

# HIDDEN MENACE



global witness

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**HOW SECRET COMPANY OWNERS  
ARE PUTTING TROOPS AT RISK AND  
HARMING AMERICAN TAXPAYERS**

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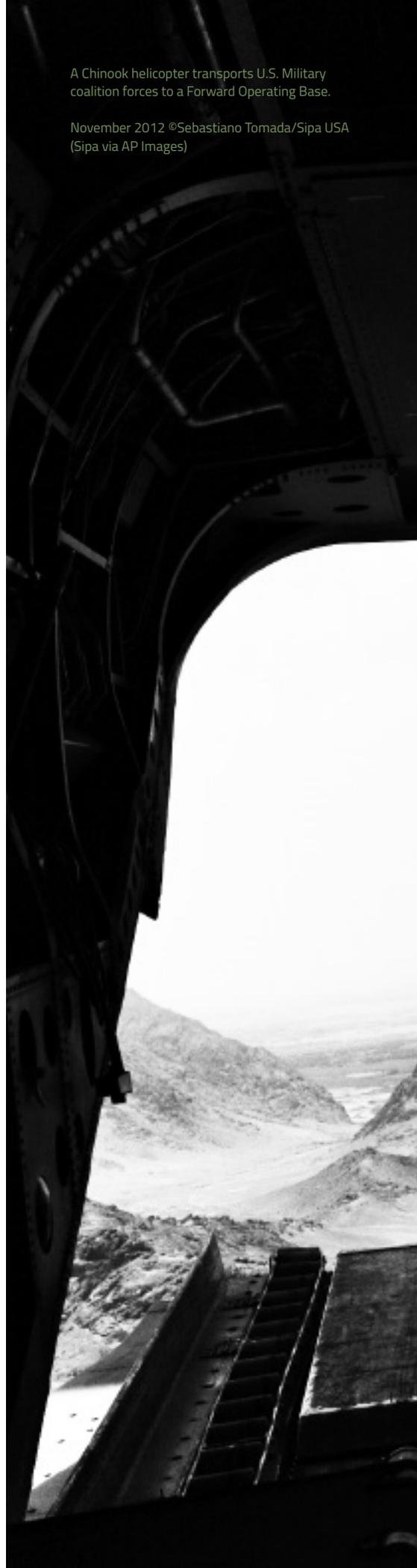
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A Chinook helicopter transports U.S. Military coalition forces to a Forward Operating Base.

November 2012 ©Sebastiano Tomada/Sipa USA  
(Sipa via AP Images)





“Contracting expenditures represent a powerful tool in the anti-corruption fight, and U.S. and international contracting agencies must be pushed to look beyond cost, schedule, and performance and to focus most intently on the impact of select contracts....”<sup>1</sup>

Report to Congress on Progress Toward Security and Stability in Afghanistan, November 2010

# INTRODUCTION

Since the financial crisis and release of the Panama Papers, we have heard a lot about the revenue governments lose to tax avoidance and evasion, but what about the losses resulting from corruption and fraud when governments spend money on goods, services and infrastructure?

Around the world governments spend \$9.5 trillion each year on public procurement.<sup>2</sup> It should be no surprise that fraudsters, and corrupt officials, take advantage of this. According to research by the United Nations (UN), corruption may amount to as much as 25% of the value of government procurement contracts worldwide.<sup>3</sup> In the U.S. during 2012, “[t]he federal government lost \$261 billion, or 7[%] of total spending, to fraud and waste,” according to U.S. House Representative Darrell Issa (R-CA).<sup>4</sup> The results of such fraud are harm to all of us in the form of lower quality infrastructure and services,

higher prices, wasted tax dollars and decreased trust in government.

Criminals who are ripping off public budgets need to hide what they are up to. Anonymously-owned companies, or those whose owners are hidden, have proven to be a common facilitator of waste, fraud and abuse in government spending.

This brief reveals the seriousness of the problem of anonymously-owned

companies in federal purchasing and recommends what must be done to fix it. It focuses on the issue of anonymous shell companies in military contract spending, both because of the serious national security risks posed by their use for illicit purposes, and because of the significant proportion of the U.S. budget—approximately 8.5% of total U.S. federal government spending annually.<sup>5</sup>

“A ‘beneficial owner’ is a natural person—that is, a real, living human being, not another company or trust—who directly or indirectly exercises substantial control over a company or receives substantial economic benefits from the company.”

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# FUNDING ENEMIES IN AFGHANISTAN AND ENDANGERING TROOPS

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According to the UN and other experts, at least 25% of government money spent in fragile states is illicitly diverted into the hands of U.S. enemies.<sup>6</sup> For a country such as Afghanistan, where the U.S. has been engaged in military operations for over a decade, these diversions could amount to as much as \$28 billion of the amount the U.S. government has spent in the country since 2002.<sup>7</sup> This briefing will demonstrate that this massive theft of funds has been possible in part because of a lack of beneficial ownership transparency and include specific examples of this.

Beginning in early 2010 a military-led

group of contracting investigators called Task Force 2010 revealed this reality in a nearly 2-year long forensic investigation in to fraud and corruption associated with \$31 billion worth of U.S. spending in Afghanistan. Their findings showed that U.S. funds were flowing from primary contractors and their subcontractors on to local and international criminal and insurgent networks, including the Taliban, Haqqani network, Hezb-e Islami, Lashkar-e-Taiba and Tehrik-i-Taliban Pakistan.<sup>8</sup>

In response to the web of contractors and blurred lines between

contractors and the private sector in places such as Afghanistan, the U.S. government requires some key disclosures of contractor and subcontractor information. However, the companies the U.S. government does business with are not required to provide information about their beneficial owners, which leads to waste, fraud and abuse.

While it may be true that most contractors are honest businesses, the criminal and corrupt seek to outsmart the system with impunity and it is very difficult to know into whose hands money is flowing. This is why it is crucial that the contractor vetting process includes the collection and publication of beneficial ownership information at all tiers of federal spending. A 'flow down clause' would ensure that requirements in the primary contract also apply to subcontractors.



A Texas-born private first class looks through his tattered window during the U.S. surge in Afghanistan and deadliest year in the war for the NATO coalition.

Taliban fighters standing guard as a senior leader speaks to his fighters in southern Afghanistan.

May 2016 ©AP Photos/Allauddin Khan





“Keep close watch over contracting dollars and ‘know those with whom we are contracting.’ Failing to do so could ‘unintentionally fuel corruption, finance insurgent organizations, strengthen criminal patronage networks, and undermine our efforts in Afghanistan.’”<sup>9</sup>

General David Petraeus, excerpts of his September 2010 exit memo from commanding operations in Afghanistan

**FIVE CASES FROM THE TASK FORCE'S WORK AND OTHER LAW ENFORCEMENT INVESTIGATIONS ILLUSTRATE THE PROBLEM:**

**DEBARRED CONTRACTORS GETTING BUSINESS**

An American couple with ties to Afghan fighters almost got away with \$5.3 million in new federal contracts through their Texas-based anonymously-owned company. This was despite the fact that they were debarred and facing criminal charges for overbilling the U.S. government at least \$17 million under a previous contract that they had won to supply security services in Afghanistan.<sup>10</sup>



**FUNDING THE TALIBAN**

A U.S.-Afghan contractor funneled at least \$3.3 million of U.S. taxpayer dollars to notorious Afghan power brokers, who deliberately hid their ownership interests in companies within the contractor's network to avoid association with the insurgency. These individuals in turn funded the purchase of weapons for the Taliban and insurgents.<sup>11</sup>



**COLLUDING FOR THE PERFECT BID**

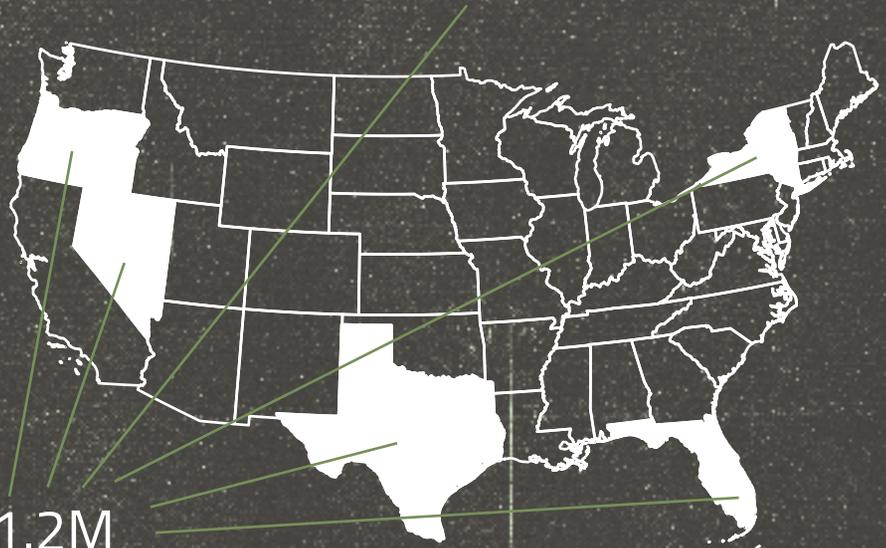
A U.S. Lieutenant Colonel passed on information to a business owner and contractor to create the perfect bid, and steal more than \$20 million from taxpayers and Afghan commando troops while transferring their loot through anonymous shell companies in Virginia and Massachusetts.<sup>12</sup>



### FUGITIVE SUPPLYING SHODDY PARTS TO THE TROOPS

A former America's Most Wanted fugitive made millions by defrauding the U.S. government of \$11.2 million during a time of armed conflict. He supplied shoddy, dangerous parts essential to well-functioning weapons and to the safety of troops under the disguise of nominee companies created in New York, Florida, Nevada, Oregon, Washington, Texas, California, New Jersey and Canada.<sup>13</sup>

\$11.2M



### U.S. TAXPAYER MONEY REPORTEDLY REACHING INSURGENTS

A money exchange broker or hawala owner, with confirmed ties to insurgent groups in Afghanistan, received \$1.14 million from an Afghan security provider working under U.S. government contractors. This hawala owner carried out his business anonymously behind a fake persona in order to avoid authorities who had credible reporting that his business was linked to insurgent activity, such as attacks on American soldiers and goods. The leader of the Afghan security firm, Commander Haji Rohullah Popalzai, has vehemently denied paying the Taliban, while U.S. government investigations and those with direct experience question this assertion.<sup>14</sup>

\$1.14M



In all but one of these cases, a lack of information about the real owners of companies allowed fraudsters to rip

off the U.S. government, and this is just the tip of the iceberg.

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# STEALING FROM THE AMERICAN GOVERNMENT, TAXPAYERS AND BUSINESSES

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Anonymously-owned companies and the resulting harms are a problem that reaches beyond Afghanistan. This issue effects the government and taxpayers at every level of spending—at the local, state, and federal level.

When fraudsters are able to cheat legitimate contractors by hiding behind anonymous companies, responsible businesses are economically disadvantaged, excluded from the market or have to race to the bottom when forced to compete with such nefarious business actors.

“Corruption distorts markets by not allowing the best and most competitive companies to win contracts or have their projects and developments approved. Corruption removes public monies that could support investments in human capital and economic development—all contributors to economic growth and sustainable development.”<sup>15</sup>

The B Team, Ending Anonymous Companies: Tackling Corruption and Promoting Stability through Beneficial Ownership Transparency, The Business Case, January 2015

Well-maintained roads are essential for economic development, but these projects are plagued by fraud, corruption and collusion. Construction has been ranked as the industry most prone to corruption.<sup>16</sup>

April 2012 ©AP Photo/Seth Perlman File

# ROAD CONSTRUCTION AHEAD

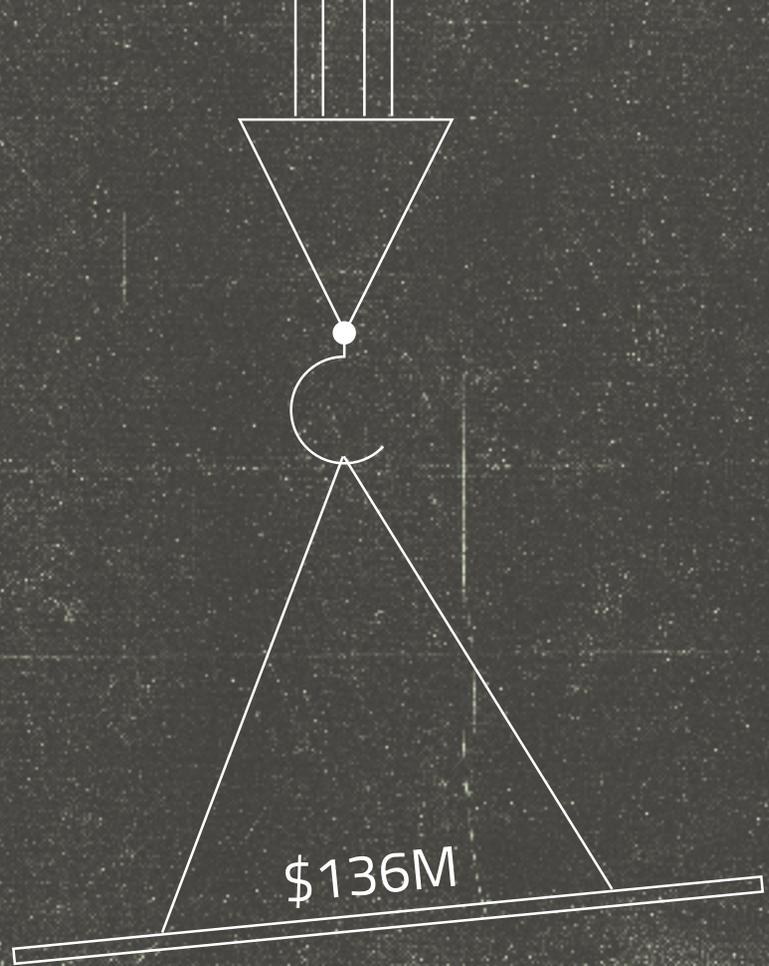


**IN A FURTHER FIVE CASES,  
ANONYMOUS COMPANY OWNERS  
EFFECTIVELY STOLE FROM  
AMERICAN TAX PAYERS AND  
LEGITIMATE BUSINESSES. THEY  
INCLUDE:**

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**SQUEEZING OUT  
DISADVANTAGED BUSINESSES**

A former construction company executive in Pennsylvania anonymously hid behind a Connecticut-based company owned by a person of Filipino descent receiving preferential treatment in U.S. government contracting. This allowed the construction executive to bid for and win contracts he wouldn't have otherwise been eligible to receive. Over 15 years, the executive won over 300 federally-funded contracts worth \$136 million in Pennsylvania alone. This was the largest fraud against socially and economically disadvantaged business owners in U.S. history.<sup>17</sup>



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**STEALING FROM YOUR  
BOSS AND CLIENTS**

A government contractor's employee tried to scam his employer's sub-contractors by using shell companies to bill them for services his employer delivered. He then tried to use a bank account in the name of his Alabama anonymously-owned company to steal \$650,000 from his employer and other family-owned subcontractors.<sup>18</sup>



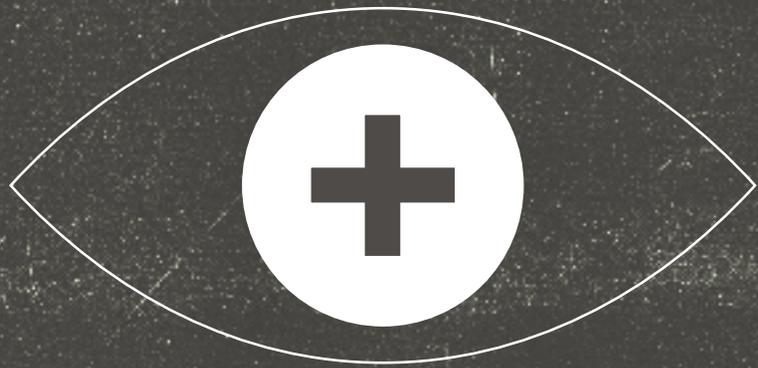
## HIDING A CONFLICT OF INTEREST FOR PROFIT

A U.S. defense contractor employee used his position to secure more than \$11 million worth of contracts for the Afghan National Army for a Tennessee-based company that he secretly owned; but that his wife ran under her maiden name to hide their conflict of interest.<sup>19</sup>



## ORGANIZED CRIME STEALING FROM THE GOVERNMENT

Criminals behind the largest U.S. Medicare fraud managed to steal over \$35 million from the government program by creating at least 118 fake health clinics in around 25 states in the names of anonymous companies incorporated in eight states—Alabama, California, Colorado, Kentucky, Maryland, Nevada, New Mexico and Texas.<sup>20</sup>



## FAKE CLINICS RIPPING OFF COMPANIES AND UNCLE SAM

Fraudsters used companies anonymously incorporated in Florida, Georgia, North Carolina, South Carolina and Louisiana to steal approximately \$70 million that was meant to help HIV and cancer sufferers through Medicare and Medicare Advantage.<sup>21</sup>



These cases are only a sample of the ways anonymously-owned companies and opaque vendor networks have been used to rip off American taxpayers, businesses and the government, while putting

Americans at home and abroad at risk.

Yet, for every case that has been exposed, many more remain hidden. As things stand, owners of

anonymous companies are able to steal from the state, businesses and taxpayers while remaining faceless and unaccountable. It is easy and the structures can be entirely legal. This must end.

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# THE SOLUTION – BENEFICIAL OWNERSHIP TRANSPARENCY

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The problem of anonymous companies in government spending is a matter of public interest. Global Witness believes that the public has a right to know how their tax dollars are being spent and who is benefiting from those funds. The U.S. Administration has the power to address this problem of fraudsters using anonymous companies to rip off the government. It should require that all companies bidding for government contracts publicly disclose their beneficial owners, the real people who own or control them.

To further combat corruption, as well as waste, fraud and abuse, Congress must require all American companies

to disclose their beneficial owners at the time of incorporation and to regularly update the information. Law enforcement would then have a critical tool in the fight against the financing of terrorism and financial crime.<sup>22</sup> Faith leaders, organized labor, public interest groups, and human rights and anti-corruption advocates recognize the importance of this information and support transparency among company owners.<sup>23</sup>

Beneficial ownership transparency reduces incidents of conflicts of interests and cronyism in contracting. It would curb false billing by contractors, and false certification for small-, disadvantaged-, veteran- or disability-owned businesses. It would help prevent individuals who are prohibited from winning contracts due to suspension, debarment or criminal conviction from evading

those bans. In addition, statistics have also shown a reduction in costs, fraud and corruption when the contracting process is open.<sup>24</sup> For example, in Ukraine, a fully open contracting portal (Prozorro) saved the government 14% on planned spending in its first year, while the number of companies bidding for contracts increased by 50%.<sup>25</sup>

Global Witness welcomes the Obama Administration's existing commitments to address anonymous company ownership under several international initiatives aimed at combatting fraud and corruption. It is worth noting that transparency of the real owners of companies is so important to our national security that President Obama included a commitment to work with Congress on this issue in his Strategy to Combat Transnational Organized Crime.<sup>26</sup>

A U.S. soldier stands guard in Kandahar, Afghanistan during a 2013 visit by the then U.S. Secretary of Defense Chuck Hagel to thank the troops for their service during the holidays.

December 2013 ©AP Photo/Mark Wilson, Pool



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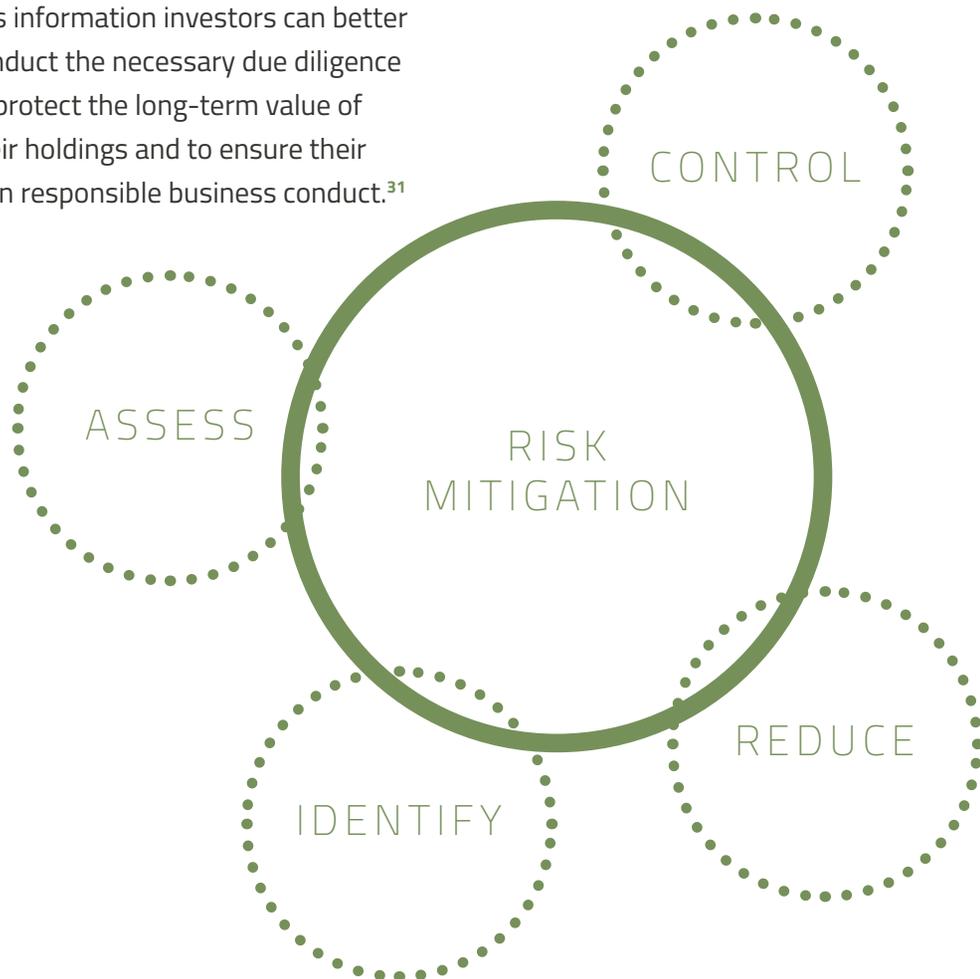
# THE BUSINESS INTEREST IN A PUBLIC BENEFICIAL OWNERSHIP REGISTER

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Global businesses also support company ownership transparency. A recent survey by the international accountancy firm, EY, shows that 91% of senior executives around the world who responded to this survey think it is important to know the beneficial owners of companies they do business with.<sup>27</sup> Similarly, 22 institutional investors managing over \$505 billion in assets have sent letters to Congress calling for an end to shell company secrecy.<sup>28</sup> American small businesses also publicly support beneficial ownership transparency, including in U.S. government contracting.<sup>29</sup> In a recent report, a number of global business leaders argued that “the business impetus for beneficial ownership transparency goes beyond compliance, contributing to risk management, and even in some instances, competitive advantage.”<sup>30</sup>

Opening beneficial ownership information to commercial actors

provides them with new channels of fruitful due diligence among supply chains and business partners. Small- and medium-size firms struggling to compete against dishonest competitors would have greater opportunities to shine as legitimate, responsible actors. Furthermore, with this information investors can better conduct the necessary due diligence to protect the long-term value of their holdings and to ensure their own responsible business conduct.<sup>31</sup>



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# RECOMMENDATIONS

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THE SOLUTION IS CLEAR:

**The Administration should collect, verify and publish information about who ultimately owns and controls all bidders for funds from any agency within the U.S. government.**

This information should be publicly available for free in a machine readable format, such as the Open Contracting Data Standards.<sup>32</sup>

This disclosure requirement must be applied to all subcontractors, regardless of contract size. To ensure the robust collection and use of this data, all American contracting systems should also be systematically updated in a planned transition. They should be developed with a common, comprehensive, and coordinated systems design for consistency, accuracy and usability.

**Congress should put information about who ultimately owns and controls American companies into the public domain for all to see.**

At present, the lack of information available on the people behind American companies is a gift to individuals who want to use them to hide their identity and move their ill-gotten gains. Congress should work with the Administration to ensure laws mandate systems

updates, implementation and funding to advance beneficial ownership transparency in contracting. These rules must be co-developed with practitioners, user communities and experts while taking into account lessons learned.

**All companies should publicly disclose who ultimately owns and controls them as an expression of business integrity and ethics.**

Companies should also require beneficial ownership disclosures from businesses in their vendor networks and use that information in due diligence and vetting processes. To level the uneven playing field, companies should call on Congress to take urgent action to end anonymously-owned American companies. They should also call on the Administration to require bidders for government funds to disclose their ultimate beneficial owners and to make that information public for all to see.



“It makes absolutely no sense that individuals and entities designated as supporting the insurgency could receive U.S. contracts; ... [i]f they get a contract not only do they get U.S. taxpayer money, but they could gain access to U.S. personnel and facilities, putting our troops at risk.”<sup>33</sup>

John F. Sopko, Special Inspector General,  
Special Inspector General for Afghanistan  
Reconstruction

A U.S. Tech. Sgt. and Air Force Pararescuemen drape an American flag over the remains of U.S. soldiers killed in an improvised explosive device (IED) attack in Kandahar province, Afghanistan.

July 2010 ©AP Photo/Brennan Linsley

# ENDNOTES

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Global Witness wants a better world — where corruption is challenged and accountability prevails, all can thrive within the planet's boundaries, and governments act in the public interest. Many of the world's worst environmental and human rights abuses are driven by the exploitation of natural resources and corruption in the global political and economic system. Global Witness is campaigning to end this. We carry out hard-hitting investigations, expose the facts, and push for change. We are independent, not-for-profit, and work with partners around the world in our fight for justice.

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