Illegal logging and timber corruption in Ukraine and links to the EU

Presentation to Chatham House Forest Governance Forum,
9 November 2018

SEE FULL REPORT FOR RESPONSES BY COMPANIES NAMED IN THIS PRESENTATION
Background / Context

1. Corruption is rampant
Viktor Yanukovych: President 2010-2014 – he & his cronies reckoned to have stolen $100 billion
“Ukraine is fighting two wars. One is near its eastern border, where it faces Russian aggression. The other is at its core, where it is wrestling with some of the worst corruption of any post-Soviet state” – The Economist, 2017

2. Ukraine’s forest sector is a key battleground
Most valuable natural resource, after fossil fuels; 4% of GDP
99% of forest is owned and managed by the State. 73% is managed by the State Agency of Forest Resources (SAFR)

3. The EU is by far the biggest market for Ukrainian wood exports
70% destined for EU – over €1 billion in 2017; imports rising fast
Mostly primary products – logs, sawn, chips/pellets, firewood, pallets, chipboard
Biggest importers: Romania, Poland, Hungary, Germany, Italy, Austria, Czech, Slovakia
How logging is managed

Control 83% of all timber production

National

Province/State

District

Manage forest, inc harvesting, sell timber at auction. Funded almost entirely from timber sales

Carpathians – 25% of timber production

Polissia – 50% of timber production

NB: There is no separation between the agencies responsible for harvesting and those responsible for monitoring forest.
Illegalities in timber harvesting

1. Illegal ‘sanitary’ felling

- Trees approved for felling by SFEs based on spurious ‘sanitary’ reasons – disease etc.
- Well known to be common, but recent study first to seek to measure
- 18 logging sites in 4 SFEs in 4 provinces in the Carpathians studied
- RESULT: In 67% – 78% of sites harvesting unjustified and therefore illegal
- Suggests illegal sanitary felling alone means 38-44% of production and exports are illegal

2. Other illegalities during harvesting

- EG logging more trees than authorised, destructive logging practices
- Separate field study in Carps in 2017 = In 10 of 15 sites was evidence of such illegalities
- NEW data from WWF – indicate illicit logging alone producing 2.2 million m$^3$ / year in Ukrainian Carpathians
Illegal wood processing

- “Shadow Lumber” industry
- BRDO Report 2017—12,000 illegal sawmills v 9200 legal ones
- 1/3 of the sawn timber exports from Ukraine may have been illegally sourced.
- Fuelled by illegal sales by SFEs & by illicit harvesting
Other kinds of corruption

1. Avoidance of enforcement

E.G. Cherevaty case – Chernivtsi, Oct 2017

2. Extortion / ‘sale’ of lucrative jobs

E.G. allegations that payments of $50k demanded for appointment as SFE head

3. Nepotism in contracting logging

In one major SFE we examined, we found 63% of total logging contract value in Sep 2016-May 2017 went to companies linked to former SFE Director

4. Corruption by Customs officials
Corruption in wood sales – links to EU
High-level corruption in sales of timber

- Direct Russian-gauge rail link
- When opened => EU log imps from Ukr DOUBLE
- Repeatedly found to have used illegally sourced Romanian wood since 2015 – FSC disassociated
The Sivets file

- Viktor Sivets – former head of Ukraine’s State Forest Agency
- Tennis partner of kleptocrat former President Yanukovych
- Currently on run. Until recently subject of Interpol arrest warrant

Pre-trial investigation by Ukrainian prosecutors found that during 2011-2014 he:

- Exerted unofficial control over dest. of all timber sold by SAFR SFEs
- Solicited illegal payments from overseas timber buyers to access this wood at below market rates
- Routed $$ millions to Swiss banks through secretive offshore ‘shell’ companies (UK Limited Liability Partnerships – LLPs, owned by companies in Panama)
- One of the companies which made these payments was Slovakian firm Uniles s.r.o, a subsidiary of...
Are similar schemes still going on?

We don’t know for sure. But there are certainly some big RED FLAGS

Q: Where is Ukraine’s largest timber exporter based?

- Claim to handle >800,000 m³ of exports each year
- Registered as two Limited Liability Partnerships, with letterbox address at accounting services firm in St James’ Square
- These are in turn owned by companies registered in Panama
- Named in ongoing criminal corruption investigation in Ukraine
- Prosecutors told court they have reason to suspect that they have been obtaining timber from SFEs at below-market prices, then selling on to Schweighofer & Egger
- Emails between EU importers and SAFR officials in Kiev also indicate such schemes continued since Sivets ousted
Buying from high-risk suppliers

CASE STUDY 1 – Chernivtsi oblast, Carpathians

• **Dec 2015** – Forestry officials from two of the five SFEs convicted of illegal logging

• **Jul 2016** – Two criminal corruption investigations launched against provincial forestry chief Roman Cherevaty and officials from 3 of his 5 SFEs for illegal sanitary felling and “systematic illegal sale of timber”

• **Aug 2016** – Further criminal investigations launched against senior officials of two of the five SFEs

• **Sep 2016** – OCCRP/Rise Project documentary alleges illegal sanitary felling and bribery for access to timber in Storozhynets SFE

• **Oct 2016** – Kiev Post publishes allegations of illegal sanitary felling at Beregomets SFE

• **Oct 2017** – Cherevaty arrested for offering bribes of $10k/mth to police to turn a blind eye to illegal logging in his SFEs

• **Feb 2018** – Earthsight inform Egger about their evidence
Importing logs banned from export

- Applies to products classified under international harmonised **Customs Code 4403 - ‘wood in the rough’**

**EU CUSTOMS CONTINUE TO RECORD LARGE VOLUMES OF IMPORTS - >1 million m3 by Dec 2017**
Importing logs banned from export

- Almost all the HS4403 logs arriving in the EU were exported from Ukraine as HS440110 – ‘Fuel wood’ / ‘Wood for use as fuel’
- Commonly blamed on ‘different definitions’ used in Ukraine and EU - NOT TRUE – Customs HS definitions identical
- Logs are not being ‘smuggled’ – Ukr Customs is failing to implement law, instead following SAFR definitions
- Evidence SFEs were already misdeclaring logs prior to ban, in order to circumvent rules on auctions & timber marking

**Strict interpretation = if the logs are destined for any other use than as fuel, then they should not have been permitted to be exported**

**Q: Does this look like firewood to you?**

**TO MITIGATE RISK, DDS MUST CONSIDER TWO QUESTIONS:**

1. Was the wood cleared by Ukrainian Customs?
2. Should it have been?
Suspect Ukrainian wood gets everywhere

- Importer/processors include 8 billion-dollar firms:
  - World’s largest paper company, and biggest cellulose fibre firm
  - World’s 3 largest wood-based panel makers
- These firm’s products are on sale in brand-name products and retailers across Europe and US
Undue diligence – are buyers compliant?

**KEY TEST:** Can risk mitigation measures address most common forms of illegality:

- Corruptly licensed **sanitary felling** by SFEs
- **Illegalities in sales** of timber by SFEs
- **Mis-declaration** of logs as ‘fuelwood’ by SAFR/Customs

• Asked big buyers what due diligence steps being taken
• Answers were at best **inadequate** and at worst **meaningless** (e.g. supplier promises)
• All have been inspected and signed off by relevant CAs despite this
Undue diligence

1. Official documents

E.G. ‘Certificates of Origin’ and barcode tags

Often ONLY form of risk mitigation

PROBLEMS

• Issued by same corrupt officials => cannot be trusted

• Also regularly forged

• Plentiful examples in public domain demonstrating weakness

• Recent BRDO study said CoOs are at particularly high risk of being associated with corruption
2. Even more meaningless steps

- Face-to-face meetings
- Demand suppliers sign promises wood is legally sourced
- Only deal with middlemen (???)
- Governments can’t log illegally by definition, right?
- Only deal with ‘established’ suppliers
Undue diligence

3. Field checks - FSC Certification

BACKGROUND

- No big buyers demand all Ukr wood is FSC FM, but its importance as a form of ‘risk mitigation’ is growing
- Rapid growth in FSC certification in Ukr since EUTR
- 90% of SAFR forests in Carpathians now certified
- Many forests which do not have full FSC have FSC ‘CW’

EVIDENCE OF FAILURE TO MITIGATE RISK IN UKRAINE

- Most illegal sanitary logging and other illegal logging sites detected by 2017 field studies were FSC certified
- Much of the wood exports on which Sivets systematically extracted bribes was FSC certified
- Wood from the Chernivtsi and Klesiv case studies mentioned earlier remained FSC certified despite evidence of risk
- Testimony of ex-SFE chief: “Easy” to circumvent; take inspectors to unrepresentative ‘best practice’ logging sites
Undue diligence

3. FSC Certification

WHY IS FSC FAILING IN UKRAINE?
• Fundamental problem that docs demonstrating legality issued by same corrupt entity being certified
• Legality checks mandated by FSC FM are very limited
• New CW standard better for legality than FM standard - but still flawed
• Easy for corrupt SFE to circumvent checks
• Auditors do not pro-actively search court records or the media for evidence of wrong-doing
• Where illegalities are detected, they are treated as ‘minor’ issues, meaning cert is maintained
• One auditor has reportedly stated that it will only take formal investigations into account when a guilty verdict has been reached
Undue diligence – testing

THE MYSTERY SHOPPER

- Fake Ukr company – offering sawlogs [BANNED] and ‘fuelwood logs’ of >2m [MOSTLY BANNED]
- Not formally registered, no address/landline, no certifications, no website

SOME RESPONSES

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<thead>
<tr>
<th>Company</th>
<th>Response</th>
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<tbody>
<tr>
<td>Hungary Lumber mill</td>
<td>Asked how we could export logs despite moratorium; we replied we had ‘good relations’ with Ukr Customs =&gt; requested price offer for 4m logs</td>
</tr>
<tr>
<td>Hungary OSB mill</td>
<td>Asked for confirmation we could ship logs &gt;2m; we explain that “Ukrainian Customs is very co-operative with us” =&gt; asked for quote and face-to-face meeting</td>
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3rd largest wood-based panel maker in world
Recommendations for EU

1. EUTR Competent Authorities
   - Demand more meaningful risk mitigation by buyers, starting with biggest firms
   - Inc but not limited to responding to SCs we will be submitting in due course
   - Prosecute and penalise importing companies which do not apply such due diligence

2. Wider EU government
   - Investigate role of Uniles / Schweigofer in Sivets case under anti-bribery laws
   - Stop pressuring Ukraine to overturn log export ban
   - Provide political and financial support for key steps needed in Ukraine
     - Establishment of independent forest enforcement agency
     - Increased transparency of key government information
     - Faster processing of serious timber corruption cases
**Reaction**

**Prime Minister** – at specially arranged Cabinet meeting, expressed serious concern and ordered inspections by various agencies; asked for help of EU

**Minister of Ecology & Nat Resources** – expressed appreciation for report and asked for our help with reform in Ukraine

**Deputy Minister of Agrarian Policy and Food** – welcomed our information and views and said was ‘personally impressed’ by European Commission – welcomed our information, invited us to present to group of Member State govt representatives, who are now investigating

**EU importers** – investigating and taking seriously our findings; some have halted imports; others have blacklisted particular suppliers

**State Forestry Agency** – totally deny any problem exists. Claim that we are in the pay of mysterious “oligarchs” or IKEA competitors intent on privatizing Ukraine’s forests

**Austrian ambassador in Ukraine** – falsely claim that our allegations against Austrian companies are “without evidence” (but welcome our proposals for reform of Ukr forest sector, including inc transparency)
Thank-you

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