IMPROVING CONDITIONS FOR REGULATORY COMPLIANCE IN RUSSIAN POWER INDUSTRY

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Center for Business Ethics: Major Milestones

- A Russian non-commercial partnership founded in 2000 to generate Russian best practices (www.ethicsrussia.org)

- Over Past 10 years:
  - Draft laws for Russia’s new “Anti-Corruption Action Plan”
  - Help TNK-BP create anti-corruption compliance system
  - Current Focus — Help Russian/multinational companies develop new voluntary standards of anti-corruption compliance

CBE Model - Business as “change agent” in Russia
Regulatory Challenges in Power Industry

- **Russian market** for sale of energy-efficiency technologies, equipment and public-private projects should grow
- **Sales** largely to federal, regional and municipal agencies, state-controlled industries
- State procurement can be characterized by uncertainty and risk, making compliance by business challenging
- On October 29, Head of “Rosfinmonitoring” Yury Chikhanchin advises President Medvedev that Russia loses 1 trillion rubles ($32 billion) during state procurement to illegal payments
- State is increasing budget for modernizing national energy grid, making this industry subject to new risk
- **Laws**, regulations governing industry **change rapidly**
- Institutions that govern procurement, certification are not strong, independent

Russia’s Modernization Strategy – “Change Management”

- **Increase energy efficiency** by 40%
- Create conditions for technology transfer from U.S., other western nations
- **Change environment** in which leakage occurs during state procurement of new technology from West
- To change environment, president’s program combines legal and government reform with educational campaign:
  - require **financial disclosure** by officials;
  - increase independence of **judiciary**;
  - **limit arbitrary, surprise inspections** of companies by authorities;
  - train lawyers and judges
- **Prevent leakage**
Collective Action By Business in Power Sector – Major Opportunity

- Counter regulatory uncertainty, minimize compliance risk and increase transparency
- Generate new business based on competitive performance
- Improve energy efficiency in Russia – including utilization, transmission, distribution
- Build “smart grid” through public-private partnerships
- Improve governance and institutions in Russia for benefit of all stakeholders
- Create environment of respect and trust for industry leaders and their power systems products

Multiple Industry Challenges

- Challenge is “under-enforcement” of rules governing state procurement and competition
- Procurement can be strengthened by collective action
- **But, how? Industry must determine:**
  - whether to take collective action
  - form of collective action
  - How to build trust within industry group
  - generate trust between industry group and government
- Government officials should respect/trust industry leaders
- How to sustain collective action, based on leverage and agreed milestones
Illegal payments also prohibited by international law adopted by Russian Federation:

- Article 12: Russia obligated to work with business to improve tendering and procurement
- Article 13: Russia obligated to work with civil society to increase government accountability

President Vladimir Putin, February 14, 2008:

“We have signed a number of European anti-corruption agreements and also the UN anti-corruption agreement. We need to incorporate the provisions of all of these agreements into our own legislation. An expert group is working on this now and we will definitely pass an anti-corruption law.”

Possible Form of Collective Action in Power Sector -- “Integrity Pacts”

- Practical form of collective action designed to reinforce the laws governing state procurement
- Business, regulatory authorities agree on transparent set of rules that will govern a specific tender
- Each participant signs a pledge of no illegal payments, subject to sanctions
- Civil society monitors design and execution of tender
- Made popular by Transparency International, World Bank
- Center for Business Ethics does first “integrity pact” in Russia. See http://www.cfbe.ru/declaration.htm
Other Possible Forms of Collective Action in Russian Power Sector

- Engaging Regulatory Agencies as Stakeholders in improving Transparency and Compliance Standards
- Training/Certifying Companies in Industry Supply and Distribution chain to improve compliance Standards
- Advocacy of Regulatory Reform to reduce Risk, enforce Standards
- Exchanging Best Practices with Agency Officials accountable for Standards

CFBE Mission – “Generalized Trust”

Important element in Russian modernization – Generalized trust

- Provides social capital that makes it possible to cooperate in large groups, run corporations, innovate new products
- Lack of trust is deep – prevents even likeminded peoples from finding each other/solving problems
- Difficult to have “extended order”
- Instead, individuals and cultural groups rely on their informal ties to government
New Initiative -- “Russian Energy Compliance Alliance”

Center for Business Ethics and Corporate Governance, US-Russia Foundation, launch pilot in Russian power industry to:

- Define new voluntary Standards of Compliance
- Foreign and Russian partners exchange Best Practices
- Industry organizes to engage Russian regulatory agencies in the exchange of best practices, development of standard
- Civil Society organizations will “certify” compliance with standard

Alliance Project Definition and Scope

Long-term Objectives

- Create national compliance standard – applies to all companies in power industry
- Develop standard into “Russian best practice”
- Institutionalize a recognized certification process (cf. ISO, IAS) that is practical for large and small companies in Russia
Key Criteria of New Standard (1)

Business interaction with state officials:
- Employee obligations and rights when dealing with the authorities
- Management of inappropriate conduct initiated by government officials
- Compliance with government regulations
- Strict prohibition against illegal payments
- Special attention to procurement, tendering
- Relationship with Companies owned by the State

Key Criteria of New Standard (2)

Business Relations with Third Parties:
- **Significant Risk** -- Outsourcing of problem through "Appointed Intermediaries"
- Pre-qualification standards must show legitimate business purpose, track record
- Agents must sign an anti-corruption warrant requiring that they refrain from making corrupt payments to state officials
- Strictly prohibited to hire companies owned by state officials who have jurisdiction over the company
Certifying Compliance with Standard

- Employee surveys to test understanding of code of conduct
- Certification signed by individual company managers affirming compliance
- Self-evaluation audits performed by company
- Spot audits
- Participatory audits (customers, business partners, community)