors once the due diligence has been completed.

Companies rely on reports from their internal or external advisers carrying out due diligence as part of the sign-off process.

Sign-off processes often involve corporate committees, the composition of which varies. One company had a sign-off panel which included external lawyers as well as its senior executives and legal officers to vet the results of due diligence in indirect offset transactions; only the CEO's sign-off was required for direct offset transactions.

VIII) BROKERS

There are a small number of specialist offset brokers. These range from companies with established compliance officers to one-man organisations. There are relatively few "common" practices amongst offset brokers other than being subject to the due diligence processes of the principal obligor in a defence transaction.

Some brokers view having their own due diligence process, which they apply to prospective partners of

the principal obligor, as a competitive advantage and part of their business model. Blenheim Capital, for example, subscribes to such a model. A sample of their due diligence questionnaire is shown at Appendix II to this report.

Others, notable the smaller broking firms, are keen to ensure that the prospective partners for the principal obligor are clean even if they do not have the resources themselves to carry out extensive due diligence which the principal obligor would carry out. They regard protecting their own corporate reputation as essential to their business.

A third category of brokers takes the view that the principal obligor is responsible for carrying out due diligence and that their responsibility as broker is limited to responding to the principal obligor's questionnaires and processes. Thus, it is not clear that all brokers operate to the same standards espoused by some. It also cannot be guaranteed that some brokers do not turn a blind eye to difficult issues in some jurisdictions.

Trade associations could make an important contribution to increased transparency by requiring broker members to adopt minimum, published standards of business practice. This would have the additional benefit that companies using brokers thus accredited could take some comfort that minimum standards were applied.



Companies have sign-off processes to authorise proceeding with a particular project including partners or subcontractors once the due diligence has been completed. Credit: istockphoto

5. Challenges

VERIFYING INFORMATION

Most interviewees noted verifying and testing information gathered in the course of the due diligence process as the principal challenge. It is often difficult because of the local environment, and it is expensive, because it may involve investigators on the ground. Finally, verification poses a challenge because it goes to the heart of when and whether companies will raise concerns.

We were unable to establish through these interviews whether the due diligence and verification process—and in particular the outcome of red flag issues—is carried out with the same thoroughness by all companies in all jurisdictions. Many companies were honest about the difficulties, and that even in some cases they will not know themselves, especially if it is a local subsidiary or local adviser doing the due diligence.

The vulnerable points in companies' due diligence procedures emerging from the interviews were the following:

1. That the process for some companies is mere box ticking so that difficult issues can be ignored.
2. Over-reliance on self-certification by a potential partner with a vested interest.
3. Not tracking down answers to the key questions, principally:
 - Who has authority in decisions on the main and offset contracts?
 - Who is the contractor dealing with as a potential partner/sub-contractor?
 - Are any of the potential partners and subcontractors connected with those involved in letting the main contract?
 - Is there a recognisable network of connection?

- Who is the real beneficial owner of that partner/sub-contractor?
- What is the offset broker's fee or commission and is it proportionate to the services actually provided?
- How does the money flow throughout the offset deal?
- What are the reputations of the people involved?

Carrying out direct interviews of key personnel in territory or gathering information on the ground is expensive. However, this is essential especially if red flag issues have been raised. Some big companies conduct interviews directly whilst others rely on external advisers, such as law firms, accounting firms or investigative firms. Some companies use their internal audit function to help.

Those carrying out due diligence on location had a different perspective.

In particular, they felt that, ultimately, finding answers to some difficult questions depends on gathering information on the ground by speaking to various individuals and cross-checking information. Interpretation of such intelligence is crucial and some interviewees thought that the processes of companies could deliberately enable them to gloss over issues (i.e. there would be no reason not to appoint X because no one had found any negative information, rather than no one had found positive information to justify the appointment). Several due diligence service providers felt that they were too narrowly deployed and that sometimes those commissioning the work did not have a sufficiently detailed knowledge of the

Several due diligence service providers felt that they were too narrowly deployed and that sometimes those commissioning the work did not have a sufficiently detailed knowledge of the specific issues to get the best out of their advisers.



All the contractors interviewed said that their corporate procedures would require them to address red flags but ultimately it would depend on judgment as to whether the answers provided were sufficient to allay concerns raised by a particular issue. Credit: flickr/rww.

specific issues to get the best out of their advisers. They all stressed that if they felt something was an issue they would draw it to their client's attention since their own reputations would suffer if they did not do so.

SMALLER COMPANIES

Smaller companies have the same verification challenges as larger ones but generally have fewer resources to deploy. The extent to which smaller companies deploy such resources is less clear, although it is likely that companies in jurisdictions where there are tough anti-bribery laws will be more zealous in doing a thorough job. If they are part of the supply chain, smaller companies may take the view that the prime obligor will be in full control of the due diligence process.

The major challenge for smaller companies is how they verify information either provided by self-certified questionnaires or red flags identified in any external report.

RED FLAGS

Red Flags are issues or questions which raise potential concerns and which need to be investigated further whilst not themselves necessarily being a bar to doing business with the relevant third party.

Examples of red flags where an intermediary such as broker, adviser or sponsor is used

- History of corruption in territory;
- Adviser has lack of experience in sector and/or territory;
- Adviser does not have residence in territory;
- Adviser has no significant business presence in territory;
- Adviser represents other companies with questionable reputation;
- Adviser refuses to sign agreement that has not and will not make prohibited payment;
- Adviser makes inappropriate statements;
- Adviser is recommended by government official or customer;
- Adviser holds position with potentially relevant government agency.

Examples of deal structure red flags

- Control mechanisms lacking or inadequate;
- Payments contemplated or made to accounts/ persons not connected to the contract;
- Territory listed which has no role in transaction without reasonable commercial justification;

- Contemplated use of shell companies, holding companies or blind trusts without reasonable commercial justification;
- Proposed involvement of parties who do not have any apparent substantive role;
- Decision makers in awarding contracts are beneficiaries (e.g. shareholders) of and/or control companies awarded offset contracts.

How do companies address red flags?

All the contractors interviewed said that their corporate procedures would require them to address red flags but ultimately it would depend on judgment as to whether the answers provided were sufficient to allay concerns raised by a particular issue. For example, a red flag might be that the ultimate beneficiary in a subcontract is someone who is involved in the ministry of defence procuring the prime contract but not letting the offset contract. If this person is a small shareholder (e.g. under 5 per cent) and unable to exercise control over the decisions of the subcontractor, some companies might decide that this is insignificant and not a bar to proceeding with the offsets project.

It is significant that companies, however, were reluctant to be more specific on what would be an absolute bar to proceeding. Several did, nevertheless, confirm that they had declined to proceed in transactions where they could not get sufficient comfort from due diligence.

Views differed between American and European firms. Some American companies felt aggrieved that non-American companies did not operate to the same due diligence standards, and paid 'lip service' to due diligence.

In contrast, the view from some Europeans was that US companies followed a box ticking approach, which is solely designed to protect the corporation and is not substantive a risk based approach.

A small number of companies stressed that having a very strong approach to due diligence and the follow up of red flags gave them a competitive advantage in both the offset programme and the main contract.



The view from some Europeans was that US companies followed a box ticking approach, which is solely designed to protect the corporation and is not substantive a risk based approach. Credit: istockphoto

6. Role of Governments

Whilst companies interviewed recognise the need for transparency and integrity in their own offset programmes, they would like to see governments be much more directive in the transparency requirements they place on obligors. The obligation is then on all bidders, not just those who choose to demand high due diligence standards.

This need for strong requirements by governments also came up repeatedly in the discussion following TI-DSP's earlier 2010 offset corruption risks report. Transparency, accountability, and integrity should be essential requirements when public funds are being spent. There are many actions that can be taken by governments and their offset authorities to increase integrity, accountability and transparency in offsets arrangements.

TI-DSP has made a number of concrete recommendations to governments in its 2010 "Defence Offsets" report. These are reproduced in box 3 below, as governments' role in improved offsets due diligence must fit into a broader framework of measures aimed at increasing the transparency of offsets. TI-DSP has also made recommendations to all EU member states. These actions are based on the implications of the EU Defence Procurement Directive for offset processes throughout the EU.

BOX 3 | RECOMMENDATIONS FOR EXPORTING GOVERNMENTS

1. Exporting governments should publish annually all offset obligations into which national defence companies have entered.
2. National governments should make companies liable for the actions of partners and third parties in offsets agreements, including local companies, agents, representatives, and consultants involved in the process. Exporting governments should also increase enforcement of anti-corruption laws.

RECOMMENDATIONS FOR IMPORTING GOVERNMENTS

Offsets framework

3. Importing governments requiring offsets should ensure that performance delivery and transparency are the cornerstones of the offsets policy.
4. National governments should ensure that defence purchases do not deviate from the basis of strategic security requirements on account of the offset arrangements.

Offsets management

5. Procurement directors should ensure that the offsets team is properly constituted with competent and experienced personnel bound by a robust code of conduct – offsets are a specialist area not suitable for defence ministry officials or military officers without experience in the field.
6. Procurement officials should be subject to regulations requiring the disclosure of any potential conflicts of interest, particularly in respect of possible beneficiaries from the offset package or contracts.
7. Governments and procurement agencies need to establish clear responsibility and accountability for oversight and management of offsets programmes. They should ensure that there is an agreed cycle of performance and value-for-money audits.
8. National governments should require due diligence to be carried out to ensure that no member of the government or official will benefit improperly from any offset contract, and to ensure that all potential conflicts of interest by officials, military officers and Parliamentarians are disclosed.

Evaluation, monitoring and transparency of offsets

9. National governments should require that every offset obligation contract is specific about how offset performance will be monitored. They should be public about their valuation mechanisms, and should establish incentives and penalties for performance.
10. National governments should commit to publishing the offset obligations and publish annually the achievement of progress against those obligations.
11. National authorities dealing with defence procurement should actively consider a dual pricing requirement to facilitate an enhanced monitoring process. This involves all bids being submitted with two prices for the defence capability being procured: one with the offsets package and one without, allowing for a real cost-benefit analysis to be made on offsets and increasing visibility over the economics of offsets.
12. National governments should develop mechanisms to recognise each other's black listing processes, increasing the toll on improper conduct from suppliers.

7. Conclusions & next steps

While some companies have made substantial progress in improving their offset due diligence over the last five years, there remains substantial variation across the industry. There is now a block of companies with strong, well established due diligence practices. On the other hand, there are many companies who have either rudimentary processes or who have very recently established processes that have not yet settled down.

Even within those with established processes, practices vary considerably more.

Verification remains the most challenging area for both large and small companies. Verifying information is costly, time-consuming and can prove challenging as it requires obtaining on-the-ground information. Companies who did take due diligence seriously went to great lengths to verify partners' self-certification and other party information. This area also remains the distinguishing feature of how seriously a company approaches its due diligence.

There are huge opportunities for improvement. There is much scope for service-providers who can follow up on local information and red flags in a more cost-effective manner.

NEXT STEPS

Governments, companies and industry associations all have a strong role to play in raising offsets due diligence standards and incorporating more transparent and accountable policies into their everyday practices.

In order to make offsets due diligence widely practiced and effective, companies should incorporate due diligence into their normal business practices. In particular, companies should include specific policies and procedures on offsets in the company's business conduct requirements, business ethics practices and training programmes.

Governments can act as a pivotal lever to raise standards by requiring high minimum standards of transparency and accountability for all offset bidders. If governments were clear and direct in their transparency requirements for all bidders, this would shift the obligation of due diligence to all companies, rather than those who choose to demand high due diligence standards.

Finally, industry associations have a strong role to play in facilitating higher standards across the industry. Often, they can act as a driver for change by getting ahead of government regulation. One way industry associations could do this is by providing common verification checklists and sources of information for companies of all sizes to use.

Appendices



Dear Sir or Madam,

Due Diligence in Offset deals – request for participation

I am writing to request your cooperation in a best practice project conducted by Transparency International UK (TI).

TI is the civil society organisation leading the global fight against corruption. We work with partners in government, business and civil society to develop and implement effective measures to tackle it. TI's Defence and Security Programme is working with all stakeholders in the defence sector – defence companies, governments, multilateral organisations and civil society – to minimise corruption through enhanced transparency and accountability.

We are carrying out a project to collate the international defence industry's current practices, and government expectations, on due diligence practice in relation to corruption risks of offset transactions. The research will review what due diligence defence companies normally carry out on offset partners/beneficiaries when acting as principal contractors. The objective is to highlight what is current "good practice" in due diligence and to make recommendations for improvement as appropriate. The resulting work will be published and publically available.

We are surveying the industry through a specially constructed questionnaire, followed by interviews with company officers and legal representatives. The responses are all non-attributable. The questionnaire is attached, and we would be very grateful if you could spare time to complete it. This may be done either in hard copy or electronically (it is available at www.ti-defence.org, or by email from my colleague Julia Muravska; see below). The follow-up interviews will be non-attributable and will not be published. We will not be connecting current practices with any individual company, nor ascribing opinions to any one company or legal firm.

We have brought this project to the attention of the Global Offset and Countertrade Association (G.O.C.A) members and other industry associations. G.O.C.A believes such an independent study could provide participating companies and the industry with useful information regarding due diligence best practices being applied globally by industry to manage potential risks associated with offset transactions.

APPENDIX II.A | A SAMPLE DUE DILIGENCE INFORMATION LIST FROM BLENHEIM CAPITAL HOLDINGS LIMITED

COUNTERPARTY DUE DILIGENCE INFORMATION LIST

Introduction

This document sets out the initial requirements for Obligor counterparty due diligence checks. These checks are necessary in order for Obligor and its affiliates to comply with applicable laws and regulations, including anti-money laundering regulations, international sanctions and laws preventing criminal/terrorist financing.

Compliance is based on risk assessments, so the level of information required will vary from situation to situation. Obligor reserves the right to require additional background information at the initial due diligence stage or at any time thereafter.

For each category, every document listed below must be supplied. Where notarised or certified copies are referred to, this means the actual document containing the notary's stamp must be sent by post to Blenheim, not a pdf or photocopy.

1. Individuals

All of the following:

- a) A notarised or certified copy of the individual's passport
- b) An official document (such as a utility bill or driving licence) showing the individual's current home address
- c) A bank reference from a reputable bank or financial institution

2. Companies whose shares are listed/traded on a major recognised stock exchange and whose shares are held by the public

All of the following:

- a) A group structure chart showing the group's corporate structure (or the relevant part of the structure).
- b) Full name and address details for the ultimate parent company of the group, and (if different) for the company which proposes to contract with Blenheim.
- c) A notarised or certified copy of the certificate of incorporation/registration, and a notarised or certified certificate of good standing from the relevant authorities for the ultimate parent company of the group and (if different) for the company which proposes to contract with Blenheim.
- d) If any shareholder holds more than 5% of the ultimate parent company's shares, a list of the names of those shareholders (and due diligence may then be necessary on those shareholders).
- e) Details of the stock exchange on which the parent company's shares are listed/traded.
- f) A bank reference from a reputable bank or financial institution.
- g) Identification information (as referred to above in 1a and 1b) for the corporate's directors and majority shareholders.

3. Unlisted Companies, Companies listed on minor stock exchanges, and Companies whose shares are not held by the public (whether or not listed)

All of the following:

- a) A group structure chart showing the group's full corporate structure.
- b) Full name and address details for the ultimate parent company of the group, and (if different) for the company which proposes to contract with Blenheim.
- c) A notarised or certified copy of the certificate of incorporation/registration, and a notarised or certified certificate of good standing from the relevant authorities for the ultimate parent company of the group and (if different) for the company which proposes to contract with Blenheim.
- d) The names of all of the directors of the ultimate parent company of the group and (if different) for the company which proposes to contract with Blenheim.
- e) A notarised or certified copy of the register of shareholders of the ultimate parent company of the group. If any of the shareholders are not individuals, then due diligence information will need to be provided on those shareholders so that the ultimate beneficial ownership of the shares can be established.
- f) A list of the names and addresses of any shareholders which hold 5% or more of the shares (and further due diligence may be necessary on these shareholders)
- g) A bank reference from a reputable bank or financial institution.
- h) Identification information (referred to in 1a and 1b above) for the company's directors and majority shareholders.

4. Partnerships

All of the following:

- a) Full name and address details of the partnership.
- b) Full name and address details for each partner.
- c) If the partnership is registered, a notarised or certified copy of the certificate of registration, and a notarised or certified certificate of good standing from the relevant authorities for the partnership.
- d) A bank reference from a reputable bank or financial institution.
- e) Identification information (referred to in 1a and 1b above).

5. Trusts and other entities/associations

Please discuss with Obligor's legal/compliance group in advance.

6. State or Governmental entities, and members of Royal Families

Please discuss with Obligor's legal/compliance group in advance.

APPENDIX II.B | SAMPLE DUE DILIGENCE QUESTIONNAIRE FROM BLENHEIM CAPITAL HOLDINGS LIMITED

DUE DILIGENCE QUESTIONNAIRE | Blenheim Capital Holdings Limited (the “Company”)

I. Relevant Business Activity and Organisation

A. Company Name:

B. List of all jurisdictions in or with which the Company does business:

C. Please provide the contact information of the Company including telephone, fax, e-mail, and website:

D. Legal structure of the Company (e.g., Corporation, Partnership):

E. Date and Place of Company Incorporation/Registration:

F. Years the Company has been in business:

G. Please briefly describe the establishment of the Company, the primary areas of business activity, changes in ownership, changes in areas of concentration, growth plans, potential new markets, etc.:

H. Please list any subsidiaries, joint ventures and other affiliates that are owned, directly or indirectly, in whole or in part, by the Company (“Affiliates”). For each Affiliate, please provide the following information:

Name	Legal Structure & Company interest in affiliate	Date/Place of Incorporation	Type of Business	Whether and how involved in PROJECT

I. Please list any direct and indirect parent companies¹⁶ of the Company:

Name	Legal Structure and Interest in Company	Date/Place of Incorporation	Type of Business	Whether and How Involved in [PROJECT]

II. **Company Ownership and Control**

A. With respect to each officer and director of the Company, please provide the following information:

Name	Title	Responsibilities for (1) the Company generally and (2) with respect to [PROJECT] in particular	Percentage ownership in Company	Citizenship

B. With respect to each beneficial individual owner of an interest in the Company, including a direct or an indirect ownership or voting interest (i.e., through a parent company), please provide the following information:

Name	Citizenship	Beneficial Interest in the Company (i.e., percent ownership or control)	Responsibilities for (1) the Company generally and (2) with respect to [PROJECT] in particular

C. Please identify each officer, director, or beneficial owner of the Company (collectively, "Principal"), or any immediate family member of a Company Principal, that: (i) is an employee, officer, or representative of any civilian or military government agency, instrumentality of a government agency, or a government-owned/government-controlled association, organisation, or commercial enterprise; (ii) holds a legislative, administrative, or judicial office, regardless of whether elected or appointed; (iii) is an officer or holds a position in a political party; (iv) is a candidate for political office; (v) is an individual who holds any royal family, official, ceremonial, or other position with a government or any of its agencies; (vi) is an officer or employee of a supra-national organisation (e.g., World Bank, United Nations, International Monetary Fund, Organisation for Economic Cooperation and Development); or (vii) any other person connected or associated personally, including by family relationship, with any of the above categories, for the purpose of providing an indirect benefit to a Government Official ("Government Official"), as follows:

Name	Relationship with Company or Company Principal	Government Position and Duties

¹⁶ A company that owns enough voting stock in another firm to control management and operations by influencing or electing its board of directors.

D. Please describe the relationship between any of the Company Principals with any Government Official responsible for providing, approving, or authorizing the granting of offset credits or otherwise connected to the [COUNTRY] Offset Agency (“OFFSET AGENCY”), including the role in [PROJECT] of each such Principal:

III. Intermediaries

A. Please identify any trading companies, agents, consultants, representatives, or other third parties involved with the Company (“Intermediaries”) in connection with [PROJECT] as follows:

Name	Relationship with the Company	Role in [PROJECT]	Terms of Compensation

With respect to each such Intermediary, please provide the following information for each of its Principals:

Name of Principal	Role in [PROJECT]	Government Positions Held by the Principal

B. Please describe any involvement of each such Intermediary in actions taken by Government Agencies in regard to [PROJECT]:

IV. Participation in [PROJECT]

A. Please describe the role of XXXX in [PROJECT]:

B. Please describe all actions involved with the negotiation of offset credits and the parties involved:

C. Please provide an accounting for all payments made or received or value otherwise received or conveyed by XXXX in relation to [PROJECT]:

V. Business References

Please provide at least three unaffiliated business references:

Full Corporate Name	Name of Contact Person and Full Address	Contact Information

VI. Documents

- A. Please confirm that the attached Certification of Registration of XXXX, is current.
- B. Please confirm that the attached Memorandum and Articles of Association of XXXX, is current.
- C. Evidence from official government agency that the Company is in good standing.
- D. Company Code of Ethics or similar document. **XXXX Anti-Bribery Compliance Program. (Attached)**
- E. Written Anti-bribery Guidelines (if any). **XXXX Anti-Bribery Compliance Program. (Attached)**
- F. Copies of any agreements with Intermediaries relevant to [PROJECT]. None

Submitted on behalf of XXXX by:

Signature: _____

Name : _____

Title: _____

Date: _____

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