

**Initial Assessment By The UK
National Contact Point For
The OECD Guidelines For
Multinational Enterprises**

**COMPLAINT FROM A CIVIL
SOCIETY ORGANISATION
AGAINST A UK BANK (B) IN
RESPECT OF A BUSINESS
RELATIONSHIP WITH A COMPANY
IN RUSSIA**

DECEMBER 2012

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Summary of the UK NCP decision

- **The UK National Contact Point (NCP) for the OECD Guidelines for Multinational Enterprises (the Guidelines) has decided to reject the complaint against Royal Bank of Scotland Group (RBS) because the link with the bank's responsibilities under the Guidelines is not substantiated. This Initial Assessment concludes the complaint process under the Guidelines.**
- **Parties in a complaint are not usually named in the initial assessment unless the complaint is accepted. In this case the UK NCP has named the main parties in line with their wishes, but references to other parties are anonymised.**

The complaint and response

1. On 31st July 2012, Sakhalin Environment Watch wrote to the UK NCP, raising concerns related to the impacts on local property owners (the Stroitel Association) of an oil and gas production complex in Russia.
2. The complaint named Royal Bank of Scotland (RBS) and two other UK banks¹. The complainants alleged that these banks had business relationships with the Russian company operating the oil and gas complex (Company R), and that the banks had failed to comply with the responsibilities placed on them by the OECD Guidelines to address impacts to which they were linked by a business relationship. The impacts resulted from actions of Company R that were allegedly inconsistent with many of the OECD Guidelines standards (the Guidelines do not apply to Company R directly as Russia is not an adhering country).
3. The same failures of compliance were alleged for all the banks named, but the nature of the alleged relationship with Company R was different in the case of each bank.

Guidelines provisions cited in the complaint

4. The complaint referred to events taking place between 2002 and 2012. Multinational enterprises' responsibilities in respect of business relationships were strengthened when the OECD Guidelines were updated in 2011. At the UK NCP's request, the complainants clarified how they applied requirements in the former and updated Guidelines to their allegations:

¹ The complaint also named a Netherlands-based enterprise. See paragraph 11 for details of handling discussions with the Netherlands NCP.

- a) They alleged that the UK banks had failed to comply with the following responsibilities under Chapter II of the pre-2011 Guidelines:

Paragraph 7. [Enterprises should] develop and apply effective self-regulatory practices and management systems that foster a relationship of confidence and mutual trust between enterprises and the societies in which they operate. (retained in updated 2011 Guidelines)

Paragraph 10. [Enterprises should] encourage, where practicable, business partners, including suppliers and sub-contractors, to apply principles of corporate conduct compatible with the Guidelines. (retained as part of paragraph 13 in updated 2011 Guidelines)

- b) They alleged that continuing business relationships with Company R meant that from September 2011 the banks failed to comply with responsibilities under the updated 2011 Guidelines:

Chapter II General policies

Paragraph 10. [Enterprises should] carry out risk-based due diligence, for example by incorporating it into their enterprise risk management systems, to identify, prevent and mitigate actual and potential adverse impacts as described in paragraphs 11 and 12, and account for how these impacts are addressed. The nature and extent of due diligence depend on the circumstances of a particular situation.

Paragraph 12. [Enterprises should] seek to prevent or mitigate an adverse impact where they have not contributed to that impact, when the impact is nevertheless directly linked to their operations, products or services by a business relationship. This is not intended to shift responsibility from the entity causing an adverse impact to the enterprise with which it has a business relationship.

Chapter IV Human Rights

Paragraph 3. [Enterprises should] seek ways to prevent or mitigate adverse human rights impacts that are directly linked to their business operations, products or services by a business relationship, even if they do not contribute to those impacts.

- c) The complainants also alleged that the business relationship implicated the banks in actions inconsistent with a range of provisions in:

Chapter I Concepts and Principles, Chapter II General Policies, Chapter III Disclosure, Chapter IV Human Rights, Chapter VI Environment

These provisions were in the pre-2011 Guidelines and were carried forward unchanged in the updated Guidelines, with the exception of the Human Rights Chapter which was added in the 2011 update. The complainants alleged that the banks were implicated in actions before 2011 inconsistent with the Guidelines applying at that time, and that continuing relationships with Company R implicated them from September 2011 additionally in actions inconsistent with the Human Rights Chapter.

Note on UK NCP application of 2011 Guidelines

5. The UK NCP applies the 2011 Guidelines to actions of multinational enterprises from 1 September 2011 onwards. In respect of the new provisions on business relationships added in the 2011 Guidelines, the UK NCP's policy is as follows:
 - a) Enterprises are not accountable under the new provisions for actions they took before those provisions applied.
 - b) the due diligence provision added in Chapter 2, paragraph 10 acknowledges that the nature and extent of due diligence will depend on circumstances. The UK NCP does not consider that it obliged enterprises proactively to review all their existing business relationships at 1st September 2011.
 - c) The UK NCP therefore looks for evidence that an enterprise should have been prompted to apply the provisions in a specific relationship. This evidence might relate to the enterprise's knowledge of an ongoing impact at 1st September 2011, or to new actions or events from 1st September 2011 (for example, the enterprise signing a new contract with the related business, receiving a new report on the related business, or receiving representations from stakeholders about an impact of the related business).

Detail of the allegations

6. The complainants alleged:
 - a) That Company R had established a Sanitary Defence Zone (SDZ) around the oil and gas production complex smaller than that required by the Russian Ministry of Natural Resources in giving its permission for construction in 2003. Stakeholder communications produced by Company R also suggested to the property owners represented by the complainants that a larger SDZ would apply. These property owners understood that their properties and cultivated land would be within the SDZ. Under Russian law this

would have required Company R to resettle and fully compensate them. However, their properties were not within the smaller SDZ established. Company R made them an offer of compensation in 2006, but this was significantly less than would have been due in the case of a legally mandated resettlement.

- b) That the construction of the complex from 2003-2007, and its operation from 2007 had adverse impacts on the property owners, and their land. Pollution and associated health risks affected their food security, and other impacts included safety risks, damage and disturbance, loss of property values and loss of cultural and community life. These impacts also suggested that the smaller sanitary zone was inadequate.
- c) That each UK bank was involved in making loans to Company R and/or its controlling shareholder, and so had a business relationship with Company R.
- d) That each UK bank was a signatory to the Equator Principles, and so had committed to self-regulatory practices that required loans not to be made unless projects met social and environmental standards.
- e) That each UK bank was failing to comply with Guidelines requirements on business relationships and self-regulatory practices, and that each bank had a responsibility under the Guidelines to use its influence to encourage Company R to address the adverse impacts of the project and provide a remedy for the property owners represented by the complainants.

Allegations against RBS specifically:

- 7. The complainants alleged that RBS had a business relationship with Company R through RBS's acquisition in Autumn 2007 of a Netherlands based bank. In 2007, prior to being purchased by RBS, the Netherlands based bank arranged loans that the complainants alleged allowed a Russian multinational to acquire a controlling interest in Company R. The complainants alleged that this gave RBS a financial interest in Company R and direct influence over it.

Response of RBS

- 8. RBS responded on 12 October, noting that it was unable to disclose information that was confidential, commercially sensitive and/or protected under contract law.
- 9. In respect of the allegations about its relationship with Company R, RBS said that a company it owned jointly with other banks acquired a

Netherlands based bank in October 2007 had earlier participated in a syndicate that made loans to a Russian multinational that subsequently became Company R's controlling shareholder. These loans were corporate loans which could have been used in acquisitions, and they had now lapsed (RBS did not say when the loans lapsed).

10. RBS said that Company R was not a party to the loans it acquired and no business relationship can be established between RBS and Company R under these loans. RBS referred to the advice of the OECD Committee on International Investment and Multinational Enterprises (CIME) in 2003 on determining the existence of an investment nexus that could give a company influence over a business partner. On the basis of this advice, RBS said that it did not have an investment nexus with or influence over Company R and therefore asked the UK NCP not to accept the complaint for further consideration.

The UK NCP process so far

11. On 31st July 2012 the complainants sent the complaint to the UK NCP and the Netherlands NCP (NL NCP), naming the 3 UK banks and a Netherlands based enterprise. The UK NCP and the NL NCP subsequently agreed to treat the complaints against each company separately, with the NL NCP considering the complaint against the Netherlands company and the UK NCP considering the complaints in respect of each of the UK banks.
12. On 29 August the UK NCP informed the complainants of the agreed handling arrangements and asked them to clarify the complaint (see paragraph 4).
13. On 29 August, the UK NCP forwarded details of the complaint and clarification request to RBS and invited its response.
14. On 13 September the UK NCP received the complainants' clarification.
15. On 15 October the UK NCP received RBS's response.
16. On 16 November, the complainants submitted some comments on RBS's response.
17. The UK NCP shared the details of the complaint, clarification and response with both parties. Each party was offered a meeting with the UK NCP. The complainants did not take up the offer. The UK NCP spoke to representatives of RBS on 2 October to explain the complaints process, and shared notes of this conversation with both parties.

UK NCP decision

18. The UK NCP **rejects** the complaint against RBS. The UK NCP took the following points into account when considering whether the complainants' concerns merited further consideration:

Identity of the complainants and their interest in the matter:

19. The UK NCP **is satisfied** that the complainants are legitimate, that they represent parties directly interested in the issues raised in the complaint and that they are able to supply information about impacts of the oil and gas facility and actions of Company R.

Whether the issue is material and substantiated:

The complaint depends on demonstrating that RBS's responsibilities under the Guidelines in respect of self-regulatory practices and/or in respect of business relationships should apply in relation to Company R.

20. The NCP finds that this is **not substantiated** for the reasons set out below. As these responsibilities are not shown to apply, evidence about the actions of Company R and their impacts is not relevant to a complaint against RBS.
21. Based on the information provided in the complaint and the response, RBS's link with Company R is that RBS acquired a company that had arranged loans for Company R's controlling shareholder. The loans may have been used to purchase the controlling interest in Company R and – as they were arranged a few months before RBS's acquisition – may have been outstanding when RBS acquired the bank. The loans have since lapsed.
22. The complainants cite the Equator Principles as the self-regulatory practices applying to UK Bank B's link to Company R. In 2007, when the relevant loans were arranged, the Equator Principles applied to project finance, defined as follows:

“project finance is a method of funding in which the lender looks primarily to the revenues generated by a single project, both as the source of repayment and as security for the exposure. This type of financing is usually for large, complex and expensive installations that might include, for example, power plants, chemical processing plants, mines, transportation infrastructure, environment, and telecommunications infrastructure. Project finance may take the form of financing of the construction of a new capital installation, or refinancing of an existing installation, with or without improvements. In such transactions, the lender is

usually paid solely or almost exclusively out of the money generated by the contracts for the facility's output, such as the electricity sold by a power plant. The borrower is usually an SPE (Special Purpose Entity) that is not permitted to perform any function other than developing, owning, and operating the installation. The consequence is that repayment depends primarily on the project's cash flow and on the collateral value of the project's assets."

23. The loans arranged by the Netherlands bank do not appear to fall within this definition, and the UK NCP does not consider that RBS inherited any Equator Principles obligations in respect of these loans when it acquired the Netherlands bank. The UK NCP notes that the Equator Principles Association is currently finalising an update that may extend the Principles to this type of loan in future.
24. In respect of the Guidelines, the requirement on RBS at the time of its acquisition was to *"encourage, where practicable, business partners.....to apply principles of corporate conduct compatible with the Guidelines"*. Commentary on this provision in the pre-2011 Guidelines refers to the importance of the Guidelines to:

"suppliers, contractors, subcontractors, licensees and other entities with which MNEs enjoy a working relationship. It is recognised that there are practical limitations to the ability of enterprises to influence the conduct of their business partners. The extent of these limitations depends on sectoral, enterprise and product characteristics such as the number of suppliers or other business partners, the structure and complexity of the supply chain and the market position of the enterprise vis-à-vis its suppliers or other business partners. The influence enterprises may have on their suppliers or business partners is normally restricted to the category of products or services they are sourcing, rather than to the full range of activities of suppliers or business partners. Thus, the scope for influencing business partners is greater in some instances than in others. Established or direct business relationships are the major object of this recommendation rather than all individual or ad hoc contracts or transactions that are based solely on open market operations or client relationships. In cases where direct influence of business partners is not possible, the objective could be met by means of dissemination of general policy statements of the enterprise or membership in business federations that encourage business partners to apply principles of corporate conduct compatible with the Guidelines".

25. RBS claims that it did not have an "investment nexus" with Company R. The further submissions made by the complainants on 16 November dispute this. Both parties refer to the advice on determining an "investment nexus" given by the OECD Committee on Investment and

Multinational Enterprises (CIME) in 2003. The UK NCP understands this advice to establish that Guidelines requirements on business partnerships apply to financial enterprises and relationships as well as the supply chain relationships which are more generally understood to be the subject of the Guidelines' provisions. The advice clarifies the circumstances in which NCPs may conclude that a financial enterprise is a business partner of another company, referring to whether the relationship has the character of an investment in the business partner. The advice supports a case by case approach by NCPs, however, and does not limit the ability of NCPs to apply the Guidelines to financial enterprises to a defined investment nexus test.

26. Both parties cite previous cases in which NCPs have considered whether an investment nexus exists. The UK NCP has considered these submissions. Give the CIME's support for a case by case approach, and noting that the test has not been incorporated into the Guidelines, the NCP does not consider previous cases a determining factor here.
27. In this case, the NCP notes that there is no substantiated claim that either Company R was a party to the 2007 loans when they were made, or that the loans directly supported activities of Company R. The NCP understands that the production complex was operational when the loans were made, and that the loans apparently financed a change in ownership of Company R that had been completed when RBS inherited the loans.
28. Considering these factors, and also that the loans were made by a number of banks to a company that had substantial resources and operations other than its shareholding in Company R, it does not appear to the UK NCP that RBS was able to influence Company R directly. The Guidelines commentary suggests that where direct influence is not possible, enterprises may encourage business partners by their general policies or membership of relevant business associations, and the NCP notes that RBS had such policies and memberships in place, including its membership of the Equator principles.
29. The UK NCP therefore finds that it is not substantiated that RBS's link with Company R gave it an obligation under the Guidelines that was not met by the general policies it had in place.
30. No evidence is offered to establish a business relationship between RBS and Company R from September 2011) that would trigger the enhanced requirements of the updated 2011 Guidelines in respect of "*impacts directly linked.....by a business relationship.*"

Other points noted by the NCP

Whether the consideration of the specific issue would contribute to the purposes and effectiveness of the Guidelines:

31. As the complaint has not been accepted, mediation or further investigation will not be pursued. But the UK NCP notes that in a complaint about business relationships, the scope of any mediation may be limited where the relationship in question has ended.
32. The UK NCP believes that the general nature of the pre-2011 Guidelines requirement on encouraging business partners is open to a broad range of interpretations. The 2011 Guidelines provide more detailed guidance to enterprises on their responsibilities in this area.

Relevance of applicable law and procedures, including court rulings:

33. The complainants allege that Company R broke Russian law by not resettling owners whose properties fell within the larger sanitary zone on which permission for the project is based. The UK NCP notes that the Guidelines represent voluntary principles and standards of behaviour of a non-legal character and are not a substitute for (nor should they be considered to override) local law or legal remedies,

How similar issues have been, or are being, treated in other domestic or international proceedings:

34. As noted, the UK NCP is considering allegations in relation to two other UK banks, and the NL NCP allegations in relation to a Netherlands based company. The alleged involvement of each company is different, and treatment of each complaint is only of limited assistance in determining how to proceed in the others. However the UK NCP took a consistent approach in the treatment of the parallel complaint against UK Bank A
35. The UK NCP notes that both parties in the complaint referred in their submissions to cases in which other NCPs have considered the existence of an “investment nexus”. The UK NCP’s approach to this is set out at paragraphs 25 to 27 above
36. The UK complaints also raise some general issues about applying the Guidelines in the financial sector, and the UK NCP will ask the OECD to consider these in the context of its current work in this area.

Next steps

37. This Initial Assessment concludes the complaint process under the Guidelines.

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UK National Contact Point for the OECD Guidelines for Multinational Enterprises

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