



Preliminary Assessment Report

**Complaint Regarding the Lukoil Overseas Project
(Kazakhstan - Karachaganak/03)**

Western Kazakhstan Oblast, Kazakhstan

April 5, 2009

**Office of the Compliance Advisor/Ombudsman
International Finance Corporation and
Multilateral Investment Guarantee Agency**

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1. Introduction

The Compliance Advisor Ombudsman (CAO) is the independent recourse mechanism for the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA). The CAO reports directly to the President of the World Bank Group. Its mandate is to address in a fair, objective, and constructive manner complaints brought by communities or individuals affected by IFC or MIGA projects, and to enhance the social and environmental outcomes of these projects.

Upon determining that a complaint meets the specified criteria for a CAO intervention, the CAO Ombudsman conducts an assessment of the situation to clarify the issues, facilitate communication between the parties about their perspectives and interests, and assist them in identifying opportunities for resolution.

The current complaint to CAO, filed in May 2008 by two organizations – Crude Accountability and Green Salvation Ecological Society – is the third regarding IFC's involvement in the Karachaganak Petroleum Operation B.V. (KPO) project. The first complaint, filed in September 2004, resulted in a CAO Compliance audit of IFC, and the second, filed in April 2007, was closed following an ombudsman assessment and CAO Compliance appraisal.

This third complaint argues that the KPO project is in violation of both Kazakhstan legislation and the IFC's policy on involuntary relocation, that the Village of Berezhovka should be relocated in accordance with that policy, and that villagers should be compensated for hardship endured since the project was first financed.

In 2002, the IFC financed Lukoil Overseas Karachaganak B.V., one of the partners in the KPO venture, to fund a portion of Lukoil's share of development of the Karachaganak field.

The CAO Ombudsman held a number of meetings and conference calls with the parties in advance of a November 2008 site visit to Kazakhstan to facilitate a meeting of the KPO venture partners, and to meet individually with representatives of Green Salvation and the Berezhovka Initiative Group. The venture partners' meeting was planned and coordinated in advance by KPO specifically to address issues raised in the CAO complaints, and to discuss strategies for engaging with the community, the IFC, and other stakeholders to resolve them.

In January 2009, Lukoil ended its contractual obligations to IFC by pre-paying its outstanding balance.

Despite the pre-payment, the CAO Ombudsman has remained engaged with the complainants and the company to help them address the concerns raised in this complaint.

This report is an assessment of the stakeholders' perspectives and opportunities for resolving the outstanding issues.

2. Summary of the Complaint

The current complaint was filed jointly on May 9, 2008, by the NGO's Green Salvation Ecological Society and Crude Accountability on behalf of the Berezovka Initiative Group regarding the Karachaganak Petroleum Operation B.V. (KPO) project. The Berezovka Initiative Group includes concerned citizens from a village about three kilometers from the Karachaganak oil and gas field boundary.

The complaint maintains that Kazakhstan legislation at the time of the loan required the project to have a Sanitary Protection Zone (SPZ) of no less than five kilometers. It says the Environmental Assessment conducted by Bechtel and Kazekologiya Center in 2002 recognized national legislation, which stated: "According to the 'Sanitary Standards for the Design of Industrial Installation,' at installations producing natural gas containing high levels of hydrogen sulphide (over 2-3%) and mercaptans, the size of the standard (minimum) SPZ must be not less than 5000m."

The complaint says that because the project was financed in 2002, IFC's current social and environmental performance standards do not apply to the project. Rather, they say the IFC's previous safeguard policies, including Operational Directive 4.30 – Involuntary Resettlement – should be the policies which IFC is required to supervise the project.

According to the complaint, when IFC provided financing for Lukoil's share in the project, the legal SPZ was 5 kilometers, and anyone living inside the zone should by law have been resettled. The complaint quotes paragraph 1 of Operational Directive 4.30: "Any operation that involves land acquisition or is screened as a Category A or B project for environmental assessment purposes should be reviewed for potential resettlement requirements early in the project cycle." Complainants say IFC's March 2002 Environmental Assessment contains no reference to a review for potential resettlement.

The complainants' understanding of the Kazakh and IFC documentation governing this project is that KPO was in violation of IFC guidelines at the time financing was provided. They say the residents of Berezovka began raising complaints to the World Bank Group in 2003, following what they considered to be an illegal decision by government to reduce the size of the SPZ.

To resolve the issue, the complaint states: "The residents of Berezovka demand compensation, not only for their loss of home, income, land and community, but also for the hardships—mental, physical, emotional, and environmental—that they have endured since 2002. They demand that the IFC, working together with the appropriate state bodies of Kazakhstan and with the management of KPO, compensate them at full cost for their homes, livelihoods, health and well-being; assist them with the move and support them during the transition period in the resettlement site; assist in their efforts to improve their former living standards, income earning capacity, and production levels; and pay particular attention to the needs of the poorest to be resettled, including the elderly, women and young families."

2.1 Previous Complaints

The first and second complaints to CAO regarding the KPO project raised similar concerns.

The first was filed in 2004 by the Berezovka Initiative Group, with assistance from Crude Accountability. Following an ombudsman assessment, the parties were unable to reach

agreement on a strategy for resolving the issues, and the complaint was transferred to CAO Compliance. A CAO Compliance appraisal determined that an audit of IFC's involvement in the project was merited.

The results of that audit were made public in February 2009, and are available on CAO's website (<http://www.cao-ombudsman.org/>).

The second complaint, filed in April 2007 by the Green Salvation Ecological Society, raised similar concerns about the impact of the project on villagers' health and quality of life, but in the context of the legality of national permissions and licenses under which the project operates. Based on the then-ongoing audit, as well as the complainants' previous request for the compliance audit, rather than attempting a process of assisted negotiations with KPO, the complaint was transferred to CAO Compliance. CAO Compliance closed the case following an appraisal by referring the complainants to the then on-going audit of IFC in relation to the project's air emissions, and it transferred specific fraud and corruption charges to the World Bank Group's Department of Institutional Integrity.

All three of the complaints to the CAO about the Lukoil Overseas project raise concerns about:

1. The project's compliance with Kazakhstan and World Bank Group social and environmental requirements,
2. The impact of the project's emissions on the health and quality of life of residents of Berezhovka village, and
3. The legality of a Kazakh government decision to reduce the size of the SPZ that encompasses the field.

In addition to the CAO cases, Green Salvation has filed suit against the Kazakh government over the SPZ decision, and the claim is currently pending in the Kazakh courts.

3. Summary of the Project

In 2002, IFC provided US\$150 million in loans to Lukoil Overseas Karachaganak B.V. to fund a portion of its share in the development of the Karachaganak oil, gas, and condensate field in Kazakhstan. The project is known as Karachaganak Petroleum Operation B.V., or KPO.

According to KPO documents, the expansion of the KPO field involves investments of more than US\$ 5.5 billion, and it is currently one of the biggest internationally funded projects in Kazakhstan.

Development of the field is overseen by four international shareholders – BG Group, based in the United Kingdom, and Eni of Italy – each with a 32.5 percent interest; Chevron USA – with 20 percent; and LUKOIL of Russia – with 15 percent. KPO's operations are regulated by a Production Sharing Agreement that was signed in 1997 by the government of the Republic of Kazakhstan and the KPO shareholders. Under the agreement, KPO will operate the Karachaganak project until 2038.

On January, 8, 2009, Lukoil ended its contractual obligations to IFC by pre-paying its outstanding balance. Despite the pre-payment, IFC continued to work with KPO to address

issues raised in a CAO compliance audit that was triggered by the first complaint. During the week of January 12-16, the CAO audit team visited the project site and concluded the project was in compliance with applicable IFC requirements on a majority of the issues identified in the audit. Several other issues related to reporting of project performance remain outstanding. Following the CAO Compliance team's visit, KPO committed to an action plan to address the outstanding issues.

The CAO Ombudsman also has remained engaged with the parties and will conclude the assessment in accordance with CAO's Operational Guidelines.

4. CAO Ombudsman Assessment

4.1 Background

The assessment of the current complaint has involved an extended period of consultations and interviews – including individual meetings, telephone conversations, e-mail exchanges, and conference calls with the complaints, the Berezhvoka Initiative Group, KPO representatives, and IFC project team and management.

In the fall of 2008, the ombudsman assessment period was extended with agreement of the parties. The CAO sought this extension following KPO's request for a CAO-facilitated meeting of the venture partners to discuss the case and potential strategies for working together with the complainants. The ombudsman team saw this request as an important opportunity to frame the issues for the whole venture partnership, who previously had not taken part in CAO complaints, and to take steps toward a first assisted negotiation on this case.

4.2 Approach and Perspectives of Key Stakeholders

In November 2008, a CAO Ombudsman team traveled to the project site to meet with the stakeholders. The team met first in Almaty with representatives of Green Salvation, and several days later in Berezhvoka with members of the Initiative Group, whom the complaints are representing, to discuss their perspectives and possibilities for resolving the complaint.

The team then met with and facilitated a day-long meeting of the KPO venture partners and operations staff. The objective of the meeting was to update the partners on the history of the CAO complaints, and to explore options for resolving the current case.

The following are summaries of those meetings.

November 17 – Meeting with Green Salvation Representatives

The meeting took place in Almaty with three representatives of Green Salvation, an NGO working in partnership with Crude Accountability on behalf of the residents of Berezhvoka. Green Salvation staff members updated the ombudsman on the NGO's legal case against the Government of Kazakhstan regarding the project, and described their perspectives on the current complaint. The CAO team informed Green Salvation of the (then) upcoming meeting with the KPO venture partners, and explained that KPO had specifically requested a facilitated meeting in order to inform all the venture partners about the history of the CAO

complaints, and to explore options for engaging with the NGOs, IFC, and CAO to resolve them.

Green Salvation summarized what it believes to be the legal claims surrounding the case. They argue that the project is in violation of both Kazakhstan legislation and the IFC's policy on involuntary relocation; that human rights, as well as international conventions, have been violated; and that the people of Berezvoka are being exposed to harmful pollutants that are negatively impacting their health and well-being.

In addition to the legal arguments, Green Salvation believes there should be formal acknowledgement by KPO and the government that the rights of Berezvoka residents were violated with the government's decision to reduce the size of the sanitary protection zone, and its subsequent decision to rescind an earlier commitment to relocate the village.

According to Green Salvation, resettlement is the desired outcome of a CAO intervention – both for the community and for the signatories to the complaint.

November 20 – Meeting with Berezvoka Initiative Group members

The CAO team met in Berezvoka with a group of people representing the Initiative Group to discuss the issues raised in the complaint and their various perspectives on what should be done to resolve them. The CAO informed participants of the (then) upcoming meeting with the KPO venture partners, and explained that KPO had specifically requested a facilitated meeting in order to inform all the venture partners about the history of the CAO complaints, and to explore options for engaging with the NGOs, IFC, and CAO to resolve them.

According to the meeting participants, the issues are long-standing and have been raised often, over a number of years, in various grievances to the government, the World Bank Group, the company and to other international appeals bodies, but without satisfactory resolution.

The perspectives of Berezvoka residents who attended the meeting include the following:

- The Sanitary Protection Zone surrounding the field should be 5 km, according to Kazakh law.
- People are afraid of the air quality in Berezvoka. Very often residents can smell the gas. When people call to report excessive odours, laboratory personnel can take several hours or longer to arrive, by which time the wind has shifted and/or the concentrations have diminished.
- The water is contaminated by the project's emissions and not suitable for drinking or irrigating.
- Many residents are frightened of KPO's operations and live in fear that a disaster or serious accident could happen at any time.
- For a number of reasons, the Community Forum that was established by KPO is not a trusted venue for raising concerns or resolving grievances.

- Money that KPO spends on community and social development projects could be better spent on relocating Berezhovka. Initiative Group members believe these projects are intended to pacify residents and divert their attention away from the true impacts of the project.

According to participants at the meeting, there are many villagers who wish to be resettled in a safer location, and a small number who say they do not want to leave the area.

November 21 – Meeting with KPO Venture Partners

The CAO team met with the KPO venture partners for a daylong meeting, which had been requested by KPO's Corporate Affairs Manager and other shareholders.

The meeting opened with a viewing of the film "Changing Lives," the story of the TCO Company's resettlement of 750 families from the Tengiz field in Kazakhstan. A representative of TCO then joined the meeting by telephone for a discussion about the broader challenges and lessons from the relocation project.

The CAO Ombudsman team reviewed the history of the three complaints, which relate specifically to the Sanitary Protection Zone and decision of the Kazakhstan government to reduce it. The CAO reviewed its complaint-handling process, as mandated in CAO's Operational Guidelines, and clarified that the complaints, and CAO's involvement, are linked specifically to IFC's contractual relationship with Lukoil.

The partners discussed the outstanding CAO audit and other issues related to IFC's involvement in the project, including the roles and responsibilities of Lukoil and the venture as a whole in adhering to IFC requirements.

The CAO team described their understanding of the positions and interests of the various stakeholders, identified areas of apparent common ground and areas of ongoing disagreement. This was followed by an open discussion about working toward resolution of the outstanding complaints.

The following suggestions were generated by the meeting participants:

- KPO should continue working to develop a productive relationship with the village of Berezhovka. The CAO Ombudsman team also should continue working with the parties to mediate, or assist in creating a neutral process, where the two parties can attempt to reach some understanding. The goals of this mediated process would have to be scoped, with clear objectives and an end-point.
- Appropriate strategies for enhancing / enabling community participation in the project are being explored and this should include input from the community.
- A third-party neutral could be used to facilitate between KPO and Village Council members to discuss engagement with all of the communities near the project. Several suggestions of organizations with local capacity in community development were made.

- KPO could consider convening a meeting with the NGO Green Salvation, who appears to serve as a trusted interface with the communities, to discuss broader issues of community engagement and development.
- KPO should explore strategies for improving engagement with local authorities. A more productive working relationship with local Akims and Akimats could result in more positive community development and partnerships between villages, public officials, and KPO.
- KPO should complete the review of its existing grievance mechanism and strengthen it to ensure it is effective at resolving complaints and concerns.
- If the Republic of Kazakhstan (ROK) calls for a relocation of Berezvoka, the onus will be on KPO to develop appropriate timing, a management plan, influencing plan, and whatever else may be required to make a relocation as successful as possible. If this is mandated, KPO should develop a strategy for working with and influencing government. There are many projects where government has been the primary agent for resettlement; KPO should apply lessons learned from those projects.

4.2.1 IFC Perspective

Throughout the current assessment, and during previous ombudsman and compliance assessment periods, the IFC has maintained that the KPO project is in compliance with IFC policies and guidelines, and that it uses sophisticated pollution abatement technology and facility management procedures to control emissions. IFC has stated that extensive measurements taken through a monitoring system, over an extended period, show that the air quality inside and outside the facility is safe for the workforce and local communities.

Regarding compliance with Operational Directive 4.30, IFC says that at the time of investment, no relocation was anticipated – based on a detailed review of the environment and health of the population, combined with improved source-control measures being undertaken at the time of investment. IFC says that review assured the institution that relocation of villages could be avoided.

IFC maintains that decisions about whether villages should be relocated are solely those of the government, which sets the size of the SPZ and regulates the project under legislative mandate.

4.3 Assessment of Opportunities for Resolution

The current complaint is focused specifically on IFC's requirements when it financed the Karachaganak project in 2002. At that time, the government-mandated Sanitary Protection Zone was 5 kilometres, which meant, according to the complaint, that anyone living inside the zone must be resettled in accordance with Kazakhstani law. Thus, the complaint states, the IFC's involuntary resettlement policy, Operational Directive 4.30, should have been activated.

IFC says that a review for potential resettlement at the time of investment showed no justification for relocating villages. In addition, both IFC and KPO say that decisions regarding resettlement and SPZ boundaries are solely those of the government.

While the complainants have said they agree that government is the key decision-making body regarding the size of the SPZ and any resettlement mandate, they maintain that from an accountability perspective, IFC did not comply with World Bank requirements at the time of the loan, and should not have provided funding to Lukoil until it conducted a proper review for potential resettlement (per Operational Directive 4.30).

KPO says that regardless of the complexities associated with IFC's involvement in the project, the venture would immediately engage with appropriate authorities and community members should the government mandate a change in the SPZ and trigger a resettlement of Berezvoka.

In such an event, KPO says it would do whatever is necessary to ensure that a potential resettlement is undertaken in accordance with international standards. KPO also says it is important for all the stakeholders to recognise the central role of the local and Oblast Akimats, and the limitations of existing legislation with respect to resettlement. While KPO says it would comply with international standards, the support of both the Oil & Gas authority (KazMunaiGas or KMG) and the Oblast Akimat also will be crucial.

Shortly after the November 2008 ombudsman meetings, in January 2009, Lukoil prepaid its outstanding balance to IFC. Despite the prepayment, IFC and CAO Compliance have remained engaged on the issues raised in the compliance audit that was triggered by the first complaint.

Regarding CAO Ombudsman's assessment of the current complaint, and in response to Lukoil's prepayment, KPO has requested that the CAO team remain engaged with the stakeholders to assist them in reaching a common understanding of the issues, and in identifying strategies for working together more effectively to address the social and environmental concerns of all the communities impacted by the project.

In February 2009, Green Salvation, Crude Accountability and the Berezvoka Initiative Groups submitted a letter to CAO requesting that the case be transferred to CAO Compliance for appraisal. Following this request, and in light of the difference in opinion between the complainants and the company on how best to move forward, the CAO Ombudsman initiated a conference call in March 2008 with the directors of Green Salvation and the Berezvoka Initiative Group to discuss their request for a third audit appraisal. The ombudsman also discussed the request separately with Crude Accountability.

During the conference call with Green Salvation and the Initiative Group, the ombudsman related KPO's offer to engage in a facilitated dialog in an effort to seek solutions and improve the working relationship between the community and the company. After discussing the possible outcomes of a facilitated dialog versus a CAO Compliance review, the complainants said they would consider the company's offer, pending receipt of this report, and would make a final decision based on the outcome of this assessment.

As the parties consider their next steps, the following issues should be taken into account:

- Based on the assumptions of both KPO and the IFC, it is expected that the Government of Kazakhstan will make a decision in the coming year about whether to extend the size of the SPZ, and whether to trigger a relocation of the village of Berezvoka.
- Various complaints to the CAO, the World Bank Group President, the World Bank Office of Institutional Integrity, KPO, Kazakhstan courts of law, and to other international bodies have not resulted in the relocation of Berezvoka. Given the general agreement among the parties

that the relocation decision rests with the Government of Kazakhstan, the complainants should evaluate the likelihood that a third compliance appraisal of the IFC's due diligence, or an assisted negotiation through the CAO ombudsman, will directly result in a relocation of the village.

- After nearly five years of involvement with the CAO, including two CAO Compliance interventions, the parties have not yet attempted to resolve the issues through a facilitated dialog or formal process of assisted negotiation with the CAO Ombudsman.

4.4 Suggested Next Steps

Given the above considerations, and in view of KPO's offer to enter into assisted negotiations and the complainants' willingness to consider it, the CAO recommends the parties undertake a facilitated dialog process aimed at improving communication and reaching a common understanding of the key issues and perspectives, stakeholders' interests, and possibilities for future engagement.

Based on the concerns and interests identified throughout the assessment period, the suggested facilitated dialog process should have the overall goal of addressing the following questions:

1. How can the communities and KPO work together more effectively to share information, build trust, and improve communication?
2. In the event the Government of Kazakhstan triggers a relocation of Berezvoka, how can the community and KPO work together to ensure a resettlement that is participatory, respectful, and in compliance with international standards?
 - What steps should be taken to ensure the relevant local and national authorities engage constructively with the community and company in the resettlement process?
 - Should a third-party neutral or other appropriate organizing body be hired to coordinate a resettlement program? If so, how should that entity be selected and who will be responsible for drafting the terms of reference?
3. In the event the government of Kazakhstan does not trigger a relocation of Berezvoka, how can the community and company work together to ensure a clean and safe environment?
 - For example, would a Participatory Monitoring Program, in which local residents are trained to take part in collection and analysis of air and water quality data, be a practical way to involve community members in environmental oversight and protection of the area?
4. Can the Village Council process be improved so that residents view it as a trusted resource for raising concerns and exchanging information, or are there alternative strategies for accomplishing this?

If the principles from each party (Green Salvation and Crude Accountability, the Berezvoka Initiative Group, and KPO) are amenable to this approach, or to an alternative participatory

approach suggested by the parties, the CAO requests that the parties submit to the CAO Ombudsman a brief written statement of their willingness to do so.

Following receipt of the written statements, the CAO Ombudsman will produce a short memorandum of understanding, to be approved by the parties and made public, stating that the parties have agreed to undertake an assisted negotiation process.

The CAO will then contact each of the parties individually to further scope the goals of the process, discuss preliminary ground rules and time lines, and solicit additional input about the process.

If the parties are not amenable to this or an alternative participatory approach, and are unwilling to enter into assisted negotiations, the CAO requests they submit a brief written statement to the CAO Ombudsman confirming this, and the complaint will be transferred to CAO Compliance for appraisal.

This preliminary report will be made public as a Final Assessment Report after the parties have had an opportunity to review and respond to it.

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