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FERROSTAAL

FINAL REPORT

COMPLIANCE INVESTIGATION

13 April 2011

DEBEVOISE & PLIMPTON LLP

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FERROSTAAL

Final Report – Compliance Investigation

I. EXECUTIVE SUMMARY

A. Findings of Questionable Payments

The Compliance Investigation (the "Investigation") found that **Ferrostaal**[1] made questionable or improper payments on many of its largest and highest profile projects. These projects ranged across many business sectors and countries.

Questionable or improper payments do not appear to have been systematic, in that they were not centrally coordinated or controlled but rather the result of various schemes operating independently of each other. However, many of these payments appear to have been systemic, in that they occurred repeatedly throughout the Company on projects of all sizes. Some of the schemes were similar in approach and execution.

While the Investigation uncovered some evidence indicating that certain questionable or improper payments were paid on as bribes, for most payments the available evidence does not establish their ultimate destination. Even in those cases where the circumstances suggest the possibility of bribery, an analysis of the facts may still permit different legal conclusions to be drawn on the potential offenses involved, such as, for example, breach of trust (*Untreue*).

The Investigation reviewed payments made by Ferrostaal between 1999 and 2010. In order to assist in the quantification of the findings, the payments reviewed were divided into four categories:

Category 1: Payments with respect to which the Investigation found clear evidence of corrupt conduct and was able to identify intended or actual end recipients, either by name or generically. This category also includes instances of other forms of potentially criminal conduct that we identified (such as a payment made to a competitor as compensation under a bid-rigging agreement).

Category 2: Payments which gave rise to grounded suspicions of corrupt or other criminal conduct, such as breach of trust, and which could move to Category 1 with additional evidence, such as admissions by witnesses or verification of the payment flows to

[1] "Ferrostaal" (or the "Company") is used in this Report to refer collectively to Ferrostaal AG and to certain affiliated or subsidiary companies whose activities were a focus of the Investigation, including Ferrostal Industrieanlagen GmbH, Fritz Werner Industrie-Ausrüstungen GmbH, Ferrostaal Piping Supply GmbH, Ferrostaal Argentina S.A., Ferrostaal Chile S.A.C., Ferrostaal Colombia Ltda., PT Ferrostaal Indonesia, Ferrostaal South Africa (Pty) Ltd. and DSD de Venezuela C.A. (now ProCon de Venezuela C.A.), but excluding MarineForce International LLP.

the end recipients.

Category 3: Payments which presented serious compliance issues and significant red flags but with respect to which the Investigation did not identify specific evidence of corrupt or other criminal conduct.

Category 4: All other payments substantively reviewed during the Investigation, based on the initial risk assessment, but with respect to which the Investigation found no further evidence warranting inclusion in one of the above categories.[2]

The above categorization represents our assessment of payments based on the evidence identified and the compliance criteria applied during the Investigation. It does not constitute an analysis of the potential criminality of the payments under German or any other applicable law. While we have taken the limited information made available by the Office of the Public Prosecutor in Munich (the "Munich Prosecutor") into account in formulating our views, the payment categorization does not purport to predict how the Munich Prosecutor or other authorities may view such payments.

A detailed table of payments by investigative workstream appears at **Annex A**. In summary, the four categories contain payments totaling approximately €1.18 billion: just under €9 million in Category 1, just over €81 million in Category 2 and just under €246 million in Category 3.

Almost €1.13 billion of the total payments categorized relate to Ferrostaal AG or one of its subsidiaries other than Ferrostaal Industrieanlagen GmbH ("**FIA**"). Of that amount, just over €5 million was assessed in Category 1, just over €76 million in Category 2 and approximately €228 million in Category 3. The largest amount of Ferrostaal AG Category 1 payments (approximately €3.4 million) was paid in connection with the Venezuelan business.

Just under €50 million of the total payments categorized relate to FIA and its subsidiary Fritz Werner Industrie-Ausrüstungen GmbH. Of that amount, just under €3.7 million was assessed in Category 1, just over €5 million in Category 2 and approximately €18 million in Category 3. The largest amount of FIA Category 1 payments (approximately €2.1 million) was paid in connection with the Libyan business.

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[2] Inclusion in Category 4 does not signify that the payment was necessarily commensurate with the services rendered or that the documented proof of performance of the services provided was adequate. It simply means that the evidence of potential criminality or of serious compliance issues inherent in the other categories was absent.

Payments made by MarineForce International LLP ("**MFI**"), a 50:50 joint venture between Ferrostaal and ThyssenKrupp/Howaldtswerke-Deutsche Werft GmbH ("HDW"), are not included in these categories, but we note that our compliance audit of MFI ("Compliance Audit") did not reveal any payments in Categories 1 or 2. A limited number of MFI payments (£320,926.68 plus €250,000) would qualify under Category 3 (but, again, are not included in the totals noted above).

The table at **Annex B** lists the various consultants,[3] agents, representatives or other third parties to whom the Company made the payments included in the four categories set out above, again, with the exception of MFI payments.

B. Systems and Controls

This Report analyzes the compliance-related systems and controls at Ferrostaal and the way in which they were implemented. In summary, the Investigation found that:

- Ferrostaal's systems and controls were inadequate to address the risk profile of its business and failed to prevent and detect potential compliance violations.
- Ferrostaal had no meaningful compliance function and no internal audit function. It relied on its parent, MAN SE (until 2009 MAN AG and hereinafter "MAN"), for such central functions.
- The internal control measures that Ferrostaal operated were limited in scope and focused on tax issues, namely the deductibility of consultants' fees as expenses (pursuant to § 160 *Abgabenordnung*).
- The anti-corruption measures and controls that existed were not meaningfully implemented or enforced and were easily circumvented in several instances.
- When compliance red flags or corruption-related issues arose, there was little to no meaningful investigation and no discipline was imposed in cases in which compliance policies (or the laws) were violated. What investigation, review or analysis occurred appeared largely driven by tax considerations, not by compliance, and was primarily aimed at creating a record that would support tax deductibility of potentially improper payments, rather than a diligent effort to root them out.
- The fear of detection in an audit by tax authorities (*Betriebsprüfung*), rather than a substantive concern about compliance, played an important part in

[3] The term "consultant" is used in this Report to include any third party assisting the Company with sales promotion and may therefore include agents or representatives, regardless of the precise term used in the respective contractual documentation.

Ferrostaal's approach to dealing with payments to consultants. This is borne out by the evidence surrounding some of the principal examples of internal controls/compliance circumvention, such as the restructuring of Railways consultant Marijan Kunina's commission or the senior management discussions about payments to the Company's Greek agent, Marine Industrial Enterprises S.A. ("MIE"). Concerns about the practice of the *Betriebsprüfung* also featured as a consideration in the establishment of MFI and the decision to hive off Ferrostaal's submarine business to that entity.

- Ferrostaal's deference and leeway to certain senior managers (such as the former member of the Managing Board (*Vorstand*) responsible for Marine and the former head of Merchant Marine) and to certain consultants, as well as its far-flung, federated structure, complicated efforts to implement comprehensive compliance policies and controls.

C. Leadership and Management

The Investigation assessed the involvement and knowledge of senior management in potential compliance violations and evaluated the tone and direction it set on the issues of anti-corruption and compliance. In summary, the Investigation found not only that senior management failed to fulfill its duties to ensure that the Company developed adequate compliance systems and controls, but also that it was instrumental in fostering an ethos where compliance violations could be committed and go undetected and/or unremedied.

1. "Tone at the Top"

Despite the former CEO's official statement that "*as a matter of principle, we do not pay bribes*," the *Vorstand* did not promote a "tone at the top" that emphasized compliance and that made clear that the Company would not engage in non-compliant business. While paying lip service to the requirements of the law, the *Vorstand's* actions fostered a climate where willful blindness became an acceptable mode of operating. No clear message was provided that Ferrostaal had to be compliant even if it risked losing business or upsetting historically important business partners.

The overwhelming lack of substantive compliance-related discussions and action at the *Vorstand* level is striking, particularly in view of (i) Ferrostaal's history of paying bribes prior to Germany's adoption of the Organization for Economic Cooperation and Development ("OECD") 1997 Anti-Bribery Convention, (ii) its operations in many countries prone to corruption and in business areas at risk of being affected by corruption and (iii) numerous red flags indicating potential instances of corrupt practices.

Managers of business units or local subsidiaries generally did not consider their responsibility for compliance to extend beyond satisfying the formalistic

requirements for the approval of consultancy contracts. The understanding that policies and controls served a real purpose was not widely shared.

2. Close Involvement of the *Vorstand*

Notwithstanding their near uniform refusal to cooperate with the Investigation, the available evidence shows a relatively high degree of close personal involvement by former members of the *Vorstand* in potential compliance violations or their treatment.

Insofar as actual involvement is concerned, this Report contains several examples, such as the efforts in 2003–2004, led by the *Vorstand* member then responsible for the business unit (*Bereichsvorstand*) (and involving, to a lesser extent, the former CEO), to reduce Railways consultant Marijan Kunina's ostensible commission percentage. The case of the Greek commission payments, described in this section and in detail in Section III.A.1, reveals the intimate involvement in highly questionable and possibly corrupt payments by the former *Bereichsvorstand* for Marine. What is more, that same *Bereichsvorstand* has given evidence to the Munich Prosecutor in which he openly admitted his awareness, at the time of making the arrangements in question, that certain payments may be forwarded as bribes, but – in a clear example of willful blindness – stressed that he had not wanted to have actual knowledge of these matters, and in particular of the recipients and amounts paid to them.

With respect to the treatment by the *Vorstand* of potential compliance violations, the totality of the evidence we reviewed shows that the *Vorstand* made certain choices which could be interpreted as evincing an intention to shield themselves from responsibility for potential violations.

First, it appears that the *Vorstand* did not want to create extensive documentation of discussions concerning compliance issues. There were no minutes of *Vorstand* meetings before 2003, apparently because the CEO at the time was of the view that minutes would have detracted from and undermined the *Vorstand's* culture of collective decision-making. The minutes of *Vorstand* meetings prepared from 2003 onwards are not detailed and typically do not record discussions of any compliance issues, except in very few instances (for example, in December 2006, when the only reaction of the *Vorstand* to the Siemens scandal was a general statement that the Company should make sure that it adheres to the compliance policies of the group). At no time did corruption-related incidents reported in the press, even those concerning Ferrostaal itself, occasion alarm or efforts to ensure that the Company's business was indeed compliant. A review of the Supervisory Board minutes showed no evidence that the *Vorstand* reported to the Supervisory Board on compliance issues between 2003 and 2008 except for one meeting on 10 September 2007, where the implementation of certain compliance measures was announced (relating to the "e-learning tool," compliance training and anti-corruption guidelines introduced by MAN).

Second, it appears that in instances where questionable payments were brought to the attention of the *Vorstand*, it either failed to take aggressive action to stop or turned a blind eye to the conduct. Signs of particularly grave compliance violations were not sufficiently investigated and appropriate remedial action was not taken. The "investigations" – internal and external – that did occur appear to have had a "whitewash" function in that they were deficient in scope, reached conclusions that were difficult to reconcile with the facts and ultimately purported to legitimize the action the *Vorstand* decided to take for reasons other than its desire to ensure compliant conduct.

Two examples are particularly instructive in this regard.

(a) Dolmarton Claim

Perhaps the most striking example is the treatment by the *Vorstand* of the Greek commission payment issue, including its initial review in 2002–2004 by the former head of Marine, as well as the subsequent investigation by external advisers after Dolmarton Associated Inc. ("Dolmarton") asserted a claim in 2006.

The former CEO directed the first internal review of consultancy arrangements, purportedly with a view to reducing the commissions and, according to the former Marine employee tasked with the review, to helping the Company rise from its "murky" past (*Schmuddelecke*) in this sector by investigating potential compliance violations. While, in the case of Greece, the efforts did in fact lead to a reduction of the commissions contractually due to the Company's Greek agent, MIE, the review was a significant missed opportunity to investigate potential compliance violations at an early stage. Serious red flags – including an admission, supported by documentation, by MIE's principal, Michael Matantos, that he had passed €55.1 million to various third parties at the instruction of the Company – were effectively ignored on the basis of the view, allegedly shared by the former head of Marine and the former CEO to whom he reported, that the payments were "*Matantos' problem*," as no further payments were due to him. When the issue resurfaced two years later in the face of Dolmarton's renewed claims for payment, the Company's external investigators, Control Risks Group Ltd. ("Control Risks"), were tasked with investigating the persons involved, but with a view to helping the Company assess the commercial risks of non-payment, not to advising on possible red flags or corrupt practices by the key participants. Similarly, the external lawyer advising and representing the Company in this matter, Dr. Hans-Hermann Aldenhoff of Simmons & Simmons, performed some fact-finding, but his mandate was restricted to investigate only insofar as necessary to defend the claim, thus limiting the pursuit and clarification of potential compliance violations discovered in the process. Dr. Aldenhoff ultimately provided the Company with advice that paved the way for it to make an additional questionable payment of €11 million in 2007 and to decide not to sue the former *Vorstand* member most closely connected to the potentially corrupt or otherwise illegal payments for breach of duty, all under the cloak of legal legitimacy.

The minutes of the impromptu 30 July 2007 meeting of *Vorstand* members at which the €11 million payment to Dolmarton was approved stated that the *Vorstand* agreed with Dr. Aldenhoff's view that there were no indications of potentially criminal behavior militating against making the payment. That characterization of Dr. Aldenhoff's view in the minutes was inaccurate, as he confirmed to us in an interview. At the time of the proposed settlement, Dr. Aldenhoff in fact believed (as he had from the start) that there was an initial suspicion of criminal behavior (*Anfangsverdacht*) with respect to the Dolmarton affair. Some months before the *Vorstand* meeting (at which he was not present) he had even advised the then director of Legal Services that any judge apprised of the Dolmarton claim would have referred it *ex officio* to prosecutors for investigation. The significance of this fact cannot be underestimated, given that these minutes are the only record of the *Vorstand's* collective decision-making process pursuant to which it authorized the questionable €11 million payment on the basis of which the Munich Prosecutor is now investigating the Company. Yet the minutes are wrong on perhaps the most crucial point of all: the existing indications of potential illegality in the underlying arrangements with Dolmarton.

(b) 2007 Special Audit Venezuela

Pursuant to a request from the then CEO, the then head of Legal[4] and the then commercial head of Power Industry carried out a Special Audit (*Sonderprüfung*) in 2007 of consultancy arrangements in connection with the Termozulia I power plant project in Venezuela. A previous review by MAN Internal Audit had found not only an absence of documentation of contractual agreements and of the services purportedly rendered by several consultants, but also evidence – in the form of statements by the former General Manager ("GM") of the Venezuelan subsidiary – that several of the commission payments constituted *Nützliche Aufwendungen*.[5] MAN Internal Audit further obtained evidence suggesting that the commissions encompassed payments to two public officials, one of whom was a high-ranking minister.

The stated purpose of the Special Audit was to explore further the MAN Internal Audit findings and to clarify their context and background. The actual purpose of the Special Audit, however, appears to have been to find ways to legitimize the questionable consultancy payments and to undermine the MAN Internal Audit findings in the process. The Special Audit report even begins by calling into

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[4] Throughout this Report we use a short form to refer to certain central functions at Ferrostaal AG, such as the legal department, the tax department and the accounting department (respectively "Legal," "Tax" and "Accounting").

[5] Documents and interviews suggest that this term was widely used at the Company, at least historically, to denote bribe payments. It is used in this Report with that meaning in mind, although we note that according to some interviewees the term was not necessarily limited solely to improper commission payments.

question the reliability of the MAN Internal Audit findings. Relying on the local subsidiary's GM – a key protagonist who had been involved in certain of the questionable arrangements and to whom MAN Internal Audit had attributed the admissions of corruption – to liaise with the consultants in question to obtain documentation of services and corporate records, the Special Audit concluded that the irregularities identified in the earlier audit were based on poor record-keeping and a selective focus on certain statements made by the Venezuelan subsidiary's staff. The Special Audit made no effort to speak with members of MAN Internal Audit about their findings or to request their work papers. Nor did those conducting the Special Audit make any attempt to speak directly with the consultants or with the other individuals at the Venezuelan subsidiary involved in authorizing the payments. Focused on legitimizing the arrangements by collecting documentary evidence of performance – some of which was created only at the time of the Special Audit – the Special Audit did not directly confront the indications of corruption and thus effectively turned a blind eye to serious red flags of potential illegality.

3. Structural Weaknesses

In some respects, Ferrostaal was run more like a small and secretive club than an organization involved in high-value international projects all over the world. One former employee recounted how, at the time he took over responsibility for Marine in the summer of 2003, the Company was effectively run by ten people. Information about sensitive matters such as consultancy contracts would generally not be made available to anyone outside a trusted circle of individuals.

In the case of Marine, one of the highest-risk business units, the *Vorstand* was at crucial times deficient from a structural and a personnel perspective to deal with the compliance challenges presented. In an interview, the *Vorstand* member responsible for Marine from 2001 to 2003 described an arrangement devised by the former CEO pursuant to which he was to play largely a representative role, while his predecessor would effectively continue to run the Marine business, despite having moved to take a position on the *Vorstand* of HDW, Ferrostaal's consortium partner. As a result, a relatively inexperienced executive was nominally in charge of one of the areas most prone to compliance violations, but without the mandate, experience or even the ability to impose himself on the business, the running projects and the personalities involved. The evidence shows that some of the most serious compliance violations the Investigation uncovered occurred during his tenure. The individuals who were in effect left to run the Marine business, the former *Bereichsvorstand* (by this time at HDW) and his former head of Marine, showed scant regard for compliance. In their testimony to the Munich Prosecutor, they recounted how they had made significant financial arrangements with an opaque group of consultants and lobbyists who worked behind the scenes, fully cognizant of, and apparently unconcerned by, the fact that those individuals would be making corrupt payments if necessary.

It is not clear whether this result was intended by the then CEO – whose testimony to the Munich Prosecutor is replete with references to his unwavering

commitment to compliance – when he made the decision to install a young and relatively weak *Vorstand* member and curtailed his actual responsibility for the operative business, or whether it was merely coincidental. What is clear, however, is that this particular *Vorstand* constellation was simply not fit for purpose and created a gap in senior management, and with it clear compliance risks, as well as a risk that the lines of ultimate responsibility for adherence to compliance would become blurred.

The deference to certain senior managers, such as that shown to the former *Bereichsvorstand* for Marine in the submarine business, was replicated in other business lines. Some senior managers, such as the former head of Merchant Marine and the former CEO of PT Ferrostaal Indonesia ("**FSI**"), openly expressed their ambivalence about compliance but were nonetheless given significant leeway in running certain high-risk businesses. By way of example, in 2009, when three colleagues heard a FSI manager purportedly condoning corrupt practices, including alleged statements alluding to the possible use of consultants by FSI to effect bribe payments, there was no meaningful investigation of the Indonesian business or any sanction of the manager, who was even promoted to CEO of FSI one month after the incident. The then CEO of Ferrostaal AG was personally informed about this case and even received a letter of apology from the manager in question in which he did not deny having made the incendiary statements alleged. The former *Vorstand* member then responsible for the Asia region and Marine was aware not only of the incident involving the FSI manager, but also the attitude towards compliance of the former head of Merchant Marine. According to the former head of Merchant Marine, when his refusal to participate in mandatory online compliance training (introduced in the spring of 2008) led to pressure from MAN on this former *Vorstand* member, the *Vorstand* member arranged for his assistant to log on to the online system as the former head of Merchant Marine and complete the training in his stead. We have not confirmed this with the former *Vorstand* member or his assistant.

In this sense, the Company made personnel decisions in high-risk business areas that created reasonably foreseeable risks of compliance violations occurring in the future.

4. The Special Case of FIA

From the time of its formation in 2002, FIA had almost no compliance infrastructure, either in Geisenheim or supplied by Ferrostaal AG or MAN. There were no stand-alone compliance or internal audit functions in Geisenheim. Legal examined contracts and behavior merely from a civil law perspective and did not see compliance as part of its formal role, believing that function was filled in Essen. Apart from mandatory checking of consultancy agreements by Tax in Essen, which evidence suggests was deliberately circumvented in certain cases, there is little indication that FIA availed itself of central compliance-related functions in Essen, to the extent they existed. Circulars from Essen appear to have been distributed with little comment. On several occasions, specific requests from Tax regarding

consultants met with hostility or, as the evidence suggests, with manufactured documentation.

The evidence and our interviews suggest that FIA management demonstrated little compliance-related "tone at the top" and that certain former managing directors (almost all of whom declined to be interviewed) may have been aware of or involved in a number of questionable payments. One former managing director was particularly defensive when it came to consultancy contracts. According to the former head of Tax, this former managing director never seemed to accept that compliance required providing even basic details about a consultant's identity or performance. Documentation indicates that another former managing director had to be reminded repeatedly about the need to provide basic records about a consultant operating in Turkmenistan.

There is some evidence that the *Vorstand* members responsible for FIA tolerated the managing directors' apparent indifference to compliance. For example, one interviewee recalled that when one former *Vorstand* member who had been responsible for FIA was informed that a FIA managing director wanted nothing to do with FIA Legal, the former *Vorstand* member declined to act.

D. Investigation History

1. Investigation Triggered by the Munich Prosecutor

In or around May 2009, the Munich Prosecutor began investigating allegations of corruption at MAN (and later MAN Turbo AG). Evidence gathered in the investigation pointed to possible corrupt payments at Ferrostaal AG, a former wholly owned MAN subsidiary in which it still held a 30% share: MAN Internal Audit work papers identified irregularities on Ferrostaal projects, including projects in Venezuela, while questionable transactions at MAN Turbo implicated a FIA project in Turkmenistan. Moreover, evidence emerged indicating potential irregularities in Ferrostaal's business relating to Mützelfeldtwerft GmbH, including evidence of potential embezzlement implicating the former head of Merchant Marine.

In July 2009, the Munich Prosecutor raided Ferrostaal's offices in Essen and Geisenheim and arrested the former head of Merchant Marine and the former *Vorstand* member responsible for Marine. The former head of Merchant Marine began cooperating with the Munich Prosecutor, including by giving testimony about potential corruption in other business units and projects of the Company.

2. Internal Investigation: Phase I

In August 2009, the Supervisory Board and *Vorstand* of Ferrostaal AG jointly tasked Heuking Kühn Lüer Wojtek ("Heuking") and Ernst & Young with an internal investigation of possible corrupt payments made by the Company ("Phase I"). The

Phase I investigation was to commence with a review of the Mützelfeldtwerft project, as well as the re-performance of a creditor analysis first done by KPMG in 2007.[6]

Although the Supervisory Board proposed in the early stages that the investigation not be confined to specific projects but expanded to perform a "scan" of the Company's business as a whole, this met with resistance from the *Vorstand* and the CEO at the time, who wanted to limit the investigation to specific projects.

By late 2009, primarily due to requests of the Munich Prosecutor, Phase I had expanded to include submarine projects (and related offset transactions) in Greece, Portugal and South Africa; a methanol plant project in Oman (M3000); a power plant project in Venezuela (Termozulia I); FIA projects in Libya (Tazerbo, Ghani Gir, A100 and Ras Lanuf) and Turkey (MKEK); and the Company's dealings with VACE Consulting GmbH of Linz, Austria ("VACE").

This direction of Heuking and Ernst & Young reportedly faced considerable resistance from the former CEO, the former head of Legal, the current *Vorstand* member responsible for FIA and two officers who had been especially appointed by the CEO to oversee and supervise the investigation as part of a project office.

Phase I encountered several significant obstacles and was plagued by the failure of management to install an infrastructure to support an independent investigation without management interference. *First*, there was delayed and incomplete data collection due to the fact that several existing and former employees opposed the collection of their data. *Second*, only a few interviews were conducted. Those that did take place were rendered unreliable by the fact that members of the project office participated in them and reported on what was disclosed to the then CEO. *Third*, the *Vorstand* introduced an amnesty policy that made decisions about the grant of amnesty entirely dependent on management, meaning that employees seeking amnesty were effectively required to report their observations directly to senior management. Unsurprisingly, the initial amnesty policy was unsuccessful as a means of encouraging employees to come forward. *Fourth*, the *Vorstand* sought legal opinions to the effect that an investigation led by the Supervisory Board would be illegal and that the *Vorstand* would have to stay in control of the entire investigation and its results at every instance. *Fifth*, effectively implementing the advice received in those opinions, the *Vorstand* and its advisors reviewed and amended the draft reports prepared by Heuking and allowed lawyers of individuals concerned to perform similar reviews. *Sixth*, the Company did not permit Heuking and Ernst & Young to conduct work outside of Germany despite the fact that the investigative team had identified important evidence necessitating visits to and data collections in specific countries (notably, Venezuela and South Africa).

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[6] The Turkmenistan project (Korpedje), as well as three other FIA projects (Ghani Gir, A100 and Ras Lanuf), had already been investigated by the Company with the help of an outside firm, Dierlamm Rechtsanwälte, which issued written reports in July 2009.

In February 2010, the Company provided the Munich Prosecutor with interim reports prepared by Heuking containing the preliminary results of the Phase I investigation of certain projects. These reports were in fact edited and amended by members of the Company's project office as well as by the Company's criminal defense counsel at the time, who, among other changes, removed the legal evaluation contained in the reports before they were released.

Later that month, the Phase I investigation came to a halt – save for some reduced investigative activity – following certain disagreements between the Supervisory Board and the *Vorstand*, not least as to the direction and scope of the investigation.

3. Internal Investigation: Phase II

On 19 March 2010, the Munich Prosecutor conducted a second raid at Ferrostaal headquarters in Essen, ostensibly as a result of new investigative leads and suspicions involving the Marine/governmental business units (particularly the Greek, Portuguese and South African submarine projects, a tugboat project in Egypt and offshore patrol vessel projects in Argentina and Colombia) as well as the Indonesian business, based on incriminating testimony by the former head of Merchant Marine.

In a subsequent meeting with representatives of the Supervisory Board and *Vorstand*, the Munich Prosecutor expressed dissatisfaction with the progress and scope of the internal investigation and the Company's general posture towards cooperation.

The Supervisory Board resolved to renew its commitment to cooperate with the Munich Prosecutor and to commission an investigation that would be sufficiently comprehensive and be led by the Supervisory Board in a way that would ensure independence and safeguard against interference by management. On 5 May 2010, the Company entered into a mandate agreement with Debevoise & Plimpton LLP ("Debevoise") and similar agreements with Heuking and Ernst & Young to conduct a renewed investigation aimed at examining the Company's critical activities in a thorough and comprehensive way ("Phase II"). The conceptual underpinnings of Phase II were to bring key forensic disciplines to bear on the Investigation: Debevoise was to conduct intensified data (and in particular e-mail) review, with the assistance of Ernst & Young, and to conduct forensically focused witness interviews, based on the review of such data. Prior limitations on the choice of interviewees (such as former employees or external consultants) were removed. Moreover, the approach in Phase II was intended to provide facts needed to permit responses to compliance certification requests, strengthen compliance measures and internal controls, assess potential claims against former employees and enable the Company to defend itself against claims.

A number of steps were taken to make the second investigative phase more effective than the first. *First*, Ferrostaal introduced a revised version of its amnesty

program (Circular 01/2010) and expressly directed all employees to cooperate with the Investigation (Circular 02/2010). While few individuals came forward to participate in the revised amnesty program, certain important investigative leads (notably with respect to the Cedico payment system at FIA (Category 1)) surfaced under the aegis of amnesty. *Second*, in order to support the Investigation and maintain its independence, the Company installed a new project office, headed and overseen by the new *Vorstand* member in charge of Compliance and Administration, which managed and coordinated the Investigation and attempted to clear obstacles to getting information. *Third*, the Company implemented a rigorous claims management process, led by Heuking, which demonstrated its commitment to assert breach of duty and other claims against wrongdoers and thus gave real teeth to the Investigation and the overall compliance effort. *Fourth*, the Company entered into negotiations with the works council on a new data protection/data sourcing agreement. The resulting shop agreement (*Betriebsvereinbarung*), which became effective on 4 June 2010, ensured wider access to custodial data while increasing the level of data security and generally providing enhanced safety and protection standards. *Fifth*, a revised data collection and review method was established that, unlike the Phase I version, provided for the collection of additional data outside Germany.

Debevoise and the Company agreed that the Investigation was to report exclusively to the Supervisory Board or its subdivision (the Audit Committee). In addition, Debevoise, Heuking and Ernst & Young were to regularly report their detailed findings to Compliance, Legal and Finance to enable the Company to take all appropriate steps to respond to such findings on a real-time basis. In addition, the *Vorstand* and Supervisory Board authorized and instructed Debevoise, Heuking and Ernst & Young to report findings to investigating authorities, in particular the Munich Prosecutor, following a review process conducted by the project office and the Company's current external criminal defense counsel to ensure that the rights of employees were safeguarded.

Pursuant to the Phase II work plan, the Investigation was to proceed on a comprehensive, risk-based approach, rather than a more narrow, project-by-project approach. Debevoise, together with Heuking and Ernst & Young, was to conduct a risk assessment, based on the work done in Phase I and further scoping in the early stages of Phase II, primarily through the preliminary review of project and business unit data, as well as informational meetings with the business unit heads. The aim of such a risk-based approach was not only to be responsive to the requirements of the Munich Prosecutor, but also to get ahead of external forces, such as business partners and customers, as well as preventing any other significant wrongdoing from going undetected.

The Phase II work plan focused on selected businesses in four key areas – FIA, Marine, Petrochemicals and Power – as well as allegations involving FSI that had emerged in the investigation by the Munich Prosecutor. A more limited review was to be conducted of two other business areas, Piping Supply and Railways. Importantly, and in contrast to the approach in Phase I, the work plan envisaged that

the Investigation would, within each key business area, sample projects, examine key vendors, focus on management-level decisions and assess the role of involved subsidiaries. Moreover, the Investigation was to examine the business culture, evaluate the controls environment, assess the conduct of top management and collect and assess consultancy agreements across business areas.

No work was envisaged in lower-risk business areas. Certain initially envisaged workstreams were either performed by Heuking (e.g., VACE) or not substantively pursued at all (e.g., Equipment Solutions) based on the conclusions as to risk profile reached during the scoping exercise.

At the request of the Supervisory Board, Debevoise was also tasked with a review of the compliance environment (with a particular focus on the role of former members of the *Vorstand*), a compliance audit of MFI and an investigation of certain automotive projects in Algeria (leading to a separate report not included herein).

The immediate priorities for Phase II were (i) the automotive projects in Algeria (with a view to satisfying the requirements of business partners Daimler AG, Rheinmetall AG and MTU Friedrichshafen GmbH), (ii) the Greek and Portuguese submarine projects (with real-time reporting to the Company with a view to assisting KPMG's work on the audited financial statements) and (iii) identifying and conducting potentially high-value interviews with individuals in key positions at the Company, such as the former head of Legal (as set out in the body of this Report, it transpired that most of those individuals were not available to the Investigation).

E. Limitations and Qualifications to this Report

The Supervisory Board requested this Report to set forth in one place a written summary of the activities and findings of the Investigation. Such a written summary may assist the Supervisory Board, and the Company more generally, in many ways. Among other benefits, a written report organizes and makes accessible a considerable amount of information, and it permits informed discussion throughout the Company about compliance reforms and whether they effectively address past problems.

The Report nevertheless is only a summary. Detailed findings have been reported to Legal, Compliance, Tax and Accounting in the extensive download and handover sessions conducted since 2 September 2010, which included written "talking points" and extensive supporting documentary evidence. Such documentation is available both at the Company and in an electronic library, which the Company asked Heuking to set up in connection with its claims management task. In several instances, the Company immediately reacted to the findings and established work groups to investigate further and to prepare the necessary corporate decisions. Accordingly, this Report does not detail all of the evidence that has been amassed during the Investigation and does not purport to provide a factually complete account of every project or every consultancy arrangement reviewed.

This Report is the work product of Debevoise and sets out the views and assessments of Debevoise only. In this Report, Debevoise describes its findings on the areas that were subject to the Investigation pursuant to the mandate from the Supervisory Board, detailed in Section I.D.3 above. Debevoise does not describe, or express opinions on, areas of investigation that continued in Phase II but were led by Heuking, such as Oman (M3000), VACE or Portugal/ACECIA.

This Report addresses the conduct of Ferrostaal and some of its corporate bodies and internal organs concerning compliance matters. The Report does not address or reach conclusions about the conduct of any individual and should not be read as doing so, either explicitly or implicitly. The Report anonymizes the names of current and former employees to protect against information being attributed to any particular individual, to help the Company preserve applicable legal privileges, to comply with German data protection and privacy laws and, in certain cases, to protect the safety of individuals. Similarly, in a number of places the Report generically describes the activities of "management," "managers," the "*Vorstand*" or other groups of Ferrostaal's personnel or corporate bodies. When doing so it is important not to assume that the knowledge or conduct described is attributable equally to all individuals within that group or body. No two individuals are identically situated; knowledge of and involvement in activities described in this Report varies widely from individual to individual, and in many cases at least some individuals within a broadly defined group or corporate body may have had no knowledge of or involvement in the activities described. What is important for this Report is not the knowledge or involvement – or lack of it – of any particular individual, but rather the fact that at least some individuals within that group or corporate body had such knowledge or involvement.

In line with the mandate conferred upon Debevoise to conduct an investigation into possible compliance deficiencies and weaknesses in the Company's internal controls, the conclusions of the Investigation are based on standards of proof that may be lower than those applied in civil or criminal cases. Further, it should be noted that – as stressed repeatedly in the substantive discussion in this Report – a number of significant witnesses declined to cooperate with the Investigation, which limited the ability to reach conclusions on certain topics. Many of the key witnesses were former employees who could not be compelled to participate in interviews. In some instances this Report expressly states that an individual declined to be interviewed by Debevoise; but even where this is not expressly stated, it should not be assumed that the individuals mentioned (whether current or former employees or third parties) were interviewed.

Debevoise attempted to interview all current and former employees described directly or indirectly in the Report, in some cases extending multiple interview invitations, attempting to negotiate with their individual counsel and proposing amnesty in appropriate cases. Insofar as the former *Vorstand* members are concerned, their refusal to be interviewed has been near uniform: out of nine former *Vorstand* members we sought to interview, only one actually participated in an Investigation

interview. The *Vorstand* members who refused have, directly or through their counsel, given various explanations for their refusal to be interviewed, including that they were concerned about prejudicing themselves in connection with pending or threatened criminal or civil proceedings. Regardless of the explanation, the effect of that refusal has been that these individuals have chosen not to provide their perspectives and recollections, and in doing so have foregone the opportunity to have those perspectives and recollections taken into account in the Investigation's findings.

In analyzing and reporting on the Investigation, we have considered the nature and quality of the evidence regarding each allegation, and have endeavored to describe our assessment of the evidence. For example, we are generally reluctant to make a finding based only on a single, uncorroborated statement. However, where such a statement is corroborated by other witnesses or by documentary evidence, or is supported by the totality of surrounding circumstances, it provides a firmer basis for investigative findings. Hence a statement that a payment to a consultant was made for an improper purpose, standing alone, typically requires further scrutiny; that statement becomes more credible, however, if examination of the project with which it was associated reveals that no demonstrable services were provided in return, the payment was disproportionately large compared to any ostensible services to be provided, the payment was justified based on fictitious proof of performance, neither the consultant nor any of the employees involved can offer a legitimate basis for the payment, or similar facts tending to call into question the *bona fides* of the payment.

The Investigation, by the terms and scope of its mandate, has not meant to establish evidence sufficient for any legal defense, claim or other measure that the Company determines to pursue. The task of making the relevant legal assessment, as well as undertaking any additional investigations that may be required to complete the necessary fact-finding, has in each case been conferred to other firms. The Company has established processes to ensure access to the findings of the Investigation.

Debevoise is issuing this Report to the Supervisory Board. The Supervisory Board, in conjunction with *Vorstand*, may decide to publish parts or all of this Report to certain constituencies with an interest in its contents. The publication decision is, however, for the Supervisory Board and the *Vorstand*. The limitations we have described are an integral part of this Report. Any further publication by the Supervisory Board of this Report in whole or in part must likewise include corresponding publication of the limitations that necessarily qualify the Investigation's findings.

II. COMPLIANCE SYSTEMS AND CONTROLS

This section addresses how Ferrostaal's systems and controls failed to prevent questionable or improper payments from being made after the law prohibiting corrupt payments to foreign officials (*Gesetz zur Bekämpfung internationaler Bestechung*, or "*IntBestG*") went into effect. As a general matter, the Company's senior management – in particular the *Vorstand* – did not develop and implement a comprehensive

strategy on how risks associated with payments to consultants could be identified, evaluated, managed and minimized. The *Vorstand's* response to the difficult compliance challenges faced by the Company's business after 15 February 1999 was, on the whole, inadequate.

This section sets out the *Vorstand*'s legal obligation to ensure that business is conducted lawfully, as well as the steps the *Vorstand* and other members of senior management took to promote compliance with anti-corruption laws. The evidence indicates that these steps did not sufficiently change the Company's culture and failed adequately to address the risk profile of the Company's operations. The *Vorstand* also missed important opportunities to take comprehensive and effective action to deal with specific circumstances that brought compliance issues to the fore.

This section does not provide a comprehensive analysis of all compliance violations identified during the Investigation or described in Sections III and IV of this Report. It does not seek to assess why each and every potential compliance violation occurred or to identify the precise weaknesses in the Company's controls and structures that failed to prevent to such violations. Rather, it identifies the key red flags that came to the attention of the *Vorstand* but were not adequately addressed, as well as the structural issues that contributed to Ferrostaal's culture of compliance failings.

A. Management's Responsibility to Ensure Lawful Business

Under the rules of proper business management of the Stock Corporation Act (*Aktiengesetz*), the *Vorstand* has to establish and maintain an effective compliance organization. The *Vorstand* is not required to establish or oversee every detail of the compliance program, but it does have to promulgate policies and compliance guidelines, oversee that the compliance organization ensures their appropriate enforcement, monitor whether employees adhere to them and correct deficiencies if needed.

To fulfill its general obligation to establish and oversee a compliance organization, the *Vorstand* is required to analyze the particular compliance risks faced and to develop measures to eliminate them. An effective compliance organization would thus take into account whether the Company was at particularly high risk of compliance violations by virtue of the business it engaged in, its size, its decentralized organizational structure, its operations in high-risk countries and its past practices.

To fulfill its general obligation, the *Vorstand* must also demonstrate commitment to the compliance program; assign responsibility for the compliance organization to individuals invested with real authority; create a suitable system for reporting compliance violations; provide adequate resources, training and supervision for the compliance organization; and ensure that compliance officers are not burdened by conflicts of interest. Finally, the *Vorstand* is also responsible for developing an

effective control system that makes clear to employees that compliance violations would be detected and adequately disciplined.

B. Development of Compliance Systems and Controls

Set out below is an overview of the key compliance systems and controls in place at the Company during the Report period. As discussed in Section II.C. below and detailed in Sections III and IV, these measures proved insufficient in themselves to prevent compliance violations.

1. Initial Responses to Changes in German Law

In January 1999, the then CEO wrote to the *Vorstand* and to the heads of the business units and subsidiaries about the imminent implementation of the *IntBestG*. According to the memorandum, responsibility for addressing the new law rested with the *Bereichsvorstände* and the subsidiary heads, who were to coordinate with the business units. The CEO's memorandum specifically referred its recipients to an attached analysis by the then head of Legal indicating that the new law applied both to payments made pursuant to agreements entered before the change in the law and to payments made indirectly via third parties.

In April 1999, the then CFO circulated a memorandum setting out new procedures for the payment of commissions in view of the recent introduction of the *IntBestG*. According to the memorandum, a commission payment was to be made only if the underlying agreement was memorialized in writing, approved by the responsible *Bereichsvorstand* and filed with Accounting, which was to use the information therein to check against the corresponding payment request. The memorandum also conditioned payment on proof that the recipient had performed services.

In a follow-up memorandum in May 2001, the CFO updated the procedures to require that the underlying agreement be submitted for approval before it had been signed, that it be accompanied by the answers to a 21-point questionnaire (requesting information on the consultant's qualifications, organization, shareholders and beneficial owners) and that it be cleared by the CFO in addition to the *Bereichsvorstand*. The memorandum also called on the business units to document correspondence with the consultant or, in the absence of written communications, to document regularly the consultant's activities. The memorandum advised that Tax, pursuant to its responsibility for verifying the deductibility of commission payments, was to inspect such records. In addition, Tax was to ask responsible employees (i.e., those who had signed the consultancy agreements or payment authorizations) to sign a declaration that they had no indication that the commissions were to be used in violation of the *IntBestG*.

By late 2001, the CFO and the respective *Bereichsvorstände* were routinely consulting Tax and Legal in connection with their review of consultancy agreements.

The involvement of the two departments was cemented in the January 2002 edition of the organizational guidelines (*Organisationsrichtlinien Anweisungsberechtigungen*), which required that consultancy agreements be cleared by Tax and Legal in addition to the two *Vorstand* members. By virtue of its inclusion in the organizational guidelines – a set of rules issued by the *Vorstand* to govern the Company's commercial dealings (e.g., the approval of projects, the assumption of certain risks and the authorization of payments) – the new procedure became binding on Ferrostaal AG and generally on its subsidiaries.

2. Key Elements of Ferrostaal's Compliance Systems and Controls

By January 2002, three years after the CEO's memorandum concerning the changes in the law, Ferrostaal's anti-corruption policies and controls were largely in place. Except for comparatively minor modifications such as the ones discussed below, this basic configuration of directives, procedures and resources remained essentially unchanged until the introduction of MAN measures in 2008–2009.

For most of the decade, Ferrostaal had no central mechanism for the detection of compliance risks. Instead, it relied on a combination of functions that had been assigned compliance-related responsibilities but were principally focused on other Company interests: Accounting, Legal, Tax, MAN Internal Audit, the business unit heads and the *Vorstand*.

(a) Accounting

The former CFO's April 1999 memorandum made Accounting a key part of the Company's early anti-corruption measures. Although its prominence waned with the development of the consultancy agreement approval process, which made Tax the default central location for the contracts and the initial reviewer of proof of consultant performance, Accounting remained responsible for a number of important internal controls. The effectiveness of those controls, however, depended largely on cooperation from other units at the Company whose adherence to compliance-related procedures was inconsistent.

For example, in order for Accounting to fulfill its responsibility for ensuring that each commission payment corresponded to the terms of the consultancy agreement and to evidence of the consultant's performance, it naturally required the respective business unit to provide such information. It appears, however, that business units did not reliably do so. In 2001, for example, the then CFO reported to subordinates that an examination of commission payments had identified multiple instances in which the business units had failed to provide the required documents. An audit more than six years later had similar findings.

Evidence of the consultant's performance was a particular issue, with documents and numerous interviews indicating that the business units had no set standards for maintaining such material and, in many instances, did not do so at all.

Although "proof of performance" was a focal point of Ferrostaal's anti-corruption measures from 1999, it appears that the Company did not formally define the term with respect to consultancy agreements until 2008. In 2005, when the concept first appeared in the organizational guidelines in connection with service contracts generally, it was presented as a requirement that could be satisfied simply with the written instructions for payment by a manager with the appropriate level of authority. Accounting seemed to have arrived at the same standard. As commission payment request records suggest, business unit managers apparently satisfied the proof of performance requirement by putting the request in a signed note and sending it to Accounting.

By 2002, Accounting's main compliance-related role appears to have been assessing the creditworthiness of new creditors through public searches (*Kreditauskunft*). Although the checks were not specifically focused on potentially corrupt payments – Accounting had performed this task even before 1999 – they gave Ferrostaal AG a measure of control over commission payments requested by subsidiaries such as FIA that were not using the parent company's internal approval process but were using its accounting system. In such cases, Accounting could send the new creditor-consultant to Tax for review even though Tax had no formal role in the subsidiary's consultancy agreement approval process.

According to the former head of Tax, Accounting was the function best positioned to detect consultancy payments disguised as compensation for other kinds of services, such as technical assistance or material delivery, as it had access to all of the Company's payment streams. Tax, by contrast, reviewed only consultancy agreements and certain agency agreements. The former head of Tax recalled that Accounting was not tasked with testing for creditors paid both for consulting work and other services. The Investigation also found indications that, at least in the early 2000s, Accounting controls would not necessarily have detected that Ferrostaal was making commission payments to a consultancy firm at the same bank account that the Company had previously used to make payments to a different consultancy firm.

(b) Legal

The Company's organizational guidelines called for Legal to review consultancy agreements for their "*legal compatibility.*" As with the Accounting creditworthiness check, the legal compatibility check was a compliance-related responsibility carved out of a responsibility that Legal had been performing all along. Separate sections of the various guidelines issued from 2000 to 2008 described Legal's general responsibilities in reviewing all agreements for their validity and their adherence to the model contracts. A former head of Legal stated in an interview that he approached all the contracts he reviewed in this way, including the consultancy agreements. In those cases, he typically checked whether the contract included the anti-corruption clause provided by the model contract and was otherwise well-drafted. But he did not perform any further red-flag analysis. A member of Legal at FIA

stated in an interview that the consultancy agreement approval process used by the Geisenheim subsidiary assigned Legal no compliance role whatsoever.

Beyond its role in the consultancy agreement approval process, Legal had other responsibilities that touched on compliance. Members of Legal prepared the template for consultancy agreements that was distributed when the review process became part of the guidelines in 2002 and lectured occasionally on anti-corruption laws. As Ferrostaal did not have its own internal audit system, Legal was sometimes also tasked with conducting internal investigations of compliance-related issues or overseeing such investigations by external counsel. Given that such special assignments came from the CEO, to whom Legal reported, there were, in some cases, inherent conflicts of interest which limited Legal's ability to investigate thoroughly and independently when the compliance issues potentially involved senior management. Legal was also asked to advise the Company as it faced corruption-related claims. As such claims affected the commercial and legal interests of the Company, the circumstances placed additional limits on Legal's possible role in investigating compliance violations.

(c) Tax

The Company's organizational guidelines called for Tax to review consultancy agreements for their "*tax compatibility*." The former head of Tax stated in an interview that his chief concern in such review was ensuring tax deductibility. As such, Tax appeared to have been primarily focused on being satisfied that the agreements did not indicate possible violations of the *IntBestG* and that there was sufficient proof that the stated payment recipient was providing genuine, business-related services and could be identified with precision (*Endempfängerbenennung*). As suggested by its detailed questionnaires and requests for employee certifications, Tax's focus on identifying signs of potentially criminal conduct made it one of the more assertive elements of the Company's internal controls system.

At the same time, and as the former head of Tax acknowledged, Tax's principal interest was to avoid attracting attention in the *Betriebsprüfung*, not necessarily to detect and prevent non-compliant conduct. Although compatible to an extent, the two interests were sometimes in tension with each other. For example, in one memorandum to the business units on the practical consequences of the *IntBestG*, the former head of Tax, after making the usual pronouncements about the importance of proof of performance, advised that "*tax risks associated with proving the identity of the end recipient could be avoided, in appropriate cases, by entering into a consortium with the commission recipient. In that case, payments to the consortium partner are not registered on our books, since they are made directly to the partner by the customer.*" As Sections III and IV illustrate, Ferrostaal employees found several different ways to make payments that posed clear compliance risks but were unlikely to create difficulties in the Tax approval process. At FIA, for example, project calculation sheets for a project in Iran indicated that the head of Industrial Plants was aware of a business partner's detailed plans to pay *Nützliche Aufwendungen* that

would have been opaque to the *Betriebsprüfung*, even if they had ultimately come from FIA's consortial share.

There are other ways in which tax and compliance interests may have diverged. A review system oriented around avoiding further scrutiny by the *Betriebsprüfung* may become excessively formalistic, thereby skewing the compliance risk assessment. One interviewee recalled that at Ferrostaal, a commission of 3.5% was widely known to be the upper end of the acceptable range, with anything higher more likely to attract the attention of the tax authorities in an audit. Agreements submitted for approval with commissions higher than 3.5% apparently underwent more scrutiny from their reviewers. The Investigation came across a striking number of consultancy agreements at the Company that, seemingly regardless of the volume of the project or the services involved, had commissions of exactly 3.5%. Although from the perspective of Tax, the risk of the various agreements may have been relatively similar, the underlying compliance risks were likely very different depending on substantive red flags. Similarly, one interviewee stated that one reason why the Cedico payment system at FIA escaped attention for so long was because tax auditors tended to work by running searches on SAP for codes for certain expenditures, such as commission payments, rather than by other identifiers, such as names. He recalled that even though the consultancy payments to Cedico were exhaustively audited, the *Betriebsprüfung* never learned that Cedico also received payment for material deliveries, which were coded as third-party goods. An internal tax review similarly focused on consultancy agreements to the exclusion of other kinds of arrangements may have been well-prepared for the challenges posed by the *Betriebsprüfung* but not necessarily the risks posed by commercially sophisticated employees determined to make questionable payments.

As discussed above with respect to Accounting, Tax's effectiveness as a compliance control largely depended on access to records of consultant activity maintained by the business units. The former CFO's May 2001 memorandum called for Tax to conduct random checks of the business units to ensure proper maintenance of such records. It is unclear why such checks apparently were rarely, if ever, carried out. Some years later, the Company commissioned BDO AG to prepare a report on the organizational measures and formal guidelines that it had used from 1998 to 2002 to identify potentially non-deductible commission payments. The 2005 report, which found that Ferrostaal's measures and guidelines had generally been adequate in the period reviewed, recommended that Ferrostaal maintain a list of all consultancy contracts concluded within a financial year to facilitate random checks. The recommendation was not implemented.

(d) MAN Internal Audit

Ferrostaal did not have its own internal audit function and relied instead on MAN Internal Audit, whose approximately 15 auditors (five tasked with compliance) were shared with other MAN Group companies. MAN Internal Audit reportedly performed over 200 audits at Ferrostaal between 1999 and 2009. While some of these

audits touched on compliance issues (e.g., a 2005 audit examining possible misappropriation of funds in Venezuela identified weaknesses in internal controls), the first audit expressly tasked with investigating possible bribery or assessing anti-corruption measures apparently only took place in 2007. The report of that audit identified numerous weaknesses in the controls at Ferrostaal AG and FIA, including the lack of a uniform standard for proof of performance, and concluded that the Company had "*no comprehensive strategy*" on how the risks associated with third-party contracts could be detected and managed. The report indicated that the then CEO was responsible for implementing its recommendations.

(e) Business Unit Heads

The role of the business unit heads in compliance matters appears to have been limited in the period from 2002 to 2008 to ensuring that the consultancy agreements they entered contained the anti-corruption clause recommended in the template provided by Legal.

(f) *Vorstand*

Debevoise was able to interview only one former *Vorstand* member. The information he provided indicated that the topic of compliance was dealt with by the *Vorstand* as a collective decision-making body. He identified the above-mentioned checks by the CFO and Tax as the main instances in which such *Vorstand* discussions were triggered.

The exact role of the *Bereichsvorstand* in the consultancy agreement clearance process was relatively undefined. The approval process itself underwent relatively minor modifications in April 2005, when revised guidelines provided that Tax and Legal were to review the agreement before the *Bereichsvorstand* and that the CFO and CEO would become involved only if Tax or Legal disapproved of the proposed agreement. The November 2005 guidelines maintained the review responsibilities of Tax and Legal but shifted responsibility for approval of smaller commission payments from the *Bereichsvorstand* to the business unit heads. Contracts with commission payments of less than €100,000 in the aggregate would merely require notification of the *Bereichsvorstand* but not his express consent; contracts with commissions exceeding €100,000 in the aggregate continued to require approval from the *Bereichsvorstand.*

In February 2006, the management board of MAN issued a "Code of Conduct" that set out a basic behavioral codex, including anti-corruption policies, applicable to all employees of the MAN Group. In a circular, the Ferrostaal AG CEO at the time informed employees of the promulgation of the Code of Conduct and summarized its external and internal goals. The Code of Conduct replaced a set of business conduct guidelines, also with anti-corruption language, that Ferrostaal had issued in 2000.

The CEO encouraged employees by way of the circular to approach a newly created body responsible for ensuring adherence to the Code of Conduct, the MAN Compliance Board. Representatives of the Compliance Board would be available to answer questions about the Code of Conduct and to receive reports of compliance violations on a confidential basis. We saw no evidence that the MAN Compliance Board substantively addressed any of the questionable and potentially illegal compliance practices subject to our Investigation.

In November 2006, the Siemens bribery scandal was widely reported in the press. In its first meeting thereafter, on 14 December 2006, the *Vorstand* resolved: "*The work of the MAN Ferrostaal Vorstand focuses on the observance of the Corporate Governance Codex. Over-invoicing and slush funds [schwarze Kassen] are not supported by the Vorstand and are not permitted. The Vorstand points out to all business unit heads that the Code of Conduct of MAN needs to be adhered to. [The director of Legal Services/Legal] is responsible to continuously examine in coordination with the Compliance Board of the MAN, whether the existing systems at MAN Ferrostaal are sufficient in order to prevent improper conduct or whether additional measures are necessary.*" We identified no evidence that the director of Legal Services or any other member of Legal performed such examinations.

3. MAN Compliance Measures Applicable to Ferrostaal

Express incorporation of MAN's "Anti-Corruption Guideline" in September 2008 reinforced the principles and requirements for consultancy contracts, such as due diligence to verify the consultant's identity, integrity and experience. One notable feature not apparent in prior Ferrostaal guidelines was a provision mandating that consultancy agreements contain a clause requiring the consultant to provide documents evidencing the services rendered. Where breaches of fundamental contractual obligations were found and, in particular, where compliance-related failures were apparent, the MAN Anti-Corruption Guidelines required the consultancy contract to be terminated.

The former head of Legal was given the title of chief compliance officer as late as 2008 but we found no evidence that he actually undertook additional compliance functions after that date. The Investigation did not find evidence that individual business units or regional subsidiaries appointed group or local compliance officers.

Until the introduction of an "e-learning tool" in the spring of 2008, Ferrostaal offered no systematic anti-bribery training to its employees. Prior to that time, compliance training – other than occasional speeches on the topic – appears to have been limited to top management and employees with a commercial power of attorney (*Handlungsbevollmächtigte*). The extent to which compliance training was indeed implemented on a large scale for Ferrostaal employees is unclear; according to the minutes of the Compliance Board meeting on 18 June 2008, only 73 Ferrostaal employees would undergo compliance training in 2008.

The absence of more regular and expansive compliance training opportunities in view of an anticipated discussion on intensified training had been discussed in May 2007 in an e-mail exchange involving the former head of Legal and several former *Vorstand* members. Responding to the former CEO's proposal to advocate before the MAN Compliance Board training for a limited group of employees every two years, the former head of Legal (and Ferrostaal's representative to the Compliance Board) opined that such a proposal would likely be viewed as inadequate. The e-mail, when read against the backdrop of Ferrostaal's very limited compliance training at the time, highlights management's lack of emphasis on this topic.

C. *Vorstand* Awareness of Red Flags

What makes the *Vorstand's* purported discharge of its duty to ensure compliant business through the measures set out above even more lacking in substance is the fact that *Vorstand* members must have known that there was a real risk that Ferrostaal managers were continuing to make improper payments and taking steps to conceal them. Ferrostaal's business, or at least substantial parts, should have been classified as "high risk" and thus have led to enhanced compliance measures.

Bribery had occurred at Ferrostaal prior to 1999. It was the recognition of precisely that fact that led to the adoption of the 1999 memorandum from Legal – discussed above – which pointed out that bribe payments under contracts concluded before 1999 must no longer be effected. Moreover, numerous press reports, investigations, office raids and other red flags had pointed to potentially corrupt business practices at Ferrostaal which should have raised the *Vorstand's* level of awareness of the continuing risk of corruption. Compounding the *Vorstand's* awareness of substantial historical and ongoing compliance risks, a limited group of employees (principally the former CFO and the former head of Tax) and advisors routinely raised questions regarding the tax deductibility of consultancy payments, starting in 2000, thus bringing these payments and some of the problematic issues surrounding them to the attention of the *Vorstand*.

The *Vorstand* failed to investigate those red flags and its response, from a compliance perspective, to identified issues was on the whole either inadequate or non-existent. The list of such individual red flags brought to its attention – from external and internal sources – is indicative of the *Vorstand's* passive approach and shows how the Company missed opportunities to identify and cure compliance problems and thus to prevent them from reoccurring in the future.

- In October 1999, *Spiegel* reported that Ferrostaal, in 1993, had paid DEM 200,000 in bribes to Bacharudin Habibie, the trade secretary of Indonesia (and later its President). Such payment had been made in connection with the assignment for improvement of a steelworks in Indonesia and was processed through accounts in Liechtenstein. *Spiegel* published the corresponding payment document. The review of the Indonesia business shows that internal payment records dating back to the 1990s identified payments to entities

associated with Habibie as *Nützliche Aufwendungen* (see Section III.C.1). Debevoise saw no evidence of any form of a Company internal investigation into the issue, as a result of the *Spiegel* article or otherwise.

- On 28 May 2001, three *Vorstand* members (the then CEO, the then CFO and the then *Bereichsvorstand* for Marine) met with the then head of Tax to discuss commission payments to MIE, the Company's Greek agent. When the head of Tax raised the point that the volume and modality of payments might trigger investigations by the public prosecutor, the CEO agreed that such investigations could not be excluded due to the change in law: "*In light of the new legal environment we can indeed not rule out investigative proceedings by authorities in the future. However, Ferrostaal needs to confront this situation.*"[7] The CEO's conclusion, to the effect that Ferrostaal simply had to face such risk, in conjunction with his position that the issues raised by the former head of Tax regarding the high level of commission payable to MIE were not serious enough to renege on the payment, which he had personally promised to MIE, are indicative of how objections raised through the internal controls mechanisms were simply swept aside by the *Vorstand*. This incident, together with similar examples of *Vorstand* discussions about subsequent payments to MIE (see Section III.A.1), also show the clear limitations of the allegedly collective decision-making process on compliance matters that the former *Bereichsvorstand* (present in those discussions) described.

- On 21 April 2002, the *Handelsblatt* reported allegations that Ferrostaal had paid bribes to Sani Abacha, the Nigerian dictator. Ferrostaal had been awarded a contract for the construction of an aluminum smelting works in Nigeria in the 1990s. This project triggered office raids at Ferrostaal in August/September 2004 based on allegations that a former Ferrostaal employee had received improper payments from Nigerian parties and prompted investigations by prosecutors in Bochum against the former CEO for aiding and abetting a breach of fiduciary duty.

- A 27 November 2002 memorandum by the future head of Marine to the then CFO identified irregularities with respect to payments to an offset consultant used in connection with the Greek submarine project, including that that the commission percentage due to the consultant was not fixed but in a range and that two payments had been made on the basis of an oral agreement. The record does not reveal any form of follow-up to this memorandum. Instead, Ferrostaal proceeded to make payments of approximately €7.48 million between 2002 and 2004 to the offset consultant, PDM Ltd., and its allegedly affiliated entity, Zelan Ltd. The nature and purpose of the arrangement, the

[7] "*Auf Grund der neuen Rechtslage können Ermittlungsverfahren in Zukunft tatsächlich nicht ausgeschlossen werden. Dem muss sich Ferrostaal aber stellen.*"

payment modalities and the complete lack of documented proof of performance by the consultants raise serious concerns (see Section III.A.1(d)).

- In connection with the sale of a tug boat to the Egyptian Suez Canal Authority, employees of Merchant Marine made an oral agreement with the Company's Egyptian agent to increase its commission percentage (see Section III.A.5). Upon learning of this increase, the then CFO and the then head of Tax pointed out the incompatibility of the pre-existing agency agreement with the orally arranged commission, which was justified to the CFO on the basis of higher project costs. To respond to the CFO's concerns, Merchant Marine entered into an addendum to the original agency agreement in February 2003 specifying the higher commission percentage, but by then the payment had already been made based on the oral agreement. There was evidently no effort by the Company to probe the substantive legitimacy of the increased commission percentage or, indeed, to question why a payment had been made based on an oral agreement.

- On 23 December 2003, *Financial Times Deutschland* reported on the conviction of a British businessman by a Swiss court for money laundering. According to this report, the court found that Ferrostaal had made DEM 20 million in payments to a bank account belonging to Abacha. In connection with the case, Essen tax authorities obtained a warrant to search Ferrostaal headquarters in 2004. Debevoise saw no evidence of an internal investigation into this issue as a result of the adverse press reports or the tax authority search.

- In February 2008, the then head of Tax requested that the heads of Ferrostaal's business units declare that they were not aware of non-deductible payments between 2006 and 2007 and certify that their respective business units were in compliance with applicable laws and regulations. The former head of Merchant Marine signed the declaration only pertaining to the issue of tax deductibility but omitting the entire second paragraph of the declaration. The head of Tax, according to a handwritten note on the declaration, decided not to address this issue with the head of Merchant Marine because he considered the refusal not to be "*overly significant.*" In our interview, the head of Merchant Marine said that he informed the responsible *Bereichsvorstand* that the certification as drafted would require him to ignore payments in Argentina, Indonesia and Thailand. Because he did not want to certify a falsehood, he substantially changed the declaration. According to the head of Merchant Marine, others in Marine likewise refused to sign the certification in the manner requested, something that we have not been able to verify. No action was taken in response, nor did a substantive review of payments in the business unit occur as a result.

- On 10 September 2004, the Trinidad & Tobago State Anti-Corruption Investigations Bureau raided the offices of CNC Limited in Trinidad and

confiscated correspondence relating to its fiscal incentives and gas contract with the National Gas Company of Trinidad & Tobago. CNC Limited was a project company in which Ferrostaal had a share and on whose board the then head of Petrochemicals sat. Debevoise identified no evidence that the Trinidadian raid led to an examination by Ferrostaal of its business practices or contracting and payment arrangements on the project, even though the then CEO and the then head of Legal obtained press reports regarding the raid.

- On 27 October and 15 November 2004, respectively, the former CEO, the former head of Marine and a former *Vorstand* member responsible for Marine were questioned as witnesses by Düsseldorf prosecutors investigating allegations involving payments by HDW (and possibly Ferrostaal) to Sotiris Emmanouil, the president of Hellenic Shipyards ("HSY"). The witness statements were sent to and kept by the former director of Legal Services. While it appears that Ferrostaal played no role in the payments from HDW to benefit Emmanouil – having rejected a "Heads of Agreement" proposed by HDW in the fall of 2001 that stipulated payments to a company affiliated with Emmanouil – Ferrostaal did in fact pay that same company approximately €2.2 million in 2002 via MIE. Neither Legal nor anyone else at Ferrostaal took steps to investigate the allegation of Ferrostaal's involvement in such potentially corrupt payments. Had they done so, they might have discovered that at least one person at the Company at the time, the new head of Marine, had confirmation of the payments to the entity in question (see Section III.A.1).

- On 19 June 2006, Düsseldorf authorities raided Marine offices on the suspicion of bribery of South African officials in connection with the sale and supply of four corvettes to the South African Navy.

- On 16 February 2007, the tax auditor of the Düsseldorf public prosecutor recommended that criminal proceedings be instituted against as-yet unknown individuals at Ferrostaal for tax evasion in connection with payments to Mallar Inc., a consultancy firm engaged on the South African submarine project. The matter was later passed to prosecutors in Bochum. The former CFO was a suspect in these proceedings before they were halted due to insufficient evidence of bribery. Debevoise saw no evidence that Ferrostaal's consultancy arrangements on the South African submarine project were subject to any form of internal compliance review or examination as a result.

- On 3 April 2006, a lawyer from Simmons & Simmons delivered a presentation to the *Vorstand* on third-party contracts in international sales. He focused on certain key issues, including anti-bribery laws and the consequences of their violation. With respect to examination by the *Betriebsprüfung*, the lawyer pointed out the necessity of having sufficient documentation of services and recommended that the Company not make payments to offshore accounts. The potential misuse of consultancy contracts to facilitate bribe payments was

clearly illustrated in three hypothetical scenarios. This did not prompt the *Vorstand* to order a detailed examination of whether such violations had occurred at Ferrostaal, despite the fact that the Company used an extensive network of consultants throughout the world.

- In 2006 and 2007, Dolmarton made renewed claims for payment of significant outstanding commissions relating to the Greek submarine project. Following the departure of the former *Bereichsvorstand* and the former head of Marine, the issue of third-party payments made on the project via MIE had been the subject of enquiries made by the new head of Marine in 2004. The initial review and the subsequent investigation through external advisors in 2006–2007 were inadequate and fundamentally flawed, at least as regards their compliance-related remit (see Section III.A.1).

- In the spring of 2007, the then CFO retained KPMG to conduct an analysis of Ferrostaal's creditors based on its accounting data. Although KPMG found no firm indications of wrongdoing, it noted a number of risks – including a striking number of Ferrostaal creditors associated with offshore jurisdictions or in countries prone to corruption – that possibly presented "*grounds for concrete investigation.*" While the then CFO ordered additional testing of some individual creditors, Debevoise saw no evidence that the report led to changes in the way that new creditors were to be evaluated by Accounting.

- In 2007, a MAN Internal Audit report found serious compliance defects at FIA, including no systematic controlling of consultancy contracts, poor documentation and violations of the "four eyes" principle. Shortly after the audit report was released, the head of Tax asked FIA representatives to provide assurances that Samir Mhana, a Libyan consultant specifically cited in the report as an example of inadequate proof of performance, actually had provided legitimate services. After initially responding that Mhana was an "*information dealer*" who provided information to FIA orally (therefore "*[p]roof of performance cannot be documented*"), FIA employees proceeded to generate backdated reports purporting to document Mhana's performance over the previous two years.

- A 2007 MAN audit of Ferrostaal's Venezuelan subsidiary uncovered evidence of possibly corrupt consultancy payments and substantial internal controls weaknesses in connection with the Termozulia I project. The former CEO's response to MAN's report, namely to commission a "Special Audit" with a questionable remit, is described in Section III.B.1.

- In 2008, MAN Internal Audit reported to the *Vorstand* that it had uncovered evidence and an admission of private-sector bribery by an employee in the trading division of the Indonesian local company. The employee in question was subsequently terminated, but no further investigation of the business in question or, indeed, the Indonesian business more generally, occurred.

- In October 2007, the then CFO of FIA asked the CEO, CFO and *Vorstand* member responsible for FIA then at Ferrostaal AG to approve an apparent agreement between FIA and tax authorities pursuant to which DEM 981,084 in Libyan commission payments in 1997, 1998 and 2001 would not be considered tax-deductible in exchange for assurances that the issue would not be forwarded to prosecutors. Accompanying the former FIA CFO's request was a memorandum noting that FIA had declared some of the pre-1999 payments to be *Nützliche Aufwendungen* and had been unable to convince auditors that a number of the other payments had actually been destined for the stated recipients. The *Vorstand* members acquiesced in the agreement. The Investigation found no indication that the *Vorstand* members enquired into the background of the payments or whether FIA had improved its documentation of consultancy arrangements in the interim.

- The *Vorstand's* failure to take appropriate action in light of problematic statements by a former manager and later CEO of the local company in Indonesia in May 2009 has already been set out in Section I.C.3.

In summary, no specific investigations were launched into events that came to the *Vorstand's* attention and no specific questions were raised as to whether the compliance systems were adequate to address the challenges posed. The Investigation identified no evidence that the *Vorstand* performed a risk assessment to evaluate whether further measures were required. Similarly, we received few indications that specific measures responsive to any of these red flags or, indeed, the potential compliance violations outlined in the remainder of the Report, were taken.

III. DETAILED INVESTIGATION FINDINGS: ESSEN

A. Vessels

1. Submarines Greece

(a) Projects Investigated

Building on the work performed in Phase I, Debevoise analyzed payments from Ferrostaal to its Greek agent, MIE, and other third parties in connection with the two Greek submarine contracts of the German Submarine Consortium ("GSC").

The *Archimedes* contract was signed on 15 February 2000 and has a volume of approximately €1.14 billion, of which approximately €263.2 million represented Ferrostaal's share. Under the contract, the GSC was to deliver material packages for three Type 214 submarines to HSY in Greece, with the fourth submarine to be built at HDW's shipyard in Kiel. The consortium also incurred associated offset obligations in the amount of €1.53 billion.

The *Neptun II* contract involved the modernization of three Type 209 submarines at HSY, with an option for a fourth submarine. The contract was signed on 31 May 2002 and has a volume of approximately €469.4 million, of which approximately €43.8 million is attributable to Ferrostaal. Offset obligations in relation to this contract amounted to €563 million.

(b) Metrics

During Phase II, Debevoise interviewed eight current or former Ferrostaal employees in connection with the Greek submarine projects, including one former *Vorstand* member. A number of key former employees who were approached declined to be interviewed. Debevoise also interviewed certain third parties, including Yannis Beltsios, a consultant; Anthony Chagias, a former employee of MIE; Dr. Aldenhoff of Simmons & Simmons; Oliver Schulz of Control Risks; and David Way, an English attorney who represented a group of individuals who asserted claims against Ferrostaal in 2004, with whom we spoke briefly by telephone. While we contacted many of the other third parties involved in the Greek submarine projects (most notably Michael Matantos), the attempts to interview them were unsuccessful.

Debevoise reviewed electronic data and substantial hard copy files, including more than 60 binders that had been confiscated by the Munich Prosecutor. Debevoise also reviewed materials provided as a result of the Company's access, late in the Investigation, to the Munich Prosecutor's investigation files (*Akteneinsicht*).

(c) Background and General Observations

The story emerging from the evidence of the non-transparent third-party payments from Ferrostaal via MIE to the "prayer circle" (*Gebetskreis*[8]) – a mysterious group of allegedly highly influential and well connected consultants and lobbyists – is complex, confusing and at times contradictory. Nearly 70 protocols of witnesses and accused taken by the Munich Prosecutor – including current and former Ferrostaal employees, consultants, former managers of HDW and other business persons – have produced an almost equal number of different theories and explanations of the rationale and justification for the payment arrangements and some of the individual payments, as well as of the roles of the individuals involved.[9] The Greek third-party payments are at the heart of the Munich Prosecutor's investigation against Ferrostaal. The account in this Report does not purport to be a comprehensive analysis of the

[8] The former head of Marine interchangeably used the term "Team A" to describe the same group of individuals. Throughout this Report, we refer to the group by the term *Gebetskreis*.

[9] For example, the differing characterizations of the role of Alexandre Avatangelos, purportedly a key figure of the *Gebetskreis*, are striking: the former *Bereichsvorstand* did not mention him as part of the *Gebetskreis*; the former head of Marine attributed to him a central role and referred to him as "*Big Alex*" (*der große Alex*); MIE's Matantos denied having heard of him and Hermann Graf von Pückler, said to be himself a member of the *Gebetskreis*, did not consider Avatangelos to be part of the circle.

entirety of the evidence and, in particular, does not exhaustively analyze the wealth of evidence available as a result of the *Akteneinsicht*.

Instead, this section describes the two focal points of Debevoise's investigative approach, as it was informed by the totality of the evidence (as and when it became available) but also inevitably limited by the inaccessibility of some of the key protagonists due to the parallel investigation by the Munich Prosecutor. *First*, we analyzed the payments from Ferrostaal to MIE and sought to identify, to the extent possible, the third-party recipients who received the approximately €55 million forwarded by MIE, in order to establish the likely nature and purpose of those payments. *Second*, we reviewed the Company's own investigative efforts, including in connection with the repeated claims by Alexandre Avatangelos, an alleged *Gebetskreis* member, in order critically to assess the implications that may be drawn as to the Company's approach to compliance. We scrutinized the role of the *Vorstand* and central functions in evaluating the Company's actions in this highly contentious matter that culminated in the €11 million settlement payment to Dolmarton in 2007. In addition, we also reviewed the evidence of MIE's own performance, which confirms that – in addition to performing the role of payment intermediary – MIE provided genuine and extensively documented consultancy and representation services.

What emerges from this review is the likelihood that at least some of the third-party payments were intended for corrupt or other criminal purposes. Notwithstanding claims that the *Gebetskreis* provided genuine and legitimate consultancy or lobbying services, the extent of obfuscation in diverting more than €55 million to largely unidentified third parties without a documented contractual basis suggests that improper motives may, to a large extent, have been at the root of the payments. In repeated testimony to the Munich Prosecutor, the two protagonists responsible for selecting the recipients and organizing the payments – the former *Bereichsvorstand* and the former head of Marine – conceded the distinct possibility, and indeed likelihood, that the payments were used, at least in part, for corrupt purposes:

> *We all knew that if it was necessary to forward money to decision-makers, this would be done. I did not want to know from Mr. Demirdjian how much and whom he paid.*

> *We did not concern ourselves much with what Team A was going to do with all this money at the time we made the contractual arrangements, notwithstanding the suspicion that public officials might benefit from the funds. This happened before 1999 and thus was not a big issue.*

> *I can't tell you to whom monies might have been paid. We did not know whether the defense minister or the economy minister received something. Frankly, we were not interested in that. We never wanted to know that.*

It was clear to me that, if necessary, money would be passed on. And it was acceptable to me if this were to happen.

I don't know how much of their compensation the consultants passed on. It is evident that they likely passed on a portion of their funds. We did not talk about who received these funds. I agree with you in assuming that these people passed on a portion of their fees, in accordance with the existing usages in Greece.

Although the precise roles and functions of the third parties remain murky, it appears that the British-Lebanese businessman Ago Demirdjian and the German businessman Hermann Graf von Pückler initially played key roles in arranging for Ferrostaal's contacts in Greece. Demirdjian and von Pückler, both accused (*Beschuldigte*) in the Munich Prosecutor's investigation, knew each other from business deals in Saudi Arabia and elsewhere. In approximately 1996 or 1997, they were approached by the then *Bereichsvorstand* for Marine as to whether they could recommend a group of advisors who could help Ferrostaal pursue a submarine project in Greece. Demirdjian recalled identifying Michel Filipidis, with whom he had done business in Saudi Arabia and who indicated that he knew the right people in Greece, most importantly Avatangelos. Filipidis and, in particular, Avatangelos thereafter emerged as Ferrostaal's principal advisors within this group, according to Demirdjian's testimony to the Munich Prosecutor.

Ferrostaal signed several contracts in 1997 with offshore entities associated with *Gebetskreis* members. Having allegedly determined in 1998 that contracts with offshore entities were no longer viable for reasons connected with the OECD Anti-Bribery Convention, Ferrostaal bundled its individual agreements with the *Gebetskreis* into one contract with MIE, on the understanding that MIE would distribute a share of payments it received from Ferrostaal to those offshore entities at Ferrostaal's instruction. The previous individual contracts between Ferrostaal and the offshore entities, three of which were said to have been deposited in a safe at UBS Zurich, were subsequently allegedly destroyed.

Ferrostaal's March 1998 agreement with MIE, under which MIE would receive a 7% success fee for assisting in the acquisition and execution of the *Archimedes* contract, thus also encompassed the commissions due to the *Gebetskreis* entities. Following a 4% agreement with MIE in 2002 pertaining to the *Neptun II* contract and related offset obligations, Ferrostaal managed to reduce the overall commission percentage due under the MIE contracts to 5% pursuant to a final agreement in October 2003 that replaced all prior contracts. In sum, payments from Ferrostaal to MIE totalled €83.97 million between 2000 and 2003, of which approximately €55.1 million was forwarded by MIE to third parties.

In various meetings in early 2004, Avatangelos asserted claims against Ferrostaal for further payments. The claims were rejected by the new head of Marine for lack of evidence of a contract and of services rendered. Two years later, through his offshore entity Dolmarton, Avatangelos claimed outstanding payments of €52

million (later increased to €66.5 million) and threatened to submit a detailed complaint against Ferrostaal to the Essen district court (*Landgericht*). With the tacit agreement of its former consortium partner, Ferrostaal reached a mediated settlement with Dolmarton in July 2007 in the amount of €11 million.

(i) Third-Party Recipients

A principal focus of the Investigation was to ascertain the identities of the third-party beneficiaries. The starting point and key document in this regard is a list prepared by Michael Matantos, MIE's principal, which indicates amounts and dates of payments to two individuals and seven corporate entities (the "Matantos list").[10] Matantos provided the list to the then head of Marine in 2004. The Matantos list is reproduced below:

March 2000: YB – €1,000,000

10 April 2000: Georgios Agouridis – €1,000,000

13 June 2000: Asian & Middle Eastern Engineering & Consulting Inc. – €9,200,000

13 June 2000: Wilberforce Investments Ltd. – €11,500,000

5 July 2001: Asian & Middle Eastern Engineering & Consulting Inc. – €11,442,000

5 July 2001: Wilberforce Investments Ltd. – €7,500,000

4 January 2002: Inveco – €890,088

24 July 2002: Inveco – €1,390,603

31 October 2002: Rangiroa Holdings Ltd. – €3,355,000

5 December 2002: Morgan Stanley Ref. Kyros – €2,070,000

5 December 2002: Morelia Trading S.A. – €890,225

[10] Two further payments MIE is alleged to have forwarded to third parties are not included on the Matantos list: (i) €2.5 million to Dolmarton allegedly in cash to Beltsios; and (ii) €300,000 to Eurotechnik GmbH, an entity owned by von Pückler. As regards the first payment, although Dolmarton alleged in its draft claim of March 2007 to have received the funds through a cash payment from Matantos to Beltsios, the state of the evidence does not allow conclusive corroboration of that allegation. With respect to the second payment, documentary evidence shows that MIE indeed paid €300,000 via check to Eurotechnik GmbH on 14 June 2000. Matantos confirmed the payment in his testimony to the Munich Prosecutor and noted that he likely simply forgot to record the payment on his list. We include the payment in Category 2. Moreover, several payments contained on the Matantos list appear to have been paid out in foreign currencies. We have not attempted for purposes of our quantification to recalculate the currency exchange rates at the time the various payments were made. Instead, we are using the figure of €55.1 million as the sum of the third-party payments, as indicated on the Matantos list.

29 October 2003: Dolmarton Associated Inc. – €3,800,000

29 October 2003: Rangiroa Holdings Ltd. – €1,115,000

The list includes recipients who are not considered, based on testimony given to the Munich Prosecutor, to be part of the *Gebetskreis*, which suggests that Ferrostaal may have used MIE to conceal other payments. Due to the offshore locations of most entities on the list, it has been largely impossible for the Investigation to identify the individuals behind them. Ownership of three of the seven offshore entities has been claimed by *Gebetskreis* members. Demirdjian acknowledged to the Munich Prosecutor that he was a beneficial owner of Asian & Middle Eastern Engineering & Consulting Inc. Avatangelos, in the context of his legal dispute with Ferrostaal, declared himself to be the sole beneficial ownership of two entities, Dolmarton and Wilberforce Investments Ltd. Furthermore, Inveco Holdings S.A. ("Inveco") appears to be affiliated with Emmanouil, the former General Manager of HSY, who was not part of the *Gebetskreis*. The identities of the beneficiaries of the remaining entities remain largely unknown.

Although we identified no direct evidence that a portion of the funds paid to the entities and individuals on the list were intended or in fact used as bribes to Greek public officials in connection with the submarine contracts, the Investigation determined that three recipients were at least closely connected to or affiliated with influential Greek public officials: "YB" (Yannis Beltsios), Inveco and Georgios Agouridis. It is in connection with these three recipients (as well as Dolmarton, discussed in detail below) that the Investigation was able to make most progress.

(1) Yannis Beltsios

a. Contractual Basis

Yannis Beltsios is a Greek civil engineer who signed three consultancy agreements with Ferrostaal in 2000.

- On 28 February 2000, DSD Dillinger Stahlbau GmbH ("**DSD**"), a Ferrostaal subsidiary engaged in steel projects, entered into an agreement with Beltsios' company, Urbanica S.A., under which Urbanica would coordinate projects in Greece, in particular infrastructure works at HSY. Urbanica would receive a success fee of 3% for projects carried out by DSD up to a value of DEM 15 million. For projects exceeding a value of DEM 15 million, the remuneration percentage would be negotiated separately.

- On 10 October 2000, Ferrostaal and Kerkini Enterprises Ltd., a Cyprus-based Beltsios company, signed a success-based consultancy contract that pertained to infrastructure works at HSY.

- Also on 10 October 2000, Beltsios signed a second agreement with Ferrostaal in his individual capacity, pursuant to which he received a monthly retainer of

DEM 15,000 for support and consultancy on various projects in Greece. Beltsios was paid €314,725 under this retainer agreement between 2000 and 2003.

A former head of Marine who apparently prepared and then co-signed the two Ferrostaal contracts alongside the former *Bereichsvorstand* stated in an interview that he did not know the reason why Beltsios received two Ferrostaal agreements on the same day and merely recalled that this was the instruction he had received from the then *Bereichsvorstand* during a joint trip to Athens.

b. Pivotal Role Played by Beltsios

Although several former employees stated in interviews that they knew of Beltsios only as a civil engineer (*Bauingenieur*) who advised the Company in connection with the construction of an assembly hall at HSY, the evidence suggests that Beltsios' value to Ferrostaal greatly exceeded that narrow function. Indeed, he appears to have played a far more influential role in assisting Ferrostaal with the submarine projects at the governmental level. According to the draft claim of Dolmarton, Beltsios also served as a representative of Dolmarton – and thus a member of the *Gebetskreis* – and on one occasion allegedly even received funds in cash on Dolmarton's behalf.

Beltsios' single most important function, however, appears to have been his longstanding connection to Akis Tsohatzopoulos, the Greek defense minister at the time of the *Archimedes* award and the minister of development at the time of *Neptun II* and the privatization of HSY. The former *Bereichsvorstand* told the Munich Prosecutor that the minister even explicitly recommended that Ferrostaal use the services of Beltsios if it was interested in winning the submarine contract:

> *Mr. Beltsios was supposed to throw a rock into the water in order to create effects. We were interested solely in the relationships to certain people, which Beltsios had. Greek defense minister Tsohatzopoulos recommended Mr. Beltsios to us as someone who knows a lot of people and could possibly be useful for our purposes.*

Similarly, the former head of Marine stated that Beltsios knew the minister and arranged meetings between him and the Company:

> *Yes, we were aware that he knew the defense minister, Mr. Tsohatzopoulos. He also initiated and set up our meetings with Mr. Tsohatzopoulos.*

Significantly, former HDW CFO Hans-Joachim Schmidt, in his statement to the Munich Prosecutor, attributed even greater personal influence to Beltsios over the interactions between HDW/Ferrostaal and the former minister:

> *[Mr. Beltsios] was the person whom you had to tell what you wanted from Minister Tsohatzopoulos. He was mentioned to me as someone who would first check whether you would be admitted to Mr. Tsohatzopoulos.....He was, so to speak, the initial checkpoint for access to Mr. Tsohatzopoulos.*

The very limited documentary record from the period in question bears out Beltsios' influence at the governmental level in Greece even prior to the *Archimedes* contract award. Company records from 1999 ascribed to Beltsios detailed information concerning deliberations by the Greek government about anticipated offset requirements. Specifically, a memorandum from the then head of Marine referred to a telephone call between the *Bereichsvorstand* and Beltsios, in which Beltsios advised on the key components that needed to be included in the GSC's offset offer, based on a conversation with his "*little friend*" – likely referring to an official from the Greek offset directorate or, according to some witnesses, Yannis Sbokos, the then head of the Greek military procurement body, the General Directorate of Armaments. The memorandum also recorded Beltsios previewing an impending official meeting between the GSC and the "*little friend*" to discuss contractual details and to ensure timely coordination in case of a contract award. Finally, Beltsios was said to have invited the then *Bereichsvorstand* to Athens to resolve details that were not to be discussed over the telephone. The behind the scenes machinations alluded to in this memorandum are irreconcilable with Beltsios' role being confined to providing technical engineering advice.

Moreover, Company records suggest that Beltsios was present at crucial meetings in 2000 when the remuneration arrangements of the *Gebetskreis* were discussed. In particular, a travel expense report of the former head of Marine lists Beltsios as being one of the participants at a meeting at Hotel Imperial in Vienna on 26 March 2000, the same date and location where a payment schedule was, according to Dolmarton's 2007 claim, negotiated between Beltsios and the then *Bereichsvorstand* together with the then head of Marine. This payment schedule, memorialized in handwritten form on a hotel note pad, is one of the key pieces of evidence in the Munich Prosecutor's investigation.

Beltsios appears to have received extra-contractual payments. The initials "YB" on Matantos' payment list identify Beltsios as the recipient of €1 million in March 2000 – one month after the GSC was awarded the *Archimedes* contract. Matantos and the former head of Marine, in a statement to the Munich Prosecutor, recalled that the payment was intended as a bonus from Ferrostaal. Although no such entry is found on Matantos' list, Beltsios is also alleged by Dolmarton to have received a €2.5 million cash payment from Matantos on its behalf in 2003, something that Matantos has denied in his testimony to the Munich Prosecutor.

In our interview, Beltsios confirmed his former activities and functions in PASOK, the governing political party in Greece at the time both submarine contracts were awarded, and acknowledged having known Tsohatzopoulos for a long time. Beltsios also confirmed his previous position as Supervisory Board Chairman of

DEPA, the public gas company, in 2002, a time when Tsohatzopoulos served as development minister and had jurisdiction over public utilities. Beltsios described having provided only civil engineering services to Ferrostaal and vehemently denied having established or maintained political connections on behalf of Ferrostaal to Tsohatzopoulos or any other Greek official. Beltsios claimed to have received only the €314,725 in retainer payments pursuant to his consultancy contract from October 2000, which he said was offered to him by Ferrostaal in order to meet his costs, given that his February 2000 consultancy agreement with DSD was not bearing any fruit due to DSD's continued lack of success in Greece. He was categorical that he received no further payments from or in connection with Ferrostaal's submarine projects, either directly from Ferrostaal or indirectly via MIE. Accordingly, he denied having obtained the €1 million payment in March 2000, as is indicated on the Matantos list, or the alleged €2.5 million cash payment in 2003 on behalf of Dolmarton.

Beltsios acknowledged knowing Avatangelos from business dealings in connection with the installation of a parking system facility for Greek municipalities in the early 1990s, where Avatangelos apparently represented a French contractor. Beltsios stated that Avatangelos had no involvement in the submarine projects. He vociferously denied any involvement with Avatangelos or other alleged *Gebetskreis* members on the submarine projects and said that he had no knowledge of any improper payments to Tsohatzopoulos or other Greek officials. The Beltsios interview was nonetheless notable in that it was the only time that an interviewee not only acknowledged having met Avatangelos, but also provided some indication, however vague, of Avatangelos' previous business dealings and, significantly, of having worked with him in the past.

Notwithstanding his role in connection with the acquisition of *Archimedes* and his political affiliations with at least one public official, the state of the evidence does not permit the Investigation to conclude how much money Beltsios received indirectly from Ferrostaal, for what purpose and what he did with it. Nonetheless, Beltsios' close connections to the former minister – by all accounts one of the key decision-makers in the Greek government on the award of at least *Archimedes* and likely the privatization of HSY – including the fact that he is said to have been recommended by that same minister and was then the linchpin in the GSC's relations with him, in conjunction with the fact that he knew Avatangelos from previous business dealings, give considerable credence to the assertions made by Dolmarton in 2007 and raise very serious questions about the role played by Beltsios and, indeed, the propriety of his involvement. Even absent any proof that Beltsios was involved in coordinating or effecting illegal payments to the former defense minister, it is highly unusual and suggestive of potentially improper influence that a foreign company bidding for public contracts in Greece would be liaising with the key Greek official, not through official government channels but through a private consultant.

(2) Sotiris Emmanouil

From 1999 onwards, Emmanouil occupied a key position as the General Manager of HSY, until mid-2002 a state-owned shipyard which served as prime contractor, and thus the GSC's contractual counterparty, on the *Archimedes* and *Neptun II* contracts. Three of the four Type 214 submarines envisaged under *Archimedes* were to be assembled at HSY; the modernization of the Type 209 submarines under *Neptun II* was also to take place at HSY. Moreover, as a quasi-condition for being awarded the *Neptun II* contract in May 2002, HDW and Ferrostaal had agreed to purchase the majority of HSY's shares, signing the purchase agreement on the same day as the contract for *Neptun II*.

The documentary record suggests that Emmanouil acted as one of the most important negotiating partners for the GSC on numerous contractual and financial issues and that, over and above being the General Manager of the prime contractor, he functioned as a liaison between the GSC and the relevant Greek ministries. The former *Bereichsvorstand* for Marine suggested in testimony to the Munich Prosecutor that the GSC would likely not have won the submarine bids without Emmanouil's support.

In October 2002, HDW made a substantial indirect payment to Inveco, a Marshall Islands entity beneficially owned by Emmanouil. Notwithstanding Ferrostaal's refusal to participate in this payment arrangement on the basis of compliance concerns and the lack of a clear commercial rationale, the Matantos list shows that the Company nonetheless proceeded to make payments totaling €2.28 million itself to Inveco only shortly after its official rejection of the HDW proposal. An earlier payment on the Matantos list, the €1 million paid to Agouridis, also appeared to have been made for Emmanouil's benefit, as explained below.

Debevoise commissioned Zepos & Yannopoulos, a Greek law firm, to analyze whether Emmanouil had the status of a public official under Greek law in 2002. Its conclusion was that Emmanouil likely was a public official at least until the date of the privatization of HSY on 31 May 2002, and that payments made to him could thus have criminal law implications. Even if Emmanouil were not properly viewed as a public official, his position as General Manager of the GSC's contractual counterparty, HSY, would nonetheless mean that any payments made to him personally could also trigger applicable prohibitions of private-sector bribery.

Ferrostaal's payments to Inveco were, like all other concealed third-party payments, made via MIE and likely funded from an apparently extra-contractual commission paid to MIE in October 2001. As such, this provides an instructive example of how the Company's internal controls mechanisms identified potential irregularities in the MIE payment arrangements but, crucially, failed to follow them up appropriately. What transpired was a workaround solution – the production of a likely backdated contract with MIE – that paved the way for further improper and potentially corrupt payments being made via MIE.

a. Georgios Agouridis

The first payment on the Matantos list associated with Emmanouil is the 10 April 2000 €1 million payment to Agouridis, an Athens-based attorney. The former head of Marine stated in an interview that when he confronted Matantos about the identity of the third-party payment recipients, Matantos told him that Agouridis was Emmanouil's lawyer and that he was paid €1 million, which was to fund or contribute to the purchase of an apartment for Emmanouil in Athens. For that reason, the former head of Marine noted the word "*flat*" next to Agouridis' payment entry on the Matantos list.

A Control Risks report commissioned by Ferrostaal in 2006 to investigate the claims for payment made by Dolmarton suggested that Agouridis was Emmanouil's personal attorney. Matantos, in testimony to the Munich Prosecutor, confusingly recalled that Agouridis was an attorney who worked on behalf of Ferrostaal, which has been denied by Ferrostaal witnesses. While we cannot say so with any certainty, the available evidence suggests that the payment to Agouridis was in fact a payment for the benefit of Emmanouil himself. Agouridis did not respond to a request for an interview.

b. HDW "Heads of Agreement"

A confidential "Heads of Agreement" drafted by HDW in September 2001 provided that HDW and Ferrostaal would compensate Inveco for its assistance in the acquisition by HDW/Ferrostaal of HSY through a number of components. The draft agreement envisaged, *inter alia*, a 1% success fee on future contracts between the Greek ministry of defense and HSY, transfer of 9% of HSY's shares to Inveco, and a payment of €2.2 million to cover Inveco's costs. A second affiliated draft agreement of the same date between HDW/Ferrostaal and Emmanouil personally provided for the latter's employment with HSY for five years at €250,000 per annum, as well as possible bonus and incentive payments.

To solicit Ferrostaal's agreement to the arrangements and its financial contribution, the then CFO of HDW, Schmidt, approached Ferrostaal's then *Bereichsvorstand*, likely in October 2001. Strongly disapproving of HDW's intent to reward Emmanouil without prior coordination with Ferrostaal and in the absence of a substantive basis or performance that would justify such compensation, the *Bereichsvorstand* stated in our interview that he reported the matter immediately to the Ferrostaal CEO, who simultaneously served on HDW's Supervisory Board. According to the then Ferrostaal CEO's statements to the Munich Prosecutor, he in turn voiced serious concerns to the HDW Supervisory Board, asked for HDW to commission legal opinions on the payments and ultimately resigned from the Supervisory Board in protest over the issue. Others at Ferrostaal also had contemporaneous awareness of the "Heads of Agreement," including the then head of Marine, who indicated in testimony in 2004 to the Düsseldorf public prosecutor that the "Heads of Agreement" was considered during an early part of the negotiations

over the acquisition of HSY to compensate Emmanouil for his "*assistance*." The former head of Marine, who at the time in question worked as a lawyer on Marine matters and in particular the privatization of HSY, stated in our interview that a copy of the draft "Heads of Agreement" "*landed*" on his desk one day, but that he wanted nothing to do with it.

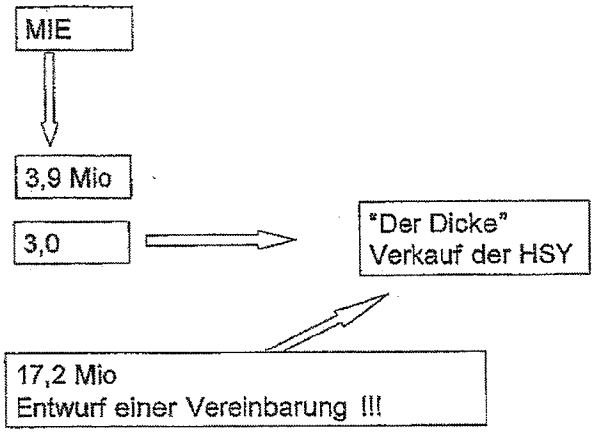
Despite Ferrostaal's refusal to enter into the "Heads of Agreement" with HDW and Inveco and the uniform statements of rejection of the proposal expressed by former Ferrostaal managers, HDW proceeded to make a substantial indirect payment to Emmanouil. In October 2002, HDW made a €17.276 million payment to Hong Kong based Metallco International Ltd., an entity owned by Gian Carlo Bussei, Ferrostaal's agent for submarine business in Italy and someone with whom HDW also had a prior relationship. Of this amount, Bussei retained €1 million for his services. Emmanouil confirmed in writing that he received €14 million for consultancy services. The remaining €2.276 million were attributed to costs and expenses, in particular legal costs. Although this amount is almost identical to the €2.2 million in costs foreseen in the draft "Heads of Agreement" and to the €2.28 million paid to Inveco by Ferrostaal via MIE, we cannot establish whether there is in fact any connection between these figures. The Investigation thus is not in a position to say whether the amount paid by Ferrostaal was its contribution to the costs envisaged in the draft "Heads of Agreement" or whether it was additional to the sums paid by HDW.

As noted above, the payment from HDW to Metallco triggered a criminal investigation in 2004 by public prosecutors in Kiel and Düsseldorf against several HDW executives for breach of trust. During the investigation, which was ultimately suspended, three Ferrostaal executives, including the former CEO, the former *Bereichsvorstand* and the former head of Marine testified as witnesses. In their respective statements, they recalled their skepticism at the time over the "Heads of Agreement" and asserted ignorance of HDW's decision to pay Emmanouil via Metallco; they also confirmed that Ferrostaal had no part in the arrangements and did not make payments to Inveco. The protocols of the testimony of the latter two were kept by the director of Legal Services. Yet neither he nor anyone else at the Company took any steps to investigate the matter further. Had this been done at the time of the Kiel/Düsseldorf prosecutorial investigation, the fact that Ferrostaal itself had in fact made payments to Inveco may have come to light: at least one person then still in the Company, the head of Marine, had by that stage in 2004 obtained documentary proof – in the form of the Matantos list – that payments had indeed been made to Inveco by Ferrostaal itself, as described below.

c. Third-Party Payments to Inveco

Because of the non-transparent nature of the concealed third-party payments via MIE, it is difficult, if not impossible, to determine which of the payments from Ferrostaal to MIE were subsequently channelled, in whole or in part, to the third parties on the Matantos list. One document in the evidence does, however, provide

some clues in this regard: a handwritten note confiscated by the Munich Prosecutor in 2010 – apparently stemming from the desk of the then *Bereichsvorstand* for Marine – appears to establish a direct link between a commission payment from Ferrostaal to MIE and the subsequent (partial) onward distribution of funds to Emmanouil. A clear connection is drawn in that note between the €3.9 million commission paid to MIE in October 2001 and a €3 million payment channelled to Emmanouil, referred to in the note by his nickname "*the fat one*" (*der Dicke*). The note also referenced HDW's payment of €17.2 million to Metallco for Emmanouil's benefit, but it did not convey a direct relationship between the HDW payment and the Ferrostaal payment. The relevant part of the note is reproduced below:



The Investigation could not reach conclusions as to whether anyone other than the former head of Marine had knowledge of Ferrostaal's concealed payments to Inveco. The *Bereichsvorstand* for Marine in charge at the time of the payments stated in an interview that he did not know about them, consistent with his professed lack of knowledge of any of the third-party payments. But the timing of the payments – occurring only a few months after the Company had apparently voiced its strong objection to participating in HDW's proposed scheme – is striking. The documentary record of how these payments were made paints a damning picture of the effectiveness of the Company's internal controls mechanisms and is examined further below.

(ii) Irregularities in MIE Payments

An analysis of some key MIE payments, from which various third-party payments, including those to Inveco, were funded, shows how the Company's existing internal controls mechanisms – namely the checks made and questions raised by the former head of Tax and the former CFO – were perfunctory and, rather than triggering genuine investigations into the basis and purpose of the proposed payment, failed to address the underlying irregularities. Because Ferrostaal's internal controls organs were concerned, first and foremost, with ensuring that a payment had a

documented basis for tax purposes, they acquiesced in explanations and solutions offered by the CEO and Marine employees that swept aside substantive red flags as if they were irrelevant.

The Investigation identified serious irregularities with each of four installments paid by Ferrostaal to MIE during the tenure of the young and inexperienced *Bereichsvorstand* (see Section I.C.3). It is notable that the then *Bereichsvorstand*, although present for the pertinent discussions, played no substantive role in the decision-making process concerning the MIE payments. Rather, the then CEO and the then head of Marine appear to have addressed and resolved the concerns expressed by the CFO and the head of Tax.

Payment to MIE of €24 million (May 2001):

- On 7 May 2001, MIE submitted an invoice pursuant to its 1998 contract in the amount of €24 million. Memoranda by the head of Tax and the CFO to the CEO, the *Bereichsvorstand* and the head of Marine pointed out that the amount of the €24 million invoice was not reconcilable with the contractual provisions and that the overall volume of payments to MIE could trigger reviews by the *Betriebsprüfung*. The head of Tax even warned that the circumstances of the arrangement might result in prosecutorial investigations. In reply, the then CEO conceded that the recent change in the corruption law might indeed produce such investigations, but advocated in favor of making the payment because he did not view the concerns raised by the head of Tax as sufficiently serious to renege on the payment, particularly given that he had personally promised Matantos timely payments. As noted in Section I.C.3, this example shows how objections raised through the internal controls mechanisms were simply swept aside by the *Vorstand*.

- In the case in issue, the incompatibility of the invoice amount with the existing contract did not result in a rejection of the invoice or reduction of the payment. Instead, and with the knowledge of the CFO and the Head of Tax, the Company entered into a contract addendum with MIE that expressly provided for payment of the €24 million and a subsequent payment of €6.88 million. The €24 million invoice was then authorized by the CEO, the *Bereichsvorstand* and the head of Marine.

Payments to MIE of €3.9 million (Oct 2001) and €6.88 million (May 2002):

- MIE submitted a €3.9 million invoice in October 2001 which Ferrostaal paid promptly, with its internal payment authorization relating the payment to the 1998 MIE contract. A memorandum from the head of Tax to the CFO (with copies to the CEO, the

Bereichsvorstand and the head of Marine) stated that no concerns existed to the payment being made as an advance in light of MIE's extraordinary efforts with respect to the HSY privatization.

- When MIE submitted its next invoice in May 2002 in the amount of €6.88 million, however, the CFO concluded that the earlier €3.9 million payment did not in fact relate to MIE's 1998 contract (or the 2001 addendum) as set out in the Company's internal payment documentation, but instead pertained to services in connection with the privatization of HSY not contemplated by the existing agreements. The CFO voiced this observation in a memorandum to the *Bereichsvorstand* and the head of Marine, noting that payment of the outstanding invoice of €6.88 million would therefore result in overpayment.

- The consequence of his realization was not, however, to question and investigate why the previous €3.9 million had been paid at all and on what basis. Instead, in May 2002, the former CFO requested the *Bereichsvorstand* to provide him the documented contractual basis of the previous payment made in October 2001. The record suggests that the head of Marine thereafter produced a separate agreement with MIE, ostensibly dated January 2000, that stipulated payment of €3.9 million for assistance with the privatization of HSY. Circumstantial evidence strongly suggests that that agreement was only created at that time (i.e., in May 2002) and backdated, solely to satisfy the requirement for a documented basis of the past payment. Indicia of the sham nature of the agreement – over and above the fact that it was only produced seven months after the payment which it purportedly triggered – include the fact that the agreement is visually very different from other MIE contracts, that it lacks a Ferrostaal and/or MIE letterhead, and that its description of the purchase of HSY by the GSC could not have been contemplated with such specificity at the time of its purported date in January 2000.

- This episode shows that despite the identification of clear red flags – such as the fact that an apparently extra-contractual payment had been made – the internal controls mechanisms at the Company lacked substance and teeth. Perversely, the insistence by the former head of Tax and the former CFO on a documented contractual basis for each payment ultimately permitted a solution pursuant to which the initial absence of such documentation appears to have been ignored and a likely fabricated contract was accepted after the fact. As a result, the Company made not only the €3.9 million payment in October 2001, from which potentially corrupt payments to Inveco appear to have been funded, but also paved the way for further payments to MIE in part at least for the purpose of satisfying obligations to various third parties.

Payment to MIE of €8.17 million (October 2002):

- An internal Ferrostaal payment authorization from October 2002 relating to an MIE invoice of €26.45 million shows that only €8.17 million of that amount had in fact been paid to MIE, with the remaining €18.28 million being apparently deposited in a "*MIE investment account.*"

- The former head of Marine stated in an interview that, as far as he knew, no funds were in fact deposited in such an account. He also dismissed the concept of an "*investment account*" as a misguided proposal by his predecessor, which the latter justified as Ferrostaal holding back funds due to MIE to contribute, at a later stage, to MIE's intended participation as an investor in HSY. The former head of Marine surmised that this explanation was simply pretextual and that the intention of his predecessor had likely been to "park" monies that may or may not have been needed to meet various commitments to third parties.

- Although we do not know the full background of the MIE "*investment account*," the retention or intended retention by Ferrostaal of significant amounts otherwise owed to MIE – effectively in some form of escrow arrangement – raises serious concerns, particularly when viewed in the context of MIE's role as a payment intermediary. The Investigation has seen no evidence that the Company's internal controls mechanisms operated to ask questions about the true nature and purpose of this arrangement.

(iii) Dolmarton

The second focus of the Investigation's review of the Greek submarine projects was Ferrostaal's approach to assessing, investigating and, ultimately, settling a claim for payment by an alleged *Gebetskreis* member in 2007. Ferrostaal's internal and external investigative measures – both in 2004 and then again in 2006–2007 when claims were reasserted – evidence a desire on the part of the Company to suppress relevant evidence about potential past compliance violations in order to avoid negative publicity and potential liability. Rather than getting to the bottom of the very serious facts and red flags discovered, the Company limited the investigative mandate of its external advisers and failed to draw the necessary conclusions and take the necessary actions. Instead, it ended up making a further questionable payment as late as the summer of 2007.

(1) Initial Meetings in 2004

Ferrostaal and MIE reached a global settlement in October 2003 that reduced MIE's aggregate remuneration to approximately €80 million (excluding the €3.9

million discussed above). Within months of the settlement with MIE, however, the former head of Marine requested his successor to meet with individuals asserting claims for outstanding payments. Accordingly, through the first half of 2004, the then current and former heads of Marine had several meetings in London with two individuals – Avatangelos and Filipidis (at times accompanied by an attorney, Way) – who asserted claims, albeit without any documentary proof of either their services or a contract, for unpaid commissions with respect to their work on the Greek submarine projects.

Importantly, the then former head of Marine who attended several of the meetings confirmed the assertions made by Avatangelos and Filipidis that he and the former *Bereichsvorstand* for Marine had made significant payments to them in the past, routed via MIE. The then head of Marine, in his testimony to the Munich Prosecutor and in his interviews with Debevoise, dismissed the seriousness of the meetings and underlying demands by portraying his interlocutors as free riders (*Trittbrettfahrer*) who introduced themselves only by their first names and made frivolous assertions without any merit. Yet that dismissive attitude is difficult to reconcile with his realization that these individuals had indeed received significant concealed payments from Ferrostaal in the past, as well as the contemporaneous evidence that shows him referring to the activities of the *Gebetskreis* as early as 2001, thus attributing some level of awareness to him of the existence of a group of consultants or lobbyists working for Ferrostaal behind the scenes in Greece. Another former manager in the Marine division also stated in an interview that the former *Bereichsvorstand* and the former head of Marine would openly refer to the *Gebetskreis* in front of their colleagues sitting in their leaf of the open-plan office in Essen, but without providing any further detail.

The state of the evidence is unclear as to whether the then head of Marine simply rejected the claims made by Avatangelos and Filipidis or, as later asserted by Dolmarton, made commitments in principle of settling them, possibly through the newly formed HDW/Ferrostaal joint venture company, MFI. Although the then head of Marine has vehemently denied this, both Way, in a telephone interview with us, and Demirdjian, in his testimony to the Munich Prosecutor, stated that such assurances were given. Be that as it may, there is no room for doubt that the former head of Marine received unequivocal confirmation of the fact of past third-party payments via MIE when he subsequently confronted Matantos.

(2) Receipt of the Matantos List

The then head of Marine met Matantos at Zurich Airport to confront him with the claim that he had funnelled money to third parties on behalf of Ferrostaal. Matantos confirmed that he had done so at the instruction of Ferrostaal (and the former head of Marine in particular) and showed him the third-party payment list, of which he took a copy. While the same head of Marine stated in an interview that Matantos denied that any of the payments shown on the list were made for corrupt purposes, the reliability of such a denial appears minimal in light of the fact that

Matantos could not in fact identify any of the payment recipients, with the sole exception of Agouridis, whose receipt of €1 million certainly qualifies as a questionable and potentially corrupt payment, as set out above.

The same head of Marine recalled that, after informing the then CEO (and possibly the then CFO) of his meeting with Matantos, they agreed not to make further enquiries into the identity of the alleged recipients or the purpose of the third-party payments. As the payments had been made in the past and there existed no contractual obligation to make further payments, they viewed it as "*Matantos' problem, not our problem.*" This reaction to the discovery of a glaring compliance and controls violation is remarkable. It is even more striking when one considers that the then head of Marine had previously been responsible for "*cleaning up*" Marine. This task – which the outgoing CEO and the incoming CEO had assigned to him in late 2002 – purportedly included a substantive compliance review of consultancy agreements. In an interview, the same head of Marine claimed that he would have filed a criminal complaint (*Strafanzeige*) against Matantos or others at the slightest hint of wrongdoing. Yet when confronted with an admission – corroborated by an incriminating document that is now one of the key pieces of evidence in the Munich Prosecutor's investigation – that Matantos had passed €55.1 million to unknown third parties (and, in one case, to Emmanouil, the General Manager of Ferrostaal's contractual counterparty and potentially a Greek public official), he did nothing of the sort.

Ferrostaal's non-action in the face of such qualitative evidence is irreconcilable with the Company's professed commitment to compliance. Debevoise found no indications that anyone at Ferrostaal at that time attempted to investigate the arrangement further, including by discussing the issue with Matantos, the former *Bereichsvorstand* or the former head of Marine. Nor are there signs that Legal, Tax or Accounting were asked to consider the respective implications of the third-party payments. Furthermore, the discovery that MIE functioned as a payment intermediary appears not to have been reported to MAN and was not recorded in *Vorstand* or Supervisory Board meeting minutes. The discovery of the third-party payments was, nonetheless, information of sufficient gravity to have caused some commotion in the Ferrostaal ranks: according to the former head of Marine, the then retired CEO who was at the time in question serving as a member of the Supervisory Board of Ferrostaal, asked him for a four-eyes meeting in which he sought to assure him that he had personally been unaware of the payments.

The controversy surrounding the whereabouts of the copy of the Matantos list is also instructive. The former head of Marine could not recall whether he showed the list to the CEO or the CFO but did not believe that he provided a copy to anyone. According to his testimony to the Munich Prosecutor, he instead placed the list in a folder, which he claimed had later been lost. In fact, during the 19 March 2010 raid, police confiscated the copy of the list in a binder of materials that he had stored at the home of his mother-in-law. The Investigation is not able to conclude definitively whether this represented a deliberate effort on his part to suppress potentially

incriminating evidence or even to shield the former *Vorstand* members from actual knowledge of such evidence and its potential implications. At best, however, it displays an astonishing level of carelessness in handling vital evidence by a senior manager who claimed that compliance was one of his main briefs. The relevance of the information on the Matantos list has been mentioned in several other sections of this Report: it could and should have been a point of reference to (i) assess Ferrostaal's involvement in payments to Inveco in the wake of the Kiel/Düsseldorf prosecutorial investigation into HDW; (ii) evaluate Dolmarton's reassertion of claims in 2006; and (iii) assist in this Investigation, in both Phases I and II.

(iv) Reassertion of Claim in 2006

Avatangelos, through his company, Dolmarton, renewed his claim in 2006 by demanding €52 million in two letters to the then CEO. In addressing Dolmarton's claim and throughout a process that ultimately culminated in a mediated settlement, Ferrostaal showed few signs of a genuine intent to investigate the basis for Dolmarton's claim, evaluate the historical facts and draw the appropriate conclusions. Although Ferrostaal hired two firms of external advisers to conduct a degree of fact-finding, the evidence suggests that the primary purpose of their engagement was to bolster the legitimacy – commercial and legal – of an eventual payment to Dolmarton.

While rebuffing Dolmarton's initial letters, Ferrostaal retained Control Risks to explore the background to Dolmarton's claim, the profile and level of current influence in Greece of the players involved and any evidence of potential embezzlement by the former *Bereichsvorstand* and the former head of Marine. Ferrostaal also hired Simmons & Simmons to provide the *Vorstand* with information that enabled it to respond to the claim. Simmons & Simmons interviewed the former *Bereichsvorstand* and the former head of Marine, who both confirmed the basis for Dolmarton's claim and described the rationale for retaining Dolmarton and other *Gebetskreis* members in the late 1990s. Although asserting that the *Gebetskreis* members were reputable individuals, their statements made clear that these were consultants or lobbyists who worked discreetly and behind the scenes and whose principal role and utility was to provide access to the higher echelons of Greek politicians to whom Matantos did not have access. That, coupled with the explanation as to why their payments were concealed through MIE and the fact that Control Risks was unable to find evidence of Avatangelos having any form of public profile in Greece, should have sufficed to raise every possible alarm bell that the Company was dealing with arrangements that were not only in breach of internal regulations but potentially illegal.[11] Certain statements made by the former *Bereichsvorstand* for Marine to the advisers simply added to the plethora of already existing red flags: he

11 Underscoring the questions about the alleged role and profile of Avatangelos, we note that protagonists, such as Graf von Pückler, professed no real knowledge of Avatangelos and denied that he formed part of the *Gebetskreis*.

intimated that the *Gebetskreis* members were engaged to do things Ferrostaal would not do itself.

The Investigation identified little evidence in the files of the director of Legal Services, in the materials provided by Simmons & Simmons or, indeed, in any other contemporaneous communications that the Company discussed the implications of the factual findings – such as the fact that potential compliance violations may have occurred in the past – and the implications, from a compliance perspective, of any future payments to the same group of individuals.

In an interview, Schulz of Control Risks confirmed that he and his colleagues viewed the evidence as containing clear red flags indicative of corruption but stressed that the ambit of their retainer was to conduct a commercial risk assessment, not a fraud or corruption audit. Although he believed that the red flags required further follow-up, he was disappointed that Ferrostaal never instructed Control Risks to proceed. Similarly, Dr. Aldenhoff confirmed that he was not tasked with undertaking a compliance audit and that he received no instructions to take any further forensic steps to assess the likelihood of past corruption.

Ferrostaal continued to treat the claim as groundless until Dolmarton, now represented by Düsseldorf-based counsel, threatened in March 2007 to submit a detailed claim – sent to Ferrostaal in draft – to the Essen district court for €66.5 million. Although the draft claim did not enclose an executed contract or written evidence documenting the services rendered, it evidenced substantial knowledge of the Greek submarine projects and outlined specific payments already received. Attached to the claim were, *inter alia*, the handwritten Hotel Imperial payment schedule signed by the then *Bereichsvorstand* and the then head of Marine in 2000 and three checks made out to Wilberforce Investments Ltd. and Dolmarton showing receipt of €22.8 million from MIE between 2000 and 2003. Dolmarton also asserted having received €2.5 million in cash from Matantos in 2003 through Beltsios. These payments, save for the alleged cash payment to Beltsios, could, of course, also be found on the Matantos list, but it appears that the former head of Marine did not make that list available to either Control Risks or Simmons & Simmons.

The breadth and detail of Dolmarton's draft claim and the threat of submission to a public forum (the Essen district court) appear to have forced Ferrostaal to alter its previous, purely reactive position. In an interview, Dr. Aldenhoff said that he advised the then director of Legal Services that his risk analysis resulted in three possible responses: (i) the "*do nothing option*" of awaiting Dolmarton's submission to the Essen district court with the attendant risk of publicity; (ii) the "*aggressive option*" of filing a criminal complaint – as a defense tactic against the ensuing civil claim – with Essen prosecutors against Dolmarton and the former Ferrostaal managers for committing breach of trust and corruption; or (iii) seeking resolution of the claim through a confidential, out-of-court dispute resolution procedure. In preparation for the "*aggressive option*," Simmons & Simmons even drafted a criminal complaint citing the evidence of possible corruption, which it sent to Legal Services in May

2007. Dr. Aldenhoff also advised the then director of Legal Services that the Essen district court would likely refer the Dolmarton claim *ex officio* to the responsible prosecutor for economic crime (*Schwerpunktstaatsanwaltschaft für Wirtschaftskriminalität*), with attendant criminal investigations against responsible persons at Ferrostaal/MAN and at the ThyssenKrupp Group (of which HDW then formed part). As is set out below, Ferrostaal ultimately decided to pursue the out-of-court dispute resolution route, in large measure due to the reputational and legal risks associated with the other strategies.

(v) The Mediated Settlement

Dr. Aldenhoff confirmed in his interview that he always viewed the facts of the case – as set out in the Dolmarton draft claim and confirmed by the statements of the former Ferrostaal managers – as being sufficient to found an initial suspicion of wrongdoing (*Anfangsverdacht*) from the perspective of a German prosecuting authority, although he maintained that there was no probative evidence of actual corruption. We attempted to reconcile that position, evidenced by the fact that Dr. Aldenhoff had in fact gone as far as actually drafting a criminal complaint for the director of Legal Services, with the ultimate outcome of the case in which a further payment was made to Dolmarton to achieve a settlement. The question, simply put, was what convinced Dr. Aldenhoff and, ultimately, the Company, to overcome any concerns about potential criminality and recommend and then conclude a settlement. The interview with Dr. Aldenhoff and the documentary record suggest that there may have been two main reasons:

(1) Informal Assurances from Dolmarton's Counsel

Ferrostaal made informal attempts to enquire of Dolmarton's counsel whether his client had made corrupt payments with funds received from Ferrostaal in the past. Dr. Aldenhoff stated in an interview that Dolmarton's counsel, Dr. Ekkehard Arendt, in negotiations rebutted any suggestion of corruption in what he perceived to be a credible and genuine manner. Moreover, on the initiative of Ferrostaal's director of Legal Services, Dr. Sven Thomas, a Düsseldorf-based defense attorney who had a longstanding connection to Dr. Arendt, made similar enquiries on behalf of Ferrostaal which Dr. Arendt again denied. That oral and purely informal assurance of someone who had no personal knowledge of past events appears to have been decisive in giving the Company the additional comfort it needed. The Investigation has not been able to test this assertion with the former director of Legal Services or, indeed, with any *Vorstand* member.

(2) ThyssenKrupp

The extent to which ThyssenKrupp influenced Ferrostaal's decision to pursue a settlement is not entirely clear, although there are strong indications in the evidence that this may have played an important part in the decision-making process.

ThyssenKrupp was not a party to the dispute between Dolmarton and Ferrostaal and thus took no official position on the matter, other than to say that it was a Ferrostaal topic and of no concern to ThyssenKrupp. Nevertheless, as a consortium partner involved in the Greek submarine projects, ThyssenKrupp was aware of the Dolmarton claim. The initial demand letter by Dolmarton in 2006 was addressed not only to the CEO of Ferrostaal but also in copy to the CEO of ThyssenKrupp Marine Systems AG, and a subsequent letter from Dolmarton's counsel recounted meetings with managers from ThyssenKrupp in Berlin in 2005.

There are indications that ThyssenKrupp pushed for a settlement of the Dolmarton dispute. Ferrostaal regularly advised and consulted with ThyssenKrupp on the progress of the matter, including on the legal strategy. In his interview, Dr. Aldenhoff recalled presenting ThyssenKrupp's general counsel in April 2007 with the three possible approaches for responding to Dolmarton's claim, including the "*aggressive option*" of publicly asserting corruption by Dolmarton. According to Dr. Aldenhoff, in that meeting the general counsel showed a preference for and gave his "*standing blessing*" to Ferrostaal pursuing a mediated non-public settlement.

ThyssenKrupp's own relationship with Avatangelos in connection with its anticipated (and ultimately unsuccessful) efforts to sell frigates to Greece may have also affected ThyssenKrupp's stance on the issue. In April 2007, according to a memorandum from Dr. Aldenhoff, the former Ferrostaal *Bereichsvorstand* reported that Walter Klausmann, a member of the ThyssenKrupp Marine Systems *Vorstand*, had approached him to urge a resolution of the matter because Avatangelos was causing substantial difficulties in Greece. Other e-mails from March 2006 and May 2006 suggest that ThyssenKrupp managers were aware of claims for outstanding payments from the *Gebetskreis* and, indeed, pushed Ferrostaal to achieve a resolution of those claims. In his testimony to the Munich Prosecutor, a former Ferrostaal *Vorstand* member who was briefly responsibility for Marine in early 2006 confirmed that ThyssenKrupp wanted Ferrostaal to settle with Dolmarton, he believed, to avoid problems with its frigates business in Greece. Other testimony from ThyssenKrupp managers to the Munich Prosecutor go as far as confirming that ThyssenKrupp itself had entered into arrangements with Avatangelos (albeit with different corporate entities than Dolmarton and Wilberforce) for consultancy work in relation to the frigates project.

(vi) Acceptance of Settlement

Upon the recommendation of Ferrostaal's then director of Legal Services, a Swiss lawyer, Dr. Daniel Wehrli, conducted a one-day mediation on 25 July 2007. In light of the mediator's – perhaps surprising – initial view that Dolmarton was able to prove the conclusion of an agreement with Ferrostaal (with the mediator stating that it was not unusual to keep contracts of this type in "*discreet locations*") and a *prima facie* entitlement to further sums due, with Ferrostaal being unlikely to establish any underlying illegality, he recommended a settlement of €11 million (€9.8 million plus €1.2 million in interest). The circumstances of the mediation, including the

mediator's initial indication, the questions in connection with the quantification of the settlement figure (which, according to Dr. Aldenhoff conformed with Ferrostaal's aim of achieving a eight-digit figure, plus interest), and the fact that Ferrostaal paid all legal and mediation costs of the other side, raise doubts about the *bona fides* of the whole mediation process.

Having been granted one week to withdraw from the proposed settlement after its acceptance by Dolmarton on 27 July 2007, Ferrostaal resolved to accept the settlement proposal, on the recommendation of Simmons & Simmons, in an impromptu meeting attended by three of its four *Vorstand* members and the head of Legal on 30 July 2007. The minutes of the meeting, drafted by the head of Legal, state that "*the meeting participants – just like Dr. Aldenhoff – saw no indications that would suggest violations of the law (§ 134 BGB or § 138 BGB)*," sections of the German civil code referring to transactions violating statutory prohibitions and public policy, respectively. When shown this document during his interview, Dr. Aldenhoff confirmed that the characterization of "*no indications*" was too simplistic and inaccurate, given that he had always maintained an initial suspicion of wrongdoing in connection with the payments to Dolmarton, and merely saw no "*actionable*" or "*legally sufficient*" proof of corruption that could be asserted successfully in the proceedings against Dolmarton (as confirmed in Dr. Aldenhoff's legal opinion of 27 July 2007).

An official *Vorstand* meeting (with the remaining member in attendance) took place on the same day. We cannot ascertain why the *Vorstand* did not discuss and approve the Dolmarton settlement during its regular meeting. No mention of the Dolmarton settlement is made in the minutes of that *Vorstand* meeting or in the minutes of the next Supervisory Board meeting.

During the 30 July 2007 meeting, the *Vorstand* members present resolved to accept the €11 million settlement proposal, conditional on obtaining a further description of the services rendered by Dolmarton and confirmation of Dolmarton's beneficial ownership. In order to address the first point, Dr. Aldenhoff drafted declarations stating that Dolmarton had provided legitimate consulting services, particularly in connection with the privatization of HSY, which the former *Bereichsvorstand* and former head of Marine duly signed when presented to them. These declarations are notable in that they do not contain much of the information raising potential red flags that was set out in the memoranda recording the questioning of these former managers by Dr. Aldenhoff and Control Risks in the summer of 2006. Dr. Aldenhoff also flew to Copenhagen to secure Avatangelos' signature on a pre-drafted affidavit (*eidesstattliche Erklärung*) to the effect that he had provided consultancy services in connection with the HSY privatization, that he was the sole beneficiary of Dolmarton (and Wilberforce) and that he had not made any corrupt payments. The two-page affidavit lacked any real substance as to Avatangelos' activities on behalf of Ferrostaal. Notably, Dr. Aldenhoff did not verify Avatangelos' identity or proof of address. Dr. Aldenhoff explained that the meeting took place in the presence of Avatangelos' attorney, Dr. Arendt, whom he trusted, and he thus did

not request such documentation. An attempt by the Investigation to locate Avatangelos' purported home address in Cyprus, recorded on the affidavit, showed that this was an office building with no sign of Avatangelos or Dolmarton. We have not been able to locate Avatangelos in Athens, either.

These additional steps on which the acceptance of the settlement had been made conditional appear to have been no more than efforts to construct a record that made a further payment defensible for the *Vorstand* and enabled the Company to make such payment tax-deductible given that the payment recipient's ultimate beneficiary, Avatangelos, had been verified. On the latter point, Dr. Aldenhoff confirmed that he was contacted by the then CFO and the then head of Legal after the €11 million had been paid to double-check precisely whether it was appropriate to include the payment as a tax-deductible expense. What these additional steps did not do in any way was to address the previously identified concerns about the legitimacy of the underlying arrangements or even to get a specific explanation of the services Avatangelos had purportedly rendered.

The totality of the evidence concerning the Dolmarton issue conveys a strong impression that it was Ferrostaal's principal aim to construct a defensible basis for paying the settlement, rather than to ensure its substantive legitimacy. The impression that suspicions or red flags indicative of criminal conduct were "removed" to pave the way to settlement is reinforced by the content of Simmons & Simmons' legal opinion of October 2007 – two months after the settlement. This opinion analyzed whether the *Vorstand* had a legal duty to assert claims against the former *Bereichsvorstand* and the former Marine head for entering into contractual arrangements with Dolmarton in violation of existing rules and guidelines. Simmons & Simmons concluded that no such duty existed given the remote likelihood of prevailing in such proceedings and the considerable risks, including the possibility that a court might view the payments to Dolmarton to have been undertaken with corrupt intent. While not expressing a conclusive view, the opinion clearly and expressly left open the possibility that the Dolmarton arrangements had a corrupt purpose. Yet the legal opinion rendered by Simmons & Simmons previously on 27 July 2007 to advise the *Vorstand* on the envisaged settlement was much more attenuated and did not contain an analysis of the possibility that the arrangements may indicate underlying illegality and of the implications for the proposed settlement.

The Investigation cannot draw definitive conclusions on what ultimately motivated Simmons & Simmons in drafting its opinions and whether they had express or tacit instructions not to address the red flags or potential illegality in the pre-settlement opinion advising the *Vorstand*. But the existence of that opinion, together with the inaccurate minutes of the *Vorstand* meeting of 30 July 2007, suffice to draw the conclusion that the net effect was to "whitewash" a highly irregular set of facts with clear compliance red flags and indicators of potential illegality into nothing more than the settlement of a somewhat unusual commercial dispute.

(d) PDM/Zelan

In connection with three transactions under the *Archimedes* offset contract, Ferrostaal made six payments between 2002 and 2004 totaling approximately €7.48 million to PDM Ltd. (later Project Development and Management Enterprises Inc., or "PDME") and Zelan Ltd. PDM was a Delaware-based entity with a Swiss bank account. Zelan was a Cyprus-based company whose director is a Cypriot attorney. The beneficiaries of PDM and Zelan are unknown.

Serious questions exist with respect to the rationale for their engagement and the services purportedly rendered. These concerns are heightened by the complete absence of written documentation and specific information about their services and identities, which no one at the Company could recall. Although Debevoise identified no concrete evidence that the payments were used or intended as bribes or kickbacks, it is remarkable that €7.48 million could be paid to two letterbox companies under these circumstances. The evidence and explanations provided during interviews suggest that the payments were made for an improper purpose.

(i) Rationale for Engagement and Services Rendered

Debevoise received no credible explanation as to the process and rationale for engaging PDM and, subsequently, Zelan and the services purportedly provided. In interviews, Ferrostaal employees did not recall how or on whose recommendation the relationships with PDM and Zelan were formed. One employee noted that they were regularly approached by various people in Greece who offered their services, including in "*hotel lobbies and lifts*," and that was likely how they would have met PDM.

As to the rationale for engaging PDM and Zelan, the employee responsible for the Greek offset business who prepared the payments for internal authorization stated that they helped Ferrostaal receive offset credits from the Greek offset directorate after Germanos S.A. – Ferrostaal's offset counterparty – had suddenly refused to release to Ferrostaal crucial documentation, on the grounds that it contained classified military information. Although she was not able to explain this with any specificity or precision, the employee claimed that PDM (and later Zelan) somehow resolved the impasse, obtained the necessary documents from Germanos and thus assisted Ferrostaal in obtaining the corresponding offset credits for the Germanos project. No convincing explanation was offered as to why MIE, Ferrostaal's agent in Greece, could not have performed these services instead. The employee also confirmed that Germanos had indicated its willingness to release the documents in question to PDM but not to Ferrostaal, although she did not recall that PDM had the necessary classified clearances to obtain the documents in question.

As confirmed by the relevant Ferrostaal employee, there exists no written documentation whatsoever evidencing the consultants' purported services. The

Investigation thus has no verifiable information concerning what qualifications or expertise the letterbox entities PDM or Zelan possessed that would have enabled them to facilitate legitimately the retrieval of classified documentation. In fact, it remains unknown who operated these entities. The responsible Ferrostaal employee vaguely associated a "*Frau Dr. K.*" with PDM (without being able to recall her full name or to describe her role in detail) and had no recollection of any individuals who worked for Zelan other than the Cypriot attorney. The employee said that all communications with the consultants were by telephone.

The former Ferrostaal managers who signed or approved the payments, including the former *Bereichsvorstand* and the former head of Marine, had no recollection as to their precise purpose.

(ii) Contractual and Payment Modalities

In addition to the substantive concerns about the services rendered by PDM and Zelan, the contractual and payment modalities contain several questionable features.

Ferrostaal made its first two payments to PDM in 2002 on the basis of an oral agreement. The then controller (later a head of Marine) identified this internal controls violation in a memorandum to the then CFO in November 2002, in which he also noted, *inter alia*, that PDM's commission percentage was not fixed but in a range. Indeed, the success fee stipulated in the service agreement constituted a percentage range between 1.5% and 3.5% of the offset transaction, and payment orders to PDM and Zelan cited remunerations of varying percentages. We received no credible explanation for this highly unusual feature nor, indeed, any documented evidence of how, if at all, the question raised in the controller's memorandum was resolved. One employee stated in an interview that the percentage commission for each payment would only be set after PDM or Zelan called her to say how much they wanted to be paid for the offset transaction in question.

In April 2003, PDME notified Ferrostaal that it should make further payments due under its contract with PDM to the Cyprus-based entity Zelan, citing "*increased business opportunities of Offset purposes in Greece and Cyprus*" as the reason for the establishment of Zelan. Debevoise received no further explanation for this change in Ferrostaal's offset consultant and the relationships between PDM, PDME and Zelan. Zelan's director, the Cypriot attorney, in response to written questions, was unwilling to describe the relationship between PDM and Zelan, merely noting that Zelan had taken over part of the business portfolio of another entity, PDME. His answers were also notable for what they failed to address: the specifics of the services provided by the entities and the identities of their beneficial owners. It is highly doubtful that a practicing Cypriot attorney is himself in a position to provide substantive services in connection with Ferrostaal's Greek offset obligations.

Notwithstanding that Ferrostaal accordingly made payments to the account of Zelan as of May 2003, the Company never entered into a contract with Zelan to provide a basis for these payments, nor was its agreement with PDM novated to reflect the fact that future payments would be made to Zelan instead.

2. Submarines Portugal

(a) Projects Investigated

The investigation focused on a 2004 agreement between the GSC (comprising Ferrostaal, HDW and Thyssen Nordseewerke GmbH ("TNSW")) and the Portuguese Navy for the supply of two Type 209 submarines. The total volume of this contract was €881.48 million, of which Ferrostaal's share was €132.22 million. There were offset obligations amounting to €1.21 billion.

This project was the subject of significant investigation in Phase I, both as to potential corruption or other compliance violations in connection with the work of the Company's consultants (in particular Espirito Santo Commerce, or "ESCOM"), but also with respect to the Portuguese prosecutorial investigation into allegations of offset fraud involving the Company's offset service provider, ACECIA.

Only limited further investigative activities were performed in Phase II in order to verify the conclusions reached in Phase I. Debevoise continued a limited review of custodial data of a number of *Vorstand* members and members of the Marine division. Debevoise also reviewed approximately 30 relevant binders that had been seized by the Munich Prosecutor. In addition, Debevoise asked questions relating to the Portugal submarine project in three interviews, although the project was not the primary focus of those interviews. Debevoise's limited review produced no findings of significance that in any way altered the conclusions formed in Phase I.

Debevoise did not investigate the alleged offset fraud involving ACECIA, which was pursued solely by Heuking.

(b) ESCOM

In Phase I, payments amounting to €30.4 million to Espirito Santo Commerce (UK) Ltd. ("ESCOM UK") and Espirito Santo Commerce S.A. ("ESCOM S.A.") were identified between 2001 and 2007. The large majority (€30.06 million) of the total was paid to ESCOM UK. Ferrostaal paid an early termination fee in 2008 to ESCOM UK, which amounted to €1 million.

Phase I established that ESCOM's consulting services on behalf of the Company, which are extensively documented, were genuinely performed. Although it is not possible for us to assess objectively whether the amount paid to ESCOM is commercially justified, no evidence uncovered in the Investigation suggests that it was not.

We did not find any further evidence shedding light on the concerns raised in Phase I, namely the fact that almost all of the payments were made to the UK entity (ESCOM UK), with the attendant questions about the nature of that entity and whether or not the services were in fact provided by it, and, secondly, the convoluted ownership structure of both ESCOM entities, which does not provide full transparency as to their ultimate beneficial ownership.

The investigation during both Phase I and Phase II did not reveal any direct or even circumstantial evidence of corruption involving ESCOM. Furthermore, the main source of the allegations of corruption against ESCOM, the former head of Merchant Marine, conceded in an interview that he did not have any actual personal knowledge of improper payments having been made by ESCOM.

(c) Dr. Jürgen Adolff

In 2003, Ferrostaal entered into a consultancy agreement pursuant to which Dr. Jürgen Adolff would receive 0.3% of the project value for his assistance in securing the submarine contract in Portugal. There is no documentary proof of the services rendered under the consultancy agreement, which was entered into only after the purported services had been rendered.

After the GSC and the Portuguese government entered into the aforementioned contract, a dispute between Ferrostaal and Dr. Adolff arose regarding the amount due under the consultancy agreement. Ferrostaal and Dr. Adolff concluded a settlement agreement on 9 December 2004. Pursuant to the settlement agreement, Ferrostaal paid Dr. Adolff a total of €1,679,342.21 in 2004 and 2005.

The Munich Prosecutor appears to consider this a clear case of bribery, on the basis of the apparent status of an honorary consul as a public official. In light of the fact that all necessary facts were known from Phase I, Debevoise did not carry out any further investigation of this issue.

(d) Rogerio D'Oliveira

In 1996, Ferrostaal entered into a consultancy agreement with Vice-Admiral Rogerio D'Oliveira, under which D'Oliveira would provide services in connection with the Portuguese submarine contract. Under this contract, Ferrostaal paid a total of €1 million to D'Oliveira. No documentary proof of the services provided by D'Oliveira was identified.

Debevoise carried out limited additional e-mail review in relation to D'Oliveira but was not able to advance its findings beyond those made in Phase I.

3. Submarines South Africa

(a) Projects Investigated

The Company identified one project in South Africa with a volume of €660 million, of which €128 million accrued to Ferrostaal, and which involved a number of consultants. During Phase I a significant review of the project – the sale of three Type 209 submarines to the South African Navy by a consortium consisting of Ferrostaal, HDW and TNSW – was conducted. Phase II focused on the open questions pertaining to the consultants, and also took a broader look at the offset obligations arising under the contract and the Company's relations with one former official.

During Phase I, three informational briefings were conducted with one former Ferrostaal employee who worked on the South Africa project. During Phase II, eight interviews were conducted with five current and former employees of Ferrostaal, of which one was an amnesty interview. One former consultant was interviewed, and two informational briefings were conducted with three current and former employees. Key former employees refused to be interviewed. Most of the review of project documents was conducted during Phase I of the Investigation, but it continued during Phase II. The data of nine key custodians and numerous others was reviewed during Phase II, including documents and accounting data retrieved from a site visit to Ferrostaal South Africa (Pty) Ltd. ("**FERISA**").

(b) General Observations

The Investigation identified three main issues of concern regarding the South African submarines project, all of which indicated a lack of controls and minimal concern at ensuring compliant business.

First, Ferrostaal paid very little care to defining and monitoring the precise services of its chief consultants, Tony Georgiadis and Tony Ellingford, even though these two consultants were Ferrostaal's largest payees on the project, taking in more than 25% of Ferrostaal's revenues. There is no sign that anyone at Ferrostaal ever knew with any specificity what the two consultants did (or was at least willing to state it in writing). Their contracts each contained a detailed list of services; but the lists were identical, suggesting both that there was no intent or expectation that they would provide the indicated services, and that the lists were created merely for appearance's sake.

In the one instance where a Ferrostaal employee expressed doubt that a demand for payment was not properly backed up by commensurate services, the message from the very top came back loud and clear: whatever had been done by the consultant was enough, and payment was not to be delayed or withheld on any account. On that occasion, at the start of 2003, the then CFO officially objected to both a fellow *Vorstand* member and to the then CEO that the scant documentation attached to a €2 million invoice from Georgiadis was insufficient to justify such a

large payment. The CEO peremptorily told the CFO that he was wrong and ordered that the payment be made. The CFO did not raise further objections or conduct additional checks.

Second, Ferrostaal spent a considerable amount of money (more than €60 million) on offset projects, most of which failed or performed poorly. Responsibility for offset for long periods of time was in the hands of relatively junior employees in South Africa, away from the controls of Essen. The *Vorstand* member then responsible for offset appeared uninterested in it, despite the risk profile that attached to the business. When a senior employee reported that offset was merely a vehicle for *Nützliche Aufwendungen*, there was no investigation into whether his allegation was true.

Third, from 2002 to 2007, Ferrostaal in South Africa had close business connections with Chippy Shaik, the head of acquisitions at the Ministry of Defence from 1997 until 2001, and as such, one of the key people in determining who would win the submarines contract. Such a relationship with a former key decision-maker is not *per se* improper – if due care and consideration is applied prior to entering into any business. Yet there is scant sign that anyone considered the propriety of doing business with Chippy at all;[12] in fact, numerous red flags – Chippy's former position; one brother's role as a South African consul in Germany; another brother's conviction for corruption; and Chippy's own purchase of shares from Ferrostaal at a significant loss to the Company – were simply ignored. When in 2008 the press queried Ferrostaal's business dealings with Chippy, Ferrostaal made the inaccurate statement that it had broken off business relations with Chippy's company as soon as it had learned of his involvement.

(c) Key Consultants

This section proceeds, first of all, to examine the key consultant relationships, then summarizes the Investigation's work on the offset business and, finally, reviews Ferrostaal's relationship with Chippy.

(i) Tony Georgiadis

Through his companies Mallar Inc. and Alandis (Greece) S.A., Georgiadis was paid €16.5 million by Ferrostaal between 2000 and 2004. Georgiadis was introduced to Ferrostaal by Thyssen Rheinstahl-Technik GmbH ("TRT"), with whom Ferrostaal had worked on the first phase of the South African naval project, which was later separated into submarine and frigate components. In 1997, Christoph Hoenings of TRT told the Ferrostaal employee then responsible for the submarines project that Ferrostaal should pay Georgiadis $20 million "*for the purpose of securing the German package*" and that Georgiadis would use the payment to convince "*key*

[12] We refer to Chippy by his first name because he had three brothers – Shabir, Moe and Yunis – two of whom had dealings with Ferrostaal as well.

decision-makers" to support the German bid. The responsible offset employee sought approval from his superior, the then head of Marine, which the latter gave, apparently, without concern.

In October 1998, Ferrostaal and Georgiadis signed an agreement whereby Georgiadis would receive 2.5% of the contract value in return for advising and supporting Ferrostaal in its efforts to win the submarine bid. That 2.5% ultimately worked out to approximately $20 million. Attached to a revised version of the contract was a list of services that Georgiadis was to provide to Ferrostaal. This list was identical to that appended to a Ferrostaal contract with the other main consultant, Tony Ellingford, which indicates that the list was appended to the contract merely for appearance's sake, and raises questions as to whether Georgiadis was expected to perform any of the listed services.

It is apparent that Georgiadis' chief role was as a conduit to politicians. The record shows that he knew a number of senior politicians, including President Thabo Mbeki and possibly Nelson Mandela, and introduced Ferrostaal employees to these politicians. Indeed, the former head of Marine informed the former CFO in 2003 that "*political contacts*" with Mallar (and previously TRT) had a decisive influence on the tender for the submarines. The CEO's overriding of the CFO's objections to paying the €2 million invoice in 2003, set out above, shows how highly Georgiadis' services were valued at the top of the Company.

Mallar also had some involvement with the offset program. It was intended that Mallar would co-invest with Ferrostaal on one offset project, although that does not seem to have eventuated.

Overall, there is little evidence to suggest that Georgiadis did work commensurate with the fee received. By the same token, however, there is no direct evidence that he gave any of the money he received from Ferrostaal to third parties.[13]

There are unanswered questions about a third Georgiadis company, Elmar Maritime Inc. In November 1998, Ferrostaal agreed to pay Elmar approximately $2 million for the transport of oil to South Africa, as part of "*pre-offset obligations.*" It paid Elmar $1.865 million in November 2000. It is not clear how "*pre-offset obligations*" could have arisen more than a year before Ferrostaal had even won the submarines contract, or why Ferrostaal needed to bring oil to South Africa. Oil

[13] There is some evidence that Georgiadis passed on money received in connection with a contract to sell frigates to South Africa, a project that involved a Thyssen subsidiary but not Ferrostaal. These payments, among others, were investigated by the Düsseldorf prosecutor in 2006–2008, but the prosecutor dropped the case for lack of evidence. As part of the investigation, the prosecutor raided Ferrostaal's offices. It passed its findings regarding Ferrostaal to the Essen public prosecutor, who passed the case to the Bochum Economic Crimes Unit. Bochum ceased investigations in 2008.

seems the more likely original author of these letters because they reported information which, based on Mathers' background and other letters and reports written by him, appeared to be within his knowledge. It is therefore possible that copies were made by Ferrostaal, to be signed by Ellingford and placed in his file, in order to provide documentary evidence of services rendered by him and thus seek to justify the amounts paid to him, if they were ever questioned by the internal controls organs or, indeed, a tax audit.

Ellingford did not respond to requests for a meeting.

(iii) Jeremy Mathers

Jeremy Mathers was a retired admiral hired by Ferrostaal to support the bid, specifically by providing information on the Navy's requirements. Between 1998 and 2005, Ferrostaal paid Mathers €1.2 million under three contracts.

The first contract, signed in 1998, included both monthly payments and a success fee based on the ultimate price of the contract. Mathers said that he did not ask for the success fee and was surprised when his Ferrostaal counterpart inserted it into the contract presented to him. In 1999, before the submarines contract was awarded, Ferrostaal suspended Mathers' contract and told him that it would not pay him the success fee. Mathers learned that the reasons included a complaint by Accounting about the success fee. Over the next few years, Mathers negotiated with Ferrostaal, principally with the then head of Marine, for a resumption of the contractual relationship and/or a payment of his success fee. Eventually, he and the then head of Marine agreed to enter into two new contracts, even though both of them knew that Mathers would not be doing substantial work under the contracts; in other words, the contracts were merely a new documented basis allowing Mathers to get the success fee he was due under the 1998 contract. During his interview, Mathers said that entering the new contracts "*turned an enormous amount of money into something that was more plausible.*"

The contracts were signed in 2001. Under the terms of one contract, Mathers had to produce various studies. He did so, although in his interview he admitted both that they were of little or no use to Ferrostaal and that the amount of work that went into them was only a fraction of what Ferrostaal was going to pay him. One of the studies, for example, concerned the potential naval market in other countries in the region, such as Angola and Mozambique – places where Ferrostaal had no intention of doing naval business. Years later, when Tax was going closely through various payments to Mathers, the successor to the head of Marine gave the various studies and reports that Mathers had compiled to the then head of Tax, telling him that the studies were all "*rubbish.*"

Nonetheless, Mathers was paid more than €1 million under the two 2001 agreements. In 2005, for reasons as yet unexplained, Ferrostaal stopped payment to

imports were not part of Ferrostaal's offset obligations. Nobody has been able to explain the need or rationale for this agreement and payment.

Georgiadis refused a request for a meeting.

(ii) Tony Ellingford

Tony Ellingford was a former executive in the defense industry hired by Ferrostaal in 1998 to advise on the submarines contract. Like Georgiadis, he was paid €16.5 million by Ferrostaal between 2000 and 2003, through his company Kelco Associates S.A. ("Kelco"). According to consultant Jeremy Mathers, Ellingford was hired because the responsible Ferrostaal *Bereichsvorstand* in the late 1990s, wanted someone with "*political connections*" to help Ferrostaal win the contract. Mathers asked Llewellyn Swan, an old contact from the South African defense industry, for advice; Swan recommended Ellingford, who was then hired by Ferrostaal. Ellingford, like Georgiadis, also had multiple political connections, and introduced Ferrostaal to various decision-makers, including Defence Minister Joe Modise.

As noted, the list of services appended to Ellingford's contract was identical to that of Georgiadis. There is evidence of meetings arranged and intelligence gathered by Ellingford, but the amount of work done does not seem commensurate with the payments he received. It appears that he, like Georgiadis, was paid to provide political access.

The involvement of Swan was another likely instance of payment for access to decision-makers. Swan was CEO of ARMSCOR Ltd., the South African arms procurement parastatal, from late 1998 until late 1999. In that position, he was one of the key individuals deciding who would win the submarine contract.

In November 1999 – weeks before the submarine contract was awarded – Swan unexpectedly resigned from ARMSCOR. No later than March 2000, he was working for Ferrostaal, albeit indirectly: at that time, Ellingford informed Ferrostaal that Kelco was working with a subcontractor called MOIST cc, represented by Swan. In fact, this may not have been Swan's first involvement with Ferrostaal: Mathers stated in an interview that Swan was working for Ferrostaal at least as of 1998, before he became CEO of Armscor. That is, Swan may have worked for Ferrostaal both before and after he was in charge of arms procurement in South Africa. The Investigation found no evidence that Swan tendered his decision in favor of Ferrostaal in return for either payment or promises of payment, but Swan's position was a significant red flag that Ferrostaal ignored.

There is another unexplained similarity between the documentation for consultants' services: three letters to Ferrostaal that were purportedly written by Ellingford are virtually identical to three letters purportedly written by Mathers. During his interview, Mathers remembered writing the letters, but he could not explain why nearly identical versions appeared under Ellingford's name. Mathers

Mathers while €400,000 under the two contracts remained unpaid. Mathers continues to contend that he is owed this money by Ferrostaal.

As noted above, Mathers was asked about the identical copies of letters in his and Ellingford's names, but could not provide an explanation, at least as to the genesis of the Ellingford version.

Although the mechanism by which Mathers' 1998 contract was replaced and the envisaged success fee resurrected reveals a lack of controls and compliance with accounting and financial standards, there is no sign that any of the payments to Mathers were passed on to decision-makers or that they were intended to be. The consultant's agreement to meet for an interview suggests a level of openness and transparency about the services he provided that was absent from the vast majority of consultants encountered on the Investigation (although his outstanding claim for payment may also have played a role).

(d) Offset Projects

Offset commitments were a particularly important part of the tenders for the submarines contract. In fact, official South African government documents show that the Ferrostaal consortium won the contract because of its superior offset offer.

The consortium agreed to deliver offset spending worth almost €3 billion. It should be noted that this did not require investment actually worth €3 billion; rather, offset investments are granted multipliers by South Africa's Department of Trade and Industry ("DTI"), one of the contract signatories on the South African side. The offset provider would thus invest a figure that was unknown at the start of the project but in any event significantly less than €3 billion. In its internal calculations, Ferrostaal expected that it would only need to provide investment of approximately 1.5% to 2% of that amount, and indeed it ultimately spent €62 million, approximately 2% of €3 billion.

Offset in South Africa was formally divided into two types: Defence Industrial Participation, ("DIP") and Non-Defence Industrial Participation ("NIP"). The DIP portion was by far the smaller and is of little concern from a compliance perspective.

The NIP bid was predicated on one very large project: a stainless steel plant at Coega on the South African coast. However, between the signing of the contract in December 1999 and its coming into force in July 2000, it became clear to Ferrostaal that it would not be able to proceed with the Coega project. The DTI at that stage agreed that Ferrostaal could fulfill its offset obligations through other projects. In order to find and invest in these other projects, Ferrostaal established a new South African subsidiary, FERISA. Between 2001 and 2010, Ferrostaal AG transferred approximately €35.1 million to FERISA, most of which FERISA spent on loans and capital contributions to offset companies. Ferrostaal AG wrote off almost all of that

amount. The remainder of the spending on offset companies was made directly by Ferrostaal AG, principally after 2006.

As noted, investment figures in the offset world are not as they seem at first glance. A project is proposed to the DTI, which then assesses it on a number of criteria, particularly the following three: sustainability (that the project will be long lasting and provide benefits into the future); additionality (that it will provide benefits which did not exist before); and causality (that the project would not happen without the offset partner). Other criteria include involvement of non-whites (Historically Disadvantaged Individuals, in South African government terminology) and the expected amount of exports to be generated.

The DTI applies its multiplier based on these criteria. For example, if Ferrostaal proposes investing €10 million in an electronics company, and that investment scores highly on the stated criteria, the DTI might apply a multiplier of 60, making that investment worth €600 million in offset credits. What evidently mattered to Ferrostaal in determining whether to proceed with a proposed investment was therefore not the business case for the investment, or the likelihood of good returns, but its prediction of how much the DTI would like the project, based on the DTI's published criteria and what multiplier it would receive. This had the potential to create unusual incentives, and it is possible that these played a part in the selection of some projects.

The Investigation found no evidence that projects were selected for improper reasons, such as, for example, to funnel money to a company owned by a relative of a DTI official. But the projects, looked at individually and as a whole, are nonetheless problematic.

At a meeting in 2005, the employee formerly in charge of the offset program in South Africa alleged that a *Vorstand* member had said that South African offset projects had been used to pay *Nützliche Aufwendungen*. He also said that consultants Ellingford, Georgiadis and Swan had approached him in that regard, and that he had seen an agreement regarding these payments. Debevoise was unable to obtain an explanation of this statement, as both the employee and the relevant *Vorstand* members declined to be interviewed. But the lack of investigation or corrective action is in keeping with the Company's general lack of follow-up when serious allegations were made, as noted in other sections of this Report.

Set out below are the offset projects that raise particular concerns, based on the circumstances of the investment or the offset companies involved.

- MAGWA: MAGWA was a tea plantation in the Eastern Cape province of South Africa, the home of many leading politicians from the African National Congress. Ferrostaal made the investment to the Eastern Cape Development Corporation, a quasi-governmental body. Chippy supposedly brought the project to Ferrostaal. Ferrostaal invested ZAR 23.5 million on this project in

2005. As this was paid via a "*non-refundable loan*," Ferrostaal received nothing in return.

- SAMES: Ferrostaal loaned ZAR 42.2 million to SAMES between 2005 and 2007, of which the majority has not been repaid. SAMES is a subsidiary of Labat Africa Ltd., a company with close ties to the African National Congress. Labat Africa was also chaired by Defence Minister Modise until he died in 2001.

- Atlantis Development Trust: Ferrostaal invested more than ZAR 26 million in Atlantis Development, an educational body, between 2003 and 2006. The body failed and there were allegations of fraud; before that, however, the head of Ferrostaal's South African operation had informed Atlantis Development that it would never have to repay the money provided to it.

- Other: In at least two other cases, the project invested in failed utterly and the entire investment had to be written off: Condomi (ZAR 1.5 million invested in 2002 and 2003) and Trimica (ZAR 9 million invested in 2005).

Ferrostaal employees referred us to the frequent use of a "*non-refundable loan*" to make offset investments. Functionally, there is no difference between this and a straightforward grant, which was confirmed by the accounting and tax personnel interviewed in the course of the Investigation. The examples above illustrate that Ferrostaal was prepared to support and invest in projects, including through such loans, that it seemed to have had little interest in succeeding. One former manager responsible for offset said that this just confirmed the questionable nature of the offset business, in which DTI credits were the only real factor driving Ferrostaal's investment decisions.

(e) Chippy Shaik and His Brothers

As noted, Chippy was in charge of acquisitions at the Ministry of Defence from 1997 to 2001. As such, he was one of the key people in determining who would win the submarines contract. As was to be expected, Ferrostaal had numerous dealings with Chippy during his tenure at the Ministry. On one occasion, one interviewee said, Chippy told Ferrostaal and its consortium partners that they must grant the subcontract for the submarine combat suite to African Defence Systems (Pty) Ltd. ("ADS") a company controlled by Chippy's brother, Shabir. According to the same interviewee, HDW, the shipbuilding member of the consortium, refused to do so because of ADS' partnership with a French company.[14] This incident is

[14] ADS was in fact used to provide the combat suite on the frigates contract for the South African Navy. Chippy's involvement in that decision was controversial, and he was censured by the Ministry of Defence. Shabir himself spent four years in jail for corruption in his relations with then Vice President and later President Jacob Zuma.

nonetheless indicative of the possibility that Chippy may have sought to derive a personal benefit from his public function.

Ferrostaal had numerous business dealings with Chippy after he left the Ministry in 2001. These dealings, although not *per se* improper, are problematic; in particular, the commercial rationale for some of them is difficult to understand, and there is no sign that Ferrostaal took appropriate care, or conducted any due diligence, before engaging with Chippy.

Chippy's most extended cooperation with Ferrostaal came through a joint venture called TAN Mining and Exploration (Pty) Ltd. ("TAN"). In 2004, Ferrostaal, Chippy's company Enable Mining (Pty) Ltd. and Mining Projects Development (Pty) Ltd. ("MPD"), a South African engineering company, formed TAN with the purpose of mining tantalum in Mozambique and selling it to manufacturers in Europe. The terms of the joint venture agreement required each partner to contribute capital to TAN, although MPD was allowed to contribute a significant portion of its capital in kind because of its engineering expertise.

Ferrostaal contributed just under $1.5 million to the joint venture between 2004 and 2006. It appears that neither MPD nor Enable Mining made any cash contributions to the joint venture; at one stage, Ferrostaal considered loaning Enable Mining the stake it needed to invest. Ultimately, the joint venture failed and in 2007 Ferrostaal sold its stake in TAN to Enable Mining for ZAR 310,000 (about $40,000). This was not only significantly less than Ferrostaal had invested in the company, but also a fraction of the amount it had been offered for its stake one year previously. Indeed, at that time, BDO advised that Ferrostaal's stake was worth ZAR 10 million (about $1.25 million).

In 2008, members of the press asked Ferrostaal about its association with Chippy through TAN. Ferrostaal replied that it had ended its association with Enable Mining as soon as it discovered that Chippy was behind the company. This answer was plainly false, as it was known to Ferrostaal all along that he was behind Enable Mining; indeed, Ferrostaal negotiated directly with him.

Evidence suggests that Chippy may also have been behind a company called Illima Community Financial Services (Pty) Ltd. ("Illima"), a consultant that supposedly had "*vast knowledge of the South African business environment.*" FERISA paid Illima ZAR 1.8 million in 2005, supposedly in return for services relating to various offset companies and other joint ventures. But Illima's identity and purpose – and whether it performed any of the stated services – are unclear. Its directors were listed as Moses Mayekiso and Julekha Mahomed, both politically connected people (Mayekiso was a leading trade unionist and Mahomed is Jacob Zuma's attorney). However, at a meeting at FERISA in 2006, Ferrostaal staff attacked the management for its ties to Illima and claimed that the engagement of Illima was solely a way to pay Chippy. Given the unavailability of key former employees, we have not been able to obtain any explanation of this issue.

Further connections with the Shaiks include:

- In 1998, while Ferrostaal was bidding for the submarine contract, Chippy's brother Moe, the South African consul in Hamburg, asked Ferrostaal (and other German companies) to donate money to a concert at the Hamburg consulate.
- Ferrostaal paid for Chippy's round-trip, business-class travel to Egypt in 2002 in connection with a gold mining project that was never realized.
- Chippy may have introduced the MAGWA project to Ferrostaal.
- Chippy's brother Yunis tried to broker a deal between Ferrostaal and an offset company, and represented Enable Mining in the purchase of TAN shares.

As already noted, none of these interactions or transactions with Chippy *per se* constitute illegal or even improper conduct, absent the existence of corresponding promises on the part of the Company at the time when he was the principal interlocutor to confer benefits or advantages on him after he ceased being in government. Nonetheless, the level of dealings with a former government official and the complete lack of scrutiny and examination to which these dealings were put, raise important questions about the compliance and risk culture at the Company, as well as the systems and controls in place at the time.

4. Offshore Patrol Vessels

(a) Projects Investigated

The Munich Prosecutor has been investigating allegations that improper payments were made in Argentina in connection with the award of a contract for the design of one offshore patrol vessel ("OPV") in 2008. Debevoise investigated the respective OPV projects in Argentina, Colombia and (to a much more limited extent) Chile. These projects were not investigated in Phase I.

Debevoise conducted a total of nine interviews with seven current or former employees and one consultant. Debevoise also carried out one informational briefing. Certain key employees, including the current head of the responsible division at Fritz Werner Industrie-Ausrüstungen GmbH and the former *Bereichsvorstand* for Marine, declined to meet for interviews. Debevoise reviewed the electronic data of 20 current and former employees, as well as hard copy files of potentially relevant documents.

(b) Argentina

(i) Summary of Allegations

Ferrostaal acted as the representative of the German shipbuilding company Fr. Fassmer GmbH & Co. KG ("Fassmer") in connection with the potential sale of OPVs

to the Argentine Navy. Current and former employees of Ferrostaal AG and Ferrostaal Argentina S.A. ("FSA") alleged to have known of the bribe payments to Argentine officials in connection with the OPV project include the former head of Merchant Marine, the former *Bereichsvorstand* for Marine, as well as a former FSA CEO and a former FSA consultant and director (a previous CEO of FSA from 1985 to 1997, then retained by Ferrostaal AG on a consultancy basis in 1999 and re-appointed as a director of FSA in 2007 for tax reasons). Indeed, the former head of Merchant Marine appears to have been the person instrumental in making some of the key agreements regarding those payments and devising the initial plan to effect them as early as 2005. He admitted his involvement in statements to the Munich Prosecutor and in interviews with Debevoise. He is a principal source behind the allegations against the other Ferrostaal AG and FSA employees, although Fassmer's principal has reportedly also have given corroborating evidence to the Munich Prosecutor.

The consultant/director of FSA is alleged to have served as the point person tasked with intermediating between the principal Argentine official requesting the bribes (Navy lawyer Osvaldo Parrinella) and Ferrostaal AG/Fassmer, including as to the payment channels to be used. He thus allegedly played a pivotal role in the improper activities and was (unlike the former head of Merchant Marine) fully aware of the mechanics of the improper payments. The allegations against the CEO of FSA put him in a less prominent role, but he is alleged to have been fully informed of the fact that bribes were being paid and to whom. Moreover, he is said to have proposed to the former head of Merchant Marine that other decision-makers should be paid and that alternative payment channels should be used. Finally, the former *Bereichsvorstand* is said to have been informed by the head of Merchant Marine that bribes were being paid in the context of the project, a course of action he allegedly approved. We identified no documentary evidence to substantiate that allegation and understand that the former *Bereichsvorstand* has denied it.

(ii) Ferrostaal Commission for Sale of OPV Design and Basic Engineering

Ferrostaal had initially envisaged a turnkey contract that would have encompassed the construction and sale by Fassmer of several OPVs to the Argentine Navy, with an anticipated volume exceeding €200 million. Discussions to pursue such a contract reach back to the mid-2000s.

Following a decision by the Argentine government in or around 2006 not to pursue a direct contract with Fassmer/Ferrostaal for the construction and purchase of several OPVs, however, the negotiations in Argentina focused on a significantly smaller project in scope and volume. In late 2007 or early 2008, the Chilean shipyard ASMAR and the Argentinean Navy ultimately concluded a contract worth €2.25 million for a naval and ship system design package. In turn, ASMAR purchased basic engineering and design from Fassmer in January 2008 for a contract volume of €2,047,500. Ferrostaal was due a commission of 8.5% of the contractual value from Fassmer, or €174,038. Of that amount, Ferrostaal AG's share was 5% (amounting to

€102,375), while 3.5% (€71,663) was paid to FSA. The total amount actually paid to Ferrostaal AG by Fassmer was reduced by €25,000 on account of (i) a €15,000 cash payment apparently made by the former head of Merchant Marine to consultant Peter Fischer-Hollweg in Essen and (ii) €10,000 paid by Fassmer to the consultant/director of FSA which, according to the former head of Merchant Marine, had been agreed as an additional bonus for his work on the OPV project.

In August 2009, Fassmer also executed a license agreement with the Argentine Navy for the construction of said OPV. The volume of the license agreement was €500,000 and FSA received the entire commission amount of 8% (€40,000).

The Investigation found no indications that any of these payments were passed on to decision-makers. The former head of Merchant Marine stated in an interview that none of the payments set out above were used or intended to be used for improper purposes. Nonetheless, two of the payments raise questions about the adequacy of the internal controls at the Company. Why an additional bonus to an external consultant/director of FSA should be paid by Fassmer directly and then deducted from Ferrostaal AG's official commission, rather than officially paid and accounted for as a bonus payment, is simply unexplained. More importantly, the cash payment to Fischer-Hollweg, described in the invoice to Fassmer as a payment for "*local services*," was apparently made by the former head of Merchant Marine because the consultant required this payment as a cash advance paid in Germany (apparently for his wife, who was resident there). The former head of Merchant Marine stated that Fischer-Hollweg subsequently reimbursed the Company that amount, although we have not verified this or the accounting/booking treatment of this alleged reimbursement.

(iii) Alleged Agreement to Pay Bribes Amounting to 6.5% of Contract Value

According to the former head of Merchant Marine, Parrinella had reached an agreement with Ferrostaal and Fassmer that a commission of 6.5% of the value of the contract between Fassmer and ASMAR would be paid to him. During his interviews, he articulated his understanding that a portion of the funds paid to Parrinella – himself a public official – would be passed on to the relevant decision-makers in the Argentine Navy, including (but not limited to) an Admiral Lepron and a Captain Palma.

The former head of Merchant Marine recalled how he was himself involved in negotiations at which a 3.5% commission was agreed for Parrinella. He further stated that that he was angered by Fassmer's subsequent decision to agree to a 6.5% commission with Parrinella, which he only found out after the fact. A cost calculation sheet sent by Fassmer to the former head of Merchant Marine on 1 August 2005 includes specific line items for commissions to "*Goldlocke*" in the amount of 1.5% (Parrinella) and "*Leppi*," confirmed to denote Admiral Lepron, in the amount of 0.5%, respectively. The existence of this calculation sheet adds credibility to the account of

the former head of Merchant Marine of the clear intention to make bribe payments on the project.

The former head of Merchant Marine further contended that payments to Parrinella were logistically coordinated by the consultant/director of FSA, with the full knowledge of the CEO of FSA. The consultant/director is said to have received payment requests from Parrinella and communicated those requests to the former head of Merchant Marine, who would inform Fassmer of the need to provide the funds to an account nominated by the consultant/director of FSA, who would in turn distribute the funds to Parrinella. According to the former head of Merchant Marine, this practice was altered subsequently, with him no longer being actively involved in the communications about the payments to Parrinella. As such, in his interview the former head of Merchant Marine was not in a position to say through which accounts or entities Fassmer was routing the payments in question, as these were matters that the consultant/director of FSA was coordinating directly with Fassmer. Importantly, he confirmed that Ferrostaal was not making any improper payments itself.

The Investigation focused on identifying evidence that would corroborate the allegations made. The custodial data collected at FSA contained copies of the following documents:

- A draft consultancy agreement between Fassmer and Uruguayan company Wiler S.A. dated 9 January 2008 (just days after the signature of the contract between Fassmer and ASMAR). According to its preamble, the purpose of the agreement was for Wiler to promote in Chile the sale "*of the design and basic engineering of the vessel Fassmer OPV 80 [...] that can have as its final destination the Navy of the Argentine Republic*" in exchange for payment of €135,000 in three installments. The vague description of the project in question tallies with the OPV Argentina project.

- A 7 July 2008 addendum to the consultancy agreement providing for an additional payment of €10,100 to Wiler. The stated purpose of this agreement was to "*provide further support in the sale of the Fassmer OPV80 for the Colombian Navy*," but in fact the payment envisaged appears to relate to the Argentina OPV project, not the Colombia OPV project.

- E-mails showing that the CEO and the consultant/director of FSA played a role in transferring documents (including Wiler invoices and the addendum to the consultancy agreement) between Fassmer and Wiler, as well as having arranged for Wiler to sign contractual documentation and to confirm receipt by Wiler of payment from Fassmer.

Business intelligence research conducted by Ernst & Young indicates that Wiler was owned and managed by Roberto Perasso (as president) and his wife (as vice-president). Perasso was a long-time business associate of the CEO of FSA and his fellow shareholder in two entities in which Ferrostaal AG used to have an indirect

holding: FerroExport S.A. and Plod Company S.A. (discussed further below). The involvement of Perasso and his company point towards the involvement of the CEO of FSA in the matter. Indeed, documents from custodial data of FSA reveal communications between the CEO of FSA and Perasso in which the former conveys to the latter Fassmer's request for Wiler's signatures on the consultancy agreement in question in the following terms: *"Fassmer needs you to send him two versions signed by Wiler. Please let me know when you will send them to him."*

The initially agreed upon commission amount with Wiler – equivalent to 6.59% of the contract between Fassmer and ASMAR – is nearly identical to the 6.5% of the value of the OPV contract purportedly promised to Parrinella by Fassmer. Further, the sequencing of the payment schedule set out in the draft Wiler consultancy agreement broadly tallies with the expected payments from ASMAR to Fassmer pursuant to the basic engineering and design contract, suggesting that Wiler was receiving some form of success fee on receipt of customer payments by Fassmer. Both the consultant/director and the CEO of FSA disclaimed any knowledge of the substance of these arrangements which they said must have been made by Fassmer without their knowledge and further denied that they were designed to make payments to Parrinella and other officials. They had no explanation of what services Wiler allegedly provided. In fact, the consultant/director of FSA who acknowledged that he had played a "*messenger*" function for Fassmer (forwarding Wiler documents to Fassmer), was not aware of Wiler having provided any actual services on the OPV Argentina project. He had no explanation for the fact that Fassmer had agreed to pay this apparently unknown Uruguayan entity approximately twice as much as FSA's official hard-earned and hard-fought commission. All of these factors, taken in the round, undermine the credibility of the denials provided by the CEO and consultant/director of FSA and provide strong evidence that the arrangements with Wiler represented the alleged 6.5% bribe arrangement with Parrinella.

While we have not received a clear explanation for the further payment to Wiler envisaged under the addendum, the Munich Prosecutor is reportedly investigating allegations that this payment was made at the request of Parrinella, who had complained of receiving insufficient funds. One possible explanation, posited by the former head of Merchant Marine, is that Wiler would have retained a handling fee for its services and that this shortfall in payments to Parrinella needed to be made up through the additional payment pursuant to the Addendum. We saw no evidence to verify this allegation. We also saw no payment documentation establishing whether Wiler itself, or Parrinella and possibly other Argentine officials, in fact received any funds.

(iv) Earlier Alleged Bribe Payments Through Plod Company S.A.

A further line of enquiry by the Munich Prosecutor centers on the allegation that earlier payments were effected to Parrinella via two companies in which Ferrostaal had a shareholding until 2006, together with the CEO of FSA and Perasso:

FerroExport S.A. ("FerroExport") and Plod. The Munich Prosecutor suspects that the alleged payments from Fassmer to Plod were effected in connection with the award of the OPV contract in Chile, although the intended recipient of the payments appears to have been Parrinella, in return for his support in helping Fassmer win the Chile contract.

FerroExport is an Argentine company said to have supported Ferrostaal AG in the steel trading business, receiving commissions for successful sales from Ferrostaal AG. Internal documentation suggests that FerroExport requested Ferrostaal AG to pay part of its commission to Plod, a Uruguayan company with a US-based bank account. Ferrostaal AG appears to have owned 50% of the shares of FerroExport through its Swiss holding entity, Investment Holdings, with the CEO of FSA (40%) and Perasso (10%) owning the remaining shares. The shareholdings in Plod were identical to those in FerroExport. The CEO of FSA is said to have acquired the 50% shares in FerroExport and Plod sold by Ferrostaal in 2006 or 2007 when Ferrostaal decided to exit the steel trading business. The Investigation did not conduct a full review of the shareholdings in these entities, but did receive confirmation from the former CEO of FSA that he and Perasso had the personal shareholdings described above at the relevant time when the payments under review were made.

The Investigation identified a draft debit note from Plod to Fassmer in the amount of $45,675, dated 4 July 2005. The debit note refers to "*consultancy services conducted for the promotion of Fassmer products in South America.*" The cover letter to which the debit note is attached is on FerroExport letterhead and addressed by Perasso to the former head of Merchant Marine, with copies to the CEO and consultant/director of FSA. During his interview, the former head of Merchant Marine recalled how Fassmer had informed him that he was making a $45,000 payment to Parrinella in three tranches, something that is corroborated by a contemporaneous e-mail communication from Fassmer to him referring to the payment to Plod in three tranches. He further recalled how this payment was to be paid out in cash to Parrinella on site in Argentina and that the consultant/director of FSA coordinated the cash payment on behalf of Fassmer.

In interviews at FSA, the CEO and consultant/director both disavowed any knowledge of the arrangements between Fassmer and Plod. The CEO did, however, confirm his shareholding in Plod, which he described as a Uruguayan offshore entity incorporated to conduct non-Uruguayan business. He also confirmed that Plod was paid part of FerroExport's commissions by Ferrostaal AG in the steel trading business.

The former head of Merchant Marine's recollection of the discussions with Harold Fassmer and the consultant/director of FSA regarding this matter, supported by the documentary record, make this a rare case where a specific payment to an entity can be identified as an intended bribe. No other explanation of the payment to Plod has been put forward in the interviews we conducted. However, and given that the payments in question were to be made by Fassmer, not the Company, we have no

way of verifying whether they were made, or whether Parrinella received the funds apparently intended for him.

(v) General Observations and Level of *Vorstand* Involvement

The facts outlined above provide credible evidence that the FSA CEO and consultant/director of FSA, in addition to the former head of Merchant Marine, worked together with Fassmer in order to effect the payment of potential bribes by Fassmer – not Ferrostaal – to Argentine public officials. The evidence also suggests that they did so through the use of corporate entities in which one or both of them (or individuals close to them) had an interest or some form of affiliation, giving rise to a suspicion of them having made a personal profit from these transactions. As such, our review of the OPV Argentina project has revealed very serious compliance concerns, particularly in view of the fact that the two employees of FSA involved until very recently held the most senior positions at a Ferrostaal local company.

As regards the knowledge and involvement of the *Vorstand* with respect to these compliance violations, absent further corroborating evidence we cannot attribute sufficient probative value to the statements of the former head of Merchant Marine that he informed the former *Bereichsvorstand* of the fact that bribe payments were being made on the project, a course of action he allegedly sanctioned. The former *Bereichsvorstand* has denied those allegations in discussions with the Company's project office. Debevoise did not have the opportunity to interview him.

Certain circumstantial evidence does suggest, however, that the compliance risks of the OPV Argentina project could and should have been identified by the Company's most senior management. According to several employees interviewed, the former CEO of Ferrostaal AG had taken an unusually close interest in this project at the stage when it was still being pursued as a turnkey project. His personal involvement apparently went as far as making a decision to engage Helmut Cristian Graf, an Argentine lawyer of German descent, and Fischer-Hollweg, a former German diplomat, as external consultants. Debevoise was informed that both were intended to lobby the Argentine government, and in particular the Navy and the Ministry of Defense, on behalf of the Company. This met with strong opposition both from the former CEO, the then consultant/director of FSA and the former head of Merchant Marine, all of whom made their unhappiness with the activities of Graf/Fischer-Hollweg known inside the Company. The convergence of two related incidents in this regard show how the compliance risks were brought to the attention of the former CEO.

First, Fischer-Hollweg sent the former CEO a series of e-mails during the course of 2005 in which he complained about the fact that the former head of Merchant Marine used "*the corrupt Parrinella*" who he also claimed had been associated by other officials in the Argentine Navy as being on the Company's "*payroll.*" While these e-mails may have been written as an attempt to undermine the

activities of the rival camp inside the Company (composed of the former head of Merchant Marine, the CEO and consultant/director of FSA), they nonetheless contain allegations of sufficient severity against Parrinella that would have merited further investigation of the Company's dealings with this individual. The Investigation found no indication that this was in fact done.

Second, the former head of Merchant Marine stated in an interview that he complained to the former CEO about the decision to use Graf and presented the former CEO with a straightforward choice of continuing to pursue the OPV Argentina project with either him or Graf. He recalled explaining his opposition to Graf and the latter's request for a 10% consulting commission on the basis that Graf was not lobbying the right officials in Argentina and would therefore not be paying the right people, meaning that the Company would be wasting its money. He also allegedly informed the former CEO that he and FSA had identified the right interlocutor in Parrinella, someone with a "*proven track record.*" The former head of Merchant Marine stated in an interview that his discussion with the former CEO was open and direct and that he was clear that his opposition to Graf was not on the basis of a compliance concern, but rather a commercial assessment of the value of paying a high commission to a consultant who had failed to identify the appropriate end recipients to promote the Company's interests successfully in return for payment. While it is unclear why the final decision to terminate the relationship with Graf and Fischer-Hollweg was taken and whether or not it is true that the former CEO made this decision following the discussion with the former head of Merchant Marine, as alleged, internal documentation does confirm that the relationship was indeed terminated towards the end of 2005 and that the former CEO was involved in the discussions on the matter.

Put together, these two facts raise the possibility that the former CEO may have personally known of the intended bribe payments on the project. Even if the former head of Merchant Marine's account of his private discussion with the former CEO is discounted, however, one is left with e-mail documentation from a Company consultant – apparently personally chosen by the former CEO – in which the risk of corruption involved in dealing with a government official, or at least the perception of such a risk on the part of the Argentine government, is very clearly set out for the former CEO. The subsequent decision to sever ties with the consultant making the allegations and to continue working with the very man accused of corruption at the very least displays a lack of compliance awareness and a compliance failure.

This Report must, of course, be read subject to the caveat that we did not have an opportunity to question the former CEO about this matter.

(c) Colombia OPV Project

Ferrostaal also acted as Fassmer's representative in connection with the sale of offshore patrol vessels in Colombia. In August 2008, Fassmer signed a contract worth

a total of €17.26 million with the Colombian shipyard Cotecmar to provide a design, material packages and technical assistance for the construction of one OPV.

Fassmer agreed to pay commissions to various Ferrostaal entities which amounted to 8% for the design and technical assistance, and 5% for the material package portion. Of the 8% for the design and technical assistance, 5% was to go to Ferrostaal AG and 3% was for Ferrostaal de Colombia Ltda. ("FSC"), with Ferrostaal AG being obliged to pay 1.5% of the contract value to their Colombian agent (and former CEO of FSC) Jose Huerga. Of the 5% for the material packages, 3.125% was to go to Ferrostaal AG and 1.875% was to go to FSC, with Ferrostaal AG obliged to pay 1% of the contract value to Jose Huerga.

Debevoise understands that the Munich Prosecutor was initially investigating allegations, based on generalized assertions made by the former head of Merchant Marine during his initial interrogations, that bribes amounting to 2.5–3% of the value of the contract were paid to unidentified recipients. Debevoise has identified no evidence to support these allegations. Indeed, the former head of Merchant Marine during his interview distanced himself from the allegations made, stating that he had no actual knowledge whether improper payments were in fact made in connection with the project. Debevoise further understands that the Munich Prosecutor is no longer investigating the initial allegations made.

(d) Chile OPV Project

Ferrostaal Chile S.A.C. ("FSCHI") acted as the representative of Fassmer in connection with an OPV project. In 2005, Fassmer entered into a contract with ASMAR to supply a design and technical information, together with a licence to construct two OPVs from this design. The total value of the contract was €1.52 million. Unlike in Argentina and Colombia, a written consultancy agreement was entered into with Fassmer, pursuant to which FSCHI was paid a fee of €76,000 (equating to 5% of the value of the customer contract).

As outlined above in connection with Plod, there is an allegation of improper payments having been made in connection with this project. However, other than the temporal connection between the Plod payments and the OPV Chile project, the Investigation identified no evidence that this payment was in fact connected to the work of FSCHI with respect to the OPV project or that the funds were paid to Chilean public officials.

5. Egypt/Ferromisr

(a) Projects Investigated

In Phase II, we investigated a project for the sale of one 100 ton tug boat to the Suez Canal Authority ("SCA"), another project in respect of which allegations of bribery had been made to the Munich Prosecutor by the former head of Merchant

Marine. We also carried out a much more limited investigation of two other projects involving the same Egyptian agent who had worked on the 100 ton tug boat project. None of these projects were the subject of investigation in Phase I.

A total of four interviews and one informational briefing were conducted. Certain key former employees, including a former *Bereichsvorstand* who was responsible for the project in its latter stages, the former head of the responsible department, and the commercial manager of the project in its initial stages, declined to be interviewed. Ferrostaal's Egyptian agent, Mahmoud Salama (the principal of Ferromisr Commercial Agencies Co., "Ferromisr"), agreed to an interview but then cancelled it at short notice and ultimately refused to be interviewed. We reviewed the electronic data of 15 current and former employees, as well as hard copy files of potentially relevant documents.

(b) Egypt 100 Ton Tug Boat

In May 2002, Ferrostaal signed a contract with the SCA for the delivery of one 100 ton tug boat. The total value of the contract was €12.5 million. In connection with this contract, Ferrostaal paid a commission of 2% of the value of the contract (€250,000) to Egyptian agent Ferromisr. The project ran into a number of problems which significantly delayed delivery of the vessel, but were ultimately resolved by a settlement agreement on 1 November 2007. On 4 December 2008 Ferrostaal received back its warranty bond, thus bringing the project to completion.

(i) No Evidence Corroborating Allegation of Bribery Through Salama/Ferromisr

Two specific allegations of improper payments were made in connection with this contract. The first was that improper payments were made from Salama/Ferromisr's commission fee in the initial stages of the project, in order to secure the order from the SCA. The second allegation was that a second commission payment of €250,000 was made to Salama/Ferromisr in April 2008, from which bribes were paid in order to secure the release and non-extension (and thus repayment) of the outstanding warranty bond. Both of these allegations were made by the former head of Merchant Marine in a statement given to the Munich Prosecutor in February 2010, and were reiterated during an interview.

The Investigation found no evidence to corroborate either allegation of bribery. As regards the first allegation, the former head of Merchant Marine clarified that his assertion was not based on personal knowledge, but rather statements made to him by his predecessor. Although we found documents in which Salama attempted to justify demands for a higher commission percentage by referring to "*obligations*" that had to be fulfilled, we do not consider such suggestive language to be sufficient, without more, to corroborate the allegation of bribery. As regards the second allegation, the former head of Merchant Marine insisted in an interview that he had attempted to make this payment in April 2008, and that as far as he was aware, this

payment was duly made. However, an in-depth search of documents and Ferrostaal's accounting and banking data revealed no evidence of a second payment to Salama/Ferromisr in or around April 2008.

(ii) Potential Compliance Violations in Connection with Other Salama/Ferromisr Invoices

The Investigation did identify evidence of potential compliance violations in connection with other invoices rendered by Salama. Four invoices that were booked to the 100 ton tug boat project all referred to "*materials and equipment.*" We found no evidence that Ferromisr was ever involved in the purchase of materials and equipment in Egypt. In fact, there are a number of indications to the contrary. To begin with, two interviewees who were closely connected with the project stated that they were not aware that Salama ever purchased materials and equipment and stated that local purchasing was not part of his mandate or role. Second, when Salama was recently asked by the project manager to produce the usual back-up documentation such as invoices for the material and equipment purchased, Salama informed him that such evidence had already been destroyed in accordance with applicable legal requirements. Third, in relation to a very similar invoice from Salama (albeit one that was actually booked to a different project), there is evidence of a former employee explicitly instructing Salama to send him an invoice referencing the purchase of materials and equipment if he wished to get paid. The clear implication of this e-mail is that Salama simply used the "*materials and equipment*" title on invoices in order to obtain payment from Ferrostaal which would otherwise not have been due to him. In addition, interviewees expressed doubts that invoices for materials and equipment would have amounted to round numbers, as they always appeared to in these circumstances.

While there is thus strong evidence that several Salama/Ferromisr invoices were falsified, the Investigation found no indication that monies paid pursuant to such invoices were passed on to public officials. As such, it is possible that the payments were simply made in order to advance Salama/Ferromisr monies that would otherwise not have been due under the success-based agency agreement or, alternatively, to increase the commission to which Salama/Ferromisr was contractually entitled. Both possibilities raise internal control and compliance issues, even absent any evidence pointing towards a corrupt intention. As all relevant payments were made prior to November 2004 and under the watch of former employees who declined to be interviewed, the Investigation was unable to reach any clear conclusions on this issue.

(c) Indications of Salama Passing Monies on to Third Parties

The Investigation identified evidence suggesting that Salama passed monies on to third parties in connection with another Ferrostaal project. In an e-mail to the former head of the commercial shipbuilding division, a former commercial manager on the 100 ton tug boat project reported on a conversation with Salama during which the latter had "*confidentially*" informed him that he had decided to "*invest money*" in

order to accelerate the flow of information. The former commercial manager further proposed that Ferrostaal AG contribute to Salama's expenses with a "*modest*" amount which would be deducted from any commission ultimately due to Salama/Ferromisr. The former commercial manager then described how a decision had been reached with the project manager of the tug boat project that the amount in question (€10,000) should be given to Salama and booked on the project. Indeed, an invoice was generated on the same date, referring to *"spare parts for the Schottel Propeller"* in the amount of €10,000. The payment instruction referenced a project for a 40 ton floating crane for the SCA. We were unable to identify to which project this payment related. The payment was made approximately one month later. The project manager of the tug boat project could not provide us any information to clarify the incident, but it is safe to conclude that a consultant paying unidentified third parties to acquire information implicates compliance violations.

6. MFI

(a) Summary of the Compliance Audit

In view of the allegations of corruption in the submarine business, Ferrostaal proposed that Debevoise conduct a compliance review of MFI, the 50:50 joint venture between Ferrostaal and HDW/ThyssenKrupp, formed in 2004 to undertake the sales and commercial aspects of the submarine business previously carried out by the HDW/Ferrostaal consortium.

The Compliance Audit was accompanied by Hengeler Mueller, representing ThyssenKrupp, HDW's current majority shareholder. Unlike many Ferrostaal projects discussed in this Report, the Compliance Audit did not pursue existing allegations of improper payments. Instead, Debevoise focused on assessing MFI's compliance systems and identifying potential risk areas, in addition to determining whether any improper payments may have occurred in the past.

Debevoise reviewed past, ongoing and anticipated projects in thirteen countries, including Algeria, Brazil, Colombia, Egypt, Greece, India, Indonesia, Italy, Korea, Pakistan, Turkey, United Arab Emirates and Venezuela. Debevoise conducted thirteen interviews of MFI employees (including the current managing directors and the senior sales executive) and reviewed the e-mail data of all but one current MFI employee, as well as that of two former MFI managing directors who have since returned to Ferrostaal. In addition to interviews, we collected e-mail data, server data, and hard copy documents at MFI, approximately 120 binders in total, including all relevant materials on consultants and third-party relationships. Moreover, Ernst & Young acquired the complete accounting data from MFI's external accountant, Venthams Ltd., reviewed MFI's creditor accounts and bank entries and searched for select entities and payments in the accounting data.

As mentioned in Section I, Debevoise did not identify any Category 1 or 2 payments made by MFI. The €250,000 payment to Turkish offset service provider

Triton Consultancy and Trading Ltd. ("Triton") in connection with the Yonca-Onuk A.O. offset project qualifies as a Category 3 payment, although the information we have is too limited to come to a definitive conclusion. Given certain statements made by MFI's former Indonesian service provider as to his intention to "*grease*" the "*pockets*" of Indonesian officials, all payments to him also fall within Category 3, amounting to a total of £320,926.68.

The general absence of questionable payments is, of course, a very positive message that merits special attention. Nonetheless, the Compliance Audit identified areas of concern, both as regards MFI's existing projects and consultancy arrangements, but also structural issues regarding its compliance program and system, that will need to be addressed in order to reduce the risk profile of the business, particularly in view of the exigencies of the UK Bribery Act.

(b) History of MFI

After the effective end of their consortium relationship in 2003, HDW and Ferrostaal decided to place all sales and commercial functions of the submarine business into a new joint venture entity, with the former consortium partners retaining the ongoing projects in Greece, Portugal and South Africa.

MFI was first established as a limited liability partnership in April 2004, constituting a 50:50 shareholding between HDW and Ferrostaal. The entity became operational on 1 January 2006 (following the signature of an amended deed of partnership) and has its seat and office in London.

(i) Criminal Law Consideration in Choosing Location

London was selected as MFI's place of business – over Singapore, Dubai and Monaco – for a number of commercial reasons, including its centrality in the world of banking, finance and shipping, its developed offset market, and its accessibility from Germany and elsewhere. The intent of its shareholders to insulate themselves from potential tax and prosecutorial investigations in Germany by effectively outsourcing commission payments to a foreign joint venture entity represented an additional important consideration.

Debevoise identified numerous communications that underscore the extent to which the practice of the *Betriebsprüfung* in connection with audits of foreign consultancy payments, and related criminal law considerations, played a part in deciding to set up MFI in London. Memoranda and presentations from Ferrostaal's outside counsel, Simmons & Simmons, compare and contrast the procedural and substantive provisions of the UK and German legal systems, with an emphasis on criminal law factors such as the treatment of bribes – a term used expressly in one powerpoint presentation – by tax authorities and prosecutors, as well as the question whether there existed a prosecutorial discretion or obligation to investigate suspected bribery. Ferrostaal, in particular, appeared concerned about the view taken by

German authorities on foreign commission payments and, in particular, by what it viewed as overzealous inquiries by the German *Betriebsprüfung*, which was obliged to pass information about such payments to public prosecutors and, since 2003, intensified its efforts in this regard, thus opening the way to unwelcome prosecutorial investigations at Ferrostaal or HDW.

(ii) Insulation of Shareholders and "Firewall"

In parallel to selecting a suitable location, the shareholders sought ways to protect themselves from proceedings of the German authorities and potential liability for commission payments made by MFI through the erection of a so-called firewall. A central aspect animating the discussions of such firewall concerned the comparative protections offered by a "Limited Liability Partnership" ("LLP") and a "Limited" ("Ltd.").

The shareholders began discussing how to insulate themselves from liability before MFI was created and continued to explore the concept of a firewall until well after MFI had become operational, culminating in Ferrostaal's decision to install an intermediate entity as MFI's shareholder. Introducing the explicit intent to shield the shareholders from investigations into commission payments, a meeting memorandum from November 2003 involving Simmons & Simmons lawyers and HDW and Ferrostaal representatives responsible for setting up MFI stated: *"PB explained the concerns relating to Ferrostaal and HDW's role in the UK entity and the need to have 'firewalls' in place relating to services provided by the UK entity (including the activities of agents and commission payments)...PB also explained the issue relating to commission payments and HDW's desire to keep a 'low profile' with the Inland Revenue and to limit the risk of the commission payments to agents being investigated by the tax/criminal authorities in the UK..."*

The discussions over whether MFI should be incorporated as a Ltd. or a LLP centered on the tax benefits of the LLP, but, crucially, also noted the advantage of the Ltd. in shielding shareholders from possible investigations by German authorities. Concluding that even a LLP could provide sufficient protections for the shareholders, Dr. Aldenhoff of Simmons & Simmons informed his key contacts at Ferrostaal and HDW in January 2004 that, although a complete consolidation of the LLP could not be avoided, the solution proposed accomplished the desired "*avoidance of visibility of single expenses and payments on shareholder/partner level.*" The intention, as explained by Dr. Aldenhoff in an interview, was to avoid giving the German *Betriebsprüfung* direct access to information that would allow it to question MFI expense items, such as commission payments, on a line item basis.

Not only did Ferrostaal's outside counsel advise on the effectiveness of a firewall and the appropriate legal form of MFI, but the topic constituted a source of discussion among the principals of Ferrostaal's tax and finance departments and several *Vorstand* members following incorporation of MFI as a LLP in April 2004. A memorandum from the former head of Tax to the former CFO in October 2004

expressed concerns over unjustified investigations by the *Betriebsprüfung* and noted the non-deductibility of *Nützliche Aufwendungen* in both the UK and Germany in describing factors that could trigger investigations by German authorities. Concluding that the risk of investigations by German authorities was lower if the entity was organized as a Ltd., the former head of Tax denoted his preference for re-incorporating MFI as a Ltd. instead of a LLP.

This question of re-incorporation against the background of firewall considerations remained alive not only until the operational start of MFI on 1 January 2006, but continued into 2007 when MFI and its shareholders weighed up the feasibility of re-incorporation (*Neugründung*) to better insulate themselves by adding an intermediate layer to the corporate structure. The principal Simmons & Simmons partner advising MFI and its shareholders on the issue described the topic in an internal e-mail as a "*highly sensitive area which is on board level at both Thyssen and MAN.*" While HDW retained its shareholding structure, Ferrostaal ultimately interposed another layer between Ferrostaal AG and MFI by transferring MFI's shareholding from Ferrostaal AG to UK-based Ferrostaal London Ltd.

The available evidence about discussions concerning insulation from the risk of investigation by authorities of commission payments and the implementation of a firewall does not expressly reference an intention on the part of the shareholders that MFI make improper payments. Rather, it appears that the shareholders debated these considerations against the backdrop of what they perceived to be ill-founded and unjustified investigations, triggered by the practice of the *Betriebsprüfung*, into legitimate commission payments that would result in substantial cost and reputational damage to the shareholders. As such, we cannot draw any conclusions as to whether there was an intention, at least on the part of Ferrostaal, to continue making potentially questionable payments in the submarine business through MFI rather than directly. However, the frequency of the criminal law discussions and the much debated question of the firewall, viewed in conjunction with the Company's history of questionable payments (at least on the Greek submarine project) – of which the principal author of the MFI idea and Ferrostaal's key negotiator, the former head of Marine, was aware in 2004 at the latest – do not permit us to exclude this possibility. At the very least, there is no evidence that Ferrostaal intended for MFI to take a markedly different approach to commission payments to consultants than the approach followed by Ferrostaal itself.

(c) Greece

(i) *Altproblem Griechenland*: Potential Overlap with Outstanding Ferrostaal Obligations

MFI did not have any active projects in Greece but the record shows negotiations with MIE regarding the conclusion of a consultancy and other agreements during the course of 2006.

As discussed above (see Section III.A.1), it is a point of contention in the evidence whether the former head of Marine in the 2004 meetings with *Gebetskreis* representative and their lawyer, Way, gave assurances that their outstanding claim would be settled via MFI. The MFI data shows no payments to any of the entities affiliated with the *Gebetskreis* and we have found no evidence in the MFI data concerning the *Gebetskreis*.

Section III.A.1 describes in detail the circumstances under which Ferrostaal paid its Greek agent MIE €83.97 million in commissions between 2000 and 2003. Debevoise identified no formal claims by MIE in excess of this amount or additional payments following the final settlement payment from Ferrostaal in October 2003. Circumstantial evidence, however, indicates that in 2006, MFI and its shareholders considered entering into contracts of questionable utility with entities affiliated with Matantos providing for an aggregate of €6 million in fixed sum payments, not for genuine commercial reasons related to MFI and set out in the agreements themselves, but in order to settle claims Matantos was asserting against Ferrostaal and/or possibly, HDW.

The draft minutes of a meeting in January 2006 attended by HDW and Ferrostaal executives, as well as MFI employees, reference a problem of €20 million in outstanding payment obligations in Greece, according to HDW, and suggest that the responsible Ferrostaal *Vorstand* would resolve the issue. The meeting notes further state that additional projects with MIE could be arranged only after the "legacy problem" (*Altproblem*) had been solved.

During interviews, MFI managers had little or no recollection of the matter described in the draft meeting note and of its discussion. A MFI managing director said that the amount of €20 million sounded excessive and that he recalled hearing that MIE was claiming either €4 million or €6 million from Ferrostaal. The former head of Marine, on the other hand, asserted that the outstanding payment obligations referenced related not to Ferrostaal, but to promises made by ThyssenKrupp's subsidiary Blohm & Voss in connection with frigates contracts that never materialized.

In March 2006, concrete discussions took place between MFI and its shareholders to advance a draft consultancy agreement between MFI and MIE relating to Greece which, according to the record, was first sent by MIE to MFI in 2004. In interviews, no one could explain why such a draft would have been sent to MFI at a time when it was not even operational; all MFI and Ferrostaal managers whom we interviewed denied that the 2004 draft proposal was in any way related to the payment demands being made during 2004 by Avatangelos and Filipidis, as described in Section III.A.1.

The 2006 mark-up of the draft MIE consultancy agreement contains handwritten notes from one of the two MFI managing directors at the time, addressed to the other managing director stating that the percentage compensation for MIE had

to be left blank pending an agreement on an amount between Matantos and the responsible Ferrostaal *Vorstand* member and HDW *Vorstand* Walter Freitag, following which they (meaning the MFI managing directors) would insert the appropriate "fee" in the draft contract. It is difficult to understand why the HDW and Ferrostaal *Vorstand* members would be negotiating a percentage commission on behalf of MFI, to be inserted in a consultancy agreement envisaging future business for Matantos with MFI. The more plausible explanation – consistent with a natural reading of the wording in the handwritten notes and with the previous discussions regarding the *Altproblem* involving MIE – is that the two *Vorstand* members of Ferrostaal and HDW, respectively, would be discussing a settlement amount with Matantos for his outstanding claim against one or both of the shareholders. The MFI managing directors would then reflect the settlement amount by inserting the equivalent "fee" into the draft consultancy agreement between MFI and MIE.

One MFI managing director and addressee of that handwritten note acknowledged that the draft consultancy agreement with MFI would have been one way for Matantos to "earn" the outstanding amounts by providing further services to MFI. He denied, however, that the very purpose of the draft consultancy agreement was to find a way in which one or both shareholders could settle pre-existing obligations to Matantos that were unrelated to the business of MFI. The former MFI managing director who authored the handwritten note stated that he was not aware of any pre-existing obligations on the part of Ferrostaal towards MIE and that he had understood the anticipated discussion between the Ferrostaal and HDW *Vorstand* members and Matantos to relate solely to a future collaboration between MFI and MIE.

A day after the meeting of Matantos and the HDW and Ferrostaal *Vorstand* members previewed in the handwritten note, MFI conducted its regularly scheduled members meeting (in which the MFI managing directors and the responsible *Vorstand* members of HDW and Ferrostaal participated) on 10 March 2006. While no reference to the pre-existing obligations is made in the meeting minutes, on the same day the Ferrostaal *Vorstand* member sent an e-mail to the head of Marine, entitled "*mfi*," in which he stated the following:

> *Mr. Matantos continues to be relentless. He insists on the payment of the large amount, which he considers still to be owed to him. In addition to this, Freitag [the respective HDW Vorstand] is pointing to further very large remaining claims of the known circle. He attributes the problems in the execution of the Greece business very clearly to this issue.*

The evidence suggests that in response to the meetings in London between Matantos and the responsible *Vorstand* members of Ferrostaal and HDW, various individuals at Ferrostaal were involved in providing MFI a template consultancy agreement. Within days, the *Vorstand* member then responsible for Marine held a meeting with the head of Legal at the time to discuss a template consultancy agreement for MFI. On the same day, 14 March 2006, the head of Marine e-mailed the head of Legal a template for a MFI consultancy contract identical to the draft

consultancy contract between MFI and MIE described above. The *Vorstand* member responsible for Marine also received an e-mail from the former head of Marine attaching an overview of all payments made by Ferrostaal to MIE between 2000 and 2003 under the existing consultancy agreements, which in itself suggests that the question of claims to further payment had been asserted by MIE.

(ii) Three Initialed Contracts for €6 Million

The electronic data of a MFI employee and now managing director who at the time was responsible for controlling contained two draft liquidity planning charts showing anticipated payments to MIE of €6 million over the space of several months starting in 2006. Although we could not establish the precise reasons these draft liquidity charts were created or to whom they were sent – none of MFI's official monthly liquidity charts that were sent to the shareholders contained a comparable line item – they provide clear documentary evidence of the fact that making fixed payments to MIE in the sum of €6 million must have been at least contemplated by MFI. None of the MFI managers interviewed, including the former controller in whose data the document was found, could provide an explanation of the chart.

The Investigation traced the figure of €6 million to the fixed payment obligations contained in three contracts between MFI and Matantos entities which the parties initialed in August 2006:

- The consultancy agreement between MFI and MIE Europe Ltd., discussed above, which related to MFI's activities in Greece and provided for a success fee of 5%, plus a €1 million advance payment upon signature of the agreement.

- A contract for a research study for the benefit of the Greek Navy, under which MFI would pay €2.5 million to MIE Europe Ltd. upon completion of the study.

- A contract with Marconsult Ltd. (another Matantos entity) for a building evaluation of a deadweight post-panamax vessel to be sold to Venezuela, which also provided for a fixed fee of €2.5 million.

The purported commercial rationale for these three agreements, as it was explained in interviews, was less than convincing and tends to support the notion that the agreements were devised for another purpose, namely to provide a mechanism to make future payments to Matantos promised to him by one or both of the shareholders.

MFI ultimately did not enter into these contracts or any other contracts with Matantos or MIE. But the mere fact that it not only pursued the idea, but contemplated paying Matantos/MIE a fixed sum of €6 million in 2006 (in addition to any success fee due under the consultancy agreement) is remarkable, considering (i)

the significant difficulties the shareholders were already facing at the time to recover the huge debts owed by the Greek state under the existing submarines projects, (ii) the related poor prospects for future submarines orders in Greece and (iii) MFI's precarious financial situation during this start-up phase, when it generated no income and was wholly dependent on financial support in the form of shareholder loans.

Moreover, it is noteworthy that the initialed August 2006 version of the consultancy agreement, unlike its precursor discussed in March 2006, now contained the additional – and unusual – obligation on MFI to pay a non-refundable €1 million advance upon contract signature. With one possible exception (see the payment to Dr. Mathiopoulos, below), we saw no parallel of this non-refundable arrangement in any other MFI consultancy agreement or, indeed, in the Ferrostaal agreements with MIE.

As regards the Greek study agreement, no credible explanation was provided as to why paying €2.5 million to MIE in order to provide the Greek Navy with a logistics study would have been money well spent. The rationale for this arrangement is also hard to reconcile with the fact that the consortium was in effect already clearly present in the Greek market, both by virtue of the *Archimedes* and *Neptun II* contracts, but also given that it owned and managed HSY. Again, we have seen no parallel at MFI of €2.5 million being paid for any study. Similar questions arise in relation to the study agreement relating to the Venezuelan offset project.

MFI eventually abandoned efforts to finalize these contracts in October 2006, when it signed "letter agreements" with MIE and Marconsult that referred to MFI's inability to enter into the contracts "*due to the reasons mentioned to you*," identified in an interview as liquidity reasons. The letters stated that the initialed contracts would not be signed at that time but only upon entering into a submarine contract in Greece and Venezuela, respectively. The notion that MFI could not enter into the contemplated agreements due to liquidity reasons is, of course, entirely consistent not only with the state of MFI's finances at the time, but also the possibility that MFI's shareholders ultimately did not sanction the agreements – devised for the shareholders' benefit in settling their obligations to Matantos – because they were not prepared to make the appropriate funds available to MFI. None of the MFI managers whom we interviewed accepted that the decision was in any way driven or influenced by a decision on the part of the shareholders regarding settlement of the pre-existing claim. The MFI managing director confirmed that MFI's continued liquidity problems were the sole reason for entering into the "letter agreements," but that it subsequently also became clear that there were no foreseeable short-to-medium term prospects for submarine contracts in Greece or in Venezuela. At least as regards Greece, it is hard to credit the assertion that this was not already clear in early/mid-2006, when MFI started negotiating the draft consultancy agreement.

Notwithstanding assertions in interviews by MFI managers to the effect that the contracts were not devised to fulfill outstanding obligations but represented genuine commercial opportunities, the evidence indicates that MFI's shareholders directed all relevant efforts in this matter, displaying an unusual degree of

involvement and suggesting that they, or at least Ferrostaal, likely intended to use MFI as a vehicle for further payments. While the arrangements were not concluded and no payments were made to MIE or any other Matantos entity, the episode is thus important nonetheless, to the extent that it indicates that the shareholders, or one of them, may have intended to use MFI – with the connivance of its managing directors – to make payments they did not want to or could not make directly.

(d) Overview of MFI Compliance Program

MFI maintains and applies a functioning compliance program, with significant input from external advisers. MFI receives regular advice on compliance-relevant aspects before engaging consultants from its external counsel (Simmons & Simmons) and Control Risks. In addition, MFI's board, consisting of two managing directors, customarily produces a due diligence memorandum that summarizes the available information about a prospective consultant or agent.

MFI's shareholders conduct regular "members meetings" at which important strategic decisions, as well as topics related to the engagement of consultants and agents, are discussed. According to an internal MFI policy, the shareholders should in principle be notified of all consultancy agreements. Moreover, and according to the same internal policy, any proposed consultancy agreement with a success fee exceeding 5% must be expressly approved by the members. In practice, virtually all consultancy agreements have had success fees not exceeding 5%.

MFI's internal capacity on compliance issues was enhanced in late 2009 when its in-house counsel was also appointed to the position of compliance officer, although the parameters of her exact role, responsibility and authority have yet to be defined. Until then, MFI's managing director had served in dual roles as managing director and compliance officer. Although the merging of these two roles in one individual undoubtedly put resource constraints on his time and leads to the question whether a managing director could, in fact, perform the compliance role properly and independently of business considerations, designating the most senior person in the organization as the compliance officer does, on the other hand, establish a "tone at the top" which emphasizes the importance of compliance. With the help of its external counsel, MFI has developed an updated draft of its existing compliance policies with a view towards the anticipated implementation of the UK Bribery Act.

The Investigation identified procedural compliance and internal controls weaknesses in certain cases. The undetected submission of what appear to be false invoices by MFI's former Indonesian service provider in connection with a reimbursement of costs for a bid bond highlights the need to formalize certain procedures, including by assigning responsibility for the substantive review of invoices (evidenced by stamps and signatures) to the respective employee. The current system contains no such procedure and thus lacks a mechanism to verify the substantive correctness of invoices.

Select statements of MFI employees during interviews give rise to some concern over their compliance awareness and a potential attitude of willful blindness. Most notably, the MFI sales executive responsible for Pakistan indicated that he had no interest in knowing what a consultant did with his fees – even if there were positive indications that the consultant intended to make payments to public officials.

MFI has suspended or terminated business relationships with third parties as a result of compliance concerns. Several of these cases are further discussed below; they indicate an appropriate awareness of and sensitivity to compliance. With respect to its long-time agents in Egypt and Pakistan, MFI recently determined not to extend their contracts pending the conclusion of the Compliance Audit. In the case of its Indonesian service provider, MFI refrained from entering into a consultancy agreement due to amount of the desired commission, of which he intended to distribute part to an Armed Forces welfare/social fund of dubious legality. Finally, with respect to the contemplated retention of an offset services consultant for a prospective submarine contract in India, MFI decided not to retain the consultant after learning negative background information in a Control Risks report.

In other instances, however, MFI has retained consultants and made payments notwithstanding significant compliance concerns. These cases raise questions about the entity's approach to compliance when substantial business interests are at stake, and the extent to which not only the letter, but also the spirit of the policies and procedures is applied. Examples of decisions falling into this category include:

- The engagement of a consultant for a very lucrative contract in Korea, notwithstanding his prior conviction of bribery, which appears particularly risky in light of the requirements of "adequate procedures" under the new UK Bribery Act.

- The payment of an offset services provider in Turkey despite serious documented reservations by the compliance officer about its legality.

- The use of an Indonesian service provider who made explicit references to third-party payments to the former MFI managing director but was neither reprimanded nor terminated.

- The retention of consultants in Italy (Bussei) and Egypt/Croatia (Mathiopoulos) who are known to MFI managers to have been involved in potentially problematic activities on behalf of MFI's shareholders.

The following sections contain more detailed descriptions of our observations of the applications of MFI's compliance program. Only specific examples that are most pertinent to the themes identified during the Compliance Audit are included; several countries/projects where no issues of significance were identified are omitted.

(e) Korea

In August 2008, HDW/MFI entered into a contract with the Korean Defence Acquisition Program Administration ("DAPA"), pursuant to which DAPA would purchase from HDW/MFI commodities for the construction of six Type 214 submarines ("KSS 2nd batch"). A separate offset contract between the same contractual parties provides for direct offset obligations of €325.6 million.

MFI signed two agreements in 2006 for commercial and marketing services, respectively, in Korea with Super Supply & Trade, a Hong Kong based consultancy firm. The general agreement provided for a retainer of €50,000 per quarter, whereas the specific agreement foresaw a success fee of 3%. Approximately one year later, the MFI board resolved in November 2007 to terminate the agreements, instead opting to pursue a consultancy contract with Ubmtech Korea Co. Ltd. ("Ubmtech"). The MFI managing director stated in an interview that both entities are controlled by the same individual, E.S. Chung.

MFI instructed Control Risks to prepare a due diligence report on Ubmtech and its principal in anticipation of a potential contract. The Control Risks report, dated 5 December 2007, raised several significant compliance concerns, chiefly the bribery conviction of the company's founder and principal, E.S. Chung. Chung was convicted in 1993 for bribery of several Korean defense officials and paying approximately $320,000 to the commander of the Royal Korean Navy in connection with a destroyer contract. He subsequently served two years of his three-year sentence before being pardoned in 1995.

Notwithstanding the prior conviction and other concerns about his business dealings in the Control Risks report, MFI pursued negotiations with Ubmtech and – per board resolution – even appeared willing to meet Ubmtech's original commission demand of 7%, which markedly exceeds the percentage in MFI's other consultancy agreements. In light of the obvious concern arising from Chung's prior bribery conviction, the MFI managing director conducted a one-on-one meeting with Chung which he summarized in a due diligence report that accompanied the MFI board decision to retain Ubmtech:

> *Mr. Chung E-Sung reacted in a very moderate, calm and honest approach stating that this information [concerning the conviction] is correct. The signee pointed out that he would have expected that such information should have been addressed by Mr. Chung E-Sung himself to MFI in the past as he was informed by MFI about the great awareness of MFI to avoid any risk of the reputation of MFI if any allegations of corruption were to be maid [sic] in relation to this project. Mr. Chung E-Sung answered that the case occurred 14 years ago and that he could not see any direct link to the current project in terms of reputation as his standing within the Republic of Korea is outstanding and that he is an honourable member of the*

> *society... Furthermore, he for himself has achieved other focuses in live [sic] as he is actively involved in religious [sic], scholarship and charitable activities which reflect his strong religious believe [sic]...After all the signee had the impression not to go any further questioning about the 1993 incident as he had the feeling that in case Mr. Chung E-Sung could withdraw from the project if he feels uncomfortable about the understanding with his contractual partners.*

The due diligence report suggests – and its author confirmed in an interview – that the decision to engage Ubmtech depended in large part on his personal judgment that Chung had altered his behavior since the bribery conviction – evidenced by a religious conversion and involvement in charitable causes. The due diligence report also intimates, however, the overriding importance MFI attributed to preserving a positive relationship with Chung and Ubmtech, which is indicated by the managing director's reference to his reluctance to probe further due to concerns that Chung would become uncomfortable and withdraw from the project.

On 15 January 2008, MFI and Ubmtech entered into a "Project Work Sharing and Collaboration Agreement" that provided for a commission of 5% of the contract's net value. The commission percentage was subsequently reduced through various amendments and adjustments to the payment schedule to 4.5%. Accordingly, MFI has to date paid Ubmtech approximately €42.9 million, including a lump sum installment of approximately €34.4 million. Further payments will be due in accordance with the agreed payment schedule.

A due diligence update from Control Risks, requested in August 2010, apparently triggered by a small name change of Ubmtech and personnel changes in the company's leadership, did not raise significant new concerns about Ubmtech or Chung. In connection with the due diligence update, MFI also considered sending Ubmtech a list of questions concerning its operations and use of funds. Interviews indicated that the MFI managing director determined not to submit such a list of written questions – which were also intended to address the requirement of "adequate procedures" under the new UK Bribery Act – and instead would raise these topics with Chung in a face-to-face meeting.

Although the Investigation identified no improper payments in connection with the award of the delivery contract to HDW/MFI in 2008, Chung's bribery conviction in 1993 and subsequent prison sentence constitutes a significant red flag. The retention of Ubmtech – with full knowledge of Chung's bribery conviction – may be viewed as MFI placing a premium on the value of Chung's apparently considerable skill, experience and influence with the Korean Navy at the expense of compliance considerations. While confronting Chung in a personal meeting was laudable, the retention of Ubmtech nonetheless represents a continuous risk to MFI. This risk is exacerbated by the new UK Bribery Act, which requires corporates to prove a defense of "adequate procedures" to the new corporate criminal offence of failing to prevent

bribery, which would be triggered if a third-party agent such as Chung engaged in bribery.

Informal discussions on a no-name basis with the director of the UK's Serious Fraud Office ("SFO"), Richard Alderman, (on an unrelated matter) confirmed that the SFO would view this is a very significant red flag and that a corporate would need to make its decision to retain such a consultant based on a risk-assessment which it would then need to explain to the SFO (in the event of an instance of overseas bribery). In particular, the corporate would need to satisfy the SFO as to why it deemed it necessary to work with this particular consultant and what steps it took to prevent the consultant from engaging in bribery. Alderman expressed his view that the corporate would be starting from a difficult position, given its knowledge of the consultant's history. Thus, any wrongdoing by Ubmtech or Chung on behalf of MFI, even without its knowledge, could have very serious consequences for MFI under the new anti-corruption regime in the UK.

(f) Turkey

(i) Consultancy Contract with Tetico

HDW/MFI signed a €2.06 billion supply contract for the delivery of six material packages for Type 214 submarines to the Turkish Navy in July 2009 and a separate offset contract. Prior to entering into the delivery contract, MFI retained HDW's long-time Turkish representative Tetico A.S. in November 2008 under a 3% success-based consultancy agreement.

The Investigation reviewed the circumstances of a €2 million loan extended by MFI to Tetico several days before the delivery contract was signed in July 2009. Because of the purely success-based nature of the consultancy agreement, MFI had not made any payments at this time to Tetico. Before making the loan, MFI received written approval of its shareholders and legal advice from Simmons & Simmons. The members resolution authorizing the loan explains that the difficult price negotiations with the Turkish Navy had resulted in an arrangement between Tetico and MFI whereby the consultant reduced its success fee by approximately one-third. The MFI managing director confirmed in an interview that the overall reduction in the offer price due to pressure from the customer forced all subcontractors and consultants to accept a reduced commission. Against this backdrop, and in light of Tetico's cash flow difficulties, MFI and Tetico signed a loan agreement with 5% interest payable and repayment within six months. We identified no evidence that Tetico used the loan to make improper payments leading to the execution of the delivery contract.

(ii) Contracts with Offset Service Provider Triton

The combination of significant offset obligations under the Turkish delivery contract and a lack of in-house experience led MFI, on the recommendation of Tetico, to retain in March 2010 the services of Triton, a Malta-based offset services provider.

Prior to contracting with Triton, MFI had approached Simmons & Simmons for advice on the legality from a tax and compliance perspective of retaining an offset consultant which is incorporated outside Turkey and subcontracts services to a Turkey-based partner.

Following completion of its usual compliance checks into the individuals behind Triton, MFI signed an offset services framework agreement with Triton on 17 March 2010, pursuant to which Triton was to receive a monthly retainer of €5,000 to help identify, prepare, and advance offset projects eligible and acceptable to the relevant Turkish offset authority. On the same day the parties also concluded two specific offset services agreements ("SOSA") for the actual offset projects facilitated by Triton. SOSA No. 1 provides for payment of approximately €1.8 million and €484,000 at a subsequent stage – based on the timing of down payments from the Turkish ministry – as consideration for Triton's support in preparing and conducting negotiations relating to the offset agreement. SOSA No. 2 provides for a down payment of €250,000 thirty days after receipt of the pre-approval letter of the Turkish offset authorities and a success fee resulting from an offset project facilitated by Triton: the export of fast patrol boats to the Government of Egypt constructed at the Turkish Yonca-Onuk shipyard. If fully realized, the project is intended to trigger €100 million in offset credits by the Turkish SSM, which approximates to 40% of MFI's offset obligations.

(iii) Concerns by MFI Compliance Officer About Yonca-Onuk Payment

The MFI compliance officer raised concerns with respect to the anticipated €250,000 down payment to Triton, which she memorialized in an undated "Compliance Report Turkey" and an e-mail to herself. Neither document had been distributed or formalized, and both were identified in her electronic data.

A meeting in January 2010 with the responsible MFI offset employee and representatives of Triton, who expressed the urgent need for a payment of €250,000 for lobbying work to help the Yonca-Onuk shipyard obtain approval for the project from the Turkish offset authorities, left the MFI compliance officer with several compliance concerns, which she discussed with the MFI managing director. Her concerns included (i) whether the pre-approval letter to the Turkish SSM was factually correct and MFI causally facilitated the offset project; (ii) whether a board resolution existed approving this project; and (iii) whether MFI's payment to Triton might be passed to Yonca-Onuk.

According to the MFI compliance officer's report on Turkey, the MFI managing director dismissed her concerns as not valid. Moreover, according to her internal note, the MFI managing director decided to take control of the offset project and thus removed her from further involvement in and responsibility for the matter.

An e-mail of 31 March 2010 she wrote to herself records a subsequent conversation with the responsible MFI offset employee and the MFI managing director and again reflects her serious concerns over payments to Yonca-Onuk. According to the e-mail, the offset employee approached her and explained that "*we will pay Triton an agent commission and Triton will pay from that money Yonca-Onuk a certain amount a payment as a sustainer for proceeding with its project. We do not know how much Triton will pay to YO.*" The e-mail further notes that the compliance officer subsequently spoke again with the MFI managing director and asked "*[I]s such payment legal? Reply: This is how offset is done. It is very common.*" The MFI compliance officer further noted in the e-mail that she would await a tax opinion from a Turkish law firm concerning the legality of the Triton arrangement and would also raise her above-cited concern about the legality of the payment with Simmons & Simmons.

In an interview, the compliance officer admitted that she had serious reservations about the Yonca-Onuk payment on the basis of the information provided to her, but that because the MFI managing director had taken over her role, the issue was no longer under her direct responsibility.

(iv) Payment to Triton for Yonca-Onuk Project Made Regardless

The Yonca-Onuk project materialized, with the Turkish shipyard concluding a contract with the Egyptian Ministry of Defense following pre-approval by the Turkish offset authorities in 16 February 2010. MFI made payment to Triton pursuant to SOSA No. 2 in the amount of €250,000 on 25 November 2010 and following receipt of an opinion confirming legality of the payment under Turkish tax law. However, no legal opinion exists with respect to the legality of the payment to Triton from a compliance perspective, as the compliance officer had requested. In an interview, the compliance officer said that she did not know whether the legality of the payment had been thoroughly analyzed. Given that she had raised serious concerns about the payment, it is remarkable that she was not in a position to confirm that the issue had been fully and thoroughly analyzed, as she herself had suggested. The MFI managing director in his interview indicated that no conclusive answer had been received on the issue from Simmons & Simmons. Debevoise is not in a position to conclude whether the payment was improper, as its purpose and the actual payment modalities (such as the question of whether it would be passed on by Triton and, if so, to whom) remain unclear.

Nonetheless, the manner in which the MFI compliance officer was sidelined after she had raised significant compliance concerns – the first and only time she has in fact done so on a project – suggests insufficient sensibility to compliance concerns and raises questions about the role, authority and independence of the compliance officer within the MFI organization.

(g) Pakistan

HDW/MFI submitted a bid for the delivery of material packages for three Type 214 submarines in 2006 and were selected following disqualification of the French competitor DCN due to technical deficiencies. The negotiations with the Pakistani Navy halted in 2009, however, and the prospects for completion of the contract appear currently uncertain. Issues relating to financing, payment conditions, and final price are still unresolved, and the German government has indicated that it will not provide the necessary export permits.

Because MFI's work sharing and collaboration agreement for commercial and marketing support with its Pakistani representative Systems Co. ("Sysco") is success based, no payments to Sysco have been made to date. Sysco is headed by Tariq Durrani, a former long-time employee of Ferrostaal's office in Pakistan and subsequent Ferrostaal representative in Pakistan.

(i) Allegation of Contemplated Bribery

On 11 August 2010, a German military attaché in Pakistan, Klaus Wolf, sent an e-mail to a member of a German military procurement agency, in which he alluded to "*legitimate allegations of attempted bribery and improper business practices by Sysco and Mr. Durrani.*" After subsequently receiving the e-mail, the current MFI managing director confirmed to Wolf on 23 August 2010 that Sysco is MFI's representative in connection with the planned submarine project in Pakistan and requested written evidence of any legitimate allegations. In reply, Wolf indicated that he would meet with MFI personally under the assumption that sources would be protected.

Such personal meeting between Wolf and the MFI managing director and the MFI compliance officer took place in Istanbul on 25 October 2010. According to Wolf's meeting memorandum, he explained learning from his predecessor as military attaché in Pakistan, Alois König, that Sysco had promised bribes in the amount of $66 million in connection with the anticipated submarine contract and that political levels were implicated. This amount approximately constitutes the commission due to Sysco in the event of successful conclusion of the delivery contract. The same specific allegation is noted in a memorandum of the meeting prepared by the MFI managing director.

The day after meeting Wolf, the MFI managing director and the MFI compliance officer met with Tariq Durrani at a Paris trade show and confronted him with the allegations. According to the MFI managing director, Durrani reacted angrily and quickly retained a German lawyer to pursue claims before German courts against Wolf for libel and slander unless Wolf withdrew the accusations.

The MFI managing director met in London in January 2011 with the alleged source of the allegations. A meeting note prepared by the MFI managing director suggests, however, that the MFI managing director did not question König about the bribery allegation. It thus remains unclear to whether and to what extent König supports the allegations attributed to him by his successor Wolf.

According to the managing director of MFI, as a result of the allegations against Sysco and Durrani, MFI has decided, as a precautionary measure, not to extend its work sharing and collaboration agreement with Sysco and currently intends not to pursue further business with Durrani.

Although no payments have been made to Sysco in connection with the anticipated submarine contract, the very specific bribery allegation provides grounds for concern. The concern is somewhat heightened by the fact that the former head of Merchant Marine generally intimated in his interview that Durrani, who is known to have excellent contacts to the highest political and business circles in Pakistan, has in the past been involved in bribery payments in Pakistan, albeit without providing documentary proof or specific examples.

(h) Indonesia

Indonesia bought two Type 209 submarines from HDW in 1996, "Cakra" and "Nanggala." The submarines were overhauled by a Korean shipyard in 2004 and 2008, respectively. HDW and Ferrostaal competed for and lost the bid to overhaul Cakra; HDW/MFI competed for and lost the bid for the Nanggala overhaul. At the time of the Cakra and Nanggala overhauls, Ferrostaal and MFI were represented in Indonesia by PT Prakora Daya Mandiri ("PT Prakora"). PT Prakora had worked as a Ferrostaal agent in Indonesia since the early 2000s and subsequently was retained by MFI in 2006.

HDW/MFI are currently considering how to respond to a request for proposal from the Indonesian Navy for construction of new Type 214 submarines. Debevoise was told that HDW/MFI are contemplating whether to proceed alone or in conjunction with a Korean shipyard. To assist with preparations in case HDW/MFI were to submit their own bid, MFI recently retained a representative, PT Adventura Prokreasi.

(i) PT Prakora

MFI used the services of PT Prakora from 2006 until 2008 pursuant to an office and infrastructure agreement with a monthly retainer of €8,500. In addition to providing an office infrastructure, PT Prakora also made small-scale expenditures for MFI and supplied MFI with information regarding political developments and personnel moves within the Indonesian Navy.

Serious concerns about the business practices of PT Prakora's principal, Indradjit Prawoto, are triggered by his suggestions to make a grease payment to government officials and his demand for a very significant commission in a consultancy contract that encompassed potentially questionable payments to an Armed Forces welfare/pension fund.

(1) *"Grease in to my Buddies Pockets"*

In a 12 July 2006 e-mail, Prawoto provided an update to the former MFI managing director about a hearing of Indonesian governmental agencies concerning planned new Navy projects. Previewing a strategy meeting in the following week involving a high-ranking public official and parliamentary committee members prior to a presentation to the head of the Indonesian Navy, Prawoto wrote that

> *Next week Djoko S/Kom I members and I will be meeting to strategize in the 6 subs/USD 750 mio issue, thus to eliminate this issue if eventually KASAL present this package. This means I will be putting "grease" in to my buddies pockets. 2. Therefore may I ask you to consider my request for an advance payment of the August monthly expense support, while waiting for Barclays & StandChart to settle their mishap. As soon as Prakora receives the July payment, we will transfer back the amount to MFI. August payment is due in another 10 days from now and the August payment will come in handy next week.*

Subsequent e-mail exchanges between the former MFI managing director and Prawoto indicate that the MFI managing director did not reprimand Prawoto for his apparent suggestion to make payment to public officials with funds provided by MFI. Instead, the MFI managing director made efforts to ensure that the funds were wired to PT Prakora as requested.

One week after his initial e-mail intimating the planned payment to public officials, Prawoto informed the MFI managing director in an e-mail entitled "Meeting/dinner with MOD VIPs," that he "*had several meetings with the Ministry of Defense and the Indonesian Navy.*" On the next day, Prawoto confirmed receipt of the July and August 2006 monthly installments, which, in line with Prawoto's request, had been expedited in August. Although we cannot determine whether Prawoto indeed made payments to the public officials, as suggested by his e-mail, the acquiescence and support of the managing director of MFI at the time for a *prima facie* non-compliant proposal raises substantial concerns.

In his interview, the former MFI managing director did not recall what Prawoto intended to do with the advance payment and could not explain what the reference to "'*grease' in my buddies pockets*" may have meant. The former MFI managing director did not recall his reaction to Prawoto's e-mail but asserted that he had previously made it clear to Prawoto that MFI would not tolerate any improper payments. He had no explanation for why Prawoto nevertheless felt sufficiently

comfortable to document his questionable intentions in an e-mail. Debevoise identified no evidence that others at MFI were aware of the e-mail or the reason for the accelerated monthly retainer payment.

(2) Proposed Payment to Armed Forces Welfare/Pension Fund

In 2008 MFI considered engaging PT Prakora as a consultant in anticipation of its bid for the Nanggala overhaul. Following an unremarkable Control Risks report, MFI and PT Prakora negotiated (ultimately unsuccessfully) the terms of a consultancy agreement. A marked-up agreement included an extraordinarily high commission of 12%, split into 8% for services rendered during the acquisition phase and 4% for services rendered in the execution phase.

The MFI managing director indicated in an interview that the 8% portion was intended for the Dana Komando armed services welfare fund, with PT Prakora retaining the remaining 4%. He stated that this proposal had come from PT Prakora and had been met with skepticism by MFI, which expressed its unwillingness to enter into any such arrangement absent a transparent corresponding provision in the customer contract and a legal opinion confirming its validity. MFI indeed commissioned and received a legal opinion (which provided an unclear answer on the legitimacy of such payments) but eventually refrained from finalizing the contract with PT Prakora.

Subsequent to its failure to agree on a commission percentage with PT Prakora, HDW/MFI lost its bid for the Nanggala overhaul. Shortly thereafter, MFI terminated its relationship with PT Prakora.

In statements to the Munich Prosecutor, the former head of Merchant Marine alleged that MFI lost the Nanggala project because it was unable to make a requested bribe payment worth 22% of the contract value. In an interview, the former head of Merchant Marine recalled meeting with the MFI managing director and the MFI senior sales executive in Essen to discuss how PT Prakora could pay the requested bribe, but reached the conclusion that the amount was too high to be reflected in the project's budget. The two individuals in question denied in interviews ever discussing such matters with the former head of Merchant Marine or at all.

(3) Bid Bond Reimbursement

A final issue of concern with respect to PT Prakora indicates shortcomings in MFI's internal controls process. As a prerequisite for submitting bid papers for the Nanggala overhaul, HDW/MFI were required to post a bid bond of $750,000. In light of the short time allotted, PT Prakora agreed to post the bid bond on behalf of HDW/MFI, but incurred bank charges in the amount of €11,850. Rather than submitting an invoice for this rather uncontroversial expense, PT Prakora split the costs into three unrelated invoices and was paid accordingly. The invoices falsely

characterized expenses as advertisement costs, sponsorship of a golf tournament, and retention of legal advice.

Seeking to explain this method of reimbursing PT Prakora for the bid bond costs, the former MFI managing director wrote a handwritten letter to his successor, in which he stated that the reimbursement was divided into three unrelated invoices to help the MFI managing director with "*compliance arguments*." The former MFI managing director who wrote the note could not recall the reason for this arrangement. The other MFI managing director speculated that his colleague may have misunderstood his suggestion that PT Prakora pay for the bid bond costs itself to boost its financial credentials with a view toward a possible financial due diligence or also referred to as financial compliance.

Although the reimbursement of bid bond costs in question concerned a relatively small amount of money and there are no indications that the funds were used to make improper payments, the circumvention of internal controls by splitting invoices with false descriptions raises questions as to the effectiveness of MFI's internal controls.

(i) Italy

In November 2008, HDW/MFI entered into a contract worth €196 million with Fincantieri, an Italian shipyard, to deliver components for two Type 212A submarines and to overhaul the submarine "Todaro" (another Type 212A submarine). Having retained the services of Hong Kong-based Metallco International Ltd. in 2006 through a retainer agreement, MFI in 2008 engaged the entity Metallco Overseas Services SRL to pursue the submarine project with a 2% success-fee based consultancy contract. Both entities are owned by Gian Carlo Bussei, an Italian businessman. To date, Metallco Overseas Services has received approximately €750,000 from MFI.

The retention of Gian Carlo Bussei's firms exemplifies MFI's practice of engaging consultants and agents who have previously worked for HDW and/or Ferrostaal. Bussei had been a long-time agent for Ferrostaal in Italy and was hence known to the relevant managers at MFI. He may also have worked for HDW. Although the benefits of retaining consultants who have worked for the shareholders are self-evident, the case of Bussei illustrates the limitations of MFI's current approach to compliance due diligence.

Having obtained a business intelligence report from Control Risks that highlighted Bussei's low business profile and eccentric personality, MFI did not apparently check with the responsible departments at HDW or Ferrostaal to seek further views on Bussei. The then head of Marine had previously terminated Bussei's retainer agreement with Ferrostaal after, when asked about the services he provided, Bussei allegedly responded simply by remarking "*I am available.*"

Furthermore, as the current managing director of MFI and others at MFI appear to have been aware, Bussei was used by HDW to channel payments in 2001 or 2002 in connection with the privatization of the HSY shipyard in Greece for the benefit of Emmanouil, HSY's president at the time (see Section III.A.1 above). The payments to Emmanouil triggered a criminal investigation against various HDW executives in 2004 by the public prosecutors in Kiel and Düsseldorf. Although the prosecutor investigation was ultimately not pursued, the information relating to the role of Bussei and his company in this transaction should at the very least have been one of the factors considered by MFI during the due diligence stage, irrespective of what decision MFI ultimately decided to take.

(j) Egypt

The retention of two consultants MFI has used in its efforts to obtain business in Egypt demonstrates the same limitations of in its due diligence process as the example of Bussei.

(i) Margarita Mathiopoulos – European Advisory Group ("EAG")

In November 2004 – more than one year before it became operational – MFI signed consultancy agreements with EAG (represented by Margarita Mathiopoulos) to assist with anticipated projects in Egypt and Croatia. Although no projects materialized, MFI paid Prof. Mathiopoulos in December 2004 the contractually agreed upon advance payments of €850,000 and €350,000, respectively.

MFI made the advance payments – upon which Prof. Mathiopoulos allegedly insisted as a non-negotiable condition – notwithstanding serious concerns that Prof. Mathiopoulos was going to pass some funds to relevant officials in Egypt. In response to a letter from Prof. Mathiopoulos' attorney that appeared to suggest her urgent need for the advance funds for meetings with government officials in Egypt on the basis that she would have expenditures there, MFI immediately terminated the agreement with reference to a grave breach of the agreement's anti-corruption provision. MFI's swift response appeared warranted especially in light of her attorney's alleged confirmation in a telephone conversation with MFI that the funds were necessary because "*she could not arrive with empty hands*" for the discussions in Egypt. After several meetings in the following days, Prof. Mathiopoulos persuaded MFI's managing director and HDW's *Vorstand* Freitag that she would not make improper payments and that the references to her need of funds in the prior communications had been misunderstood. MFI thereafter revoked the termination and subsequently made the agreed upon upfront payments of €1.2 million in December 2004. MFI determined, however, not to enter into additional agreements with Prof. Mathiopoulos notwithstanding various attempts on her part in the following years.

Prof. Mathiopoulos was well known at Ferrostaal at the time she was engaged by MFI. The former head of Marine referred to her in an interview as one of the consultants with whom Ferrostaal no longer wanted to pursue business and thus found it surprising that MFI entered into a contract with her, although an MFI manager told us he was instructed to sign the EAG contract by the same former head of Marine. Moreover, it appears that HDW's Peter Bracker had also enquired about Prof. Mathiopoulos' reputation, based on an e-mail from Simmons & Simmons that referred to a discussion with Bracker in which the need to ensure that Prof. Mathiopoulos would make no corrupt payments was emphasized to an extraordinary degree. MFI's consent to enter into agreements with Prof. Mathiopoulos with significant upfront payment obligations, and its reconsideration of the revocation of her agreement notwithstanding explicit corruption concerns, appears questionable in light of the warnings MFI had received.

(ii) Mamoud Salama (Ferromisr Commercial Agencies Co. ("Ferromisr"))

Following the discontinuation of its relationship with EAG, MFI retained the services of Ferromisr, Ferrostaal's long term Egyptian agent in the marine sector, in connection with the negotiations for the sale of two Type 209 submarines.

Whereas MFI obtained the usual due diligence reports from its external advisors, it appears that no inquiries were made of Ferrostaal about Ferromisr or its principal, Mamoud Salama. MFI entered into a work sharing and advisory agreement with Ferromisr in 2008, pursuant to which it received a monthly retainer of €5,000, along with a 4% success fee in case the anticipated submarine sale were to come to fruition. The anticipated submarine project has not yet materialized, and the likelihood of it occurring is uncertain in light of export license considerations and other problems.

Although MFI has received no indications of improper payments by Ferromisr or Salama in connection with activities on the prospective submarine contract, MFI suspended its agreement with Ferromisr in late 2010 following allegations that Salama was implicated in alleged bribe payments on a Merchant Marine project in Egypt. It is unclear whether and how MFI will seek to resume its relationship with Ferromisr in the future.

The Investigation identified no improper payments by Ferromisr pertaining to the MFI project. As discussed above (see Section III.A.5), we identified circumstantial evidence implicating Salama in at least one questionable payment to unidentified third parties on behalf of Ferrostaal. Moreover, the former head of Merchant Marine has made specific and serious allegations against Salama.

Although unlikely that it would have yielded evidence of impropriety by Salama, a broader due diligence approach that harnessed existing knowledge and information from MFI's shareholders would have been warranted.