

OFFICE MEMORANDUM

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O.I. R7-704-F044

DATE: June 1, 2005

TO: Meg Taylor, Vice President, CAO

FROM: Rashad Kaldany, Director, COCDR

EXTENSION: 36787

SUBJECT: CAO Assessment Report: Complaint regarding Lukoil Overseas Project (Karachaganak Oil and Gas Field) Burlisky district, Western Kazakhstan Oblast, Kazakhstan

IFC received the CAO Assessment Report regarding Karachaganak Project on April 15, 2005. The report outlined three areas of concern based on a complaint from individuals from the village of Berezovka, which lies about 5 km from the Karachaganak field border. Below are IFC's responses to CAO's findings and recommendations related to the three issues.

Complaint Allegation #1: Are emissions from the Karachaganak field responsible for adverse health impacts experienced by the Berezovka population?

CAO Findings

The CAO states that it is difficult to understand why the full results of the various health studies commissioned by the Government of Kazakhstan and the Project operators have not been made available to the complainants. We would certainly support such release. However, it is our understanding that even the study that was commissioned by KPO in 2001 at the government's request remains, as do other such studies, in the government's domain, subject to its explicit permission to publish.

It is IFC's view that no amount of disclosure of medical studies would have been satisfactory, given the complainant's stated lack of trust in any KPO or government-commissioned studies. However, since the complainant's focus has over the past few years changed from the initial request to resettle based on the SPZ size reduction to the reasons driven by the alleged adverse health impacts of the Project, we believe that more attention by CAO on the Project's emissions – the basis of the complainant's current request to resettle - could have gone a long way towards quelling complainant's fears and increasing their understanding of the situation in terms of emissions from the field.

In this regard we would have welcomed an independent field review by CAO to examine equipment, validate methodology, and assess monitoring by KPO and its contractors (including the work of the local government's auditors who verify the data provided by KPO, as well as the work of IFC's own specialists and IFC's independent consultants hired each year to certify the project's compliance). An independent report on the *quality* of the emissions data and the Project's *compliance* with the Kazakh government and IFC's standards during the period of observation would be helpful. We believe that it would demonstrate that the Project is not poisoning the Berezovka villagers, as the complainants allege.

CAO mentions the Project's liquid and hazardous waste concrete-lined polygons and states "*this should mean that no contaminants escape into the surrounding surface or ground water*". The CAO further explains that "*KPO performs ground and surface water testing within the field and 12 wells within the village areas*", but that those KPO's confidential reports "*were not seen by CAO*". It is not clear from this statement if the CAO requested to see the results of these tests from KPO and were denied – IFC would have been happy to provide CAO with the data, most of which is

available in the Annual Monitoring Report. CAO's independent opinion on the facts rather than allegations would have been immensely valuable.

Both IFC's specialists and IFC's independent consultants have found the Project to be in compliance, *despite* its poor legacy. Because the CAO did not investigate the Project's compliance (as part of the overall emissions investigation mentioned above), statements such as *"It has not been possible for the CAO to differentiate potential impacts of current oil and gas field operations from the effects of poorly maintained municipal infrastructure, contaminated water supplies, waste disposal practices, and other pre-existing environmental degradation that may also contribute to the poor health of villagers"* only enhance the ambiguity surrounding the Project's compliance with IFC's standards, further fueling speculation about Project-induced health impacts on the Berezovka villagers.

CAO Recommendations

With respect to CAO's recommendations related to allegation #1, we would like to understand what kind of protocols do you have in mind for the improvement of understanding of the government-held health studies? If the government refuses to grant KPO the permission to disclose these studies, it is difficult to devise any sort of protocol for disclosure of these studies.

And finally, please expand on the third recommendation that *"KPO should revise its procedures for disclosures of environmental information to the public ensuring that it has taken into account public concerns relating to the materiality of information released."* We are unsure of the meaning of materiality or the kind of information that needs to be disclosed. We have seen from a recent letter from Crude Accountability, which is heavily involved with the complainants, in which it is requesting that KPO publish raw monitoring data, not the analyzed data currently presented to the public. IFC has encouraged KPO to present the analyzed data in a user-friendly format, for the ease of understanding. Publishing raw numbers would only be useful to those with highly specialized knowledge. With respect to *"KPO should regularly be consulting with communities and other affected parties about their concerns and ensuring that environmental and social monitoring activities are appropriate to resolving issues raised"*, IFC would like to repeat that KPO has been undertaking, in addition to consultation, educational campaigns in the villages around the Project. The mobile monitoring units were instructed to invite villagers into the mobile labs for demonstration of how air emissions are monitored and measured. The campaign was successfully implemented in the summer of 2004 and is scheduled to continue. *"KPO should operate on a presumption in favor of disclosure with respect to environmental monitoring information so that it effectively quells the current level of rumor and potential misinformation that exists in the region."* We have not seen an indication in the CAO Findings section that would demonstrate KPO's reluctance to operate on this basis – the suggested presumption is the reason for the Project's wide dissemination of environmental monitoring data and free distribution of the results published in the local newspapers.

Complaint Allegation #2: Complainants claim that the Project led to a deteriorating economic situation for Berezovka residents

CAO Findings

The CAO findings related to this allegation correctly point out the higher standard of living evidenced in Berezovka relative to other villages in the area. The CAO also correctly describes the US\$10 million that KPO is obliged to invest in Social and Infrastructure programs in the area. The report then states that the local authority (Akimat) is in charge of the selection process and the Project companies have limited influence in practice. In fact, the legal document that governs this project, the Final Production Sharing Agreement (FPSA), states that the Oblast proposes the list of such projects and that the Oblast, in *consultation* with the Contractor (i.e. the KPO Project) shall determine the list and scope of projects to be covered in the relevant period that will be funded by the annual US\$10 million contribution. Given the

limited “consulting” role, as prescribed by the FPSA, KPO’s involvement is reduced to execution of the construction projects that the government selects. The report goes on to say that KPO, “*despite the fact that the Oblast authorities have a final say in selection of such projects*”, managed to influence the allocation of US\$3 million of the past two year’s budgets, by using the needs identified in the Social Baseline Study.

It is therefore difficult to understand the basis for the suggestion that “*KPO’s contributions to the local authorities to select and design community development projects would benefit from better due diligence*”. CAO is correct in pointing out that “*community programs supported by the Project have not typically used participatory approaches or capacity-building of community-based institutions as an effective strategy for community development*”. The answer again lies in the FPSA-imposed constraints.

Over the past few years, only *infrastructure* projects have been funded due to the interpretation of the “Social and Infrastructure Expenditure” term in the FSPA. However, KPO proposed that in 2005 an advance of US\$3 million is given to a private company for a Hot Zinc Coating Plant Construction project in Uralsk. This is still under review but it would be the first income generating project under this budget. KPO is arguing for the project as a social infrastructure – not only would it help a coating plant, but 180 people would be employed in the plant, and in addition, there would be additional benefits realized in the supply chain.

Thus, the focus on “infrastructure” projects has been argued by the Oblast as a first priority. Only recently has the Project succeeded in proposing and funding non-infrastructure projects (job training associated with a hot zinc company in Uralsk). The infrastructure projects are otherwise monitored closely from the perspective of conception, construction, spending, and delivery. Contractors are selected in open bidding (itself a development impact for Kazakhstan because it avoids corruption in selection of contractors and over-budgeting); the progress in construction is monitored; the projects are reviewed for technical soundness and only delivered to the beneficiaries when acceptably complete. Reports are generated on all these steps. KPO knows how its money has been used and that it has been used in a cost-effective manner.

In terms of improved documentation of *social* benefits, the Project is aware that the monitoring does not yet include “key quantitative indicators” such as “so many more high school graduates” — as result of a school built or “so many more lives saved” as a result of improved medical facilities and equipment. IFC has discussed the desirability for KPO to start capturing these kinds of “impacts” and they indicated a willingness to try and do this, but it will not happen overnight.

Given the role that the government plays in all three allegations, we would appreciate if you could let us know with which government officials did you discuss the problems stated by the complainants (health studies release, social and infrastructure projects selection and the SPZ issue)? It would be helpful to understand what insights CAO got from these discussions because many recommendations in the report directly depend on the government’s (local and/or central) good will.

IFC would also like to address the CAO assessment of the interactions between the complainants and the project. The CAO states: “*Although the CAO is aware that community interactions between KPO and Berezovka have been described by IFC’s independent monitoring as frequent and comprehensive, there are indications that communication on both sides has been reactive and incomplete, lacking coherence in format, content and direction.*” IFC would appreciate if CAO could expand on the evidence for this conclusion.

CAO Recommendations

CAO’s recommendation that KPO’s contributions to the selection, implementation and monitoring of the Social and Infrastructure Expenditures should be strengthened needs to be considered in light of our comments to CAO’s findings. As mentioned above, KPO operates effectively within the constraints posed by the FPSA by emphasizing the

results identified in the Social Baseline Study to divert expenditures to areas in need and is trying to steer the decision-making process towards more sustainable projects. The suggested public consultation and participation in the design of programs should be directed at the local government.

Complaint Allegation #3: Was the reduction in the Sanitary Protection Zone justified?

CAO Findings

While IFC can understand the CAO's rationale in investigating the previous two complaint allegations, the SPZ issue is a more difficult one for IFC to accept as a justified complaint that needed to be addressed by the CAO. The text of the complaint states that "*the issue of resettlement of Berezovka was dropped from the agenda, despite previous decisions by the Government of Kazakhstan to include Berezovka in the SPZ*". The text of the complaint points to the government's authority to decide on the SPZ size and on the relocation of any villages in or around the SPZ area. Although IFC is of the opinion that this allegation should not have been taken into consideration, IFC commends the CAO for accurately describing the content of the relevant legislation.

CAO Recommendations

It is difficult to accept the CAO recommendation for KPO to "*implement a series of public meetings*" to explain the history and rationale of what clearly has been *the government's decisions* in this matter. While KPO was implicated in the resettlement process *at the request* of the government, it does not follow that it should take the government's role and assume the government's responsibilities.

IFC cannot accept recommendations stemming from complaint allegation #3 because of the recommendation's future implications and the impact it might have on the existing grievance mechanism, particularly when viewed in light of cultural sensitivities (requiring people to sign written statements of understanding is very difficult to achieve).

cc: Messrs./Mmes. A. Jabre, F. Khambata, R. Kyte, S. Varma, K. Harry, W. Bulmer, P. Miller, S. Cosic, R. Orellana, R. Wyness, John Butler, L. Varbanov