

**DRAFT SEMINAR REPORT**  
**Seminar 3: Sustainability and the Governance of Corporations**

**Centre for Environmental Policy and Governance**  
**London School of Economics**  
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In collaboration with the University of Leicester, the Scott Polar Research Institute (SPRI) and Environment & Community Worldwide (ECW) Ltd.

**Seminar 3 Report**  
**Andy Gouldson, Emma Wilson and Mike Bradshaw**

The aim of Seminar 3 was to promote a cross-sectoral dialogue on the theme of sustainability and corporate governance as it relates to oil and gas development in Russia. The seminar drew on the experiences of the previous two seminars in this ESRC series, which focused on community-industry dialogue and the Sakhalin Island case study respectively. The papers for these seminars are available on the following websites: <http://www.spri.cam.ac.uk/events/russianoil/> (English and Russian), <http://www.leicester.ac.uk/geography/intro/ESRCresearchseminars.html> (English) and <http://www.leicester.ac.uk/geography/intro/ESRCresearchseminarsrussian.html> (Russian).

Speakers represented the academic, business/consultancy and NGO sectors. Participants also represented government departments. Due to budget and time constraints, there were no speakers from local Russian communities. However, there was one Russian speaker (representing WWF Moscow). The presentations and discussion focused geographically on Siberia and the Russian Far East (principally Sakhalin).

Judging from their feedback, participants were pleased that representatives from a range of professional areas were present. However, some also expressed their disappointment that certain speakers only attended for their own presentations and potential opportunities for a more meaningful dialogue were missed. Several participants had attended one or both of the previous seminars, demonstrating that a network is evolving. Seminar series organisers hope to build on this in future and possibly formalise the network.

Most speakers did not use PowerPoint or provide any written summary of their presentation. Therefore this seminar report summarises the main ideas in all the presentations. The report will be translated into Russian.

**1. Regimes of Governance: Examining the Structures that Shape the Context for CSR in Russia** *Dr Andy Gouldson (LSE) and Dr Emma Wilson (Associate of SPRI and Director of ECW Ltd)*

Gouldson and Wilson presented a framework for the analysis of corporate governance and stakeholder involvement developed by Gouldson, and demonstrated how it can be used to analyse the Sakhalin Island case study. Governance is a multi-actor, multi-level phenomenon that depends on a complex web of relations and a multitude of different activities and processes. With the shift away from the 'controller state' to the 'enabler state', new governance roles have evolved for non-state regulators or corporate activity (economic/market, social/civic and self/corporate).

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Governance can be from inside and from without, and the boundaries between these are blurring as new forms of transparency, accountability and engagement emerge.

Governance by civil society (in particular NGOs) is most often analysed in academic literature. International NGOs working on Sakhalin-related issues influence the multinational offshore oil and gas projects primarily through project lenders (e.g. the European Bank for Reconstruction and Development [EBRD] in the case of Shell's Sakhalin II project) and the international media. The challenge for companies is to develop effective modes of direct engagement with NGOs and with those local stakeholders who have little voice in international debates. As debates can be highly politicised, there is a need for companies, NGOs and the media to develop an in-depth understanding of local politics and society.

The Sakhalin case study reflects the powerful role of the national government and the significantly weaker position of the regional (Sakhalin Oblast) administration. Strict environmental legislation is undermined by weak enforcement and the dominance of economic drivers. There is a need for more constructive engagement on issues of sustainability between government (especially at the Oblast level) and companies and other stakeholders.

Sakhalin has been associated with particular reputational risks that pose a great concern for the multinationals, their lenders and shareholders. Joint ventures between international and domestic companies give rise to major issues about governance patterns (e.g. corporate cultures and policies). Significant external influence is exerted by multilateral lenders such as the EBRD. As an investor and key consumer, Japan has major concerns about the impacts of the Sakhalin projects, especially on ecology and fisheries.

Companies are not monoliths and internal dynamics and negotiation play a significant role in company performance. Sustainability depends on more than the activities of the environment and external affairs departments and there is a need for corporate sustainability strategies that embrace all areas of company activity. Effective governance depends on transparency and good (internal and external) communications. Stakeholders face challenges on when, where, how and with whom to engage. The ESRC seminar series organisers hope that this series has enabled a wide range of stakeholders to discuss these issues in a relatively neutral space.

### **2. Industry Perspectives – BP *John Baldwin (BP)***

BP has two major activities in Russia: 1) a 50% equity interest in BP TNK; and 2) 49% equity in a joint venture (JV) with Rosneft on Sakhalin, where the JV is engaged in exploratory drilling. As the eighth largest non-governmental oil company in the world, TNK-BP's activities are more developed. TNK-BP produces approx 1.44 billion barrels/day from 250 fields in Western and Eastern Siberia. Samotlar (W. Siberia) has been producing for 40 years. TNK-BP also has refining, distribution and retail activities, with a total of 6 refineries.

Because of its large footprint, TNK-BP has a greater corporate responsibility. When the JV was first set up they had aspirational intents in the areas of employment, ethics and financing control. There was a need to make the transition from old Soviet systems to modern systems. The corporation is now beginning to effect change by doing what makes sense in terms of ethics and other CSR values.

Baldwin outlined the TNK-BP approach to addressing issues in two key areas – risk and ethics. In the area of risk, TNK-BP has:

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- Vetted their ocean transportation procedures and practices against BP procedures and practices;
- Applied vetting process to standards relating to inland water systems;
- Developed a programme to address leakage from pipelines and committed 1 billion USD over the next 5 years to address the systems defects identified;
- Addressed legacy issues (TNK is made up of multiple Russian companies).

In the area of ethics, TNK-BP has:

- Introduced modern project management methods (including a new accountancy programme and financial transparency);
- Brought hiring and employment procedures and practices in line with international standards.

### *Summary of responses to questions:*

With a JV you create a new corporate culture from existing ones. BP brings project management and technological advances; TNK has technical capacity and local knowledge (e.g. good knowledge of Contractors). TNK-BP is influenced by BP, the many companies that made up TNK, the Russian government and NGOs. However, according to Baldwin, NGOs in Russia currently do not represent a considerable force.

Auditing of corporate social responsibility (CSR) is in line with BP, but as TNK-BP is a separate company it has to develop its own methodology, partly so as to fall in line with Russian standards. So far BP-TNK does not have the equivalent of BP's Sustainability Report, but is exploring the possibilities. BP seeks to influence JVs and has influenced TNK-BP's policies, but other areas are outside their control. Reputational risks from JVs are the same as from Contractors.

TNK-BP works according to Russian Federation (RF) law. New projects will be engineered in accordance with RF law and international standards. TNK-BP has programmes of engaging people and promoting the importance of adhering to international standards. TNK-BP has general commitment on new greenfield projects that it will apply international standards. The WWF representative challenged this stance in relation to a proposed greenfield project in Eastern Siberia. Regarding the Sakhalin project, BP is prepared to talk to other existing operators on Sakhalin and learn from their experiences. It is too soon to talk about collaboration on sustainable development matters at a regional level with government and communities.

### **3. Industry Perspectives – Shell** *Steven Macklin (Environmental Manager for CIS and Middle East, Shell Exploration and Production, and HSE Manager of Salym Petroleum Development [Shell 50%, Evercon 50%] Western Siberia )*

Macklin presented the 'Four P's' in promotion of good governance and sustainability in the context of oil and gas production. These are:

#### *1. Policing (regulation)*

Regulation is prescriptive, complex, difficult to understand, is certificate based and the legislation conflicts with itself in places. Compliance is limited but can also be used as leverage for performance improvement. The Petroleum Advisory Forum HSE Committee (PAF) is seeking a less prescriptive risk-based approach. The regulatory system separates contractors and subcontractors, which does not help in implementation of duty of care from company through to contractor and subcontractor. Objectives and approaches of international and national regulatory requirements are sometimes different. For example impact assessment, where

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national requirements focus on calculations associated with population and international focus on issues such as habitats and breeding grounds.

### 2. *Processes*

It is not enough just to have policies. They need to be further defined and implemented through effective processes and procedures. For an international/national Joint Venture that has agreed to meet both national and international standards, it is important to understand what exactly 'international standards' means and how much it will cost to follow them. An international partner can bring technical experience and refreshing insights, and a local partner can bring local know how, and together can create something new, faster, better. Issues of mediation are also worth considering under 'process'.

### 3. *People*

It is fine to have regulation and policies, but effective performance is delivered in the field. Unless people really understand why they have to do something they might not do it. For example, many people started wearing seatbelts in the UK because of a change in the law, but now automatically do it because it's in their heart, they feel it's safer and the right thing to do. Effective performance starts with the demonstrable commitment of the CEO and management team, and can only be delivered if it's in the hearts and minds of all employees at all levels. How do we start promoting new health, safety and environment cultures?

### 4. *Partnerships*

Companies may establish partnerships with organisations for different reasons, for example partnerships with NGOs in areas where they need expertise, or where there are shared objectives, or to improve transparency or independence. Ability to provide good governance and sustainability can be particularly important at the start of a project or business. This is when standards are set and when the 'project influence curve' is highest –when key project decisions are made.

### *Summary of responses to questions:*

Another P might be performance, which is reported in the same way as any other company activity. Through the PAF committee companies are starting to share and benchmark data. The Salym project does not have an annual environmental/social report as yet. Russia is a relatively high HSE risk environment.

CSR has a long-term payback period. Anything related to HSE (Health, Safety and the Environment) and social issues, relates to business efficiency. There is a steep initial curve of cost vs. risk reduction, but at some point it no longer makes sense to put more money in for incremental risk reduction. That is the principle behind the ALARP process (reducing risk to 'As Low as Reasonably Practicable'). HSE risk in turn influences reputation risk.

Environmental assessment in Russia is a formal process and the international impact assessment process adds value. The environmental impact statement for the Salym project is not widely available but copies have been lodged at Salym local community centre. The Sakhalin case is different because the lenders demand wide circulation of the report. Social investment starts with local officials' 'wish lists'. Shell goes beyond this within the context of social performance – including community liaison officers (CLOs), community focus groups, open forums and partnerships.

In response to a participant question, the head of External Affairs at Sakhalin Energy noted that Shell is seeking to maximise local Russian managers. The project should be there for 30-40 years and Russians should be recruited to senior management roles over the next 5 years. Sakhalin Energy has an Apprenticeship Programme to train operations workers and is developing local business opportunities. The human

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resources, expertise and business infrastructure will be used by other projects in the future. Sakhalin Energy hasn't yet looked at decommissioning but will do so when the time is right (e.g. 10 years before actual decommissioning).

#### **4. The Role of Investors** *Rory Sullivan (Director of Investor Responsibility, Insight Investment)*

The missing link in many of these debates is the role of institutional investors. What do they think of what companies are doing in Russia? Insight Investment is the asset management arm of the Halifax/Bank of Scotland. Insight invests in shares, bonds and property but not directly in projects (i.e. Insight is not involved in project finance). Insight looks at the social, ethical and environmental (SEE) issues/impacts of companies for two main reasons (a) to make investment decisions, and (b) as part of Insight's own approach to socially responsible investment (SRI).

Socially responsible investment (SRI) has traditionally referred to screening (i.e. the exclusion of certain stocks from investment). This is a small part of Insight Investment's approach. Insight's approach to SRI is primarily focussed on (a) analysis of the financial implications of social, ethical and environmental issues, and (b) encouraging high standards of corporate responsibility and corporate governance through the formal rights of shareholders (e.g. voting) and the informal influence that results from being a significant shareholder. It is important to recognise that voting at company AGMs is a relatively blunt instrument and so engagement and dialogue are seen as the primary routes of influence. Insight Investment also actively works with other investors on these issues.

In broad terms, investors want to see that a company is complying with the law and is committed to business ethics, minimising environmental impacts, ensuring a safe workplace, and having management systems in place. However, reflecting broader discussions around CSR, it is important to acknowledge that being responsible may be far removed from *actual* sustainable development (SD). With that caveat, it is also important to recognise that companies can *contribute* to SD, through influencing and improving standards, ensuring the proper management and distribution of oil returns and through building longer term benefits into business planning.

As investors, Insight Investment is investing for the long-term: mostly pension funds. People need to receive a good income in a world that has not been destroyed in the process. Oil and gas projects are typically very long investments and they potentially have destructive impacts. The risks to companies are very significant. BP and Shell understand that CSR issues are important and need to be properly managed. This includes properly engaging with and responding to the concerns of stakeholders.

JVs are becoming more common in the oil and gas industry. However, there are significant questions around the manner in which JVs are controlled and, in particular, around the ability of the JV partners to ensure that JVs are operated to the same high standards that are expected of the partners. This is particularly important in Russia given the profound difficulties in operating there (e.g. bribery and corruption; local communities/NGOs; weak enforcement of legislation; regulatory instability such as changes in PSAs).

#### *Summary of responses to questions:*

Companies have policies for a reason – not just to keep NGOs happy, but as a way to formulate the way that the company wants to run its business. Investors do not see their role as 'managers' of companies. Rather, investors seek reassurance that companies have identified relevant business risks (e.g. CSR risks in Russia) and

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have appropriate systems and processes in place to manage these. Investors analyse information from different levels: from national level, from rating agencies and from the projects themselves. Ultimately the aim is to properly assess and understand the company so that a decision can be made on whether or not to invest and the risks associated with the investment.

**5. The Role of Consultants** *Matt Loose (SustainAbility)*

Loose explained that conventionally, corporate governance is understood to mean the ‘structures and procedures that ensure accountability to shareholders’. National codes and regulatory frameworks determine the rights of shareholders, ownerships functions, equitable treatment of shareholders, the role of stakeholders in governance, disclosure and transparency, and the responsibilities of the board of directors. Corporate governance responsibilities are expanding through regulation and normative standards like the UK’s Operating and Financial Review, the US Sarbanes Oxley Act, and South Africa’s King Code of Corporate Policies and Conduct. Pressure groups, such as the Corporate Responsibility (CORE) Coalition, however, demand more. The CORE Coalition wants ‘the legal requirement of directors’ duties to be expanded’ and ‘a specific duty of care for both communities and the environment’.

Looking more broadly, governance defines the boundaries within which business plans are implemented, including business principles, codes of conduct, responsibilities and accountabilities, policies and procedures, and assurance. Transparency and disclosure are prerequisites of effective corporate governance. The interests of shareholders need to be balanced against those of all stakeholders. In addition to regulatory pressure to this end, there is also pressure from other actors, e.g. through the processes of project finance via lender requirements and the Equator Principles.

The following table illustrates key issues for the oil and gas sector in Russia, together with management approaches employed to address them:

<b>Category</b>	<b>Key issues</b>	<b>Management approaches</b>
Environmental damage	loose regulatory enforcement; impacts on reputation and access to funding	environmental impact assessment; policies and procedures; responsibilities; risk assessment; training; measurement; target setting; auditing; reporting
Corruption and complicity	permitting and contracting; imports and exports; issues of enforcement; can lead to market inflation	policies and procedures; risk assessment; training; auditing; certification process; reporting
Poverty and development	low incomes and high unemployment; remote locations; licence to operate; government willingness to form partnerships; long-term sustainability	social impact assessment; stakeholder engagement; policies and procedures; responsibilities; capacity building and training; performance measurement; external review; transparency and reporting

Loose noted that companies are often asked to address problems and contribute to solutions because governments are unable or unwilling to do so. The weakness or absence of appropriate governance systems means that initiatives are often disconnected from wider frameworks.

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Loose introduced the concept of the CSR gear-box, which illustrates the levels of CSR, from Reverse through (1) Comply, (2) Volunteer, (3) Partner, (4) Integrate and finally to (5) Re-engineer.

The Extractive Industries Transparency Initiative (EITI) was used as an example of a progressive partnership. The EITI promotes transparency of revenue flows from the extractive sector to host governments and of host government spending to increase accountability. Nineteen governments, led by the UK, are participating in the EITI, together with the Publish What You Pay NGO coalition (over 280 NGOs), extractive sector companies and 46 institutional investors.

### *Summary of responses to questions:*

In more progressive companies, you can see a strong trickle-down of standards and expectations to local levels. This is more apparent with environmental, health & safety standards than for example ethical standards. In less progressive companies this kind of trickle-down is not so evident.

Companies' role in building the capacity of weak governments is a relevant but sensitive issue. Direct influence on national governments is particularly sensitive. However, multinationals can and should play a role in setting new international standards in governance. At the local level effective institutional capacity building can take place, for example, enhancing a local community's ability and knowledge so that they can hold a company to account.

The discussions at this seminar focused primarily on oil and gas extraction and production. Product use issues are much less acutely understood by some industries. However, the oil and gas sector is catching up and beginning to take some responsibility for this. The fact that Shell is measuring CO<sub>2</sub> emissions from the use of their products is a signal of this.

### **6. Pressure Group Perspectives – WWF Russia** *Tatiana Serykh (WWF Russia)*

*(Serykh summary)* The oil and gas sector is the main and vitally important sector in the Russian economy producing 13% of GDP and bringing 60% of export revenues. On the other hand, the sector is one of the largest polluters in Russia and doubtless is a key source of global climate change. Over 30 years of extensive resource exploitation have severely damaged the environment, especially in Northern regions and on the sea shelf. Numerous accidents and spills have resulted and continue to result in large-scale pollution.

At the present moment there are many ongoing and planned oil and gas projects in Russia that pose a tremendous threat to the priority ecoregions in Russia. The most remarkable examples include the Sea of Okhotsk (Sakhalin-1 project led by Exxon, Sakhalin-2 led by Shell), the Barents Sea (oil pipeline planned by Transneft and increasing marine shipping of hydrocarbons) and the Caucasus Ecoregions (new pipelines projects, marine transportation).

Furthermore, the industry's impact stretches well beyond the physical damage to the environment and biodiversity. Oil & gas and mining industries' powerful lobbying and close ties with the government lead, among other things, to biased economic policies and underestimation of the value of biological resources. For instance, Russia's new "back to coal" policy adopted under the pressure of a gas monopoly Gazprom, endorsed by President Putin and included in the country's Energy Strategy 2020, is likely to boost coal production and directly contradicts the WWF "Power Switch"

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campaign. The oil & gas lobby played an important role in the destruction of the state system of environmental management and control (State Committee on the Environment and Federal Environmental Fund were abolished five years ago) and de-environmentalisation of Russian legislation. Projected new developments in environmental law include passage of legislation allowing building pipelines and drilling in protected areas (zapovedniks [strict nature reserves] and national parks).

In 2004-2005 WWF Russia in co-operation with major environmental NGOs determined, approved, signed and published the basic principles of oil and gas companies environmental policies stated in the document "Common ecological demands to oil and gas companies, operating in Russia". The document has been widely disseminated within the oil and gas industry and governmental bodies in Russia. Several Russian oil companies (TNK-BP, LUKoil, Rosneft) and a number of Russian-based transnational oil companies (Shell, BP) have expressed their position regarding the document and have been participating in the document's discussion. There is an ongoing campaign aiming for advocacy of the Common Demands to be adopted by companies of the sector, understood and used in day-to-day work with business by the majority of Russian NGOs. The policy work with the companies has resulted in making them understand the benefits of environmentally sound management for corporate performance, risk reduction, and better public image.

Furthermore, several transnational oil companies have changed their environmental policy providing better operation technologies and access to information. TNK-BP, one of the Russian oil majors made publicly available their environmental reports, they have informed the public and NGOs about emergency situations like oil spills and they are developing their green-field projects in accordance with Russian environmental legislation. In October 2004 WWF representatives took part in a field trip organized and led by the company to visit its largest oil field in Western Siberia that is believed to be one of the most oil contaminated area in the world with (200,000 hectares of contaminated land) as a result of leaking pipelines. WWF and other NGOs regularly participate in its environmental plans discussion and up-date. Another company, Shell's subsidiary Sakhalin Energy Investment Company Ltd. (SEIC) that operates the Sakhalin-2 oil and gas project on the Sakhalin island sea shelf has changed its construction plans due to the NGO coalition campaign and WWF participation in it. The coalition called to stop the project till the company proves that it has no impact on the grey whales' population that feeds in the area of Sakhalin-2 project development. Under pressure of NGOs, independent scientists, lenders and general public SEIC changed its plans and relocated the subsea pipeline to go 30 km to the south of the grey whales' feeding area.

### **7. Pressure Group Perspectives – Friends of the Earth** *Craig Bennett, FoE Corporate Accountability Campaign)*

In his presentation, Craig Bennett argued that ethical consumerism and voluntary corporate social responsibility (to mitigate reputational risk) are not going to deliver the fundamental changes needed to address the social and environmental challenges that we are facing in this century. The Free Market will not provide a sensible response to climate change and poverty or deliver sustainable development. What oil and gas development has really led to environmental and social benefits or brought people out of poverty?

Bennett criticised both Shell's Sakhalin project and BP's Baku-Ceyhan pipeline project, highlighting their negative environmental impacts, the work of some companies to get exemption from social and environmental legislation, and the lack of positive development outcomes. (One social-environmental consultant who had

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worked on the BP project, however, pointed out that the situation there was not as black and white as Bennett had portrayed it.)

For Bennett, the main issue related to oil and gas development is climate change. Is it really appropriate for the world to be putting large amounts of money into projects that are going to have such a critical impact on climate change in the future? Why are we looking to get more oil and gas out of the ground, locking those countries and the world into an oil and gas infrastructure and dependency?

We need to draw attention to 'corporate welfare' – i.e. the huge amounts of public money pouring into oil and gas projects, contradicting the idea of a Free Market. This money could be used for developing schools or renewable energy. International Financial Institutions (IFIs) should be phasing out perverse subsidies for fossil fuels and putting that investment into renewable energy.

Legal frameworks fail to ensure companies work in the public interest, not just private interests. We should have a legal framework to properly balance social, environmental and economic interests. For genuine sustainable development, we need companies to operate in such a way as to benefit people, and people need to be able to see redress and compensation for negative impacts. The Corporate Responsibility Coalition (CORE) is working to ensure that companies introduce policies to make this happen.

### *Summary of responses to questions:*

FoE does not only criticise Shell – we have congratulated them in the past for their good thinking on sustainable development. But in fact, this century we should not be having a debate about whether or not a pipeline goes through a nature reserve, but about whether the pipeline should be built at all.

The Extractive Industries Review looked at the question of whether lending by IFIs improves projects (through conditionality) and concluded that conditions hardly ever improve projects fundamentally in the way that is needed.

A community should seek redress/compensation through the company involved in their own country. UK tax payers should be willing to offer some kind of justice if Shell's activities abroad impact on communities.

### ***Discussion: The blameless Russian State***

At the close of the seminar, Prof Mike Bradshaw drew attention to 'the curious case of the blameless Russian State'. Lack of control over resource revenue is a central feature of the failure of resource colonies. The Russian State should not remain blameless and we need to consider ways to try to change the behaviour of the Russian state. It is easy to focus on multinationals and IFIs – they are the soft target. But the result of this could be that the multinationals decide they no longer want to accept project financing and the attendant trouble that it brings. Organisations such as Friends of the Earth need to think about what they can do to bring pressure on the Russian State (e.g. lobby the European Union about energy security).

The oil industry has been Russia's only economic lifeline since their economic collapse. This flow of revenue has propped up the economy for many years. So the question now is how Russia is going to use this money to develop a broader, more sustainable economy. There is potential for us to influence government policy and NGOS should seek more effective ways to work with the Russian government, at both the national and the regional level.