

Airbus's secret past

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On the eve of the Paris Air Show, we explore the corrupt and allegedly corrupt methods that have boosted past sales

IN SEPTEMBER last year, 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 Mr 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 which helped trigger the airline's collapse four years later.

Though nominally controlled by the Belgian government, Sabena was run by the parent company of Swissair, SAirGroup, which had owned a stake of 49.5% 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.

Mr 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 Mr Van Espen that he interview Peter Gysel, a former Swissair employee now working at Airbus, who put together Sabena's deal with Airbus. Mr 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 Mr 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% by EADS and 20% 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 multi-million-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 (for instance, aircraft trade-ins, or 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 (including this newspaper) have often pointed out that American firms can side-step 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 defence budget and space programme.

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But the American government has also spoken out on the subject of bribery. Two years ago Grant Aldonas, an under-secretary 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 modernising 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.

Kuwaiti 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 Dr Mallalah from his job the previous month. But KAC had trumped up the allegations against Dr 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 Mr al Mishari was planning a shiny new post-war 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 Mr 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 Mr 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: Mr al Mishari promised the order to Airbus; and Mr Pierson pressed for an announcement at the imminent air show.

As substantial public funds were involved, KAC was supposed to follow formal process in Kuwait before placing the order. This 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, Mr 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 \$900m. A delighted Mr 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 \$100m 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 left Mr 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 Mr al Mishari had set up in Bermuda in September 1992. ALAFCO was to buy the aircraft and lease them to KAC. In late 1992 Mr al Mishari confirmed to Mr Pierson that ALAFCO would buy the nine planes and sent off a \$2.5m deposit. By buying the planes through ALAFCO, Mr 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 15th 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, Mr El Fekih received \$5,000 a month, and \$80,000 in back pay for "services" rendered to ALAFCO from February 1st 1990—31 months before ALAFCO'S incorporation—to December 31st 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 Mr El Fekih's personal account (number 0000003930B) at Crédit 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, Dr 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, Mr El Fekih, was able to match exactly offers from Boeing, after Boeing came in over \$50m 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, Dr 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 Dr Mallalah submitted a report to KAC's board on the affair, Mr El Fekih resigned from ALAFCO in March 1995.

Mr El Fekih says that he acted in an honest way; Mr 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 cancelled 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 taxman. 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.

Mr 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". Mr al Mishari, whose family is wealthy, suffered financial problems when the Kuwaiti stockmarket collapsed in the early 1980s. Mr 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 \$952m, with an option for 12 more, later exercised. This was despite the fact that, when IA set up a

committee in 1983 to recommend replacement aircraft for its ageing 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 Mr Wadehra's litigation.

These papers allege, first, that in October 1984, weeks before Mr 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, that in November, the aviation ministry gave IA just three days to appraise the offer for Mr Gandhi's office.

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

Mr 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 Mr Gandhi, approvals from IA and government bodies were a formality. For instance, the IA board approved the Airbus order at a meeting on August 30th 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 supplied by the company".

But Boeing had not been asked for any. This was because two hours before the board meeting, at 9.50am, 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 \$5m per plane. This would reduce IA's investment in new planes by \$140m, stated Mr 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 Mr Wadehra to add Airbus's Indian subsidiary to his action on the grounds that Airbus in France was not co-operating. Airbus told Mr 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 Mr 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 Mr Wadehra to get lost when he wrote to ask why France was not co-operating.

Mr Wadehra's case is now topical. This is 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 Mr Gandhi and associates. The CBI has not answered our written questions.

Mounties and banks

But there are police forces which 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. Mr 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 Mr Schreiber. In 2000, Mr 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, has supplied a copy of Mr 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 30th 1988 and October 21st 1993 (ie, as Air Canada took delivery of Airbus planes), Airbus paid a total of \$22,540,000 in "commissions" to IAL. \$10,867,000 was paid into IAL's account number 235.972.037 at the Verwaltungs-und Privat-Bank in Vaduz and \$11,673,000 into IAL's account number 18.679.4 at Swiss Bank Corporation (SBC) in Zurich. During extradition proceedings against Mr Schreiber in 1999, Airbus admitted to these payments. In October 2000 Mr Schreiber won a suspension of execution of his case.

The court ruled that IAL belonged to Mr Schreiber, but also that, to the extent that Mr Schreiber had paid out the Airbus "commissions" as *Schmiergelder* ("grease monies"), these payments could be tax deductible. Mr 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* unrecognisable 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. Mr Cashore, a producer on "the fifth estate", Canadian Broadcasting Corporation's main investigative programme, says that Mr 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 sub-accounts at SBC in Zurich. One of the sub-accounts, 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.

A Mexican idyll

Mr Iddles's wife bought Casa Las Estacas, a luxurious beach-front villa in Puerto Vallarta, Mexico, in September 1992. Documents in *The Economist's* possession show the price was \$1.5m. According to a person involved in the deal, the money was wired from account number 154963-01-10 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 behaviour 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 22½ years imprisonment each (later reduced to ten 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 \$268m. They were a former minister for economic affairs, a former transport minister, and Munir Abu Khaddur, the middleman. Mr 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 \$240m, and as a result Syrianair had incurred "big financial losses".

The only inferences to be drawn are: either there was a miscarriage of justice; or 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 our investigations into instances of corruption or alleged corruption by Airbus suggests that Mr 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 Mr 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 article 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 next week's 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 Mr Van Espen's investigation of Sabena, that would deal the company's reputation a severe blow.

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