Prof. Dr. Mark Pieth **2nd August 2007**

C.4.

Strictly confidential

EXPERT OPINION

by Prof. Dr. Mark Pieth

submitted in the proceedings

Between

Beverly Securities Limited (BSL)/
Beverly Securities Incorporated (BSI) Claimant

And

Kredietbank Luxembourg (KBL) and others Respondent

Overview

I. Introduction

1. My name is Mark Pieth and I was born in Basel on March 9, 1953. I am Professor of Criminal Law and Criminology at the University of Basel, Switzerland, and during my career I have engaged in private practice as a qualified advocate.

1. Qualifications

2. From 1989 – 1993 I have been Head of the Section of the Economic and Organised Crime of the Swiss Federal Office of Justice (Federal Ministry of Justice and Police). In this position I was involved in drafting legislation and writing bills regarding Swiss law, in particular relating to money laundering (both criminal and regulatory law), mutual legal assistance, organized crime, drug abuse, corruption, corporate liability as well as confiscation of assets.

3. As an official, and later as a consultant to Government I have acquired extensive experience in international fora, notably as a founding member of the Financial Action Task Force on Money Laundering (FATF) between 1989 and 1993, the Chemical Action Task Force on Precursor Chemicals and as the Chairman of the OECD Working Group on Bribery in International Business Transactions (since 1990 until today). As of 1999, I have been a facilitator and founding member of the "Wolfsberg Group of Private Banks" on customer due diligence (see www.wolfsberg-principles.com). I was able to further deepen my expertise on money laundering, corruption and other abuses of the financial sector when I was asked by the Secretary General of the United Nations to act as a member of the Independent Inquiry Committee into the Oil-for-Food Program of the UN in Iraq (IIC), together with Paul Volcker and Richard Goldstone in 2004 and 2005.

4. I am furthermore Chairman of the Basel Institute on Governance, a specialised, University based research, training and policy center focusing on public and corporate governance as well as on asset recovery (through its International Center on Asset Recovery, ICAR).

5. I have published extensively in the field of economic and organised crime (including money laundering, corruption, organised crime, corporate liability, financing of terrorism).

2. Mandate

6. I have been asked by Bonnard Lawson, an international law firm based in Geneva, to provide my views and advice on events described in the following summary of facts. I have furthermore been provided with

- an Initial Outline of Facts, dated June 27, 2007,
- an Expert Statement of Mr. Christian Weyer, expert in international banking activities and senior management,

- an Expert Witness Statement by Mr. Philippe Mortgé, expert in forensic accounting,
- a Witness Statement by Mr. Martin Steynberg, former employee of the Armscor Group, South Africa.

7. The mandate which Bonnard Lawson wish me to address is based upon the following:

- that I possess the necessary expertise to express views and advice on the issues arising in respect of events described in the Summary of Facts,
- that I have been afforded proper opportunity of researching and analysing the issues referred to,
- that having undertaken the appropriate research analysis, I have been able to reach and express my own conclusions,
- that I have no prior relationship with Bonnard Lawson and/or the clients BSL/BSI for whom they act in connection with the case described in the Summary of Facts.

8. Attached hereto is a copy resume of my career which identifies the basis of my expertise as well as a list of publications.

II. Background and Facts

1. Facts as given by Bonnard Lawson

9. The following Fact Summary has been provided to me by Bonnard Lawson:

"Our clients are BEVERLY SECURITIES LIMITED (BSL), an English Private Limited Company, and its sister company BEVERLY SECURITIES INCORPORATED (BSI), a Panamanian Company, (together BSL/BSI), both owned by a Liechtenstein Anstalt, ESTABLISSEMENT EUROPEEN DE FINANCEMENT (EEF) held for the benefit of the Pinhol family of Lisbon.

In the 1980's and 90's BSL/BSI were active in international trading activities, often as intermediary. Operating from Portugal, BSL/BSI were represented by General Henri Troni, a highly respected former General in the Portuguese Defence Forces, Mr Luis Pinhol, also a respected former military officer, and his son, Mr Jorge Pinhol.

THE ARMAMENTS CORPORATION OF SOUTH AFRICA (Armscor) is the state-owned South African corporation responsible for procurement and sales of defence equipment and other materials, including those for the Emergency Services sector, in that country. In the 1980's and early 1990's (during the years of the U.N. Embargo) Armscor was answerable only to P.W. Botha, who became the President of the Republic of South Africa and retained effective control of both the Defence and Emergency Services Portfolios.

When the mandatory sanctions were imposed against South Africa, Armscor already possessed a considerable fleet of helicopters designed and manufactured by Aérospatiale. Given the circumstances, it had become evident that South Africa needed to upgrade its fleet by the introduction of greater capacities which would enable search and rescue missions to be far more extensive. For this purpose in the 1980's Armscor entered into a large programme with the state-owned Aérospatiale of France for upgrading and expanding South Africa's fleet of Puma Search and Rescue (SAR) Helicopters acquired from Aérospatiale of France. As explained below, the programme was top secret and was code-named Project Adenia.

BSL/BSI played a critical role in Project Adenia, through its close contacts with key members of the Portuguese Defence Establishment with whom BSL/BSI dealt, including General Brochado de Miranda (Chief of Staff for the Portuguese Air Force), General Soares Carneiro (Chief of Staff for the complete Portuguese Armed Forces), General Casimiro Proenca (President of INDEP a leading manufacturer to the Portuguese Defence Industry) and General Rui Espadinha (Head of OGMA, the logistics business providing technical support to the Portuguese Air Force). Each knew and respected General Troni and Luis Pinhol, and accepted BSL/BSI's request made on Armscor's behalf to establish a Portuguese channel for Project Adenia deliveries from Aérospatiale to Armscor of the SAR helicopter kits.

Armscor's main bank in Europe during this period was KREDIETBANK LUXEMBOURG (KBL), today a major bank in Luxembourg owned by the KBC Group N.V., a €35 billion company listed on the Euronext Stock Market in Brussels.

The Project Adenia supply contract was conceived, negotiated and implemented between Aérospatiale and Armscor during the period of the mandatory U.N. embargo on South Africa instituted in November 1977. U.N. Resolution No. 418 precluded *"any provision to South Africa of* arms and related materiel of all types, *including the sale or transfer of* weapons and ammunition, military vehicles and equipment, para-military police equipment, *and spare parts for the aforementioned"*.
The Resolution also prohibited the provision of any *"equipment and supplies and grants of licensing arrangements for the manufacture or maintenance of the aforementioned."* (Emphasis added). Many other regional (E.U.) and national embargoes (the U.S., amongst others) were also in effect at the time. The U.N. mandatory embargo against South Africa was officially accepted by the Duchy of Luxembourg in January 1978[1].

Despite this mandatory embargoes, Armscor succeeded, with the help of KBL on the payment side to enter into and implement a number of important international procurement projects during the 1980's and 1990's, in direct and intentional breach of such embargoes.[2] KBL, with assistance of its sister company, Kredietrust Luxembourg (KTL), proposed and managed a complex structure of hundreds of front company and jump account payment channels for these procurement projects, thereby directly facilitating Armscor's financial transactions by conduct consistent with classical methods of aggravated money laundering and corrupt financial practices to avoid the consequences of the mandatory embargoes on South Africa. BSL/BSI has obtained evidence of this "grand complicity" between KBL and Armscor. It was because of this complicity that Armscor was able, with KBL's help, to deny BSL/BSI's commission payment, as explained below. The nature and extent of the KBL involvement in Armscor's business is explained in the attached Expert Report of Philippe Mortgé.

In channelling Armscor's vast movements of funds from South Africa to its various suppliers, including Aérospatiale, through those many complex and hidden payment channels, KBL were afforded total insight into the nature and pattern of Armscor's commercial activities.

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1 Letter dated 9 January 1978 from the Permanent Representative of Luxembourg to the United Nations addressed to the Secretary General.

2 By way of illustration, BSL/BSI's evidence confirms that other Armscor procurement projects at the time included, amongst others:

(a) Project Austin - Electronic Warfare Systems,

(b) Project Nimrod - Mirage Weapon Systems,

(c) Project Keepsake - Air to Air Missiles,

(d) Project Buzzard - Nuclear Components, Project Popina - Berretta Guns, and

(e) Project Scummer - Armoured Vehicles.

Each of these was clearly within the U.N. embargo. Together, they totaled billions of dollars of business for the suppliers located around the world, who received typically a 30% premium or more on the normal price.

Project Adenia, involving sale to South Africa of unarmed SAR helicopters and related parts and services, was not such an "arms" acquisition programme and hence was not precluded by the U.N. or other Sanction Resolutions or otherwise illegal.[3] While the entire scope of Project Adenia had not been disclosed to BSL/BSI, those later have evidence from former Armscor employees that Project Adenia had a total value of some 3 Billion USD. The overall value of Armscor's Projects involved sums totalling 12 Billion USD or more.

Nevertheless, Armscor and Aérospatiale and their respective state-owner were conscious of the political sensitivity of any commercial activity with South Africa which led them to conduct Project Adenia, as with all of Armscor's programmes, under a strict "top secret" regime. Minimum documents were prepared and those that were required were held and transferred always under diplomatic cover. Armscor's commercial activities were conducted out of offices (called Technical Committees) in the South African Embassies in Paris and Tel Aviv. Project Adenia was negotiated and administered on Armscor's side in Paris.

The commission agreement relating to BSL/BSI's role in opening the Portuguese channel was agreed in July 1987 by Mr Pinhol for BSL/BSI and Mr Bestbier for Armscor. It provided for a commission rate of 10% to be paid over the total of the goods and services delivered in Project Adenia. Aérospatiale accepted to cover 50% of this commission cost, as it did not have to pay its customary commission agent in Portugal. While this commission agreement was oral, its terms were recorded in a duly-signed Armscor memorandum, held in Armscor's office in Paris for use by the administrator of the Project Adenia contract. The existence and terms of that official document have been confirmed in sworn evidence BSL/BSI has obtained from former Armscor employees, including that contract administrator.

BSL/BSI also succeeded in negotiating compensation for Portugal whose Air Force's fleet of Puma helicopters needed upgrading in order to perform its NATO search and rescue obligations. Armscor agreed to procure at its cost within Project Adenia upgrade kits and parts required by the Portuguese Air Force.

BSL/BSI completed its side of the commission agreement, causing the new Portuguese channel to be successfully opened[4]. After some delays relating mostly to political concerns within France and within Aérospatiale, Project Adenia deliveries started in 1989, including the kits for the Portuguese. The agreed BSL/BSI commission was, however, not being paid. Senior Armscor executives assured Mr Pinhol that it would be paid, although it is now clear they did not intend to do so, and that Armscor was engaged in deceit against BSL/BSI. These executives were concerned that if Mr Pinhol

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3 The intended function and use of these SAR helicopters supplied under Project Adenia has been described as follows:

"These functions include the monitoring of commercial shipping activities and assisting Marine and Coastal Management in detecting red tide, oil pollution, abalone smuggling as well as monitoring illegal fishing activities in the RSA"s 200nm Exclusive Economic Zone. The Squadron also assists the South African Search-and-Rescue Organization (SASAR) by supplying a 24-hour around the clock Land and Sea Search-and-Rescue service to the country. One of their more notable contributions in this arena was their rescue of 587 people from the Greek liner Oceanos near the East London coast in August 1991 using some16 helicopters"

The website www.sasar.gov.za provides a clear picture of the scope of responsibility for such "search and rescue missions" in South Africa. Portugal's fleet of search and rescue helicopters can be found at the website www.emfa.pt/www/esquadras/esquadrasdetalhe.php?lang=ing&key=e751

4 When BSL/BSI informed Armscor that the channel had been approved, Armscor officials wished to test it in 1986 which was done in a "trial run" involving a single-delivery trial run of a night flight guidance system to be delivered from France via Portugal to South Africa. This test, code named Project Orion, was successful and assured Armscor that BSL/BSI had indeed done what had been asked of it for Project Adenia. As was customary, BSL/BSI dealt with Project Orion in an oral agreement, commercial goodwill and trust. Following completion, Armscor paid a commission of 25,000 USD from an account it controlled at KBL to a BSI account at Credit Suisse in Zurich.

became sufficiently concerned over the commission, he could cause the Generals to stop the deliveries through Portugal until the matter was resolved. BSL/BSI has sworn evidence from the Generals involved that, as the business was being done entirely on trust and good faith, had BSL/BSI informed them of any wrongdoing by Armscor, they would have not gone forward.[5]

It was at this point, in early 1990, that Armscor solicited the assistance of KBL in its programme of deceit against BSL/BSI. KBL agreed to open a new bank account for BSL in Luxembourg for the ostensible (but deceitful) purpose of receiving the 10% commission due on Project Adenia. KBL thus received Mr Pinhol in its offices on 9 February 1900. Mr Pinhol was introduced by an Armscor employee working at the Embassy in Paris for that stated purpose. The account documents had already been filled in by the Bank's officer, when the meeting started.

As KBL had no prior knowledge of BSL, its Owners or its Management, and no enquiry of any sort was directed to BSL, KBL received all information about its new client from Armscor, whose representative confirmed at the meeting that the purpose of the new BSL account was to receive the commissions due from Armscor.

The documents presented at the meeting included an application for the opening of the bank account which after signature by Mr Pinhol was attributed the account number 210370. Mr Pinhol was also shown a marketing style booklet about the Bank's rules and practices for customer accounts, but the content was not discussed. They also included, again without explanation Powers of Attorney in favour of Armscor's employees for Mr Pinhol to sign. In signing these documents, Mr Pinhol felt re-assured that BSL/BSI's position was being properly respected and was particularly comforted in that respect by the behaviour of the KBL account officer, having no reason for doubting the integrity and standing of that officer or the Bank, who had full knowledge of the asserted purpose of the new account, i.e. to receive the 10% commission due on Project Adenia. Noting that it would be a rather large sum, the KBL account officer congratulated Mr Pinhol.

The opening of the new account in order to permit the commission to be paid conveniently and discreetly to BSL re-assured BSL/BSI. No doubt as to Armscor's or KBL's good faith arose. This interpretation was misplaced as KBL and Armscor well knew from the outset that the real and deliberate cause and effect was to lull BSL/BSL and its Senior Management into a state of belief such as to stop the exercise of the commercial veto. Achieving and maintaining such deterrent over BSL/BSI's use of its influence was important to KBL, Armscor and their respective Senior Managements, to ensure not only the successful conduct of Project Adenia, but also to maintain the matrix of KBL's secretive and highly lucrative financial activities for Armscor.

BLS and BSI have conducted their business together, each making their respective contributions to the matters at hand. At the direction of the common owner of these two companies, BSL/BSI worked in conjunction with each other in discharging the obligations they had under the commission agreement with Armscor. The account at KBL was opened for their joint benefit only in the name of BSL, an English-registered company.

BSL as a client of KBL relied upon KBL's respect of its duties under the banking contract and the governing Luxembourg law, including the duties of good faith, loyalty, advice and information.[6] By its general and continuing complicity in Armscor financial affairs and its particular complicity in Armscor's scheme to deceive BSL/BSI about its commission payment in order to keep the new Portuguese delivery channel for Project Adenia in operation, KBL has violated these duties. That is the legal basis of BSL/BSI's claim against KBL, and the Senior Management involved, for recovery of its commission.

At no time during these events, did any Armscor representative raise issue over BSL/BSI's commission entitlement. It was only later when evidence eventually emerged, that Mr Pinhol and

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5 In a recent statement, General Miranda has confirmed: "If BSL/BSL had informed me that the South African Company was acting or had the suspicions that it was acting in a dishonest or bad faith manner, I would have taken the decision to deny the performance of said Project."

6 That KBL has violated its banking duties to BSL its client has been clearly confirmed by Luxembourg counsel and in an Expert Report from the former President of Banque Paribas (Suisse), attached.

legal advisors to BSL/BSI realized that the events involving KBL and Armscor in the opening of the BSL bank account at KBL were part of a deliberate and deceitful ploy by Armscor and KBL to prevent the risk of BSL/BSI exercising its veto over the new Portuguese delivery channel during the delicate period of its starting up in 1989-1990.

In late 1991, Mr Pinhol contacted Mr. Pik Botha, then Foreign Minister of the Republic of South Africa, who afforded a sympathetic hearing of BSL/BSI's complaint relating to Armscor's refusal to honour the commission agreement. The Minister offered to investigate the matter and did so with the assistance of the RSA Ambassador to Portugal.[7] Thus, two important RSA officials concluded that BSL/BSI had been mistreated by Armscor in denying the 10% commission. Pik Botha did his best to get his Government colleague, the Defence Minister of the Republic of South Africa, to correct the situation.

Minister Botha urged in a memorandum dated 1st December 1992 that the BSL/BSI commission claim be resolved so as to avoid a political incident between Portugal and South Africa. He noted that Portugal had remained one of South Africa's strongest allies throughout the sanctions period.[8] The efforts of the eminent Foreign Minister and his officials in 1993 became frustrated not just by the whitewash of Armscor's "Internal Investigation" but also because of the huge political events then leading to the end of the Apartheid Regime and the introduction of a new ANC controlled Government in 1994.

For many years thereafter, supported by their Government Owners and Controllers, Armscor and Aérospatiale, as well as KBL, deliberately engaged in a further and continuing campaign of widespread deceit and obfuscation designed to prevent evidence emerging to reveal the truth of what had taken place. They also knowingly engaged in acts and omissions which seriously misled Courts in which they had appeared to answer previous proceedings by which BSL/BSI had sought relief.

In the RSA proceedings in which BSL/BSI sought for an accounting of Project Adenia, Counsel who appeared for Armscor asserted that no commercial relationship existed between BSI/BSL or JP and Armscor. Yet in a statement obtained later, the former Head of Armscor in Paris, Toni de Klerk, an Attorney admitted to practice in South Africa in 1972, declared *"In view of my personal knowledge of the occurrences that led to the development of this channel, I was convinced that Mr. Pinhol's business was entitled to commission for the services which he rendered."*

Furthermore in the same RSA proceedings, whilst claiming privilege on grounds of national security, Armscor failed to disclose to the Court that they were actively engaged at that very time in a Project code-named Massada, the purpose of which was to destroy/quarantine documentation concerning Project Adenia and other Armscor Projects of much greater sensitivity.

The perceived dangers of BSL/BSI's claims against Armscor led the Chairman of Aérospatiale to write a letter dated the 3rd May 1996 to the RSA Ambassador in Paris urging that "*essential measures*" (intelligence speake for taking someone out in a murder sense) be taken against Mr Pinhol to prevent the steps BSL/BSI were pursuing. It was obvious that much more was at stake than a simple claim for unpaid commission.

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7 The Ambassador conducted his enquiries, including a series of meetings in early 1992 with those involved. By letter dated 21 April 1992, he reported to Pik Botha, the Minister: "After the period January 1992 until now, and after my second discussion with General Miranda I must inform you that I am convinced that Mr. Pinhol, with reference to part 2 of his letter to Armscor dated 29 January, 1992, may justly say: „BSI initiated all negotiations with (FAP) Portuguese Airforce in order to obtain permission for the kits to be manufactured at OGMA□".

8 In advising JP that BSL/BSI was best advised to pursue its case through legal action, Pik Botha expressed deep regrets and misgivings since it was obvious to him that the appropriate course for Armscor was to settle out of Court. He also said in a sworn statement provided to BSL/BSI: *"I was by then convinced that Mr. PINHOL was legally and morally entitled to payment for the decisively important services rendered by him and/or his company BSI."*

It was only during the lawsuit in South Africa,[9] that BSL/BSI, having little by way of concrete evidence to support its case, learned that Project Adenia deliveries also include 50 new helicopters equivalent to Super Puma (subsequently branded as an ORYX by the South Africans) delivered to Armscor in kit form, raising the value of the contract and the commission due. It was also later learned that the Project included maintenance and other services to Armscor.

In the 1983 South African proceedings BSL/BSI sought relief in the form of a monetary judgment, an account and a declaration, due to the lack of evidence to prove the oral commission agreement and given Armscor's defence of privilege and national security, Senior Counsel advised BSL/BSI in 1984 to withdraw the proceedings, which was done without prejudice.

At the time of the South African proceeding, Mr Pinhol spoke to the account manager at KBL, who had declined to take his calls on previous occasions. During a brief conversation, he drew attention to what was happening in South Africa and sought KBL's cooperation as well as to be informed about the BSL account. The account officer refused to discuss the BSL account and, for the first time, indicated that the BSL account was closed and that he had nothing further to add. He then put the phone down on Mr Pinhol. BSL has never had any explanation from the Bank.

BSL/BSI was then advised it could pursue new legal proceedings in France against Eurocopter, the successor to Aérospatiale, based on unjust enrichment. It was hoped that such proceedings would unearth more evidence of what had taken place in the management of Project Adenia and the BSL/BSI's commission arrangement, which the Manufacturer and the Supplier had each agreed to support to the level of 50%. As in South Africa, the claimants in the new French action were, in the end, unable to obtain discovery about Project Adenia or about the BSL/BSI commission agreement with Armscor. Again, a powerful state-owned defendant was able to overcome the claims, which were rejected, confirmed on appeal in 1999.

It was through these persistent actions in the 1990's that individuals with knowledge of the relevant matters eventually made themselves known to BSL/BSI and provided statements of what in fact happened. This evidence which emerged only in the late 1990's confirms that Armscor made serious misrepresentations in the South African Court, particularly in respect of its commercial relationship with BSL/BSI and its agreement to pay a commission for BSL/BSI's role opening the critically important Portuguese delivery channel for Project Adenia.

This confirmed the new South African Government's interest to explore events at Armscor during and towards the end of the Apartheid Regime in the early 1990's.[10] It became apparent that South Africa itself had been defrauded of 900 million USD through the financial activities of some former Senior Management at Armscor. In the early 2000's BSL/BSI conferred with the by then ANC controlled Government about its commission claims, in the end, the Office of the President did not wish to assist and chose to put support for recovery of diverted funds steps on hold.[11]

More recently, BSL's advisors have found evidence relating to the role of KBL in the loss of its commission which has lead to the preparation of the present proceedings in Belgium and in Portugal, where BSL/BSI have standing from a jurisdictional point of view and where the claims in tort and in

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9 BSL/BSI first obtained consent from the South African Government to make available (in camera) to the Court all relevant documentation on Project Adenia, following which the action against Armscor was instituted in March 1993

10 One of the early initiatives on the part of the ANC Government was to establish a RSA Commission of Inquiry chaired by a leading South African Judge, Mr. Justice Cameron. That Inquiry reached some serious conclusions about the conduct of the Senior Management at Armscor condemning particular individuals in unequivocal terms.

11 That stance is also evident from the position taken by the South African Government over the class action litigation currently proceeding before the Courts in the U.S., where victims of the Apartheid Regime are pursuing many of famous global corporations for suitable remedies on allegation that such corporations knowingly supported and sustained a Regime that everyone knew was engaged in serious crimes against humanity. This litigation is referred to generally as the Khulumani litigation after the name of the organization acting as the lead a Plaintiff in that class action".

contract are not time-barred. As part of this effort, in the case against KBL and members of its Senior Management, orders will sought in all relevant jurisdictions, including the U.S., for the production of pertinent witness and documentary evidence from all entities or persons who were involved".

III. Summary and Questions

1. Summary

10. To sum up, according to witness statements of former key employees of Armscor, responsible of organising the payment channels of covert procurement during the time of the UN sanctions against the Apartheid Regime in South Africa, [12] KBL played a fundamental role as the organiser of financial back channels in Europe. This is in particular the case, if, as Martin Steynberg says,[13] KBL handled 70 % of all the financial transactions involving the Paris based "Technical Committee", a covert organisation of arms procurement for South Africa. The methodology used, is later to become well known as the standard model of "money laundering": the creation of structures by forming front companies at off-shore centers and opening bank accounts for them (according to Steynberg 850),[14] funneling thousands of transactions through them, in order to create intransparency, occasionally breaking the paper trail by cash transactions:[15] the goal was, as Steynberg says, to ensure total control while preserving anonymity.[16] The Armscor personnel itself was merely involved through powers of attorney over these accounts. Overall, it appears from these witness statements of insiders that KBL was one of the main financial conduits instrumental to circumventing sanctions,[17] allowing South Africa to maintain its armed forces effective, to be able to combat – as Steynbeg says – "what they (the South African Government) saw as being a fight against a communist inspired uprising".[18] In effect, KBL's contribution became crucial for sanctions busting and indirectly contributed to the crimes against humanity committed by the South African Defense Forces – and it was aware of it, as the Armscor operatives indicate.[19]

11. Furthermore, KBL apparently was also used to facilitate sensitive, if not necessarily illegal, transactions like the procurement of help and rescue helicopters (the "Adenia Project").[20] In this context the reproach made against KBL and its senior managers

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12 Security Council Resolution N. 418/77.

13 Witness Statement Martin Steynberg, WS-07, N. 15.

14 Steynberg, fn. 13, N. 26.

15 idem, fn. 13, N. 16 – 22.

16 idem, fn. 13, N. 23.

17 idem, fn. 13, N. 14.

18 idem, fn. 13, N. 18.

19 idem, fn. 13, N. 61.

20 idem, fn. 13, N. 39.

(in particular Germaine Ménager)[21] was that they conspired with the Armscor management in "cutting out" commission agents.[22] The method, applied in the concrete case, involved obtaining the confidence of the head of BSL, Jorge Pinhol, by opening a special bank account to receive the commission.[23] According to Steynberg,[24] the role of KBL's senior staff was to calm down Pinhol (since his cooperation was critical) while retaining control over the account. The overall strategy was – according to my instructions – to keep Pinhol from exerting his "commercial veto" by intervening with the Portuguese Armed Forces to stop the transaction. As Steynberg clarifies,[25] the aim of the concrete maneuvers was to cut Pinhol out as soon the operation was underway and could no longer be stopped.

12. While cutting Pinhol out of his commission is not a necessary part of the wider sanctions busting activity of KBL, the two sides of the story are closely related: First, the bank uses the same modus operandi to maintain control over the accounts for Armscor, just in case a payment does have to be made: it ensures that Pinhol signs the standard power of attorney to benefit of Armscor.[26] Second, the bank officials were acting fully under instructions of their powerful client Armscor. It appears that Pinhol has not been afforded the necessary information as a bank client, neither during the opening nor during the further client-bank relationship, nor in the closing or post-closing phase,[27] rather, KBL has placed itself in a conflict of interest and has given preference to the by far more potent client, with which it was involved in illicit dealings since years.

Several questions arise from these facts:

2. Questions

13. If these facts are assumed as proven for the purpose of this Advice:

a) How is the behavior of KBL in support of its client Armscor to be qualified from a legal or a regulatory point of view?

b) How is the behavior of KBL in relation to its client BSL/BSI between 1990 and 1993 to be assessed from a legal or a regulatory perspective?

3. Structure of the opinion

14. Relating to the legal and regulatory issues raised by KBL's role in helping Armscor to subvert the UN sanctions, the opinion will first give an abstract overview over the

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21 idem, fn. 13, N. 27.

22 idem, fn. 13, N. 58.

23 idem, fn. 13, N. 51 ff.

24 idem, fn. 13, N. 53.

25 idem, fn. 13, N. 58 and 60.

26 idem, fn. 13, N. 55.

27 idem fn. 13, N. 59 – 61.

status of bank supervisory rules, including AML-rules, and sanctions regulation at the time of the activity (IV.1.). It will go on to analyse the concrete behavior in view of these rules (IV.2.). In a further chapter the analysis will focus on the treatment of the clients BSL/BSI by the Bank (V.). Again, elements of criminal, civil and administrative responsibility need to be distinguished. A concluding chapter will summarize the considerations (VI.).

IV. The Role of KBL in Helping Armscor Undercut the UN Sanctions

1. Luxembourg's rules against sanctions busting, money laundering and on fit and proper conduct of bankers

a. Sanctions busting

15. Security Council Resolution 418 of November 4, 1977, was mandatory (in application of Chapter VII of the UN Charter). It stated *"that the acquisition by South Africa of arms and related material constitutes a threat to the maintenance of international peace and security"* (1.). It went on to declare *"that all States shall cease forthwith any provisions to South Africa, of arms and related material of all types... and shall cease as well the provision of ... grants of licensing arrangements..."* (2.)

16. After the declaration of the State of Emergency in South Africa, the UN with its Security Council Resolution 569 of July 26, 1985, stepped up the sanctions to exclude all new investments or grants to South Africa overall. The European Community in a conference of Foreign Ministers, held in Luxembourg on September 10, 1985, echoed this text and adopted new measures, amongst them *"a strictly monitored embargo on the export to South Africa or weapons and paramilitary equipment"*.

17. Luxembourg has in a letter to the Secretary General of the UN declared that it subjected the sale of arms to authorization. In its letter of January 9, 1987, it indicated that it would strictly comply with the obligations under Security Council Resolution 418/77 on the arms embargo against South Africa. Whereas some UN-Members like Germany have foreseen stiff sanctions for the breach of a UN embargo,[28] other countries, especially financial centers, have enacted laws only late – especially in the context of the Iraq embargo (Security Council Resolution 661/90) – which since have been gradually upgraded.[29] Luxembourg has only indirectly implemented its commitment to international law in criminal legislation at the time. The letter to the SG written by the UN Ambassador of Luxembourg refers to the export licensing laws. Luxembourg's export licensing law of 1963[30] gives the

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28 For Germany cf. Aussenwirtschaftsgesetz (AWG) of April 28, 1961. Since 1992 it foresees a sanction of between 2 – 15 years of emprisonment!

29 Especially Switzerland, starting off in 1990 with a misdemeanour, ending up in 2003 with a serious offence, entailing up to 5 years of emprisonment.

30 Loi du 5 août 1963 concernant l'importation, l'exportation et le transit des marchandises, Journal Officiel A – No 45, 10 août 1963.

Government the right to anact regulation detailing industrial and other products under import, export or transit licensing obligations. The regulation of 1977[31] also lists helicopters above a certain weight. The omission to obtain a license is sanctioned by prison (8 days to three years) or a fine, unless special rules of the Common Benelux Market or later the EU applied.[32] Additionally the involvement in large scale sanctions busting could very well have an impact from a banking regulatory point of view.

b. Anti-Money Laundering-Rules

18. It is true, the modus operandi of KBL follows - as Steynberg describes it[33] - the logic of money laundering: the extensive use of shell corporations created at off-shore centers, bank accounts opened in their name or numbered, occasional cash transactions to break the paper trail and everything organised by a professional privilege holder. This does not, however, mean that it constitutes money laundering in a legal sense, in particular since the anti-money laundering rules emerged only gradually over time and were just about to be created at the time discussed here.

19. Anti-money laundering meant from the beginning criminalisation on the one hand (the international instruments typically contain definitions of the offence and rules on confiscation and mutual legal assistance) and preventive, regulatory measures on the other hand (in particular the identification of clients and beneficial owners, increased diligence in unusual circumstances, notification of suspicion and cooperation with authorities, sound internal organisation of financial institutions).

20. As mentioned, they have been gradually developed in international instruments and implemented at a somewhat diverging pace domestically in laws, regulations and internal company rules.

21. In Europe, the probably first international instrument requesting action by the financial sector to prevent its misuse for the *"transfer of funds of criminal origin from one country to another"* was the Council of Europe's Recommendation No. R (80) 10.[34] If the goal was at the time primarily to prevent the laundering of funds stemming from "hold-ups and kidnappings" (it was the time of the "brigate rosse" in Italy and the "Rote Armee Fraktion" in Germany), the text does not specify criminal activity when calling for the cooperation of the banking system in the prevention of crime.

22. A direct line can be drawn to the next prudential text on the use of financial institutions "for the transfer or deposit of money derived from criminal activity", the "Basel Statement of Principles" of the "Basel Committee on Banking Supervision" (Cooke Committee) of December 12, 1988 (BSP).

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31 Règlement grand-ducal du 29 juillet 1977 remplaçant la liste I annexée au règlement grand-ducal du 17 août 1963 soumettant à licence le transited certaines marchandises, Journal Officiel A – 68, 29 novembre 1977, 1974 ff. (for helicopters cf. page 1984 no. 1460).

32 Loi du 5 août 1963, fn. 30, article 9.

33 Steynberg fn. 13, N. 20 ff.

34 COE, Measures against the transfer and the safekeeping of funds of criminal origin, Rec. No. R (80) 10 of June 27, 1980, preamble, second indent.

23. Both texts focus on customer identification. Even if the BSP accepts that a bank may have no means of knowing of the criminal origin it requests *"reasonable efforts to determine the true identity of all customers"* (II.) and claims that *"banks should not set out to offer services or provide active assistance in transactions which they have good reasons to suppose are associated with money-laundering activities"* (III. in fine).

24. Interestingly enough, again the prudential texts do **not** specify the nature of predicate offence to money laundering. Only later, when through the ratification of the UN Convention of 1988 by Member States and the 40 Recommendations of the Financial Action Task Force on Money Laundering the term "money laundering" began to obtain a clearer definition in a criminalisation context, was it restricted as a minimum to drug related crime. However, as early as 1990, with the Convention 141 of the COE, the definition of "predicate offence" was widened again to all or all serious crime.[35] The full national implementation of this broadening of predicates, however, took until 1996,[36] when the FATF insisted that all serious crime was a predicate. An international acceptable definition of what was considered serious only followed in the FATF Recommendations of 2003,[37] or for corruption in 1997.[38]

25. It may be added that already the first of three consecutive EC Directives on money laundering[39] explicitly states that it is essential that Member States go beyond the narrow definition of predicate offence of the Vienna Convention on Drugs.[40]

26. Luxembourg adopted a money laundering provision relatively early,[41] however, it refused for a long period to go beyond drug trafficking as a predicate offence, and even now, the list of predicate offences is rather incomplete.[42] This has been repeatedly criticised in various evaluations by international organisations, especially by the FATF and the OECD.[43]

27. It is crucial, however, to recognise that the Luxembourg self-regulatory organisation, the "Association des Banques et Banquiers du Luxembourg" (ABBL)

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35 COE, Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, Strasbourg, November 8, 1990, No. 141, Art. 6.

36 FATF 1996.

37 FATF 2003.

38 OECD, Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, November 21, 1997, Art. 7.

39 Of June 10, 1991 (L 166/77); December 4, 2001 (L 344/76); October 26, 2005 (L 309/15).

40 EC Directive 1991, Al. 8 of the Introduction.

41 Art. 8 of the law of July 7, 1989, modifying the law of February 19, 1973.

42 Cf. Art. 506-1 – 506-507 code pénal; Pit Reckinger, Luxembourg, in: Muller/Kälin/Goldsworth, Anti-Money Laundering: International Law and Practice, 2007, 598; Rima Adas/Pierre Krier; Luxemburg, in: Clark/Burrell, A Practitioner's Guide to International Money Laundering Law and Regulation, London 2003, 825.

43 FATF Evaluation of June 28, 1993, N. 39 ff.; OECD Evaluation of Evaluation by the Working Group on Bribery of the OECD of 28 May 2004 (Phase 2) 21,44.

had immediately reacted to the BSP in its ethics standards (règles de déontologie).[44] The supervisory authority, then called the "Institut Monétaire Luxembourgeois" (IML), made it clear that the obligations to prevent money laundering included these best practices and standards of ethics.[45] It applied the broad notion of money laundering of the BSP.

28. It is only in the new legislation on the financial sector of April 5, 1993, that the obligations of the financial operators relating to money laundering were restricted to specific predicate offences detailed in the drug legislation.[46]

c. "Fit and proper conduct"

29. These considerations place the prudential anti-money laundering measures in the context from which it originally emerged:[47]

30. Already well before 1993 (since the financial center in Luxembourg took off in the 1970ies[48]) the fundamental concept, now explicitly contained in the law of 1993, was in place: banks are under the supervision of the State (formerly the IML, now the CSSF), they need a licence to do business ("un agrément").[49] Condition for licensing is "l'honorabilité et l'expérience professionnelles" (the "fit and proper conduct") of its board and of its management.[50] Apart from criminal and administrative sanctions, disrespect of laws, regulations or serious mismanagement by supervisors or top-management can, after having asked the institution to remediate the situation, lead to the suspension of the individual manager or – in very serious cases – to the revocation of the licence.[51]

2. KBL's conduct

31. If it were true, as the former employees of Armscor suggest, that KBL served as a deliberate conduit for 70 % of the clandestine trade conducted by the European central of Armscor, hidden in its Paris Embassy, opening and using up to 850 shell corporations, this would be one of the most serious forms of sanctions violation registered so far: together with those selling the goods and those serving as clandestine routes for the goods, the financial channel is a fundamental part of the conspiracy to subvert the UN Security Council Resolution 418. Concentrating on the

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44 Cf. the general standard relating to customer relations of December 5, 1988 and the implementation of the BSP of January 1989.

45 IML Circulaire 89/57 of November 15, 1989, 1 (b).

46 Loi du 5 avril 1993 relative au sector financier, Receuil de Legislation, 10 avril 1993, 462; art. 38 s. 3 ; Dean Spielmann, La repression du délit de blanchiment d'argent en droit luxembourgeois, annales du droit luxembourgeois, 1993, 166.

47 Daniel Zuberbühler, Banken als Hilfspolizisten zur Verhinderung der Geldwäscherei? – Sicht eines Bankaufsehers in: Pieth, Bekämpfung der Geldwäscherei, Modellfall Schweiz?, 34 ff.

48 In the same sense, Expert Opinion Christian Weyer, 6.

49 Art. 2, loi 1993 (fn. 46).

50 Art. 7 and 19, loi 1993 (fn. 46)

51 Art. 59 ff., loi 1993 (fn. 46).

mere exportation of the goods is an incomplete perspective. Clandestine shipment as well as financial backchannels are part of what is meant by the term "sale", used by the UN Resolutions.

32. It is, however, immaterial whether this specific behavior was domestically criminalised: it was clearly illegal according to international law (Chapter VII of the UN Charter). It is furthermore immaterial whether it constitutes "money laundering" in a strict legal sense as defined by Luxembourg Criminal Law of 1989 or Financial Legislation of 1993: A bank that deliberately channels billions of Dollars of then undoubtedly illegal payments through its system does not offer the requirements of an "honorable" and "experienced" professional. This is an obvious offence against the rule of "fit and proper conduct". Exactly this type of conduct was meant, when the first prudential instruments asked financial centers to prevent the abuse of its financial institutions for the transfer of funds of criminal origin. Besides, it is widely acknowledged that Luxembourg was then and still is through its special position as a strong financial center particularly "exposed to reputational risk".[52]

33. In short, there would have been a legal basis and an obligation of the supervisors at the time to intervene with robust sanctions against KBL for its role in sanctions busting, if they had known of the extent of its involvement in the illegal activities.

V. The Behavior of KBL towards BSL/BSI

34. Turning now to the concrete accusations against KBL and its managers for their behavior towards their client BSL/BSI, there is, as indicated, no direct link to the role of the bank as financial back channel for sanctions busting. But it seems that the bank was ready for all kinds of additional services, if asked for by Armscor, including the "cutting out of agents",[53] once they had served their purpose, as a former employee of Armscor puts it. This behavior has to be assessed under three perspectives:

1. Civil law

35. From a civil law perspective, it will have to be analysed whether the basis for a contractual or a pre-contractual responsibility of KBL is given. This analysis has already been conducted in detail for the purposes of possible court action.[54] It is not my task to further examine this option, even though it looks very promising for the Claimant.

2. Regulatory law

36. Furthermore, if a client is tricked by a banker colluding with a third party (who also happens to be a client of this bank) into dropping its "commercial veto", in order to

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52 Adas/Krier, fn.42, 8,22.

53 Steynberg, fn. 13, N. 58

54 Summons before the Tribunal of First Instance of Brussels, draft June 27, 2007.

loose the enforceability of a commission payment, this is hardly an expression of sound banking practice. Rightly, the banking expert, CHRISTIAN WEYER, analysing the circumstances of the account opening and management, has put it in strong words:

"I find the situation completely unacceptable from a banking point of view and cannot understand how any competent bank or its Senior Management or its internal or external auditors or its compliance officer, would have let such a situation occur".[55]

37. He finds the obligation to "fidelity" towards the client absolutely violated.[56] These are aspects which should have – apart from civil responsibility – given rise to a supervisory intervention in Luxembourg.

3. Criminal law

38. Slightly more complex than the consideration based on regulatory law is the assessment according to Luxembourg criminal law. The most likely possibility is that the behavior of bank staff amounted to the defrauding of Jorge Pinhol and BSL/BSI.

a. Fraud?

39. Under most legislations it would constitute a fraud to trick a person into dropping a commercial security and thereby losing chances of effectually enforcing dues owed from a contract.[57] The Luxembourg law is, however, closely modeled on Belgian and the old version of French law.[58] The Luxembourg Criminal Law on Fraud (Art. 496 code penal, escroquerie), essentially sets three requirements:

- it requires qualified "manoeuvres frauduleux" by the author,
- the "delivery" of funds or objects by the victim,
- finally the author must pursue the goal of appropriating himself of an object belonging to a third party.

aa. Manoeuvres frauduleux

40. The term "manoeuvres frauduleux" relates to an intensive form of manipulation going far beyond simple lies.[59] The "manoeuvres" have to predate the "delivery of the funds". In our case, the intensive efforts of banks staff to convince the claimant that he merely needs to open the account in order to be paid, the procurement of an unusual power of attorney as well as the unfair behavior after having opened the account in conspiracy with Armscor staff, goes far beyond simple insincerity. Such behavior would typically be considered as "manoeuvres frauduleux".

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55 Expert Opinion Christian Weyer, 8,10.

56 Idem fn. 55.

57 Cf. Art. 146 Swiss Criminal Code; Para. 263 German Criminal Code.

58 For historical details cf. Alphonse and Dean Spielmann, Droit Pénal Général Luxembourgeois, Bruxelles, 2002, 8 ff.

59 Lux. Court de Cass. 19. février 1973, p. 22, 290; 25. juin 1987, p. 27,78; cf. also ancien code pénal français annoté, N. 53, 54, 55 to Art. 405 CP.

bb. Delivery of values[60]

41. It is fundamental for the understanding of fraud that the victim damages himself by delivering the goods or, as it says in the text of the Luxembourg law, the values to the author of the crime. It is a difficult question, based on the published case law in Luxembourg, to determine whether the giving up of a "commercial veto" can be described as "se faire remettre ou délivrer des fonds, meubles, obligations, quittances, décharges": it could well amount to undeserved form of "décharge" of the debtor to let go of securities. In our context the commercial veto is fundamental to the enforceability of this confidential commission.

cc. "Dans le but de s'approprier une chose appartenante à autrui"

42. The goal of the operation was without doubt to inflict damage which corresponds with an illegal benefit on the side of the trickster. However, Luxembourg law demands, different, e.g. from German law, but in line with Belgian law, more than just the goal to enrich oneself at the cost of the victim. The author is expected to appropriate an object. It is a moot point if manipulation in order to obtain a service for free would suffice.[61] Obviously, if the authors of the crime are successful, they have made the agent work for them for free. However, in such a case the victim is not really defrauded of a service, rather of its remuneration: through his manipulations, the author has managed to trick the victim into giving up its commercial securities and the chances of obtaining payment. The object, the victim is intending to appropriate is the payment. And these are funds belonging to others.

dd. Co-authorship

43. The opening of the bank account was a key-part of the scheme to manipulate, the bank managers contribution was necessary to commit the crime: therefore the bank managers are co-authors with the Armscor representatives according to Art. 66 s. 3 code pénal Lux.

ee. Prescription

44. The criminal statute of limitation for "peines correctionelles" according to Luxembourg law is merely 3 years.[62] It is unlikely that the procedures in South Africa or in France have been able to interrupt the flow in these delays, since they were mere civil proceedings. However, if a future court dealing with civil claims against KBL (be it in Luxembourg or any other place like Belgium) should come to the conclusion that KBL staff have defrauded the BSI representative, this aspect would constitute the basis for a separate tort claim. If Luxembourg law is applicable it would subject to the long, civil law tort prescription of 30 years.

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60 „La remise", cf. ancien code pénal français annoté N. 49 to Art. 405 CP.

61 Negative the Court d'Appel Lux. 7. décembre 1993: „La prestation de service ne constitue pas un élément constitutive de l'escroquerie qui ne vise que la remise ou la délivrance d'objets mobiliés"; under old French law, which corresponded to the Luxembourg text, dissenting opinions can be found : Court d'Appel de Paris 25. mai 1989, Dr. pén. 1990, p. 90; TGI Lyon 18. juin 1970, JCP 1970 II 16514; RSC 1971, p. 129 (décision ci-jointe).

62 Art. 14 and 638 code pénal Lux.

VI. Conclusion

45. If the allegations by former Armscor employees, the entity owned by the South African Government encharged during the time of the Apartheid Regime with circumventing the Arms embargo of the UN, are correct, **KBL** was one of the primary clandestine financial conduits for the Paris based illegal procurement operation. It was responsible for up to 70 % of the covert financing of arms deals, making use of an entire system of 850 shell corporations and corresponding accounts.

46. Sanctions busting went against international law (Security Council Resolution 418 in combination with Chapter VII UN Charter), Luxembourg shared this view and promised the UN to enforce it through its export licensing system. Financing, just as much as providing back channels for goods clearly were part of the conspiracy, but they seemed to elude the control network of European countries. Yet, for a bank to be one of the cornerstones of undermining the sanctions against an entire country is a very serious matter. Even if it would not have directly contravened against the criminal provisions of a specific country at the time, running hundreds of shell corporations at clandestine accounts to subvert the sanctions was clearly not what one would call professional behavior of a serious financial institution. Even if Luxembourg codified the considerations of "fit and proper conduct" by bankers in detail, only in 1993, these rules were in place long before. Under these circumstances, if the supervisory authorities would have known of the behaviour of KBL, they would or should have intervened with the strictest of measures available.

47. KBL was a very problematic bank indeed. This impression was confirmed by the way it treated individual clients when a conflict of interest arose: It is no coincidence that it apparently lent itself to participate in a fraudulent scheme arranged by Armscor to trick an agent out of the security (commercial veto), impeding him from enforcing his claims to a commission.

48. If the conspiracy of bank employees with Armscor (in opening, running and closing the account) against another client was problematic from a prudential point of view, it most probably is the basis of contractual and pre-conctractual responsibility (an issue not examined in depth here). It is further reinforced by an additional tort claim, based on a criminal fraud charge, a real possibility, even if some technical difficulties due to the peculiarity of Luxembourg law may need to be surmounted.

49. Overall, KBL is, if these allegations are true, a serious reputational risk factor and a liability for a financial center like Luxembourg. The past needs to be rectified as soon as possible.

Prof. Dr. Mark Pieth