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APPRAISAL REPORT

CAO Appraisal for Audit of IFC

CAO Compliance

C-I-R7-Y09-F117

October 16, 2009

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**Karachaganak Project  
Kazakhstan**

**Case of  
Green Salvation/ Residents in the Village of Berezovka III**

***Summary***

This appraisal report responds to a complaint about the Karachaganak Project, an IFC investment. The complaint was filed by the civil society organizations Crude Accountability and Green Salvation Ecological Society (Green Salvation) on behalf of villagers in Berezovka, Kazakhstan. This is the third complaint to CAO in relation to IFC's involvement in the Karachaganak Project.

The first complaint filed was dated August 22, 2004. CAO Compliance completed an audit in April 2008, and found IFC to be out of compliance on issues related to how IFC assured itself that emissions to air from the Karachaganak Project complied with IFC requirements. On January 8, 2009, IFC's client ended its contractual obligations to IFC by prepaying its outstanding balance to IFC. This ended IFC's obligations to assure itself of project performance, and the CAO closed the audit. This left the systemic concerns relating to IFC internal processes, leverage, and communication when investing in a minority shareholder, unaddressed.

A second complaint filed was dated April 11, 2007. The appraisal concluded that issues related to the re-sizing of the sanitary protection zone and relocation of villagers did not meet the criteria for an audit. The issue related to air emissions and violations of IFC policy provisions did meet the criteria but were already being addressed in the then ongoing audit, which had been initiated by the first complaint. In May 9, 2008, a third complaint from Berezovka was lodged with the CAO. It raised issues regarding IFC's compliance with policies and guidelines in place at the time of the loan, the project's compliance with Kazakh law and the legality of the Kazakh government's reduction of the Sanitary Protection Zone that encompasses the field. The case was transferred to Compliance in April 29, 2009 after an Ombudsman assessment determined that the issues were not amenable to resolution.

Office of the Compliance Advisor/Ombudsman (CAO)  
*for the*  
International Finance Corporation (IFC)  
Multilateral Investment Guarantee Agency (MIGA)  
Members of the World Bank Group



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## **About the CAO**

*The CAO's mission is to serve as a fair, trusted, and effective independent recourse mechanism and to improve the environmental and social accountability of IFC and MIGA.*

The CAO (Office of the Compliance Advisor/Ombudsman) is an independent post that reports directly to the president of the World Bank Group. The CAO reviews complaints from communities affected by development projects undertaken by the two private sector lending arms of the World Bank Group: the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA).

For more information about the CAO, please visit [www.cao-ombudsman.org](http://www.cao-ombudsman.org)

## 1. Overview of the CAO Compliance Appraisal Process

When the CAO receives a complaint about an IFC or MIGA project, it first refers it to the CAO Ombudsman, which works to respond quickly and effectively to complaints through facilitated settlements, if appropriate. If the CAO Ombudsman concludes that the parties are not willing to reach a facilitated solution, the CAO Vice President has the discretion to request the compliance arm of CAO, CAO Compliance, to appraise the concerns raised in the complaint for a compliance audit of IFC or MIGA. Alternatively, a compliance audit can be initiated by request from the President of the World Bank Group or the senior management of IFC or MIGA.

A CAO Compliance appraisal is a preliminary investigation to determine whether the CAO should proceed to a compliance audit of IFC or MIGA. Through CAO Compliance appraisals, the CAO ensures that compliance audits of IFC or MIGA are initiated only for those cases with substantial concerns regarding social or environmental outcomes.

A compliance audit is concerned with assessing the application of relevant policy provisions and related guidelines and procedures to determine whether IFC and MIGA are in compliance. The primary focus of compliance auditing is on IFC and MIGA, but the role of the sponsor may also be considered.

A compliance audit appraisal, and any audit that ensues, must remain within scope of the original complaint or request. It cannot go beyond the confines of the complaint or request to address other issues. In such cases, the complainant or requestor should consider a new complaint or request.

CAO compliance appraisal will consider how IFC/MIGA assured itself/themselves of compliance with national law, reflecting international legal commitments, along with other audit criteria. The CAO has no authority with respect to judicial processes. The CAO is not an appeals court or a legal enforcement mechanism, nor is the CAO a substitute for international courts systems or court systems in host countries.

The appraisal criteria are set forth in CAO's Operational Guidelines. The criteria are framed as a series of questions to test the value of undertaking a compliance audit of IFC or MIGA. The criteria are as follows:

- Is there evidence (or perceived risk) of adverse social and environmental outcomes that indicates that policy provisions (or other audit criteria) may not have been adhered to?
- Is there evidence or risk of significant adverse social and environmental outcomes that indicates that policy provisions, standards, guidelines, etc., whether or not complied with, have failed to provide an adequate level of protection?
- Is there evidence (or perceived risk) of significant adverse social and environmental outcomes where policy provisions, standards (or other audit criteria) were not thought to be applicable but perhaps should have been applied?



- Is there evidence that the application of some aspect of a policy, standard, guideline or procedure resulted in adverse social and environmental outcomes?
- Can the cause of adverse social and environmental outcomes not be readily identified and corrected through the intervention of the project team without a detailed investigation of the underlying causes or circumstances?
- Could a compliance audit yield information or findings that might better inform the application of policies (or other audit criteria) to future projects?

During appraisal, CAO Compliance holds discussions with the IFC or MIGA project team and other relevant parties to understand the validity of the concerns and to explore whether an audit would be warranted.

After a compliance appraisal has been completed, the CAO can choose only one of two options: to close the case, or to initiate a compliance audit of IFC or MIGA.

The CAO will report and disclose the findings and decision of the CAO compliance appraisal in an appraisal report in order to inform the President of the World Bank Group, the Boards of the World Bank Group, senior management of IFC or MIGA, and the public in writing about its decision.

If the CAO decides to initiate a compliance audit, as a result of the compliance appraisal, the CAO will draw up a terms of reference for the audit in accordance with CAO's operational guidelines.



## 2. Background and Concerns that Led to the Appraisal

1. IFC financed Lukoil Overseas Karachaganak B.V. to fund a portion of its share of development of the Karachaganak oil, gas and condensate field in Kazakhstan, the Karachaganak Petroleum Operation B.V. (the Project).

2. The civil society organizations, Crude Accountability and Green Salvation, submitted the complaint to the CAO on behalf of residents of the village of Berezovka. The complaint raised issues concerning consequences for the villagers as a result of the Project, in the context of the legality of the sanitary protection zone and resettlement requirements. Berezovka is located approximately 3 kilometers from the Karachaganak project facilities.

3. IFC's involvement started in 2002, and the Project developed in different stages. The client ended its contractual obligations in January 2009, and IFC concluded its involvement in the project.

CAO Compliance	
2004	
October 1	CAO Ombudsman receives the first complaint from residents in the village of Berezovka. The complaint is dated August 22, 2004.
2005	
2006	
August 30	CAO Compliance receives the complaint dated August 22, 2004 for appraisal after the CAO Ombudsman finds that the stakeholders are unwilling to further engage in a process of negotiated dispute resolution.
2007	
April 12	CAO receives a second complaint from residents in the village of Berezovka. The complaint is dated April 11, 2007.
April 17	CAO Compliance publishes the appraisal report related to the first complaint.
June 1	CAO Compliance commissions audit initiated as a consequence of the first complaint.
October 29	CAO Compliance draft audit report related to the first complaint finalized and sent to IFC for comments and response.
November 19	CAO Compliance receives second case for appraisal after the CAO Ombudsman finds that the stakeholders are unwilling to further engage in a process of negotiated dispute resolution.
December 18	CAO Compliance finalizes the appraisal report related to the second complaint.
2008	
April 24	CAO Compliance publicly releases its final audit report initiated by the first complaint.
May 9	CAO receives the third complaint from residents in the village of Berezovka.

2009	
January 8	Client ends contractual obligations with IFC by prepaying its outstanding balance.
January 12-16	CAO Compliance undertakes a site visit to assure itself of the Project's performance.
January 16	The Project commits to an action plan to address the outstanding issues identified by CAO Compliance.
April 20	CAO Compliance closes audit with issues related to IFC's due diligence remaining unaddressed.
April 29	CAO Compliance receives third case for appraisal after the CAO Ombudsman finds that the issues are not amenable to resolution.

### 3. Scope of the Appraisal for an Audit of IFC

#### 4. The complainants have raised specific issues in their complaint regarding:

a. *Re-sizing of the sanitary protection zone.* The complainants state that the reduction of the sanitary protection zone around the project, a zone defined by national legislation, was done without a state environmental assessment, without a review by a national ecological expert, and without providing information to, or consulting with, the local residents. The complainants state that these alleged irregularities constitute a violation of the Aarhus convention and the Republic of Kazakhstan law on review by ecological experts. The complainants state that there is an ongoing national legal process that attempts to address, or partly address, the claimed irregularities.

b. *Violations of National Legislation.* The complainants state that the non-relocation of Berezovka at the time of Project approval by the Board violated national legislation, since the SPZ was 5 kilometers. The complainants state that according to Kazakhstan law, anyone living inside the zone must be resettled.

c. *Violations of IFC's policies and operating standards.* The complainants state that given national legislation and the location of the village at the time of IFC's investment in the project, IFC should have assessed and applied its involuntary resettlement policy (Operational Directive (OD) 4.30) and proceeded with the relocation of the village of Berezovka. The complainants hold that IFC violated its policies and operating standards by not activating the O.D. 4.30 when it financed the project in 2002. The complainants further state that the project was subsequently in violation of IFC's policies and standards since, according to the complainants, these standards state that IFC does not finance project activities that contravene country legislation or international agreements.

The complainants further state that the disclosure of information and public consultation in relation to the re-sizing of the sanitary protection zone was inadequate when compared with IFC's requirements.

d. *Relocation of villagers.* The complainants seek assistance in resolving the issue of relocating the residents of Berezovka to a "safe and environmentally clean" location. This is in line with the

objectives of the first two complaints. The complainants also seek 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”.

#### 4. Policy Provisions Identified as Relevant

5. CAO Compliance identified the following provisions as the basis for evaluating the issues raised:

*a. Re-sizing of the sanitary protection zone and b. Violations of National Legislation.* There are no provisions in IFC’s policies or guidelines for the use of sanitary protection zones. The establishment and application of a sanitary protection zone and disclosure of state environmental assessments is a question for national authorities. There are no provisions in IFC’s policies or guidelines for removal of receptors as a solution to potential pollution, when source control and monitoring is a viable option. Since the sanitary protection zone in itself does not pose any violation of IFC’s policies or guidelines, the applicable policy requirement would only be how IFC assured itself that the project complied with national requirements. In the specific case of national authorities re-sizing the sanitary protection zone, it is reasonable only to expect that IFC assured itself that a re-sizing did not have implications on compliance with IFC requirements, and that IFC assured itself that the Project honor any rulings or instructions from Kazakhstan authorities that have relevant legal standing.

*c. Violations of IFC’s policies and operating standards.* IFC did assess and address O.D. 4.30 when engaging with the Project, see Chapter 5 below. Decisions made by the Kazakhstan authorities regarding re-sizing of the sanitary protection zone, a re-sizing that in this case is solely a consequence of national legislation, do not fall under the IFC requirements for community consultation and disclosure.

*d. Relocation of villagers.* Relocation of villagers is in this case related to national decisions, legislation, and/or requirements, and not to IFC’s performance, or IFC’s requirements or conditions for involvement. There are no provisions in IFC’s policies or guidelines for removal of receptors as a solution to potential pollution, when source control and monitoring is a viable option. Relocation is contrary to the general IFC approach of source control.

#### 5. CAO Findings

6. The appraisal team finds the following:

*a. Re-sizing of the sanitary protection zone and b. Violations of National Legislation.* Since the sanitary protection zone in itself does not pose any violation of IFC’s policies or guidelines, and the re-sizing has no consequence for the applicable policy requirements, the question is limited to how IFC assured itself that the project complied with national requirements. IFC did assure itself that as soon as any national requirement had relevant legal standing, IFC would assure itself that the Project complied with such a requirement as stated in IFC’s policies.

c. *Violations of IFC's policies and operating standards.* IFC did assess and address O.D. 4.30 when engaging with the Project. IFC assured itself that at the time of the investment, there were no involuntary resettlements as a consequence of the activities of the Project at that time. The decision by Kazakh authorities to resettle residents in the Tungush area occurred prior to IFC engagement. IFC further assured itself that any future involuntary resettlement occurring as a consequence of activities by the Project should trigger and activate O.D. 4.30. OD 4.30 would then assure that any such resettlement would be carried out in compliance with relevant IFC requirements. During the period of IFC's investment in the Project, neither IFC nor the Project was aware of any relevant relocation or resettlement decision being presented by Kazakhstan authorities that had relevant legal standing.

Decisions made by the Kazakhstan authorities regarding re-sizing of the sanitary protection zone, a re-sizing that is solely a consequence of national legislation, do not fall under the IFC requirements for community consultation and disclosure. Therefore, CAO Compliance does not find that IFC policies on disclosure are directly applicable to disclosure of information that pertains to changes in a nationally defined zone, when there in addition are no provisions for such a zone in IFC's environmental or social policies or guidelines.

d. *Relocation of villagers.* Relocation of villagers is in this case related to national decisions, legislation, and/or requirements, and not to IFC's performance, or IFC's requirements or conditions for involvement. There are no provisions in IFC's policies or guidelines for removal of receptors as a solution to potential pollution, when source control and monitoring is a viable option. Relocation is contrary to the general IFC approach of source control.

## 6. The CAO Decision

7 The CAO concludes the following:

a. *Re-sizing of the sanitary protection zone* and b. *Violations of National Legislation.* CAO does not find that these issues fulfill the criteria for further investigation in the form of an audit of IFC.

c. *Violations of IFC's policies and operating standards.* CAO does not find that these issues fulfill the criteria for further investigation in the form of an audit of IFC.

d. *Relocation of villagers.* CAO does not find that this issue fulfills the criteria for further investigation in the form of an audit of IFC.

Based on the above, CAO will close this appraisal with no other further action.