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The Panama Papers, corporate transnationalism and the public international order[1]

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I. Introduction

Acts of international delinquency perpetrated by politicians, state officials, organised crime and terrorist organisations, such as Al-Qaida, the Taliban, ISIL (Da'esh), have not gone unchallenged in the public domain. The UN Security Council and individual states have imposed sanctions on named individuals and various entities in response to the threats to international peace and security that their activities raise.

In recent decades UN, autonomous[2] and mixed sanctions[3] regimes have sought to make sanctions more effective through the 'targeting' of specifically individual persons[4] and corporate entities, otherwise known as 'smart' sanctions. This has involved the freezing of financial resources and other assets, travel bans and arms embargoes against pariah regimes, listed persons and other non-state actors in order to counter terrorism, defend human rights norms, stem the effects of criminal activity and prevent the proliferation of weapons of mass destruction.[5]

At times such public international law ordering has yielded moderate results. This may be because the smart sanction is not adopted promptly enough, thereby hindering the execution of an assets freeze, or else there is uncertainty about what constitutes an

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[1] This *ESIL Reflection* draws on a book project that examines the relationship between international and transnational economic governance.
[2] 'Autonomous' or non-UN sanctions encompass both economic sanctions and those of a general type, including targeted sanctions against individuals and legal entities.
[3] Mixed sanctions occur where there is a coincidence of UN and autonomous sanctions.
[4] The term 'specifically designated national' or 'SDN' is used by the US Government's Office of Foreign Asset Control (OFAC).
[5] See David Cortright, George A Lopez and Elizabeth S Rogers, 'Target Financial Sanctions: Smart Sanctions That *Do* Work' in David Cortright and George A Lopez (eds), *Smart Sanctions: Targeting Economic Statecraft* (Lanham, MD; Rowan & Littlefield Publishers, 2002), pp 23-40.

asset, or there is a lack of legal authority or the necessary institutional capacity to implement the smart sanction.

What is less appreciated is that certain offshore tax havens and banking centres have intruded upon the affairs of states, individuals and entities to frustrate international sanctions. For almost half a century principals and their intermediaries in certain 'offshore' jurisdictions have incorporated and operated a global network of 'nested' shell companies, which remained impervious to international regulation. Some of those jurisdictions have remained unwilling to cooperate with national and international authorities in conducting criminal investigations or in enforcing smart sanctions. Others have even made it their business to establish corporations designed to evade tax, launder money and flout sanctions regimes. Notwithstanding the data leaks that arose from earlier investigative journalism operations,[6] it was the publication of the Panama Papers in April 2016 that revealed the extent to which this form of transnational legal ordering[7] has been used to evade *inter alia* the binding force of sanctions regimes.

The contribution first offers a brief description of the Panama Papers. This is followed by an analysis of what the data leak reveals about offshore jurisdictions, which act as conduits for illicit financial flows by establishing companies whose owners cannot be traced, anonymous trust accounts and bogus charitable foundations. Significantly, the Panama Papers reveal that smart sanctions may be difficult or impossible to enforce where named individuals and entities on sanctions blacklists use secret offshore facilities to hide behind. The final section assesses the implications of the Panama Papers for the future of corporate transnationalism in offshore jurisdictions and the public international order.

II. What are the Panama Papers?

The Panama Papers refer to the leak of 2.6 terabytes of encrypted internal documents from the internal operations of Mossack Fonseca, a Panama City-based law firm, responsible for the incorporation of thousands of offshore entities. It began in early 2015 when Bastian Obermayer, a journalist at the *Süddeutsche Zeitung* (*SZ*) received a ping from an anonymous source with the message 'Interested in data?'[8]

The Panama Papers amounted to around 11.5 million internal files from Mossack Fonseca's offices, both in Panama and its overseas branches, and included a vast amount of corporate data, from the 1970s onwards. The files were delivered in real-time instalments to Bastian Obermayer and his fellow journalist, Fredrick Obermaier at *SZ*, who subsequently shared the data with the Washington-based International Consortium of Investigative Journalists (ICIJ), the British-based *Guardian* newspaper and the British Broadcasting Corporation (BBC).

The leaked data showed that Mossack Fonseca worked with more than 14,000 accountants, banks, lawyers, and company incorporators and other intermediaries to set up companies, foundations and trusts, registered at the Panamanian offices of

[6] Earlier leaks include *inter alia* 'Offshore Secrets China', 'Luxembourg Tax Files' and the 'HSBC Files'.
[7] See Terence C Halliday and Gregory Shaffer, 'Transnational Legal Orders' in Terence C Halliday and Gregory Shaffer (eds), *Transnational Legal Orders* (Cambridge, Cambridge University Press, 2015), p 11.
[8] Bastian Obermayer and Frederik Obermaier, *The Panama Papers: Breaking the Story of How the Rich & Powerful Hide Their Money* (London: Oneworld Publications Ltd., 2016).

Mossack Fonseca or one of its branches overseas. In Europe, these offshore service providers (often known as Trust and Company Service Providers or TCSPs) were concentrated in Jersey, Cyprus, Luxembourg, the Swiss Canton of Zug; outside Europe they were located in the BVI, Panama, the Bahamas, the Seychelles and the Pacific islands of Samoa and Niue.

The data haul mapped the activities of 214,000 offshore companies, including the names of their ultimate beneficial owners, i.e. real owners, as well as passport scans, chains of email and various bank statements. The Panama Papers data leak is a potent reminder of the post-millennium surge in transnationalism, which is characterised by the increased interconnectivity and internetworking of data, but so too is the way in which it was shared by around a global network of 400 journalists through cooperating media partners.

III. Analysis of the Panama Paper revelations

What is striking about the Panama Papers is the way in which the affairs of natural and legal persons, including state and government officials, have become entangled in a form of corporate transnationalism[9] that is linked to money laundering, tax evasion, fraud and sanctions busting, frequently facilitated by TCSPs. Some jurisdictions, like Panama and the BVI, hide behind a veil of secrecy and use complex legal structures involving shell companies, which cannot be traced back to their owners and render the beneficiaries unaccountable for their actions and obligations.

While there is nothing illegal in establishing a company in an offshore jurisdiction or providing offshore banking services, some of the activities behind such a company are clearly so. There is also nothing illegal about service providers, like Mossack Fonseca, hiring professional intermediaries to conduct business on their behalf. However, they remain responsible for conducting adequate due diligence on their offshore customers to prevent money laundering, the financing of terrorism and the evasion of sanctions regimes. The Panama Papers reveal widespread flaws in this regard. Mossack Fonseca's most egregious failing was not to check who the ultimate beneficiaries were of the companies that it established for its clients.[10] In many cases they were criminals and members of the Mafia, heads of state and government, sports and entertainment personalities, as well as wealthy business people.

The issue of beneficial ownership[11] and complex ownership structures is hardly new. A 2011 report for the World Bank's Stolen Asset Recovery (StAR) initiative studied 213 cases of grand corruption from around 80 countries, involving public officials or those with the ability to wield significant power or political influence.[12] It included 150

[9] Peer Zumbansen, 'Neither "Public" nor "Private", "National" nor "International": Transnational Corporate Governance from a Legal Pluralist Perspective' 38 (2011) *Journal of Law & Society*, 50, 52.
[10] *The Panama Papers*, p 110, records that of the 14,086 companies that Mossack Fonseca established in the Seychelles it only knew who the real owner was in 204 cases.
[11] According to the Financial Action Task Force (FATF) 'beneficial owner' refers to 'the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted.' It also covers 'those persons who exercise ultimate effective control over a legal person or arrangement.' *Glossary of the FATF Recommendations* at http://www.fatf-gafi.org/glossary/.
[12] Emile van der Does de Willebois et al, *The Puppet Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It* (Washington, DC: World Bank, 2011).

instances of beneficial ownership. What the Panama Papers uncovered in Mossack Fonseca's files were the names of beneficial owners and details of nominee directorships, involving frontmen or women, acting on behalf of the real owners of incorporated entities, who otherwise remained unidentified.

A real dilemma in the public international order is how to hold to account heads of state and government, as well as senior government officials, for sanctions busting when they are operating under the cover of an elaborate network of anonymous shell companies in offshore jurisdictions like Panama or the BVI. The problem was highlighted by the Democratic People's Republic of Korea (DPRK) when the UNSC imposed wide-ranging and potentially crippling sanctions against the DPRK in March, 2016 for its nuclear testing and missile development programme. Unusually, and this was prior to publication of the Panama Papers, UNSC Resolution 2270 warned against the frequent use of 'front companies, shell companies, joint ventures and complex opaque ownership structures for the purpose of violating' sanctions and '*directs* the [Sanctions] Committee … to identify individuals and entities engaging in such practices'.[13]

Yet the North Korean Sanctions Committee had no idea how the DRPK was able to hide behind such structures until the disclosure by ICIJ team-member, *The Guardian* newspaper. It showed that Mossack Fonseca had provided assistance to the DPRK in establishing a Pyongyang front company, DCB Finance Limited, registered in the BVI, with links to the North Korean, Daedong Credit Bank.[14]

The Panama Papers leak reinforced *The Guardian*'s findings when it was able to show that Mossack Fonseca had ties to some 22 individuals who were subject to sanctions because of their support for regimes in North Korea, Russia, Syria and Zimbabwe. Previously they had remained hidden behind a complex maze of dummy companies and trusts that concealed personal and bank account details from the prying eyes of investigatory authorities and enforcement agencies.

Of the more prominent links between Mossack Fonseca and heads of state are those to Vladimir Putin through the Rossiya Bank, a private bank established in the Russian President's home town of St Petersburg, acting through the Russian cellist, Sergei Roldugin, as a slush fund for Putin's inner circle.[15] Many of 'Putin's innermost circle' of confidants, and the Rossiya Bank itself, appeared on US sanctions lists, following the Russian Federation's annexation of Crimea in 2014.[16] The Panama Papers revealed that Roldugin was the sole owner of Panama-based, International Media Overseas SA, which acted for the Rossiya Bank through other 'on-shore' companies and banks in Switzerland.[17]

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[13] UNSC Resolution 2270, adopted by the Security Council at its 7638th meeting on 2 March 2016, S/RES/2270 (2016) condemning the Democratic Republic of North Korea for its 6 January 2016 nuclear test in violation of earlier UNSC resolutions UNSC R1718 (2006), 1874 (2009), 2087 (2013) and 2094 (2013).

[14] Jack Hands, 'The Panama Papers Underscore the Futility of North Korea Sanctions', *The Diplomat*, April, 06, 2016, at http://thediplomat.com/2016/04/the-panama-papers-underscore-the-futility-of-north-korea-sanctions/.

[15] *The Panama Papers*, chapters 2 and chapter 26.

[16] E.O. 13661 of March 16, 2014 — Blocking Property of Additional Persons Contributing to the Situation in Ukraine, Federal Register, 79 Fed. Reg. 53 (March 19, 2014).

[17] *The Panama Papers*, pp 20-21.

In the case of Syria, a connection between the regime of President Bashar al-Assad and his cousin, Rami Makhlouf, and various Makhlouf family members, already existed because they appeared on US and EU sanctions lists up until 2011.[18] However, it was not until July 2012 that a corporate relationship to Makhlouf appeared with the addition of Drex Technologies, a BVI-registered company, to the US sanctions list.[19] The Panama Papers went a step further in disclosing that Mossack Fonseca had been running a web of shell companies, one of which was the Panamanian company, Drex Technologies SA, and which was linked to Makhlouf family members, who formed part of the Syrian regime. The Makloufs were known to have been involved in acts of torture and genocide against the Syrian people, including poison gas attacks on the city of al-Ghouta in 2013.[20]

Similarly, the Sharjah, UAE-based company Pangates International Corporation Ltd. (aka Pangates), and its parent company, the Abdulkarim Group, was sanctioned by the US[21] and EU[22] in July and October 2014 respectively for supplying a Syrian state-owned oil company, SYTROL, with speciality petroleum products, and the Syrian Government with aviation fuel to carry out air strikes against Syrian citizens. Although the US Office for Foreign Asset Control (OFAC) made a link between Pangates and two other Seychelles-registered companies – Maxima Middle East Trading Co. and Morgan Additives Manufacturing Co. – when it added them to its sanctions list in December 2014,[23] the Panama Papers showed that Mossack Fonseca subsequently continued to represent both companies[24] in a major failure of corporate due diligence.

IV. Implications of the Panama Papers for corporate transnationalism and its relationship to the public international order

What the Panama Papers highlight is the failure of transnational regulatory and corporate regimes that are either oblivious to or possibly unwilling to act against law firms like Mossack Fonseca and their intermediaries. It is also evident that smart sanctions may be difficult or impossible to enforce where named individuals and entities on sanctions blacklists use secret offshore facilities that rely on beneficial ownership and complex corporate structures behind which they can hide.

In terms of transnational legal ordering, the Financial Action Task Force (FATF), which is a non-binding instrument that calls on governments and entities to abide by its

[18] *The Panama Papers*, chapter 5.
[19] E.O. 13572 of April 29, 2011 – Blocking Property of Certain Persons With Respect to Human Rights Abuses in Syria, 76 Fed. Reg. 85 (May 3, 2011). On July 18, 2012, OFAC designated an additional entity (Drex Technologies S.A.) pursuant to E.O. 13572.
[20] Report of the Independent International Commission of Inquiry on the Syrian Arab Republic to the Human Rights Council, 25th Sess, Agenda Item 4, A/HRC/25/65 (12 February 2014).
[21] Executive Order (E.O.) 13582 of August 17, 2011 - Blocking Property of the Government of Syria and Prohibiting Certain Transactions with Respect to Syria, 76 Fed. Reg. 162 (August 22, 2011).
[22] Council Implementing Decision 2014/730/CFSP of 20 October 2014 implementing Decision 2013/255/CFSP concerning restrictive measures against Syria, [2014] OJ 301/36, 3.
[23] On December 17, 2014 OFAC added Maxima Middle East Trading Co. and Morgan Middle East LLC [aka Morgan Additives Manufacturing Co.] to its SDN list for their links to Pangates International Corporation Ltd.
[24] *The Panama Papers*, p. 69.

40 Recommendations,[25] and the 2005 UN Convention Against Corruption (UNAC),[26] provide the basis for an international regime in the matter of anti-money laundering and combating the financing of terrorism (AML/CFT). Additionally, many offshore tax havens and financial centres, including Panama, have signed up to international instruments, such as the Palermo Convention[27] and the Vienna Convention.[28] On this basis Panama has criminalised money laundering in its domestic law.[29] It also submits to monitoring by the FATF, more about which below concerning beneficial ownership.

Transparency, and hence accountability, in fiscal matters, is another form of transnational legal ordering. It includes a network of Tax Information Exchange Agreements (TIEAs), based on a Model 'Agreement on Exchange of Information on Tax Matters', developed by the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes, as part of a programme to address the risk to tax compliance that secretive, and hence non-cooperative, jurisdictions, like Panama, pose. Aside from the fact that not many TIEAs have been concluded - although there is one between Panama and the US[30] - they remain a bundle of bilateral agreements between individual states. Moreover, their weakness lies in lax jurisdictional standards whereby a 'requested Party is not obliged to provide information which is neither held by its authorities nor in the possession or control of persons … within its territorial jurisdiction'.[31] This obviates the need to disclose ultimate beneficial ownership and complex corporate structures, besides which such information exchange is provided usually on an 'upon request' only basis.

Meanwhile, a multilateralised form of automatic exchange of financial information has been agreed under the auspices of the OECD. The Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information[32] has 87 signatories, including the BVI (but not yet Panama). The OECD has also developed the 'Base Erosion and Profit Shifting' or BEPS[33] initiative and action plan, to address a range of issues relating to tax transparency, accountability and information exchange, arising from the artificial shifting of profits to low or zero tax jurisdictions, like Panama and dependent UK territories, such as the BVI. Both OECD schemes are in their infancy.

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[25] See Financial Action Task Force (FATF)'s Recommendations: International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation (2012, updated through October, 2016, at http://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-recommendations.html.

[26] UN Convention Against Corruption (UNAC), adopted by UNGA Res A/58/422 on 31 October 2003 and opened for signature at Merida, Mexico, in force 14 December 2005.

[27] UN Convention against Transnational Organized Crime, adopted by UNGA Res 55/25 of 15 November 2000, as subsequently amended, in force 29 September 2003.

[28] UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substance, done at Vienna on 20 December 1988, in force 12 November 1994.

[29] Sections 254 to 259 of the Panamanian Penal Code, adopted by Law 14 of 2007 (Amended by Act 26 of 2008, Act 5 of 2009, Law 68 of 2009, Act 14 of 2010 and Act 40 of 2012), under Book II, Title VII Crimes against the Economic Order, Chapter IV Money Laundering.

[30] Agreement between the Government of the United States of America and the Government of the Republic of Panama for Tax Cooperation and the Exchange of Information Relating to Taxes, Washington, DC, November 30, 2010.

[31] *Ibid*, Article 2.

[32] The Common Reporting Standard (CRS) Multilateral Competent Authority Agreement (MCAA) is seen as an alternative to TIEAs or double taxation agreements.

[33] The Base Erosion and Profit Shifting or BEPS framework, see http://www.oecd.org/ctp/beps/.

However, what the Panama Papers demonstrate is that corporate transnationalism needs to step up a gear. There must be greater access to information for investigatory authorities and enforcement agencies about the ultimate beneficiary of companies registered in offshore jurisdictions. Not only would this assist them in tracing the individuals and entities behind illegal financial flows but it could also make it easier to implement targeted sanctions.

At the G8 Summit, in 2013 there were calls for the establishment of a central register of beneficial owners of offshore companies. However, the final declaration adopted a weaker form of language, speaking of '[C]ompanies … [knowing] who really owns them'.[34] That same year the Committee on Development in its report to the European Parliament was scathing about the OECD Global Forum's laxity concerning disclosure of beneficial ownership. It called for the identification of owners and beneficiaries of companies, trust funds and foundations to ensure transparency in tax matters. It also took the view that TCSPs (like the firm of Mossack Fonseca) should be required to carry out due diligence to accurately establish beneficial ownership information under AML/CFT rules.[35] In Panama's case, the FATF had recommended a legal framework for 'the identification of beneficial owners', including 'whether applicants are acting for third parties with respect to natural person applicants', details of 'shareholders and where applicable the beneficial owners of legal entities', and 'the conduct of police and criminal background checks on the applicants and other related parties'.[36]

And yet, in the wake of the Panama Papers, there has been little progress. A report in November, 2016, by Joseph Stiglitz and Mark Pieth, former members of a Government of Panama Committee of Experts to strengthen the transparency of Panama's financial and legal system, called for inclusive international cooperation on standard-setting and implementation. Among the report's recommendations are: publicly searchable registries of the beneficial owners of each corporation, trust, foundation, or other entity, in every country; off-shore companies compelled to annually report the names of their owners and the jurisdictions in which they operate, with a full set of tax returns; tighter controls on corporate intermediaries, including a duty to know their customers; and a curb on the number of nominee directorships that a single person can hold. [37]

When it comes to the call for a central, publicly available register of beneficial ownership progress on achieving this should be measured against similar EU attempts. The transparency amendments to the EU's fourth Anti-Money Laundering Directive (AML Directive)[38] include such requirements but were watered down to take into

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[34] Lough Erne Declaration, 18 June 2013, para 3.

[35] Opinion of the Committee on Development for the Committee on Economic and Monetary Affairs of the European Parliament on the fight against tax fraud, tax evasion and tax havens (2013/2060(INI)) [rapporteur Eva Joly].

[36] IMF Country Report on *Panama - FATF Recommendation*s, p 205, para 1188.

[37] Joseph E Stiglitz and Mark Pieth, *Overcoming the Shadow Economy* (Friedrich-Ebert Stiftung, November 2016), at http://ciperchile.cl/wp-content/uploads/stiglitz_161110_IPA_ShadowEconomy_ptxt_online_1.pdf.

[38] Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing

account the possible infringement of data protection rules. Instead, the AML Directive introduces a compromise whereby EU Member States must 'ensure that corporate and other legal entities incorporated within their territory are required to obtain and hold adequate, accurate and current information on their beneficial ownership, including the details of the beneficial interests held'. However, access to such registered beneficial ownership information may be limited to those who have a 'legitimate interest'.[39]

Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC [2015] OJ L 141/73**.**

[39] *Ibid*, Article 30.