

FOOL'S GOLD

**THE ABUSE OF EXPORT COMPENSATION SCHEMES
IN KENYA AND ARGENTINA**



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Corruption is both a national and international problem. TI-Kenya and Poder Ciudadano plan to continue to expand their anti-corruption programmes and advocate for financial reform and 'checks and balances' in order to forestall the misuse of funds.

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Contents

Fool's Gold: The Abuse of Export Compensation Schemes	3
Goldenberg: Export Compensation in Kenya	7
Introduction	7
Enter Kamlesh Pattni	7
The Proposal is Accepted and Goldenberg is Born	8
Something is Amiss...	9
But Whither Come and Whither Go the Exports?	11
The Conspiracy?	13
The Saga of Nasir Ibrahim Ali	14
The Pre-shipment Finance Scandal	16
How Did it End?	18
Postscript - What became of the key players?	19
...And Whither Kamlesh Pattni?	20
La Mafia del Oro: Export Compensation in Argentina	21
Introduction	21
Creating an "Enabling" Environment	21
Enter Handy & Harman	22
Sidestepping Verification	24
Diversifying: From Gold to "Cheap" Metals	25
Dirty Banks, Dirty Cash	25
The Scandal Unfolds	29
Riojanas Refineries	29
Facing the Music	29

Fool's Gold: The Abuse of Export Compensation Schemes

Export compensation is a novel idea involving the government offering incentives to industries and institutions for the export of goods in the form of cash rebates or tax concessions. The ostensible purposes of export compensation schemes are to encourage trade and foreign exchange earnings, improve specific sectors of the economy and create economic opportunities. For example, subsidies to local manufacturers by the South African government brought about the penetration of South African goods and services into East and Central Africa, after the lifting of sanctions against the nation. This is one of the many success stories of a scheme that is as old as the American Revolutionary War and has seen success in the United States, Britain, Japan, and Mexico to name a few countries.

However when abused, export compensation has brought about adverse effects on the economies of countries affected, stained all three arms of government, weakened government institutions involved, resulted in numerous forms of corruption and served as a great injustice to taxpayers.

With this in mind, Transparency International's chapters in Kenya and Argentina, TI-Kenya and Poder Ciudadano, decided in early 2000 to undertake a combined case study on the abuse of export compensation schemes. The study involved export compensation schemes run during the 1990s in both countries. In Kenya the affair is eponymously called Goldenberg; in Argentina, La Mafia Del Oro.

In the case of Kenya, the roots of Goldenberg go as far back as the late 1980s, when the Ministry of Finance received a proposal that was in effect supposed to encourage the legitimate export of gold, with the main objective of eliminating illegal smuggling.

By giving Goldenberg exclusive rights to export gold and financial incentives (mainly in the form of export compensation), the government aim was to grant Goldenberg an advantage over the smaller gem and gold traders and the powerful black marketers ensuring that it would soon have control over Kenya's small gold mining sector. The government would be able to eliminate the black market and thus control the industry. Taxing Goldenberg's profits would provide the Exchequer with increased tax earnings and boost foreign exchange reserves.

Soon after the project was initiated in July of 1990, export compensation claims increased as the value of Kenya's gold exports "increased" and according to Goldenberg's claims hit a value of Ksh. 9.4 billion in 1993 (putting it just behind Kenya's largest export earner, tea's Ksh. 9.5 billion, though as will become apparent this did not feature in the Kenya Economic Survey, 1993).

At about the same time, in Latin America's third largest economy, Argentina, a similar export compensation scheme was in the pipeline. Initiated in 1992, three years after Goldenberg, it turned out to be a case of grand theft and money laundering by a tightly knit group of influential politicians, businessmen, bankers and foreigners now commonly referred to as "La Mafia Del Oro" that is the Gold Mafia.

For a long time, Argentina's gold revenues had remained at a stagnant level of US\$ 10 million per annum, mainly consisting of gold products derived from imported gold. However, within months of the initiation of the "La Mafia Del Oro" scheme, gold exports hit an all time high of US\$ 1 billion, during the period November 1993 to May 1995, surpassing export earnings from all other Argentinean exports, such as meat and corn.

Both these export compensation schemes resulted in major national scandals and deleterious macro-economic consequences. Commencing in 2000, TI-Kenya and Poder Ciudadano respectively conducted studies of the two affairs. The last two years of researching, translating documents and records and liaising between these two national chapters of Transparency International have resulted in "Fool's Gold", which details these schemes.

The study noted that a number of similarities existed, between both cases, which are:

- **sums involved both as claimed value of exports and export compensation claims were way above the meager scope of the legitimate gold trade in both countries**
- **exorbitant compensation claims were involved, whereby the buyer was supposed to have bought the gold or precious material at unbelievably high prices**
- **to increase export compensation claims, the schemes "diversified" from gold to other precious metals and minerals such as copper and diamonds. Financial schemes were created to increase the export compensation. High levels of corruption reigned in government offices to enable the activities to persist without any action taking place**

- numerous laws, regulations and protocols were broken and/or ignored with little if any punishment and repercussions
- the scandals contained numerous "holes" and unexplained actions that served as signs to civil society that something suspicious was going on
- the prosecution of suspects is in 'fits and starts', with no successful headway being made to recover lost funds
- conspirators involved in the two schemes live in luxury and relative freedom
- financial institutions were created in the Kenyan and Argentinean cases respectively to enable the conspirators to easily launder money obtained in the form of export compensation
- great discretion was allowed to economic policy makers in both Kenya and Argentina including the Argentina's Economy Minister, Kenya's Finance Minister and the governors of the central banks of the two countries, enabling large amounts of public funds to be transferred into the hands of undeserving individuals
- both Goldenberg and "La Mafia Del Oro" were hailed as revolutionary projects intended to source large volumes of foreign exchange for their respective countries by influential government figures
- the two scandals were the main factors in the near-collapse of two promising economies and was the start of years of economic recession and slow growth in the two countries. Kenya's economy has been on a downward spiral since the inflation caused in 1992 by both the Goldenberg scandals and the 1992 general elections. Argentina's recent economic collapse was mainly due to "Los Mafia Del Oro" and the large scale and poorly planned privatisation of public enterprises

Despite the similarities between the two cases, certain differences existed between the two scandals. The processes involved in obtaining false export compensation claims were more complicated in Argentina as they had in place more institutional mechanisms to monitor and publicize corrupt activities by politicians and businesses, stronger anti-corruption and money laundering laws and a more vocal parliament and citizenry. Handy & Harman, a reputable gold refinery in the United States, was involved in the

fraud together with well-established local jewelers and considerable volumes of gold and other metals were utilized.

This contrasted greatly with Kenya's case where no reputable international firm was involved and where only one main instance was made to acquire and sell real gold, the Kenyan version mainly involved non-existent volumes of gold and diamonds.

In Kenya, to enable the conspirators to "reinvest" money acquired from fraudulent export compensation claims, "revolutionary" financial schemes involving public funds that earned them high returns were put in place.

To date, Argentina has prosecuted many of the local and international conspirators in the scheme, with the help of the United States Department of Justice. However, the cases have never been resolved and the scheme's "big fish" have served no jail terms. In Kenya, Kamlesh Pattni, the perceived initiator of the project has been charged but not imprisoned and numerous other conspirators have gone scot-free.

Goldenberg: Export Compensation in Kenya

Introduction

Sometime in 1987, a proposal was put to the Kenya government on ways of "streamlining" the gold trade, with a view to maximising revenue benefits for the Exchequer and stamping out smuggling of the precious metal.

The ostensible nub of the proposal was a plan to centralise gold trading and export by granting exclusive rights to a single above-board exporter, rather than leave the market to black-marketeers, smugglers and con men. For the franchise to work and succeed in cleaning out the black market operators, the person granted the legal trading rights would be given a financial incentive in the form of "export compensation."

"Export compensation" was bureaucracy-speak for a new Treasury instrument introduced to assist exporters in attracting scarce foreign exchange for the country. Simply put, it was a Government subsidy, pegged at a percentage of the value of the export consignments, which would cushion exporters from the vagaries of the market. In the case of this particular gold franchise proposal, the export compensation would be necessary so as to squeeze out the black market operators by offering better prices for gold.

It all sounded perfectly sensible, even patriotic. But little did anybody know that soon the scheme would be twisted to highly illegal ends, amounting to the largest and most grotesque criminal financial fraud ever committed in Kenya's history. The cumulative, direct cost to the Kenyan taxpayer is now estimated to be in the region of US\$500 million. (Contrast this sum to Kenya's GDP, which at the time of writing is some US\$10 billion at current dollar rates).

The scam is what is now universally referred to as Goldenberg. Indeed, as will be discussed later on, it was not just a one-off scheme of export compensation fraud but a multi-headed hydra that gave birth to other even more insidious rip-offs.

Enter Kamlesh Pattni

In 1987, Kamlesh Manukhlal Pattni was relatively unknown outside the world of Asian dukawallah commerce in Nairobi. He has subsequently become one of the most (in)famous names in the local business and political world, often

bearing the appellation "billionaire businessman" or the suffix "tycoon".

Originally from Mombasa, the twenty-something year-old Pattni came from a family of gold jewellers, one among a coterie of such businessmen who cater mainly to the wealthy, close-knit Asian community in Kenya.

The proposal which he was making to the Government in 1987 would essentially entail getting into a totally new dimension of operation beyond the small confines of ordinary jewellery business in Kenya. The sums of money that would also get involved were way above the meagre scope of the legitimate gold trade in the country.

Gold deposits exist in extremely limited quantities, in some locations in western Kenya. There are no official or organised mines; the extraction is done by freelance prospectors who labour in taxing conditions on river beds and other sites where the deposits are believed to lie. These freelancers produce an average supply of 100 kgs annually. Considerably greater amounts are smuggled into and out of the country from neighbouring countries and the Great Lakes region.

It is from such a puny background (and without an organised gold or precious metals industry worth speaking of) that Pattni proposed to create a multi-million dollar gold and jewellery export machine for Kenya.

The Proposal is Accepted and Goldenberg is Born

Though the Commissioner of Mines and Geology, Collins Y.O. Owayo, embraced the idea with enthusiasm, Pattni's proposal languished for a couple of years on the shelves of the Ministry of Finance.

However, the picture suddenly changed in 1990, when events were set in motion at very high levels to make Pattni's idea a reality. For starters, Pattni registered a new company, Goldenberg International Ltd. This was on July 29, 1990. The other name appearing on the company's registration documents was that of James Kanyotu, who stated his occupation as being a farmer. Kanyotu was, of course, better known as Kenya's secret police chief: the boss of the Directorate of Security Intelligence.

Once registered, Goldenberg renewed the application for an exclusive licence to export gold, with a new twist that it be allowed to deal with diamonds as well. It should be noted that diamonds do not exist in any quantity in Kenya. This time around, the response from the Treasury was prompt.

In the licence application, sent to the Vice-President who was also the Minister for Finance, Prof. George Saitoti, and copied to the Central Bank Governor, Mr Eric Kotut, Pattni outlined that Goldenberg planned to export

100kgs of gold a month at the beginning, then 400kgs each month after the initial half-year. He did not go into the details of how Goldenberg planned to source all that gold in a country producing a mere 100kgs of the commodity in a whole year. All he would allow was that he anticipated raking in exports worth some US\$50 million a year.

Pattni asked for three things: that he be granted sole export monopoly of gold for a period of five years; that he be granted 35 per cent export compensation on his gold and diamond jewellery exports; and that he be allowed to form his own finance company, ostensibly because he was expecting to handle "numerous cash transactions on a daily basis."

In a letter dated November 1, 1990 from the Permanent Secretary to the Treasury, Mr Charles Mbindyo, Pattni was granted his first two requests. The third one, about setting up a finance house to service Goldenberg's transactions, was found not to be necessary "at the moment." (In due course, though, even this concession was granted).

Everything about the concessions, though, was pointedly illegal. Granting an export monopoly to Goldenberg while locking out other would-be competitors contravened the Monopolies Act of the Laws of Kenya, a point which was soon raised by the Customs and Excise Department but which the latter was instructed by the Central Bank, in contravention of its own regulations, to overlook. What is more, all this was being done on behalf of a company which was only four months old and which had no proven experience or expertise in the exportation of gold.

Moreover, the Treasury had no legal power to grant export compensation at the level it did – 35 per cent. The legally authorised rate, as set out in the Local Manufacturers Act, was a maximum of 20 per cent. That was the rate it remained at until January 1993, when it was reduced to 18 per cent. It was subsequently abolished altogether in June 1993, no doubt as a result of the emerging public revelations over the infamy the subsidy was being put to by Goldenberg.

Another peculiar variation of Goldenberg's new licence was that the company was permitted to handle foreign exchange, notwithstanding that such authority was then reserved for commercial banks. Exceptions to this rule were tourist-related organisations, like major hotels, who were authorised to charge their foreign guests in foreign currency rather than Kenya shillings. Goldenberg's coup in being granted this concession was indeed a remarkable one, for around this time, in 1990, stringent foreign exchange restrictions were still in full force in the country and authority to deal with foreign exchange highly curtailed. Foreign exchange controls were eventually abolished in 1993 when economic liberalisation was set in gear.

In any case, it looked patently illogical to grant Goldenberg a licence to accept foreign currency in Kenya when the company was claiming to be an exporter, allegedly dealing with customers abroad. Such customers would be expected to pay for their purchases via bank transfers – not by sending people to Kenya to pay cash in bits and pieces – which is how Goldenberg was claiming it was being paid.

Something is Amiss...

It was not long after Goldenberg got started that evidence began to surface that something was terribly wrong. All exports, by law, were required to be invoiced in a convertible currency – like the US dollar, the pound Sterling, the Deutsche Mark, the French franc or the Swiss franc – not in Kenya shillings. Since Goldenberg was supposed to be an exporter, this rule was expected to apply.

Exporters seeking export compensation were also required to go through elaborate procedures and show a sufficiently clear paper trail in order to prove they had indeed exported the goods they claimed to be exporting, and that in fact the requisite foreign exchange had been remitted back into the country.

First, a set of "customs declaration" forms (known as CD3) had to be completed in triplicate for every consignment of gold and jewellery Goldenberg exported. Stated on each CD3 form was the identity of the exporter and that of the consignee, a description of the goods, their value, the date they left Kenya, the flight number of the aircraft handling the shipment, the name of the airport that shipment flew out from, as well as the invoice number of the goods.

In addition, the goods before they were exported had to be examined by the Commissioner of Mines and Geology to confirm the value stated in the CD3 forms, after which a certificate of inspection was granted. The CD3 paper trail from the exporter's bank and the customs people was then re-routed to the Central Bank so that there was confirmation of the export consignment and of the money received, and in what currency. That confirmation then formed the basis on which export compensation could be claimed.

It soon became apparent that none of these guidelines was being complied with, even as export compensation claims started to pile up from Goldenberg. This prompted the Exchange Control Department of the Central Bank to raise the first of a series of stern inquiries with Goldenberg's bank, the First American Bank of Kenya (one of whose directors was Mr. Kanyotu).

The Central Bank's concern was that the money that First American Bank was claiming it received against exports allegedly made by Goldenberg did not tally with the figures on the invoices for the exported goods. The CD3 forms Goldenberg had filled out were also highly irregular: there were gaping irregularities over dates and invoices of the alleged consignments, and the customs' inspection certificates required to be attached were missing. Clearly, something was very wrong somewhere.

Odder still, from the point of view of an exporter, was that Goldenberg was invoicing its clients abroad in Kenya shillings, not in hard currency. In October 1991, the Commissioner of Customs and Excise, Mr Francis Cheruiyot, warned Goldenberg that this was illegal, as it contravened exchange control regulations. The Central Bank's Exchange Control Department was quick to raise this question too, pointing out that the documents it had received indicated that payments were being made in cash within Kenya, rather than by transfer from Goldenberg's alleged customers abroad.

This was more than strange. An exporter who was claiming that his consignments were being shipped overseas was being paid by those overseas consignees in Kenyan currency!

That was obviously too much, even for First American Bank. To cover up the very odd transactions, some foreign currency had to be somehow sourced so as to give Goldenberg's compensation claims some credibility. By then, Goldenberg had added Citibank and the Kenya Commercial Bank to its list of bankers, but the questions kept coming.

One prime puzzle for Citibank and the Kenya Commercial Bank, and which they sought urgent guidance from the Central Bank, was why Goldenberg was using cash in a mix of currencies (dollars, sterling, deutsche marks, francs, and so on) to cover its export transactions, instead of having the payments remitted directly by the so-called overseas buyers to the local accounts.

In other words, what everybody was asking was: what kind of clients were these Goldenberg was exporting to; who were these clients who paid in cash instead of the normal bank-to-bank transfers? Again, what sort of clients were these who were paying for single consignments in a slew of different currencies in a way that did not make sense at all? Put another way, where Goldenberg was exporting to a specific client in a specific country, it was to be expected that client would pay in the currency of that country, not in a basket of different currencies, and certainly not in cash where a bank transfer would do.

By now, it was clear to the Central Bank's Exchange Control Department and indeed to any financial analyst in the know the ruse that was

taking place. Goldenberg was buying the currencies from the black market to cover its fake export documents from which it was claiming export compensation.

As it were, the export compensation claims kept piling up. And they were huge. In one day alone, January 30, 1991, Goldenberg claimed to have exported seven consignments of diamond jewellery worth KSh336 million. This was worth KSh117 million in fraudulent export compensation.

At this point, the seemingly innocuous request Pattni had made way back during his licence application that he be allowed to open a finance house to better facilitate Goldenberg's transactions can now be seen in all its devious intention. The idea of a financial affiliate was to enable Goldenberg to carry on its strange financial shenanigans under in-house cover without undue scrutiny from outside.

Indeed, this is what eventually happened. In June 1992, the Government agreed to licence Goldenberg to open the Exchange Bank, which rolled out the same list of directors, with Pattni and Kanyotu appearing again. Evidently, the new bank's creation had become necessary after Goldenberg's previous bankers, especially Citibank and the Kenya Commercial Bank, found the company's dealings too hot to handle. In turn, Exchange Bank would guarantee the web of conspiracy, and the scope of the frauds Goldenberg was carrying out would intensify.

It was also becoming clear that the gold and diamond jewellery Goldenberg was purporting to be exporting was ridiculously overpriced. The question of value would have been conclusively established by independent valuations, which in Goldenberg's case were not forthcoming. (In fact, the documentation of Goldenberg's alleged consignments was never accompanied by a valuation report from the mines and geology department, as should legally be the case.)

Be that as it may, the value Goldenberg was attaching to the items it claimed to be exporting was literally out of this world. An example of a June 1991, invoice of a shipment said to have been made to Geneva, Switzerland, will do. The consignment of assorted jewellery items was listed as worth KSh28,521,096, of which 30 per cent of the value (or KSh8,556,328.80) was said to be in gold. As it were, the total weight of the gold component in the package was put at 218.1gms. So Pattni was purporting to be charging his alleged customer KSh39,231 per gramme for the gold contained in this jewellery.

At the time of the invoice, the price of gold on the world market stood at about US\$12 per gramme – about KSh342. This means the 218.1 gramme-gold should have cost just over KSh96,000 – not the over 8 million

shillings Pattni was quoting. Pattni was purporting to be overcharging his customer by some 11,000 per cent! In other words there were gold merchants abroad who were allegedly willing to buy the commodity from Pattni at 110 times the price they could have got it elsewhere.

The other absurdity concerned diamonds, which Goldenberg claimed to be dealing in as well. The diamond business is a highly intricate and individualised one. To start with, Kenya does not have the necessary facilities for diamond-cutting, which is a crucial basic process the carbon stones are subjected to. Neither has the country any known expertise in diamond classification – a vital component of the diamond industry. The classification covers carat weight, colour grade, and clarity.

No diamond trader anywhere in the world would consent to buy any diamond – particularly if he has not seen it – without verifying through very careful, trained scrutiny all the above factors in relation to every single stone. Diamond dealers choose their gems stone by stone, each on its own merits. Only when they are satisfied on the specific points would they judge whether a diamond is worth its quoted price.

However, Goldenberg was peddling the notion that they were selling diamonds, with a quoted price of up to nearly two hundred and fifty thousand dollars a piece in some cases, without their customers knowing anything at all about them. Going by Goldenberg's vague shipment descriptions, the importer would not even know how many diamonds there were in any one consignment. Clearly, only an outright fool would go about buying the most expensive of precious stones in this manner.

There was method, however, to the madness. The more the price was inflated, the higher the export compensation it would draw. And perhaps that was the important thing.

But Whither Come and Whither Go the Exports?

There was only one problem. Nobody seemed to have any idea where the mysterious gold and diamond jewellery was coming from, and where it was going.

At first, Goldenberg claimed to be exporting to Switzerland. The documents it passed on to the Central Bank listed a firm called Solitaire (supposedly located in Zurich) and another called Servino Securities (purportedly listed in Zurich) as the consignees. But when interested parties lodged an inquiry in March 1991 with the Swiss Embassy in Nairobi and with the Swiss Office for Trade Promotion in Lausanne, the reply was to be expected: No such companies existed.

After that ruse was exposed, Goldenberg shifted gear. The documenta-

tion it now passed on indicated that its exports were destined to Dubai, in the United Arab Emirates. The name of the consignee was given as World Duty Free of Dubai, a company associated with Kenya Duty Free shops then owned by one Nasir Ibrahim Ali, a Dubai-based Pakistani businessman operating on a Canadian passport. Available CD3 forms showed that Goldenberg claimed to have exported nearly KSh13 billion shillings worth of gold and diamond jewellery to Dubai through World Duty Free (worth, incidentally, KSh4.5 billion in export compensation at the preferential 35 per cent rate).

The veracity of Goldenberg's claims would easily have been checked with World Duty Free of Dubai. But like with the bogus Swiss companies, no such consignments went there. This fact emerged quite later in 1999 when Nasir Ibrahim Ali himself swore an affidavit in Nairobi and attached documentation showing that the alleged exports through his company were a figment of Pattni's imagination. It is presumed that Nasir Ali came to the knowledge of his company's alleged business with Goldenberg late.

In his affidavit, Nasir attached copies of CD3 forms showing that Goldenberg had alleged to have exported gold and diamond jewellery to World Duty Free amounting to a staggering KSh11, 375,405,215 in a mere 13-day period between September 1992 and March 1993. What is more, he insisted that following his own investigations, he had found out that the entire Goldenberg caper (including principal, compensation and subsequent other payments) was in the region of KSh68 billion – a lot, lot more than anybody had imagined.

The Controller and Auditor-General's office, which is supposed to audit every of government expenditure, could not fail to sniff out the scam. In his 1992 audit report to Parliament, Mr D.G. Njoroge, the controller, questioned KSh590 million which had been paid out to Goldenberg irregularly, pointing out that he had found no evidence that the gold and diamonds "claimed to have been exported originated and were processed in Kenya." As it were, Njoroge's estimates of the sums involved in the compensation fraud were substantially below the true figures.

The clincher that Goldenberg was exporting nothing and was therefore being given free public money was found in the 1993 Kenya Economic Survey. The Survey is an annual Treasury document that details every economic activity in each sector in the country. Whereas it should have trumpeted such massive and extraordinary export breakthroughs as Goldenberg was claiming, it was utterly silent on them. In March 1993, Finance Minister Musalia Mudavadi (who had taken over the portfolio from Saitoti) had claimed in Parliament that Goldenberg had so far earned KSh9.4

billion since it got the export monopoly. But nowhere in that year's Economic Survey, or subsequent ones, was this reflected.

The top export earners remained tea, horticulture, coffee and refined petroleum products. Nowhere in the list did gold and diamond jewellery feature. If the KSh9.4 billion figure Mudavadi gave was correct, then Goldenberg's activities should have scored second just below tea (at KSh9.5 billion) in export cash generation.

Total Kenyan exports to the UAE in the previous year amounted to KSh93.8 million in value, a mere 5.6 per cent of the value of jewellery Goldenberg claimed to have shipped to Dubai during that period. The amount for the entire Middle East came to some KSh1 billion, still a small fraction of Goldenberg's stated exports. Clearly, the official statistics did not reconcile with Goldenberg's export claims. As can now be anticipated, the trade figures with Switzerland for the same period or thereafter shows absolutely no correlation with Goldenberg's purported exports.

The Conspiracy?

As early as November 1990, when Goldenberg had just commenced "business," the Exchange Control Department of the Central Bank had issued written guidelines to Goldenberg regarding the correct procedures to undergo before it could lawfully make a claim for export compensation. The reminder was copied, as a routine, to the Treasury and the Customs and Mines departments.

Goldenberg clearly did not abide by these guidelines, for soon afterwards, an official of the Central Bank's Exchange Control Department, Mrs Jacinta Wanjala Mwatela, started asking awkward questions. In a terse letter she wrote Pattni and which she copied to her immediate supervisor, Mr T.K. Birech-Kuruna, she complained that there were "a lot of discrepancies" with the documentation Goldenberg was providing such as improperly filled out CD3 forms and invoices that did not tally with the exports claimed.

There was more. As Mwatela started looking into Goldenberg's so-called export transactions with the banks it was dealing with, the full picture of bizarre remittances being made in local currency, of false invoices backing imaginary exports, began to emerge. The explanations Goldenberg was giving were unconvincing, and to add to its cheek, it even tried to seek exemptions from the Central Bank's normal export strictures, which Mrs. Mwatela angrily recommended against.

Against all the evidence of a massive fraud being committed, the Exchange Control Department was overruled by the overall boss, Central Bank Governor Eric Kotut, and in effect ordered to continue processing

Goldenberg's hefty export compensation claims, despite all the irregularities. At one point, Mrs. Mwatela was summoned to a closed-door meeting in Kotut's office, after which she revealingly wrote a memo to Birech-Kuruna in which she indicated that she would be acting henceforth in accordance with instructions from her superiors. Clearly, Mrs. Mwatela was out of the loop, and someone very high up at the Central Bank, nay, higher than that, wanted to keep things that way.

The Department of Customs had also become suspicious. When the decision to pay Goldenberg the extraordinary 35 per cent export compensation was originally communicated to the Commissioner of Customs Francis Cheruiyot, he found himself unable to pay because the law expressly prevented it. In January 1991, he communicated his concerns to Attorney-General Amos Wako, the Government's legal advisor, who replied that the only way to go around it was through Parliament making the relevant amendment to the Local Manufacturer's Act. The Attorney-General also clarified that were the law to be amended, it had to be for the benefit of all exporters and not just one company.

When the Commissioner of Customs passed on this advice to the Treasury, he was instructed to pay only the regular 20 per cent export compensation. The extra 15 per cent would be dealt with by the Treasury head office, he was told. Indeed, that illegal 15 per cent was paid to Goldenberg *ex-gratia* (meaning "without liability") from the Treasury. In short, it came from a sort of Treasury slush fund akin to what businesses use to cover under-the-table payments.

Soon, Cheruiyot's suspicions hardened. In an October 9, 1991 letter, the Customs Commissioner warned Goldenberg that it was contravening exchange control regulations by invoicing its clients in Kenya shillings instead of foreign currency. "Unless otherwise exempted by the Central Bank from complying with the provisions of the circular, you should with immediate effect cease to invoice your clients in Kenya shillings and ensure all contracts are raised in specified foreign currency and must be declared in form CD3," the commissioner wrote. The warning was ignored.

It should be noted that all these complaints, as with those from the Central Bank's Exchange Control Department, were being routinely brought to the attention of the financial authorities at the Treasury, specifically the Minister for Finance and his Permanent Secretary. Strangely they took no action. In fact, as it emerged later, at certain points in the Goldenberg scam's convoluted trail, Treasury officials would issue specific instructions to the Central Bank to effect specific monetary transfers to assist Pattni's illegal transactions.

When they broke cover, top government officials were uniformly effusive about Goldenberg. On April 21, 1992, the Permanent Secretary at the Treasury, Dr Wilfred Karuga Koinange, described Goldenberg's proposal for "experimental" gold and diamond jewellery exports as "very successful." He gave a breakdown of the export figures as KSh173 million for 1990 and KSh2.2 billion for 1991. He added that the total export value for 1992 would "far exceed" the US\$50 million originally anticipated.

In the same month, the Commissioner of Mines and Geology, Mr C.Y.O. Owayo, was asserting that "all" Goldenberg's exports were, as per law, being examined, valued, verified and sealed by an officer from mines and geology in the presence of a customs officer, who also put the customs department's seal. That was patently untrue, as the complaints rushing out of Mrs. Mwatela's office and the Customs Department revealed. As indicated the documentation being passed on by Goldenberg in its export compensation claims had no verification and valuation certificates from Owayo's people, nor the necessary customs seal.

Then came the Finance Minister's unequivocal imprimatur on March 27, 1993, delivered in person in Parliament by Musalia Mudavadi, who had taken over the Treasury docket from Saitoti at the beginning of that year. The Minister claimed that Goldenberg had already earned KSh9.4 billion in valuable foreign exchange and the money received by the Central Bank. He maintained that there was no evidence of fraud in Goldenberg's deals.

Vice-President Saitoti himself took the opportunity to respond on June 15, 1993, when he told Parliament that allegations against Goldenberg or its collusion with Treasury and the Central Bank were incorrect. Said he: "There is no evidence whatsoever to conclude that there was collusion between the two institutions and Goldenberg. The Government was assured that the shipments left the country as evidenced by relevant endorsements by the officers who witnessed the shipments. Payments were also received." In conclusion, the Vice-President lambasted those linking him to a conspiracy as motivated by "malicious political reasons."

Saitoti, however, did make a highly significant disclosure, perhaps inadvertently, when he was forced to respond yet again to furious questioning in Parliament in 1999. According to Saitoti, the Goldenberg proposals and the matter of preferential export compensation had been "fully deliberated and approved" by the full cabinet. In other words, the authority behind Goldenberg did not come from the Central Bank Governor and the Finance Minister alone, but from the highest organ of State: the Cabinet.

The Saga of Nasir Ibrahim Ali

The conclusive pointer that a major conspiracy was afoot was provided in the intriguing case of Nasir Ibrahim Ali, the businessman behind the Kenya Duty Free as well as the World Duty Free in Dubai where Pattni, as we have seen, claimed he was exporting the bulk of his alleged gold and diamond jewellery.

As early as April 1993 when the Goldenberg improprieties started to trickle out, Ali was contacted separately by the Daily Nation, Kenya's largest selling newspaper, and the Independent of London to confirm whether he was the recipient of Pattni's gold and diamonds. He denied any knowledge of the consignments.

Ali then started making discreet inquiries of his own, as indicated in correspondence dating from April 1993 with his Dubai solicitors, Messrs Stockwell and Associates. But for some reason Ali did not immediately spill whatever beans he had unearthed, presumably because he did not want to jeopardise his business activities in Kenya.

In 1989, Ali had negotiated an agreement with the Kenya Government to run the Kenya Duty Free shops at Nairobi and Mombasa international airports, into which he said he invested US\$20 million. He commenced operation in 1990.

Come 1998, a strange twist befell Ali and his Kenya Duty Free business. Pattni obtained court orders placing the shops under receivership, and in short order had put in a bid to the Kenyan authorities to take over the lucrGoldenberg:

Export Compensation
in Kenya

Introduction

Sometime in 1987, a proposal was put to the Kenya government on ways of "streamlining" the gold trade, with a view to maximising revenue benefits for the Exchequer and stamping out smuggling of the precious metal.

The ostensible nub of the proposal was a plan to centralise gold trading and export by granting exclusive rights to a single above-board exporter, rather than leave the market to black-marketeers, smugglers and con men. For the franchise to work and succeed in cleaning out the black market operators, the person granted the legal trading rights would be given a financial incentive in the form of "export compensation."

"Export compensation" was bureaucracy-speak for a new Treasury

instrument introduced to assist exporters in attracting scarce foreign exchange for the country. Simply put, it was a Government subsidy, pegged at a percentage of the value of the export consignments, which would cushion exporters from the vagaries of the market. In the case of this particular gold franchise proposal, the export compensation would be necessary so as to squeeze out the black market operators by offering better prices for gold.

It all sounded perfectly sensible, even patriotic. But little did anybody know that soon the scheme would be twisted to highly illegal ends, amounting to the largest and most grotesque criminal financial fraud ever committed in Kenya's history. The cumulative, direct cost to the Kenyan taxpayer is now estimated to be in the region of US\$500 million. (Contrast this sum to Kenya's GDP, which at the time of writing is some US\$10 billion at current dollar rates).

The scam is what is now universally referred to as Goldenberg. Indeed, as will be discussed later on, it was not just a one-off scheme of export compensation fraud but a multi-headed hydra that gave birth to other even more insidious rip-offs.

Enter Kamlesh Pattni

In 1987, Kamlesh Manukhlal Pattni was relatively unknown outside the world of Asian dukawallah commerce in Nairobi. He has subsequently become one of the most (in)famous names in the local business and political world, often bearing the appellation "billionaire businessman" or the suffix "tycoon".

Originally from Mombasa, the twenty-something year-old Pattni came from a family of gold jewellers, one among a coterie of such businessmen who cater mainly to the wealthy, close-knit Asian community in Kenya.

The proposal which he was making to the Government in 1987 would essentially entail getting into a totally new dimension of operation beyond the small confines of ordinary jewellery business in Kenya. The sums of money that would also get involved were way above the meagre scope of the legitimate gold trade in the country.

La Mafia del Oro: Export Compensation in Argentina

Introduction

Argentina has almost no gold. Since the 70's, Argentina's annual exports in gold averaged \$10 million (Averages calculated by the Argentine Mining Secretary Annual reports, 1993-1995). The majority of these exports consisted of products that contained a special piece of gold, usually imported.

However, between November 1993 and May 1995 Argentina oddly registered \$1 billion in gold exports. Neither meat nor corn, the most traditional Argentine exports, reached that level in the same period (La Mafia Del Oro, Planeta, 1997). This record was not the result of a dramatic increase in the international demand of gold. Rather, it was the result of one of the biggest frauds committed against both the Argentine and US Governments.

"The Gold Mafia", as the case is known in Argentina, was an elaborate conspiracy between American and prominent Argentine citizens to launder money by shipping precious and non precious metals out of Argentina to the United States at inflated prices. Using shell companies as well as existing companies in Argentina and the United States, the co-conspirators took advantage of Argentine export incentives and value added tax regulations, creating the illusion of shipping hundreds of millions of dollars in legitimate metal-containing products.

The conspiracy would not have been possible without the complicity of high-level Argentine public officials, who not only influenced some "timely" changes in the Argentine regulations but also used their influence to frustrate the prosecution. As a result, after more than 6 years of investigation in Argentina and the US, there are still some obscure parts of the case that will probably never be discovered.

Creating an "Enabling" Environment

The government put into force different systems of regulations that would have acted as incentives for exports. The Argentine government created an enabling environment that allowed this fraud to occur at such an unprecedented level by creating different export incentive programs.

Three different systems of regulation were set up: two of them were reimbursement systems; one controlled by customs, and the other depended

on the National Tax Direction. The third system depended on the variety of "mirror system" was completely distorted for gold products: gold could be imported by financial institutions free of taxes and without any limitation and then sold to exporters for industrial uses. Exporters could then legally recover the 12.5%.

However, Cavallo denounced the repeal of the prohibition as an alembicated and almost secret rule that facilitated the fraud and as a consequence of a smear campaign by President Menem against him, Domingo Cavallo was prosecuted for raising the percentage of the gold reimbursement to 12.5%.

Argentine law N 23.349 establishes the mechanism for the value added tax stating that each supplier adds to the value of his/her work a determined percentage depending on the activity he/she is carrying out. Then, each supplier pays this amount of money to the Government as a value added tax. The rate at the time of "Del Oro", was 18%.

Since this is an internal tax, it seemed uncompetitive for the exporter to charge the value added tax they pay their suppliers to their foreign client. For this reason, Argentine law allows the exporter to recover the amount paid by the exporter to her suppliers. Thus, the more an exporter uses her suppliers in the manufacturing process of an exported good, the more the amount paid by the exporter in VAT and the more the amount recovered from the Government.

Enter Handy & Harman

Founded in 1864, Handy & Harman was known as one of the largest refinery industries in the world authorized to provide "good delivery" precious metals (the highest category a firm could aspire to). Its stamp ("H&H") is internationally known as a symbol of a high quality product. Handy & Harman originally from Delaware, is based in New York.

At the end of 1992, the management of Handy & Harman knew that the Argentine government had changed its program of export incentives for gold and other metals (the mirror system as distorted by the new monetary gold regulations). Handy & Harman has been involved in the same scheme in other developing countries that were implementing similar economic incentives.

Two managers of the company (Michel Verleysen and Axel Augspach) contacted five Argentine companies specializing in precious metals. All five companies contacted agreed to be involved in the scheme including Casa Piana, the most famous medal designer and producer in Argentina founded in 1895 and with an excellent relationship with the Argentinean ruling elite.

The fraud had two different versions (the "gold" and the "cheap metals" version), depending on the value of the raw material used and the origin of the money to be laundered. When the co-conspirators used gold, they used Handy & Harman money to buy it and created a process to recycle the raw material. When they used copper or another cheap metal, the coins exported to United States were destroyed or sold for scrap.

The "gold version" of the conspiracy can be summarized as follows:

Handy & Harman lent money to the Argentine companies by offering pre-financing loan agreements. (According to the Argentine prosecutor, Handy & Harman financed 90% of the exports. The fact that there were no records about the devolution of the money, the prosecutor introduced the suspicion of a money laundering case).

With this money, the Argentine companies bought "monetary gold" from an Argentine bank s (the two banks that imported almost all the gold involved in the fraud were: Banco de Galicia and Banco Baires), which imported gold from the Swiss Bank: Credit Suisse, free of taxes. The Argentine banks then sold the "monetary gold" to the Argentine companies for industrial uses, also free of taxes.

The Argentine companies manufactured the raw material into coins or medals in Argentina and exported them to Handy & Harman at inflated prices. The manufacturing process that was not complex in nature took place in the Argentine companies factories. However, with the purpose of fraudulently increasing the value added tax reimbursements, the Argentine companies created a false chain of purveyors which allowed them to justify the overvaluation of the products in order to recover the internal taxes supposedly paid by the false chain of suppliers.

The refining division of Handy & Harman finally reconverted the gold coins into pure or refined gold to be sold to the Swiss Banks and the process was then repeated.

To increase the amount of export incentives the Argentine companies received from the Argentine government, they agreed for Handy & Harman to "buy" the coins at a price 10% higher than the predetermined value of the gold coins.

Handy & Harman agreed that South Windsor Inc., a subsidiary of theirs, would issue two series of fraudulent invoices to the Argentine companies in order to receive their share of the export incentives as well as recoup the 10% premium they had overpaid for the coins.

The first series of fraudulent invoices charged 10% of the coin's declared value for "marketing services". In other words, South Windsor invoiced \$10 for every \$ 110 coin imported into the US by Handy & Harman.

Needless to say, South Windsor did not perform any marketing services.

In order to share the profits of the fraud, when Argentine companies recovered the custom reimbursement and the internal taxes from the government, they would "return" 50% to South Windsor, as a "sales commission".

Sidestepping Verification

The VAT law required that the Argentine companies establish a chain of suppliers that was to add value in the manufacturing of the ingots, which would allow the exporters to recover both the VAT supposedly paid by "the suppliers" and the custom reimbursement.

However, the reimbursements for exporters were subject to verification, the exporter needed to present records that proved that the product was exported, was manufactured with the intervention of local suppliers who included the VAT paid in the invoice and a sworn declaration that there wasn't any economic dependence between the exporter and the supplier.

On the other hand, before paying either a VAT or a custom reimbursement, Argentine officials would go to the supplier's factory in order to check whether the work that the exporter declared the supplier did, was done and the authenticity of the account records declared by the exporter.

Furthermore, the custom reimbursement system has an additional verification process that might or might not occur. It is a chance system of light channels when the products arrive to the airport. When the light is green, the container is not verified. Otherwise, custom officials open the container and analyze the product to verify the authenticity of the export documentation provided by the exporter.

To avoid the verification process, the Argentine companies created two chains of purveyors. The first chain of suppliers was formed by existing and independent companies who agreed to do the "manufacturing work" by maintaining in their records, the necessary documentation to show in an official inspection.

However, since the first chain of purveyors never participated in the manufacturing process, the exporters created a false "second chain of purveyors" with the two objectives. The first was to inform the tax inspectors that they did not do the declared manufacturing due to excess work in their companies and secondly they created a second chain of suppliers, so that the first chain of suppliers could compensate for the fiscal debit created by the false documentation given to the exporters.

In the "second chain of suppliers", there existed no real company, just false paperwork presented as false accountant documentation of companies

that were never registered, twin false copies of accounting documentation of existing companies dedicated to a completely different activity and accountant documentation created in the names of very poor people who had agreed to have their names used for a little money.

The testimony of one member of the "first chain of suppliers" is illustrative of how it worked:

"Casa Piana faxed me the amounts of the invoice that I should give them. Then they gave me the invoices of Milverton (a non-existent company in the second chain of suppliers) to compensate the fiscal debit generated by the false invoice that I had given. Then we met at the Bank where they paid me with a check to Milverton's order. I endorsed the check and gave them the correspondent receipt." With this procedure, the conspirators had all the necessary documentation to create the illusion that the manufacturing process actually existed.

So when the tax inspectors visited one of the "first chain of suppliers" companies, they were told that the firm had subcontracted to one of the "second chain of suppliers" and reviewed both the copies of the records presented by the exporters and the bills of the second chain of suppliers.

All the documents (accounting records, bills, invoices, delivery orders, check payments, etc.) were perfectly simulated and since the law does not obligate the inspector to verify the sub-purveyors, the "two chains of suppliers" method was a successful way to avoid being caught and to easily get free money from the government as export and VAT reimbursements.

Diversifying: From Gold to "Cheap" Metals

According to the American prosecutor Noel Hillman, as the overvaluation scheme progressed over time, the co-conspirators decided to expand the fraud using metals cheaper than gold, simulating trade at highly exaggerated prices with the objective of fraudulently increasing the Argentine reimbursements. There is no doubt that this scheme was set up to launder Argentine money.

The "cheap metals" version of the fraud differed from the "gold version" in the several ways.

The co-conspirators agreed not to use their own companies but to create several shell companies. They created at least five new shell companies in each country that worked together as exporters, purveyors and importers.

Since the price of metals used in this version was much lower than that of gold, the percentage of overvaluation was highly exaggerated in order to increase the amount of export reimbursements.

Unlike the gold transactions, where Handy & Harman had agreed to purchase the refined metal content of the finished metal products, the new shell companies would never actually purchase anything. In exchange for a share of the export incentives, the shell companies agreed to import the metal products at inflated prices to the US as if a real purchase and sale had occurred. For this reason, this version of the plan required the creation of many false bank documents.

According to the American prosecutor, bank documents were needed to justify that the purchase and sale had occurred to the Argentine authorities. However, for large bribes, Argentinean authorities were willing to turn the other way and ignore the irregularities.

Dirty Banks, Dirty Cash

The financial aspects of this version of the overvaluation plan was much more complex than that of the gold version because the conspirators were simultaneously gaining Argentine reimbursements and using the scheme to launder Argentine money. As we saw in the physical aspects of the scheme, conspirators also needed to create false bank documents to show the Argentine government that the US shell companies were purchasing the products.

We will first show an example of the simple overvalued scheme in this version of the plan and then explain the mechanisms used to implement the scheme.

One important piece of proof found by the Argentine prosecutor was a handwritten paper in which one conspirator offered the scheme to eventual investors. The summarized explanation of the "opportunity" was the following:

- **The real price of a copper coin was \$ 6.10 each.**
- **The declared cost was \$ 92 each**
- **The exported price was \$ 104 each.**
- **The VAT recovered from the Government would be \$ 16.56 (VAT recovered was 18% of declared cost).**
- **The custom reimbursement would be \$ 13.**
- **The total reimbursement would be \$ 29.56.**

The conspirators proposed that the eventual investors pay for 50% of the shipment, and offered him/her the following profit:

- **25% of the VAT recovered (\$ 4.14).**
- **40% of the custom's reimbursement (\$ 5.20).**
- **Total profit: \$ 9.34 for each \$ 3.05 invested.**

According to the description in the proof, the conspirators needed 20% of the custom reimbursement to pay bribes (described as "attention expenses").

However, neither the Argentine nor the US investigations have determined if the money used in this scheme was provided by private investors, public officials that supported the fraud in exchange for laundering their money, or both.

Until now, the only sure thing is that the money used in this scheme was provided using "black money". As a service to its clients in Argentina, some bank authorities maintained accounts in financial institutions located outside of Argentina for the purpose of hiding their customer's funds from the Argentine tax authorities. The existence of these accounts and records regarding them were not reported on the official books of the banks. These accounts were known in Argentina as "black accounts".

There were two banks involved in this scheme of the fraud: Banco Baires (one of the Argentine banks that imported gold from Credit Suisse and sold it to Argentine companies) and MTB Bank, a US financial institution that had obtained a charter from New York State to operate as a Bank in May, 1993.

Some owners of Banco Baires were also the owners of two "off shore" companies, namely Nuborn Inc of the Republic of Panama and Timbal SA, of the Republic of Uruguay, whose accounts were used as black accounts: In 1993, the two off shore companies opened their respective accounts at MTB Bank. Banco Baires also had a corresponding account at MTB Bank

According to the American files, in order to obtain the export incentives, the Argentine shell companies required documentation that certified that the false and inflated invoices from the US shell companies were actually paid, even though the conspirators had agreed that the importers were not obligated to pay the inflated prices stated in the invoices for non-gold metal products.

Former high officials of Banco Baires agreed to accept a fee from the Argentine conspirators to provide the companies with false bank documents purportedly showing the movement of money to Argentine companies through MTB Bank as payment for the fraudulent Argentine invoices issued to the US shell companies. The higher authorities of the MTB Bank knew that the money did not come from the US companies but from the black accounts of Argentine citizens.

To do that, Banco Baires authorities directed the former executives of MTB Bank to transfer funds using the Nurbon, Timbal and Banco Baires Cayman accounts at MTB Bank to create the illusion that the shell US

companies were paying monies to the shell Argentine companies.

These transfers created bank documents which Banco Baires authorities gave to Argentine exporters in order to mislead the Argentine government into believing that the shell US companies had actually purchased the products that the Argentine shell companies shipped. For this service, Argentine conspirators paid to Banco Baires authorities a percentage of each transfer of funds in cash.

In short, the movement of money actually existed. With Banco Baires and MTB Bank as accomplices, the money did not come from the "buyers" but from black accounts.

The Scandal Unfolds

Resolution 923/94.

Just a few months after the gold scam had started, the Argentine Custom Analysis Department detected the dramatic growth of the gold exports. Initially, they did not suspect the overvaluation plan - they just noticed that there was a normative problem.

In their report of November 29, 1993, they said:

"According to current regulations, monetary gold imported by financial institutions free of taxes is, after an insignificant morphological change, exported as manufactured gold allowing the exporters to gain 12.5% of the international price of the product."

A few months after, in June 1994, gold exports rose from \$ 10 million in 1992 to \$200 million in 1993. They also provided the Custom's Director with recommendations to correct the system (the power to change the rules rested with the Central Bank or the Minister of Economy, but as a matter of protocol, the Customs Analysis Division, had to go through the Customs' Director).

However, it was not until August 1994, after many political disputes, that the Minister of the Economy adopted the 923/94 resolution. According to the new rule, in order to be eligible for export reimbursement, the exported product had to contain a percentage of Argentine raw material. Since there was no gold in Argentina, the new rule was meant to eliminate the fraud. However, the conspirators were prepared for the new regulation.

Riojanas Refineries

While the Minister of Economy was studying Resolution 923/94, the conspirators due to their government connections knew in advance about the changes and were preparing a new project to overcome the changes.

The new project consisted in creating a refinery in the north of

Argentina where they planned in Menem's home province). The declared object of Refinerias Riojanas was to refine Argentine and Chilean gold so as to produce "good delivery" ingots. The board of directors consisted of four Argentine conspirators and two Handy & Harman representatives. The project was presented in the Casa Rosada (the Argentine White House) in the presence of Menem, the former Argentine president who compromised his position as head of state by publicly supporting the investment especially taking into account that the project initially involved just US\$ 5 million.

The Refinerias Riojanas never took off, after the overvaluation plan was uncovered.

There can be no doubt that the project was supposed to enable the overvaluation plan to continue, after the changes in, Resolution 923/94.

Facing the Music

Crimes in Argentine jurisdiction:

- **Fraud increased in punishment to be against the public administration.**
- **Conspiracy**
- **Money laundering**
- **Smuggling**

Crimes in US jurisdiction:

- **Conspiracy**
- **Importation contrary to Law 18 U.S.C. & 545**
- **False Statements 18 U.S.C. & 1001**
- **False bank entries 18 U.S.C. & 1005**
- **False credit application 18 U.S.C. & 1014**
- **Wire Fraud Affecting a Financial Institution 18 U.S.C. & 1343**
- **Violation to the Bank Secrecy Act 12 U.S.C. & 1957**
- **Money laundering 18 U.S.C. & 1957**

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