

JULY 2018

**earthsight**

# Illegality in the Ukrainian Forest Sector

Presentation to WRI Forest Legality Week,  
October 2018

SEE FULL REPORT FOR RESPONSES BY  
COMPANIES NAMED IN THIS PRESENTATION

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# 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

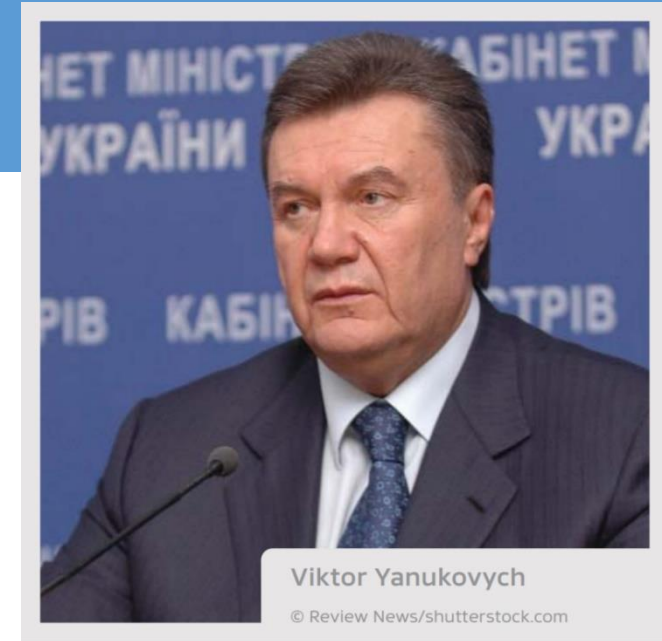
99% of **forest is owned and managed by the State**. 73% is managed by the State Agency of Forest Resources (SAFR)

## 3. The EU is by far the biggest market for Ukrainian wood exports

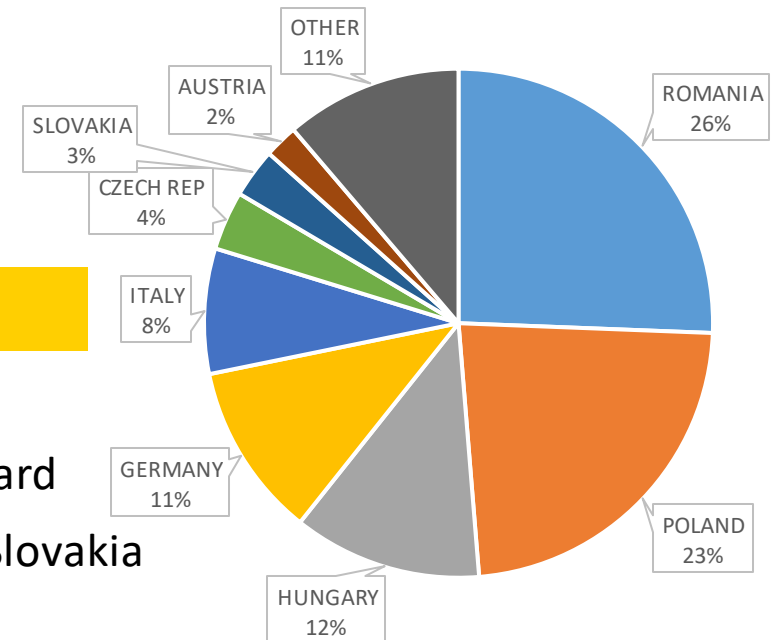
70% destined for EU – over **€1 billion** in 2017; imports rising fast

Mostly primary products – logs, sawn, chips/pellets, firewood, pallets, chipboard

Biggest importers: Romania, Poland, Hungary, Germany, Italy, Austria, Slovakia



EU Timber Imports from Ukraine 2017, by weight



# Our investigation – 2 years

## SOURCES

Customs records, govt records, undercover work, field invs, court records, surveys of buyers, 2ndry sources

## FINDINGS

1. **Corruption is pervasive in the timber sector** in Ukraine, at every stage from harvest to export
2. **EU importers are importing large volumes at high risk of illegality**. This includes world's largest wood firms
3. The due diligence measures being applied by these companies **cannot reduce the risk of illegality to a negligible level**
4. EU is importing more illegal timber from Ukraine than from all tropical countries combined
5. Failure to implement/enforce EUTR for Ukraine threatens to **undermine reputation of both EUTR and wider FLEGT**

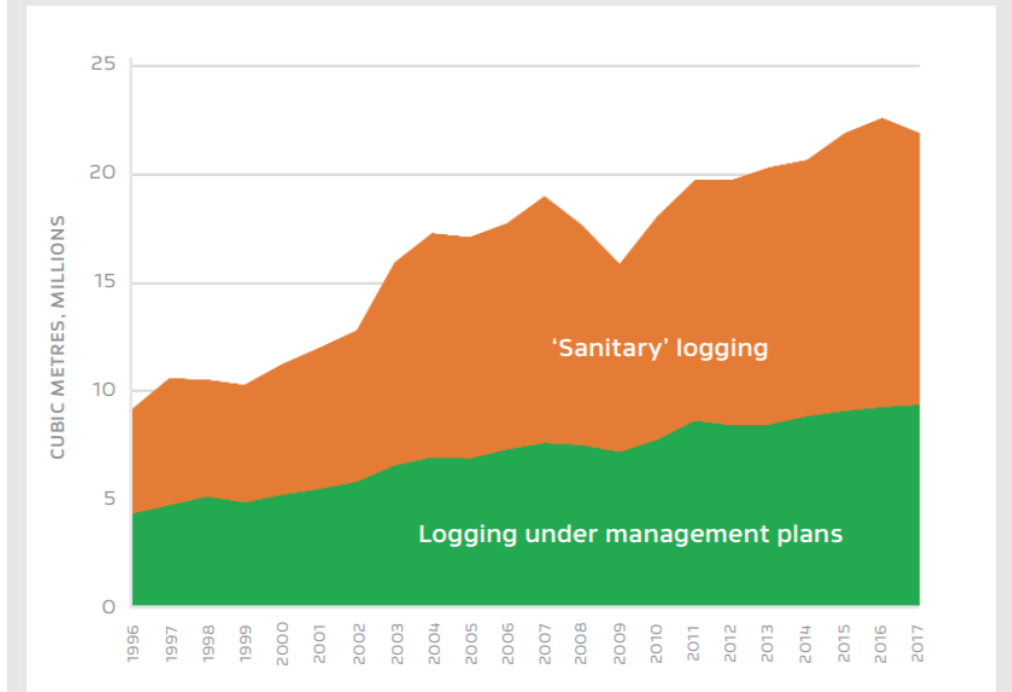
# Corruption in timber harvesting

## 1. Illegal 'sanitary' felling

- Trees approved for felling by State Forestry Enterprises (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**

FIGURE 3

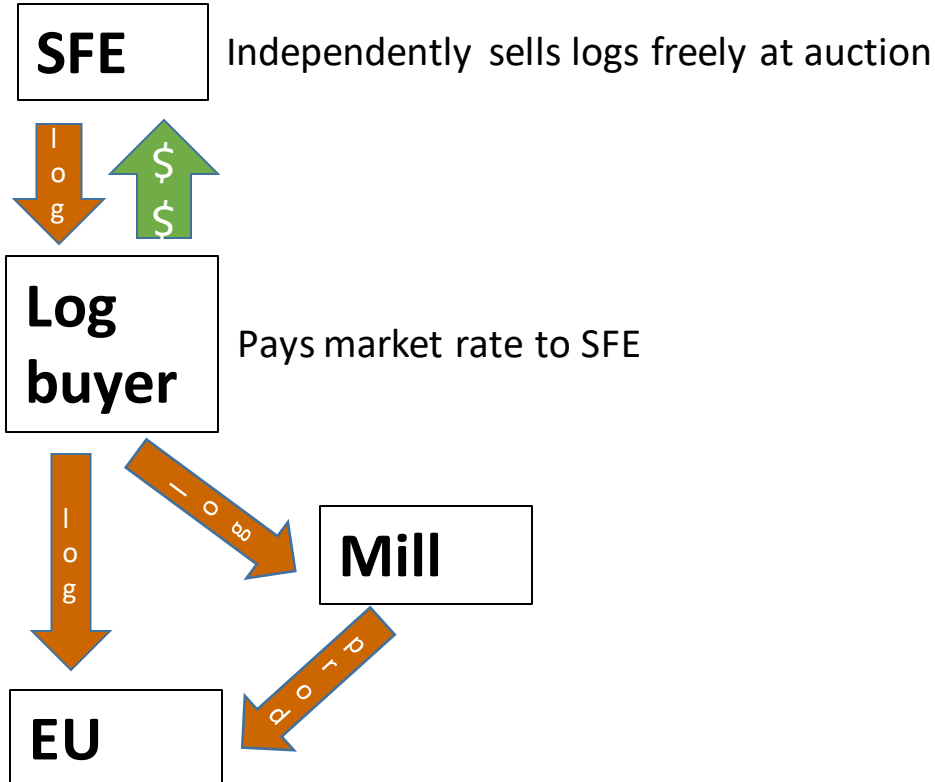
Planned and 'sanitary' timber harvesting in Ukraine, 1990 to 2017



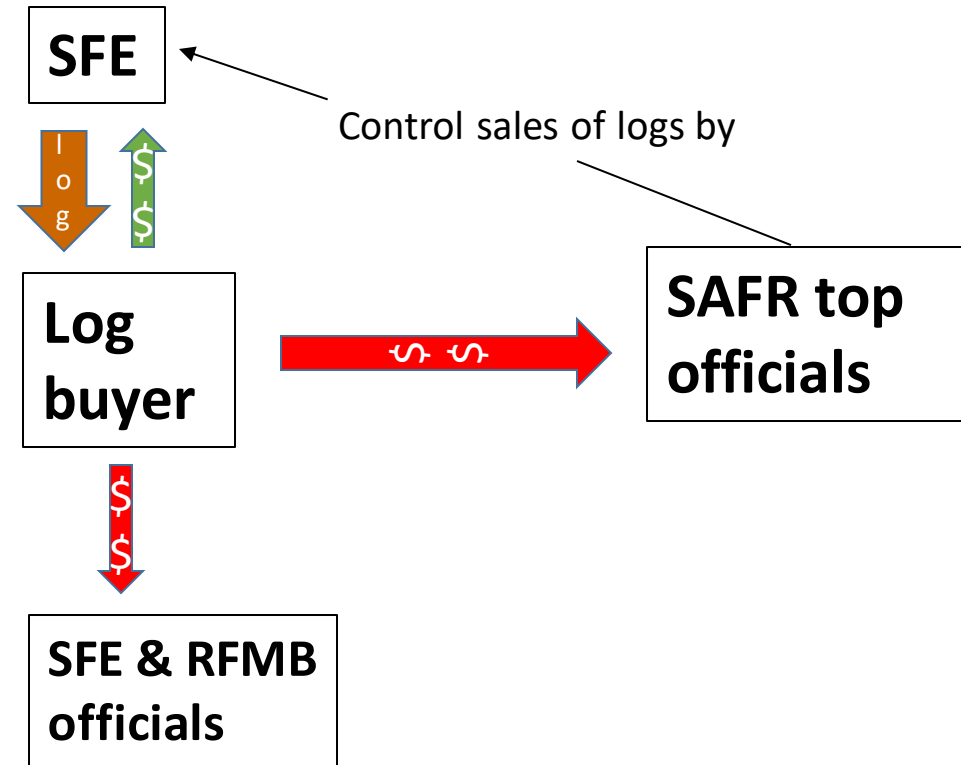
Source: Ukrstat

# Corruption in sale of timber

## THEORY

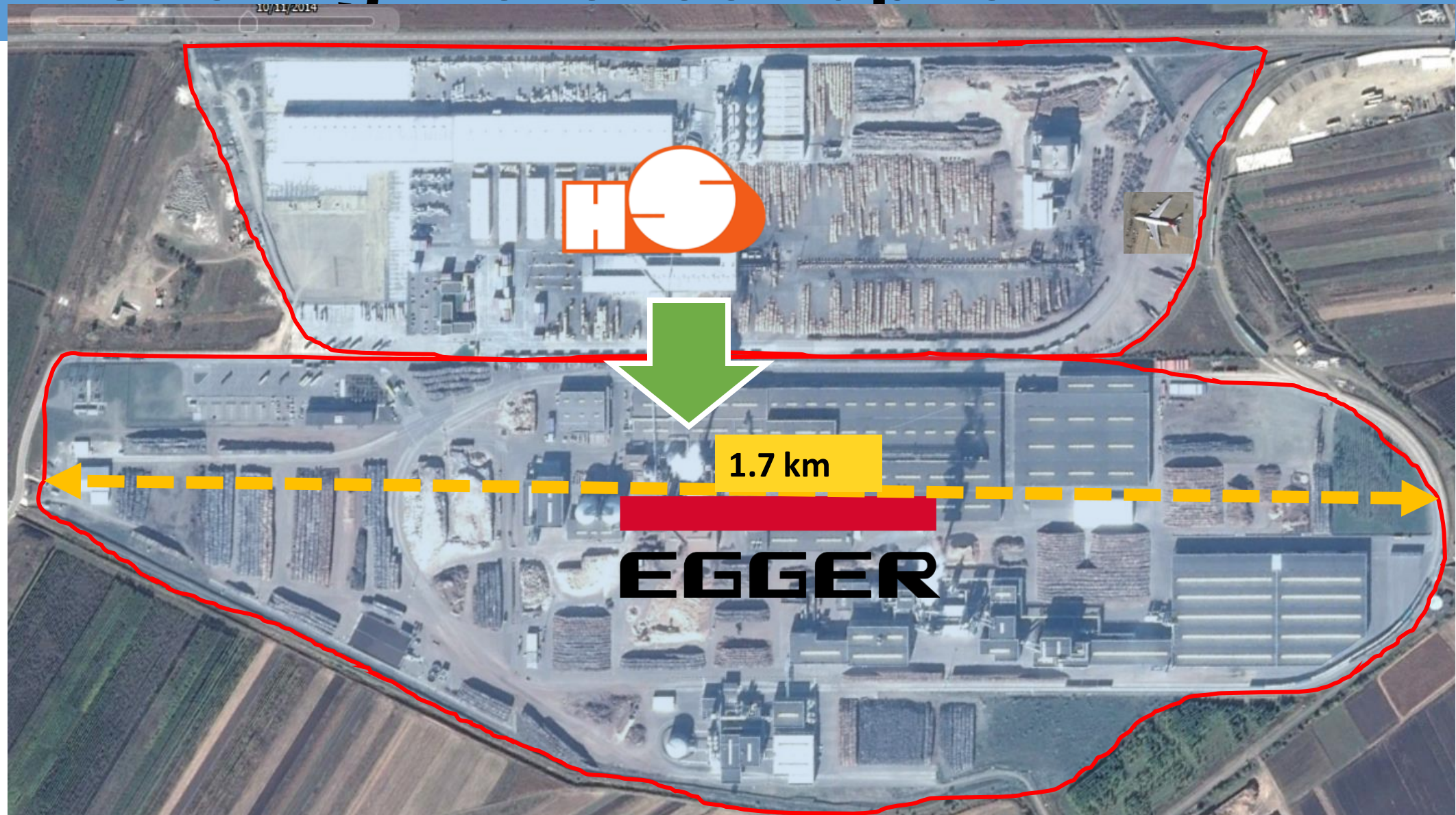


## PRACTICE





# Links to high-level corruption





# The Radauti mega-mill



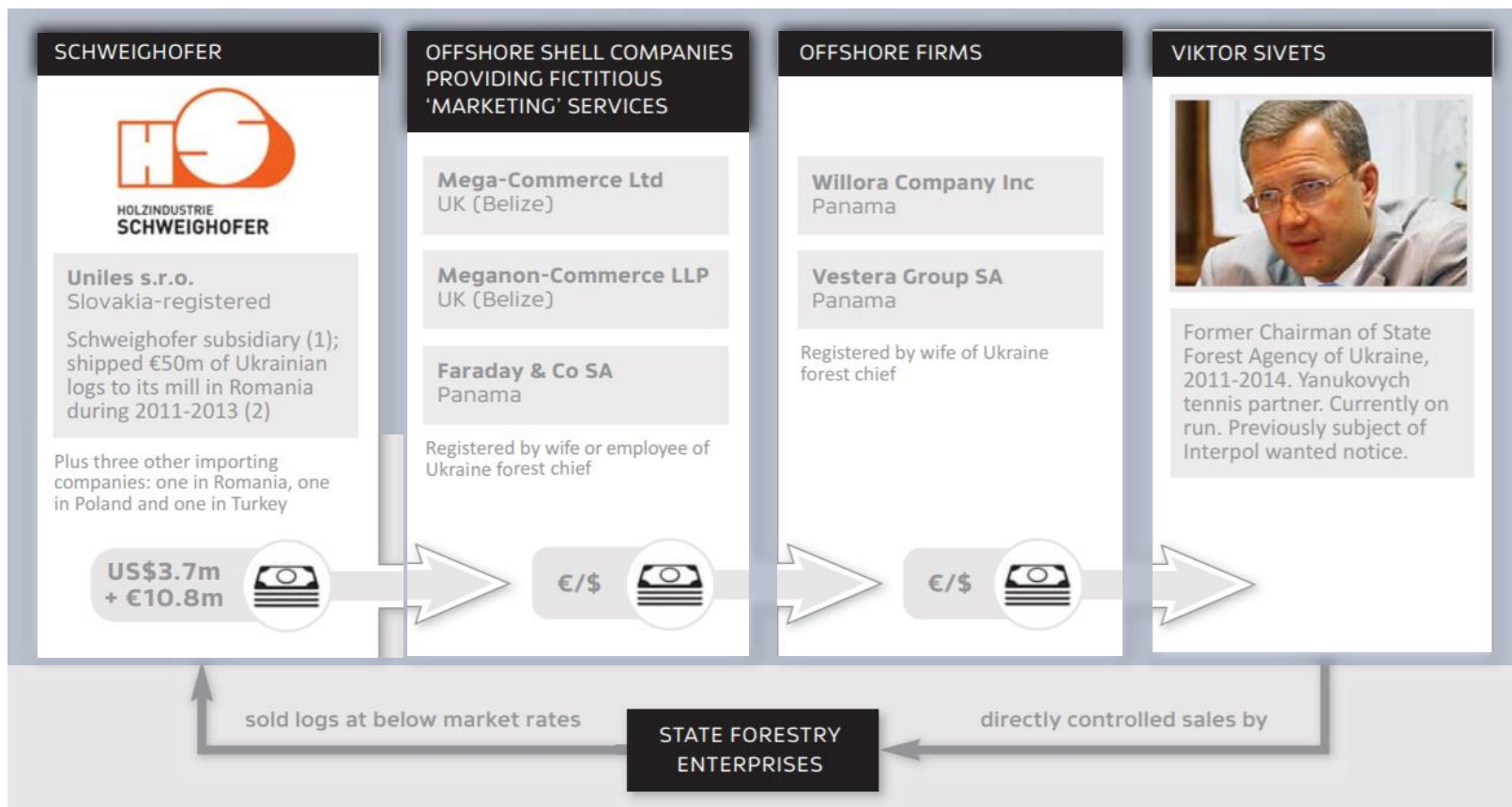
- Direct Russian-gauge rail link
- When opened => EU log imp's from Ukr DOUBLE



- Austrian, \$0.5bn turnover, mostly lumber prods
- 3 Romanian mills capable of consuming entire domestic harvest
- Repeatedly found to have used **illegally sourced Romanian wood** since 2015 – FSC disassociated

# Links to high-level corruption

Pre-trial investigation by Ukrainian prosecutors found:



- Ongoing more recent cases involving provincial level officials, in which both Schweighofer and Egger's names are mentioned
- Earthsight uncovered evidence similar Kiev-level corruption has continued since Sivets ousted in 2014
- Largest current Ukrainian exporter to EU is registered as 'LLP' in UK, with beneficial owners in Panama



# Buying from high-risk suppliers

## CASE STUDY 1 – Chernivtsi oblast, Carpathians

- **Dec 2015**– Forest guards from two of the five SFEs convicted of illegal logging
- **Jul 2016**– Two criminal corruption investigations launched against provincial forest manager Cherevaty and officials from two SFEs for illegal sanitary felling and “systematic illegal sale of timber”
- **Aug 2016**– Further investigations launched against senior officials from two of the five SFEs
- **Sep 2016** – OCCRP/PRI documentary alleges illegal sanitary felling and bribe access to timber in Storozhynets SFE
- **Oct 2016** – Kiev Post publishes allegations of illegal sanitary felling at Beregomety SFE
- **Oct 2017** – Cherevaty offering bribes of \$10k/mth to police to turn a blind eye to illegal logging in his SFEs

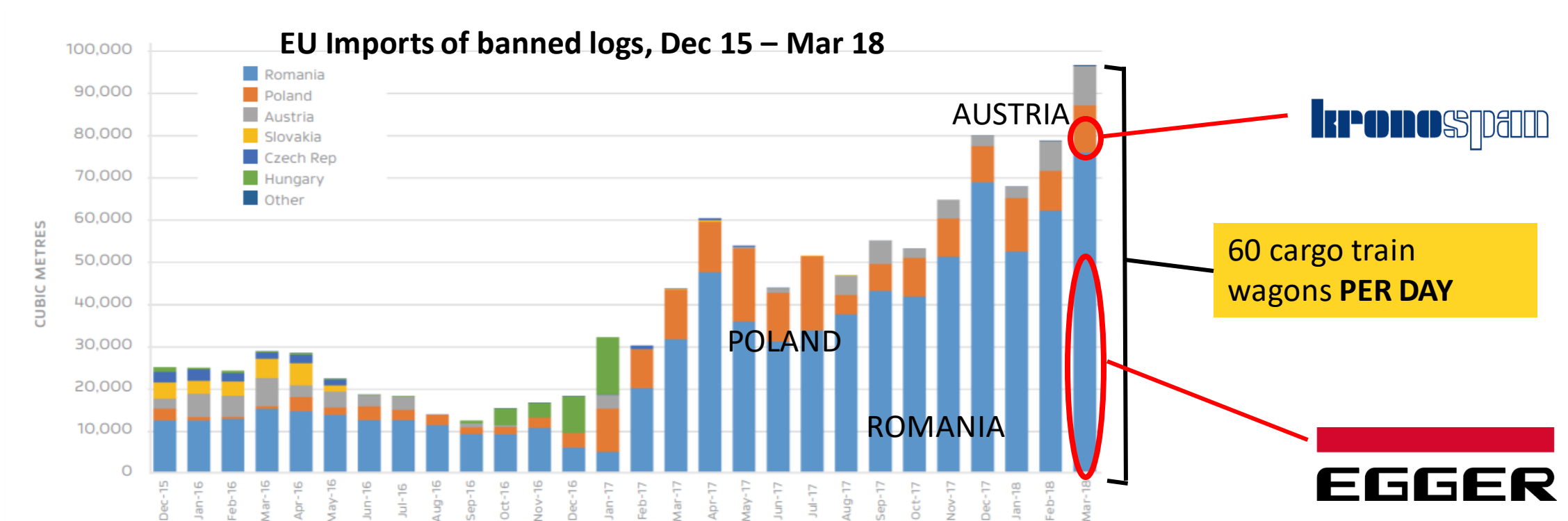


- **Feb 2018** – Forest guards from two of the five SFEs arrested about the same time

# Importing logs banned from export

- Ukrainian **log export ban**: non-pine logs from Jan 2016, all logs from Jan 2017
- 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



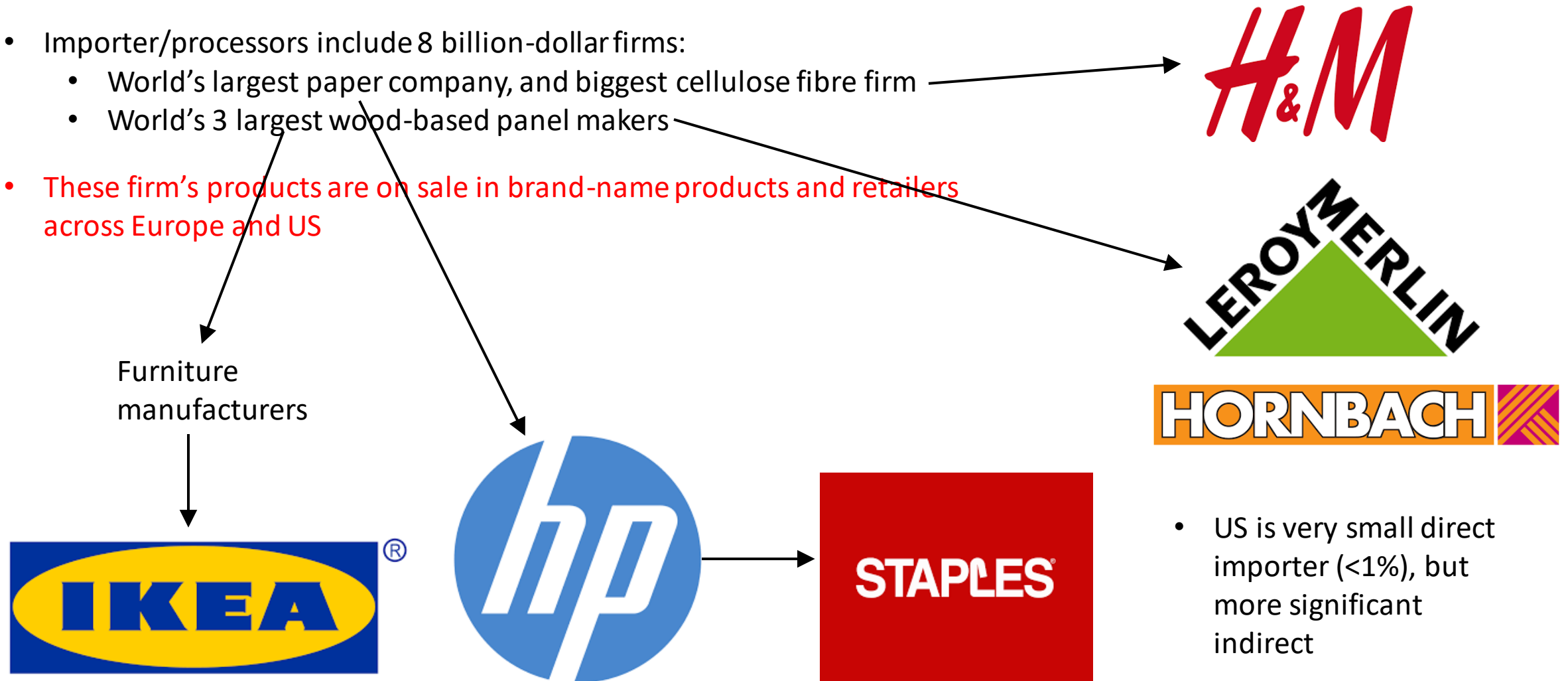
- Logs are not 'smuggled' – they are mis-declared as 'fuelwood' by SAFR and that mis-declaration accepted by Customs

# 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



- US is very small direct importer (<1%), but more significant indirect



# Undue diligence

- Asked big buyers what EUTR DD – checks inadequate, but EUTR authorities approving them

## 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 [**bullshit in, bullshit out**]
- Also regularly forged
- Plentiful examples in public domain demonstrating weakness



Barcode tags seized in Lviv in 2016, used in illegal timber syndicate involving corrupt SAFR officials

# Undue diligence

## 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
- Egger and Schweighofer claim to do some kind of own field checks but very unlikely these are any more thorough than FSC

### EVIDENCE OF FAILURE BY FSC 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 case study 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



**KEY PROBLEM:** Docs demonstrating legality issued by same corrupt entity being certified





# 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

## RESPONSES

	<b>Hungary</b> Lumber mill	Asked how we could export logs despite moratorium; we replied we had ‘good relations’ with Ukr Customs => requested price offer for 4m logs
	<b>Hungary</b> OSB mill	Asked for confirmation we could ship logs >2m; we explain that “Ukrainian Customs is very co-operative with us” => asked for quote and face-to-face meeting

**SEE FULL REPORT FOR COMPANY RESPONSES  
TO OUR FINDINGS**

# Recommendations

## 1. EU

- Prosecute and penalise importing companies which do not apply proper due diligence
- Investigate role of Uniles / Schweighofer in Sivets case under anti-bribery laws
- 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

## 2. Importers & retailers

- EU importers must improve due diligence for wood from Ukraine
- Retailers must also check their supply chains

## 3. FSC

- Reform or face irrelevance if cannot even meet demands of EUTR

# Response thus far

## 1. Ukraine

- Prime Minister ordered major crackdown in response

## 2. EU

- Preparing new guidance for CAs
- Some CAs already formally investigating; others asked for addtl info

## 3. Importers

- Some have blacklisted suppliers; others promised to 'investigate'...
- But most continue to import

## 3. FSC

- Looking into it...





Thank-you

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