

JULY 2018

COMPLICIT IN CORRUPTION

How billion-dollar firms and EU governments
are failing Ukraine's forests



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COMPLICIT IN CORRUPTION



KEY FINDINGS

The Skole Beskydy National Park in Lviv

© Roman Baluk

- > For the last two years, Earthsight has been investigating illegal logging and timber corruption in Ukraine, and tracking connections to overseas markets. Our findings reveal an industry steeped in illegality, with the biggest problems involving corruption among the state enterprises that do most of the logging, and their superiors within the country's forest administration. This corruption is threatening Ukraine's forests – home to lynx, bear and wolves - and also undermining wider governance in a fragile state suffering from armed conflict.
- > Earthsight's field studies revealed multiple breaches of regulations governing harvesting in every logging enterprise visited. The most destructive is the systematic abuse of loopholes allowing trees to be harvested to prevent the spread of disease.
- > We reveal how a previous national forestry chief is the subject of an ongoing criminal investigation for having creamed off over €30 million into Swiss bank accounts in bribes from overseas timber importers, in exchange for access to wood at discounted prices. Our evidence indicates that similar high-level corruption has continued since his downfall.
- > There are major ongoing province-wide criminal corruption investigations relating to two of the three largest timber producing regions. The head of forestry in another province, in the Ukrainian Carpathians, was caught red-handed in a sting operation in October 2017 trying to bribe police to turn a blind eye to widespread illegalities. Corruption at the district level in sales of timber for domestic processing, meanwhile, is feeding a growing 'shadow lumber' industry of over 12,000 illegal sawmills.
- > The EU is by far the largest destination for Ukrainian wood exports, representing 70 per cent of the total. EU purchases have been rising rapidly, breaking €1 billion in 2017. Our findings suggest that at least 40 per cent of this wood was harvested or traded illegally, with the aid of corruption. They also indicate that Ukraine is the largest single supplier of such high-risk wood to the EU, exceeding all of the tropical countries of Latin America, Africa and SE Asia combined.
- > The EU buyers of Ukrainian wood include many of the world's largest multinational wood processing companies. We found many of these companies are mentioned in ongoing criminal investigations relating to illegal logging, illegal wood exports and related corruption. One has even been specifically implicated in the corrupt scheme masterminded by the former forest chief. All of them continue to import large volumes of wood from state logging enterprises which are the subject of such investigations.
- > Products produced by these companies, potentially tainted with Ukrainian wood of illegal origin, are to be found on sale throughout the EU, including in branches of the largest DIY, furniture and supermarket chains on the continent.
- > The EU has long recognised that its huge demand for cheap wood has in the past helped drive illegality in the forests of supplier countries. As a result, since 2013, it has had a law in place which is meant to prevent wood imports of likely illegal origin. But our findings reveal that for Ukraine this law is not working. Authorities in key Member States are failing to meaningfully enforce it. Its impact is also being undermined by false confidence being placed by buyers and authorities in the independent 'certification' of forests by the Forest Stewardship Council (FSC).
- > Brave activists in Ukraine are battling timber corruption at significant personal risk, as are progressive elements within the government. Some European officials are making real efforts to help. But under pressure from the giant firms dependent on steady supplies of cheap Ukrainian wood, the EU has used its greatest leverage to push the Ukrainian government to overturn its ban on exports of raw logs.

EXECUTIVE SUMMARY



Our findings reveal the complicity of the EU's national governments and its largest wood processing companies in Ukraine's timber corruption crisis

INTRODUCTION

It has been said that 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.¹ Ukraine's forests have become the site of one of the biggest battles currently being fought in this second war.

Western Ukraine contains some of the largest remaining tracts of forest on the European continent, home to some of the last viable populations of brown bear, Eurasian wolf, lynx and European bison. But these forests are in crisis, their health and existence threatened by rampant illegal logging, illegal wood exports and timber-related corruption. Wood is one of Ukraine's largest export industries, bringing in \$1.7 billion in foreign exchange, employing 350,000 people and accounting for almost 4 per cent of GDP. Corruption and illegality in this sector is robbing the country of a crucial source of government revenues, while undermining broader efforts to improve governance in a turbulent state.

Over the past two years, Earthsight has been investigating illegal logging and timber corruption in Ukraine. We have interviewed sources from within government and industry, carried out field investigations, trawled

through customs records and unearthed hundreds of court documents. Our findings reveal in shocking clarity the scale and pervasiveness of illegality in Ukraine's forestry and timber sector. They also reveal the complicity of EU governments, international wood 'certifiers' and some of the world's largest multinational wood processing companies in Ukraine's timber corruption crisis.

ILLEGAL LOGGING AND TIMBER CORRUPTION IN UKRAINE

Nearly all of the logging in Ukraine is carried out by the government itself, through State Forestry Enterprises (SFEs), mostly under the auspices of the national forestry agency (SAFR). Though they seek to characterise it as a clandestine criminal activity conducted by members of the public and of quite limited scale, the reality is that the overwhelming majority of illegal harvesting in Ukraine is also being carried out by the forestry agencies themselves.

Our evidence shows that Ukraine's hundreds of SFEs engage in the systematic, deliberate breaching of a wide range of regulations during harvesting. None is more destructive than illegal 'sanitary felling'. The environmental friendliness of logging in Ukraine is supposed to be assured through careful planning of which trees can be cut

each year, but nearly 60 per cent of the harvesting occurs outside such limits, mostly in the form of 'sanitary felling' justified to prevent the spread of disease. In the face of allegations that corrupt forest enterprises were abusing this loophole on a massive scale to cut healthy trees whose harvesting would not otherwise have been allowed, including in national parks and other protected areas (even the irradiated Chernobyl exclusion zone), the national authorities tightened the rules in 2016. But the problem persists. A study commissioned by Earthsight of 18 logging sites across four of the largest timber producing provinces in 2017 found that between 67 and 78 per cent of this harvesting is unjustified and therefore illegal. Extrapolated to a national level, this suggests illegal sanitary felling currently represents 38-44 per cent of total production and exports. Our field research showed other breaches of logging regulations by state agencies are equally common.

The process by which wood produced by state enterprises enters the market is also characterised by systematic corruption. Top officials in the capital personally direct sales of logs to the largest overseas buyers, in contravention of regulations. A former forestry chief, Viktor Sivets, stands accused of channelling over €30 million from such sales into his own hands through a complex web of offshore entities during 2011-2014. Firms were required to make such payments in order to access Ukrainian wood, and in return received discounts on their purchases of logs and lumber from the SFEs under Sivets' control. Sivets, a close confidant and tennis partner of kleptocratic former Ukrainian president Victor Yanukovich, fled to Russia and was until recently the subject of an Interpol arrest warrant. The direct sales continue under his successors, and forestry experts note multiple 'red-flags' suggestive of continued corruption at the national level. Earthsight has unearthed additional evidence indicating that corrupt payments for access to timber were still being demanded by officials in Kyiv after Sivets was ousted.

SFEs are supposed to offer all of their timber for sale by auction. Even where this requirement is followed, such auctions are commonly corruptly rigged, and much of this wood ends up in the hands of the 'shadow sawmillers'. An estimated 12,000 unlicensed sawmills process this wood, mostly for export. As a result, exports of sawn timber exceed the country's entire legal production by 75 per cent: 1.2 million cubic metres of illegally-sourced lumber exports every year.

Trawling through court records, we discovered top officials in two of Ukraine's three largest timber producing provinces are the subject of major criminal investigations, involving systematic illegal logging and timber exports. The director of forestry of one of the largest timber producing provinces in the Carpathians has also been the subject of multiple corruption cases, and in October 2017 was caught red-handed offering to pay \$10,000 per month to officials of other agencies to turn a blind eye to illegalities being carried out by the SFEs under his control. Commenting on the case, one of Ukraine's chief prosecutors said that unless such men were brought to justice, Ukraine's mountains may soon be "bald".

As well as being harvested, sold and processed illegally with the aid of corruption, Ukrainian timber is commonly illegally exported as well, often with the help of corrupt customs and forestry officials.

One of the most senior forest officials in the Carpathians was arrested in October 2017 after offering \$10,000 per month to officials of other agencies to turn a blind eye to illegal logging



Cash that was offered as a bribe by the head of Chernivtsi province forestry agency in the Ukrainian Carpathians, October 2017

© National Police of Ukraine



Wagons with timber head towards the Romanian border from Ukraine

© Nikolai Petichenko

A Schweighofer subsidiary is directly implicated in the criminal corruption case against Ukraine’s former forest chief

EU IMPORTS

The European Union is by far the largest buyer of Ukraine’s wood exports, accounting for nearly 70 per cent of the total value. At the same time that illegality and corruption has been increasing in the sector in Ukraine, Europe’s imports of wood products from the country have been rising, growing by 75 per cent in just four years to breach the €1 billion mark in 2017.

The EU has long recognised the importance of tackling the global scourge of illegal logging, and acknowledged that as one of the world’s largest importers of wood, it bears some responsibility for doing so. This recognition led to a new law – the EU Timber Regulation or EUTR - taking effect in 2013, prohibiting the import of wood which was illegally sourced in the country of origin. The law also requires importers to carry out due diligence in order to minimise the risk of receiving illegal wood. This includes wood harvested or traded illegally by corrupt officials.

However, Earthsight’s research shows that this law is not working, and that wood of likely illegal origin continues to flood into the EU. More shocking still, it reveals that the buyers of this wood include a number of multi-billion dollar firms, including the three largest wood-based panel producers in the world, the world’s largest paper company, and the second largest sawn timber producer in Europe. The owners of these firms are among Europe’s wealthiest individuals.

Before Ukraine’s ban on the export of logs took full effect at the beginning of 2017, the largest buyer of the country’s wood was Austrian-owned sawmiller Holzindustrie Schweighofer, a firm already famous for using illegal Romanian wood. The company’s vast wood processing facility just across the border in Romania was the destination for 70 per cent of Ukraine’s European log exports. Earthsight discovered that the Schweighofer Group subsidiary which handled most of these shipments until 2016 is directly implicated in the criminal corruption case against the former forestry chief, Sivets. A pre-trial investigation by Ukrainian prosecutors found it was one of four firms which collectively paid more than €13 million for fictitious ‘marketing’ services to offshore companies controlled by Sivets and his wife. Though the Sivets case has yet to be tried, a Ukrainian judge considered the evidence sufficient to issue arrest warrants and order a freeze on millions held in Swiss bank accounts.

Schweighofer is far from the only big EU buyer whose name crops up in cases regarding illegal timber in the Ukrainian courts. A Romanian subsidiary of JAF Group, Central Europe’s leading wholesaler of lumber, is linked to one of Ukraine’s largest ever illegal timber export cases, exposed in Lviv province in 2016, in which corrupt officials helped launder illegal sawn wood. Court records confirm that JAF was supplied timber by one of the masterminds in that case, during the relevant period. After being informed of this by Earthsight, JAF has now blacklisted the supplier.

With the log export ban reducing purchases by others, the leading EU importer of Ukrainian wood is now Egger, the world's second largest producer of wood-based panels (used in construction and to make cheap furniture). Egger's name appears alongside that of Schweighofer in a major criminal corruption investigation in Zhytomyr, Ukraine's leading timber producer, as a recipient of wood suspected to have been corruptly sold by forest officials at below market rates to intermediary firms with shareholders registered in secrecy jurisdictions.

Though some of the other largest buyers aren't specifically named in such cases, their suppliers are. Egger's leading global competitors in the wood-based panel sector, Kronospan and Swiss-Krono, have continued to purchase large volumes of timber from Ukrainian State Forestry Enterprises whose top officials are the subject of ongoing criminal corruption probes, as has a Polish pulp mill operated by International Paper, the world's largest paper company. One third of Egger's imports in 2017 came from such suppliers, as did half of International Paper's. Some of the corruption-linked SFEs supplying these firms are also at the epicentre of an illegal amber mining industry which is devastating Ukraine's Polissia region. Far from excluding suppliers under investigation for serious corruption, our evidence indicates that the largest buyers were actually more likely to be sourcing from them than their smaller competitors.

Most of the cases mentioned above have yet to be tried. But this shouldn't matter. The EUTR requires the importers to take a precautionary approach, and only buy timber where the risk it was illegally sourced was negligible. It is impossible to see how purchasing wood from suppliers such as those mentioned above could be consistent with that demand.

In addition to buying wood associated with corruption, Earthsight's evidence also suggests that EU firms are also buying wood which was likely to have been exported illegally, including in contravention of Ukraine's 2015 ban on the export of round logs. Earthsight's analysis reveals that by December 2017, EU customs authorities had recorded importing almost 1 million cubic metres of logs from Ukraine which were supposed to be banned from export. On export from Ukraine, these logs are being mis-classified as 'fuelwood'. Though some such incorrect classification was already occurring prior to the ban and stems in part from differences in how

Ukraine's forest service categorises timber, there is also evidence of deliberate, illegal mis-labelling by SFEs, including in order to circumvent the ban and to help disguise corrupt practices. In the first half of 2018, for example, Ukrainian customs agents in a province on the border with Romania detected illegal log exports worth over \$1 million which local SFEs had mis-declared as fuelwood. Our research shows how big European buyers are connected to this too. One of the most high-profile illegal timber scandals in Ukraine in recent years involved the seizure of logs on the Ukrainian border, logs which Earthsight's research confirms were destined for Czech pulp mills operated by the multinationals Mondi (Europe's largest paper packaging maker) and Lenzing (among the world's largest producers of viscose fibre, used to make clothes). Though most of the wood was eventually released, the supplier was found guilty of mis-declaration.

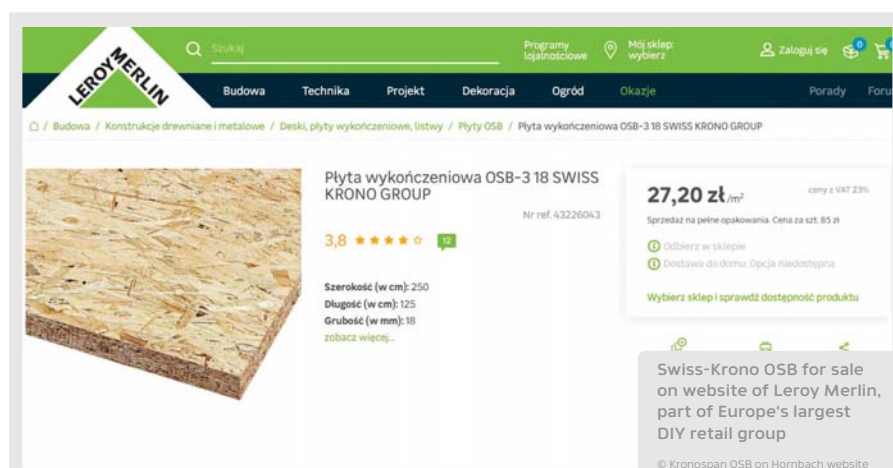
Despite their size, few people have heard of any of these companies. But most European consumers will have purchased some of their products. Timber from Schweighofer's Romanian mill has been traced to products sold in Ikea. Egger, Swiss-Krono and Kronospan are also Ikea suppliers, and supply much of the lumber, wood-based panels and wood flooring sold by DIY chains Wickes and Homebase in the UK, Hagebau, Obi and Hornbach in Central Europe and French chains Leroy Merlin and Castorama. International Paper produces the HP, Canon and Xerox-brand photocopy

paper sold in supermarkets throughout Europe. Earthsight found Canon paper produced in its Polish mill on sale at branches of leading stationery chain Staples in Germany. Products made with Lenzing's fibre are on sale in major high-street clothing chains, including H&M.

All of the big buyers of Ukrainian wood mentioned above deny wrongdoing, and insist that they implement meaningful checks on their suppliers. How meaningful they can be is questionable, however, given the corruption we have documented. In order to test just how high a priority big EU firms attach to ensuring the legality of their products, Earthsight posed as a Ukrainian company and offered to sell them logs, including sawlogs banned from export. Three expressed an interest in doing business with our shady, non-existent company, after being re-assured that we had 'good relations' with Ukrainian customs.

Drawing on our evidence, we commissioned a leading researcher to update global estimates of the volumes of likely-illegal wood entering the EU, using a recognised methodology it has itself employed. Illegal logging is usually associated with countries in the tropics. But the results of this new analysis indicate that the EU probably imports more illegally sourced wood from Ukraine than it does from all of the countries of Latin America, Africa and SE Asia combined, and more than from any other country in the world.

Despite their size, few people have heard of these companies. But most European consumers will have purchased some of their products



PLACING THE BLAME

European consumers care about forests and do not wish to be parties to crime. Recognising this, the major timber processing firms identified in this report all promise to only procure legal and sustainable timber. So do the DIY, furniture and other retail chains which sell their products. These companies are failing to abide by those promises with regard to Ukraine. But the EU has recognised that with regard to legality, such actions should not be voluntary. With the EU Timber Regulation in place, companies shouldn't need to be shamed into action. They should be forced into it.

So why has the EUTR failed to prevent Europe's demand for wood contributing to illegality and corruption in Ukraine's forests? Earthsight's research reveals that part of the problem lies with the law itself, and part with how it is interpreted and enforced. The first problem is that the law only applies to the companies whose names appear on the import documents. Though the timber travels direct to their factories, many of the largest buyers of Ukrainian wood use middlemen to do the importing on their behalf, conveniently avoiding the risk of breaching the law. These middleman firms are typically small and opaque, often little more than an individual operating out of a home office. Earthsight's research has shown that on the few occasions such firms have been caught out and had shipments seized, their owners simply dissolve them and begin trading under a new name.

Another important culprit is the Forest Stewardship Council (FSC), the world's leading forest certification organisation. Originally founded in the early 1990s by environmentalists and progressive industry leaders to help consumers identify sustainably produced wood products, FSC has been the subject of increasing criticism in recent years. Its rapid growth has been accompanied by a gradual weakening of standards, and a steady stream of scandals where FSC-certified companies were shown to have been involved in everything from illegal logging to human rights abuses. Though it was never its principal purpose, the FSC's systems include checks on the legality of timber as well its sustainability.

Though none of the big buyers documented in this report insist on FSC 'Forest Management' certification for their imports from Ukraine, most do claim to try to prioritise the purchase of this wood, and where this wood or the lower-standard FSC 'Controlled Wood' is purchased, it usually represents the main, if not the only, form of EUTR due diligence the companies apply. EUTR has

helped drive a significant expansion of FSC in Ukraine: ninety per cent of the forests under the control of SAFR in the Ukrainian Carpathians are now certified. Unfortunately, this report shows that FSC has fundamental flaws which mean it cannot currently be relied on to ensure legality in Ukraine. Its failure is amply demonstrated by the numerous cases documented in this report which the organisations' audits failed to pick up. Most of the illegal sanitary felling sites we found in the Carpathian region are in FSC-certified forests, for example, and most of the SFEs which are the subject of serious criminal corruption investigations have nevertheless remained certified. The former chief of one of the largest timber-producing SFEs in the Carpathians admitted to Earthsight he had found it easy to circumvent FSC checks.

Local activists are fighting an uphill battle, so long as the biggest market for Ukraine's timber remains open to illegally-sourced wood

The ultimate responsibility, however, lies with the EU governments whose job it is to implement and enforce the law. If they do their job well, they should be able to catch the middlemen, and force firms to go farther in their due diligence. Unfortunately, as this report shows, implementation of the EUTR in the most important EU Member States for Ukrainian wood imports has been poor. Many of these countries were still not implementing the law more than three years after it was supposed to have come into effect. Even now that they are, the available data suggests it is with limited enthusiasm. This report shows that involves what could at best be described as a 'generous' interpretation of it. The big importers highlighted in this report have 'due diligence' systems in place which have in most cases been approved by local EUTR officials. But for wood which is not FSC certified, this usually amounts to little more than promises extracted from suppliers and checks for a 'Certificate of Origin': documents issued by the same corrupt government entities which do the logging, and well known to be open to abuse.

SOLUTIONS

The ultimate solution to forest crime in Ukraine must come from within the country. More and better enforcement by relevant agencies would help, but tackling the roots of timber corruption will also require changes to how forestry is regulated, to reduce the opportunities and incentives for sleaze. Expert studies have already identified the key measures required, such as separating the responsibilities for carrying out logging and monitoring its legality, and improving transparency. Some potentially useful new regulations are already in draft, but the reform process is moving painfully slowly.

Meanwhile, the battle against the scourge of timber corruption continues, with those in the frontlines facing grave personal risks. Corrupt forest guards chase independent civil society monitors out of the forest at gunpoint. Corrupt elements within Ukraine's secret police monitor the movements of anti-corruption activists. Junior forest officials who inform on their superiors have their cars burned and their families threatened.

These activists and progressive elements within government are fighting an uphill battle, however, so long as the biggest market for Ukraine's timber remains open to illegally sourced wood. The EU is providing some useful funding and support to forest governance reforms in Ukraine. Yet its greatest influence has instead been applied to forcing the Ukrainian government to overturn its log export ban, efforts this report shows have been lobbied for by many of the same EU timber processing giants we found to be consuming suspect wood.

If the EU really wants to help, it should spend less energy strong-arming the Ukrainian government on the log export ban, and more ensuring that its Member States are implementing its own laws.

1. BACKGROUND



1.1 THE POLITICAL CONTEXT

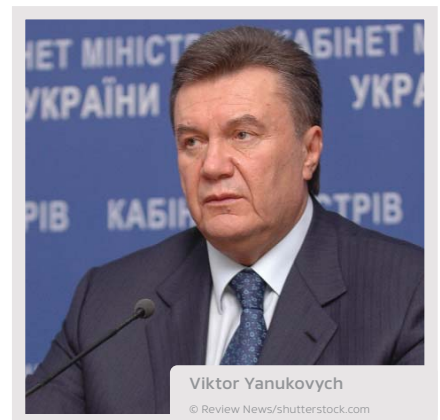
Ukraine is a country in flux. Metamorphosed after a sudden revolution in 2014, it has since been wracked by armed conflict. A post-revolution Ukraine is pre-occupied with correcting the mistakes of its past and throwing off the last shackles of the Soviet era. There have been laudable attempts at modernisation and reform of its institutions and the Government has implemented, and continues to implement, a host of anti-corruption measures in recent years, some of which hold real promise. But momentum is waning.

Viktor Yanukovich, the former Ukrainian President, and his group of kleptocrats ransacked the country for four years between 2010 and 2014, and are thought to have stolen more than \$100 billion from state coffers in that time,² most of which remains unrecovered. Although a severe setback for Ukraine, the Yanukovich regime also became the bellwether of change for the country. Disbelief and anger at the sheer scale of corruption he orchestrated during his time in power led thousands of Ukrainians to take to the streets and to social media in protest, in a wave so strong that it toppled his government. Euromaidan, symbolically called the Revolution of Dignity, signalled the strong collective wish of a majority of Ukrainians, especially young Ukrainians, to end corruption, align with the EU and usher in a long overdue era of peace and prosperity for their country.

In the four years since Maidan, many new civil society groups and journalists with a

specific anti-corruption focus have popped up, and have appointed themselves watchdogs of everything from the selection of public officials to public spending. New anti-corruption laws were passed, driven primarily by input from strong civil society coalitions.³ The year that Yanukovich's regime ended, a new anti-corruption department, the National Anti-Corruption Bureau, or NABU, was formed by the Government, with the specific mandate to tackle high-level corruption. The following year, Ukraine passed a law which made it compulsory for public officials to declare their private assets online, an unthinkable concept a few short years before. The Government has, to a great extent, succeeded in improving transparency, and is more responsive to information requests from the public than the governments of many Western European countries. A slew of cases were brought against corrupt officials and businessmen by ambitious prosecutors and government investigators, driven by a genuine desire to purge the country of graft. The grand corruption seen at the time of Yanukovich was thought to be largely a thing of the past.

Perhaps inevitably however, considering the size of the challenge, corruption remains entrenched in Ukraine today. Old patterns have started to re-emerge. When Petro Poroshenko, already a billionaire oligarch with a vast candy empire, ran for the Presidency a few months after Yanukovich was banished in 2014, he vowed to the Maidan revolutionaries that he would give up his business interests and 'be honest' once elected. More than three years later,



Corruption remains entrenched in Ukraine today



A Eurasian Wolf
Minden Pictures / Alamy Stock Photo

The forests of Western Ukraine include some of the most beautiful and biodiverse natural landscapes in Europe

he has yet to do so, and has even expanded his business empire. Many politicians in Ukraine have continued to retain significant business interests, leading to the high risk of official decision-making being subverted by conflicts of interest. Even as the nation is ravaged by a costly conflict with Russian-backed separatists, top Ukrainian military officials are stealing millions from their own people.⁴ Ukraine remains the most corrupt country in Europe, with a Corruption Perception Index (CPI) score worse than 130 other countries – including the likes of Pakistan, Sierra Leone and Honduras - and on a par with Russia.⁵ A weak judicial system, with a poor conviction record, undermines the work of diligent journalists and state investigators. Years after Yanukovich, the Ukrainian government has not taken any meaningful action to recover the assets he stole. Yanukovich himself has still not been convicted for corruption in Ukraine.

Corruption also remains the major barrier to new investment in Ukraine. In an industry survey by the American Chamber of Commerce, an overwhelming ninety eight per cent of businessmen polled stated that they thought corruption was widespread in Ukraine, while eighty eight per cent stated that they had themselves encountered corruption when doing business in the country.⁶ The Managing Director of the European Bank for Reconstruction and Development, speaking in London in July 2017, said that it was impossible to operate in Ukraine without paying bribes.⁷ Other commentators have noted that the primary reason for ineffective investigation and prosecution of the corrupt post-Maidan was not the absence or efficacy of legislation, ‘but the lack of genuine political will to tackle systemic and high-level corruption.’⁸ NABU has had a poor track-record - only a quarter of cases where it had completed pre-trial investigations actually went on to the trial stage, with most of them languishing indefinitely in courts.⁹

The Head of Ukraine’s National and Security Defence Council called the country the ‘epicentre of the confrontation between the Western democratic world and authoritarian, totalitarian states’.¹⁰ Despite high corruption levels however, Ukraine also has a particularly vibrant and voluble free press and civil society, diligent at exposing the falsehoods of politicians to the public and scrutinising every deal made by self-serving insiders and businessmen. Their continued good health will be vital to rooting out corruption and shaping the Ukraine of tomorrow.

1.2 EXTENT, SIGNIFICANCE AND THREATS TO UKRAINE’S FORESTS

Ukraine has more than 100,000 square kilometres of forest, covering 17.6 per cent of the country’s land mass.¹¹ Around half the total area is planted forest.¹² The areas with the most forest cover, which also produce the majority of the timber, are the regions in and around the Carpathian mountain range in the south-west of the country, and Polissia in the north (see Figure 1). Between 30 and 50 per cent of the land in these two areas is covered by forest.¹³

The forests of Western Ukraine include some of the most beautiful and biodiverse natural landscapes in Europe. Even though the country covers less than 6 per cent of the European continent, it contains approximately 35 per cent of Europe’s species diversity – a term used to measure the ecological value and richness of habitats – owing to its location at the meeting point of many different ecosystems and bird migration routes.¹⁵ Running through south-west Ukraine is a section of the Carpathians, a 1500 kilometre arc of dramatic mountains and forest which fan out across several Central and Eastern European countries, primarily Slovakia, Poland, Ukraine and Romania. Ukraine’s position near the centre of this arc makes the Ukrainian Carpathians a vital lynchpin in a network of forested corridors¹⁶ that are home to the biggest populations of large carnivores in Europe,¹⁷ several threatened species, some of the last remaining virgin forest on the continent and several world heritage sites.

Widely referred to as some of the largest areas of unspoilt wilderness in Europe, the Carpathians contain 30 per cent of Europe’s flora¹⁸, and are the last remaining habitat in Europe that can support viable populations of large carnivores.¹⁹ Some of Europe’s most iconic large mammals like the lynx, European bison, brown bear, almost half of the continent’s wolf population,²⁰ some of the last remaining populations of the critically endangered European mink²¹ as well as several rare and migratory birds such as the vulnerable Eastern Imperial Eagle²² call these forests home. When the Carpathians pass through Ukraine they are at their most narrow, forming a natural bottleneck for species travelling north and south along the Carpathian arc, which in turn serves to connect the ecosystems of northern Europe with the South. The Ukrainian Carpathians cover the four western oblasts of Chernivtsi,

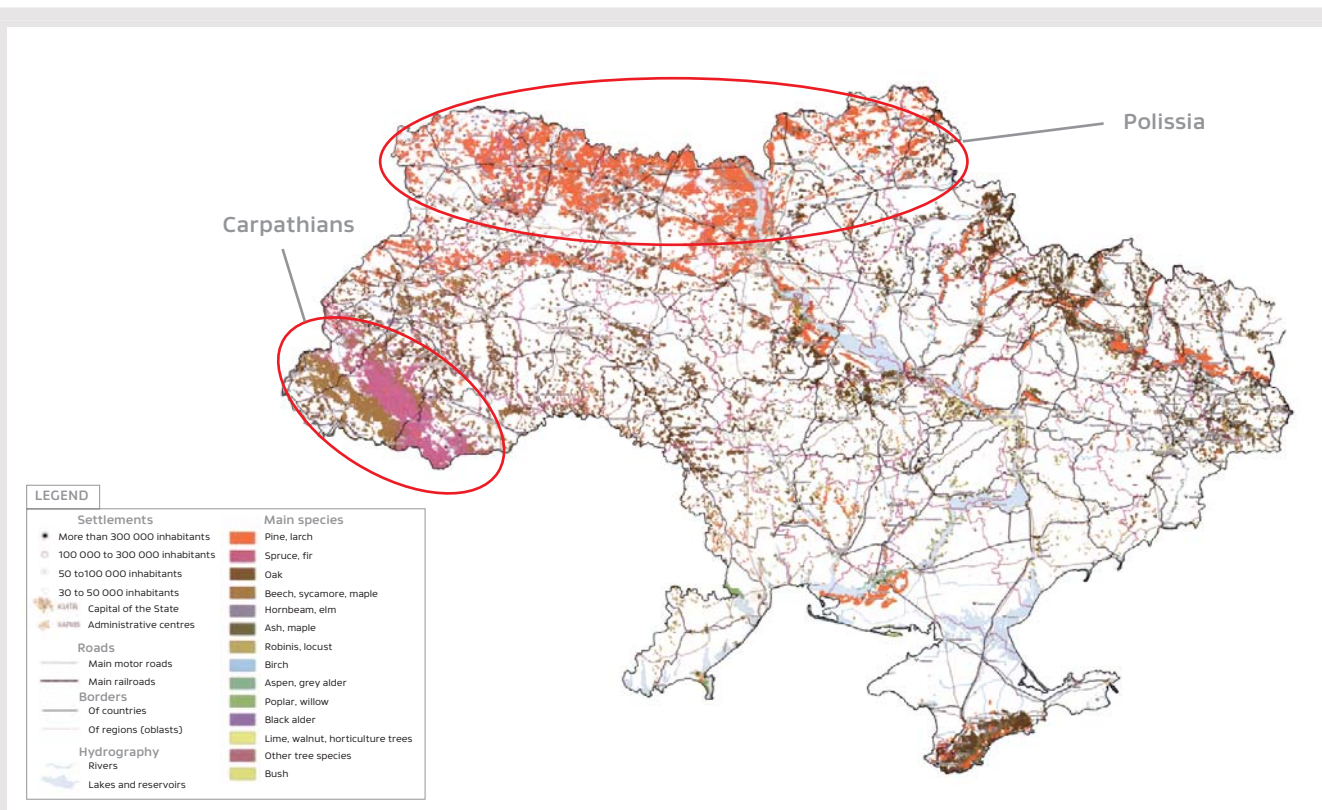


FIGURE 1
 Forest cover map of Ukraine, with the Polissia and Carpathian regions highlighted

The major species of trees found in Ukraine are scots pine (*Pinus sylvestris*), Pedunculate oak (*Quercus robur*), Norway spruce (*Picea abies*), European beech (*Fagus sylvatica*), silver birch (*Betula pendula*), black alder (*Alnus glutinosa*), European ash (*Fraxinus excelsior*), European hornbeam (*Carpinus betulus*), and silver fir (*Abies alba*). Coniferous forests occupy 42 per cent of the country's forested area and hardwood broadleaf forests account for a further 43 per cent of forest cover.¹⁴ The majority of the country's pine stock is distributed across the northern regions (Polissia), while beech and spruce are pre-dominant in the west, concentrated in and around the Carpathian mountain range. Oak is found in small pockets all over the country, with a particularly rich vein of oak and beech running through the lower part of Crimea, in Southern Ukraine.

Source: Regional Environment Center, 'Illegal Logging in Ukraine: Fact-funding Study, June 2010

Lviv, Ivano Frankivsk and Zakarpattia. Almost one third of the Ancient and Primeval Beech Forests of the Carpathians and other Regions of Europe, a group of UNESCO protected sites, fall within the Ukrainian Carpathians.²³

In the north of the country, covering the provinces (oblasts) of Volyn, Rivne, Zhytomyr, Kyiv and Chernihiv, plus part of Sumy,²⁴ is Polissia, another unique region formed of mixed pine and birch forests, wetlands and bogs. It is part of a UNESCO-designated transboundary ecological corridor connecting Poland, Ukraine and Belarus²⁵ and it is the meeting point of vital north-south and east-west migratory flightpaths for migrating birds.²⁶ The region is home to several rare species of plants and its lakes and bogs play an important role in supporting a variety of waterfowl, wading and migratory birds.²⁷ It is also home to significant populations of threatened mammals, including wolves²⁸, lynx²⁹ and bears.³⁰

Deforestation and forest degradation represent major threats to the ecosystems of western Ukraine. Polissia's biodiversity is under threat from intensive amber mining and illegal logging, which are turning vast areas of these valuable landscapes into barren wastelands.³¹ An increase in soil erosion caused by deforestation in Western Ukraine has had knock-on effects for the region's major rivers and aquatic ecosystems. A UN study predicts that decreased water quality, increased surface runoff and unreliable river flows will mean that vital freshwater sources for Western Ukraine will become increasingly insecure.³² One of Europe's most important rivers, the Dnister, originates in the Ukrainian Carpathians in Lviv and flows across western Ukraine into Moldova. The Dnister river basin is home to approximately 7 million people and it is a source of drinking water for an additional 3.5 million living outside the basin area.³³ The area covered by forests in the region around the Ukrainian section of the river has halved in the last century due to unsustainable human activity, including

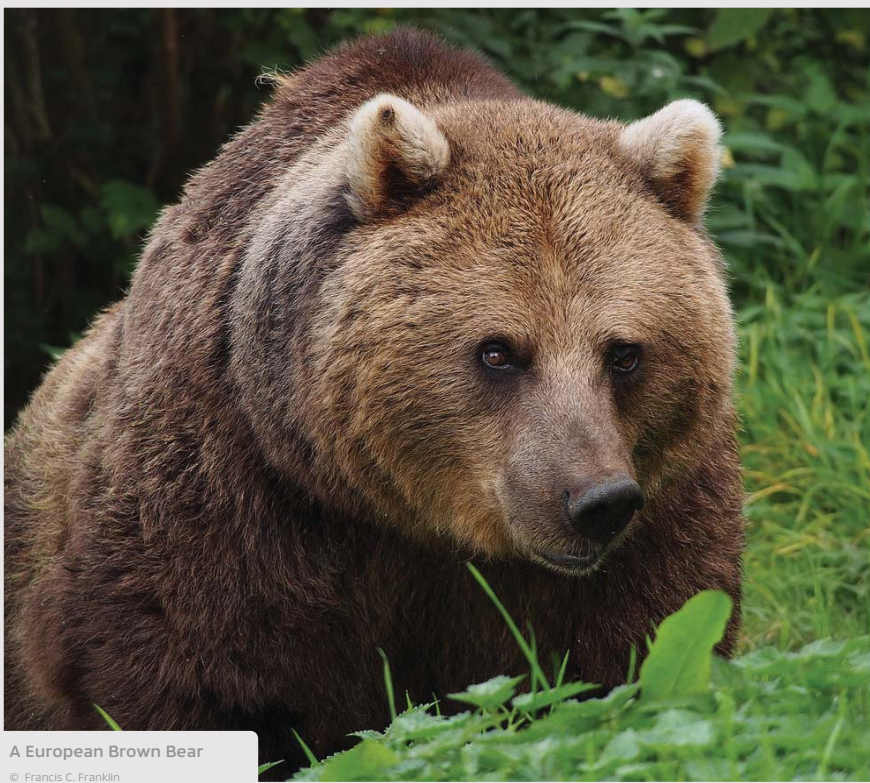
widespread unsustainable logging operations and conversion of forest land for other uses.³⁴

Increased habitat loss is also threatening Western Ukraine's wildlife. The Ukrainian population of lynx is in decline,³⁵ and other species are coming under increasing threat from human activity. Despite being protected by different national and international policies, the Carpathians are currently conduits for a booming trade in illegal timber, animals, animal parts and waste.³⁶ A lack of up-to-date information on forest cover and the effects of forest crime on these regions means that it is difficult to measure the extent of damage inflicted on these valuable ecosystems by illegal logging and other activities. Although a recent ban on logging in old-growth forests in the Carpathians has been put in place,³⁷ widespread illegal logging by state officials and poor law enforcement continue to undermine the efficacy of such measures.



A train full of Ukrainian logs at the border with Slovakia

© Goloskarpat https://goloskarpat.info/society/5726409304902/?utm_content=03131%C2%A2



A European Brown Bear

© Francis C. Franklin

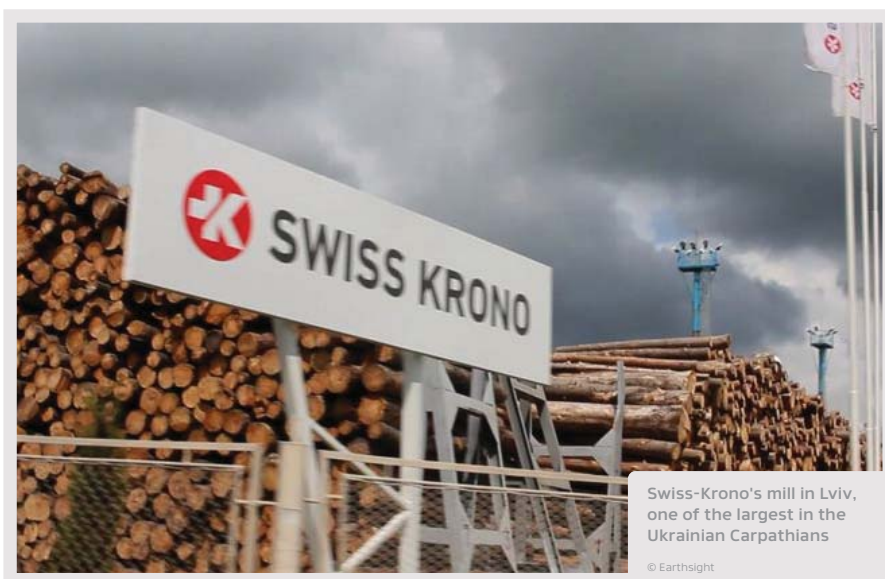
Almost all of Ukraine's forests are state-owned and state-managed

Almost all of Ukraine's forests are state-owned and state-managed. The majority of the country's forests, about 73 per cent, are under the control of the Ministry of Agrarian Policy and Food, via the State Agency of Forestry Resources (SAFR). A further 13 per cent are community forests on agricultural land, managed by provincial and local government. Another 6 per cent is split between the Ukrainian Ministry of Defence, the State Agency of Ukraine on Exclusion Zone Management, Ministry of Infrastructure and Ministry of Environment and Natural Resources. Seven per cent is forests not officially reserved as forest land and not allocated to the management of any particular agency. Less than 1 per cent of Ukraine's forests are privately owned.⁴²

1.3 UKRAINE'S LOGGING AND TIMBER INDUSTRY

Ukraine's timber resources are of great importance to its struggling economy and wood is the country's most valuable natural resource after coal, oil and gas.³⁸ The timber sector in Ukraine is reckoned to employ some 350,000 people, or 500,000 if indirect employment is also counted.³⁹ Exports bring in over US\$1.7 billion (€1.4bn) in foreign exchange.⁴⁰ The wood industry is responsible for 3.6 per cent of the country's GDP.⁴¹

The central arm of the SAFR, located in Kyiv, is ultimately responsible for overseeing the operations of all of the forestry units it manages. Implementation of the SAFR's policies is overseen at the regional level by a forestry directorate for each province. These directorates, called Regional Forestry Management Boards (RFMBs) are responsible for issuing key documentation such as harvesting permits and certificates of origin, which are required for export of timber. The RFMB is the coordinating body for the various forestry management units, called State Forestry Enterprises (SFEs), for their region. The SAFR and Ministry of Ecology



The majority of Ukraine's timber exports are raw products such as logs, lumber, firewood and charcoal

approve the Annual Allowable Cut (AAC) each year for each individual SFE, which is supposed to determine how much timber will be harvested, and where and when felling should take place. The SAFR controls a total of 306 State Forestry Enterprises in Ukraine via 24 different RFMBs.⁴³ These SFEs produce 83 per cent of all the logs harvested in Ukraine.⁴⁴ 92 per cent of the income of these SFEs comes from this logging.⁴⁵

The two main types of harvesting in Ukraine are continuous and selective felling. Clear cutting whole areas of forest, which is the most common method of harvesting⁴⁶, is referred to as 'continuous' felling, while harvesting only particular trees or groups of trees in a given area of forest is called selective felling. Sanitary felling refers to the practice of harvesting dead or diseased trees in order to prevent the spread of disease or pests to other parts of the forest; it can be either continuous or selective.⁴⁷ Logging may be carried out by an SFE's own staff or by contractors. SFEs process some of their production themselves, and the remainder is supposed to be sold through auctions, though in reality a great deal is sold through direct contracts instead (see Section 2.4.1 below).

All logs harvested within SFEs under the management of the SAFR have to be marked with a plastic tag carrying a unique barcode. This barcode provides details on the origin of the timber and the type of harvesting and must be attached to a log immediately after felling.⁴⁸ For the smallest (less than 16 cm diameter) logs classified as 'fuelwood', individual log tags

are not required, but a tag is allocated for each consignment. The tags can be looked up online on an open-source database, which in theory should allow the SAFR to track locations and volumes of harvested timber across Ukraine. This tagging and tracking system does not cover timber from forests under the control of other entities such as the provincial governments or Ministry of Defence.⁴⁹

The certificate of origin is the main document required for export of raw timber as well as other wood products from Ukraine. It contains information about which state enterprise the timber originated from, and confirms that the SFE in question has conformed to all applicable legislation.⁵⁰ Every type of enterprise, whether an SFE, private company or forestry firms under the control of other government departments, have to have a valid certificate of origin, issued by the RFMBs, to export saw logs, fuel wood logs and other timber products.

The volume of timber being harvested in Ukraine has increased significantly in recent years, reaching a high of 22.5 million cubic metres in 2016, an increase of 27 per cent over the level ten years earlier.⁵¹

Ukraine's timber processing industry is underdeveloped, with only a small proportion of logs converted into higher order products within the country. The majority of Ukraine's timber exports are of unprocessed or lightly processed products such as logs, rough sawn lumber, firewood and charcoal.⁵² The most significant more highly processed products produced in and exported from Ukraine are wood-based panels like chipboard and oriented strand board, produced by a handful of large factories. In 2015 the export of raw logs was banned, partly in order to help promote domestic processing industries, but also in an effort to protect the country's forests from unsustainable harvesting being driven by uncontrolled exports (see boxed text below).

UKRAINE'S 2015 LOG EXPORT BAN

In April 2015, the Ukrainian Parliament passed a law, No 325-VIII, prohibiting the export of raw logs (defined as those products falling under the customs code 4403) from Ukraine for a period of 10 years.⁵³ The ban came into effect on 1st November 2015 for all species of wood except pine, and took effect for pine logs on 1st January 2017.⁵⁴ The bill's proponents cited a number of justifications for it, including helping stimulate the domestic timber processing industry, but also the need to address the serious problem of uncontrolled deforestation in Ukraine, which they stated was being fuelled by indiscriminate exports of raw logs, and was an issue of growing concern to Ukrainian citizens.⁵⁵ The ban does not cover logs intended for use as fuel, which fall under a different customs code, 4401. Faced with evidence of widespread circumvention of the ban through the misclassification of logs under this code, on 12th January 2017 the head of the State Agency of Forest Resources - Christina Yushkevich - signed an order that required its SFEs to limit the length of any wood exported as fuelwood to two meters.⁵⁶

2. CORRUPTION & ILLEGALITY IN THE UKRAINIAN TIMBER SECTOR



The vast majority of the illegality which takes place in the Ukrainian forestry sector involves breaches of laws by government officials themselves

Whether Ukraine is able to entrench rule of law and ensure effective government will depend in large part on how it handles the management of its natural resources. It is well established that a country's natural wealth - whether fossil fuels and minerals, fisheries or forests - can prove a fertile breeding ground for corruption,⁵⁷ fuel conflict⁵⁸ and in countries with weakened institutions, also serve to undermine democracy.⁵⁹ An abundance of natural resources have also been known to cause an increase in corruption and rent-seeking behaviour,⁶⁰ resulting in poor management of natural capital and sluggish economic growth.⁶¹ That Ukraine also suffers from this unfortunate 'resource curse' is apparent from the high risk and incidence of corruption in this area.⁶² While Ukraine has had some success in rooting out corruption its oil and gas industry, another important natural resource has seen less attention given to it: timber.

2.1 THE SCALE AND GROWTH OF ILLEGAL LOGGING IN UKRAINE

Estimates for the extent of illegal logging in Ukraine vary dramatically. The SAFR reported 27,700 cubic metres of illegal timber were cut in 2016, just 0.17 per cent of the total volume of timber harvested by the Agency that year.⁶³ Yet independent

experts have suggested in the past that the real figure may be forty times as high: 1.2 million cubic metres.⁶⁴

The reason for such a broad range of figures can be found both in how illegal logging is defined and how it is measured. The SAFR's figures count only acts of clandestine logging by third parties within the forests under its control, and even then only capture those cases which are detected and officially recorded. Yet as this report will show, the vast majority of the illegality which takes place in the Ukrainian forestry sector involves breaches of laws by government officials themselves, and very little of this is formally detected and recorded.

One of the established methods used to capture the real scale of illicit timber production in a country affected by widespread illegal logging is a 'wood balance analysis', where figures for legal supply of timber are compared with ones for actual consumption. The extent to which consumption exceeds legal supply can be used as a means of measuring the scale and the trends in illegal production.⁶⁵ The method only captures illegal production in excess of licensed volumes, not illegalities within licensed production (such as corruption) which are the most common

form of illegality in Ukraine. Yet when carried out for Ukraine, such an analysis quickly puts the SAFR's official figures in perspective, suggesting that as much as 1 million cubic metres of illegally-produced lumber is being exported each year (see box 'Ukraine's Growing Shadow Lumber Exports').

To try to get some sense of the scale of illegalities carried out by the SFEs themselves, Earthsight submitted requests under Freedom of Information rules to a number of other agencies with a role in overseeing their activities. The most useful came from Ukraine's State Audit Service (DFS), and revealed that during just the first five months of 2017, they had already discovered multiple illegalities in SAFR forestry enterprises all over the country. They stated that they had observed a general failure of the State Agency of Forest Resources to adequately carry out its conservation objectives, including its

All the available data indicate that the problem is getting worse.

duties to oversee protected areas.⁶⁶ According to the DFS, 'As the audits showed, one of the existing problems for forest enterprises remains inadequate control over conservation and inefficient use of forest resources, as evidenced by the fact of unauthorised felling of forest resources worth more than 37 million hryvnias (US\$1.4 million), which were observed in almost every region.'⁶⁷

Earthsight analysis of court records shows that employees of numerous SFEs as well as RFMBs in Zhytomyr, Chernivtsi, Lviv, Zakarpattia, and Ivano-Frankivsk have also been convicted, investigated or sacked after probes by other Government departments or the media for illegal logging, bribe-taking or other kinds of corruption since June 2016.⁶⁸

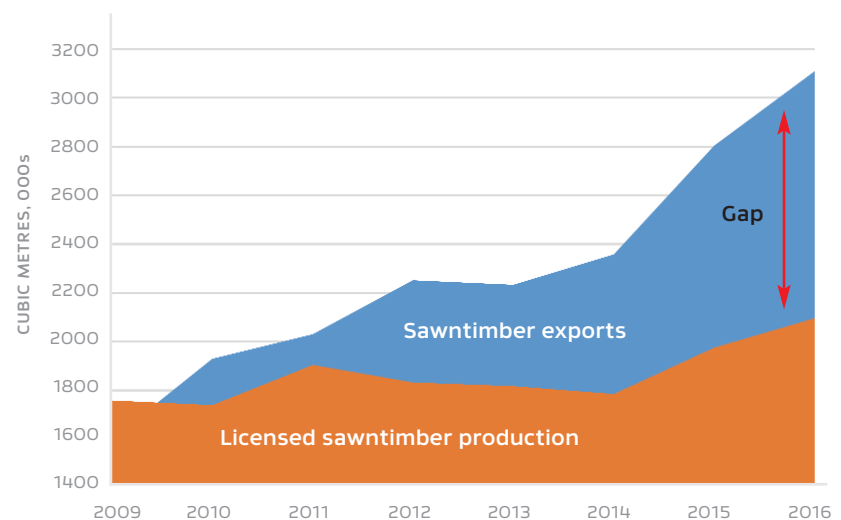
Whatever measure one uses, one thing that all the available data seem to agree on is that the problem is getting worse. In 2016, there was a recorded thirty per cent increase in crimes against the environment in the country.⁶⁹ More than half of these crimes fell under the category of illegal logging.⁷⁰ By 2016, illegal logging in the most forest-rich territory of the Carpathians, Zakarpattia, had more than doubled compared to 2010 levels, even according to

UKRAINE'S GROWING 'SHADOW LUMBER' EXPORTS

Ukrainian experts studying figures for production and export of sawn lumber have noticed a gigantic and rapidly increasing discrepancy. For at least the last six years, Ukrainian sawn timber exports alone have exceeded the total legal supply (production and imports), without even accounting for domestic consumption. By 2016, Ukraine was reporting exporting 50 per cent more sawn wood than was recorded as having been legally produced in the country's sawmills. Nearly one million cubic metres of wood was exported which could not be accounted for – a ten-fold increase since 2011 (see Figure 2).

FIGURE 2

Licensed production vs total exports of sawntimber in Ukraine, 2009-2016



Source: Popkov, 2016; Popkov, 2017. Note: Ukrainian sawn wood import figures are negligible.

While some of the discrepancy might be explained by small private sawmills which are not required to report production, experts suggest that this cannot begin to explain such a vast gap, nor can it explain how it has increased so much. It is considered likely that the majority of the excess is illegally sourced wood. If it is, this suggests that by 2016 at least a third of the sawn timber exports from Ukraine may have been illegally sourced. When one considers that at least some of the legal supply will have been consumed domestically, the proportion is likely to be even higher.

Apparent confirmation of the illegality of these sawn timber exports was revealed in an important paper on the Ukrainian timber industry released in 2017. The analysis, conducted by the Better Regulation Delivery Office (BRDO), found that there were 12,000 illegal sawmills operating in Ukraine, far outnumbering the 9200 legal ones.⁷³ This compares with just 500 illegal sawmills in 2001.⁷⁴

the SAFR's own figures, released in response to a request by Earthsight.⁷¹ A major recent report on Ukrainian forestry reported that in the six years to 2017, losses caused by illegal logging increased by 77 per cent.⁷² The data also indicate that 'shadow lumbering' has also risen dramatically over the last few years (see boxed text).



Timber corruption in Ukraine is pervasive, and extends from the lowest level forest ranger to national forestry chiefs

2.2 BACKGROUND TO CORRUPTION WITHIN UKRAINE'S STATE AGENCY OF FOREST RESOURCES

Timber corruption in Ukraine is pervasive, and extends from the lowest level forest ranger taking a cash bribe to turn a blind eye to a truck loaded with illicitly felled logs, to the chiefs of district state forest agencies signing off on illegal sanitary cuts or rigging local auctions, to the provincial and national-level officials taking corrupt payments from massive timber firms for access to the largest volumes. It also extends to customs authorities turning a blind eye to illegal timber exports or, as recently noted in the Districts of Vinnytsya, Volyn, Zakarpattia, Ivano-Frankivsk, Lviv and Odessa, themselves participating in illegal export schemes.⁷⁵

The roots of corruption in Ukraine's forest sector lie in how it is regulated. Despite ambitious efforts at modernisation since the 2014 revolution, State Enterprises in Ukraine are in poor health. Employees of State Forestry Agencies are badly paid and their departments under-resourced and under-funded. There is just one forest

guard per 1000 hectares.⁷⁶ There is no independent enforcement authority to address forest crime.⁷⁷ It is largely left to journalists and civil society, along with local Prosecutors offices, the State Audit Service and the police to identify and expose illegal logging and corruption in Ukrainian forests. Even where cases are brought to court, it is common for them to languish for months or years without a verdict being reached. Penalties, when handed out, have little deterrent value as they are usually not commensurate with the nature of the offence, and are often commuted to lower sentences on appeal.⁷⁸

An important timber industry analysis of Ukraine in 2017 found that 50 per cent of existing regulations in the forestry sector in the country carried a high associated risk of corruption and that the existing forest regulation was 'powerless against illegal logging.'⁷⁹ It concluded that a significant risk of corruption currently exists at each of the key stages of logging activity in Ukraine, from the preparation of the forest inventory and planning of annual allowable harvesting levels by officials, to the issuance of harvesting permits, the sales of timber through auctions and the issuance

of export permits by the state.⁸⁰ It noted in particular that State Enterprises are in charge of both issuing harvesting tickets and supervising the process of issuance, creating a fundamental conflict of interest which can easily be exploited to obtain illegal profits and dodge tax.⁸¹ A comparison of penalties issued for illegal logging in Ukraine to other countries found that the penalties in Ukraine were often orders of magnitude lower than penalties for similar violations in other countries in Europe.⁸² The paper also stated that it was virtually impossible to trace timber back to where it was harvested, an EU requirement for timber imports, and that mechanisms for sale of timber such as auctions were fundamentally flawed and non-transparent.⁸³

These problems, coupled with the continued booming demand for Ukrainian timber from lucrative markets in Europe and elsewhere, has led to an epidemic of corruption in the forestry sector, as this chapter will show. RFMBs are responsible for monitoring harvesting, via specially formulated committees, but in practice, these committees are often composed of friends and family members of the State Forest Enterprises themselves⁸⁴ and even people who have previously violated forest laws.⁸⁵ This kind of nepotism infects and undermines the legality of the processes by which State Enterprises award contracts for logging and other services, and whom they

sell timber to. Even where prosecutors have the will to tackle illegal logging, the burden of proof lies with state officials, who are responsible for reporting violations to prosecutors in the first place, creating a grave conflict of interest. It is also widely understood that many forest guards only investigate cases to avoid being accused of negligence by prosecutors.⁸⁶

2.3 CORRUPTION AND ILLEGAL HARVESTING

2.3.1 Illegal sanitary felling

The most common and most destructive form of illegal harvesting occurring in Ukrainian forests today is illegal sanitary felling.

As in most forestry systems around the world, in Ukraine the trees which are permitted to be felled in any given area each year is strictly controlled. A maximum 'annual allowable cut' (AAC) is assessed, which in theory ensures that the harvesting is sustainable, with removals matching the level of re-growth. Younger trees and those in certain areas such as steep slopes or close to rivers are also excluded or heavily restricted. Areas subjected to recent harvesting are made off limits until they have had time to recover. Areas of particular ecological significance are protected from logging entirely. However, Ukraine's forestry legislation allows additional trees are

The most destructive form of illegal harvesting occurring in Ukrainian forests today is illegal sanitary felling



Site of a recent clear cut in Zakarpattia

© Earthsight

The mis-use of sanitary felling rules is making a mockery of regulations meant to ensure harvesting is environmentally friendly

permitted to be harvested in exceptional circumstances, such as where they are infected with pests, damaged by wind or already dying back due to environmental stress. Originally intended to be rarely used, this provision has been corruptly exploited by state forestry enterprises on a massive scale, making a mockery of the regulations meant to ensure that harvesting is environmentally friendly.

An analysis of timber harvested in the Ukrainian Carpathians in 2016, for example, showed that the amount of timber harvested under the sanitary felling classification far outstripped the amount of timber cut under the pre-planned AAC.⁸⁷ The analysis, based on documentation provided by the SFEs themselves, showed that almost half of the timber harvested in the Carpathians – 1.9 million cubic metres – came from sanitary felling alone, the majority of which were clear cuts, while only a third of the total harvested volume of timber was felled under the AAC.⁸⁸ Nationwide, the volume of timber being cut for other – mostly ‘sanitary’ – reasons has more than doubled since 2000 (see Figure 3), reaching 12.4 million cubic metres in 2017, far exceeding the 9.4 million cubic metres cut as part of the planned felling.⁸⁹

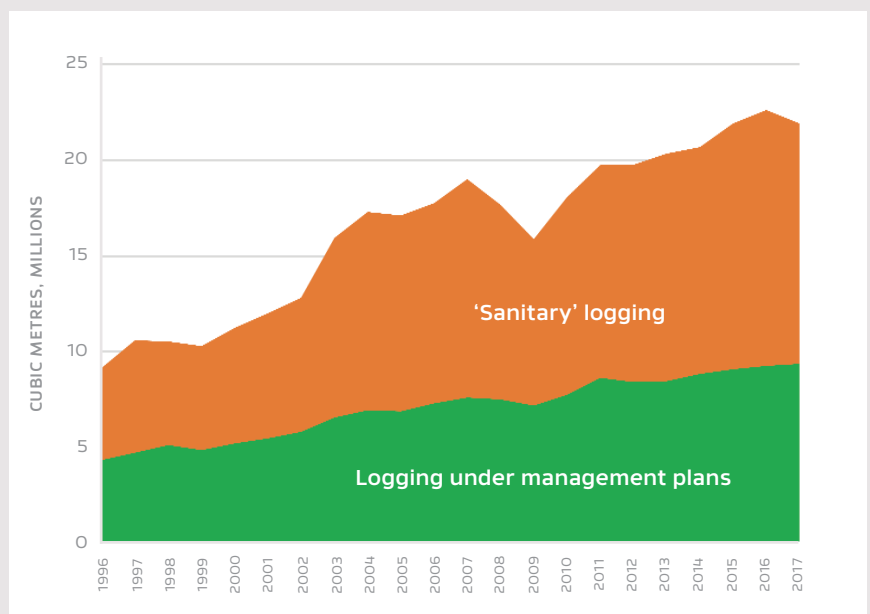
SFEs in each Ukrainian district can make proposals for large areas of forests under their control to be selectively logged or clear cut under the sanitary logging classification; such proposals require

approval from a specialised forest health unit within SAFR. In principle, RFMBs and provincial level officials of the State Environmental Inspectorate are tasked with monitoring this, but nepotism, bribes and corruption are often used to obtain harvesting permits to log forests under this classification.⁹⁰

As a result, large areas of healthy forest are being illegally felled by forestry officials under the excuse of protecting them from disease or to remove damaged or dead trees.⁹¹ Experts have found that forests have even been deliberately set on fire in the past, to manufacture official grounds for sanitary felling.⁹²

This unjustified, illegal sanitary felling has even extended into some of Ukraine’s most precious forests. A 2015 study showed how indiscriminate and illegal sanitary felling by SFEs in protected forests had been occurring all over Ukraine, from remote nature reserves to forests close to the capital.⁹³ For example, the Department of Ecology of the Lviv State Administration was found to have illegally approved sanitary felling on thousands of hectares of protected forest over 2014-2015, which led to the harvesting of more than 50,000 cubic metres of illegal timber.⁹⁴ Illegal sanitary harvesting was discovered in fifteen National Parks, including the Carpathian Biosphere Reserve. In total, the study estimated that thousands of hectares of forests under protection had been illegally felled, using permits illegally

FIGURE 3
Planned and ‘sanitary’ timber harvesting in Ukraine, 1990 to 2017



Source: Ukrstat



Researchers visit the site of a clear cut in an SFE in Zakarpattia, June 2017

© Earthsight

issued by the government in the two years to 2015.⁹⁵

Illegal sanitary logging has even been discovered in the protected – and radioactive – forests around Chernobyl in the Polissia region, the site of the worst nuclear disaster in living memory. A 2016 investigation by the New York Times found large tracts of forest being clear-cut there under the guise of sanitary felling of forests damaged by wildfire. The pine logs were allegedly being sold to companies in Ukraine and Romania, after which they could be mixed with timber from elsewhere and resold to other countries in Europe.⁹⁶

In addition to exploiting the sanitary felling loophole to fell timber illegally, SFEs are also able to exploit lax rules on the use of the resultant timber. Unlike other wood, timber harvested under this label does not even have to be put up for sale in auctions. It is often sold via direct agreements between the State Enterprise and the buyer.⁹⁷ This creates the perfect conditions for illegally sanitary-felled timber to be sold with minimum scrutiny.

Belatedly acknowledging the problem, in October 2016 the Ukrainian forest authority enacted new rules on sanitary felling. The rules prohibit sanitary felling in national parks and protected areas, and state that sanitary felling in other types of forests should only be carried out in moments of extreme necessity. The rules also require SFEs to publicly declare the justification for planned sanitary felling, and call for the expansion of special committees to oversee sanitary felling processes.⁹⁸ But a new study

shows that illegal logging under this loophole remains standard practice in Ukraine’s forests.

In the summer of 2017, Earthsight made the first ever attempt to scientifically assess the scale of the problem. We commissioned an international team of forestry experts – including forest pathologists – to conduct a random sampling exercise on 18 different sites across four different provinces in the Carpathians that were earmarked for clear and selective cuts under the sanitary felling classification. The team was tasked with examining the forest stands in each of the different plots and coming up with an independent assessment of whether each had been correctly classified by officials as warranting sanitary felling. The results are shocking. In 14 of the areas (78 per cent), the sanitary felling classification was deemed to be inappropriate or questionable. Even if only the sites where the firmest conclusions could be drawn were included, the proportion was 67 per cent.⁹⁹

The team even discovered that one SFE in Zakarpattia had made up a completely new category of harvesting, called the “urgent clear cut,” possibly to get around the new rules on sanitary felling.¹⁰⁰ This type of harvesting does not exist in any national legislation and is most likely illegal.¹⁰¹ The SFE had used this spurious classification to justify further harvesting on one site that it had already selectively logged, and was also using it to harvest spruce, fir and beech stands of a lower age than allowed by legislation on three other sites.

14 of the 18 planned sanitary felling sites we studied were found to be of questionable legality



Logging site in Ivano-Frankivsk province

© Roman Baluk

Other forms of illegal harvesting are also common, and state forestry enterprises are once again some of the worst culprits

Further evidence of the failure of the new rules to rein in illegal sanitary felling comes from the courts. An examination of court records shows that new cases continue to be brought against state-owned forest enterprises controlled by SAFR, as well as against forest enterprises managed by the Military and the Agricultural Ministries.¹⁰²

2.3.2 Other illegalities by SFEs during harvesting

While unjustified sanitary felling is probably the most widespread and destructive form of illegal harvesting in Ukraine, other forms of illegal logging are also common. Within forests under the control of the SAFR, State Forestry Enterprises are once again some of the worst culprits.

Common illegalities perpetrated by SFEs include cutting outside the boundaries of planned harvesting areas, and cutting more trees in a given area than permitted in the forest management plan.¹⁰³ Regulations

designed to minimise the impact of logging on the general environment are also routinely flouted. The same study commissioned by Earthsight which examined 18 sanitary felling sites across four Carpathian provinces in the summer of 2017 also assessed the legality of the harvesting practices. It found that in 16 of the 18 sites (89 per cent), pre-harvest procedures such as the proper marking of trees had not been followed, while in 6 of 11 sites (55 per cent) where harvesting was ongoing or recently completed, breaches of regulations were seen, such as damage to trees not earmarked for felling or excessive damage to soils on steep slopes. At least one, and usually multiple, violations of forest law were found in every site visited.¹⁰⁴

In a separate study commissioned by Earthsight looking specifically at illegal harvesting practices, a sampling exercise was carried out in the summer of 2017 on 15 different forest plots in the Carpathians on which clear cuts were planned or had taken place. The plots were located in the Svalyava and Velykyi Bychkiv SFEs in Zakarpattia province, Vygodna and Bolehiv SFEs in Ivano-Frankivsk, and the Slavske, Skole and Skole Beskidy National Park SFEs in Lviv (see map on page 16 for locations). Violations of forest law were discovered in ten of the sites, including sites in every one of these provinces. Observed violations ranged from clearing more area than legally allowed, illegal felling practices such as dragging timber through streams, and detected non-conformities between official maps and actual boundaries of harvested sites.¹⁰⁵ One logging contractor recently operating in one of the biggest timber-producing SFEs in Ivano-Frankivsk province, meanwhile, told Earthsight that during selective harvesting there, up to 25 per cent more timber was being harvested in each plot than was officially planned.¹⁰⁶

Even where external criminal actors are implicated in illegal logging activity, local officials often collude with them. Forests in North Western Ukraine, for example, are being felled in search of another precious natural resource- amber. Amber is a fossilised tree resin valued for its use in jewellery making. Gangs clear-fell relevant areas before using high-pressure hoses to remove the soil and expose the amber, leaving a devastated, pockmarked landscape in their wake (see picture on page 14). It is alleged that state officials and violent armed gangs work together to run a largely illegal and highly lucrative trade in amber mining in what has been dubbed

Ukraine's 'Wild West'¹⁰⁷ covering densely forested provinces like Rivne, Volyn and Zhytomyr.

Another area relating to the harvesting of timber which is rife with corruption is the management of logging contractors by SFEs. One former logging contractor at an SFE in Ivano-Frankivsk province in the Ukrainian Carpathians, for example, told Earthsight that the entire State Enterprise operated like a family business, with family members and close associates of the forestry officials inevitably winning the most lucrative contracts. Earthsight's own checks show that many of the top contracting companies are indeed closely related to current or former forestry officials at the SFE. By obtaining and analysing data on tenders awarded for the period and researching ownership records of the companies named, we established for example that over 63 per cent of the value of the contracts awarded during September 2016 to May 2017 were to companies linked to the former Director of the SFE.¹⁰⁸ 2018, verdicts had yet to be reached.

2.3.3 The avoidance of detection through bribery

Corrupt SFEs don't have to worry too much about being caught harvesting illegally by the main body tasked with that job, since that body is themselves. When their superiors, or officials in other government agencies, do start poking around, they can always turn to bribery. For example, in Rivne – the third largest timber producing province in the country - several directors of SFEs were reportedly arrested in 2016 for illegal logging and bribing other officials in the State Forestry Agency to falsify inspection reports.¹⁰⁹

The most recent and high profile example of the avoidance of detection through bribery occurred in October 2017, when Ukrainian Police arrested Roman Cherevaty, the head of the RFMB in Chernivtsi in the Ukrainian Carpathians, one of the top ten timber producing provinces in the country. He had been caught in a sting operation, offering to pay "tributes" of US\$10,000 per month to the National Police in return for them turning a blind eye to illegal logging in the forests under his control.¹¹⁰ Later at the pre-trial stage, investigators alleged that he wasn't acting alone, but had been acting jointly with Directors of three of the four SFEs under his purview - Sokryanske, Beregomet and Chernivtsi - to offer the bribes.¹¹¹ He is currently out on bail awaiting trial.¹¹²

2.4 CORRUPTION IN SALES OF TIMBER

There are limits to the opportunities to government officials for person enrichment stemming from the harvesting process itself. Though forest guards might take bribes to turn a blind eye to theft of timber by outside parties or logging contractors, and their bosses may enrich their families by handing out contracts for logging to firms they own, by far the biggest opportunities for corruption come during the sale of the timber. Indeed, it may be that expectations of additional corrupt skimming of profits during timber sales lie behind many illegalities during harvesting, since these enable individual SFEs to harvest more timber, of higher value, more cheaply.

The biggest cases of corruption in the Ukrainian forest sector ever exposed involve timber sales, and extend right to the top of the forest agency. But corruption in timber sales also extends throughout the government forestry apparatus, through individual SFEs in the districts to the RFMB authorities at the provincial level.

When other agencies start poking around, senior forest officials turn to bribery



A clear cut site in Osmoloda SFE, Ivano-Frankivsk, May 2017

© Earthsight

2.4.1 Corruption at the district level in the sale of timber through auctions

Ukrainian Forestry Regulation number 42 states that State Forestry Enterprises are meant to only sell their roundwood logs to Ukrainian registered companies through auctions.¹¹³ If, and only if, they are not successful in selling the entire volume of timber via the auction process, they can negotiate the terms of direct contracts with suppliers, to sell any surplus amount of timber to them. Foreign companies can participate in local auctions if they have a registered Ukrainian address, or can enter into direct contracts with State Enterprises for timber.¹¹⁴

In practice however, auction procedures are poorly understood and commonly not followed, or auctions are rigged in favour of businessmen who are close associates of officials.¹¹⁵ Timber is commonly undervalued on official documents of sale, and then sold on at higher prices, with the difference in profits being pocketed by a handful of individuals.¹¹⁶

Ukrainian MP Ostap Yednak, who formerly worked in the timber industry in Ukraine, told Earthsight that there are two ways to get large volumes of wood from SFEs in Ukraine: either a company has to know traders who are directly related to officials, or they have to pay a corrupt fee.¹¹⁷ Direct contracts are also undermined by corruption and nepotism. "Local producers can go to the auction, can buy 100 cubic metres of oak logs and then come directly to the SFE and agree some special terms to get more volumes at special prices or mix the grades" Yednak told Earthsight, "There is still big room for manipulation and corruption here as well."¹¹⁸

In a conversation with Earthsight, a forester from an SFE in Zakarpattia province, one of the largest timber producers in Ukraine, confirmed that bribery of officials to secure access to timber was common within the SFE. He said, "There are violations at auctions. For example, an entrepreneur comes and says: 'I want to go to the auction, to buy 500 cubic metres.' And they say to him: 'I will sell it to you, but from every cubic meter, pay me 2-3 dollars more than the official price.' And the one who pays this amount, is the person who wins at the auction."¹¹⁹

The former logging contractor at an SFE in Ivano-Frankivsk to whom Earthsight spoke in 2017 alleged that the corruption there also extended to timber sales, with the same family-linked firms being given lucrative logging contracts also getting preferential treatment when participating in local auctions for raw timber or entering

into direct timber sales contracts with the SFE.¹²⁰

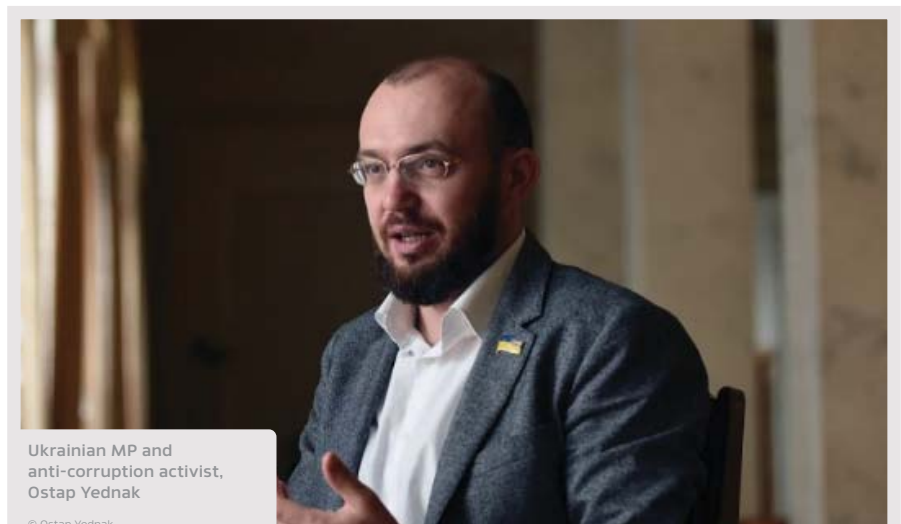
It is also very common for timber to be auctioned which has not yet been harvested. The winner of the auction is allowed to log the timber straight from the forest, which means he may harvest more than the agreed amount.¹²¹

Requests for information sent to State Auditors by Earthsight revealed that SFEs across Ukraine, from Vinnytsia, Dnepropetrovsk, Zhytomyr, Poltava, Kharkov and Chernigov to Zakarpattia and Ivano-Frankivsk, had been selling timber to companies at artificially low prices, causing losses of millions of Hryvnia to the Ukrainian budget during 2017.¹²² They also found that Ukrainian SFEs had repeatedly failed to comply with the official regulations relating to the sale of raw timber at auctions. Dozens of formal investigations have been filed in Ukrainian courts against SFEs in key timber producing districts for forging documents, receiving bribes from timber companies and causing losses to state revenues by illegally undervaluing timber at auctions.¹²³

To avoid being caught by auditors and made the subject of such cases, SFE officials also commonly mis-classify high quality logs as firewood, sales of which are exempt from the timber auction rules.¹²⁴

Regulation 42 also demands that SFEs only allow firms with proper registrations and facilities to enter auctions and purchase timber. Corrupt breaches by senior SFE officials of this and other auction rules helps explain how Ukraine's massive 'shadow lumbering' industry, with its many thousands of illegal sawmills (see box on page 15), manages to maintain its supply of raw materials.

Auctions are rigged in favour of businessmen who are close associates of officials



Ukrainian MP and anti-corruption activist, Ostap Yednak

© Ostap Yednak

Former forest chief Victor Sivets is on the run, accused of skimming millions from timber exports

2.4.2 High-level corruption in timber sales to foreign companies

Ukraine's problem of corruption in the SAFR does not stop at the district level but runs right to the heart of government. We discovered an intricate arrangement of corruption within the highest echelons of the State Forestry Agency that was developed during the era of the kleptocratic President Yanukovich, with corruption and nepotism scandals continuing ever since.

Yanukovich appointed his tennis partner and political crony Victor Sivets to the plum job of SAFR Chairman, and he took full advantage. Sivets, who was in office from 2011 to 2014, is alleged to have been the primary architect of a system of high-level export-related corruption from which he and his family personally benefited to the tune of over €32 million.¹²⁵ He is currently on the run from Ukrainian authorities, and was until recently the subject of an Interpol arrest warrant.¹²⁶

Ukrainian commentators have recently disclosed exactly how these arrangements worked. According to a report prepared for the World Bank by a top Ukrainian forestry expert which draws on the findings of the official investigation into Sivets, the SAFR established a centralised enterprise called Ukriskonsulting during Sivets' time in power, whose staff were middlemen in charge of negotiating with foreign companies hoping to import Ukrainian timber.¹²⁷ It states that even though SAFR officials do not have any right to interfere with the economic activities of SFEs, it 'secretly lobbied for export supplies,' leading to a number of corruption offences over the years, some of which have been formally investigated, and some of which are 'waiting for their turn.'¹²⁸

Once the terms of the export contract had been agreed with SAFR middlemen, the bulk of the value of the contract was transferred to the SFE, but only after importers had also agreed to pay a cut, calculated per cubic metre of timber sold, into offshore accounts controlled by SAFR officials, for 'marketing services'.¹²⁹ The prices for export of raw timber from Ukraine are also extremely low, which the report notes is most likely due to their deliberate understatement by the SAFR, so that they could 'extract corrupt benefits.'¹³⁰ 'Severe penalties' were handed out to any SFEs that refused to comply with the SAFR's orders. Therefore, far from State Enterprises operating as competitive entities, 'systematic, centralised corruption, governed by the State Forestry Agency of Ukraine'¹³¹ became entrenched in SFEs all over the country, with the SAFR's top brass interfering with, and siphoning off an illegal cut of, all overseas timber shipments made by them.

Ostap Yednak, the Ukrainian MP to whom Earthsight spoke who was involved in the timber industry at the time, claims that every market player in Ukraine, internally and externally, knew of the existence of these arrangements.

Though Sivets' period in charge ended when the Yanukovich government was toppled in 2014, the legacy of high-level cronyism and corruption has continued under his successors. The system of 'Lists' of pre-approved overseas buyers reportedly continued under his replacement Valery Chernyakov, and Alexander Kovalchuk, who took over from Chernyakov as head of the State Forestry Agency in May 2015.¹³² Kovalchuk was forced to resign in disgrace a year later after coming under severe criticism for failing to prevent large scale illegal logging and reports of malpractice during recruitment of new forestry officials.¹³³

The October 2016 report produced for the World Bank found that SAFR officials in Kyiv were continuing to direct sales by SFEs, contrary to their own policies and regulations.¹³⁴ According to the report, after a short hiatus of four months in the aftermath of Maidan, the old schemes resumed once again, though with Ukriskonsulting replaced by advisors of the head of the SAFR as the middlemen in charge of negotiating the contracts. SFEs allegedly continue to be forced to export timber only to a set list of companies, at prices dictated by the SAFR.¹³⁵ Whether this control was still being exerted in order to accrue personal financial benefits was less certain, though the author noted a number of 'red flags' suggestive of continued corruption.



Viktor Sivets was the Yanukovich-era head of the State Agency of Forest Resources

© Epravda: <https://www.epravda.com.ua/publications/2011/08/9/294314/>

Earthsight has unearthed evidence that overseas timber buyers were still being forced to pay bribes to officials in Kyiv after Sivets was ousted

One such ‘red flag’ was the continued trading of wood from Ukraine through letterbox firms in secrecy jurisdictions. Earthsight’s research has confirmed how letterbox firms whose ownership is shielded through offshore secrecy jurisdictions continue to play a major role in timber exports from Ukrainian SFEs (see next Section). It has also unearthed evidence that after the end of the era of Sivets and Yanukovich, timber companies were still being forced to pay bribes by officials in Kyiv to obtain access to timber.

In email and other communications seen by Earthsight investigators from late 2015, a Polish parquet company complained that it was being forced to pay bribes into the bank account of a Singapore-based consulting firm, even though it had already agreed the terms of a direct contract with an SFE for timber. The Polish company was called to a meeting in Kyiv with a senior forestry official from the SAFR. In an email exchange seen by Earthsight following the meeting, the Polish company states, “In

connection with the fact that we agree to start cooperation, please do not block our contracts.” In reply, a middleman for the senior official sent the company the bank details of the consulting firm in Singapore, along with a draft contract for the provision of ‘consulting services’ for the company to sign. The middleman also had another request which he described as ‘hugely’ important: “In the destination of the payment, indicate – ‘CONSULTING SERVICES’ ”, he wrote. “Otherwise it will create a lot of problems”.¹³⁶

In the summer of 2017, an influential Ukrainian fixer for foreign timber companies told Earthsight investigators that it remained necessary to pay “tributes” to state officials in Kyiv to access the Ukrainian timber market.¹³⁷

The current head of the SAFR is Christina Yushkevich, who was previously Kovalchuk’s deputy. She is reported to have a close circle of advisors to guide her in her duties, most of whom do not have any forestry experience, and who are suspected to be representing vested interests.¹³⁸ Many Ukrainian forest experts to whom Earthsight has spoken have questioned Yushkevich’s capacity to bring real reform to the forest sector.¹³⁹

REPERCUSSIONS FOR LOCALS WHO REPORT ILLEGAL LOGGING IN UKRAINE

Junior foresters, journalists and civil society activists in Ukraine are commonly met with intimidation and violence from forestry officials and others when they try to report or investigate illegalities in Ukraine’s forests. One forestry official we spoke to in the Carpathian region specifically declined to tell us of his observations of criminal activity in forest enterprises because he was “afraid for his family.” In another district in the Carpathians, a junior forester told us how he was physically attacked and his car burnt when he tried to report even minor violations in the local SFE by a businessman reportedly close to senior forestry officials.¹⁴¹ There have been several reported incidents of local officials interfering with and intimidating journalists in Chernivtsi province in the Ukrainian Carpathians, and heavy handed attempts to stop them from filming.¹⁴² When journalists attempt to bring charges against the perpetrators, their reports rarely make it to court.¹⁴³

When a team of forestry experts commissioned by Earthsight visited Beregomet in Chernivtsi in summer 2017 to assess the legality of sanitary felling by the local district SFE, they were violently assaulted by two heavily armed forest guards, who tried to forcibly evict them and confiscate their cameras.¹⁴⁴ The guards attacked the group, first verbally and then physically, and threatened to use their guns on them if they did not leave.

When the local chapter of the environmental organisation WWF investigated reports of illegal logging in nearby Vyzhnytsky National Park soon after this incident, a group of forest guards, plus around 30 people claiming to be “mushroom pickers,” headed by the leadership of the National Park itself, tried to prevent them from entering the harvested sites.¹⁴⁵ Earlier in the year, a routine check by environmental authorities had revealed an illegal logging scheme and timber theft in the National Park, for which they had ordered Park authorities to pay sizeable damages.¹⁴⁶

In April 2018, a German TV crew visiting Uzhansky National Park in Zakarpattia in the company of local environmentalists were chased through the forest and physically attacked by a large group of unknown assailants. The attack occurred during an investigation into illegal logging in a UNESCO World Heritage Site.¹⁴⁷

Evidence from court records certainly suggests that senior SAFR district and provincial officials continue to be involved in corrupt schemes involving export of timber. Authorities in Rivne in Polissia, the third largest timber producing province in Ukraine, are under investigation by Ukrainian prosecutors for such offences (see Case Study 3 on page 38 for more on evidence of corruption in Rivne). Two major criminal investigations are also ongoing in nearby Zhytomyr, accusing RFMB officials and Emilchinsky, Sarnensky and Gorodinitzky SFEs of setting up schemes to circumvent the rules on the sale of logs, dodging millions of UAH in tax by selling timber through letterbox companies registered in the UK.¹⁴⁰

2.4.3 UK letterbox companies and timber corruption in Ukraine

UK shell firms played a key part in the massive system of timber corruption allegedly operated by Sivets. Other cases under investigation by Ukrainian prosecutors suggest that UK letterbox firms have continued to be connected to illegal timber activities in Ukraine since Sivets was removed from office in early 2014.¹⁴⁸

Most of the UK firms previously exposed for wrongdoing in relation to Ukrainian timber

exports were Limited Liability Partnerships (LLPs), or the similar Scottish 'Limited Partnerships' (SLPs), and all were ultimately owned or controlled by other companies registered in secrecy jurisdictions such as Panama and Belize. Because all the 'partners' of such companies are allowed to be companies registered in such places, these kinds of firms are especially effective in hiding the true identity of the individuals in control.¹⁴⁹ As a result, they have been repeatedly used to shield criminal activity in recent years, from money laundering to arms dealing.¹⁵⁰ They are particularly commonly used to launder money from Russia and other ex-Soviet states such as Ukraine.¹⁵¹ One recent UK government study found that SLPs had been used to move \$80 billion out of Russia in just four years and that there were more than 17,000 SLPs registered at just 10 letterbox addresses.¹⁵²

Numerous UK shell firms have been linked to key figures in the kleptocratic regime of Ukraine's former President Victor Yanukovich. Despite his having been ousted four years ago, Yanukovich and his cronies continue to use UK shells to launder profits from activities in Ukraine.¹⁵³

One London address which crops up repeatedly is 43 Bedford Street in Covent Garden. The sheer number of companies linked to corruption and registered at this address prompted Ukrainian anti-corruption outfit Nashi Groshi to dub it "London's dormitory for Yanukovich."¹⁵⁴ One company registered at the address, Mega Commerce Ltd, is specifically cited in the case involving forestry chief Victor Sivets (see Figure 6 on page 35).¹⁵⁵ Earthsight has discovered that other UK companies registered at this address continue to ship timber to the EU.¹⁵⁶ The ease with which such companies are created means that if one is exposed, it is a simple matter for those behind it to shut it down and set up another.

Customs records obtained by Earthsight reveal that a very large proportion of Ukraine's wood exports to the EU continue to be traded via UK letterbox companies. A quarter of all the 'fuelwood' trade from Ukraine to the EU continues to pass through these firms, as does at least 7 per cent of all the sawn wood.¹⁵⁷ The biggest such trader is the Osuna Group, which at one point was handling a quarter of all Ukraine's log exports. Its purchases have been flagged as suspicious by Ukrainian forestry experts and are under investigation by Ukrainian prosecutors (see Case Study 1 on pages 26-27).

2.4.4 Other top-level corruption

Though they have received the most attention, the control of sales of timber for export are not the only forms of corruption which forestry authorities in Kyiv have been accused of. In addition to allegations of having using their power to hire and fire in the past in order to force SFEs to take part in their corrupt timber sales schemes¹⁶⁹, they have also been accused more recently of having used this power to extort money directly.

In early 2017, Ukrainian media reported allegations by a senior forestry official in Chernihiv – the second largest timber producing province in Ukraine – that they were being forced to pay tributes of \$15,000 per month to forestry 'advisors' based in Kyiv, who act as intermediaries for top SAFR officials. Their source also told how in order to be appointed as an SFE Director, you need to pay up to US\$50,000. He explained that the need to feed these demands forced local foresters to log illegally and irresponsibly, and that if it goes on, in a couple of years' time there will be nothing left to cut. "We thought that after the flight of Sivets, the black schemes would wither away. But the miracle did not happen. This industry is full of lawlessness", the source was quoted as saying.¹⁷⁰

UK letterbox firms have played a key part in timber export corruption schemes, and a large proportion of exports still pass through them



CASE STUDY 1

THE SECRETIVE UK LETTERBOX FIRM WHICH IS UKRAINE'S LARGEST WOOD EXPORTER

In recent years, one of the largest traders of Ukrainian timber to the EU has been the 'Osuna Group'. On its website, Osuna claims to be the "biggest exporter of Ukrainian wood products", with a yearly volume of 500,000 cubic metres of logs, 300,000 cubic metres of pulp and 60,000 cubic metres of lumber.¹⁵⁸ This is the equivalent of 50 railcars or shipping containers every single day. If correct, these figures suggest that at its peak Osuna was handling one quarter of all Ukraine's log exports.¹⁵⁹

Osuna operates through two UK LLPs: GLD Trade Holding LLP and Osuna Holding LLP, registered to the same letterbox address in London and with controlling entities in Panama.¹⁶⁰ The timing of the establishment of these companies and the pattern of their trading is strongly suggestive. The two companies were established in November 2015, the very month that Ukraine's ban on exports of

non-pine logs took effect. Immediately thereafter, these companies took control of the majority of the logs being exported to Romania, previously the largest destination for non-pine log exports.¹⁶¹ The manner in which large numbers of supposedly independent SFEs simultaneously shifted their sales to pass through these firms has been highlighted by one leading Ukrainian forestry expert in a report for the World Bank as evidence that officials in Kyiv continue to personally direct export sales, for their own corrupt benefit.¹⁶²

In 2016, Osuna's two UK letterbox firms were named in a Ukrainian criminal corruption investigation into State Forestry Enterprises in Zhytomyr. Prosecutors told a court that they have reason to suspect that the SFEs corruptly sold timber to these companies at undervalued prices, with the wood subsequently sold on to Romanian firms Schweighofer and Egger.¹⁶³

Using shell companies to sell state owned assets at artificially low prices and pocketing the difference in profits has been recognised as a "corruption classic" in Ukraine by prominent anti-corruption group, Antac.¹⁶⁴ Despite all this, in January 2017 the two firms were approved by FSC auditors to self-certify the Ukrainian wood they buy as legally sourced according to FSC's 'Controlled Wood' standard. The companies decided that there is a 'low risk' of customs violations and did not assess the risk of offshore trading and transfer pricing because they judged this criteria to be 'not applicable'.¹⁶⁵ When they were audited by FSC in January 2018, they were found to have falsely labelled as 'Controlled Wood' without any checks timber from SFEs in Rivne whose main FSC certification had been cancelled due to rampant illegal amber mining. Since the auditors judged this to be a 'minor' violation, the firms were allowed to keep their FSC status.¹⁶⁶



Osuna's two UK letterbox firms are named in an ongoing Ukrainian criminal corruption investigation into State Forestry Enterprises in Zhytomyr

In 2017 Osuna was forced by new UK rules on beneficial ownership to reveal one of its owners to be Ukrainian national Vadym Koriukalov. Presented with Earthsight's findings, Mr Koriukalov stated that his companies are incorporated in the UK for various reasons including the "predictability and attractiveness of the legal system" and its "double-taxation and investment protection treaties". He did not respond to our request that he identify the other shareholders of his firms. Regarding the Zhytomyr case, he told us that "it is of public knowledge that almost all domestic and international participants in the Ukrainian timber market are mentioned in an investigation", but that to his knowledge "no-one has been officially accused of any wrongdoing" and that the case is "at a very incipient stage despite more than two years of investigations." He insisted that his firm complies with all relevant laws, and had also complied with FSC regulations

with regard to the Rivne suppliers. With regard to evidence of SFEs having logged illegally, he said he "failed to understand" our line of argument given the ownership structure of these entities. This suggests that he believes it is impossible by definition for government-owned logging firms to log illegally.

At least 25,000 tonnes per month of Ukrainian wood exports continue to be handled by the Osuna Group.¹⁶⁷ They continue to control the majority of the 'fuelwood log' exports to Romania, customs data for which reveal are being declared as banned HS4403 logs on import.¹⁶⁸ In a particular irony, the letterbox address of Osuna's UK companies is now in the prestigious St James' Square in London, right next door to Chatham House, where one of the largest international meetings on tackling illegal logging is held each year.

At least 25,000 tonnes per month of Ukrainian wood exports continue to be handled by the Osuna Group



Osuna's letterbox address in St James' Square, next door to think-tank Chatham House, which hosts meetings on illegal logging

© 2018 Google

“We thought that after the flight of Sivets the black schemes would wither away. But the miracle did not happen. This industry is full of lawlessness”

Senior Forestry Official,
Chernihiv, February 2017

2.5 CORRUPTION AT THE POINT OF EXPORT

Almost every imaginable type of violation that can exist in conjunction with the export of timber from Ukraine has been documented at customs points across the country, from Odessa on the Black Sea in the east to Zakarpattia in the west. It is well known within Ukraine that the Customs Service is ‘decrepit and corrupt,’ an opaque and secretive arm of government whose misconduct is responsible for sucking an estimated US\$2 billion out of state revenues each year.¹⁷¹ In the timber trade, illegalities are discovered in exports from Ukraine on a weekly basis, while in some major timber exporting regions authorities find at least one illegal shipment being exported every single day.¹⁷² The types of documented illegalities are wide-ranging: from shipments of timber for which key documents of export have been forged,¹⁷³ or are missing,¹⁷⁴ to under-declaration of weights, species, lengths and origin of wood¹⁷⁵ on documents, and smuggling of other contraband such as cigarettes¹⁷⁶ mixed in with timber.

Shipments of timber from Ukrainian customs points are rarely checked by authorities, unless a particular one has been flagged as suspicious. In any case, as government prosecutors have repeatedly uncovered, the customs officials in key regions for timber export – for example in districts like Vinnytsya, Volyn, Zakarpattia, Ivano-Frankivsk, Lviv, Odessa and Chernivtsi¹⁷⁷ – have themselves been found guilty of participating in illegal export crimes.¹⁷⁸ Corruption of customs officials plays a key role in facilitating organised illegal timber laundering schemes in Ukraine.¹⁷⁹ A probe by the Kyiv Post noted that importers of Ukrainian commodities can declare their goods at customs points of their own choosing, which means they can deal with customs officials with whom they have a ‘favourable relationship.’¹⁸⁰

An employee from the Ukrainian customs department agreed to speak to Earthsight, under condition of anonymity. The source confirmed that shady deals were commonly struck between the timber industry and customs officials.¹⁸¹ “People who deal with illegal export of timber have friends at customs”, our source told us. “They can make it so that, when submitting declarations, the database does not show any flags. I have come across this in my work. When we analysed documents, we understood that this is what was done.”¹⁸²

The ‘Certificate of Origin’ is the most important document required by national legislation for timber export, and gives details of the place of origin, and other key characteristics of the logs and lumber timber being exported. This certificate, which is issued by the regional forestry board (RFMB) for each province, is the main document checked by customs officers for timber exports. Analyses of Ukrainian legislation governing the issuance of these certificates show that the system is ripe with opportunities for corruption, and that multiple, conflicting laws apply, some parameters of which are ‘technically impossible to perform’.¹⁸³ Since the certificates are issued by SAFR officials, often based on information provided by other such officials, if those officials are potentially corrupt then the documents cannot be relied upon. Our source at Ukrainian customs also explained that the people issuing these certificates simply transfer information provided to them on freight invoices, without further checks. The timber volumes and qualities recorded on these invoices are easily and commonly tampered with by timber suppliers, and any false figures copied across into the certificates of origin.¹⁸⁴ The use of bribes to obtain Certificates of Origin and the bribing of officials at customs points to export timber without proper documentation and markings are also common.¹⁸⁵

Timber suppliers often work with one or more insiders in the forestry agency to circumvent the system of Certificates of Origin. As a major scandal in the Carpathian province of Lviv in 2016 shows (see Case Study 2 on page 36) these crimes are organised and facilitated by actors at all levels, with bankers, lawyers, forestry officials and private companies working together. In that case, real Certificates of Origin were being issued by corrupt officials, who were covering their tracks by justifying issuing them on the basis of other documents they knew to be fake. A similar large case was exposed in Odessa in early 2017.¹⁸⁶ In other cases the certificates themselves are simply forged, including by officials from other agencies. In 2016, customs officials in Chernivtsi were being criminally investigated for colluding with private timber suppliers, using fake documents to export wood to the EU.¹⁸⁷

New illegal export ruses have emerged in response to Ukraine’s log export ban. The most common is the mis-declaration of banned logs as ‘fuelwood’. Ukraine’s log export ban applies to logs classified under the internationally standardised customs



A train full of logs headed to the Czech Republic, stopped by activists at the Ukrainian border

© Goloskarpat https://goloskarpat.info/society/5726409304902/?utm_content=03131%2E%40

code 4403, which includes sawlogs and pulp logs.¹⁸⁸ However, exports of firewood, or ‘wood for use as fuel’, which fall under the separate code 440110, are still permitted. Our analysis of hundreds of court documents shows that when inspections of ‘440110’ timber shipments (often described as ‘technological wood’ on documents) do occur at Ukrainian customs points, authorities commonly discover that they are banned logs which should be classified under customs code 4403. There are also plentiful local reports regarding cases of breaches of the log export ban using this ruse, and some of these demonstrate the risks to those seeking to expose them. A Latvian businessman working in the forestry industry in Vinnytsia reportedly told the Kyiv Post he was shot at after he blew the whistle on a local SFE who was marking down its timber and exporting it as firewood.¹⁸⁹

In a major 2016 case, activists forcibly stopped several wagons full of timber falsely declared as fuelwood at the Chop customs point in Zakarpattia (see Case Study 4 on page 42). Officials of Berezhansky, Turka, and Halsillis subsidiaries Slavskoe and Skole, inter alia are being investigated or have been recently convicted for trying to export banned saw logs under the 4401

Every imaginable type of violation possible in the export of timber from Ukraine has been documented

code.¹⁹⁰ In 2017 properties of the former deputy director of Busk SFE in Lviv were reportedly seized in connection with an ongoing investigation in which prosecutors allege he engaged in forgery and attempts to illegally export saw logs as fuelwood over 2016 and 2017.¹⁹¹ Investigators in the case reportedly said that SFEs in 10 other regions, as well as two subsidiaries of Halsillis (which handles timber produced at SFEs under the control of the agriculture ministry), were also suspected of illegal export of saw logs as fuelwood.¹⁹² According to a statement by the head of customs in Chernivtsi, 6-metre length saw logs were regularly being illegally exported under the guise of firewood through 2016.¹⁹³ The issue is clouded by discrepancies between how the forestry authorities and customs authorities classify timber (see Section 2.5 for additional details), and by the customs code for 440110 being based on how wood is intended to be used, which is hard to prove. Some of the cases have been dropped after customs agents have agreed

to cede to forestry authorities’ opinions. Many other cases have been successfully prosecuted, however.

Another means by which the log export ban may be being illegally circumvented is through the falsification of the country of origin. In early 2017, just after the ban came into full force, customs officials reported a jump in in the amount of ‘transit timber’ – timber purportedly from other countries, primarily Belarus - being exported to Romania via Ukraine.¹⁹⁴ Several reports indicate that this may be partly due to timber suppliers laundering Ukrainian wood. Recent investigations by the media suggest that high quality, banned-length logs from Volyn, Rivne and Lviv in Ukraine are being exported to Romania in Belarussian wagons.¹⁹⁵ A lack of scrutiny by and corruption of customs officials makes it likely that the Belarus-origin timber classification is yet another loophole being abused by timber exporters in Ukraine.

3. EU IMPORTS OF ILLEGAL AND HIGH-RISK WOOD FROM UKRAINE

Almost 70 per cent of Ukraine’s timber exports are destined for the EU

3.1 BACKGROUND

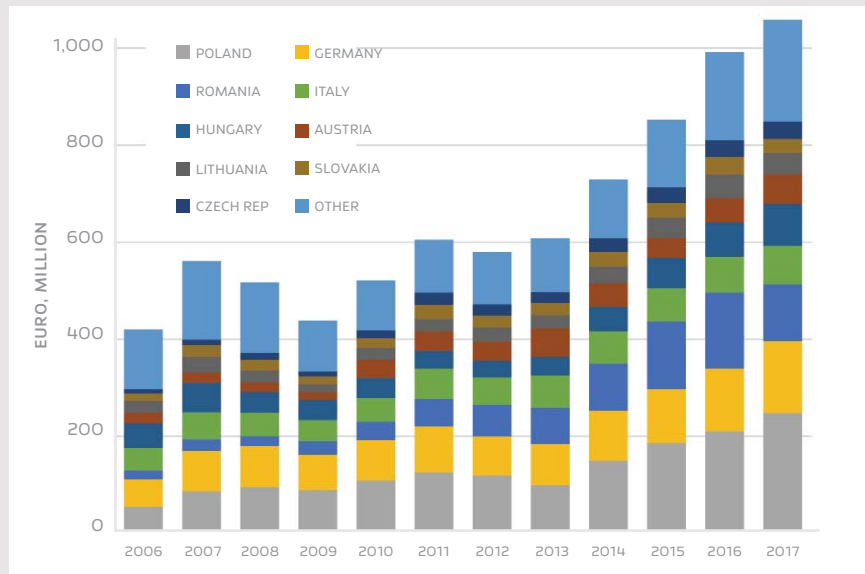
3.1.1 EU consumption of Ukrainian timber

Almost 70 per cent of Ukraine’s timber exports are destined for the EU.¹⁹⁶ Though EU wood imports from Ukraine dipped in the years following the global financial crisis of 2007/2008, the general picture has been one of steadily increasing trade (see Figure 4a below). EU wood imports from Ukraine increased by more than 50 per cent between 2012 and 2015, from just over 3 million tonnes to 5 million tonnes.¹⁹⁷ While the 2015 Ukrainian ban on the export of unprocessed timber (HS Code 4403), (the ‘log export ban’ – see box on page 13), has led to a reduction in the EU’s imports of

timber from Ukraine in weight terms (see Figure 4b), the value has continued to rise. 2017 saw imports pass the €1 billion mark for the first time.¹⁹⁸

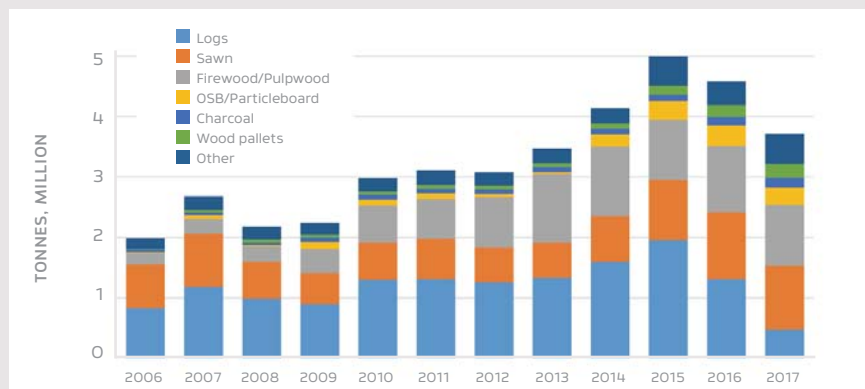
The EU’s timber imports from Ukraine are mostly unprocessed (see Figure 4b). In 2015, more than half the imports were logs.¹⁹⁹ Most of the rest were other minimally processed or low value products, such as sawn timber, wood chips and charcoal. Just three member states - Poland, Romania and Germany – dominate the trade, and are collectively responsible for around half of all the EU’s imports (see Figure 4a).²⁰⁰ Hungary, Italy, Austria, Lithuania, Slovakia and the Czech Republic are also significant importers of Ukrainian timber and wood products.

FIGURE 4a
EU timber and wood product imports from Ukraine, 2006-2017, by value and destination)



Source: Eurostat, data for timber, pulp, paper and wood furniture

FIGURE 4b
EU timber and wood product imports from Ukraine, 2006 - 2017, by weight and product



Source: Eurostat, data for timber, pulp, paper and wood furniture

THE GIANT AUSTRIAN FIRMS WITH MULTI-MILLIONAIRE OWNERS WHO ARE PROFITING FROM UKRAINE'S FORESTS

Many of the world's largest wood processing conglomerates were founded in Austria. These family businesses began processing wood locally in the 1950s and 1960s, but have since expanded their operations throughout Europe and often even farther afield. Most are still owned and controlled by the founding families, who are among Austria's wealthiest. After the collapse of communism in the 1990s, these firms entered Eastern Europe in search of new sources of raw material and built huge new factories to process it, with the products mostly destined for export to the richer countries in Western Europe and beyond. These mills are now among the largest consumers of timber from Ukraine's forests.

Prior to Ukraine's log export ban, by far the largest importer of Ukrainian wood was Holzindustrie Schweighofer. The company's headquarters are located in the baroque Palace of a former Austrian archduke in Central Vienna, where Gerald Schweighofer, its billionaire owner, also resides.²⁰⁶ In search of higher profits, Schweighofer sold its Austrian processing factories in 2001 and moved into Romania²⁰⁷, where it now dominates the wood industry. Soon the demand for raw materials of its Romanian mills exceeded the capacity of the local forests²⁰⁸, and the firm started importing large volumes of timber from Ukraine. By 2015, Schweighofer was importing almost 1 million cubic metres per year of Ukrainian logs.²⁰⁹

Ukraine's ban on the export of the saw-quality logs which Schweighofer mostly requires has dramatically reduced the firm's imports of late, but its place has been filled by two other Austrian giants: Egger and Swiss-Krono. Schweighofer's huge processing site close to the Ukrainian border in Romania is shared with Egger, the second largest producer of wood-based panels²¹⁰ in the world.²¹¹ The family behind Egger is one of the top 30 richest in Austria as a result, with assets of over €1.5 billion.²¹² Between them, the company's chipboard and oriented strand board (OSB) mills at Radauti are consuming more than 20,000 tonnes of Ukrainian wood every month.²¹³

The current largest consumer of Ukrainian wood, however, is Egger's competitor Swiss-Krono, the world's third largest wood-based panel maker.²¹⁴ Though it is headquartered in Switzerland, Swiss-Krono is owned and operated by the Austrian Kaindl family, whose timber-related assets lead them to feature on both the Austrian and the Swiss 'rich-lists'.²¹⁵ Swiss-Krono operate three large mills in Ukraine²¹⁶, including the two largest wood processing factories in the Ukrainian Carpathians. Together these mills are responsible for half of all Ukraine's exports of particleboard and oriented strand board, shipping 13,000 tonnes per month to the EU.²¹⁷ In 2016, the firm also opened a large new mill close to the Ukrainian border in Hungary, producing OSB.²¹⁸ Swiss-Krono was spun off by the Kaindl family from its parent group, Kronospan, which is the

largest wood-based panel maker in the world.²¹⁹ Kronospan is also among the largest buyers of Ukrainian wood, with its factory in Poland receiving around 6,500 tonnes per month of fuelwood logs and a mill in Volyn in north-western Ukraine which ships 8,000 tonnes per month to the EU.²²⁰ In 2017 it also received approval to purchase a controlling stake in a large Ukrainian medium-density fibreboard (MDF) plant from a wealthy Ukrainian mogul.²²¹

Other large Austrian firms connected to Ukraine include the JAF Group, whose Hungarian subsidiary Jaf Holz Ungarn is the largest EU importer of sawn wood from the Ukrainian Carpathians (see Case Study 2 on page 36). Czech and Slovak pulp mills owned by Lenzing, one of the world's largest producers of viscose fibre (which is used in the manufacture of clothing) are also known to have sourced substantial volumes of wood from Ukraine in the recent past (see Case Study 4 on page 42).

The rapid expansion of many these big firms into Eastern Europe has been assisted by European institutions. The European Bank for Reconstruction and Development (EBRD), for example, provided 60 per cent of the funding for the construction of Egger's large chipboard mill near the Ukrainian border in Romania²²², and has also helped fund Kronospan's Ukrainian operations.²²³ The Hungarian government subsidised the construction of Swiss-Krono's new mill on the Ukrainian border.²²⁴



Egger's giant processing site at Radauti in Romania, close to the Ukrainian border

© Nikolai Petichenko



The timber these countries import from Ukraine is processed into higher-order products. A large proportion of these products are then re-exported to other EU countries. Though their direct imports are minimal, countries such as the UK and France are significant consumers of Ukrainian wood. The biggest market is probably Germany, however. Ukrainian wood finds its way into a vast array of products. Aside from being widely used in construction and for flooring, it is commonly used in making the flat-packed furniture found in most homes²⁰¹, the cardboard packaging on many supermarket goods²⁰², even the clothing sold in high-street retail chains.²⁰³ Waste wood from the factories producing these products is commonly turned into pellets, to be burned to produce heat and power for domestic homes across Europe.²⁰⁴

While high-risk tropical wood entering the EU is imported and processed by relatively small companies, the biggest EU consumers of Ukrainian wood are large firms, many of them multinationals with multi-billion Euro turnovers. A startling number of these, including the four largest consumers of Ukrainian wood in 2017²⁰⁵, are Austrian-owned (see boxed text on page 31).

All make bold promises about their sustainable credentials.

Giant mills owned by these firms can be found in the member states bordering Ukraine, each with its own rail spur connecting to it. Some also have mills inside Ukraine, whose products are almost entirely destined for the EU. Cargo trains, some more than half a kilometre long, shuttle back and forth, delivering the remains of thousands of trees to these mega-factories every day.

3.1.2 The EU's commitments on timber legality

In the late 1990s and early 2000s, there were a steady stream of exposés regarding illegal wood being consumed in EU member states. Plywood from Indonesia²²⁵, garden furniture made from stolen Cambodian trees²²⁶ and mahogany from the Brazilian Amazon²²⁷ were among the many supply chains investigated. Studies indicated that these were the tip of the iceberg: it was estimated that the EU was one of the world's largest consumers of stolen wood. Shocked by the scale of its complicity in the illegal destruction of the world's forests, public pressure helped drive the EU authorities to act.

For 15 years now, the European Union has been a world leader in efforts to tackle illegal logging and related trade. In 2003, the EU agreed an Action Plan on 'Forest Law Enforcement, Governance and Trade' (FLEGT), which included a range of measures, including bilateral support for producer countries and regulatory actions – the EU Timber Regulation or EUTR – designed to restrict the entry of illegally harvested timber into the EU (see boxed text opposite). Independent assessments have demonstrated the positive impact the EU's efforts have had to-date.²²⁸ One NGO working on forest issues has hailed the EU's efforts as 'trail-blazing'.²²⁹

The main focus of the EU's efforts on tackling illegal logging has been on tropical forests. All of the major exposés which helped drive it to act related to the tropics, and all of the FLEGT bilateral agreements with producers it is negotiating or implementing are with tropical countries. One of the key messages from an independent review of the EU's Action Plan published in 2016 was the need for increased work on non-tropical countries, including Russia and the countries of the 'eastern periphery of Europe'.²³⁶ The same assessment found that the importance of

THE EU LAW MEANT TO PREVENT IMPORTS OF ILLEGAL WOOD

One of the most important measures taken by the EU as part of its Action Plan on forest law enforcement and governance was the EU Timber Regulation (EUTR), which came into effect in March 2013.²³⁰ With regard to wood from overseas²³¹, the EUTR makes it an offence to 'place on the market' (i.e. import²³²) wood which was illegally sourced in the country of origin. It includes a parallel requirement that importers must carry out appropriate due diligence in order to minimise the risk of receiving illegal wood.²³³ They can be prosecuted for failing to exercise due diligence, even if the wood concerned cannot be proven to be of illegal origin. Source country laws to which EUTR applies include laws governing timber harvesting and those governing the trade and export of wood. Though corruption is not specifically mentioned, it is captured if it involves breaches of those laws.

Importers must collect pertinent information regarding a given product by a particular supplier, use it to assess the risk, and then take steps to mitigate any risks identified to the point where they reach a 'negligible' level. If risks cannot be mitigated, then they should not buy the products. Though copies of government documents attesting to the legality of timber can be considered, as can certification under third-party legality and sustainability schemes such as FSC, these alone do not necessarily guarantee that companies have met the due diligence demands of the EUTR. Official EUTR guidance states that where there is significant corruption, "even official documents issued by authorities cannot be considered reliable."²³⁴ EU guidance also recommends that the assessment of third-party verification take into account substantiated reports of shortcomings of specific schemes in specific countries.²³⁵

EU law demands that importers ensure the risk of receiving illegally-sourced wood is reduced to a 'negligible' level



Greenpeace protest in London calling for the EU to ban illegal timber, 2006

© Sion Touhig / Greenpeace

EU buyers of high-risk Ukrainian wood include the three largest wood panel producers in the world and the world’s largest paper company

the countries on the EU’s ‘eastern periphery’ (which includes Ukraine) to the EU’s total estimated imports of illegally sourced wood had grown dramatically in the decade since the Action Plan was approved.²³⁷ The study estimated the EU’s imports of illegal wood using an established methodology developed by the UK think-tank, Chatham House.²³⁸

Some actions have followed. In October 2016, for example, Ukraine and Austria signed a Memorandum of Cooperation on Forestry, which included a commitment to work together to ensure the legality of timber in accordance with the EU Timber Regulation.²³⁹ Ukraine has been repeatedly discussed at meetings of relevant Member State officials in Brussels.²⁴⁰ A formal EU ‘mission’ to Ukraine to explore the subject was even recently undertaken.²⁴¹

However, as this report will show, these actions have been far outweighed by a broader failure. High risk wood likely associated with illegalities and corruption continues to flood across the border, and the relevant EU member states are failing to implement the laws on their books which are meant to stop it.

3.2 EU IMPORTS OF ILLEGAL UKRAINIAN WOOD

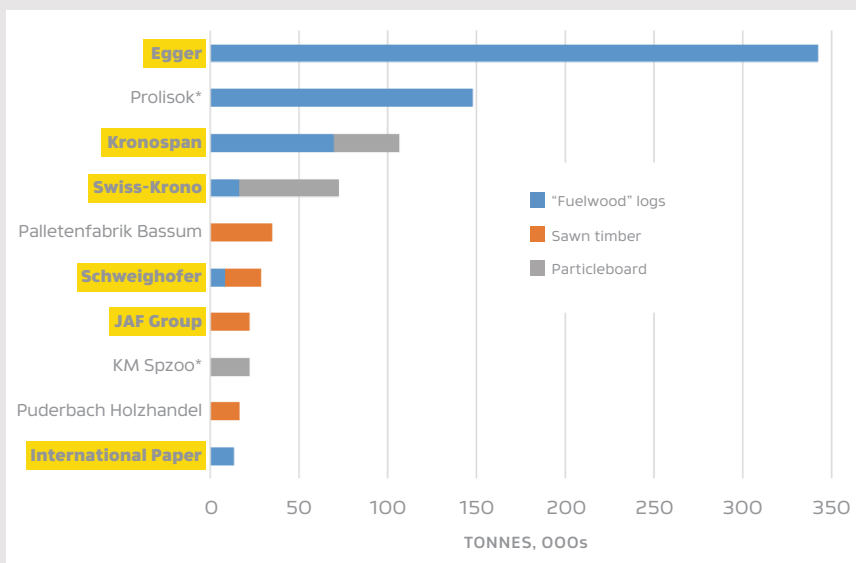
Earthsight’s in-depth research over the past two years indicates that the EU is by far the largest destination for Ukrainian wood of likely illegal origin. As this chapter will show, it also reveals that the buyers of this wood include a number of multi-billion dollar firms, including the three largest wood-based panel producers in the world²⁴², the world’s largest paper company²⁴³, and the second largest sawn timber producer in Europe.²⁴⁴ Earthsight research also suggests that the EU is importing more illegal wood from Ukraine than from all the tropical forest countries of the world combined.

3.2.1 The EU firms named in high-level Ukrainian timber corruption probes

Holzindustrie Schweighofer, one of the group of giant Austrian timber firms buying much of Ukraine’s exports (see box on page 31), owns three huge sawmills in Romania, which together have the capacity to consume nearly all of the softwood logs produced in the country each year.²⁴⁵ While the other two mills are mostly dependent on domestically harvested logs, the largest mill, at Radauti, close to the Ukrainian border, has traditionally depended on imports for most of its raw material.²⁴⁶ The mill occupies one half of a massive industrial facility which also houses a large mill operated by multinational wood-based panel firm Egger. The facility has its own direct Russian-gauge rail link to Ukraine. When it came into full operation, this single facility was responsible for doubling the quantity of logs being imported into the EU from Ukraine.²⁴⁷ By the time the Ukrainian log export ban began to take effect at the end of 2015, Schweighofer’s Romanian mills were consuming more than 1 million cubic metres of Ukrainian logs per year: 80 railcar loads every working day. Seventy per cent of all the logs being exported from Ukraine to the EU were destined for this one company.²⁴⁸

Schweighofer’s Romanian mills have previously been exposed for sourcing large volumes of illegal Romanian timber. In 2015, NGO the Environmental Investigation Agency (EIA) accused the firm of being the single biggest driver of illegal logging in Romania over the last decade.²⁴⁹ EIA’s allegations of widespread consumption of illegal wood were subsequently confirmed by independent investigations by the Romanian authorities²⁵⁰ and by the Forest Stewardship Council (FSC).²⁵¹ These in turn

FIGURE 5
The 10 largest buyers of Ukrainian wood in the EU, 2017
(companies exposed in this report highlighted)



* These are trading firms which do not carry out their own processing. It is likely that a large proportion of the imports which on paper are destined for Prolisok in Romania are actually being consumed at the large chipboard and oriented strand board factories operated by Kronospan in that country, making its total consumption of Ukrainian timber closer to its competitor, Egger.

NB: The data shown are for exports from Ukraine for which the companies named are recorded as the consignee in Ukrainian Customs records. This does not necessarily mean that the goods concerned were imported by the named company. In some cases a third party will have taken the formal role of importer, or in the parlance of the EU Timber Regulation, acted as the ‘operator’.

Source: Ukrainian Customs export records, analysed by Earthsight

led a number of major EU buyers²⁵² and the FSC to dissociate from the company. Our evidence suggests that the company has historically been no more discerning in its purchasing in Ukraine.

Chapter 2 of this report described how a pre-trial investigation by Ukrainian prosecutors concluded that during the reign of kleptocratic Ukrainian President Yanukovich, who was deposed in February 2014, bribes were demanded by his forestry chief Viktor Sivets from foreign buyers for shipments of logs overseas, in exchange for which Sivets ordered state forestry enterprises under his control to supply timber for below market prices. Schweighofer was by far the largest buyer of Ukrainian logs at the time, and is specifically implicated in court filings. In documents seen by Earthsight, the Schweighofer group's Slovakian subsidiary²⁵³, Uniles s.r.o., is specifically named by prosecutors as having been found during their pre-trial investigation to be one of four companies from which Sivets received illegal payments totalling €13.6 million during the period February 2011 to February 2014. The payments – for fictitious 'marketing services' – were sent to the Latvian bank accounts of three shell companies – two of them registered in the

UK - before being routed on into Swiss bank accounts of two Panamanian firms established by Sivets' wife (see Figure 6). Though Sivets remains on the run, the Ukrainian authorities continue to investigate and pursue the case. The most recent action was in February 2018, when a Ukrainian court upheld at appeal the freezing of millions of dollars held in one of the Swiss bank accounts involved.²⁵⁴

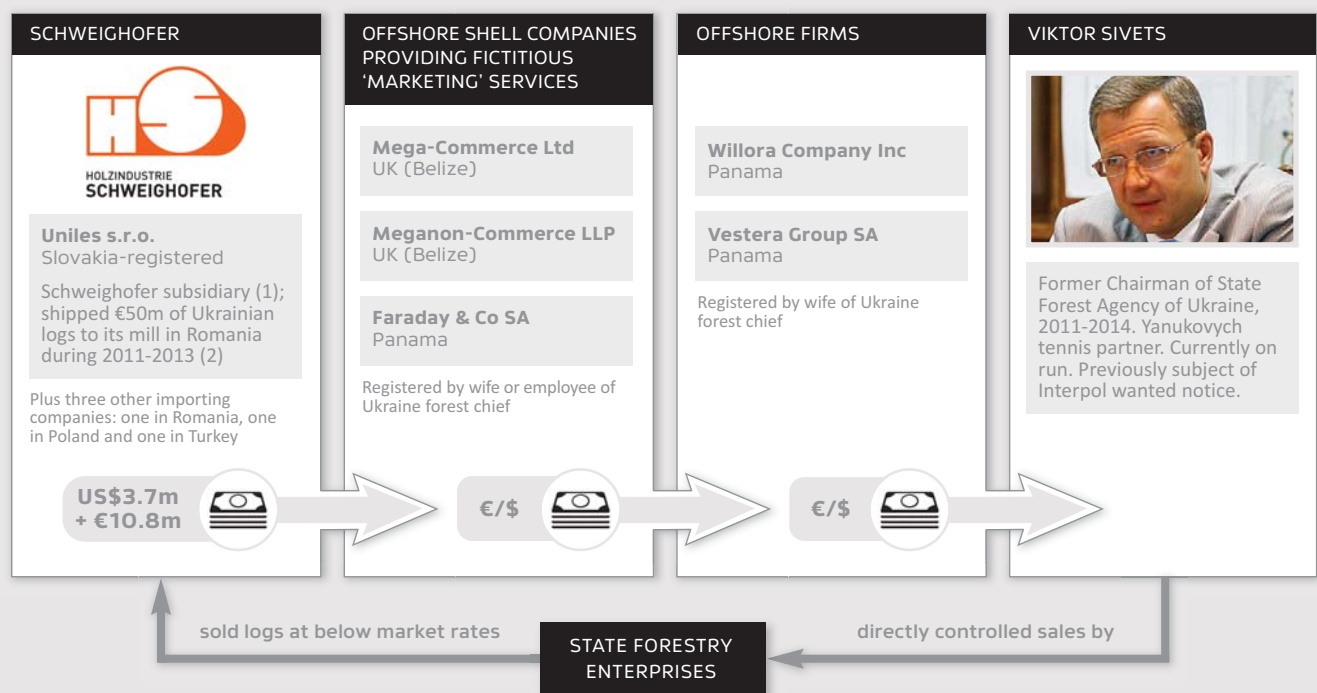
Romanian records obtained by Earthsight confirm that almost 50 per cent of the Ukrainian logs being shipped to Schweighofer's Radauti mill during 2011-2013 were supplied by Uniles, timber worth nearly €50 million.²⁵⁵ More than 40 per cent were still being shipped by Uniles in 2015.²⁵⁶

Earthsight wrote to Uniles s.r.o., its parent the Schweighofer Foundation and Holzindustrie Schweighofer with our findings regarding its connection to the Sivets case. Uniles, replying on behalf of all three firms, stated that "we only act within the relevant laws and regulations and strongly reject any allegation that states the contrary". The company did not deny that it is named in the Sivets corruption probe, stating only that it will cooperate with any authorities involved in official investigations,

A Schweighofer subsidiary is alleged by Ukrainian prosecutors to be among four firms from which Sivets received millions in illegal kickbacks

FIGURE 6

**'Person 4':
The Schweighofer connection to high-level corruption during the Yanukovich era**



Source: Description in Ukrainian court records of results of pre-trial investigation by Ukrainian prosecutors judged by those courts, in an investigation which remains ongoing, to be sufficiently credible to freeze assets and issue arrest warrants (in one record Uniles is referred to as 'Person 4'); except (1) Company registries of Slovakia and Austria and (2) Romanian Customs records

CASE STUDY 2

CORRUPTION ENABLES OVER \$1M OF ILLEGAL UKRAINIAN SAWN WOOD TO ENTER MULTIPLE EU COUNTRIES



A sawmill in Lviv province

© Earthsight

In August 2016, a large-scale organised criminal scheme was revealed involving export of illegal sawn timber to Europe from Lviv, one of the four Carpathian oblasts of Ukraine. A joint special operation by provincial police and prosecutors had found that some 12,000 cubic metres of illegal wood – enough to fill 200 rail wagons – had been laundered using fake documents and shipped to the EU. The stolen wood was worth an estimated \$1.2 million.²⁶²

The gang – which included lawyers, several bank employees, and officials at two different government agencies - had created fictitious companies and produced fake documents regarding the wood’s origin, and then with the aid of a corrupt official of the Lviv provincial forestry department, had obtained more than 200 ‘certificates of wood origin’ with genuine seals and signatures, enabling them to export the timber abroad. As well as laundering wood of likely illegal source, the criminal group also made use of offshore shell companies in Panama, the British Virgin Islands and Belize to understate the value of the timber and

evade taxes. Prosecutors also allege that the group sold additional counterfeit certificates of origin to other enterprises.²⁶³

Court documents relating to the scandal or to other related cases reveal the identity of four European companies which received wood from the accused suppliers. These include the Romanian sawmill of the Austrian-owned JAF Group, Central Europe’s leading timber wholesaler; a Lithuanian oak flooring producer whose products are on sale across the continent, including in the UK, Germany and Belgium; and a leading Polish wood flooring producer and exporter. These companies received shipments of wood from one or more of the offshore shell companies involved, including ones whose ultimate owner is now on the run from the Ukrainian authorities.²⁶⁴ Press reports also cited exports to the Netherlands, Italy, the Czech Republic and Latvia.²⁶⁵ There is no evidence that any of the European buyers were aware of the scheme. Informed of our findings, JAF Group stated that their company being mentioned in court documents did not mean that it had

broken laws, and that its due diligence system’s EUTR compliance has been confirmed by Competent Authorities in the EU Member States in which it operates.²⁶⁶ After its internal investigation confirmed that it had received wood which originated from one of the suppliers at the centre of the scandal, via a middleman, JAF blacklisted the supplier.²⁶⁷

It appears that the case may have been the tip of the iceberg with regards to corruption and illegality in the forestry sector in Lviv. In August 2017, a slew of additional criminal investigations were revealed, including against the head of the provincial forestry authority and the heads of three state forest enterprises (SFEs).²⁶⁸ The provincial forestry head was later convicted of receiving a bribe in February 2017 from a forester from Halsillis, to manipulate documents.²⁶⁹ In September 2017 the head of Busk SFE, one of the largest suppliers of wood to the EU from the Carpathians in the recent past, was given a suspended jail sentence of 1.5 years for his role in covering up the illegal harvesting of over 200 trees.²⁷⁰

but “as a matter of principle we do not comment on (alleged) investigations of authorities on third parties”.²⁵⁷

The Sivets case isn’t the only Ukrainian corruption investigation in which a Schweighofer group company’s name crops up, and Schweighofer is not the only EU firm mentioned in such investigations.

The biggest customer for Schweighofer’s Radauti factory is the chipboard mill operated by fellow Austrian timber giant Egger, right next door.²⁵⁸ Since Ukraine’s log export ban, Egger has overtaken its neighbour Schweighofer to become by far the largest EU buyer of wood from the country (see Figure 5).²⁵⁹ As detailed in the Chapter 2, in September 2016, a major criminal corruption investigation was filed in Zhytomyr, a province in the Polissia region of north-west Ukraine which is the country’s leading timber producer. Prosecutors are investigating officials of three of the largest timber-producing SFEs (Emilchinsky, Gorodnytsky and Olevsky) for having corruptly colluded to sell timber at below-market rates to two UK letterbox companies (see Case Study 1 on page 26), who were then selling it on at higher prices to firms in Romania. The court records name those two firms as Egger and Holzindustrie Schweighofer.²⁶⁰ Ukrainian customs records confirm that both firms were receiving large volumes from the same SFEs at the time.²⁶¹

EarthSight has found that a number of EU firms, including yet another large Austrian firm, are also linked by court documents to one of the biggest illegal timber scandals to emerge in Ukraine in recent years, which occurred in the Carpathian province of Lviv, and involved corruption at the provincial forestry headquarters (see Case Study 2, opposite).

3.2.2 EU firms buying wood from suppliers found guilty or under investigation by Ukrainian prosecutors

Even if other EU firms might not themselves be named in court documents relating to timber corruption cases, their suppliers are. As Chapter 2 detailed, Ukrainian news media and publicly available court records document numerous cases of alleged misconduct by specific SFEs in Ukraine. In some cases senior officials have been found guilty; in others they remain under investigation and have yet to be brought to trial, but courts have judged the evidence to be sufficient to justify arrests and searches. If its law was working, the emergence of this evidence might be expected to impact on sales from such SFEs to the EU. Yet on each occasion, a detailed analysis of Ukrainian customs records shows absolutely no impact from these cases on the volume of exports. Shipment volumes from the SFEs named in these cases remained the same in the months after each case came to light as they were in the months prior to their being opened.²⁷¹ Those same records also reveal that the companies continuing to buy their wood include many of the largest wood processing firms on the continent.

The Zhytomyr case mentioned above is one such example. Egger and Schweighofer’s purchases from the SFEs under investigation for corruption continued after the case was filed in publicly available Ukrainian court documents.²⁷² Other firms which have continued to purchase large volumes include Silva S.p.z.o.o, a Polish subsidiary of Kronospan (the largest wood-based panel producer in the world, and third largest buyer of Ukrainian wood in 2017), and a Hungarian OSB mill owned by Swiss-Krono (the third largest wood-based panel producer in the world, and fourth largest EU buyer of Ukrainian wood).²⁷³ The same

Schweighofer is not the only large EU firm whose name crops up in Ukrainian court records regarding major timber corruption investigations



One of Schweighofer’s mills in Romania

© Environmental Investigation Agency

CASE STUDY 3

CORRUPTION AND ILLEGAL AMBER MINING IN RIVNE PROVINCE LINKED TO LARGE EU FIRMS



Deforestation for timber and amber in Western Ukraine

© Brendan Hoffman

The province of Rivne in the Polissya region of north-western Ukraine is the third largest timber producer in Ukraine and among the largest exporters to the EU. What Earthsight uncovered in one of the most heavily forested districts of this province perfectly illustrates the failures of due diligence by the billion-dollar firms which are among the largest importers from the region.

The district of Klesivske in Rivne is at the epicentre of an illegal amber mining crisis which has left wide swathes of Polissya’s forests effectively lawless, controlled by armed gangs. These gangs strip the forests and then use high-pressure hoses to wash away the soil and reveal the valuable gemstones. The industry funnels hundreds of millions of dollars a year into the hands of what are known locally as Ukraine’s ‘amber mafia’, a criminal network alleged to include many senior government officials.²⁷⁴

Evidence suggests that serious local corruption also extends directly to timber.

In March 2017, a pre-trial investigation by Ukrainian prosecutors found that the regional forestry chief demanded bribes of US\$5000 from several SFEs in the district, including Klesivske, in return for not carrying out scheduled inspections and for concealing forestry violations.²⁷⁵ The year before, a pre-trial investigation into a separate case of high-level corruption had found that Rivne forestry authorities had been cutting large volumes of wood illegally and laundering it for export.²⁷⁶ Although Klesivske was not among the SFEs named, investigators noted that almost all forestry workers in Rivne District were involved in these illegal timber laundering schemes- from the foresters reporting to the Directors of SFEs, to these Directors themselves, right up to the top officials at the RFMB.²⁷⁷

Despite the illegal amber mining being well publicised in international media, and despite the serious corruption allegations, the flow of timber from Rivne’s State Forestry Enterprises to the EU has

remained unaffected. Many of the SFEs specifically implicated remain among the largest individual exporters in Ukraine. Klesivske SFE, for example, shipped 12,500 tonnes of wood to the EU during Feb-August 2017. The majority was shipped to Egger and Schweighofer’s mills in Romania, Kronospan and International Paper’s mills in Poland, and Swiss-Krono’s new OSB mill in Hungary.²⁷⁸

When Rivne’s increasingly dubious province-wide FSC certificate came up for review in 2017, the local forestry chief voluntarily chose to exclude Klesivske and three other district SFEs from the assessment, because of rampant illegal forest clearance for amber mining.²⁷⁹ The big EU firms kept buying its wood regardless. Egger, Kronospan, Swiss-Krono and International Paper all remained among Klesivske SFE’s top customers long after its FSC certificate was terminated in August 2017.²⁸⁰

four firms have also continued to purchase timber from government suppliers in Rivne province (Ukraine's third largest timber producer) whose senior officials are the subject of multiple serious investigations for timber-related corruption. Some of the relevant SFEs are also at the epicentre of the illegal amber mining crisis, and have had their FSC certificates dropped as a result. International Paper, the world's largest paper company, has also been importing from these same sites (see Case Study 3, opposite).

Another example relates to one of the most important Carpathian provinces for export of timber to Europe. Chernivtsi, whose mountains are clothed with dense stands of spruce and fir trees, lies immediately across the border from Schweighofer and Egger's massive processing site at Radauti in Romania. The three major SFEs in the region – Beregomets, Storozhynets and Putyla, have been some of the biggest suppliers of timber to companies like Schweighofer in the last few years.²⁸¹

When Earthsight first spoke to activists and conservationists in Chernivtsi in May 2017, they described a 'mafia-like' network of corrupt forestry and customs officials, set up to launder illegal timber and ship it over the border into Romania.²⁸² Rumours and

allegations of widespread corruption within the state forestry agencies in the province have existed for many years. An investigation by journalists from the OCCRP and Rise Project in late 2015 reported egregious illegal sanitary felling, and bribery for access to timber by officials in Storozhynets SFE, and highlighted the connections to Schweighofer.²⁸³ An inspection by the State Ecological Inspectorate the same year exposed illegal logging, illegal sanitary felling, and violations of rules on export of timber by Beregomets SFE.²⁸⁴ The suspicions were strengthened when, as mentioned in Chapter 2, in 2016 multiple criminal investigations were launched against the head of the provincial forest agency and

EU firms continued to buy from SFEs in Chernivtsi even after their boss was caught trying to bribe police not to investigate their illegal activities

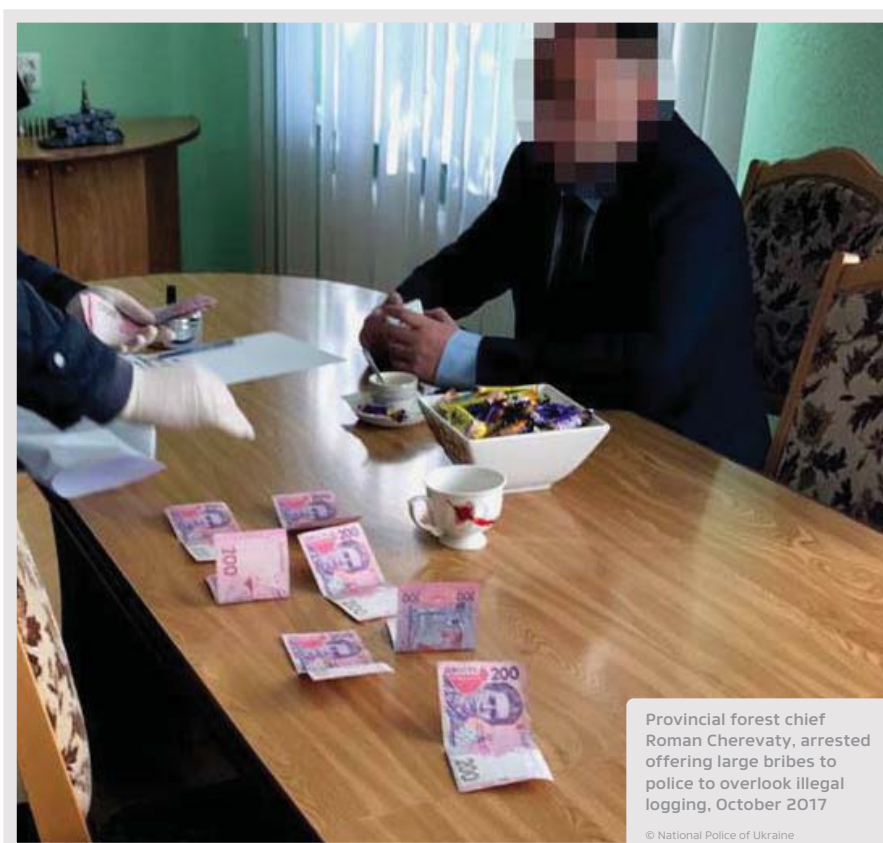
senior officials of the main SFEs, for overseeing systematic illegal logging and exports.

Egger and Schweighofer's 'due diligence' systems either failed to pick up on this publicly available information, or they didn't consider it sufficiently serious to classify the timber as being of anything less than 'negligible' risk of illegality. Even after the Chernivtsi corruption cases came to light, both firms continued to buy large volumes of 'fuelwood logs' from SFEs in the province. Egger's purchases were from the specific SFEs named in the corruption cases, and both Egger and Schweighofer have continued to buy timber from SAFR SFEs in the province even after its forestry chief was caught in October 2017 offering bribes to other enforcement agencies to turn a blind eye to wrongdoing within the forests under his purview (see Section 2.3.3).²⁸⁵ Further evidence of the high risk of corruption associated with these imports was the study on sanitary felling commissioned by Earthsight in the summer of 2017 (see Section 2.3.1). Of six planned or recent sanitary cutting sites in Beregomets SFE visited by the team, only one was found to have been legally justified by the condition of the forest.²⁸⁶

Earthsight's analysis of export records from Ukrainian customs reveals that not only did the large EU buyers mentioned above continue to buy 'fuelwood' logs in 2017 from the SFEs in Chernivtsi, Zhytomyr and Rivne which were the subject of major criminal investigations for timber-related corruption, they even seemed actually to be favouring them.

Four of the largest combined suppliers of fuelwood logs to these firms in 2017 were SFEs whose top officials were the subject of criminal corruption probes, including the top supplier, Emilchinsky in Zhytomyr. Each of the five big buyers was sourcing at least 25 per cent, and sometimes as high as 50 per cent, of its fuelwood logs from corruption-linked SFEs. Collectively, these five 'big' firms were consuming 44 per cent of Ukraine's total fuelwood log exports to the EU in early 2017, but 85 per cent of those from the corruption-linked SFEs.²⁸⁷

We presented the firms mentioned above with the findings in this and the previous subsection in advance of publication. Silva (Kronospan) stated that it "buys wood on the Ukrainian market exclusively in a legal manner... on the basis of a purchase contract based on observance of the rules of due diligence" and that our accusations are therefore "unfounded".²⁸⁸ Egger stated



Provincial forest chief Roman Cherevaty, arrested offering large bribes to police to overlook illegal logging, October 2017

© National Police of Ukraine

The EU’s own customs data suggest it is receiving 60 train-car loads of banned logs from Ukraine every day

that it had initiated audits by internal and external experts on the basis of our information, and would not provide further comment until after our report was published.²⁸⁹ Swiss-Krono stated that they don’t deal direct with SFEs, and even if they did, “does one rotten apple spoil the whole box?”²⁹⁰ International Paper did not comment on the corruption investigations, but stated that all of the wood they received from Ukraine had been either FSC Forest Management or Controlled Wood certified.²⁹¹ Schweighofer told us that while its standard policy is only to drop suppliers when they have been found guilty, they acknowledge their “responsibility to assess relevant info about potential wrongdoings in its supply chain even before there is a legally valid verdict”, and that our information constituted such relevant information. It said our findings were being analysed and had launched special audits into its current Ukrainian lumber suppliers. However, the company also stated that “in countries with [a] challenging environment (such as Ukraine), [our company] has to rely to a certain extent on state authorities. By the force of the constitution, [we] cannot be expected to execute the role of public prosecutors.”²⁹² All of the firms insist that they are in full compliance with EUTR, though our examination of the details of their due diligence systems (see Chapter 4) calls this into question.

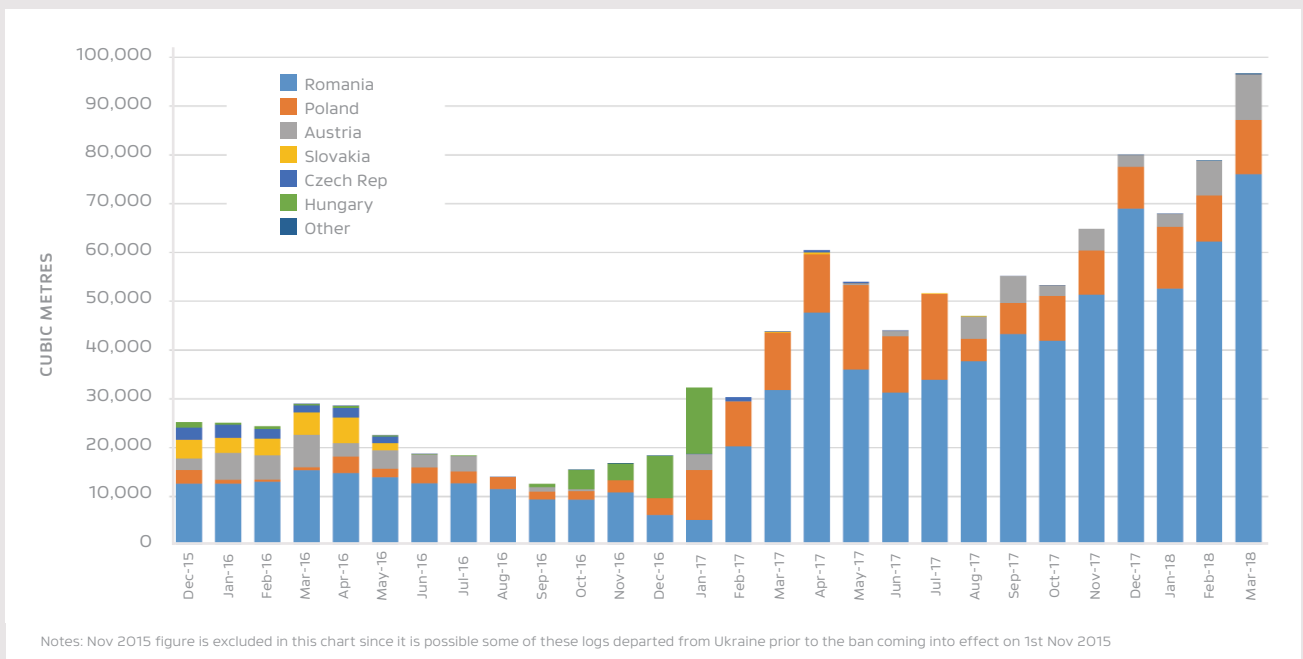
3.2.2 EU firms importing banned logs

In addition to buying wood associated with corruption, Earthsight’s evidence also suggests that EU firms – including some of the biggest timber processors on the continent – are also buying wood which was likely to have been exported illegally, including in contravention of Ukraine’s ban on the export of round logs. As described in Chapter 2, there is a wealth of evidence from press reports, NGO investigations and court records of rampant flouting of this ban. A Ukrainian customs agent who spoke to Earthsight on condition of anonymity confirmed this picture.

The EU’s own customs records appear to confirm that vast volumes of banned logs continue to be received. By December 2017 almost 1 million cubic metres of logs had been recorded as imported into EU Member States which were banned from export in Ukraine (wood classified under international customs code HS4403, including pine from Jan 2017 and all other species from November 2015).²⁹³

Fifteen different EU member states have reported importing such logs, but just six – Romania, Poland, Austria, Slovakia, the Czech Republic and Hungary – imported nearly all of them. Romania alone was the destination for two-thirds, and Poland a

FIGURE 7
Reported imports by the EU of logs (HS4403) from Ukraine which are banned from export, December 2015 - March 2018 (volume)



Notes: Nov 2015 figure is excluded in this chart since it is possible some of these logs departed from Ukraine prior to the ban coming into effect on 1st Nov 2015
Source: Eurostat customs data for HS4403. Pine logs included from Jan 2017 onwards, when they were encompassed by the log export ban.



Egger timber on sale in a branch of DIY chain Wickes, UK

© Earthsight

fifth. Imports in the most recent month for which data is available (March 2018) were the highest on record (see Figure 7).²⁹⁴ An average of 60 train cargo wagons, each carrying 50 cubic metres of banned logs, are entering the EU every day.

Ukrainian customs records (obtained by Earthsight) confirm that these products were not legally exported under the same commodity code. It appears most are being declared as 'fuelwood' logs on the Ukrainian side of the border; as explained in Chapter 2, such products fall under a different customs code (HS440110) and are not banned. Discrepancies in the classification of these logs by Ukrainian and EU customs pre-date the export ban, but have worsened since. The growth in these discrepancies has not gone unremarked in Ukraine. The government in the border province of Zakarpattia, for example, through which many such shipments pass en route to the EU, has noted how most of the exports being declared as fuelwood "on arrival overseas...[are] miraculously transformed into technical and industrial wood prohibited from export by Ukrainian legislation."²⁹⁵

The original cause of the differences lies with the mis-classification of timber by Ukrainian forestry authorities. Though Ukraine's customs code descriptions (on which the log export ban is defined) are identical to those used by the EU²⁹⁶, the Ukrainian forestry authorities which produce the wood diverge from international standards in allowing low-quality logs destined for pulp or chipboard manufacture to be classified as 'technological fuelwood'; Ukrainian customs follow their lead and have therefore also traditionally classified them as such, in contradiction of their own definitions.²⁹⁷ The mis-classification of these logs as fuelwood by Ukrainian forest authorities has increased over the years.²⁹⁸ Regulations governing the measurement and marking of such logs are weaker than those for normal logs, and the increasing misclassification has been attributed to efforts by individual state forestry enterprises to abuse these weaker controls in order to cut more timber than would otherwise be allowed and to enable corrupt schemes such as "re-sorting"²⁹⁹, whereby the quality and price of wood is understated in timber sales in return for "kickbacks" from buyers.³⁰⁰

Wood-panel giant Egger is receiving 25,000 tonnes a month of logs declared at Romanian customs as products which Ukraine has banned from export

CASE STUDY 4

LOGS SEIZED EN ROUTE TO EU PULP MILLS OWNED BY MULTI-NATIONALS

In April 2016, police in the town of Chop on the Ukraine-Hungary border seized a large shipment of logs. A second large shipment from the same company, also destined for export to the EU, was seized three months later. In all, 50 rail wagons filled with timber were detained. The logs had come from SFEs in the Carpathian provinces of Zakarpattia and Lviv, and were destined for buyers in Hungary and the Czech Republic. Investigators found that the logs had been mis-declared as ‘firewood’, in order to circumvent the log export ban. Around a quarter of the logs were also found to have fake certificates of origin. The logs were being exported by a company called Ukrliskompleks. Though the seizures in early 2016 were what made headlines and even elicited a comment from the Ukrainian Prime Minister, they were not the first. Another two railcars of mis-declared beech logs had been seized from the same company in December 2015, shortly after the ban on non-pine log exports took effect.³⁰⁶

All of the seized timber was destined for a Czech firm called Wood Source s.r.o.³⁰⁷ This company was set up in 2010³⁰⁸, with the specific purpose of importing timber from Ukraine and Belarus to supply three of the Czech Republic’s largest wood processors – pulp mills Mondi Steti and Biocel Paskov and lumber firm Mayer Melnhof.³⁰⁹ Mondi Steti is owned by multinational paper giant Mondi, the largest packaging paper producer in Europe³¹⁰; Biocel Paskov is a subsidiary of Lenzing, one of the world’s largest

producers of viscose fibres used in the manufacture of clothing.³¹¹ Wood Source later expanded into supplying Romanian mills owned by another two big EU timber firms – Egger and Schweighofer.³¹² In 2013, the company claims to have imported over 50,000 cubic metres of timber.³¹³ Ukrliskompleks and Wood Source’s controlling shareholders are the same two Russian men: Maxim Ditsky and Yevgeny Derevyanko.³¹⁴

Court documents obtained by Earthsight confirm that much of the seized wood was destined for Mondi and Lenzing’s Czech pulp mills. Lenzing’s name appears as the consignee in the December 2015 case³¹⁵, and part of the April 2016 shipment was also reportedly destined for the company.³¹⁶ Mondi’s mill is cited in court documents filed in April regarding the seizures, though it is not clear which of the seizures the documents refer to.³¹⁷

Communications made public in court records shed further light. When queried about the April 2016 case by Ukrainian customs, Lenzing replied in an email on 22nd April that the wood it obtains from Wood Source is only of ‘firewood quality’; that the company has a “strict compliance system”; and that it buys only legally harvested wood. But Lenzing’s head of wood procurement also admits that the company has no idea from whom Wood Source is getting its Ukrainian supplies.³¹⁸ The fact that Lenzing was still buying Ukrainian wood from Wood Source in April 2016, four months after a shipment of

wood being supplied to it by the company was seized, also suggests a failure to monitor its suppliers effectively.

Most of the timber was eventually released, but Ukrliskompleks was found guilty of mis-declaration and fined in relation to part of the consignment seized in December 2015. Criminal and administrative cases relating to the later seizures are still ongoing. Both Ukrliskompleks and Wood Source have publicly denied wrongdoing.³¹⁹

While Wood Source no longer appears in Ukrainian customs records as a buyer, in December 2016 its co-owner, Yevgeny Derevyanko, took control of another Czech company, WD Solution.³²⁰ This new firm continued to import logs from the Carpathian region during early 2017. Though the identities of the ultimate buyers of these logs no longer appear as consignees in Ukrainian customs records, the address given for many is that of Mondi’s mill.³²¹

When presented with our findings in advance of publication of this report, Mondi denied receiving wood from WD Solution. It stated that all of its purchases from Ukraine are FSC certified or FSC controlled wood, and that it relies on certification systems in order to source wood responsibly.³²² It confirmed that all of its Ukrainian wood purchases are made through trading firms, such that Mondi is not considered an ‘operator’ under EUTR rules.³²³ This means they are under no obligation to ensure the wood is legally sourced. The company said that it was aware of the seizures in Ukraine to which we referred and claimed that the cases had “been closed without findings of legal noncompliance”, though the blog post they cited to support this contention relates to a completely different set of seizures which took place from May 2016 onwards.³²⁴ Lenzing also confirmed that it has never acted as an ‘operator’ with regard to its purchases from Ukraine³²⁵, but nevertheless insisted that it had been complying with the EU Timber Regulation since it was first issued, and agreed to review once again its Ukrainian wood purchases. It offered to have a third-party auditor undertake this, if Earthsight agreed to share the cost.³²⁶



Logs en route to Czech pulp mills seized at the Ukrainian border, 2016

© Goloskarpat https://goloskarpat.info/society/5126409304902/?utm_content=03131%C2%A1

Prior to the log export ban, 33 per cent of Ukraine's 'fuelwood' exports were being classified as HS4403 on arrival in the EU. Since the log export ban, that proportion has risen to 50 per cent.³⁰¹ It is likely that this is due to additional, larger logs being misclassified, in order to circumvent the log export ban. Other evidence appears to confirm this, and suggests that at least some of those illegally mis-declared logs are destined for major EU buyers.

The head of one State Forestry Enterprise in the Ukrainian Carpathians, for example, has been found guilty of mis-declaring banned logs as fuelwood. The logs involved gave the consignee as Egger and were being shipped via middleman trading firms during November 2015- February 2016.³⁰² A number of other cases involving the misclassification of banned logs as fuelwood relate to named buyers in Romania.³⁰³ One of the most high-profile cases of alleged mis-declaration of sawlogs as fuelwood, which occurred in April 2016, connects to two pulp mills in the Czech Republic, owned by Europe's largest paper packaging producer (Mondi, Turnover €7 billion) and its largest producer of viscose pulp (Lenzing, €2 billion) (see Case Study 4 on page 42, including both companies' responses). Given what we have heard from Ukrainian customs officials, it is likely that such seizures are the tip of the iceberg.

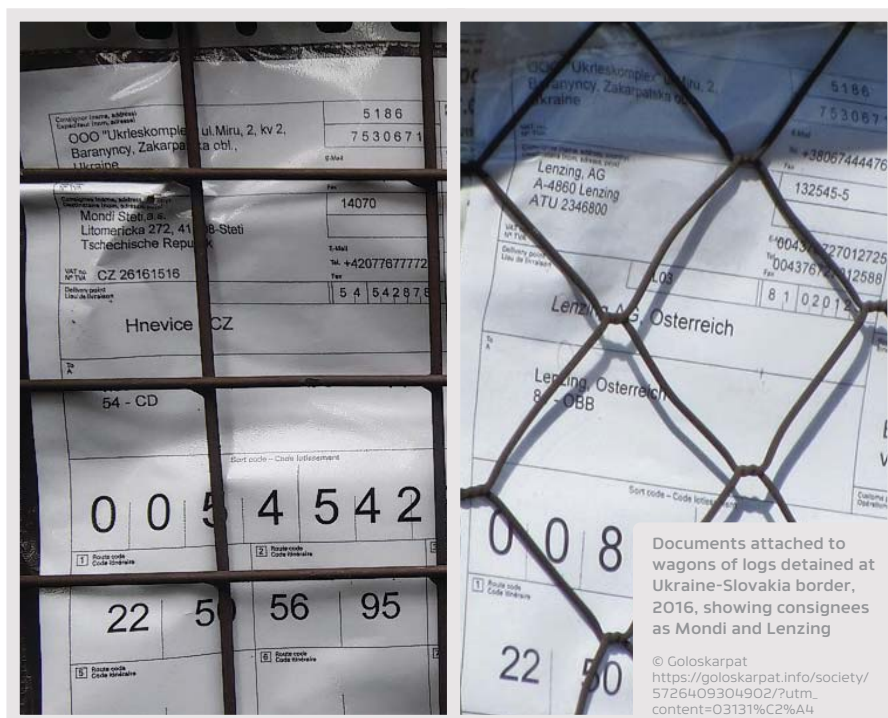
Careful comparison of EU and Ukrainian customs data reveals that major EU buyers are among those who have been receiving the logs being classified by EU customs as being of banned HS4403. By far the largest buyer is Egger's mill at Radauti in Romania. Romanian customs records confirm that during 2017, Egger was receiving 25,000 tonnes of such logs from Ukraine each and every month. Egger also declined to comment on this finding, other than to state that it had initiated additional audits by internal and external experts following the receipt of our information. Additional evidence that these imports may be illegal emerged in June 2018, when customs in Chernivtsi announced that following cooperation with customs in Romania, it had detected illegal, mis-declared exports of logs worth over US\$ 1 million during the first five months of the year by three SFEs in the province.³⁰⁴ Comparison with shipment records suggests that these allegedly illegal shipments represent nearly all of those SFE's exports of 'fuelwood' logs during that period. They also show that Egger buys over 80 per cent of the logs these SFEs export to Romania.³⁰⁵

3.2.3 The EU firms expressing an interest in buying suspect logs

Confirmation of the apparent absence of meaningful due diligence of major EU buyers with regard to Ukraine comes from undercover work carried out by Earthsight in late 2017. Posing as Ukrainian exporters, Earthsight approached a number of major EU buyers, offering to supply for export both sawlogs and 'technological fuelwood' logs longer than 2 metres. The former are categorically banned from export. As explained earlier, the legality of exports of the latter when destined to be used for purposes other than 'fuel' is a matter of debate, but such lengths are certainly prohibited from being sold for export by the SAFR SFEs which produce the vast majority of timber in the country (see box on page 13 regarding the log export ban). Longer logs are preferred by most buyers, even where they are to be chipped or pulped.³²⁷

Despite our fake firm offering to supply illegal wood, and despite it not being registered anywhere, providing an address or landline phone number, let alone having relevant certifications or a website, three large EU firms expressed an interest in doing business with it. One of these was Erdert Tuszer, Hungary's largest timber company, which produces and distributes sawn and planed lumber and other wood products.³²⁸ Erdert, privately owned by the wealthy Toth family, also has a large facility close to the Ukrainian border, complete with its own rail link. Prior to the

Three large EU firms expressed an interest in doing business with our shady fake Ukrainian supplier





INTERNATIONAL PAPER

POLAND



Group turnover: €18 billion

- Paper factory at Kwidzyn in Poland is one of the 10 largest EU consumers of Ukrainian wood
- Half of the Ukrainian logs it purchased in 2017 were from State Forestry Enterprises in Ukraine which are the subject of major ongoing corruption investigations
- Buying timber from areas rife with illegal amber mining, whose FSC certification had been dropped as a result



Group turnover: €7 billion

- Mills in Czech Republic and Slovakia sourced large volumes of logs from Ukraine until early 2016
- Shipment of logs destined for Czech mill detained by Ukrainian Customs; supplier was prosecuted for using mis-declaration to circumvent log export ban
- Lobbying EU to press Ukraine to overturn log export ban



CZECH REPUBLIC



C A R P

SLOVAKIA



Group turnover: €2 billion

- Prior to Ukraine's log export ban, was among the top 10 largest EU consumers of logs from Ukraine
- Logs destined for Lenzing's Czech mill were detained in December 2015 and April 2016 by Ukrainian Customs; supplier was prosecuted for mis-declaration
- In communications with Ukrainian Customs in relation to the latter detention, Lenzing admitted not to knowing where the wood supplied to it by its Czech intermediary had originated



Group turnover: €0.6 billion

- Largest EU importer of sawn timber from the Ukrainian Carpathians
- Romanian subsidiary is linked to one of Ukraine's largest ever illegal timber export cases, exposed in Lviv province in 2016, in which corrupt officials helped launder illegal sawn wood. Court records confirm that JF Furnir was supplied timber by one of the masterminds in that case, during the relevant period.
- Less than 2 per cent of recent spruce imports from the Ukrainian Carpathians by JAF's Hungarian subsidiary were FSC certified



HUNGARY

THE EU MONSTER MILLS BUYING HIGH-RISK UKRAINIAN WOOD



For full details and sources, plus responses to our findings from the companies mentioned, please refer to the main text of the report

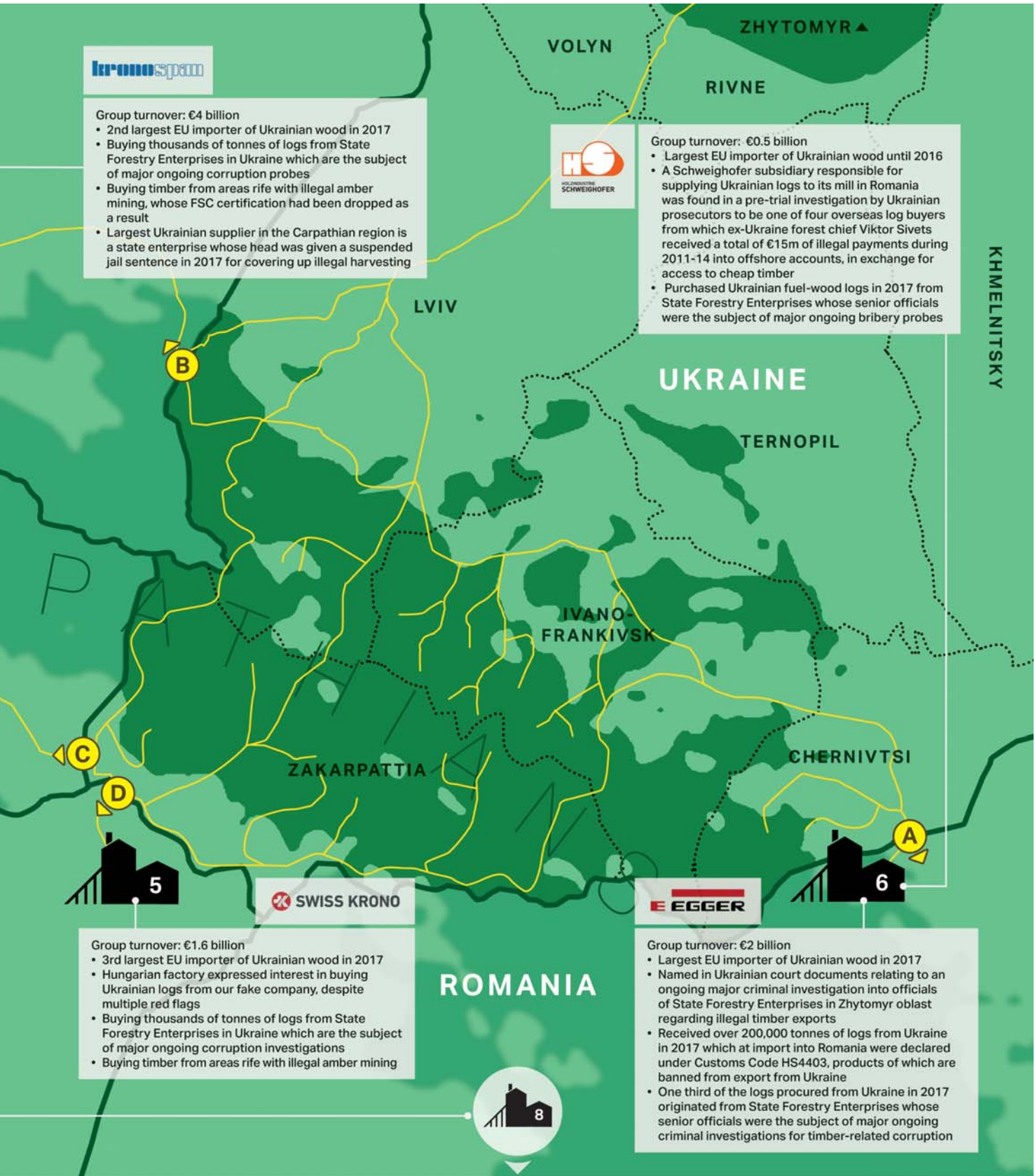
Group turnover: €4 billion

- 2nd largest EU importer of Ukrainian wood in 2017
- Buying thousands of tonnes of logs from State Forestry Enterprises in Ukraine which are the subject of major ongoing corruption probes
- Buying timber from areas rife with illegal amber mining, whose FSC certification had been dropped as a result
- Largest Ukrainian supplier in the Carpathian region is a state enterprise whose head was given a suspended jail sentence in 2017 for covering up illegal harvesting



Group turnover: €0.5 billion

- Largest EU importer of Ukrainian wood until 2016
- A Schweighofer subsidiary responsible for supplying Ukrainian logs to its mill in Romania was found in a pre-trial investigation by Ukrainian prosecutors to be one of four overseas log buyers from which ex-Ukraine forest chief Viktor Sivets received a total of €15m of illegal payments during 2011-14 into offshore accounts, in exchange for access to cheap timber
- Purchased Ukrainian fuel-wood logs in 2017 from State Forestry Enterprises whose senior officials were the subject of major ongoing bribery probes



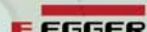
Group turnover: €1.6 billion

- 3rd largest EU importer of Ukrainian wood in 2017
- Hungarian factory expressed interest in buying Ukrainian logs from our fake company, despite multiple red flags
- Buying thousands of tonnes of logs from State Forestry Enterprises in Ukraine which are the subject of major ongoing corruption investigations
- Buying timber from areas rife with illegal amber mining



Group turnover: €2 billion

- Largest EU importer of Ukrainian wood in 2017
- Named in Ukrainian court documents relating to an ongoing major criminal investigation into officials of State Forestry Enterprises in Zhytomyr oblast regarding illegal timber exports
- Received over 200,000 tonnes of logs from Ukraine in 2017 which at import into Romania were declared under Customs Code HS4403, products of which are banned from export from Ukraine
- One third of the logs procured from Ukraine in 2017 originated from State Forestry Enterprises whose senior officials were the subject of major ongoing criminal investigations for timber-related corruption



MILL

1. International Paper Kwidzyn
2. Biocel Paskov (Lenzing Grp)
3. Mondi Steti Slovakia
4. Silva Ltd - Kronospan Mielec
5. Swiss-Krono Hungary
6. Holzindustrie Schweighofer / Egger Romania
7. JAF Holz Ungarn
8. JF Furnir



CUSTOMS POINT

- A. Vadul-Siret
- B. Korczowa-Krakovets
- C. Chop
- D. Batovo

KEY

- Carpathian mountains Ukraine
- Selected rail routes
- Oblast (province) borders
- Country borders



Swiss-Krono's new mill close to the Ukrainian border in Hungary

© Attila Balázs / SWISS KRONO Kft.

Our fake company's claims that Ukrainian customs is "very co-operative with us" satisfied initial buyer concerns over log export controls

log export ban, the company was importing 4000 cubic metres (3500 tonnes) per month of sawlogs from Ukraine.³²⁹ In 2017, the company was continuing to import over 1000 tonnes per month of sawn lumber³³⁰, less than half of it FSC certified.³³¹ Its largest supplier was the controversial Klesiv SFE in Rivne³³² (see Case Study 3 on page 38).

After an initial call with a member of the firm's wood purchasing staff in which an interest in purchasing sawlogs was expressed, our investigator was passed on to Erdert's purchasing Director Toth Arpad. Mr Arpad asked for confirmation that our company was able to export round logs, in spite of the moratorium on exports. Our investigator stated in response that our company had 'good relations' with Ukrainian customs and that this therefore would not be a problem. Apparently satisfied, Mr Arpad then passed us on to one of his staff to finalise the deal; that staff person requested a price offer for logs of 4 metres in length. When informed of our findings, Erdert stated only that its internal purchasing policy requires compliance with all laws.³³³ In response to a general query regarding its due diligence procedures, it stated that for non-FSC wood this was limited to checking for a valid Certificate of Origin issued by the export authorities.³³⁴

Another firm willing to discuss business with our shady fake supplier was the third

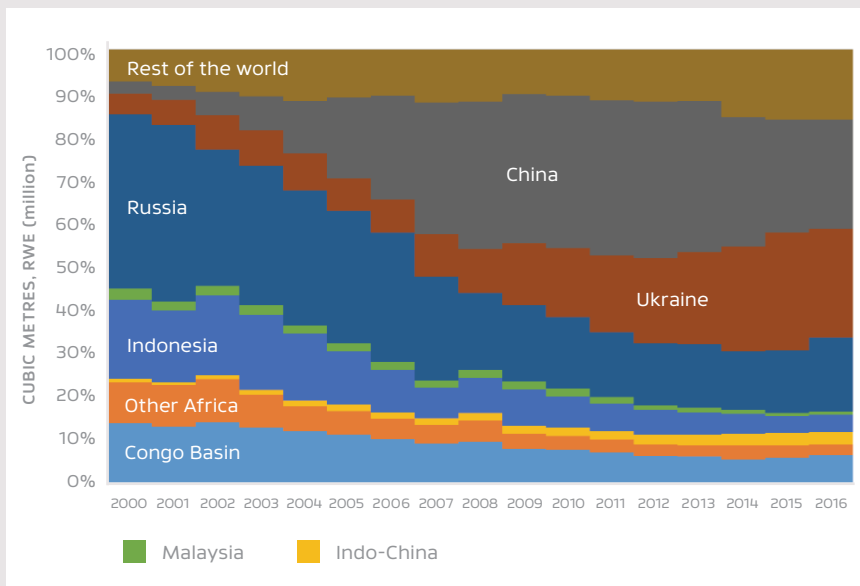
largest EU consumer of Ukrainian wood, Austrian firm Swiss-Krono. A large spike in declared imports of banned HS4403 logs from Ukraine into Hungary occurred between October 2016 and January 2017 (see Figure 7).³³⁵ The sudden increase began the same month that a large new Hungarian mill owned by Swiss-Krono started production.³³⁶ The mill, which produces oriented strand board (OSB), had been constructed close to the Ukrainian border, with its own rail spur linking directly to the neighbouring country.

In December 2017, a timber procurement official of Swiss-Krono's Hungarian OSB mill expressed interest in buying logs offered to him by Earthsight's cover company. When procurement officer Bogdan Bodis asked for confirmation that we were able to export logs longer than 2 metres, our undercover operative stated that our company had shipped such logs already to Europe during 2017 and that Ukrainian "Customs is very co-operative with us". Mr Bodis then asked for a price quote, confirmed continued interest in buying the logs and requested to arrange a face-to-face meeting.³³⁷ When Earthsight told the parent company about our undercover investigative findings, a representative stated that its due diligence procedures involve asking questions of prospective suppliers about the origin of their goods in face-to-face meetings, at which such suppliers are also required to promise to comply with all relevant laws. They also check that all shipments have certificates of origin and shipping documents containing the address of the consignee. The company insisted that it "honours and obeys all laws and regulations".³³⁸

A large pulp mill in Slovakia called Bukoza also expressed interest. The mill produces pulp and paper products mostly from beech, and exports most of its production, with its largest markets being Austria, Germany and France.³³⁹ Prior to the log export ban, it had been among the top 10 largest importers of Ukrainian hardwood logs in the EU.³⁴⁰ The conversation only came to an end because we weren't able to supply sufficient quantities. When an offer to supply 50 tonnes per month of beech 'technological fuelwood' logs of lengths of 3 metres and above was prepared, the official said he would be interested but only if we were able to supply 500 tonnes or more per month.³⁴¹ Bukoza did not reply to our repeated requests for comment on our findings or our questionnaire regarding its due diligence procedures.

FIGURE 8

Estimated EU imports of illegal wood, by source country/region, 2000-2016



Source: Import-source analysis produced by James Hewitt for the EU, adapted and extended for Earthsight

The EU is importing more illegal wood from Ukraine than all of the countries of the tropics combined

3.2.4 Estimating the scale of the problem

The standard method for estimating the volume of trade in illegally-sourced wood between two countries – developed by respected UK think-tank Chatham House – involves multiplying the best available estimates of illegality in the source country (adjusted where justified to reflect efforts to distinguish legal from illegal) with total trade volumes. A global analysis of this kind carried out for the EU in 2016 indicated that imports of illegal wood from the countries of the ‘eastern periphery’ of Europe were of increasing importance.³⁵³ That analysis did not separate imports from Ukraine from other countries such as Belarus. Earthsight commissioned the author of that analysis to provide that added detail, and extend the study to 2016. The study applied an estimate of illegality to Ukrainian wood exports of 40 per cent, which is supported by both the 2017 study of illegal sanitary felling Earthsight commissioned, and the wood-balance analysis of sawn wood exports discussed in Chapter 2.

The results indicate that by 2015 the EU was importing more wood of likely illegal origin from Ukraine than from any other country in the world (see Figure 8). In roundwood-equivalent terms (the volume of raw logs needed to produce the various products imported), the EU was estimated to be importing more illegal wood from Ukraine than from all the countries of the tropics – SE Asia, Africa and Latin America – combined.

LINKS TO THE EU’S LARGEST RETAILERS

The global wood processing companies exposed in this report as purchasing Ukrainian wood associated with illegality and corruption are hardly household names. But the firms which sell their products are much better known.

Wood from Schweighofer’s mills in Romania has previously been traced to products sold in Ikea.³⁴² Chipboard from both Egger and Swiss-Krono, coated with melamine, is also used to produce flat-packed furniture sold by the Swedish giant.³⁴³ Much of the lumber, wood-based panels and wood flooring sold by major DIY and builders’ merchants across the EU is supplied by Egger, Kronospan and Swiss-Krono, including products on sale in branches of Wickes, Homebase and B&Q in the UK³⁴⁴ and Hagebau³⁴⁵, Obj³⁴⁶ and Hornbach³⁴⁷ in Germany, Austria and other countries in Central Europe. Their products are also stocked by French-owned chains Leroy Merlin³⁴⁸ and Castorama.³⁴⁹

Lenzing’s viscose fibres are used in the production of clothing sold by H&M³⁵⁰, Zara³⁵¹ and Marks and Spencer³⁵², among others. International Paper produces the photocopy paper sold across Europe under the Canon, HP and Xerox brands. Earthsight found HP paper produced at the firm’s Polish mill (which uses Ukrainian wood) on sale in branches of the office retail chain Staples in Germany (see picture below).



4. HOW THE EU IS FAILING UKRAINE

EU buyers are using due diligence checks which this report shows are woefully inadequate

EarthSight wrote to all the Ukrainian wood buyers featured in this report to ask what due diligence they were conducting with regard to the legality of their Ukrainian wood purchases. Their answers reveal why Ukrainian wood of likely illegal origin is continuing to flood into the EU. They show that some of these buyers are managing to avoid their responsibilities under EUTR through the use of middlemen. Those firms which do carry out the importing themselves are applying due diligence checks that this report's findings reveal to be woefully inadequate. They also suggest that the responsibility for the continued flow of suspect wood does not end with the firms themselves, but extends to the authorities in the relevant countries charged with enforcing the EUTR, who are signing off on these flawed due diligence systems.

4.1 THE USE OF MIDDLEMEN

Unlike similar laws in other jurisdictions such as the US, with regard to imported wood the EU Timber Regulation's key requirements apply only to those companies which do the importing, and not those who process or sell that wood on.³⁵⁴ Our evidence suggests that some of the largest EU consumers of Ukrainian wood may be using this loophole to avoid their responsibilities. Ukrainian customs data commonly show that while the rail trains carrying Ukrainian wood into Europe may travel direct to these firm's mills, and those companies' names may even appear as 'consignees' on relevant records, the firms legally responsible under the EUTR are very often third parties: small, opaque 'middlemen'.

International Paper's mill in Poland, for example, uses a company called FHU Import-Export for all of its purchases from Ukraine.³⁵⁵ This tiny firm's registered address is a flat above a shop in a small village in eastern Poland (see picture below).³⁵⁶ In addition to shielding the real buyers from legal responsibility, if caught breaking the rules these middlemen firms can also quite easily re-invent themselves. Prior to the log export ban, for example, an obscure Czech middleman firm called Wood Source s.r.o. was handling huge volumes of Ukrainian timber imports destined for major buyers such as Holzindustrie Schweighofer, Egger, Lenzing and Mondi.³⁵⁷ After two of its shipments were seized by Ukrainian authorities at the border and the firm and its Ukrainian sister company were embroiled in scandal and the subject of action in the Ukrainian courts (see Case Study 4 on page 42), Wood Source was blacklisted by some buyers³⁵⁸ and its name stopped appearing in customs records. But at the same time, its owner took control of another Czech firm, WD Solution, and began using it to import Ukrainian wood instead.³⁵⁹

Though middlemen are allowing some big firms receiving shipments from Ukraine to avoid the risk of prosecution under EUTR, the firms featured in this report which use such middlemen nevertheless have procurement policies which involve both legality and sustainability demands. Such policies are prompted by the concerns of their customers to be good citizens, and are especially important for the largest firms with brand reputations to protect. In fact, in their responses to our questions, the firms using middlemen claimed to be implementing much the same kinds of checks as those for whom such steps are mandatory under EUTR. The problem is that those checks cannot actually guarantee very much at all.

4.2 THE MISPLACED FAITH IN FSC

The most meaningful form of due diligence cited by the big buyers in their responses is Forest Stewardship Council (FSC) certification. FSC forests are audited by third parties, who are supposed to ensure that the logging is both legal and sustainable. Inspectors visit each certified forest annually, checking documents and carrying out field inspections.

The enactment of the EU Timber Regulation has helped trigger the rapid expansion of FSC in Ukraine. Nearly 3.7 million hectares of Ukrainian production forest are now FSC certified, including 1.4 million hectares in



The registered address of the middleman used by International Paper for its imports from Ukraine: a residential apartment above a supermarket in a small Polish village

© 2018 Google



the Carpathian provinces. Almost 90 per cent of the forests under the control of the State Agency of Forest Resources in the Ukrainian Carpathians are FSC certified. The area of FSC-certified forests in Ukraine has doubled since EUTR took effect.³⁶⁰

Unfortunately, Earthsight's research shows that in Ukraine, FSC certification cannot currently be relied on to ensure legality. Its failure is amply demonstrated by the numerous seizures and corruption cases which have come to light in recent years which involve FSC forests and FSC-certified wood. Much of the exported timber on which the wanted ex-forest chief Viktor Sivets was allegedly soliciting bribes during 2011-2014 was coming from FSC-certified SFEs. The large-scale organised criminal timber laundering scheme exposed in Lviv province in late 2016 involved State Forestry Enterprises which were FSC-certified, and their certificates were re-issued in early 2017 in spite of it. Though auditors found the space to comment on the type of trousers used during harvesting, no mention at all was made of the sawn-timber laundering scam.³⁶¹

Most of the logging sites in the Carpathians where illegalities by SFEs were identified in the research commissioned by Earthsight in 2017 were FSC-certified, and illegalities were found in every FSC-certified site visited.³⁶² Senior staff at one of those SFEs, Beregomets, have been the subject of multiple formal investigations into suspected illegal logging and bribery over the last two years, and it was their boss at the provincial forestry office who was caught in October 2017 offering bribes to

protect their activities from inspection by other government agencies (see Section 2.3.3). Yet the SFE retains its FSC status. At its most recent inspection, FSC auditors spent a grand total of two days there. Most of the SFEs in Rivne and Zhytomyr which are the subject of ongoing formal investigations into serious corruption and illegal logging are FSC-certified, and have retained that status despite media coverage of the allegations. Shipments of logs from FSC-certified SFEs have been found to have been illegally mis-declared at export.

Digging more closely into how FSC operates, it is easy to see how such examples can occur. Its systems and procedures are incapable of reliably detecting or preventing the main kinds of illegality known to occur in Ukraine, such as illegal sanitary felling and bribery in timber auctions.

When referring to checks on legality, public summaries of FSC assessments in Ukraine typically refer to such things as the enterprise having trained staff and copies of legislation in its possession, its own records on cases of illegal logging, and its own self-assertions regarding steps it takes to prevent it. When significant illegality issues are examined, this is usually only because they have been raised by an NGO. In such cases it is common for the certifier to dismiss the allegations based on documents and assertions supplied by government agencies, including the enterprise being certified.

Such an approach cannot work in a situation where corruption is rampant, and where the entities doing the logging and being certified are the same ones responsible for

Logging enterprises which are the subject of serious criminal corruption investigations nevertheless remain FSC certified

The former head of a logging enterprise in the Carpathians told Earthsight it is easy to circumvent FSC checks

enforcing the law. That FSC systems and procedures are not fit for purpose in a climate of rampant corruption has been recognised for some time. In 2013, a study by the U4 Anti-Corruption Resource Centre found that while FSC may have some effect in combatting corruption in situations where such corruption was sporadic, it had limited positive effect in places where corruption was systemic.³⁶³

There is some evidence that FSC has recognised and is trying to address its limited ability to guarantee legality, both generally and in the Ukrainian context in particular. In July 2017, a new FSC standard was introduced which is much more rigorous on the issue of legality than any predecessor. It was developed in recognition that the old standard could not be relied on to ensure compliance with the EUTR. Detailed new requirements are defined for particular countries, including Ukraine.

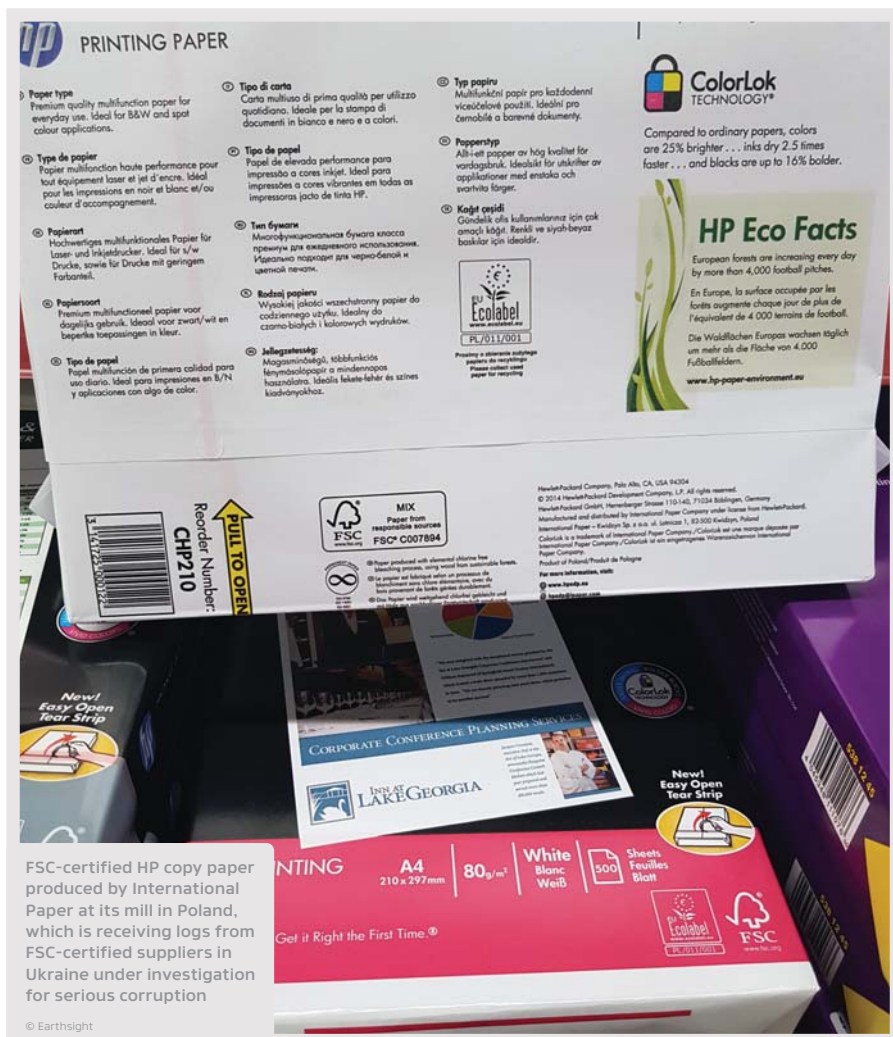
To ensure the legality of sanitary felling, for example, it requires checks of planned

felling sites by suitably qualified independent experts, and for customs violations it requires the contents of an actual truck or railcar to be compared with official documentation.³⁶⁴ Though a substantial improvement, it is likely that a state forest enterprise which wanted to could still find it easy to circumvent them. Oddly, it also only applies to forests certified under FSC's 'Controlled Wood' standard, while nearly all of the FSC forests in Ukraine are certified under the broader 'Forest Management' standard³⁶⁵, and so the new legality checks do not apply to them.³⁶⁶ Regardless of the standards, the validity of 'Controlled Wood' certification is also undermined by the fact that the checks are carried out by the traders themselves, not by independent third-party auditors.³⁶⁷ It is questionable whether traders can be trusted to meaningfully apply the checks with regard to the timber they themselves are selling (see Case Study 1: the Osuna Group).

How easily officials can circumvent FSC legality checks was confirmed to Earthsight by the former head of one of the largest timber-exporting State Forestry Enterprises in the Carpathians. He admitted that during his time in charge, he had found it easy to circumvent FSC checks, which he described as "just box-ticking exercises". He said that assessments mostly involve auditors asking managers "Is it all OK?", and them replying "Yes, it is all OK". Where actual field inspections do take place, he said it was common practice for foresters to ensure auditors only visit unrepresentative 'best practice' logging sites specially prepared for them.

Given the rampant corruption in Ukraine and the likelihood that state forestry enterprises will seek to hoodwink auditors, it is especially important that they examine independent information relating to possible illegality. Yet Earthsight has discovered that they do not. FSC rules do not require auditors to search for relevant information. They will only consider information such as court records, NGO reports and journalistic reports where these are raised by a stakeholder whom the auditor approaches for comment.³⁶⁸

Even where relevant information is raised by third parties, auditors tend to be very generous in how they deal with it. For example, they will often choose not to classify individual examples of illegal logging as sufficiently serious to justify suspending an FSC certificate, on the assumption that they are exceptions. With regard to formal investigations and court cases, one of the largest FSC certifiers has



FSC-certified HP copy paper produced by International Paper at its mill in Poland, which is receiving logs from FSC-certified suppliers in Ukraine under investigation for serious corruption

© Earthsight



reportedly said with regard to Ukraine that even if they are made aware of them, they will not raise an issue unless a guilty verdict has been reached.³⁶⁹ Such an approach cannot be considered to meet the risk-mitigation demands of EUTR, and is particularly questionable given the slowness of the Ukrainian court system, where cases can remain pending for years.

4.3 UNDUE DILIGENCE

Though even FSC cannot effectively reduce the risk of importing illegal wood, much of the timber being imported from Ukraine by these companies does not even meet that standard.

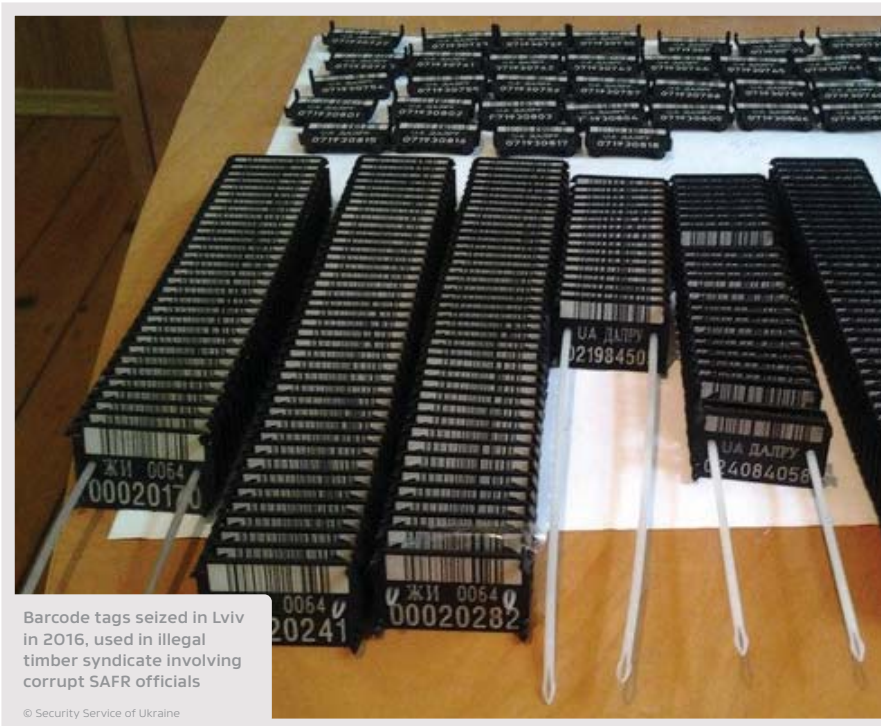
None of the large importers featured in this report require their Ukrainian purchases to have full FSC 'forest management' certification, and most admitted in response to queries from Earthsight to receiving substantial volumes which do not have this. Ninety-eight per cent of the sawn lumber being imported by the JAF Group's Hungarian subsidiary is uncertified³⁷⁰, as are around a third of Egger Romania's Ukrainian purchases³⁷¹, and thirty per cent of Swiss-Krono Hungary's.³⁷² More than half of the sawn wood imported by Erdert Tuszer in Hungary is uncertified.³⁷³ Neither Kronospan or Schweighofer replied to our query regarding the proportion of wood certified, but our own analysis indicates that around 25 per cent of the former's shipments to its mill in Poland are uncertified, and 98 per cent of the sawn wood received by Schweighofer in August

2017 was supplied by firms without FSC 'chain-of-custody'.³⁷⁴ International Paper told Earthsight that 88 per cent of its purchases from Ukraine in 2017 had full FSC certification³⁷⁵, though our analysis of individual shipment records contradicts this and suggests a much lower proportion of 53 per cent.³⁷⁶

Some of the remaining volumes being received by Egger and Swiss-Krono may have been self-verified by suppliers under FSC's lower 'Controlled Wood' standard, but the only firms which claimed to have received only wood which met at least this standard during 2017 were those using middlemen: International Paper, Lenzing and Mondi.

The due diligence measures these firms claimed to be taking for uncertified wood (which most were also applying to the certified purchases, though not JAF and Erdert) were even more inadequate than those demanded under FSC. Most of the firms mentioned that they check that shipments are accompanied by a 'Certificate of Origin'. But these certificates are issued by the same corrupt agencies which are carrying out the logging. An SFE willing to log illegally is unlikely to then refrain from issuing such certificates for the timber involved. SFEs are also known to have corruptly issued such documents for timber felled illegally by third parties. They are also regularly forged (see Chapter 2). Similar concerns relate to other documents cited by the buyers, such as transport or export documents.

The due diligence measures being used for uncertified wood were even more inadequate



Many due diligence ‘checks’ amount to little more than the extraction of unsubstantiated promises from suppliers

Many of the firms mention checks which they carry out on their suppliers, but these are usually even more meaningless. Swiss-Krono claimed to only deal with ‘established companies’ which have also supplied their large competitors.³⁷⁷ Yet as our report shows, some of the most established traders have been found guilty or are under investigation by Ukrainian prosecutors. Swiss-Krono’s claim is also contradicted by its willingness to engage in a discussion of prices and delivery terms with our undercover company, which didn’t even exist (see Section 3.2.3). Swiss-Krono’s response is that they would have done additional due diligence on our company via a face-to-face meeting³⁷⁸, but it is unclear how verbal answers to questions can constitute meaningful evidence. Similarly, a number of the companies, including International Paper³⁷⁹, Lenzing³⁸⁰, Swiss-Krono³⁸¹ and Kronospan³⁸², say that they require suppliers to sign documents (such as purchase contracts or ‘codes of conduct’) attesting to the legality of the wood they supply, but this also amounts to little more than extracting an unsubstantiated promise.

The only firms which referred to any kind of field checks were Egger and Schweighofer, but the extent and meaningfulness of these remained unclear. Schweighofer said its suppliers were subject to its ‘on-site verification programme’³⁸³, while Egger said its internal audit team “makes on site audits and field verifications to check the source of the wood materials”, a step it

claimed went beyond EUTR demands.³⁸⁴ It is very unlikely that any of these field checks are any more effective in reducing risks of illegality to a negligible level than the flawed ones being undertaken for FSC certification.

The responses we received from these companies suggest that some do not fully understand what illegal logging is, and think it only refers to clandestine felling and smuggling by external, non-government actors, entirely separate from licensed production. Osuna, one of the largest traders of Ukrainian wood to the EU, even seemed to believe that it was impossible by definition for a government entity to log illegally (see Case Study 1 on page 26). Others seem to have a poor understanding of their responsibilities under EUTR. Swiss-Krono, for instance, sought to claim credit for not having any direct relationships with Ukrainian wood companies or SFEs, as if importing through intermediaries somehow distanced it from the potential of illegalities.

4.4 FAILURE OF EU AUTHORITIES

In their responses to our findings, JAF, Egger and Schweighofer all stressed that they had been inspected by EUTR Competent Authorities from within the relevant Member State(s) and been found to be compliant. The companies assert that this proves that they are abiding by the EUTR.³⁸⁵ But our evidence suggests that they – and most likely also other importers named in this report - are passing these checks because the authorities involved are taking a lax attitude to what constitutes meaningful due diligence with regard to Ukraine, which is at best contrary to the spirit of EUTR, and may constitute a breach of these Member States’ legal responsibilities under it.

Official EUTR guidance states that where there is significant corruption, “even official documents issued by authorities cannot be considered reliable.”³⁸⁶ Recognising this guidance, for example, authorities in Sweden and Denmark have concluded that valid documents from the state-owned company with sole rights to cut and export timber from Myanmar do not constitute sufficient due diligence, because of high corruption risk.³⁸⁷ It appears that authorities in the main EU countries importing wood from Ukraine are adopting a very different attitude.

A lax approach to implementing EUTR has been evident in these countries for some time. The EU countries which share a

border with Ukraine and are among the largest importers of its timber were among the slowest to implement EUTR into national legislation. By the spring of 2015, two years after EUTR had become effective, none of these countries had implemented it. The European Commission was forced to begin formal investigations. While this finally prompted Poland to act, the Commission had to launch formal infringement procedures against Hungary and Romania for continued failure to implement the law.

Hungary was not fully applying the law until September 2016³⁸⁸, and the infringement case against Romania was not closed until December 2016.³⁸⁹ As of March 2017, Slovakia was still under investigation by the Commission for not having in place required penalties for breaches of EUTR.³⁹⁰ Even where the Commission judges a country to be compliant, this only means that it has passed relevant legislation and nominated an agency to implement it. Other evidence also suggests either a lack of enthusiasm or insufficient resources.

None of the countries has responded to surveys by NGOs regarding numbers of checks carried out and penalties applied.³⁹¹ Though third-country agents are commonly involved in their imports from Ukraine and most of the wood is re-exported within the EU, Poland and Romania are also two of only a handful of EU countries which have not reported any collaboration with EUTR authorities in other member states.³⁹²

Ukraine has been the subject of regular attention at meetings of European EUTR

competent authorities during the last two years, and the focus of compliance checks by a number of countries.³⁹³ Increasing efforts are being made, including in some of the key neighbouring countries. The EU even sent a mission to Ukraine in early 2018 to investigate the issue, which included representatives from Member State EUTR Competent Authorities. It found that “substantial corruption risk can be found in every supply chain and is widespread throughout the whole country”. However, its conclusion with regard to the implications for EU imports was doubly odd, stating that there was “not enough evidence publicly available to convince EU operators of the risks linked to Ukrainian timber.” Aside from being arguably untrue, this suggests that EU timber importers have to be persuaded to comply with EU law, rather than being forced to by their home governments. Hopefully this report will help fill the gap they believe exists.

Our evidence shows that Member States are still not implementing EU law effectively with regard to Ukraine. As a result, many EU companies are continuing to import Ukrainian wood at high risk of illegality, without carrying out meaningful due diligence.

In Brussels meanwhile, though bureaucrats working directly on supporting the implementation of EU legal commitments on timber legality with regard to Ukraine have made substantial efforts to encourage greater compliance, the EU institutions’ greatest efforts on the issue of EU wood imports from Ukraine have been directed elsewhere.

Authorities in EU importing countries are taking a lax attitude to what constitutes meaningful due diligence with regard to Ukraine



Greenpeace protesting the failure to implement the EU Timber Regulation, 2015

© Pierre Baelen / Greenpeace

The European Commission is trying to force Ukraine to overturn its log export ban

4.5 A GRAND HYPOCRISY: STRONG-ARMING THE UKRAINIAN GOVERNMENT

In a grand hypocrisy, the EU has been strong-arming the Ukrainian government to overturn one of the key measures it has enacted in recent years to try to stem the flow of illegal wood and give breathing space for governance to improve.

As explained in Chapter 1, in April 2015 Ukraine banned the export of logs.³⁹⁴ Though other factors were also important, one of the justifications for the ban was as a means of helping tackle uncontrolled and often illegal log exports and thereby protect Ukraine's forests. In September 2016, the Ukrainian National Prosecutor's Office, in a report about rampant illegal logging and exports, even recommended that the ban be extended to cover sawn timber, in order to provide additional support to efforts to tackle illegality.³⁹⁵ Not long before the ban was enacted, Ukrainian authorities had exposed the massive, high-level corruption scheme relating to log exports run by former forest chief Victor Sivets, which went right to the heart of government (see Section 2.4.2). With a new government in power, determined to root out corruption, a ban on exports was seen as a means of

reducing the opportunities for graft, buying time for longer term governance measures to be implemented to prevent it. It is also harder to export illegal wood if you have to process it first, since that requires factories which can be discovered, and requires the wood to remain in the country for longer. Other countries affected by rampant illegal logging, such as Indonesia, have successfully used log export bans to help tackle the problem.

Rather than supporting the measure, however, the EU has sought to force the Ukrainian government to overturn the ban. The EU alleges that the ban contravenes the free-trade terms of its May 2015 €1.8 billion loan agreement with Ukraine³⁹⁶, and has repeatedly withheld large tranches of that cash in order to try to force the government to overturn it.³⁹⁷ In December 2017, the EU cancelled the final €600 million tranche, with one of the four reasons cited being the continued failure by the Ukrainian authorities to implement their earlier promise to repeal the ban.³⁹⁸ These strong-arm tactics have triggered protests by Ukrainian activists³⁹⁹ and led one Parliamentarian to accuse the EU of 'blackmailing' Ukraine into lifting the ban, and thereby undermining the country's efforts to protect its forests from the scourge of illegal logging and corrupt wood exports.⁴⁰⁰ Opponents of the EU's action note that the wider 2014 Association Agreement between the two jurisdictions allows for trade restrictions where they are justified on the grounds of public policy and to protect nature.⁴⁰¹ By seeking to force Ukraine to overturn the ban, the EU was itself arguably in breach of the other terms of the agreement under which it commits to support efforts to prevent corruption, illegal logging and cross-border trade in stolen goods.⁴⁰²

Ukrainian commentators have alleged that the real reason the EU is pressuring for the lifting of the ban is that a number of large EU wood processing companies are enriching themselves on a ready supply of cheap, likely-illegal, logs from Ukraine. Earthsight's research reveals that many of the same giant firms which have been buying Ukrainian wood tainted with evidence of possible illegality and corruption have been actively pressuring the European Commission to force Ukraine to overturn the ban. The company most affected by the ban, Schweighofer, has reportedly pushed for the ban to be lifted through the European Organisation of the Sawmill Industry (EOS), a Brussels-based lobbying group, which had representatives at the meeting where Ukraine's President Poroshenko announced



Activists calling for Ukraine to maintain the log export ban, in the face of EU threats

© Ukrfoto



that he was to accede to the EU demands by overturning the ban.⁴⁰³

Freedom of Information requests to the European Commission by Earthsight reveal further details of the influence being brought to bear by big EU wood buyers and their industry association representatives, as well as the governments which host their factories. At a meeting in November 2016 of DG Trade’s Market Access Advisory Committee, including representatives from various EU Member States - including Romania - and a number of European wood industry representatives, one (unidentified) government representative stated that “its wood processing industry had been very heavily affected, with wood prices skyrocketing since the introduction of the ban”. The Commission took note of the Member State concerns and promised strong efforts to achieve the repeal of the ban would continue “at all levels”.⁴⁰⁴ European Parliamentarians representing Austria, Hungary, Poland and Romania – the countries in which the big buyers’ factories are based, plus the home state of many of them – have also been working hard to press for the overturning of the ban.⁴⁰⁵

The Confederation of European Paper Industries (CEPI) has also been lobbying the European Commission hard regarding the ban. In one of a number of meetings it has held on the subject with the Commission, in October 2017 CEPI met with one of the Trade Commissioner’s closest advisors, Nele Eichhorn. According to the minutes of the meeting, CEPI stressed the “repercussions on EU industry” of the ban and requested that DG Trade “scale up pressure on Ukraine” to overturn it. They were reassured that steps are being taken to “assist” Ukraine in lifting the ban.⁴⁰⁶

Both Mondi and International Paper have seats on the CEPI Board⁴⁰⁷, while Lenzing and Bukoza are represented by their national associations. Both Mondi and Lenzing admitted to Earthsight to having lobbied the Commission regarding the ban, via trade associations of which they are members.⁴⁰⁸

All of these companies were substantial consumers of Ukrainian logs prior to the ban. This report shows all of them have also received suspect wood.

Earthsight’s research shows this has happened under pressure from the giant EU firms using suspect Ukrainian wood

5. SOLUTIONS



Lynx
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The big importers must take a more meaningful approach to ensuring that any Ukrainian wood that they buy is clean

The ultimate solution to forest crime in Ukraine must come from within the country. Efforts are underway, but are moving painfully slowly.

In early 2017, the SAFR announced plans to introduce a number of sweeping reforms to forest governance in Ukraine.⁴⁰⁹ The stated objectives of a new draft five year reform strategy include improving the processes that govern how logs are sold, introducing new mechanisms to prevent corruption in management decisions, upgrading the status of the SAFR so it is directly subordinate to the Cabinet of Ministers, increasing cross-sectoral cooperation and generally bringing Ukrainian forestry standards in line with European standards.⁴¹⁰ One of the stated goals was also to establish a new system of legality of wood handling at each stage, in accordance with the European Union Timber Regulation.⁴¹¹ A number of new regulations have since been drafted. While this is a much needed step in the right direction by the SAFR, it remains to be seen whether the planned changes will be implemented, and even if they are, it is unclear if they will be capable of ensuring that the current environment of rampant corruption in the forestry sector becomes a thing of the past. A much broader range of measures are needed, some of which extend beyond the SAFR's stated reform goals.

Just prior to the publication of this report, the Ukrainian Parliament passed new legislation dramatically increasing the penalties for illegal logging and wood trading.⁴¹² Though it is a welcome step, it is questionable what difference the level of penalties can make, if corrupt officials are never caught in the first place, or investigations into their activities drag on for years before being brought to trial. It is essential that serious timber corruption cases are investigated and prosecuted much more quickly. Authorities should also begin targeting the companies who are paying bribes, as well as the officials receiving them. The same new law, due to come into effect on 1st January 2019, also bans the export of firewood, in order to help halt the widespread circumvention of the log export ban documented in this report. This will make it harder to bypass the ban, but there are other ruses which are likely to be used instead.

Though more action is certainly needed, a discussion of the precise detailed steps needing to be taken by the Ukrainian government to stamp out timber corruption is beyond the remit of this report. The focus of this report is on the role played by the EU. And what is certain is that Ukraine's fight against timber corruption is not taking place in a vacuum. Whether it succeeds will depend to a significant extent on whether

the biggest market for Ukraine's wood exports remains open to timber sourced illegally and corruptly.

The obvious starting point for action in the EU is the companies which import and process Ukrainian wood, especially the multinational giants mentioned in this report. These companies must take a more meaningful and pro-active approach to ensuring that any Ukrainian wood that they buy is clean. This must go beyond checking for government documents or seeking promises from suppliers. It also cannot rely solely on the independent certification provided by the Forest Stewardship Council (FSC).

According to Ukrainian forest experts, FSC certification has helped improve forest management in the country. It is therefore important that it continues to be supported. But as this report demonstrates, its current systems and procedures are incapable of ensuring that certified wood is legal and free from corruption. If it is to remain relevant in Ukraine and useful for overseas buyers, FSC must overhaul its systems and procedures. As a start, it must expand the new legality checks included in its Controlled Wood standard to its main Forest Management standard, require auditors to pro-actively check Ukrainian media and court records, and preclude from certification those suppliers under formal investigation for serious timber-related offences, or found guilty of them. FSC also needs to look more broadly at how it addresses the unique challenges faced by forest certification in countries with high levels of corruption.

Demand for reform by FSC, and for action by the big companies processing Ukrainian wood, needs to come from the retailers which sell their products. Major retail chains like Ikea must act urgently to investigate their supply chains for products made from Ukrainian wood, and demand more meaningful assurances that any such wood is legal and corruption-free. They cannot continue relying on FSC certification alone to protect their brands.

Action by the big buyers on issues of timber legality should not be voluntary, however. The EU has recognised this, which is why it passed a law banning the import of illegal wood and making checks on legality obligatory. But for Ukraine this law is not doing what is supposed to. The blame for that lies mostly with the national authorities in individual EU countries, who are tasked with implementing and enforcing it. If the flood of suspect wood

into Europe from Ukraine is to be stemmed, these authorities, especially those in Romania, Poland, Hungary, Austria and Germany, have a crucial role to play. They must demand more meaningful due diligence by importers.

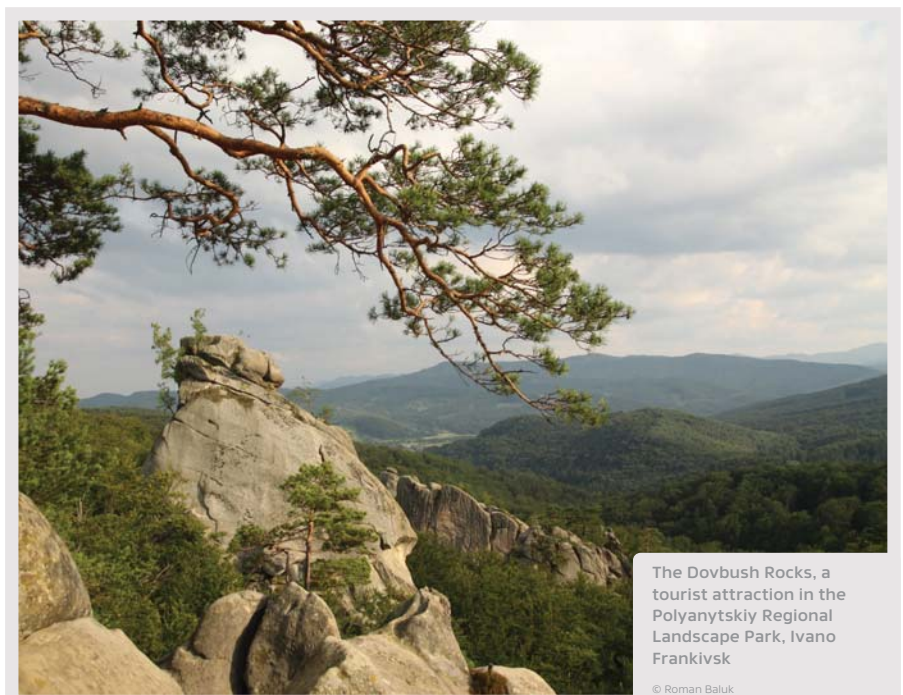
If those national authorities do not act, it is the duty of the EU institutions in Brussels to force them to. European officials working specifically on timber legality have taken some actions with regard to Ukraine, but this action must be ramped up. Specific formal guidance must be given on Ukraine in particular, and on how to address issues of corruption more generally. If additional help and guidance to national authorities does not work, then stronger steps may be needed.

Authorities in the countries which receive Ukrainian wood must demand action by the importers. EU officials in Brussels must make sure that they do

Action at the EU level also needs to go beyond the narrow confines of those working on EUTR implementation. The European Commission has been providing important support to efforts to reform forest governance in Ukraine, but is undermining those efforts by failing to implement EUTR effectively, and has wasted its greatest efforts on trying to force Ukraine to revoke its ban on export of logs. Top officials in the Commission must provide the high level political and financial support necessary to ensure that EUTR implementation is improved, and must re-direct the Commission efforts currently being applied to the log export ban to instead bolster support to Ukrainian forest governance reform. To ensure big firms cannot circumvent it through the use of middlemen, the Commission should also consider amending the EUTR to place the same responsibilities on downstream traders and retailers.

The attention of EU and Member State authorities should also not be limited to those with responsibility for forest issues. The use of letterbox firms and secrecy jurisdictions and the possible involvement of EU firms in timber corruption in Ukraine should demand the attention of authorities responsible for enforcing money laundering and anti-bribery laws.

Brave activists and officials are taking the fight to timber corruption in Ukraine. But they need help. Companies and officials in the EU must answer their call.



The Dovbush Rocks, a tourist attraction in the Polyanyskiy Regional Landscape Park, Ivano Frankivsk

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- 404 Draft Minutes, Market Access Advisory Committee, 17th November 2016 (redacted), 23rd November 2016 (Ref. Ares (2016)6652986 - 28/11/2016), released by the Commission in response to a Freedom of Information request made by Earthsight, and now publicly available at <https://www.asktheeu.org/en/request/4068/response/13592/attach/3/10%20MAAC%20November%202016%20final%20minutes%20Redacted.pdf>. Participants list available at <https://www.asktheeu.org/en/request/4865/response/16172/attach/5/list%20of%20participants%20MAAC%2017%20November%202016%20Redacted.pdf>
- 405 European Parliament, Parliamentary questions, 9th January 2018, E-000063-18, <http://www.europarl.europa.eu/sides/getDoc.do?type=WQ&reference=E-2018-000063&language=EN>
- 406 Minutes of meeting between Nele Eichhorn and CEPI on 2 October 2017 (Ares (2017)4921615), released by the Commission in response to a Freedom of Information request made by Earthsight, and now publicly available at <https://www.asktheeu.org/en/request/4866/response/15885/attach/5/Ares%202017%204921615%20Meeting%20report%20Redacted.pdf>
- 407 Confederation of European Paper Industries, webpage, <http://www.cepi.org/about-us/organisation>, accessed 25th May 2018
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- 409 Press release from SAFR, 10th February 2017, http://dkg.kmu.gov.ua/forest/control/uk/publish/article?art_id=183724&cat_id=32888
- 410 Strategy for Sustainable Development and Institutional Reform of Forestry in Ukraine to 2022, as published on the website of SAFR 11th November 2017, http://dkg.kmu.gov.ua/forest/control/uk/publish/article?art_id=182241&cat_id=32888
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- 412 Interfax Ukraine, 'Rada limits domestic use of unprocessed timber, temporarily suspends lumber exports', 3rd July 2018, <https://en.interfax.com.ua/news/economic/515655.html>

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