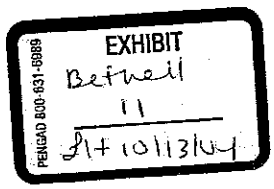

BAKER & McKENZIE
Attorneys at Law
805 Third Avenue
New York, New York 10022
Telephone: (212)751-5700
Facsimile: (212) 759-9133

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TO: Paul Werzanski

CC: Robert J. Gareis (w/o attachment)

FROM: Robert B. Cartwright

PRIVACY AND CONFIDENTIALITY NOTICE

MESSAGE

For your review

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RJG

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DRAFT

November __, 1997

Mr. Paul Werzanski
Vice President and General Counsel
Stone & Webster Engineering Corp.
245 Summer Street
Boston, MA 02210

Dear Paul:

Enclosed are three copies of a revised draft of our Report on the TPPI Project Please distribute copies to Kerner and Tom. The changes reflect the comments made by you and Kerner at the meeting in Boston on Tuesday as well as other corrections and additions which we believe are appropriate. I enclose drafts of two officers' certificates which we would like to have executed before the Report is finalized. We also need to confirm that Kerner Smith actually used the draft "directive" that we prepared in Boston. (see page 16.) You also were going to send us the April 1, 1997 memo from Peter Wu to you (now Exhibit I to the Report.)

Shortly before the special Audit Committee meeting on December 15, we will make any indicated amendments to update the Report. (Given the sensitivity of the matter, we suggest that we meet in person with the Audit Committee on the 15th, not by video conference.)

As we understand it, the next regularly scheduled meeting of the Audit Committee is February 17, 1998. As now reflected in the Recommendations section of the Report, in our judgment that represents the outside date by which the U.S. Eximbank matter should be resolved by the withdrawal of TPPI's Eximbank application or by disclosure. That is not to say, however, that there is any definitive rule on what constitutes timely withdrawal from what otherwise may constitute the Company's participation in a conspiracy.

Sincerely yours,

Robert B. Cartwright

Encl

cc: H. Kerner Smith
Thomas Langford

[NYCORP] 68484 1

COPY FOR YOUR INFORMATION

DRAFT 11/20/97

Report to
Stone & Webster, Incorporated
and
Stone & Webster Engineering Corp.
from
Baker & McKenzie
with respect to
PT Trans-Pacific Petrochemical Indotama
Tuban Olefins and Aromatics Complex
EPC Contract

ATTORNEY CLIENT PRIVILEGE
ATTORNEYS' WORK PRODUCT
Prepared by Special Counsel
In Anticipation of Litigation
and Pursuant to Corporate
Authorization.

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November __, 1997

Table of Contents

INTRODUCTION

On April 17, 1997, our firm was retained by Stone & Webster Engineering Corp. ("SWEC"), the principal operating subsidiary of Stone & Webster, Incorporated (the "Company" or "SWINC"), to evaluate a proposed agency agreement. Under the proposal, SWEC was to retain an agent purportedly in connection with obtaining and performing an EPC Contract (the "Contract") with PT Trans-Pacific Petrochemical Indotama ("TPPI"), an Indonesian company.

TPPI is a member of the Tirtamas Group, a large Indonesian conglomerate whose principal shareholder is the brother-in-law of a daughter of President Suharto of Indonesia. The Contract calls for SWEC to perform engineering, procurement and construction services in connection with the Tuban Olefins and Aromatics Complex at Tuban, East Java, Indonesia (the "Project").

Subsequently, the scope of our engagement was expanded to conduct a corporate investigation into the broader circumstances in which the Company is undertaking the Contract.

Review Procedures

In preparing this Report, we have interviewed the persons listed in **Exhibit A** and reviewed the documents described in **Exhibit B**.

Demand of Owner - Recycled Payment

The legal issues which we have evaluated arise from the demand of a principal Owner of TPPI to utilize SWEC as a vehicle to recycle a portion of the payments SWEC receives under the Contract to the principal Owner of TPPI, either directly through inflated invoices or indirectly though an ersatz agent. (There are two principal Owners of TPPI. One was active in promoting the recycled payment scheme but the other clearly was aware of the demand and acquiesced in it. For ease of reference hereunder, the active Owner is described as the "Owner.")

Materiality of Contract

SWEC's portion of the nominal Contract price (inclusive of the proposed recycle amount) is approximately $950 million. The recycled payment would represent 15% of SWEC's total nominal receipts under the Contract or approximately $147 million. The Contract is the largest single contract in the history of the Company. To illustrate its magnitude, $950 million represents 81% of the Company's total 1996 revenues. Excluding the proposed recycled payments, the Contract price represents 69% of the Company's total 1996 revenues.

U.S. Laws

The basic legal concerns for the Company and SWEC arising from the Owner's demand are the potential for creating false records, for creating an off-book fund which could be used to make prohibited payments to foreign officials, and, in connection with proposed Eximbank financing for the Project, the submission of false data to a U.S. Government agency. The U.S. laws that require analysis in this context are outlined below.

- Documentation of business transactions, including agreements and invoices, by a public company, must accurately reflect the underlying economic realities to assure compliance with the accurate recordkeeping and adequate internal accounting control requirements set forth in sections 13(b)(2)(A) and (B) of the Securities Exchange Act of 1934 ("1934 Act").

- The Company also cannot be used as a vehicle to make payments to create off-book funds, particularly in circumstances where all or a portion of those funds may be paid to foreign officials to obtain major governmental approvals or authorizations in connection with projects from which the Company benefits. This is to seek to assure that there is no violation of the antibribery prohibition in the Foreign Corrupt Practices Act. Section 30A of the 1934 Act.

- Certifications or other representations to U.S. government agencies such as the U.S. Exim Bank ("Eximbank") must be accurate. False filings with U.S. government agencies are prohibited by the False Filing Statute, 18 U.S.C. §1001, and may constitute part of a conspiracy to defraud a U.S. Government agency. See 18 U.S.C. § §286 and 371.[1]

SEC Disclosure

SEC financial and other disclosure issues also arise because the revenues generated by the Contract are clearly material. We express no opinion on these issues. We understand that SEC reporting responsibilities fall within the purview of the Company's Chief Financial Officer, General Counsel and the Company's outside SEC counsel. It is important to point out, however, that a recent SEC administrative report imposes a duty on outside directors to satisfy themselves that such disclosures are adequate, particularly as they concern those matters within their particular knowledge. In the Matter of W.R. Grace & Co., SEA Rel. No. 39157 (September 30, 1997). **Exhibit C**. See **RECOMMENDATIONS**.

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[1] With Indonesian counsel, we have satisfied ourselves that the facts do not pose for SWEC or the Company any criminal liability under Indonesian law, as a result, for example, of the non-disclosure by the Owner to minority equity investors in TPPI of the existence of the recycled amounts.

FACTS

Initial Demand

The history of the Owner's demand and the knowledge concerning it attributable to Company and SWEC personnel is complicated. The Owner apparently first raised the issue in January 1996 with a Group President when the Owner referred to his need to receive a portion of the contract price, apparently for downstream equity investment purposes. The initial reaction by the Group President was to accommodate the demand, but conditioned on the legality of any arrangement under U.S. law.

At a meeting on January 12, 1996 in Houston, the Owner mentioned to several SWEC employees that if SWEC did not immediately need all the funds it received from TPPI upon payment of SWEC invoices under the Contract, then a portion of the "unused funds" should be returned to him. The SWEC General Counsel recalls that the Owner also discussed "overage" at this meeting, i.e., funds arising from false, inflated invoices. There was, however, no discussion at this meeting of 15% of the contract price or of a dollar amount, but those present, including SWEC's General Counsel, advised the Owner that SWEC could not "return funds" to the Owner. The Owner was advised that SWEC "is not a bank" and the SWEC General Counsel told him that, among other things, such a transaction would result in the Company paying tax on the total invoice amount, i.e., paying tax on monies in effect not received. The SWEC General Counsel advised us that he informed the then recently appointed CEO of SWINC ("CEO") of his January 12 discussions with the Owner in March 1996, including the points made in rejecting the suggestion. The SWEC General Counsel advised us that the CEO concurred in his rejection of the Owner's scheme.

Second Demand

The issue was apparently not raised by the Owner again until a meeting in Jakarta on July 15 or 16, 1996. At this meeting, the Owner made clear that he expected SWEC to engage in an overinvoicing scheme under the Contract and to recycle to him the overinvoiced amounts. According to the SWEC General Counsel and another SWEC attorney who was also present, the Owner described the overinvoicing scheme by waving his hand and repeating the phrase 'back and forth, back and forth.' The SWEC General Counsel advised us that he responded by saying "we cannot do that. We're an American company." This was confirmed by the other SWEC attorney present. According to the SWEC General Counsel, a Division Vice President later advised SWEC personnel present in Jakarta that the Owner was very unhappy with this negative response and the Division Vice President criticized the SWEC counsel and admonished them to "find a way."

Following counsels' return to the United States, a debriefing on the Jakarta meetings was held on July 23, 1996 with a number of Company and SWEC executives. The CEO was advised of the Owner's overinvoicing demand. According to several participants in the discussion, the CEO asked 'doesn't he know we can't do this" and told those present 'tell him we cannot do

this.[2] On August 15, 1996, however, the Division Vice President wrote a letter to the Owner in which he stated, among other things,

> "We are actively exploring various methods in which we can reimburse you for any payments in excess of our contract requirements." **Exhibit D**.

The SWEC General Counsel received a copy of this letter after it was sent and advised the Division Vice President in a memorandum to clarify this statement in writing "as someone could infer an improper action on your part which could be misconstrued as a violation of U.S. law." **Exhibit E**. The SWEC General Counsel advised us that he made further attempts to have such a written clarification made, including efforts to enlist the assistance of the Group President and the CEO. The CEO followed up on the matter on two occasions with the Group President but no written clarification was ever made by the Division Vice President.

The Division Vice President, when queried about his August 15 letter to the Owner and asked precisely what he meant when he referred to "payments in excess of our contract requirements," explained that his thoughts were dominated by the refusal of the Owner to provide a letter of credit. The Division Vice President said SWEC was very concerned about procurement exposure in the event the job "cratered" in the absence of a letter of credit from the Owner to cover procurement expenses. The Owner, on the other hand, was concerned that SWEC would be advanced more money than was required to cover its costs. Thus, there was tension between the Owner's concern about surplus advances and SWEC's concern to stay "cash neutral."

The Division Vice President was asked whether he meant by the reference to excess payments amounts which would result from the Owner's overinvoicing demand. He said he was aware that this amount was (or would be) included in the contract price. The Owner had mentioned to him several times, that he (the Owner) needed it for downstream equity, but the Division Vice President says "I did not actually understand." The Division Vice President stated he always told the Owner "if we can do it legally, we'll do it. We're a U.S. company."

On July 16, 1996, the Division Vice President provided to the Company's Internal Audit Department his Foreign Representative Questionnaire Response. This initial response was not executed by him personally but by a marketing manager who worked for him. **Exhibit F**. Subsequently, on August 5, 1997, he provided his answers to the FCPA questions reflected in items 4, 5 and 6 but these answers were not responsive in terms of his own personal knowledge. **Exhibit G**. It was not until October 29, 1997 that Division Vice President finally provided responsive answers. **Exhibit H**.

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[2] The CEO confirmed to us that he recalls issuing these instructions. He also advised that no one told him about an amount or percentage in 1996.

Interim Contract Payments

The balance of 1996 was generally devoted to difficult negotiations related to the commercial terms of the Contract, with agreement on an interim contract being reached in December, 1996. The Interim Contract was thereafter executed as of January 24, 1997. In the meantime, SWEC was providing services to TPPI and was invoicing therefor on an ad hoc basis, including, on a provisional basis, for a pro rata portion of the $147 million.

Agency Proposal

During the first quarter of 1997, the concept of an agency agreement with a British Virgin Islands company called Gates Commercial Company was developed in conjunction with the Owner in lieu of the overinvoicing scheme. A SWEC regional marketing manager recommended the appointment of Gates in a memorandum dated April 1, 1997. A so-called "due diligence" memorandum was attached to the request memorandum. **Exhibit I**. Gates reportedly had an office in Hong Kong. We reviewed this arrangement in April and subsequently advised SWEC in May that it was legally unacceptable.

There were a number of red flags raised by the Gates agency proposal, not the least of which were the sheer magnitude of the commission amount, the apparent incommensurate relationship between the proposed commissions and the services to be rendered, and the fact that Gates had no office, employees or operations in Indonesia where the purported services were to be performed. From a books and records perspective the change to an agency arrangement would, in essence, only convert a false inflated invoice scheme generated by SWEC to a false inflated invoice scheme generated by a third party (Gates).

Our advice was based upon, among other things, facts provided by a firm of private investigators in Hong Kong. These facts made clear that Gates was not legally registered to do business in Hong Kong and that the Owner was a "partner" and "shareholder" of the entity that occupied the premises described in the draft Agency Agreement as being Gates's premises. The proposed Gates arrangement appeared, therefore, merely a conduit to funnel funds to the Owner. This was later confirmed by the Owner himself.

Our advice is reflected in our opinions to SWEC dated April 17 and June 5, 1997 (**Exhibits J and K.**) As noted, at a subsequent meeting on June 17, 1997, the Owner acknowledged that "Gates is his company." The previous "due diligence investigation" of Gates, conducted by a SWEC regional marketing manager, was flawed, perfunctory, and clearly inadequate. See **Exhibit I**.

Rejection of Agency Proposal

After having been informed of our advice by the SWEC General Counsel, the CEO advised both Owners at a meeting in London on June 17, 1997, that the proposal was rejected In response to due diligence inquiries posed by the CEO and Group President, both Owners affirmed their familiarity with the requirements of the U S. Foreign Corrupt Practices Act ("FCPA"), their compliance therewith and their intent to use the $147 million for downstream equity investments, i.e , plants that would purchase the off-take from the Project. They specifically affirmed that none of the $147 million was for the purpose of paying bribes in connection with the Project

No Recycled Payments Made.

We have reviewed with the SWEC General Counsel a summary of records of disbursements on the TPPI Project prepared from the general ledger by the Company Controller at the request of the SWEC General Counsel. Based on that review, we believe no funds were actually ever recycled, i.e., that no payments have in fact been rebated by SWEC to the Owner.

Daelim

When the CEO advised the Owners that the Gates proposal was rejected, the Owners suggested that the Korean company, Daelim, be partially substituted for SWEC and assigned a portion of SWEC's Contract scope (including the "obligation" to pay $147 million or any other amount to cover the Owner's downstream equity funding) [3] The Owner's proposal potentially addressed one of the Company's legal concerns, i e , removing the $147 million amount from the SWEC Payment Schedule incorporated as part of the Interim Contract To the extent the Payment Schedule relating to the assigned scope of work were negotiated solely between TPPI and Daelim, without any involvement of SWEC, and was excluded from the Interim Contract and Contract, the books and records inaccuracy arguably could be cured. On this basis, the Company concluded to pursue the Owner's scope transfer proposal [4]

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[3] We are advised by SWEC that the Daelim scope includes no U.S. content procurement but we have in turn advised that this fact does not solve the disclosure issue which exists so long as U.S. Eximbank financing is being sought or is obtained. (See below)

[4] As noted below, based upon conversations with Project personnel, we are concerned that the documentation of the scope transfer may indeed create additional books and records issues in that the position of Daelim as a consortium member may not be an accurate characterization of its role

This approach, however, would not address the other, more serious legal issue which was brought to our attention later relating to misstatements in U.S. Eximbank submissions. We learned of these in July and reported on them in our opinion dated July 9, 1997. **Exhibit L**. That opinion is that unless Eximbank financing is abandoned or the inaccurate data corrected, the legal issue would not be addressed. Moreover, SWEC will be subject to the Eximbank requirement to disclose unusual payment arrangements by third parties, i.e., between Daelim and TPPI, in Eximbank Supplier Certificates. See **RECENT EXIMBANK DISCLOSURE REQUIREMENTS**. In this connection, SWEC personnel, contrary to our advice, actively participated in negotiations with Daelim related to the allocation of Contract price to transferred scope of work. These negotiations reportedly specifically encompassed the $147 million amount. It is quite clear in these circumstances that SWEC not only has actual knowledge that the "obligation" to recycle this amount was in fact assumed by Daelim, but also actively participated in arranging that assumption. Its disclosure duty in the context of the Eximbank Supplier Certificate is, in our opinion, manifest. See **DUTY TO CORRECT AND DISCLOSE**.

Records

The following SWEC and Company records, to the extent each reflects or mischaracterizes the $147 million amount, suggests that violations of the SEC requirement that public companies maintain accurate records have occurred.

- The proposed Gates Agency Agreement.
- Internal projections prepared by SWEC personnel reflecting the $147 million amount as (Gates) "agency fees."
- The invoices submitted to TPPI by SWEC from January to July 1997 including a pro-rata uplift to accommodate the $147 million in "agency fees" payable to Gates.[5]

[5] These invoices have subsequently been corrected by the issuance of credit memoranda in their full amount and the issuance of replacement invoices in amounts which, according to SWEC financial personnel, no longer containing any part of the $147 million. We understand that these replacement invoices also reflect, by agreement with the Owner substantial revisions (reductions) in certain amounts previously invoiced by SWEC, including for amounts already expended by SWEC, largely for changes in the scope of work (infrastructure) resulting from the scope of work transferred to Daelim. (Daelim will presumably reimburse SWEC when Daelim is paid by the Owner.) As a result of the issuance of corrected invoices, amounts billed TPPI no longer match amounts nominally due under the Interim Contract.

- The Interim Contract containing Exhibit A-2 entitled "Payment Schedule (AEC, SWEC, PEI, JGC)." (This Payment Schedule reflects a total project cost of $1,725,000,000 and includes the $147 million amount demanded by the Owner.)

- The $147 million amount is included in estimate sheets approved by the CEO and submitted as back-up material to the Company's Board of Directors.

- BA of Asia Ltd.'s Preliminary Information Memorandum dated February, 1997, to U.S. Eximbank which reflects a total project cost of $1,725,000,000. (SWEC personnel participated in preparing the underlying cost data, including the $147 million amount, and provided it to BA of Asia Ltd. specifically for submission to Eximbank.) It was recently learned that this conduct was repeated in October, 1997. See **KNOWLEDGE AND CONDUCT** below.

- The Daelim Consortium Agreement and related documents perhaps mischaracterizing Daelim's role in connection with the Project in that Daelim could be argued to be acting in part as SWEC's agent or alter ego.

Due Diligence Procedures and Corrective Actions

In accordance with our advice and recommendations and those of the SWEC General Counsel, the CEO has taken or directed the Group President and SWEC personnel to take, the following corrective actions.

- Affirmed to the Owner SWEC's commitment to compliance with U.S. law, and terminated the Gates Agency Proposal.

- Revised the pricing provision of the Contract and amended the payment schedules to delete reference to the $147 million.

- Restated invoices to IPPI for the months of January through July 1997 and issued revised invoices reflecting only actual services and costs. See Footnote 5.

- Requested both Owners meet with counsel and arranged an interview of the Owner with counsel.

- Incorporated FCPA representations by IPPI in the Contract, including a provision for a sanction for breach.

- Hand-carried a letter to the Owners affirming SWEC's understanding that Owners will pursue ECA financing from JEXIM only, and confirming Owner's understanding of SWEC's legal obligations. **Exhibit M**.

LEGAL ANALYSIS

The Securities Exchange Act of 1934 (the "1934 Act").

(a) The 1934 Act requires all issuers of publicly-held securities to maintain accurate records and an adequate internal accounting control system. §§13(b)(2)(A) and (B). The Securities and Exchange Commission ("SEC") and the Department of Justice ("DOJ") have taken the position that agency or representative agreements and other types of contracts as well as invoices, are records for purposes of the accurate recordkeeping requirement. Documentation which fails to reflect the underlying economic realities of a transaction or, indeed, falsifies or disguises those realities, violates these accounting requirements. In our opinion, the invoices that included a pro rata share of the Owner's demand amount and the proposed Gates Project Representation Agreement are documents which would, if executed, disguise indirect payments to a Project insider and misstate the relationship between the Company and Gates. We are also reviewing the same issue with respect to the various agreements with Daelim. Sanctions for violations of the accounting requirements include civil, administrative and criminal fines for corporations of up to $2,500,000 and fines for individuals of up to $1,000,000 and/or ten (10) years imprisonment, or both.

The SEC Policy Statement sets forth the position of the SEC with respect to the adequate records and internal accounting control provisions of Section 13 of the Act. In that statement, the SEC has commented upon the liability of an issuer for the acts of its employees:

> With respect to issuer liability for recordkeeping violations, we will look to the adequacy of the internal control system of the issuer, the involvement of top management in the violation, and the corrective actions taken once the violation was uncovered. Barring, of course, the participation or complicity of senior company officials in the deed, when discovery and correction expeditiously follow, no failure in the company's internal controls would have existed. To the contrary, routine discovery and correction would evidence effective controls."

While it is unclear whether the Company satisfies the conditions set forth in the SEC Policy Statement, the determination to reject the Gates agency proposal and the refusal to make the $147 million recycling payments represent substantive efforts to achieve compliance and should render sanctions applicable to any residual violation resulting from an inaccurate agreement, internal projections and invoices to one of an administrative or civil, rather than criminal, nature.

In order to avoid characterization of the Contract as an inaccurate record for these purposes, we recommended that the pricing provisions and payment schedules for the Consortium Members, including, specifically, Daelim, and specification of a total project cost that includes the tainted amount, be excluded from the document. These revisions were made. As of the date of this report, however, the final Contract is only initialed and is not yet in effect. The Interim Contract with its uncorrected price schedules remains operative.

(b) The proposed arrangement with Gates and the proposed overinvoicing arrangement could also disguise the role played by the Company or other entity (Daelim) in serving as a vehicle to generate off-book funds in circumstances where all or a portion of these off-book funds may be paid to foreign officials to obtain major government approvals or authorizations in connection with the Project, or perhaps other projects from which the Company might benefit. Hence the need for FCPA representations, which now have been obtained. (It is also a concern, as noted below, and clearly a concern of Eximbank, that no proceeds from its loans be used to bribe foreign officials.) Penalties include fines for corporations of up to the greater of $2,000,000 or twice the gross gain on the contract and, for individuals, fines of up to $250,000 and/or six years imprisonment.

False Filing and Conspiracy to Defraud

We advised management that inclusion of the $147 million as part of the total project costs in Eximbank submissions, directly or indirectly, is materially false and inaccurate. The $147 million is to be used, according to the Owners, for downstream equity investments. The use of such funds for this purpose, however, would not constitute a "project cost."

In this connection, the U.S. Eximbank is limited by its charter to specifically permissible financings, guarantees and insurance arrangements. Loans or guarantees to TPPI which in effect inure to the benefit of the Owner to finance his other equity investments even though related and beneficial to the project nominally being financed (or, obviously, to pay bribes) do not fall within the Eximbank charter.

For these reasons, we believe the participation by SWEC in providing inaccurate data to Eximbank has resulted in a violation of the Federal False Filing Statute (18 U.S.C.§1001) and may constitute a part of a conspiracy with the Owner and/or TPPI to defraud a U.S. Government agency in violation of the Federal Conspiracy Statute (18 U.S.C. §286.) Accordingly, in the event the Eximbank financing application is not withdrawn within a reasonable time, as the Owner has indicated he will do, we have made the recommendations described below that are intended to help SWEC substantiate the argument that it has withdrawn from any conspiracy to defraud Eximbank. Unfortunately, that argument will be undercut by any other activities in the meantime that continue to support the Owner's Eximbank application.

Recent Eximbank Disclosure Requirements

Recently, to minimize any possibility of bribery in connection with transactions which Eximbank might support, Eximbank revised its Suppliers Certificate to require, in addition to the information already required from suppliers, disclosure of offers or other arrangements by the supplier or by *third parties* for any payments not already disclosed in the invoices submitted to Eximbank. This additional requirement seeks to uncover unusual payments that take place with the knowledge of the supplier, but are not made directly by the supplier. If any payments disclosed in the Supplier's Certificate appear inappropriate, Eximbank may refer the matter to the U.S. Justice Department for further investigation. SWEC's involvement in arranging payment allocations between TPPI and Daelim subject it to these disclosure requirements.

Duty To Correct and Disclose

The implementation of the due diligence recommendations described above are salutary procedures that address the books and records and FCPA issues and, indirectly, the Eximbank issue. However, as noted, more is required to address the Eximbank false filing matter because inaccurate project cost data have been submitted to the U.S. Eximbank. Moreover, Eximbank Supplier Certificates now require disclosure of arrangements for certain payments to be made by third parties, i.e. Daelim. Accordingly, we recommended that the Company:

(i) Advise the Tirtamas principals either to correct the inaccurate data or terminate efforts to apply for Eximbank financing and insurance. Management has so advised the Owners and, as noted, the Owners responded that they would pursue JEXIM and other non-ECA financing to the exclusion of Eximbank financing (Exhibit J) at an early date, but the Owners' degree of commitment to this course remains uncertain as of the date of this Report.

(ii) If the Tirtamas principals do not correct the data and continue to seek Eximbank financing, then the Company should either (A) itself correct the inaccurate data or, (B) if Eximbank financing is nonetheless somehow still obtained following correction of the inaccurate data and the Company continues in the Project, it will be required to disclose the Daelim-Tirtamas arrangements in future Eximbank Supplier Certificates.

Except as noted above, the Company deferred complete implementation of our advice as to U.S. Eximbank pending receipt of past due amounts from TPPI. To a certain extent, securing past-due amounts is a valid reason for deferral, at least so long as the intent exists to implement the advice and the action is taken within a reasonable time. Indeed, we are advised that the Company recently received two payments of approximately $20 million and $40 million from TPPI. TPPI is, however, still delinquent in that it has not paid $70 million due upon initialing the Contract.

We were also advised the payments made to date, plus the $70 million now past due if made, would bring SWEC close to a position of cash neutrality and that, as a result, withdrawal from the Project would not, in the opinion of the Group President, "hurt too badly." Nonetheless, if TPPI continues to pursue Eximbank financing, then the correction and disclosure recommendations reflected in (ii) above will become more pressing and, within a reasonable period consistent with timely withdrawal from a conspiracy to defraud the U.S. government, will have to be implemented. See **RECOMMENDATIONS**.

The commitment by involved Project personnel of the Company to implement the recommendation to file corrected, accurate data needs to be re-enforced. We were recently advised, for example, that SWEC personnel provided a spreadsheet to BA Asia Ltd. for inclusion in a submission to Eximbank that reflects total Project cost that includes the $147 million amount. The difference between inaction and active continuation of a program to provide inaccurate data to U.S. Eximbank is or should be evident.

Monitoring Procedures

Pursuant to our recommendation, the Project management has now instituted written procedures in connection with the Project to monitor the furnishing of information for use by Eximbank in connection with the Project. **Exhibit N**. The effectiveness of these procedures has not been verified as of the date of this Report. We further understand that even as those directives were being issued, SWEC personnel were meeting with Brown & Root representatives (acting for Eximbank) in England.

We are presently reviewing the arrangements which SWEC continues to negotiate with Daelim in connection with the transfer of work scope to Daelim and Daelim's joining the Project consortium. We are concerned that the substance of these arrangements may at least in part suggest that Daelim is acting not as a consortium member but as an agent or alter ego of SWEC and AEC.

KNOWLEDGE AND CONDUCT

It became clear during our interviews that a number of Company and SWEC personnel had knowledge of the Owner's payment recycling scheme and the role SWEC was to play in implementing it. During 1996, many of these persons justified or rationalized the Company's continuing role, including its preparation and submission of inflated invoices (since corrected) on grounds that "we will accommodate him but only if its legal under U.S. law" without, however, taking timely active steps to ascertain its legality.

Others were concerned about inaccurate disclosures to Eximbank, but succumbed to heavy pressure from superiors to accommodate the Owner in the meantime. These employees, with some exceptions, adopted the "good soldier" defense, i.e., 'I only followed orders from my superiors." A recent federal appellate court decision upheld the SEC's consistent rejection of this so-called Nuremberg defense in the context of an employee who falsified records on the instruction of his superiors. Securities and Exchange Commission v. Hughes Capital Corporation, ___ F.3rd__ (C.A. 3, 1997), CCH SEC §99.516 **(Exhibit O)**. On the other hand, some senior executives, not otherwise involved in the Project, appear to have made conscious efforts to avoid learning of these issues and felt no duty to learn despite the magnitude of the Project and their official responsibilities. It also appears that certain Company personnel knew the Gates agency arrangement was phony. Also of serious concern was rejection of legal advice that SWEC personnel avoid participation in the pricing aspects of any scope transfer to Daelim and avoid continuing submissions of inaccurate data to Eximbank.

On the positive note, the conduct of the SWEC General Counsel, in supervising and coordinating the independent due diligence review by us and in providing salutary and difficult advice to senior management, has been exemplary. Had it not been for his efforts, the likelihood is that the Company would today be confronted with the existence of an executed false agency agreement, an off-book fund and the diversion of recycled monies. His conduct and efforts deserve recognition and commendation.

We also note that the CEO directed the SWEC General Counsel to have the Gates agency fee proposal reviewed by outside counsel and concurred in the recommendation of the SWEC General Counsel, who interviewed four law firms, to retain our Firm. The CEO has acted consistently in accordance with our advice.

Finally, the performance of the Group President in the difficult circumstances during the recent round of negotiations in Jakarta, with the support of the CEO and counsel, was effective **See Exhibit P**. See also **Exhibit M**.

RECOMMENDATIONS

Our recommendations are that the Company (i) establish effective procedures designed to prevent submission of inaccurate pricing data to Eximbank, correct the Company's inaccurate books and records and take effective steps to withdraw from any conspiracy; and (ii) if TPPI and Owner persist in pursuing Eximbank financing, to correct the inaccurate data previously supplied to Eximbank and, if necessary, to withdraw from the Project

As noted above, the Company must act to correct prior inaccurate data submitted to Eximbank so long as Eximbank financing is sought by the Owner. We have been assured by the CEO that the Company is committed to making the corrections and the Owner has assured the Company (See Exhibits M & P) that TPPI will abandon Eximbank financing shortly, pending arranging alternative financing sources. In the meantime, however, the Owner asserts that TPPI cannot withdraw its application for Eximbank financing because such withdrawal would adversely affect its efforts to secure alternative financing. In light of this, the Company has concluded that it is in its best interest to defer the corrective disclosure to Eximbank pending receipt of over-due payments under the Contract and pending TPPI's efforts to obtain alternative financing. We do not believe that the Company's position in this regard is unreasonable in the circumstances, but in order to preserve the integrity of the Company's commitment, we believe that, in any event, disclosure to Eximbank should be made no later than the meeting of the Audit Committee in February, 1998 (or such earlier time as circumstances permit).

In this connection, the nature and degree of SWEC's involvement in the Daelim scope transfer leads us to conclude that even withdrawal from the Project (and hence avoiding the requirement to furnish a Supplier Certificate) will not be sufficient to protect the Company, SWEC and involved personnel from criminal exposure if Eximbank financing proceeds. We believe the Company, SWEC and involved personnel can only effectively protect themselves in the circumstance of Eximbank financing to the Project if the Company's withdrawal is accompanied by correction of the prior inaccurate data (See **DUTY TO CORRECT AND DISCLOSE**.)

It is, in our opinion, critical to the welfare of the Company that these recommendations be implemented. Otherwise, the Company and certain of its personnel may be implicated in criminal activity. In this regard, we have received the support and endorsement of the CEO and the SWEC General Counsel. The CEO has instructed the Group President and Project personnel to implement the recommendations. However, there have been instances where the Group has not done so.

In order to enhance the likelihood of effective implementation of the recommendations, we believe the Chief Financial Officer and General Counsel of SWINC should familiarize themselves with the relevant details of the transaction and should monitor the compliance efforts of Project personnel. This active oversight involvement by these persons would augment the efforts of the CEO in achieving compliance. It will also better enable the CFO and SWINC GC to discharge their SEC disclosure responsibilities and provide appropriate assurances to the Board of Directors that these disclosures will be properly and accurately made.

In furtherance of these efforts, the CEO has taken steps to make clear to all involved Company personnel that any deviation from the policy and procedures prepared by the Group to monitor information to be provided to Eximbank, and any failure to implement the recommendations will result in severe disciplinary action, up to and including termination. The CEO has issued a directive to involved Project personnel emphasizing the necessity of compliance with the Eximbank monitoring procedures **Exhibit Q**

Finally, we recommend that the Company continue, under the direction of the SWEC General Counsel, its training and education program, but with particular emphasis on Company policy concerning disciplinary actions. These programs should also continue to be specifically addressed to senior executives and those employees engaged in international marketing activities to assure a more complete understanding of their responsibilities under SEC disclosure regulations, the FCPA and related U S criminal statutes requiring accurate filings with U S. Government agencies.

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Senior management and the Governance Committee of the Board of Directors may also wish to consider whether establishment of an Ethics Committee, a Compliance Office or and the institution of a hotline for employees would represent effective and appropriate compliance improvements.

BAKER & MCKENZIE