

Corruption Risks in Defence Procurement in Ukraine¹

Presented at the 2018 Danyliw Seminar,
Chair of Ukrainian Studies, University of Ottawa, 8-10 November 2018

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Draft: Not to be Cited Without the Author's Permission

Introduction

Ukraine's defence sector scored a 'D' overall in the most recent edition of Transparency International's Government Defence Anti-Corruption Index (GI 2018), signifying low transparency and a high risk of corruption. Defence procurement scored even lower and was highlighted as the most opaque and corruption-prone area in the defence sector. The annual budget of the Ministry of Defence for 2018 totalled 86.6 billion UAH (2.8 billion EUR) (VRU 2018). Out of this amount 32.7 billion UAH (1 billion EUR) (MoD 2018) is designated for procurement. Around 55 per cent out of this procurement budget is allocated for classified procurements, while the procurement of armament and military equipment is 95 per cent classified (MoD 2018). Military analysts interviewed for this report estimate that between 5 and 40 per cent of the budget can be stolen in case of classified procurement. Greater transparency and heightened controls are clearly needed to ensure that resources are better directed towards protecting civilians and soldiers.

Corruption can be detected and prevented. While corrupt deals can be complex and opaque, clear patterns and signs of problematic behaviour exist. In this preliminary report we have sought to identify the most common 'red flags' or signs of corruption,² by interviewing 35 well-placed sources and analysing over 47 incidences of alleged or proven corruption in Ukrainian military purchases made during the period 2014–2018. For each case, we asked two principal questions:

1. What 'red flags' might have alerted defence officials, civil society or oversight bodies that more scrutiny was needed?
2. What specific data should be released in the future to help prevent the most common types of corruption, or facilitate its identification by oversight actors?

Competition can be deliberately constrained

In a competitive market, too few bidders to an advertised tender, or a preference for a single bidder could indicate collusion—a corrupt agreement between companies in order to deliberately constrain competition in the procurement process. These collusive agreements can also include MoD officials. One or fewer than expected bidders can indicate "bid rigging," in which the bidders (a group of suppliers or a bidding company and government officials) determine between themselves who should "win" the tender, and then arrange their bids—for example, through schemes such as bid rotation, complementary bidding or cover pricing—in such a way as to ensure that the pre-designated bidder is selected by the purportedly competitive process.³

Defence ministries can have legitimate motives for restricting competition or awarding contracts on a non-competitive basis. For example, there may be only one supplier of a particular product, or the procurement could be extremely urgent or, for national-security reasons, the technology required must come from a trusted source. According to our research these legal exemptions are frequently exploited in Ukraine, with too many contracts being awarded without a full or even partial

¹ This research is co-authored by Eva Anderson and Dmytro Khutkyy and was conducted for NAKO, a joint project by Transparency International Defence & Security and Transparency International Ukraine

² Please be aware that for the purpose of this research "six red flags" refer to the most frequent corruption risk indicators in procurement by the Ministry of Defence of Ukraine.

³ For more on the practice of bid rotation, see OECD (2012).

competition and in classified circumstances. In these instances, the justification should be objectively verifiable to the public or an oversight agency. But in Ukraine, there is no current obligation on the MoD to justify why a supplier has been selected.

Specific 'red flag' warning signs

1. A high number of contract awards awarded to one bidder.
2. There are fewer than expected bidders to an openly advertised tender.
3. The window for bidding can be unreasonably short.
4. The ministry can accept a bid from a supplier with terms that do not favour the supplier, then subsequently renegotiates more favourable terms—suggesting the company and an official could have engaged in “low-balling.”
5. Bidders or bids that appear legitimate can be set aside, with an unclear or no justification.
6. The MoD can award the contract on a single source basis when a competition would be more typical, appropriate or economical.
7. Two or more competing suppliers can win contracts in a repetitive order, suggesting they are colluding in a scheme known as “bid rotation.”
8. Companies can submit bids that appear intentionally defective, uncompetitive or that they prematurely withdraw from the competition, often at the last minute, leaving one remaining bidder.
9. The winning supplier can provide benefits to a losing bidder after the award takes place—for example, make payments to the loser or hire it as a subcontractor or other service provider—suggesting that the two companies may have colluded to favour the winner.

A 'smoking gun'?

In November 2016, the Ukrainian MoD advertised a tender for 150 tonnes of “ДC-56”, a specific brand of camouflage smoke for military field operations: 50 tonnes of summer smoke and 100 tonnes of rain-resistant winter smoke, for UAH 5.3million (172,400 EUR) (ProZorro 2018a). There are no legal maximum, minimum or recommended timeframes in Ukrainian procurement law, however TI experts estimated that suppliers would need at least 14 days' notice, after the winner had been announced, in order to produce and deliver two versions of camouflage smoke in such large amounts (TI Ukraine 2017). The tender gave a short 7-day deadline for the winning supplier to deliver 150 tonnes of ДC-56 brand camouflage smoke (ProZorro 2018a). Only one bidder applied for the tender—Alpha Ltd (ProZorro 2018).⁴ Transparency International Ukraine publicly questioned the tender and the short deadline. The Military Prosecutor's Office announced a criminal investigation and its initial findings on the case (MPO 2018):

- 1) The camouflage smoke delivered by Alpha was not brand ДC-56, as had been specified in the tender.
- 2) MoD officials had not tested Alpha's camouflage smoke prior to completing the acquisition.
- 3) The camouflage smoke did not fulfil the function it had been purchased for, namely it does not camouflage soldiers for a minimum of 30 minutes, as had been specified in the tender.

The Military Prosecutor's Office reported that Alpha's camouflage smoke was designed for film productions and theatre sets, and it could fulfil no useful purpose for military operations. A criminal investigation into misuse of defence budget funds continues (MPO 2018).

What specific data could prevent this 'red flag' corruption risk?

There are significant discrepancies in the amount of data that the MoD releases for classified and non-classified procurements—no useful information is published on classified procurement. This is ostensibly for national security reasons, but much of the information that oversight actors require to identify corruption has no or very little impact on national security. For example, the numbers of bidders, a description of the product/service, and number of tenders awarded to an individual supplier are released for non-classified procurements in Ukraine but not for classified procurements. This opacity significantly heightens the risk of corruption in classified procurements. Yet this data is

⁴ The legally registered beneficial owners of Alpha Ltd. are Tetiana Skoryk and Oleksandr Skoryk (Opendatabot 2018)

routinely released by many other states, such as the United States, UK and the Netherlands, for classified and non-classified procurements. The MoD needs to develop internal, publicly available guidelines on how to conduct pre-tender market research, formalise technical requirements, perform due diligence on bidders and classify information.

For all procurements, including classified procurements, the MoD should publish the following information, within 20 days of the award:⁵

1. The legal names of bidding and winning companies (released post-award), contract number, modification number, description of what is being bought, length of time tender was advertised for, length of time stipulated in the tender between contract award and expected delivery/completion, the winning bid price (released publicly immediately after—not before—the contract award).
2. In aggregate, the number of tenders awarded to a supplier, the total contract value over a three or 12-month period, the dates of award and the awarding official.
3. The names of sub-contractors, agents and consultancies used/employed under the contract.⁶

An official may intervene in the procurement process to favour, unjustifiably, a particular company

An official can use their formal or informal role in the procurement process to alter, or attempt to alter, the outcome in favour of a specific company. In many cases, the favoured company will not appear to be the most qualified, or it will not offer anything that advances the public interest in it being selected. This increases the likelihood that the official has intervened because they or someone in their political, social or business networks has an interest in the company, or that the company has paid the official for their help.

Specific ‘red flag’ warning signs

1. An official can take irregular or unreasonable steps to ensure that a company is allowed to compete. For example, they might grant the company an exemption from an open, competitive tender, or from the prequalification or testing process.
2. A company can be granted a contract directly, without engaging in a competitive process.
3. An official can take unusual steps, for example by narrowing the technical specifications, to ensure that a company is the only supplier able to compete under the revised offer terms.
4. An official can give a winning or competing company preferential access to confidential information to use in crafting its bid.
5. An official with final or high-level decision-making authority can override the outcome of the procurement process, or otherwise alter the decision of the officials originally charged with selecting the winners.
6. The conduct of the procurement process can depart from the government’s established rules, standards or criteria, and/or exhibits a high or unusual degree of discretion and/or secrecy.
7. An official with influence over the award can suggest, recommend or require that the company partner with another company to apply for the contract or a sub-contract, effectively creating a “forced marriage.” This can particularly be of concern when the company imposed by the official is less experienced, offers less sophisticated equipment or has political connections.

Talanlehprom’s Boots

In 2016, the Ministry of Defence, through a series of 12 tenders, purchased 245,000 army boots worth 355 million UAH (11.5 million EUR) (TI Ukraine 2017). There are many suppliers in the Ukrainian market but only one company, Talanlehprom Ltd, bid for and won the tenders (ProZorro

⁵ 20 days is the current timeline for releasing these datasets for non-classified procurements.

⁶ Currently, if a sub-contractor performs over 20% of the contract, it should be indicated in the contract between the supplier and the MoD, it is not clear if this information is verified. This data is not provided in classified procurements.

2018c). Two other suppliers submitted formal complaints to the MoD citing an unreasonably short period of time in which to compete for and produce the boots: the MoD had given a deadline of six days in which suppliers had to compose and file 52 documents, produce and confirm bank guarantees, produce, present, and arrange for the MoD to approve two separate boot designs (ProZorro 2018c). The MoD refused to extend the deadline (ProZorro 2018c). In order to fulfil the contract conditions the winning bidder would have to produce a pair of boots in less than 3 minutes, working 24 hours a day, 7 days a week, assuming that the supplier already possessed all the required materials stipulated in the tender (TI Ukraine 2017). Talanlehprom renegotiated and extended the production and delivery timelines for 24 of 25 contracts it won, to enable it to complete the order (TI Ukraine 2017). The final price agreed between the MoD and Talanlehprom was approximately double the market cost for this product (Interview 17).

One alternative supplier appealed to the Ukrainian Antimonopoly Committee citing discriminatory requirements—the technical requirements detailed in the tender advertisement could only be provided by one company: Talanlehprom Ltd (ProZorro 2018c). The complaint was terminated and the supplier received no response from the Committee as to why it was terminating its appeal (ProZorro 2018c).

According to MoD sources interview for this report, the boots had been requested by the Centre for Material Provision of the Armed Forces of Ukraine, which had set out a much more generic technical specification for the boots than the final specification which was issued (ProZorro 2018c). The Centre's more generic specifications would have enabled many more companies to bid. We have been unable to establish why these technical requirements were then narrowed by the Tender Committee of the MoD.

What data could prevent this corruption risk?

The Ukrainian defence procurement cycle is too opaque and there is no current obligation on the MoD to justify why a supplier has been selected. Nor are there any legal consequences for a supplier that submits false data to the MoD. By releasing the following specific data sets, the MoD could better prevent corruption or collusion, and better facilitate its identification.

These datasets are released as standard in most countries in the European Union and in the United States.

1. The MoD should publish confirmation of:
 - a. Which companies have been granted a contract directly, without engaging in a competitive process.
 - b. The tender procedure elected for completed tenders (open, negotiated or single sourced for example).
 - c. Under which legal criteria the exemption to an open competition has been granted, and the legally valid reasons for selecting a 'negotiated' procedure or a direct award procedure, and the names of the justifying official/s.
2. At the time of submitting a bid, the bidding company's CEO should make available for publication a certified confirmation that the company, its owners and senior directors fulfil all prequalification requirements.
3. The MOD should also publish a certification from the lead procurement official that the winning company fulfils all prequalification requirements.

The winning bidder may have a shareholder or other business relationship with a politically exposed person (PEP)

Procurement officials and oversight actors should always take a closer look when a ministry does business with companies that have politically exposed persons (PEPs) as legal shareholders, as a conflict of interest can often arise. The presence of a conflict of interest is not a definite sign of corruption. But it does significantly heighten the risk that the official could use their entrusted power in ways that undermine the award's integrity or potential returns to the state. The more powerful

the PEP, the more likely it become that their role in the process could weaken built-in checks and balances.

In many jurisdictions, PEP-owned or managed companies are either prohibited from competing for government contracts or face higher levels of scrutiny. But there may be other, more indirect channels through which PEPs connected to the supplier can benefit. A supplier might channel payments to the PEP via a third-party business relationship, such as a consultancy or a subcontractor.

Uncovering such a situation requires scrutiny, as the third-party business relationship could be a conduit for transferring funds to the PEP—especially if the payments exceed the value of the service provided. It may be that the legal shareholders of the supplier or sub-contractor are not easily identifiable, in combination with other factors this may point to a hidden beneficial ownership by a PEP, which requires closer review. As well as seeking certified disclosure from the supplier of their beneficial owners, it may be necessary to scrutinize all entities in a company's ownership structure, given that PEPs sometimes hold their interests indirectly—e.g. through an offshore subsidiary or holding company structure.

Specific 'red flag' warning signs

1. The PEP may fail to disclose conflicts of interest and/or fail to recuse themselves from the selection process.
2. A PEP may be a legal shareholder in a company or sub-contractor which is selected for tender and therefore entitled to dividends or some other share of its earnings. Similar conflicts might exist where an individual has familial, personal, political, business or other close financial ties to a PEP who is a shareholder, director or officer in the company and could mean the individual is a proxy or "front" for the PEP.
3. The supplier's shareholder structure may include a chain or network of shell companies, or a complex holding company structure, which obscures who ultimately owns or controls the company. For example, through nominee shareholders, bearer shareholders, unissued shares or a trust.⁷
4. The supplier may engage a PEP or his/her firm as a consultant or service provider.
5. The PEP may be able to exert influence over decisions at multiple points in the selection process, either by occupying more than one decision-making role, or by holding positions in more than one of the official bodies involved.
6. A PEP or his/her company may provide the supplier with a loan agreement, promissory note or other debt instrument.

Bogdan Corporation's network of PEPs

The Bogdan Corporation is a significant supplier to the Ukrainian defence sector. Most of the tenders it receives are not competitively tendered, but direct, classified procurements where Bohdan is the only competitor for the contract.

In 2009, Petro Poroshenko sold his controlling stake in Bogdan Corporation to his business partner, Oleg Hladkovsky (NSDCU 2018). From July 2012 until February 2015, Hladkovsky was President of the Bogdan Corporation (NSDCU 2018). In August 2014, (shortly after Oleg Hladkovsky changed his name from Oleh Svyarchuk) Poroshenko appointed Hladkovsky as Chairman of the Interdepartmental Commission for Military-Technical Cooperation Policy and Export Control (NSDCU 2018). Hladkovsky is currently First Deputy Secretary of the National Security and Defence Council of Ukraine (NSDC) (NSDCU 2018). There is a very obvious potential conflict of interest when the controlling stock of a significant single-source supplier to the MoD was recently owned and

⁷ Nominee shareholders: Corporate records may explicitly identify the individual as a nominee, or he/she may exhibit common characteristics of nominee, for instance being a shareholder or director in numerous other entities; working for a law firm, corporate services firm or other business that specializes in creating shell companies or managing private wealth. Trust: for example, a list of shareholders for the company, whether contained in a corporate filing or some other official document, does not fully account for all of the company's issued shares, or the company's shareholder structure includes a significant block of authorized but unissued shares. In some, though certainly not all cases, this could raise suspicions that the company is holding the block of shares in reserve for a PEP.

controlled by the current head of a government body charged with governing the defence sector of Ukraine."

The network of PEPs currently or recently managing Bogdan's subsidiaries is also extensive, for example PSC 'Plant 'Kuznya on Rybalsky' which manufactures 'Giurza-M' armoured boats is owned by President Poroshenko and MP Ihor Kononenko.⁸ Yet these links did not appear to trigger a thorough due diligence process to ensure any conflicts were identified and avoided. At the very least, the MoD could have sought to avoid corruption risks by ensuring these tenders were not single-sourced and by providing an objectively verifiable, public justification for why these companies have been selected as MoD suppliers.

In addition to close PEP-ties, we identified a number of additional red flags surrounding Bogdan Corporation's awarded tenders. For example, during 2015-2017, the MoD purchased six 'Giurza-M' armoured boats (Censor.net 2018) (Segodnya 2017). The Navy had highly specialised requirements: the boats were meant to be loaded with a 30-mm automatic cannon, 30-mm automatic grenade launcher, a 7.62-mm machine gun and two missile systems (Segodnya 2017). PSC 'Plant 'Kuznya on Rybalsky' was a commercial shipyard, with no previous experience constructing military grade armoured ships (Interview 22). The 'Giurza-M' reportedly failed testing in a number of areas including: defective construction, insufficient speed to operate well at sea and issues with firing (Interview 22). It is therefore not clear why the MoD chose to procure these boats directly when a negotiated procedure could have ensured a degree of competition, reflecting price, national security and quality criteria. It is also unclear why the MoD pressed on with this purchase despite the perceived issues around conflict of interest and inability to pass military testing.

Bogdan's Chinese Pickup Truck Ambulances

Bogdan Corporation participates in at least 12 current acquisitions programs for the MoD, including armoured vehicles and ambulances, produced by a subsidiary, Automobile Company Bogdan Motors PJSC. In January 2017, the MoD's website reported that the Bogdan-2251 ambulance had been approved by the State Scientific Testing Centre as able to perform all types of off-road rescue operations (MoD 2017). In a classified, non-competitive tender procedure, the MoD purchased 100 ambulances for USD\$ 32,000 per vehicle (Novoye Vremia 2018). A high price given the refurbished vehicles were built on the chassis of a Chinese-manufactured pickup truck (Interview 4).⁹

During the first year of operation, 50% of the vehicles broke down, which was confirmed by the MoD's Volunteer Council (Interview 22) (Ukrainian Pravda 2018b). It subsequently emerged that the testing conditions had not included ice or snow (TI DS and TI Ukraine 2017). The pickup truck chassis had a load capacity of 1,000 kg. An ambulance medical cabin weighs 600 kg, leaving room for 400kg of load (TI DS and TI Ukraine 2017). A medical team usually consists of 6-7 staff (1 driver, 1 armed escort, 2 paramedics and 2-3 wounded), not including medical equipment (TI DS and TI Ukraine 2017). To be operational the vehicle would be constantly overloaded, increasing the likelihood of breakdowns (TI DS and TI Ukraine 2017).

Bogdan blamed the technical failures on low-quality fuel, improper usage and violations of the service condition (Ukrainian Pravda 2018a). MP Oksana Korchynska, claims that Bogdan Corporation demanded extra payment for repairing the malfunctioning ambulances (Ukraina Moloda 2018). Sources we interviewed say these defects would have been apparent at the testing stage; yet the purchase was approved (Interview 3).

A military ambulance is a dual-purpose product, which can be produced by a civil manufacturer (as it was in this case) and does not feature any unique military technology; the majority of the vehicle is made from reassembled, refurbished parts. The ambulances could have been purchased via an

⁸ According to the information of Mind.ua outlet, the plant is owned by the President Petro Poroshenko and his business partner MP Ihor Kononenko (Mind.ua 2018). An official information request via the Unified State Register of Legal Entities and Individuals Entrepreneurs of Ukraine (MoJ 2018) revealed that as of 1 June 2018 PSC 'Plant 'Kuznya on Rybalsky' is managed by Shandra Valerii Oleksandrovych. Nevertheless, according to an official information request via the Unified State Register of Legal Entities and Individuals Entrepreneurs of Ukraine (MoJ 2018), as of 1 June 2018 both Ihor Kononenko and Petro Poroshenko were ultimate beneficial owners of the PSC 'Plant 'Kuznya on Rybalsky'.

⁹ "Great Wall Wingle 5" pickup truck model.

open, competitive tender which would have enabled other suppliers to compete and win on the basis of best price—several suppliers were in a position to compete for the tender.¹⁰ Alternatively, a ‘negotiated procedure’ would have enabled procurement officials to judge both price and quality criteria. Before announcing the tender, the MoD had invited several potential ambulance suppliers to discuss the MoD’s operational requirements, obviating the need to make this a single-source procurement (TI DS and TI Ukraine 2017). One source told us that Bogdan had been selected as a supplier before Bogdan’s ambulance models had been produced or tested and even before the MoD had met with the other suppliers (TI DS and TI Ukraine 2017). The MoD has refused to release any information on the tender to the NAKO, and we can find no obvious need for this to be a classified, single-source purchase.

What specific data could prevent this ‘red flag’ corruption risk?

1. The published names and positions of officials who have played a formal or informal role in the decision-making process, and published confirmation by the Defence Tender Committee, for each tender, that any person connected to the development or award of contracts who holds a conflict of interest has been identified and segregated from the decision-making process.
2. Confirmation of all legal, beneficial shareholders including for proposed (and later confirmation for employed) sub-contractors and consultants. Detailed to all +5% beneficial owners.
3. Whether there are any financial ties to a PEP or defence official/their family or business associates through a shareholder, director or officer in the company or proposed sub-contractor, and if so, the PEP's name and relationship to the company.
4. Confirmation from the bidders as to whether a PEP or one of their associates has provided the supplier with a loan agreement, promissory note or other debt agreement.

The MoD can allow an unqualified or hostile state supplier to win and deliver a contract

When a supplier that does not have sufficient technical, operational or financial capabilities wins an award, it is unlikely to be the best choice for effectively executing the contract. The supplier may have been allowed to compete or prevail for an illegitimate reason—because it paid an official with influence over the award or has financial ties to a Politically Exposed Person (PEP), for instance. In most cases, unqualified suppliers are likely to be motivated by financial gain. But this might not always be the case. A senior source at Ukroboronprom reports that suppliers located in, or owned by hostile state agents regularly bid for tenders, posing a serious national security risk to the Ukrainian state, either because suppliers are ‘shell’ companies, taking part in a procurement to thwart delivery of required products and services, to provide counterintelligence, or to intentionally provide defective equipment to troops (Conversation 2018). A thorough due diligence process will enable defence officials to analyse how experienced and appropriate a supplier is, as well as identifying any company or principal links to a potentially hostile state.

Specific ‘red flag’ warning signs

1. The supplier may fail to meet the ministry’s pre-qualification standards or other guidelines for the selection process, but be selected anyway.
2. The supplier and/or its principals may have no prior relevant work experience, little or no industry reputation or name recognition.
3. The company may have been incorporated or otherwise legally registered only shortly before, or even after, the award. It may appear that the company was set up specifically for the contract. It may have close links to a potentially hostile state.
4. The company might not have the basic capabilities or assets needed to contribute, including manpower, finances, equipment or technical skills. Additional concerns

¹⁰ ‘BUICK’ Production Company (PC), ‘KrAZ Scientific and Production Company’ LLC, ‘Diatech-Ukraine’ LLC, and ‘Praktika’ PJSC were initially consulted by the MoD (TI DS and TI Ukraine 2017).

could arise if the company's finances are thin and it has submitted no financial guarantee, balance sheet, audited accounts or credit rating.

5. The supplier might not show other basic attributes of a functioning business— for instance, a physical address or office space, staff or a website.

AV-Pharma's deadly tourniquets

All operational combatants should carry at least two tourniquets at all times. Used to stop traumatic bleeding, tourniquets can prevent the loss of limbs or death from internal bleeding. A faulty tourniquet can be lethal. In autumn of 2015, the Ministry of Defence purchased 30,000 tourniquets from AV-Pharma (TI DS and TI Ukraine 2017). AV-Pharma had not been operating for long—the company started producing tactical medical products in 2014, one year before it was awarded the tender (AV-Pharma 2018). While the tender was being arranged with AV-Pharma, military conscripts reported that AV-Pharma's tourniquets broke when subject to pressure—on average in 60% of the cases where they were used (Dn.depo.ua 2016). The inferior quality of the purchased tourniquets was confirmed by the volunteers of the Medical Committee of the Association of People's Volunteers of Ukraine (Facebook 2015). The Committee highlighted as problematic the low standards prescribed in the technical specifications and that testing had not been conducted into how the tourniquets would be used in combat zones (Facebook 2015).

TI Ukraine identified a number of other reputable suppliers who were available to provide high-quality tourniquets. One competitor interviewed reported initially participating in the tender, but was unable to comply with the short time period for delivery stipulated in the tender and so withdrew its bid (TI DS and TI Ukraine 2017).

Military conscripts appealed to the MoD's Military Medical Department and to the Minister of Defence, Stepan Poltorak, citing bribery of defence officials (Dn.depo.ua 2016). Despite these reports, the 2015 purchase was concluded and a further tender for 50,000 tourniquets was issued a few months later, in April 2016, using exactly the same specifications, which had initially led to the procurement of faulty tourniquets (Dn.depo.ua 2016). There has been no inquiry into why this tender was concluded despite failing to pass testing, or the number of deaths and injuries caused by the faulty tourniquets in field operations.

What specific data could prevent this 'red flag' corruption risk?

- 1) The supplier should certify (and the MoD should publish) the names and nationalities of company principals and beneficial owners its legal name, date and country of incorporation, credit rating, audited accounts, website and registered address. This information should also be certified and published for significant sub-contractors and consultants employed by the awarded contract.
- 2) The MoD should publish its pre-qualification standards and guidelines for the selection process, including how suppliers' submissions are evaluated.
- 3) Scoring/award criteria applied to submissions and justification for selection of the winning bid should be published, including for classified procurements.

The agreed terms of the award can deviate significantly from industry or market norms

If the terms of a final contract agreed between the MoD and a supplier depart significantly from expectations, past examples or industry norms, this should warrant extra scrutiny from oversight actors. Ukrainian law stipulates that the unit price in contract price can increase up to 10%, otherwise the tender competition must be repeated. Other than this there is no general rule for how much deviation is too much; only close scrutiny of the sector and country context can be used to make an informed judgment.

Most defence ministries require any contract modifications to be fully justified to the procurement official's line manager. This helps to ensure a procedure of internal checks and balances, as well as accountability during a later audit or investigation. This is problematic in Ukraine, where the

identities of officials who played a role in the tender award are usually hidden, frustrating attempts by enforcement officials to identify possible wrong-doing.

Judging whether the MoD received fair value for a sophisticated weapon or piece of technology is not necessarily straightforward. Many deals are products of negotiation. Corruption is by no means the only reason why final terms may favour the winning company more than the government. For example, officials might not have done a good job managing the award process or calculating whole-of-lifecycle costs for a tank that requires frequent servicing and unique parts. They may have set terms too low or negotiated poorly, based on limited experience, information or negotiating power. Corruption risks related to this red flag can be significantly higher when none of the reasons above are evident, as well as when other red flags are present, for example if an unqualified company with signs of hidden PEP ownership won a contract with highly preferential terms.

Specific 'red flag' warning signs

1. The final terms may include prices that are substantially lower or higher than market price.
2. The terms or prices of the final award or amended contract can be significantly more favourable to the company than those that it and the ministry initially agreed, or more favourable to the supplier than those from similar deals signed by the government, yet market conditions have not significantly changed.
3. One or more terms of the contract can be changed shortly before signing, in a manner that favours the supplier.
4. The responsible defence agency may fail to assess the market value of the contract it is awarding.
5. The winner's bid may be substantially higher or lower than ministry's own assessed value for the contract, or deviate widely from the bids made by other companies. Suspicions may be stronger if the ministry's value assessment appears realistic and based on sound technical analysis, rather than simply an opening position in negotiation.
6. The final award can show significant deviations from existing law or regulation, or from the model contract used during the selection process.
7. The final terms can include non-standard provisions that reduce the winner's obligations or make the deal more valuable to the winner. These could include excessive tax holidays, unclear or skewed currency conversion formulas or rates, unusually long payment windows, debt guarantees, or other non-standard financial support from the government to the winner.

Trade Commodity's winning style

Immediately before e-procurement reforms were introduced in April 2016 making defence procurement more transparent, the MoD awarded a number of valuable diesel and jet fuel tenders to Trade Commodity Ltd.¹¹ Trade Commodity was awarded 14 out of 15 tenders in a short period, worth over 1.2 billion UAH (39 million EUR) (DoZorro 2017). Before this, from 2015 to 2016, the MoD had also awarded Trade Commodity fuel contracts worth over 2 billion UAH (65 million EUR) (DoZorro 2017). In a highly competitive market, with 40 companies offering fuel of the same quality with only small differences in pricing, a 93.3% winning rate for a single supplier is abnormal (Minfin 2018).

In June-August 2016, the MoD and Trade Commodity signed several further deals for diesel fuel (NV Business 2017). According to the National Anti-corruption Bureau of Ukraine (NABU) these contract amendments increased the price awarded to Trade Commodity by 16% per unit, compared to the initial value of the signed contracts (DoZorro 2017). According to law, a price increase of more than 10% per unit should have triggered a new tender competition for the contract (VRU 2015). Instead the MoD continued with Trade Commodity as its chosen supplier, agreeing to pay the higher price quoted by the company.

¹¹ The online e-procurement system ProZorro was introduced 1 April 2016.

Ukraine's National Anti-corruption Bureau of Ukraine accused Trade Commodity of colluding with defence procurement officials to embezzle 149 million UAH (4.8 million EUR) (Bihus.info 2018). Four defence officials were questioned, including the Deputy Minister of Defence, Ihor Pavlovskiy; the Head of Defence Procurement, Volodymyr Hulevych; the Head of Fuel Supply, Borys Malys; and a senior inspector from the Internal Audit Department, Volodymyr Shemovniev (Bihus.info 2018). Two senior employees from Trade Commodity—including the CEO Vadym Maiko—fled Ukraine and are currently subject to an international Interpol warrant for their arrest (Bihus.info 2018).

What data could prevent this corruption risk?

1. For each tender, the MoD should publish its own 'assessed value' for the contract when advertising or inviting parties to tender, including the market price information used to guide the assessed value, including for classified procurements.
2. The MOD should share all national security sensitive procurement data and contracts with independent, security-cleared internal and external oversight agencies, such as internal and external audit, and a parliamentary committee.
3. The MOD should publish all national security sensitive procurement data and contracts once the classification period has expired.
4. The signed contract (uploaded as an attachment, with national security sensitive items redacted) and any revised contracts should be published online by the MOD, noting any agreed changes in price, delivery time and post-tender award changes in terms and conditions.

A company or individual with a history of anti-competitive behaviour wins an award.

A company involved in the award process, or an individual with an ownership interest in it, may have a reputation for, or a record of participation in, corruption, collusion or other relevant unethical misconduct. This could suggest that the company or individual has a propensity to engage in problematic business practices, or that officials treated them with favouritism. The level of scrutiny prompted by this red flag should depend on factors such as the reliability of the evidence or how often the company or individual has been accused.

Specific 'red flag' warning signs

1. The company, owner or a senior director may be under suspicion, investigation or indictment for anti-competitive practices or criminal activity, in Ukraine or elsewhere.
2. The company, owner or a senior director may have been convicted of criminal activity or violations of other relevant laws, in Ukraine or elsewhere.
3. The company, owner or a senior director may have a record of failing to perform contractual obligations or other adverse legal activity that suggests unethical business practices.

Wog Aero Jet's anti-competitive practices

On 28th November 2016, the MoD's Tender Committee conducted negotiations with Wog Aero Jet Ltd and three other companies who bid for two large diesel fuel tenders (ProZorro 2018b). Two weeks later, on 2nd December, Wog Aero Jet was awarded both tenders to supply over nine tons of diesel fuel worth 190 million UAH (6.2million EUR) (ProZorro 2018b).

Wog Aero Jet had been convicted and fined for price fixing and collusion in three separate cases by the Antimonopoly Committee of Ukraine (AMCU), which had opened a further investigation into the company (Biz.NV 2018). Despite this, the MoD conducted the tender very quickly. The MoD also chose the bidder via a 'negotiated procedure' rather than an 'open tender', where the lowest price bidder would have automatically been selected. It is not clear why the MoD chose to avoid an 'open tender', which would have guaranteed the most economic price for the government.

Within the same month, in response to a complaint filed by another bidder, the Kyiv Commercial Court banned the MoD from receiving diesel fuel from Wog Aero Jet (NV Business 2016). The court ruled that the MoD should terminate the contract Wog Aero Jet Ltd, which is reportedly close to

Yurii Biriukov, an assistant to the Minister of Defence and an Advisor to the President of Ukraine (NV Business 2016) (Interview 17).

The law empowers the MoD to conduct negotiations with bidders in order to assess how appropriate the company is as a government supplier. They should also conduct due diligence on the supplier, including what risks that supplier may pose to the MoD (VRU 2015). It is not clear on what criteria Wog Aero Jet were selected as the most appropriate bidder, nor why, given the company's previous convictions and fines for anti-competitive actions, it passed due diligence controls. Nor is it clear how routinely the MoD performs due diligence checks and, if it does, how this supplier evaded those controls.

Yet, it is known that in February 2017 the General Prosecutor's Office of Ukraine, acting in the interests of the state and the MoD sued Wog Aero Jet, and as an outcome, the court obliged Wog Aero Jet to reimburse MoD 10.3 million UAH (300 hundred EUR) (USRCD 2017). The company challenged this decision, but the Higher Court rejected her appeal (USRCD 2017).

What specific data could prevent this 'red flag' corruption risk?

1. At the time of submitting a bid, the bidding company's CEO should make available for publication a certified confirmation that the company, its owners and senior directors:
 - a. Do not have a record of failure to perform contractual obligations, or other adverse legal activity that strongly suggests corrupt business practices.
 - b. Are not under suspicion, investigation or indictment for anti-competitive practices, corrupt or criminal activity, in Ukraine or elsewhere;
 - c. Have not been convicted of criminal activity or violations of other relevant laws, in Ukraine or elsewhere.
2. When selecting a winning bidder, published confirmation from the MoD that it has performed due diligence to ensure the above statements are true.

Conclusion

Based on the results of this analysis, we identified six categories of red flags that appeared most frequently in these cases. These categories are summarised in this report, along with illustrative cases and specific recommendations on how to prevent and detect these corruption risks. This analysis could inform future reforms to the design of procurement processes by government officials, the conduct of due diligence checks by company and government actors, and the oversight activities of parliamentarians, journalists, NGOs, and law enforcement officials.

The six categories identified from the cases analysed are:

- Competition can be deliberately constrained.
- An official may intervene in the procurement process to unjustifiably favour a particular company.
- The winning bidder can have a shareholder or other business relationship with a politically exposed person (PEP).
- The MoD can allow an unqualified or hostile state supplier to win and deliver a contract.
- The agreed terms of the award can deviate significantly from industry or market norms.
- A company with a history of anti-competitive behaviour can win an award.

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