RESPONSIBLE CONTRACTING IN THE RUSSIAN OIL AND GAS INDUSTRY
This report explores the role of local contractors in oil and gas projects in Russia as an important factor influencing the environmental and social impacts. The report aims to provide information and guidance to operating companies and contractors on responsible management of contracting chains, particularly in relation to the environmental and social impacts of oil and gas activities. As such it also offers guidance for civil society organisations and government agencies that seek to monitor the performance of companies involved in the contracting chains.

### TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Introduction</strong></td>
<td>2</td>
</tr>
<tr>
<td><strong>Part I: CONTRACTING IN THE OIL AND GAS INDUSTRY</strong></td>
<td>3</td>
</tr>
<tr>
<td>Russia’s oil and gas industry: Arctic expansion</td>
<td>4</td>
</tr>
<tr>
<td>Globalisation of the Russian oil and gas sector</td>
<td>5</td>
</tr>
<tr>
<td>Contracting chains: new management models</td>
<td>6</td>
</tr>
<tr>
<td>Contractor markets</td>
<td>6</td>
</tr>
<tr>
<td>Regulatory framework</td>
<td>7</td>
</tr>
<tr>
<td>Foreign investment agreements</td>
<td>7</td>
</tr>
<tr>
<td>National legislation</td>
<td>8</td>
</tr>
<tr>
<td>Regional legislation</td>
<td>8</td>
</tr>
<tr>
<td>Licences and contractual provisions</td>
<td>9</td>
</tr>
<tr>
<td>Voluntary corporate standards</td>
<td>9</td>
</tr>
<tr>
<td>Business culture</td>
<td>11</td>
</tr>
<tr>
<td><strong>Part II: CONTRACTING CHAIN MANAGEMENT IN PRACTICE</strong></td>
<td>12</td>
</tr>
<tr>
<td>Project design</td>
<td>12</td>
</tr>
<tr>
<td>Tender and selection processes</td>
<td>13</td>
</tr>
<tr>
<td>The contracts</td>
<td>13</td>
</tr>
<tr>
<td>Training and capacity building</td>
<td>14</td>
</tr>
<tr>
<td>Supervision, control and monitoring</td>
<td>16</td>
</tr>
<tr>
<td>Accountability and transparency</td>
<td>18</td>
</tr>
<tr>
<td><strong>Part III: A GOOD PRACTICE CHECK-LIST FOR COMPANIES</strong></td>
<td>21</td>
</tr>
<tr>
<td><strong>Appendix: Methodology</strong></td>
<td>24</td>
</tr>
</tbody>
</table>
Aleksey KNIZHNIKOV
WWF-Russia

Emma WILSON
International Institute for Environment and Development, UK

RESPONSIBLE CONTRACTING IN THE RUSSIAN OIL AND GAS INDUSTRY

Moscow, 2010
Introduction

This report explores the role of local contractors in major multinational oil and gas projects in Russia. Observers acknowledge that the management of relations between oil and gas companies and their contractors (and subcontractors) is an important factor influencing the environmental and social impacts of oil and gas projects, particularly in relation to pipeline construction. Yet this is an area that has been inadequately researched and addressed to date.

Some key issues relating to the use of local contractors in the oil and gas industry include:

- Maximising local socio-economic development potential;
- Meeting international environmental, social, health and safety standards;
- Building local capacities to compete for international contracts;
- Integrating different cultures and ways of working; and
- Combating corruption in contracting and regulation processes.

In this report, our findings have been divided into two main parts. Part I covers the framework for contracting in the oil and gas sector, by which we mean the legislative, political, and economic factors that influence the way that contracting takes place. Part II explores the practical aspects of contracting chain management from project design to supervision and monitoring to public accountability.

The report aims to provide information and guidance to operating companies and contractors on responsible management of contracting chains, particularly in relation to the environmental and social impacts of oil and gas activities. As such it also offers guidance for civil society organisations and government agencies that seek to monitor the performance of companies involved in the contracting chains.

The field research was sponsored by WWF-UK. This publication was produced with support from the UK Department for International Development (DfID), the Swedish International Development Cooperation Agency (SIDA), and the Norwegian Agency for Development Cooperation (NORAD).

The authors would like to thank James Leaton, formerly of WWF-UK; Halina Ward, formerly of IIED; Judy Kuszewski and Jean-Philippe Renaut of SustainAbility; WWF’s Murmansk office; and local respondents in the Murmansk and Naryan-Mar regions who contributed to this survey.
CONTRACTING IN THE OIL AND GAS INDUSTRY

The oil and gas industry typically out-sources up to 90% of its upstream activities (exploration and production). Operators have essentially become project managers. An international oil company (IOC) may deal with over 100,000 contractors and suppliers globally. For example, in 2008 BP spent more than $66 billion on procurement of goods and services from third parties. Another oil giant, Shell, reports that 85% of contracts (by value) for the Salym project in Western Siberia have been awarded to Russian companies (13% to companies from the local area).¹

Clauses in foreign investment agreements frequently require a percentage of ‘local content’ (employment and business contracts) in the overall project development. IOCs also consider it good practice to maximise local employment and business development through procurement and local services contracting. Public reporting on local content targets has increased in recent years.

In order to benefit from business opportunities, local contractors need to have knowledge and experience of international good practice, not only in the technical sphere and health and safety, but also in the sphere of environmental and social performance, including impacts on local communities. There is potential competitive advantage for those able to demonstrate their ability to comply with international standards.

Contractors tend to suffer more injuries and fatalities than operating companies. This is partly because they are exposed to more dangerous activities. However, other factors are also important, such as: not having effective management systems in place; or behavioural culture, e.g. wearing safety clothing, using seat-belts, or driving under the influence of alcohol or drugs.

The management of environmental and social issues along the contracting chain is recognised as a key issue for the industry. Construction contractors have a front-line role in project activities, with a direct impact on the environment and direct engagement with local communities. This was demonstrated by the Sakhalin II project, where the environmental performance of construction contractors was a critical factor influencing the impact of pipeline construction on Sakhalin’s salmon rivers.

Contractors’ environmental and social performance, including impacts on communities, is not currently reported to the same extent as technical performance and health and safety. To date this issue has not had sufficient attention.

Russia’s oil and gas industry: Arctic expansion

As the world’s second largest oil producer (after Saudi Arabia)\(^1\) and the country with the world’s largest gas reserves,\(^2\) Russia is a major global player in the oil and gas sector. Russia’s main oil and gas producing regions are the Khanti-Mansiisk Autonomous Region, which produces nearly 60% of Russia’s oil, and the Yamalo-Nenets Autonomous Region, which produces over 90% of the country’s gas.\(^3\)

The Russian oil and gas industry is now expanding rapidly into further Arctic and sub-Arctic zones. Key oil producing areas include Northern Russia (Murmansk, Archangelsk Regions, the Komi Republic and the Nenets Autonomous Region), Western and Eastern Siberia and the Russian Far East (including Sakhalin Island and other areas of the Okhotsk Sea Shelf) (see map).

The Arctic is one of the most vulnerable ecosystems globally, particularly in the face of climate change. In the context of global warming, it is particularly important to find new opportunities to increase the ecological security of new oil and gas extraction and transportation projects in Russia.

---

1 Environmental Information Agency (2007) Annual Energy Outlook pp.37-38. (Russia has the eighth largest reserves of oil in the world – 79.5 thousand million barrels (10.9 thousand million tons) or approx. 6.6% of world reserves, according to the BP 2007 Statistical Review of World Energy, p.6.)

2 Russia has total proven reserves of 1,682.07 trillion cubic feet (47.65 trillion cub.m.), representing 26.3% of the world total, according to the BP 2007 Statistical Review of World Energy, p.22.

Globalisation of the Russian oil and gas sector

In recent years Russian state companies Rosneft and Gazprom have been vigorously acquiring assets from Russian and foreign companies. This includes Gazprom’s acquisition of a majority share of the Sakhalin II project from Shell and purchase of TNK-BP’s interest in the huge Siberian Kovktya gas field. Rosneft and Gazprom acquired monopoly rights to Russia’s offshore oil and gas reserves.

Nonetheless, if we take into account Russia’s need for foreign technology and investment, it is expected that international partnerships will eventually be allowed to flourish. Such partnerships have already helped to promote international environmental and social standards and practice.

Notable examples of joint ventures (JVs) are TNK-BP (a JV between UK’s BP and Alfa Access Renova) and Naryanmarneftegaz (a JV between Lukoil and Conoco Phillips). In 2008, Gazprom, Total (France) and StatOilHydro (Norway) established Shtokman Development AG to exploit the huge Shtokman gas field in the Barents Sea (600km off the shores of Murmansk Oblast). It should also be noted here that some major Russian oil and gas companies (e.g. Surgutneftegaz in Tiumen’ Oblast, Western Siberia) still operate without any significant foreign investment or partners.

Further indications of the globalisation of Russia’s oil and gas sector include Russian companies’ use of international project finance; registration on foreign stock exchanges; and purchase of assets abroad. This desire for economic integration has provided a motivation to Russian efforts to ‘clean up’ the country’s business environment. International finance often attracts the scrutiny of international civil society organisations, as was the case on Sakhalin Island where the involvement of international oil company Shell and the European Bank for Reconstruction and Development (EBRD) attracted a great deal of NGO attention.

THE SAKHALIN II PROJECT

In 1994, Sakhalin Energy Investment Company (or ‘Sakhalin Energy’) – a consortium of Shell, Mitsubishi and Mitsui – signed a production sharing agreement (PSA) with the Russian government to develop the Sakhalin II offshore oil and gas deposits.

In 1998, Sakhalin Energy began Phase I, which involved setting up a large drilling platform – Molikpaq – off Sakhalin’s northeastern coast. First oil was produced from the platform in 1999. Phase 2 involved the installation of two further platforms; 300km of underwater pipelines connecting all three platforms to shore; and more than 800km of onshore pipelines to carry oil and gas down the centre of the island to a liquefied natural gas (LNG) production plant and terminal in the south. The LNG plant was opened in February 2009.

Key environmental issues associated with the two phases included: potential threats to Grey Whale populations in the north-east; impacts on salmon fisheries from pipeline construction across rivers; indigenous peoples’ concerns relating to reindeer herding and fisheries; impacts of dredging in Aniva Bay close to the LNG plant; and displacement of a number of dachas from the site of the LNG plant.

The ecological impacts of pipeline construction across salmon rivers drew considerable public attention to the role of the project construction contractors. This demonstrated that there were significant issues related to management of the contracting chain.

In 2006, Oleg Mitvol, the deputy head of the Russian environmental oversight agency Rosprirodnadzor, raised government concerns about the environmental impacts of the pipeline construction and other work relating to the Sakhalin II project. As a result, a series of serious environmental issues came to light. Work on the project was temporarily halted pending resolution of these matters.

In the same year, Gazprom took a controlling share of the Sakhalin II project and the environmental issues were dropped. Some observers believe that the environmental issues were used as an excuse for appropriating the assets.

Phase I was financed with 116 million USD each from the U.S. Overseas Private Investment Corporation (OPIC), the European Bank for Reconstruction and Development (EBRD), and Japan Bank for International Cooperation (JBIC). Shell negotiated with the EBRD, US Export-Import Bank, and JBIC for around 1 billion USD in financing for Phase 2. After a prolonged period of due diligence the EBRD withdrew its offer to finance Phase 2 due to environmental and social issues. However, in 2008 JBIC, along with three private Japanese banks and three private European banks agreed to provide around 5 billion USD in financing for the project.
Contracting chains: new management models

The Russian oil and gas industry is going through a period of transition from the former Soviet ways of working to international standards and systems, due to greater involvement of international companies and finance, and integration of Russian companies into international markets.

Increasingly Russian companies and joint ventures are divesting themselves of their technical divisions and are contracting out technical work to external specialised companies. As one of the first companies to carry out this kind of restructuring, TNK-BP let go of 60% of its service divisions. Lukoil and Yukos followed with a similar approach.

The range of activities outsourced to contractors and subcontractors in Russia's upstream oil and gas sector today include:

- Project design
- Supply of materials and equipment
- Drilling work and associated construction support
- Construction of pipelines and permanent facilities
- Construction and upgrading of associated infrastructure (e.g. roads, bridges)
- Transportation, storage and terminal facilities
- Scientific research, impact assessments, baseline development and monitoring
- Provision of services (e.g. communications, hiring, driving, laundry, catering)
- Activities associated with the running of project assets (e.g. onshore processing facilities, liquefied natural gas terminals)

This report focuses particularly on construction contracting in the oil and gas industry. Respondents to the survey carried out as part of the research for this report identified pipeline construction as being an area of particular importance in terms of environmental and social impacts. This was a key area of focus for this report.

Contractor markets

Players in these construction chains include:

- Major operating companies
- Engineering, procurement and construction (EPC) contractors
- Large contractors (for pipelines, processing plants, port development, etc.)
- Small and medium-sized contractors (for road maintenance and upgrade, forest clearance, supplies and services)

Specialised contractors are now increasing in Russia, with consolidation of resources and rising demand from more and more large-scale projects. The advantage of a specialised contractor market is that contractors can build their expertise through their experience of working with a range of operating companies in different countries.

IOC frequently prefer to hire well-known international EPC contractors such as Schlumberger, AMEC, Aker Solutions and Bechtel, rather than hiring national contractors from the host country. International companies are perceived as being more experienced and are trusted to pass standards of international good practice along the contracting chain.

However, ‘Russian content’ clauses in investment agreements (notably in PSAs) may require operators to engage Russian companies or Russian-foreign joint ventures as EPC contractors (see section ‘Foreign investment agreements’). Furthermore, specialised contractors are now increasing in Russia, with rising demand from more and more large-scale projects.

One such example, the Russian construction contractor Stroitransgaz, is now working in Saudi Arabia, Greece, the United Arab Emirates, Algeria, India, Syria, Turkmenistan, Kazakhstan and Finland. Stroitransgaz have been able to win this work because they work to the same international standards as other international contractors but can offer more cost-competitive terms than their international rivals.
Respondents to our survey observed that the Russian EPC contractor market is dominated by monopolistic, non-transparent contractors. Relations between state officials and these companies influence the market. The monopolists also hamper opportunities for other contractors to develop. Respondents also observed that operators may experience pressure to take on specific contractors favoured by politicians as part of their contractual ‘local content’ obligations.

Respondents to our survey observed that there tends to be more competition in local markets. In some cases regional and local administrations put pressure on operators and major contractors to work with their preferred companies, which may belong to a relative of a key person in the administration. However, it was noted that local administrators are aware of their need to avoid this kind of behaviour to preserve their integrity in the eyes of the public.

Industrial capacity in a region is also critical in determining the business opportunities for local contractors, and the potential contribution of oil and gas projects to local level sustainable development. Murmansk Oblast, the Nenets Autonomous Region and Sakhalin Island are all regions with very little local capacity, although local businesses have developed in response to oil and gas related activities.

Specialist contractors and work forces for oil and gas projects may need to be attracted from other regions or countries, whereas a semi-skilled construction workforce can generally be hired locally. Nonetheless, some companies feel that it is not economically viable to hire local people. In Naryan-Mar (capital of the Nenets Autonomous Region), for example, local respondents reported that economic opportunities are lost because their own local labour is more expensive than the cheap labour that some companies can bring from other regions or former Soviet republics such as Ukraine. The local workforce may also be considered unreliable (for example, they may take time off for harvesting, or berry and mushroom gathering in the relevant seasons).

Regulatory framework

In Russia today, there has been an increased adoption of voluntary corporate standards due to the globalisation of the industry. At the same time, there has been a gradual erosion of the legal framework governing the environmental and social impacts of industrial activities and provisions for civil society involvement in decision-making. Many respondents to our survey were of the opinion that in the oil and gas sector, corporate environmental and social standards offered more reliable mechanisms than the system of legal regulation.

FOREIGN INVESTMENT AGREEMENTS

The governance of major oil and gas projects is framed within ‘investment agreements’ of various types that are negotiated between investors and host states. The terms of these investment agreements can have a major impact, directly or indirectly, on relationships between operators, their joint venture or consortium partners, and contractors. They typically address issues such as the applicable regulatory regime, environmental standards and liabilities. In many countries, the terms of these investment agreements are confidential.

In the immediate post-Soviet period (the early 1990s), international oil and gas investment projects were negotiated in the form of production sharing agreements (PSAs). Under a PSA the operator bears the cost of development, which it then recoups through its allocated share of production.

The Russian government has since abandoned the PSA format. The PSAs were negotiated in the 1990s when the companies faced much greater investment risk. Since then, over time the tax regime and currency exchange rates have stabilised, and the PSAs were no longer considered to be advantageous to Russia.

Subsequent projects, such as Shell’s Salym project in Western Siberia, have employed regular tax and royalty regimes. Nonetheless, three PSAs remain in force: for the Sakhalin-1 and Sakhalin-2 projects and the Khariaga project in the Nenets Autonomous Region.

Foreign investment agreements may stipulate that a project is to incorporate a certain amount of ‘local content’ (e.g. a minimum proportion of materials or labour, or a minimum value of con-
tracts). For example the Sakhalin-2 PSA requires that 70% of materials and labour be of Russian origin, provided they can meet equivalent prices and quality to foreign alternatives. Since 1996, the Sakhalin-2 project has sourced 91% of its materials and equipment in-country (10.2 million tons) and has awarded contracts to the value of 10.9 billion USD (out of a total of 20 billion USD).\(^1\)

IOCs sometimes set up companies specifically for the purposes of a project and registered in Russia. These are not technically ‘Russian content’, especially if they are set up with Western capital, but at present such companies are counted as local content in company reports. Western contractors and consultants who establish a project office in Russia are also counted as ‘Russian content’. In many cases, no clear distinction is made between ‘local’ companies (i.e. based in a local province where the project is located) and ‘local’ (i.e. national Russian) companies. Operating companies are free to develop their own definitions, making ‘local content’ quite difficult to measure and monitor.

Foreign investment agreements may make contractually binding the environmental and health and safety management systems adopted by the oil and gas operators. They provide a baseline for contracting relationships. PSAs may also contain explicit stipulations that the operating company require (by contract) that each of their contractors comply with the terms of the investment agreement.

**NATIONAL LEGISLATION**

At a minimum, the operating company is required to comply with national regulatory requirements, although PSAs may contain some legal exemption clauses. National regulations include the tax regime, use of subsurface resources, licences and permits, environmental regulations, procurement requirements, labour standards and social protection. Experience shows that environmental regulation is only as effective as its monitoring and enforcement. There is very little Russian legislation that specifically determines how relations between oil and gas operators and their contractors should be organised.

Most respondents agreed that while the Russian laws governing environmental management of industrial activities are good, the enforcement of these laws is not adequate. Frequently the mechanisms for implementing the law are not specified in the law. Moreover, recent amendments have undermined the legislative base itself. Respondents to our survey noted that industrial lobbying and corruption among state officials had influenced these changes.

Some commented that the Russian state was not interested in effective environmental management, only in economic growth and natural resource development, and in gathering money from environmental fines. The case of the Sakhalin-2 project demonstrates the way that ecological issues can be used as an instrument for political pressure (see p. 5).

Some bemoaned the loss of the old system of environmental control since 2000, when the former Committee of Ecology was absorbed into the Ministry of Natural Resources. The priority of this Ministry is to actively exploit natural resources, which results in a clear conflict of interest in relation to environmental protection. Two federal agencies are now responsible for inspection and regulation regarding pollution, oil spills and waste management (Rostekhnadzor) and nature protection and impacts on species and water bodies (Rosprirodnadzor). Both of these agencies are part of the overall structure of the Ministry of Natural Resources.

**REGIONAL LEGISLATION**

Different Russian regions have different forms of regional governance, though they all have the same vertical relations with the Centre. The way that a region is governed has a major influence on the way that oil and gas projects are implemented and their potential for contributing to local level development. Regional regulations might relate to areas of the tundra where driving is prohibited; permissions to hunt, fish and gather wild plants; and limitation of industrial activity within nature reserves.

---

\(^1\) http://www.sakhalinenergy.com/en/ataglance.asp?
Amendments made in 2004 to the law ‘On subsurface resources’ weakened the position of regional authorities to take part in decision making relating to the exploration and production of mineral resources on their territories. Prior to 2004 regional authorities had a voice in deciding whether or not such developments could take place; in 2004 this right was rescinded.

Voluntary approaches can however be used by regional administrations to influence the contribution a company makes to development in their region. The Nenets Autonomous Okrug administration, for example, negotiates voluntary agreements with companies, which include requirements for a certain amount of ‘local content’ (i.e. job creation and workforce training). These agreements do not contain reference to specific local businesses that companies should engage on their projects.

**Licences and Contractual Provisions**

The operating company is legally responsible for securing most of the licences to carry out the oil and gas exploration and production. The operating company (the licence holder) is responsible for land allocation issues; fees for land and water usage; advance compensation payment for projected impact on fisheries.

The operator is also required by law to complete an environmental impact assessment (EIA), including an environmental protection plan and provisions for monitoring and oversight. Until recently these documents were required to pass through a state ecological expert review (or SEER). Respondents expressed concern about amendments to the law ‘On the environmental expert review’ in 2007. Today the SEER, a process which allowed for public participation and commentary, is no longer required for most construction projects, including pipelines and other oil facilities. A SEER is now only mandatory for projects that take place on the territory of protected areas and offshore.

The EPC contract passes legal responsibility from the operator to the EPC contractor for carrying out construction work according to Russian law and the operating company’s own corporate standards and procedures. Documents such as the environmental impact assessment (including all impact mitigation commitments) are appended to this contract.

The legal responsibilities of subcontractors (contractors to the EPC contractors) are similarly established in their contracts. During construction work, subcontractors are obliged to work according to construction norms and regulations. The terms of contracts between operators, EPC contractors and subcontractors tend to be confidential.

**Voluntary Corporate Standards**

The majority of IOCs have developed their own internal management systems to address the environmental and social impacts of their operations. The minimum performance standard is compliance with national legislation or the terms of the PSA. Some companies also commit to maintaining consistent standards across their international operations. Management systems typically draw on international standards. IOCs are generally certified to international standards on quality (ISO 9001), health and safety (ISO/OHSAS 18001) and environmental management (ISO 14001).

The major IOCs usually require their standards to be used where they are a JV partner or majority shareholder. They also state that they will work with their partners and contractors to deliver the same standards. The strict requirement for standards to be followed applies only in the case of joint ventures or majority shareholdings. In practice, IOCs may be minority shareholders in many of their operations and in these cases do not make compliance obligatory.

An important development in voluntary corporate standards was the updating of the International Finance Corporation (IFC) Performance Standards on Social & Environmental Sustainability in 2006.¹ These standards are applicable to IFC-financed projects. The IFC standards require that the client receiving the credit applies the performance standards to ‘third parties’ which include con-

---

tractors. Specifically clients are required to collaborate with third parties (contractors) to meet the performance standards, and to consider the role and capacity of third parties (contractors) when analyzing social and environmental risks and impacts.

International financial institutions (IFIs) such as the European Bank for Reconstruction and Development (EBRD) have developed their own performance standards, based on – and in some cases improving on – those of the IFC. The IFC standards have also been adopted by the Equator Principles Financial Institutions, a group of around 60 major international financial institutions that collectively represent around 80 percent of global project financing.²

Russian operating companies and JVs are improving their voluntary company standards. TNK-BP and its service enterprises are certified to ISO 9001, 14001 and OHSAS 18001. Lukoil, whose strategic partner is ConocoPhillips, follows ISO certification and the environmental and social performance standards set by IFIs.

Respondents noted the positive influence of the Global Reporting Initiative (GRI) in Russian business practice, particularly in the electricity sector. Russian oil and gas companies are now starting to use the system. In 2007 Rosneft, Gazprom Neft and Lukoil all completed their sustainability reports in compliance with the GRI framework.

Respondents observed that publicly registered companies have more pressure than state companies to establish systems of corporate standards. Nonetheless, Gazprom now has the ‘Gazprom-cert’ system of voluntary certification (e.g. the Gazprom 9000 series); Transneft has its own system of certification ‘Transcert’; and Rosneft is certified to ISO 14001 and OHSAS 18001.

Major international contractors who work in Russia are generally certified with all the required international standards. There is also an increasing awareness among major Russian contractors about the need to become certified, especially to ISO 9001 but also increasingly to ISO/OHSAS 18001 and ISO 14001.

Russian companies tend to have a strong focus on quality certification, but less of a focus on environmental performance. This reflects priorities within the industry as a whole. Smaller companies tend not to be certified, due to the expense of certification.

The oil and gas industry appears to be one of the leading sectors in corporate responsibility (along with the electricity sector) in Russia.³ TNK-BP is frequently held up as a good example of the positive influence of Western environmental and social standards being incorporated into Russian business practice.

---

² http://www.equator-principles.com/
**Business culture**

Russian operating companies are starting to see some environmental and social problems as business risks. In the case of Transneft and the East Siberia–Pacific Ocean pipeline, for example, public demonstrations and court cases led to reputational damage, revision of the project, and consequently economic losses.

Despite this, respondents noted that in general the oil and gas industry in Russia appears to focus on short-term economic gain over long-term development and good social and environmental performance. Furthermore, the ‘business case’ for smaller companies, including most oil and gas contractors and suppliers, is not currently compelling enough to influence their performance.

Respondents from all sectors criticised foreign companies and personnel for their lack of understanding of the Russian context, legal framework, business practices and environmental protection practices, and for allowing decisions to be made by inexperienced people. Several respondents noted a low level of management competence in both foreign and Russian oil and gas companies.

Respondents highlighted the importance of lesson-learning, internal communication and consistent approaches to key environmental and social issues. Transnational companies are missing opportunities for learning within their vast corporate networks. This relates in part to the transfer of staff between regions of the world (every 3-4 years), leading to a lack of consistency and locally grounded knowledge and expertise. Moreover, experts based in corporate headquarters (who frequently have excellent experience and expertise) are rarely called upon by their daughter companies to provide guidance, advice or ‘lessons learned’ from other regions.

Soviet structures of management persist in many Russian operating companies and major contractors. One result of this is excessive bureaucracy. Respondents also observed that decisions taken in certain major Russian companies are not always taken by specialists. While genuine talent is supported, some people obtain positions of authority because of good contacts and nepotism. Leadership is a key issue. On the other hand, in some cases management restructuring has resulted in the loss of Soviet era systems and practices that worked more effectively.

Corruption continues to be a key issue. Subcontractors may engage in corrupt practices to facilitate a minor transaction at the local level. This may happen without the knowledge of other players in the contracting chain. At that level it may be an example of accepted cultural behaviour. This entrenched corruption culture is very difficult to address.

Changing behaviour is as much a matter of cultural change as it is a management or regulatory issue. There have been positive examples of changing behaviour such as road safety campaigns (encouraging the wearing of seatbelts and no drink-driving) and efforts to encourage workers to use protective gear such as hard hats on the worksites. Road safety campaigns have been extended to the wider local community.

However, the level of uptake of international standards and business culture may be influenced at the individual and corporate level by attitudes of ‘we don’t want outsiders to tell us what to do’. This extends to the project sites, where workers may refuse to wear hard hats and safety clothing.

Part II of this report looks in more detail at the practice of managing contracting chains in Russia’s oil and gas sector.
This analysis aims to demonstrate that effective management of a contracting chain requires much more than having good corporate standards in place. As our research indicates, it is critically important to establish the responsibility for making sure those standards are implemented throughout the contracting chain. The question of responsibility was central to this investigation.

Operating companies sometimes state that they are not responsible for the actions of their contractors. But should an operating company be held responsible for failing to provide sufficient information, guidance or supervision? A range of respondents, including those from within the industry, observed that while operating companies may not have the legal responsibility for the whole contracting chain, they do have a management responsibility to ensure that their own contractual requirements are followed, and that their own principles are implemented and enforced throughout.

IOCs tend to make the distinction between:
(a) areas that they can control directly;
(b) areas that they can influence; and
(c) areas that are outside their sphere of influence.

Our research revealed that the management of contractors’ social and environmental performance may be considered to lie either within or without a company’s sphere of control and influence, depending on the company culture and the individual managers within that company.

**Project design**

Respondents emphasized the importance of considering potential issues relating to management of the contracting chain in the early phases of the project cycle (design, pre-feasibility, feasibility). Financial institutions and other external players cannot always have an influence in these early stages. Issues relating to management of the contracting chain should be included in early stage risk assessments.

The project documentation, including all technical requirements for carrying out the work, is developed by entities that evolved from scientific research institutes. Contractor respondents observed that while these organisations include experts with good scientific knowledge, they may lack practical industrial experience. As a result, some of the technical requirements may not be appropriate in the given context. Nevertheless, contractors are contractually obliged to work according to the given requirements. It would be useful for contractors to have more of a role in reviewing and amending the project documentation; and to have a mechanism by which lessons learned from implementation could feed into amendments to the technical requirements.
Tender and selection processes

Operators invite potential contractors to provide technical and commercial information in a pre-qualification process. Most operators in Russia appear to use their own pre-qualification processes rather than international systems such as Achilles. In general, civil society respondents commented on the lack of transparency in regard to the tender and selection processes.

Some IOCs and Russian oil and gas companies noted that they give preference to contractors that are certified to ISO 9001, 14001 and ISO/OHSAS 18001. Other companies noted that it is a very minor part of the pre-tender process. Understanding the difficulty that many local contractors have in getting certified, companies do not exclude contractors that are not certified. Generally the focus is on the preparedness of the workforce, technology, experience and industrial performance, with a minor focus on environmental and social performance capacities. Operators frequently work with their contractors on the job to improve environmental and social performance.

The contracts

The design of the contract between an operating company and the EPC contractor, and between the EPC contractor and subcontractors, is a fundamental issue influencing the environmental and social impact of the contracting chain.

It is now standard (but not universal) practice for operators to append corporate health, safety and environmental stipulations and other corporate principles to the EPC contracts, together with the project documentation (i.e. technical requirements). A typical contract will state that the contractor is expected to comply with Russian legislation and the standards of the operating company. Appended corporate standards need to be in Russian as well as English.

Some respondents observed that operators frequently do not provide the contractors with the full project documentation. Respondents referred to the case of the Sakhalin II Project, where the pipeline construction contractor was not told in detail which technical methods to use to lay the pipeline and the decision on which methods to use was left to them. It is believed that this led to some of the environmental damage that occurred on this project.

There may be a vast number of commitments and recommendations from an environmental impact assessment (EIA) and state environmental expert review (SEER) (if it takes place). The transfer of these commitments to a contract was identified as a major challenge. This becomes even more challenging if the company is required to carry out an international-style environmental, social and health impact assessment (ESHIA) on top of the Russian legal requirements.

As the ESHIA is not part of the Russian legal licensing process, in some cases the contractors may already be working by the time it is completed (as was the case with the Sakhalin 2 project). This led to confusion, resistance and resentment on the part of contractors with whom Sakhalin Energy had already signed contracts that did not include some of the ESHIA commitments. An obvious solution to this problem would be to ensure the timely completion of all impact assessments before contracts are negotiated and signed.

It is standard practice for penalties and incentives to be set down in the contract for failure to comply with the standards stipulated in the contract. Contracts frequently contain the wrong balance of incentives and penalties to ensure adequate attention to good social and environment performance. The key priorities are cost and schedule. Health and safety requirements usually have a fairly high priority. However, environmental and social standards generally have a lower priority. Thus (for example) you may have 80% of incentives to do the job quickly, leaving just 20% of incentives for everything else. A strict balance of incentives between schedule, cost and responsible performance would encourage improved environmental and social performance.

Civil society respondents commented on the lack of transparency in the contracting process, in regard to the requirements contained within the contracts. While understanding that certain in-
formation is considered to be a commercial secret, they believe that other information, for example, division of responsibility for environmental impacts, or emergency response plans, could be made publicly available for the purposes of public accountability. This relates to contracts between the operating company and their EPC contractors as well as those between contractors and subcontractors.

The allocation (and protection) of a budget for addressing environmental and social issues was highlighted as a key issue. One contractor respondent observed: ‘We make demands of our contractors [i.e. the subcontractors], but we don’t have the money to help them respond to our demands.’ Respondents from TNK-BP noted that the company places special emphasis on budget protection, so that contractors ring-fence the budgets allocated to environmental and social matters.

Training and capacity building

LOCAL WORKFORCE TRAINING

Capacity building of local contractors is seen as a priority if local content targets are to be met. A key issue identified was the level of preparedness of workers employed by local contractors. Respondents attributed this to the professional selection processes used by contractors and subcontractors, levels of education and training, quality of equipment in the company, and provision of safety clothing for workers. Smaller companies may not have the capacity to carry out training with their own staff and workers and should be supported by other players, including local administrations, operators and larger contractors, and perhaps international donors.

A number of IOCs and major contractors have invested in building the capacities of the local workforce and enterprises where the necessary expertise is in short supply. In some cases the company may not yet have core business investment in that area, but may be anticipating operating

SAKHALIN ENERGY – VENDOR DEVELOPMENT PROGRAMME

Sakhalin Energy has established a training programme aimed at building the capacities and increasing the competitiveness of Russian vendors and contractors. The programme consists of training courses where Russian contractors are able to gain experience working closely with Sakhalin Energy and other major operating companies. It is open to experienced oil and gas industry contractors and to enterprises that have no prior experience in the oil and gas sector. Participants in the programme receive a password that allows them to access materials via the Sakhalin Energy website.

Training courses cover the following topics:

• Health, safety and environment (HSE)
• Quality management
• Tendering skills

Benefits of the programme (as listed on the website) include:

• Learning about requirements that international companies have for their contractors in environmental protection and safety; and quality of goods and services provided
• Access to information about Sakhalin Energy’s tendering process; training in how to prepare bids and participate in tenders, including advice on the most common mistakes in preparing bids
• Opportunities for companies to demonstrate their capabilities

Certificates are provided to companies on completion of the training course. Sakhalin Energy emphasises on its website that completion of the training does not guarantee successful bidding for any of their tenders.

Sakhalin Energy also offers online access (password not required) to information about current and upcoming tenders for provision of services, equipment and materials; a list of successful bidders for major contracts that have been awarded; and news updates about local enterprises that have won contracts with the Sakhalin-2 project.

For more information, go to: http://www.sakhalinenergy.com/en/aboutus.asp?p=vendordp
there in the future (and for the long term). Support for local enterprise development and capacity building is seen as an appropriate use of a company’s social investment funds (i.e. charitable community development funds). It is important for project managers to build in time for training local contractors and workers. However, it unlikely that a company will delay a project start date in order for such training to take place.

Norwegian companies, for example, are currently working in the Murmansk region to build local capacities. StatoilHydro began their involvement before they knew whether or not they would win a share of the Stokmann project. Other IOCs and major contractors similarly have a long-term eye on the Barents Sea developments. INTSOK (a Norwegian industry association) and StatoilHydro are working with Murmanshelf (the Murmansk Association of Contractors and Suppliers to the Oil

TNK-BP - WORKING WITH CONTRACTORS TO IMPROVE HSE PERFORMANCE

TNK-BP has over 3000 contractors. They work to the principle of a ‘unified workforce’ that includes TNK-BP and the contractors. Any violation of HSE regulations is addressed in the same way, whether the person responsible is an employee of the contractor or the company. Key areas of focus include the following:

- **Reporting**: contractors are included in TNK-BP's reporting indicators for HSE, so there is an incentive for TNK-BP to ensure the contractors perform well
- **Investigation**: incidents are investigated in the same way for company and contractors
- **Training**: there are standard approaches to training (in corporate HSE standards) for company and contractors
- **Transfer of corporate standards**: Corporate HSE standards are transferred fully to the contractors through inclusion in the contracts

In the contracts TNK-BP includes a clause that the contractors are responsible for the performance of their contractors (TNK-BP's subcontractors). TNK-BP tries to influence their contractors and subcontractors, but acknowledges that this is difficult the further you go along the contracting chain. According to TNK-BP respondents, the major international contractors all understand the situation, and the standards pass through them to their contractors. The Russian contractors need more time for this to become standard practice.

TNK-BP has its own corporate ‘Procedures for Interaction with Contractors’. These include procedures relating to all levels of the contracting process:

- **Prequalification**: HSE and ecological security are included in the prequalification requirements
- **Tender**: HSE and ecological security requirements are included in the tender process
- **Audit/control during implementation**: TNK-BP carries out regular audits of its contractors. This process started in 2006.

TNK-BP has identified four main priority areas in working with their contractors:

a) **Harmonising approaches**: Harmonising the approaches of a company and its contractors depends on long-term, robust relationships (contracts of 3+ years). TNK-BP seeks to encourage enthusiasm for good performance. Contractors also need to be aware of the threat of losing their contract if they do not perform to the required standards.

b) **Motivation**: A carrot and stick approach is required. Russian culture tends to favour punishment over encouragement, but TNK-BP tries to do both. Contracts contain penalties and incentives. Personal responsibility is encouraged. The company also offers bonuses for good HSE performance and good environmental protection actions.

c) **Supervision**: TNK-BP are developing an (outsourced) supervisory function to manage construction, infrastructure development, drilling and recultivation work. This kind of supervision is especially needed in complex projects with more than one contractor.

d) **Budget security**: TNK-BP seeks to ensure that the budget lines for environmental protection and labour standards are protected by the contractors and the money is not spent on other aspects of project work.

TNK-BP also has a focus on assurance. They check corporate standards and legal compliance.


---

See also: Report from seminar on sustainable development and the Russian oil and gas industry, London School of Economics, 20th June 2005: [http://www.spri.cam.ac.uk/events/russianoil/seminar3report.pdf](http://www.spri.cam.ac.uk/events/russianoil/seminar3report.pdf)
and Gas Industry) to raise awareness about international standards. Training seminars cover issues around tendering, business management, quality standards and health and safety. Social and environmental performance still lags behind as a priority.

**ON THE JOB TRAINING**

Some company respondents, for example TNK-BP, expressed a preference for building the capacity of their contractors and subcontractors on the job, rather than via associations of contractors and suppliers. A long-term working relationship is seen as a good way to build not only capacity but also mutual understanding and trust. TNK-BP respondents noted that one of their contractors had risen to become a major contractor in 3 years, due to working closely with them on the job. Respondents agreed that while the contract is seen as the main tool for establishing and clarifying responsibilities, the actual relationship between the two parties to the contract is equally important.

Training might be carried out by an external training organization. Methods might include: training courses and seminars; assistance with development of management plans; internal communication and feedback mechanisms; good communication of corporate standards and awareness-raising via leaflets, posters and information campaigns. Key areas for companies are emergency response training (particularly oil spill response) and road safety.

However, some NGO respondents commented that they have not observed any benefits of the capacity building efforts made to date in the form of improved environmental and social performance of contractors.

**Supervision, control and monitoring**

There are countless state bodies responsible for the oversight of oil and gas projects. These include agencies such as Rosprirodnadzor and Rostekhnadzor within the Ministry of Natural Resources, and others including the Ministry of Emergencies. This section of the report, however, relates to the ways in which contracting chains are managed from within by the operating companies.

Respondents identified five levels of responsibility for supervision, control and monitoring within a typical oil and gas company structure:

(a) parent company;
(b) cross-regional headquarters or in-country head office;
(c) local operating company;
(d) EPC contractors; and
(e) subcontractors.

At the highest level is the parent company (e.g. Lukoil or Shell, or a JV such as TNK-BP). At the next level the structure may include a company that represents the interests of several local operators across several regions, or in the case of multinational companies, the in-country head office, frequently based in Moscow. In the case of Lukoil’s operations in the Russian North, the cross-regional company is Lukoil Komi. At the local/regional level (i.e. province, Oblast, Okrug), there is a local operating company (e.g. Lukoil Sever or Naryanmarneftegaz in the Nenets Autonomous Region). The local company will have heads of departments, chief engineers, and specialists who are responsible for supervision, monitoring and regulation of the environmental and social performance of that company’s work.

The EPC contractor has responsibility for its own work on a project site, and that of its subcontractors (according to Russian law and the EPC contract). The operating company oversees this work. At the project site, there is a site manager working on behalf of the operating company who is responsible for supervising the work of project contractors. Lukoil Sever explained that their supervisors all have a certificate from Rostekhnadzor for industrial performance supervision. These experts from the operating company check the permissions obtained by the contractors, and the quality of their work: the technical processes and HSE performance. The supervisors are permanently located at the project sites during the construction period.

The operating company will also have people responsible for gathering data for their reporting requirements and overseeing the reporting carried out by the contractor.
Operating companies also arrange regular (e.g. monthly) and spontaneous site visits. In the case of Lukoil, a ‘Permanent Commission’ of managers from the parent company makes an inspection of project sites every three months. However, in the case of spontaneous spot-checks, one operating company representative reported that, due to strict health and safety regulations, experts sometimes cannot carry out such inspection trips as spontaneously as they would like to. For example, two cars are required for any trip (for safety reasons) and these need to be booked well in advance.

Ecological monitoring (of species and ecosystems) is carried out by a scientific institute hired by the operating company. It is usually carried out annually. There are three stages of ecological monitoring – before, during and after construction work. In addition the operators have emergency response teams, with international certification, oil spill response and other equipment and specially trained teams of people. Some companies also carry out training of local volunteers.

Stroitransgaz carries out its own control of the work of its subcontractors. Each branch of Stroitransgaz has its own environmental expert. These experts carry out ‘proizvodstvenniy kontrol’ (industrial control). There is a specialist on site who supervises the subcontractors.

Driving on the tundra, hunting, fishing and gathering are regulated by guards on the project sites. There are inspections for weapons, there is limited access to the roads, with inspection points where people need to show their identification cards. The companies also provide instruction and training for their contractors, so that they are fully aware of these requirements.

Innovative technological approaches have also been employed. For example, TNK-BP’s Kamennoye field, in the Khanty-Mansi Autonomous Region lies within natural lowlands, protected by the Ramsar Convention as unique bird habitat. To minimize environmental impacts they only allow GPS-enabled vehicles onto the floodplains in order to increase transport safety and facilitate monitoring of contractor performance.

ADDRESSING CORRUPTION

Corruption remains a serious factor hampering effective management of environmental and social issues along contracting chains: for example, bribes are paid for overlooking environmental violations. IOCs such as BP ensure that their Code of Conduct for employees makes clear that bribery and corruption are unacceptable. BP staff undergo checks from their line managers to make sure that they understand the code. Staff report where a bribe has been offered; these reports go all the way up to the Board. However, the effectiveness of a code of conduct depends on how it is enforced all along the contracting chain.

Respondents agreed that the best way to address corruption is through transparency – e.g. public reporting, openness with civil society. The anti-corruption policies of operating companies should also extend to contractors and subcontractors. Companies should also include specific anti-corruption clauses in their contracts with contractors. Additional methods include awareness raising, training, special inspections, incentives for non-corrupt performance.

LIMITS TO COMPANY CONTROL

Operating companies admitted that despite their efforts they cannot control everything and violations still occur, though less so today than 5-10 years ago. They do not feel that they have sufficient leverage over the contractors and subcontractors, particularly those located in outlying areas with limited transport access. They sometimes apply financial penalties; they can address their concerns to the contractor’s parent company (e.g. in Moscow); and they can withhold payment of a contract. However, they agree that this is not enough. Representatives of local communities, indigenous herding enterprises and civil society groups report cases of fishing, hunting and gathering; trade in caviare; possession of weapons; driving on the tundra outside of designated project areas; and inadequate land restoration.

Operating companies also noted that contractors from certain regions and countries of the world are less well prepared and less aware about environmental and social issues. Yet a company may have little choice about hiring them because of the limited market, or due to budget limitations.
A contractor’s main motivation may be to complete the job and secure their payment. In isolated places without adequate supervision, a contractor might just do things in the fastest way to get their money quickly. One respondent noted that inspectors sent from operating companies may sometimes encounter resistance from the contractors when they visit a project site, especially if they are foreign and have little experience of working in Russia. One respondent commented that Western companies ‘trust their contractors too much’. Contractor respondents observed that it is easier for them to work with operators who provide clear rules and strict enforcement. The worst case is where the operator has strict requirements but no control.

In relation to monitoring and evaluation of environmental and social performance, respondents raised the issue of what to measure and how to measure it. They stressed the need for industry-wide accepted methodologies for gathering and analysing environmental and social data, suitably adapted for specific Russian conditions.

Accountability and transparency

Contractors are primarily accountable to the operating company according to the terms of their contract. They are required to abide by the law of the country where they operate and to follow any further standards included in their contract. In practice, contractors are much less public-facing than operating companies. Thus there is significantly less pressure from civil society organisations for them to demonstrate responsible performance and their role as good corporate citizens. However, there are signs that this situation is changing.

REPORTING

A project has an obligation to report to the host government (quarterly and annually) with monthly performance statistics including: accidents, ecological indicators and waste management. Operating companies also provide monthly or annual reports to the parent company/companies, depending on the company requirements.

A key indicator of responsible contracting chain management is where an operating company includes its contractors’ performance indicators in its own reporting. Of the companies that we interviewed for this research, TNK-BP and Naryanmareftegaz do include their contractors’ performance indicators with their own. In general, EPC contractors are only obliged to report on their own performance to the operating company, not the performance of their contractors and subcontractors.

Respondents observed that the involvement of IFIs in project finance adds another layer of performance monitoring, and there is a danger of overloading or confusing contractors with the heavy reporting requirements.

As noted in the earlier section on voluntary corporate standards, the Global Reporting Initiative (GRI) has had an increasing uptake in Russia. In 2007 Rosneft, Gazpromneft and Lukoil all completed their sustainability reports in compliance with the GRI framework. Some operating companies (including IOCs, JVs such as TNK-BP and Russian companies such as Lukoil) now provide more information about their contractors in their sustainability reports. However, there is very little specific information about named contractors and their performance.

There are other ways of providing information about contractors’ performance. Sakhalin Energy does not produce its own sustainability report – information about Sakhalin is provided in the overall Shell sustainability report. However, the company has made available online detailed reporting of the Sakhalin-2 project pipeline river crossings, including commentary on the work of the construction contractors.¹

International EPC contractors, such as AMEC and Parsons Brinckerhoff have started producing their own sustainability reports. These reports measure the company’s performance against social and environmental indicators, using GRI guidelines.² The figures are not disaggregated by country or project.

Respondents to our survey suggested that it would be easier for operators, contractors and subcontractors to work together if the chain of responsibility were clarified in public documents about specific projects. This would also help government and civil society representatives to hold the industry players to account.

**PUBLIC ENGAGEMENT**

NGO respondents observed that Russian contractors tend not to have a culture of engaging with the public, therefore are not exposed to public pressure to improve their performance. Some Russian managers do not understand or are not aware of legal requirements for public information and participation. However, this situation is gradually changing. Public engagement and awareness in Northern Russia are expected to increase with the implementation of large-scale international projects, such as the Stokmann gas project in the Barents Sea and the construction of the Nordstream gas pipeline under the Baltic Sea. The presence of the Sakhalin-2 project has certainly served to raise public awareness about oil and gas issues on Sakhalin.

Respondents from several Russian and JV companies emphasised that they have a policy of engaging with the public and meeting with NGOs when they request a meeting. This included Lukoil (and its local daughter companies), TNK-BP and the Murmansk-based Belokamenka oil terminal (Rosneft), an offshore oil storage facility that has generated – and responded to – particularly high levels of public concern.

Contractors engage much less with the public. Some respondents felt that contractors and subcontractors should also take part in public hearings that take place by law as part of an environmental impact assessment. This would avoid situations such as the Siberian case described by a respondent, where an operating company made promises to the public to maximise local content, but the contractors, who did not take part in public consultations, ignored this pledge and hired in labour from outside.

Research has demonstrated that in many cases in outlying areas, most community issues – especially minor ones – are addressed directly between local oil workers and communities. In places where the oil workers are long-serving, these relations have developed effectively. In places where the workers are new to the area, it is important that they receive training and awareness-raising in local community issues, including environmental protection matters.

Respondents noted the need for a system of third party recourse if a contractor or subcontractor is not paying its workers or is applying discrimination, or if local communities are impacted by negligent work of project contractors and subcontractors. The public grievance procedures of operating companies do address the activities of contractors, but they are not always used by local people, due to inadequate or non-existent phone lines in isolated communities, or simply because people do not wish to use a company procedure.

The role of community liaison officers (CLOs) is important. These people live in local communities, are frequently local themselves. Their role is to help implement the public grievance procedures, and to provide a further channel of communication for addressing community issues and concerns. CLOs tend to be employees of the operating company, not the contractors, which may undermine their (limited) influence with some contractors.

---


4 For example, the Compliance Advisor Ombudsman (CAO) is the independent recourse mechanism for people impacted by projects funded by the International Finance Corporation (IFC) and Multilateral Investment Guarantee Agency (MIGA). The CAO responds to complaints from project-affected communities about the social and environmental performance of the IFC/MIGA client (http://www.cao-ombudsman.org/)
ROLE OF CIVIL SOCIETY ORGANISATIONS

There is an increasing awareness and concern among civil society organisations in Russia about the issue of contracting chain management. A coalition including WWF-Russia, Greenpeace Russia, the International Socio-Ecological Union, the Centre for Russian Environmental Policy and Sakhalin Environment Watch, has issued a set of environmental and social standards for oil and gas operations in Russia. No. 8.9 of these standards is: ‘Company informs contractors and sub-contractors about environmental protection requirements and monitors their fulfilment.’

In general, however, civil society initiatives are aimed at the operating companies, not their contractors and subcontractors. The Sakhalin-2 project demonstrated the effectiveness of NGOs’ efforts to channel their concerns via the IFIs who were providing project finance. Western operating companies and IFIs are considered to be more responsive than Russian companies and banks, and so are targeted more frequently. Russian NGO respondents recognised the need to engage more directly with Russian operators and contractors and to work more with the government to ensure they hold the companies to account effectively. They also recognised the need to educate the public to hold both government and industry to account at all levels.

WWF Russia has identified responsible management of oil and gas contracting chains as a priority in relation to Gazprom’s new project to construct a gas pipeline from Sakhalin Island to Vladivostok. This pipeline will pass through important habitat of rare species such as the Amur Tiger. WWF collaborated with Gazprom on an educational programme for Gazprom’s contractors working on that pipeline. In January 2010, there was a huge oil spill on the Eastern Siberia-Pacific Ocean oil pipeline, which had only just been put into operation. This incident also serves to emphasise the importance of contractor management and environmental NGOs including WWF have been raising these matters with Transneft, the company responsible for the pipeline, and with state regulatory organs.

---

1 http://www.wwf.ru/data/publ/serihblokgr-eng.pdf
2 This can be compared to the (much lower) level of international awareness of what is happening on the Yamal Peninsula in Western Siberia.
Our survey highlighted the following areas of good company practice. This check-list has been drawn up to help operating companies and contractors work towards more effective management of environmental and social issues.

The list can also be used as guidance for civil society organisations and government agencies that seek to monitor and control the environmental and social performance of companies involved in oil and gas contracting chains. Civil society organisations should take the opportunity to engage more directly with Russian companies, EPC contractors and subcontractors.

**Project design and development**

- Carry out an early-stage assessment of the local workforce and local enterprise capacity in regions where operations are likely to take place.
- Engage with local authorities, educational establishments and business experts about local workforce capacity and enterprise development needs. Operating companies may wish to negotiate agreements with regional and local administrations relating to hiring of local workers and businesses. (However, there should be a guarantee that companies will not be obliged to hire specific local firms.)
- Fund programmes to build the capacity of Russian and local workforces and businesses, including training in international standards of environmental and social performance, in collaboration with local government and/or educational establishments.
- Develop a local content plan and a small business development plan (as required by IFC)\(^1\) in the early stages of project design.
- Include contractor management issues into early-stage risk assessments.

---

\(^1\) [http://www.ifc.org/ifcext/sustainability.nsf/Content/EnvSocStandards](http://www.ifc.org/ifcext/sustainability.nsf/Content/EnvSocStandards)
The tender process

• Make tender processes transparent (e.g. by publishing information on websites and community notice-boards).
• Include health, safety, environmental and social stipulations in pre-qualification processes and tender requirements.

The contract

• Provide opportunities for contractors to review the full project specifications and suggest amendments to their own scope of work in advance of signing their contract.
• Include corporate environmental and social standards in all EPC contracts, with a requirement for the EPC contractor to include them in any subcontract (and to require the subcontractors to do the same).
• Ring-fence budget lines for environmental and social protection.
• Complete all necessary environmental, social and health impact assessments before signing contracts with contractors. If this is impossible, contractors should be informed in advance about possible further requirements, and sufficient additional budget should be allocated to cover mitigation activities agreed after the signing of the contract.
• Provide training to contractors to help with understanding of full technical specifications and environmental and social standards.
• Find a balance between incentives and penalties in contracts, in order to make sure that cost and schedule are not prioritised over responsible performance.

Supervision, control and monitoring

• Develop a contractor management plan (as required by IFC).
• Ensure sufficient on-site supervision, co-ordinating efforts in order to avoid overload or confusion for supervisory staff or contractors.
• Provide training and capacity building for contractors on the job, including training in international environmental and social standards, and guidance on supervising the work of their own subcontractors.
• Implement systems for learning from mistakes during project implementation, and consequently modifying approaches.
• Implement effective feedback mechanisms so that contractors have the opportunity to influence project-related decision-making.
• Ensure effective communication between the operating company and the contractors and subcontractors on-site.
• Include specific reference to contractors in transparency and anti-corruption policies.
• Extend transparency and anti-corruption practices and systems to contractors (and require that they are extended to subcontractors); provide appropriate training and awareness raising.

Accountability and transparency

• Include contractors’ HSE performance indicators in company’s own when reporting to government and shareholders.
• Use GRI systems for reporting (by operators and contractors); increase sustainability reporting from contractors.
• Include more information about contractors in operators’ sustainability reports.
• Encourage more direct engagement between contractors/subcontractors and civil society organisations, including direct involvement of contractors/subcontractors in public consultation activities.
• Ensure that public grievance mechanisms and CLO activities provide opportunities for communities to address issues related to contractors and subcontractors effectively.
• Provide training in community relations for contractors and subcontractors, especially if they are unfamiliar with local culture and issues.

This report and these recommendations are meant to provide guidance, raise awareness and open up dialogue about the issue of contracting chain management in the oil and gas industry.

We welcome feedback on the report. If you have comments and observations, please send them to:

Aleksey Knizhnikov
WWF-Russia
AKnizhnikov@wwf.ru

Emma Wilson
International Institute for Environment and Development (IIED)
3 Endsleigh Street
London WC1H 0DD
emma.wilson@iied.org
Methodology

Over the period from 2007 to 2009, we asked a range of stakeholders (based in Russia, Europe and the US) about their key concerns and observations about environmental and social issues in the Russian oil and gas sector in general, and management of oil and gas contracting chains in particular.

The consultations took the form of semi-structured interviews; informal discussions; email correspondence and questionnaires sent electronically. We attended a number of events relating to the theme of this project. We had several spontaneous informal discussions which further contributed to our overall understanding of the situation. We analysed public documents published by the companies; media reports, largely from the Internet; and academic articles.

We visited two Arctic regions, Murmansk Oblast and the Nenets Autonomous Okrug. We also drew on the direct experience of the authors of this report on Sakhalin Island, and we interviewed several people with direct Sakhalin experience. We drew on materials and consultations with people who have direct experience of oil and gas development in Western and Eastern Siberia, including the construction of the East Siberia–Pacific Ocean pipeline.

In total, we consulted with representatives of ten operating companies, five local contractors, twelve civil society organisations, three academic institutions, four local government departments, seven consulting companies, two international finance institutions.

The survey questionnaire was modified for various stakeholder groups, including operators, contractors, government and civil society groups. As an example the industry questionnaire is inserted here:
PROJECTS AND KEY ISSUES
1. What current and planned projects is your company involved in? (General information)
2. What types of work do local contractors and suppliers carry out for your company's projects?
3. How do you perceive the responsibility of (a) your company, (b) the government, and (c) other stakeholders towards ensuring that local contractors/suppliers deliver good environmental, social, health and safety performance?
4. What opportunities exist for major companies to make positive change in local environmental, social, health and safety working practices? What successes can you report from your own experience?
5. What are your key concerns related to the environmental, social, health and safety performance of local contractors/suppliers?

POLICIES AND STANDARDS
6. What key policies, standards and regulations govern the environmental, social, health and safety performance of your project activities along the supply chain, especially at the local level? What are the ‘benchmark’ standards?
7. How are policies, standards and regulations enforced at the local level? How effectively? What recommendations do you have for more effective enforcement?
8. To what extent do the local/national system of environmental/social/safety standards for the companies correspond to international standards?
9. What systems are currently in place for your company to monitor and evaluate environmental, social, health and safety practices of local contractors/suppliers? How effective are these? What recommendations do you have for improvement?

PROCUREMENT AND CONTRACTS
10. What systems does your company use to manage qualification and pre-qualification processes for local suppliers and contractors?
11. What are the environmental, social, health/safety requirements of these systems?
12. Do these systems provide an incentive for local contractors/suppliers to improve their environmental, social, health and safety performance standards/practices?
13. What opportunities are provided (by your company/contractor management service providers/local authorities) to build the capacity of (a) local contractors/suppliers and (b) potential local contractors/suppliers?
14. How can the tender process and the negotiation and nature of the contracts themselves influence the environmental, social, health and safety performance of local contractors and suppliers (positively or negatively)? What are your key concerns about the effectiveness of the procurement process?
15. What do you recommend as priority actions to (a) address key concerns and (b) maximise opportunities for improving environmental, social, health and safety performance through the contracting process? (e.g. incentives, penalties)

LOCAL COMPANIES’ STANDARDS AND CAPABILITY
16. Do local companies have their own environmental, social, health and safety management systems and policies? How are they viewed by the procurement departments of your company?
17. What are the key constraints for local companies to establish environmental, social, health and safety management systems?
18. What recommendations do you have for building the capacity of local contractors and suppliers for good environmental and social performance?
19. What are the key incentives (opportunities and benefits) for local companies to improve their environmental, social, health and safety performance? How can these opportunities be publicised, appreciated and maximised?
20. What recommendations do you have for enhancing dialogue and collaboration between major companies and their local contractors/suppliers for improved environmental, social, health and safety performance at the local level?