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# G factor of the ESG agenda in the context of sustainable development of Russian electric power companies

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**Abstract.** Reducing associated investment risks in the context of the modern ESG agenda requires a certain transformation of corporate governance in Russian power generation companies. In order to achieve this objective, a correlation analysis was carried out between the generalized G components of the ESG agenda and the principles outlined in the Russian Corporate Governance Code (Code). The priority G components of authoritative international rating agencies and the largest foreign companies, leading national rating agencies, and the Bank of Russia were examined. The study involved the analysis of Russian power generation companies that are voluntarily enhancing their corporate governance practices. The results of a general assessment of their corporate governance and additional analysis of the fulfilment of the criteria for each section of the Code are presented. The data obtained are summarized and proposals for further transformations of corporate governance in these companies are formulated. These proposals are highly relevant in the context of sustainable development of these companies. They concern the reformatting of the ownership structure and business ethics into separate G components with an appropriate set of evaluation criteria, and the introduction of modern compliance control.

## Introduction

The modern trend in sustainable development is the ESG agenda (Environmental, Social, and Corporate Governance). The importance of the G factor (corporate governance) in this agenda compared to environmental (E) and social (S) factors is clearly and undeservedly underestimated, particularly in generation companies in the electric power industry (hereinafter referred to as generation companies). Corporate governance is generally considered fundamental for the implementing these factors. As a rule, ineffective corporate governance lies behind every environmental or social violation [1]. Risks and opportunities of corporate governance are critical in decision making, including “E” and “S” decisions. They can only increase with the further development of social, political, and cultural relations [2-7]. Both an increase in the importance of corporate governance in generation companies and a certain revision and (or) reformatting of its G components are required.

The purpose of the study is to find the avenues to transform corporate governance in these companies in the context of their sustainable development under unprecedented anti-Russian sanctions and the lack of alternatives to the domestic borrowing market.

The G factor of the Corporate Governance Code of the Organization for Economic Co-operation and Development (OECD) [8], the Russian Corporate Governance Code (hereinafter referred to as the Code) are analyzed [9]. A correlation analysis of the principles of Code G components of the draft model methodology is performed for ESG ratings of the Bank of Russia and its recommendations to boards of directors on how to consider ESG factors [10-11]. The main G components in the ESG ratings of leading international rating agencies (FTSE Russell, ISS, S&P Global Ratings, MSCI ESG Rating, RAEX Europe ESG, Vigeo Eiris, RepRisk, Ernst&Young, DJSI World, GRI) and national rating agencies (PWC (TeDo), RAEX, Expert RA, NRA, ACRA, AK&M) are identified [12-22]. A comparative analysis of the significance of these G components was performed.

The underestimation of “Anti-Corruption principle,” highlighted as a priority in the UN Global Compact, is emphasized [23]. The most significant G components of ESG reporting of the largest foreign companies are identified [24]. The underestimation of the ownership structure in generation companies as the G component is emphasized. The reason is its opacity, instability, lack of restrictions for owners, and the presence of offshore zones. Associated investment risks are identified, including those arising from the lack of business ethics and modern compliance control in the G-components. An assessment based on the updated methodology of the Bank of Russia confirms the low practice of implementing the principles and recommendations of the Code in the majority of generation companies. Significant differences in their compliance with the Code criteria are identified [25-26].

All the data obtained are summarized and further steps for transforming corporate governance in generation companies are outlined to support their sustainable development. The transformations mainly concern the expansion and reformatting of the G-

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components and the criteria for their evaluation, primarily in relation to the ownership structure, corporate behavior, and compliance control.

# 1 G factor in the international and national ESG agenda

The study of the G factor of the international and national ESG agenda notes a certain similarity between the principles of the OECD Code and the Russian Code. This similarity is mainly due to the development of the principles of the Russian Code on the basis of OECD best corporate practice standards. Their fundamental differences mainly stem from different institutional environments. Most likely, for this reason, the Russian Code does not contain a principle of compliance of corporate governance with the requirements of the rule of law, effective supervision, and enforcement. There is no principle of proper redress for violations of shareholder rights.

The G components of the national ESG agenda in one form or another were previously present in the principles and (or) criteria of the Code. The differences are mainly in the emphasis on their significance. This is confirmed by the comparison of generalized G components of the Bank of Russia, in terms of the consideration by the board of directors of ESG factors, and the Bank's draft model methodology for ESG ratings with the principles of the Code.

Certain differences are identified when comparing the G components of the ESG agenda and the principles of the Code. In particular, the ESG agenda highlights the high significance of "the practice of implementing the principles and recommendations of the Code," "share capital structure," and "anti-corruption and anti-fraud measures." Moreover, they are presented as G -components, and not in the form of inconspicuous criteria for compliance with individual G components of the Code.

Good corporate governance is not limited to the G components of legislation and the Code. Many of these G components are outside the legislative sphere and are partly reflected in the ESG ratings of reputable international and national rating agencies. ESG ratings are highly valued by investors and help them identify opportunities and associated risks for the sustainability of companies in the long term. ESG ratings also play a key role for companies in building internal processes in accordance with the best corporate governance practices. A place in the overall ESG rating or in individual "E," "G," and "S" ratings is usually considered one of the main factors in the investment attractiveness of companies, their certain competitive advantage [4]. The significance of the identified G components in the ESG ratings of international and national rating agencies is determined. It is measured by the number of agencies using these G components in corporate governance assessments.

G components are considered in a generalized form, partly to facilitate their comparative analysis. In particular, "Corruption, bribery, extortion, money laundering, and fraud" are defined as "Corruption." "Structure of the Board of Directors" encompasses "Structure of the Board of Directors and its committees, diversity of the Board of Directors, etc." Corporate behavior is represented by separate components: business ethics, antitrust practices, and taxes.

Below are the differences identified in the emphasis on the significance of the same G components for international and national rating agencies? The most significant G components from the ESG reporting of the largest foreign companies are indicated.

## 1.1 The significance of G components in international ESG ratings

The highest priority G component in the ESG assessments of all international rating agencies is the structure of the board of directors. Business ethics and executive compensation are assessed only in six out of nine agencies. Only four or five agencies assess shareholder rights, tax payment, risk management, audit, and transparency. Antitrust practices and political activity, corruption and ownership structure are assessed by only two or three international rating agencies.

## 1.2 The significance of G components in national ESG ratings

National ESG ratings are distinguished by a relatively narrower coverage of G components and a different approach to their assessment. The structure of the board of directors and risk management were considered the most preferable for all national rating agencies and the Bank of Russia. Transparency and ownership structures were highly rated. Audit, tax payment, corruption, business ethics, and shareholder rights were less in demand. They were explicitly present in the assessments of two or three national rating agencies. Antitrust practice, political activity, and audit (except for the National Rating Agency) were completely absent in national ESG ratings.

## 1.3 The significance of the G components in ESG reporting of foreign companies

Additional analysis of the G components of ESG reporting of the largest foreign companies revealed that stakeholders showed the greatest interest in the board of directors, transparency, ethical behavior, and enhanced control [24]. These G components are actually the top-line factors in the ESG ratings provided by international rating agencies. The "Anti-corruption" policy proved to be clearly undervalued by the international and national ESG agenda, although in the UN Global Compact it is among the main ten principles of sustainable development [23].

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# 2 The G factor of the ESG agenda in Russian generation companies

The main G components of the corporate governance factor of Russian companies (including electric power companies), it would seem, are exhaustively formulated by the regulator (Bank of Russia) in the Code and in its further numerous recommendations on the implementation of standards of best corporate practice. However, further expansion and reformatting of these components is required in generation companies to take into consideration the identified differences in the G components of modern ESG-agenda and principles of the Code, as well as certain sectoral specifics. Primarily, this pertains to the ownership structure, business ethics, and compliance principles.

## 2.1 Ownership structure

The ownership structure in the context of sustainable development of generation companies should be considered as an independent G component (with a certain set of criteria for its assessment). This is mainly due to opacity, instability, conflicts of interest, lack of restrictions for the owners of these companies, and the presence of offshore zones. This is partly confirmed by our generalized data on the rotation of ownership in these companies, including the data from the leading news agency Bigelectricpowernews and the business newspaper Kommersant.

Italian Enel sold shares of PJSC Enel Russia (now PJSC EL5-Energo) to PJSC Lukoil (26.9%) and the investment fund Gazprombank-Freesia (29.5%). Later, PJSC Lukoil increased its share to 63.8% by purchasing shares of UROC Limited (7.4%). The share capital of PJSC EL5-Energo also included LLC PPIT-7 (5.5%). The Russian generation assets of OJSC Fortum (renamed Forward Energo) (98.2%) and PJSC Unipro (83.7%) belonged, respectively, to the Finnish concern Fortum and the German government (through Uniper). They were transferred to the management of the Federal Property Management Agency.

The Federal Property Management Agency increased its share in the share capital of PJSC RusHydro to 62.2%. PJSC VTB Bank, on the contrary, reduced it from 13% to 12.4%. Rusal (9.5%) became a shareholder of PJSC RusHydro. The share of the Finnish Fortum Power and Heat Oy increased slightly (from 29.5% to 29.99%) in the share capital of PJSC TGC-1. JSC Rusatom Infrastructure Solutions (a division of the state corporation Rosatom) acquired shares of PJSC Quadra (82.47%), later increasing this share to 95.02%. PJSC Quadra - Power Generation has lost its public status and has become JSC Quadra - Power Generation.

The presence of En+ Group (O. Deripaska) in JSC EuroSibEnergo increased to its maximum level. More than 83.4% of the shares of PJSC TGC-2 in 2023 were withdrawn in favor of the state from Kostroma Kogeneratsiya Ltd., Janan Holdings Limited, Raltaka Enterprises Ltd., Litim Trading Limited, Kores Invest LLC, and Dolgovoye Agentstvo LLC (a subsidiary of PJSC TGC-2). This seizure is mainly due to the activities of its owner (L. Lebedev). He bought PJSC TGC-2 with illegally obtained income and registered it in the name of foreign companies in the British Virgin Islands in order to hide his participation in the ownership and management of this company.

The generation assets of PJSC TGC-14 (more than 92.2%) were purchased by JSC Far Eastern Management Company. Its main shareholder is K. Lyulchev (former top manager of Russian Railways). The beneficiary of PJSC T Plus, which united the generation assets of OJSC TGC-5, OJSC TGC-6, OJSC TGC-9, and OJSC TGC-7, was V. Vekselberg. At the beginning of 2019, he owned the Renova Group (39.6%), Brookwid Trading Limited (Cyprus) (20.5%), and Gotelia Management Limited (Cyprus) (12.7%), which were declared as the main shareholders of PJSC T Plus. Merol Trading Limited (Cyprus) (11.7%) was also one of these shareholders and was affiliated with Renova Group.

The ownership structure plays a crucial role as a G component because it determines the structure and overall functioning of the board of directors. Under a relatively weak institutional environment, the board of directors “de jure” has an overwhelming number of powers to safeguard the rights and interests of shareholders, including enhanced control over their protection. Unfortunately, “de jure” in generation companies often does not coincide with “de facto” [25-26].

## 2.2 Business ethics

Business ethics is absent both from the G components of the draft model methodology for ESG ratings of the Bank of Russia and from its updated methodology for assessing compliance with the Code. It is imperative to have business ethics as a G component of the sustainable development of generation companies (with a set of corresponding criteria) alongside “corruption control,” which is currently a criterion in the Code. It is no coincidence that in the ESG ratings of reputable international and national rating agencies, business ethics is one of the priority G components, just like “corruption control” is in the UN Global Compact.

Lack of business ethics and proper compliance control in G scores has led to an increase in investment risks in generation companies, primarily in transactions with related parties and expropriation of minority shareholders, overpayment for resources or assets, underpricing when selling products or assets. In particular, the former general director of PJSC TGC-2 and the ex-head of Arkhoblenergo, in violation of procurement legislation, entered into contracts at inflated prices for the supply of fuel for the needs of JSC Arkhoblenergo. They deliberately destabilized the activities of PJSC TGC-2 with the aim of bankruptcy and appropriation of property belonging to the Arkhangelsk region. The assets of this company were transferred offshore by its beneficial owner L. Lebedev, creating a real threat of bankruptcy proceedings and the complete cessation of the activities of PJSC TGC-2.

Through fraudulent schemes, M. Abyzov and his accomplices stole large sums of money from JSC Sibeko and OJSC RES. They secretly shared insider information with a potential buyer, keeping it hidden from shareholders and regulatory authorities, to ensure a profitable sale of their stake in JSC Sibeko. Advisor to the General Director of JSC TGC-11 (part of PJSC Inter RAO) was arrested for receiving a bribe of RUR 3.5 million. A criminal case was opened against the director of capital investments, state construction supervision, and state examination of the state corporation Rosatom [27-30].

### 2.3 Compliance control

Compliance control is a critical component of the current national ESG agenda. Its capabilities are much broader in ensuring the fulfilment of the criteria for compliance with the G components, which are significant for the sustainable development of generation companies.

The results of the latest assessment of fulfilling the criteria for compliance with the principles of the Code with their status ("fulfilled," "partially fulfilled," "not fulfilled") are presented in Figure 1, based on the 2021 results. They were obtained primarily from the reports "On Compliance with the Principles and Recommendations of the Code" from the official websites of these companies.

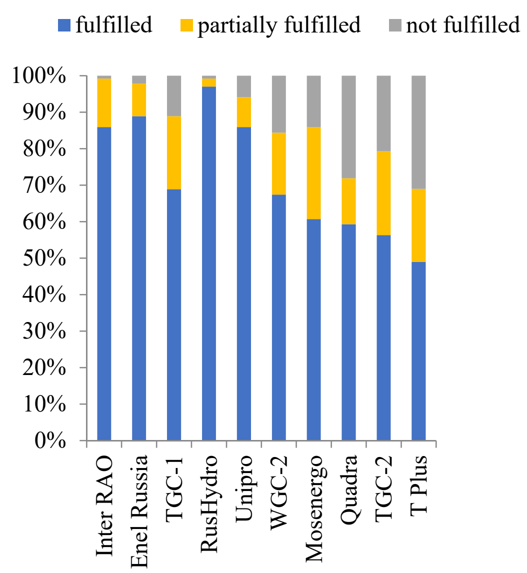


**Fig. 1.** Fulfilment of the Code criteria by generation company.

The leaders in fulfilling the criteria for the compliance with the Code are PJSC Inter RAO, PJSC RusHydro, PJSC Enel Russia, and PJSC Unipro. The outsiders are PJSC TGC-2, PJSC Quadra, and PJSC T Plus. One of the main reasons for these differences is the absence of modern Compliance control in outsider companies. This is a completely different type of monitoring of corporate governance's compliance with national legislation and the Code. Modern compliance control allows identifying risks at the early stages of their manifestation and preventing associated economic damage. It provides more real protection against corruption and conflicts of interest. Additionally, it includes a range of components to ensure the economic security of the company. Compliance control policy, unfortunately, was developed and documented internally only by companies leading in corporate governance.

## Conclusion

The modern ESG agenda requires increased significance of the G factor and transformation of its components. To this end, additional G components and partially reformatted Code criteria are proposed. They mainly relate to ownership structure, business ethics, and compliance control. These G components are especially relevant in the context of sustainable development of generation companies. They are formulated based on a summarized wide array of data, including updated ESG recommendations of the Bank of Russia, priority G components of international and national ESG ratings, ESG reporting of the largest foreign and domestic companies, and characteristic sectoral features of corporate governance. These proposals will enable potential investors to re-evaluate corporate governance in generation companies to support their sustainable development.

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