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## LOVELL FERNANDEZ MEMORIAL LECTURE: *THE GLOBAL SHADOW ECONOMY* 23 FEBRUARY 2023

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### 1. INTRODUCTION

Ladies and Gentlemen, dear friends and colleagues, it is a great honour for me to deliver this *Lovell D. Fernandez Memorial Lecture*. Lovell is alive in our memory. We remember him as an inspired teacher and as a warm-hearted person.

He personified the dramatic transition South Africa underwent: Lovell was born and brought up in the times of Apartheid. He had the stamina to survive in a difficult academic environment and he has given a lot to those who were fortunate to be born after Apartheid.

From his interest in transitional justice, he turned to economic crime. He realised that corruption and related money laundering were amongst the major challenges for economies in the Global South, including South Africa. I am personally very happy that Lovell invited me to teach at the University of Western Cape. For us (Kathrin and I) this course in South Africa is one of the highlights of the year.

### 2. GLOBALISATION

One of the keys to understanding what Joe Stiglitz and I have called the ‘shadow economy’, based on our experience in Panama, is that economic crime is global in nature. What happens in South Africa frequently starts in the Global North and goes back again to the North, when the bounty of the corrupt is hidden in financial centers.

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### **3. A CASE STUDY**

Let me illustrate what I am talking about with a case that starts in my own country, in Switzerland, and has had a serious impact on South Africa: As you know, the heavy industries corporation ABB has its head office in Switzerland.

You will remember that employees of a wholly owned subsidiary of ABB bribed a high-ranking official of the state-owned energy company Eskom Holdings Ltd to obtain business and to stay in business (considering the current power crisis it may have been more than one official). The employee shared confidential information from public procurement proceedings with the ABB employees. This provided ABB with a competitive advantage in the bidding process. Overall, the manipulations pushed up the price for the Kusile power station substantially and thereby harmed the South African state and its people. And maybe the quality of the work was not what they promised.

### **4. SANCTIONS**

South Africa was able to detect this large-scale corruption scandal and to take the responsible company to task: A joint investigation of several countries (including South Africa, Switzerland, the US and Germany) forced ABB into a settlement. ABB had to pay compensation of over USD 100 million for damage to South Africa. Furthermore, it settled Securities and Exchange Commission's (SEC) charges in the US in exchange for total payments of USD 460 million fines and civil penalties. In Switzerland, the head office settled charges for lack of due diligence in its organisation for an additional fine of CHF 4 million. The joint resolution by several countries is considered a model for further investigations in the future.

### **5. POST-COLONIALISM**

What do cases like these tell us? They show us how the so-called 'shadow economy' works: Typically, Multinational Enterprises (MNEs), based in former colonial countries, in superpowers or in freeriding countries, like Switzerland, prolong what they had been doing all along during their colonial reign; They bribe the new elites to gain access to commodities or to contracts. These elites are all too frequently happy to sell the riches of their countries for private gain. Beyond ABB, I could give you several further examples.

## **6. GLENCORE**

A well-known case, Glencore (another MNE with its head office in my country), is another good example: An intermediary, close to the President of the DRC, helped Glencore to obtain mining concessions in copper- and cobalt-mines in the Katanga province. What is more, he helped Glencore to prevent a dramatic rise in royalties. Glencore was able to deprive DRC of the necessary taxes to fund its public budget. We are talking of illegal profits of around USD 500 million per annum. That would be about the size of the education budget of DRC.

Now, Glencore managed to maneuver out of difficulties by settling the lawsuits. They paid overall USD 1 billion in fines and compensation. However, compared to the huge profits this company was able to make, especially in the area of coalmining, and as a consequence of the worldwide energy crisis, these legal costs were easily absorbed: Glencore was still able to distribute USD 8.5 billion to shareholders during the same year.

So, law enforcement does work, but it is not necessarily tough enough to keep such giant players at bay!

## **7. THE MOZAMBIQUE TUNA FLEET**

If you need an example of how to illegally access a contract, the phantom Tuna fleet of Mozambique could help: A Swiss bank (together with a Russian bank) funded fake contracts. In order to obtain loans of over USD 2 billion, Mozambique had to stand guarantor. The necessary signatures were obtained from officials, through blatant breach of national laws (without the necessary parliamentary approvals), by way of corruption. In the end, not only the investments proved useless, the tuna fleet never left the harbour, but the entire state finances defaulted. The case is still ongoing in several national courts worldwide and in arbitration tribunals. Key figures, like the son of the then President of Mozambique, have been sentenced to long prison sentences.

## **8. THE ROLE OF TAX HAVENS**

Now, corruption is frequently merely the first step of the vicious cycle; Where local taxes are evaded, the profits frequently are transferred to tax paradises, typically in the Caribbean's,

where the tax rate is close to zero (Glencore's behaviour in Zambia is an example, just think of Mopani copper mine). The funds are then transferred through special purpose vehicles, offshore companies, doing no business at all, but helping to hide the funds and to funnel the profits back to the head office of the MNE, e.g. in Zug (Switzerland).

## **9. HIDING THE BRIBES**

But the story also has a continuation with the elites and their helpers. In the countries of the Global South, there will be an army of bagmen helping to collect the bribes (just as it happened in the ABB case in South Africa). The funds will then be transferred by more sophisticated financial operators to large financial centers of the North (London, New York or Switzerland) – now we are in the real heart of darkness.

## **10. BUILDING STRUCTURES**

Take Geneva as an example. A lawyer will: Under the protection of his professional privilege create a so-called structure for the bribe takers; Acquire shell corporations from enablers at OFC's (you have read all about Mossack Fonseca of Panama). For these corporations bank accounts will be opened, best at other locations yet, like with banks in Cyprus. So, you have overall a triple protection: legal privilege; corporations at locations allowing nominee directors to be registered instead of the genuine owners; and finally bank secrecy in countries with little inclination to grant mutual legal assistance.

## **11. HIDING THE BENEFICIARY**

Now, the lawyer in Geneva would never touch the money. He would see to it that a fiduciary makes its hands dirty. The lawyer's role is essentially to hide the name of the beneficial owner of the structure.

## **12. HOW TO BREAK THE VICIOUS CYCLE?**

What can we do to break this vicious cycle? As much as the crooks in the Global North and South share roles, the North and the South both have a task to fulfill. First of all, international standards have evolved since the fall of the Berlin wall in 1990:

With the Financial Action Task Force (FATF), rules have emerged to prevent and to sanction money laundering. With a multitude of anti-corruption treaties (e.g. United Nations Convention Against Corruption (UNCAC), Organisation for Economic Co-operation and Development (OECD), African Union (AU)), national laws worldwide have been upgraded (you know all about UNCAC). The OECD Convention against Corruption in particular focuses on active commercial bribery from the Global North.

This is fine, but conventions need to be domesticated in national law and they need to be applied. Monitoring of country implementation helps, but much remains unsatisfactory, both in the North and in the South.

The problems are both in regulation and in the application of the rules. One of the key suggestions Joe Stiglitz and I made after the Panama Paper leaks, was to include the real beneficial owners in company registers and to oblige banks to know who the true beneficiaries of an account are down to an individual person.

By way of an anecdote let me briefly talk about our experiences in Panama. Panama was of course seriously affected by those leaks from the law offices of Mossack Fonseca. It became obvious that this was not just one official going astray. It was systemic. It was typical for the role of Panama in the shadow economy to create obscure company structures, shell corporations or even better shelf corporations with a “history” in any offshore center you can think of.

Now, the then President Varela, thought it a good idea to ask Joe Stiglitz and myself for external advice – *pro bono* of course. They were, however, uneasy so they linked us with a committee of reliable Panamanians, a former President, a former President of the Canal, a former Finance Minister etc.

It quickly became obvious that this was not a serious undertaking. When we came up with our suggestion to create a publicly accessible company registry containing the identities of the true beneficiaries, the game was over.

Having paraded us to the media at the beginning of the work, they simply kicked us out of the committee. This was not very wise since the world media was abuzz with accounts on “why we left Panama”. This is the only time I ever appeared in “Vanity Fair” on exactly that subject.

So, a next Public Relations catastrophe. However, the topic of transparency of beneficiaries has come back. It has developed into one of the key issues in fighting money laundering. The FATF has set clear standards, but not every country is able to follow them. Interestingly, the European Union (EU) was ready to impose transparent registries of beneficial owners on member states. Unluckily, the European Court has ruled that these registries should not be public except for certain professionals, for data protection reasons. At least they are now available to law enforcement. However, several financial centers have not yet implemented the new standards.

There is another challenge, as long as lawyers can hide the true beneficiaries of their structure behind professional privilege, we are not really making headway against the shadow economy.

Let's be clear: legal privilege has its justification when defending or advising clients. Building financial structures is, however, fiduciary work. It is not covered by attorney-client privilege, but merely by the far weaker confidentiality obligations of the financial operator. The trick – especially dear to Geneva based lawyers – is to act as architects of confidentiality structures under the cover of their attorney-client privilege. The criminals can afford expensive “enablers”.

### **13. RETURNING TO LOVELLS VISION**

Lovell was very much aware that fighting economic and financial crime is a joint task of the North and the South, since economic and organised crime is by nature global.

It is in my view no coincidence that his interests moved from transnational justice to economic crime. There is a direct link between systemic violations of human rights and economic crime. And Lovell was one of the first to see this link.

Three years after his premature death is an adequate moment to commemorate his way of looking at matters and to recognise him as visionary.

Thank you.