



CAO OMBUDSMAN ASSESSMENT REPORT

Complaint Regarding
IFC's Involvement in the Russkiy Mir II
(Tamaneftegaz) Project

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Office of the Compliance Advisor/Ombudsman
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SUMMARY

In October 2007, the NGOs *Save Taman!* and *North Caucasus Environmental Watch* filed a complaint regarding IFC's investment in Russkiy Mir II, a project involving the development of the Taman LPG/Fuel oil terminal and a railway infrastructure. The complaint questions the Environmental Impact Assessment (EIA) process that was undertaken by the IFC, and maintains the process violated Russian environmental legislation. According to the complaint, the IFC's EIA process resulted in an incorrect environmental categorization of the project.

A CAO Ombudsman assessment team traveled to Taman, Russia in March 2008 to meet with the complainants, the company, and other stakeholders. Prior to that visit, in February 2008, the Ombudsman met with Russkiy Mir's Managing Director and Group Business Development Specialist in the Hague, Netherlands, where their corporate offices are located, to discuss the issues in the complaint and strategies for addressing them. On a second trip to Taman, April 14-16, 2008, the CAO Ombudsman met with district and regional authorities to clarify the perspectives of public officials and to discuss their potential role in a stakeholder engagement process that might be undertaken to address the issues.

Based on those assessment interviews and stakeholder meetings, the CAO Ombudsman found there is broad interest in initiating some type of multi-stakeholder forum or coalition to jointly address community and regional development priorities. Suggested participants included local and regional government, citizens and community based organizations, representatives of Russkiy Mir and other companies operating in the area, and the NGO *Save Taman!* The goals of the forum, as suggested by those interviewed, included development of a long-range vision for the Peninsula, a systematic approach to allocating social development monies and contributions from the various private-sector companies operating in the area, and a multi-party monitoring program aimed at building capacity and awareness on matters of environmental protection and compliance.

However, while these issues of social development and community engagement emerged as a high priority for some stakeholders interviewed during the assessment, they are not the focus of the complaint filed with the CAO by the two NGOs. Rather, the complaint relates specifically to IFC's categorization of the loan to Russkiy Mir. The signatories believe the project should have received an environmental categorization of "A" because of the potential for irreversible damage to the environment.

Although the signatories have expressed their support for a multi-stakeholder forum to establish a long-range, sustainable development plan for the Peninsula, they believe the issue of IFC's categorization is not negotiable and should be transferred to CAO Compliance for an appraisal of IFC's compliance with its own policies and guidelines.

Therefore, in accordance with its Operational Guidelines, the CAO Ombudsman has concluded its assessment of the complaint and transferred it to CAO Compliance for appraisal.

This report includes a summary of the assessment and context of the dispute, as well as the perspectives, interests, and ideas of other stakeholders for establishing a working group to jointly address issues of concern.

The CAO has proposed several options to the community and the company for pursuing such a working group.

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 assist in addressing complaints brought by communities or individuals affected by IFC or MIGA projects in a fair, objective, and constructive manner, 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, enhance communication between the parties about their perspectives and interests, and help them identify opportunities for resolution.

THE COMPLAINT

The current complaint was filed in October 2007 by two NGOs, *Save Taman!* and *North Caucasus Environmental Watch*, regarding the impacts of *Russkiy Mir II*, a project involving the lease of rail tank cars to major oil companies for the transport of petroleum products. The NGOs believe the company's activities pose a number of threats to the natural and social environment in the region surrounding the Taman Peninsula. The complaint questions IFC's environmental categorization of the project as "B" rather than "A", and maintains that the environmental review process failed to comply with IFC standards and guidelines.

THE PROJECT

The *Russkiy Mir II* project involves an IFC loan of up to \$100 million to develop and build the Taman LPG/Fuel Oil terminal and port in the Black Sea; to purchase and expand rail maintenance facilities, purchase locomotives and rail cars, and purchase a wheel-making / spare-parts manufacturer and other rail-related infrastructure. IFC's investments consist of a \$45 million A-loan for IFC's own account, and a \$55 million B-loan for the account of B-loan participants. It is IFC's second investment in the *Russkiy Mir Group*; a \$15 million A-loan was approved in April 2004.

CAO OMBUDSMAN ASSESSMENT

I. Rational

CAO Ombudsman assessments seek to clarify issues and concerns raised by complainants, to gather information on the perspectives and interests of other impacted stakeholders who may not have signed the complaint, and to assist the parties in determining their best alternatives for resolving the issues. It does not gather information to determine fault or make judgments on the merits of a complaint.

To be eligible for CAO assessment, complaints must demonstrate that:

- The complaint pertains to a project that IFC/MIGA is participating in, or is actively considering.

- The issues raised in the complaint pertain to the CAO's mandate to address environmental and social impacts of IFC/MIGA investments.
- The complainant may be affected if the social and/or environmental impacts raised in the complaint occurred.

The CAO determined that the eligibility criteria were met in this case, and initiated an Ombudsman assessment in November 2007.

II. Methodology

Following eligibility determination, the CAO Ombudsman met with the IFC project team to summarize the issues raised in the complaint and discuss the IFC's understanding and perspective the situation. The CAO Ombudsman then spoke by telephone with the signatories to the complaint, and later met with Russkiy Mir's Managing Director and Group Business Development Specialist in the Hague, Netherlands – where its corporate office is located – to discuss the issues, review CAO's operational procedures and complaint-handling process, and to schedule meetings in advance of the site visit.

From March 12-14, 2008, a CAO Ombudsman team spoke with stakeholders in Taman, Russia during the following assessment meetings/interviews:

- With signatories to the complaint – Andrei Rudomakha and Igor Golubenkov; other members of the Temryuk-based NGO *Save Taman!* and the Anapa branch of the NGO *Environmental Watch on North Caucasus*; deputies of the Taman rural settlement and the Temryuk district council who supported the complaint; and the former mayor of Anapa – Vitaly Vasilievich Ostapenko, who represented the Krasnodar Krai in the Chamber on Social Protection and Anti-Corruption in the Southern Federal Region.
- With representatives of Russkiy Mir, Tamaneftgaz, and Ecopromsystems (a social and environmental consulting company that undertook a stakeholder analysis of the project).
- With the head of the Village (Mayor) of Taman, Gennady Grigorievich Maykov, to discuss the opinions of local authorities regarding the complaint, and broader issues of community-company relations.
- With Vladimir Victorovich Yuvenko, a representative from the Department of Transportation and Communications of the Administration of the Krasnodar Krai.
- With stakeholders from each of the above mentioned groups during a 3-hour evening meeting. The purpose of the meeting was to initiate a joint discussion about the perspectives and possibilities for future cooperation and development planning.

A second assessment trip was undertaken from April 14-16 by a consultant who was part of the original CAO assessment team to meet with district and regional authorities. The purpose of this visit was to clarify the perspectives of key public officials and to discuss their role in a potential stakeholder engagement process, suggested by multiple stakeholders, that might be undertaken to address the issues raised in the complaint as well as broader social issues identified during the assessment.

III. Key issues raised in the complaint

According to the complaint, IFC should have assigned the Russkiy Mir project an environmental category of “A,” rather than “B”, and this miscategorization impacted the entire course of project implementation. As a result, the complainants say public consultations and access to project information were inadequate; Russian laws were violated; and irreversible damage to the Black Sea coastal area, natural steppe and seaside landscapes is occurring without a proper mitigation or compensation strategy. The complainant states that “until this error is corrected and until the project is assigned category ‘A,’ it is highly unlikely that the Russkiy Mir II site can be rehabilitated.”

In April 2005, before Board approval of the project, the complainants and others began raising concerns about the environmental and social impacts of the project. A number of letters, appeals and petitions were filed directly with the IFC and the company prior to the filing of the CAO complaint. In addition to a review of the IFC’s categorization of the project, the complaints included requests for:

1. A long-term agreement between Russkiy Mir, Taman community members, and NGOs for the project to undertake a systematic plan for sustainable development in the region, and funding to support such an undertaking; and
2. Extractive industry projects in the area to be replaced with tourism and other more environmentally friendly operations, and strategies for Taman to become a self-sustaining community.

The complaint to CAO was filed in October 2007, with a specific request for an environmental audit of the categorization issue. The signatories agreed the full text of the complaint could be made public. A copy of the complaint is appended to this report.

IV. Additional issues raised during the assessment

Besides the categorization issue described in the written complaint, NGO representatives, public officials and other stakeholders interviewed during the assessment raised additional concerns about the project’s environmental and social impacts – specifically about the future of the Peninsula and preservation of the area’s culture and natural beauty.

There is general concern about the impacts of oil and gas and other large infrastructure projects operating in the Taman Peninsula. Concerns about oil and gas were reportedly compounded following the November 2007 oil spill in the Kerch Strait, between Russia and Ukraine, in which at least 2,000 metric tons of fuel oil spilled into the strait during a storm. Residents, NGO representatives, and public officials expressed fear that a similar ecological catastrophe could occur in the Taman Peninsula. People say they are unaware of what safety measures exist in Taman and surrounding areas to prevent such an occurrence.

Residents, NGO representatives, and public officials say that little information exists about the different public- and private-sector projects currently operating in the area or planning to establish a presence in the future, and that such a lack of information has caused divisions and confusion within the community. They say there are many settlements in the Taman Peninsula being impacted by rapid change and economic development. Urbanization is seen to be resulting in a loss of the recreational and agricultural lands that are central to the local economy.

Budget tourism has provided income for many local residents, who fear a loss of revenue in the face of industrialization and corporate takeover of cottage industries. Some stakeholders expressed a desire for Russkiy Mir to finance a more robust tourism infrastructure, which could both protect the area's biodiversity and generate income.

The stakeholders said that as a result of these concerns, many people remain suspicious or unsupportive of any new development in the area.

In discussions about the future of the Peninsula and the relationship between companies and communities, the stakeholders raised the following issues which they believe should be addressed, and which could serve as topics for a potential stakeholder forum:

- Loss of the region's traditional lifestyle and strategies for preserving its diverse cultural heritage;
- Retention of cottage industries and access to stable employment;
- Energy shortages and instability due to high demand for power for large-scale industries;
- Traffic congestion and damage to roads due to the growing population and infrastructure development;
- Increased pressure on an already under-funded health-care and hospital system;
- Strategies and economic incentives for keeping young people in the region following school matriculation, and adequate facilities and services to engage youth in constructive and healthful activities;
- Compensation for deteriorating living conditions, and loss of land and agricultural income;
- Overall economic benefits of the project for the local population.

Parties who did not sign the complaint discussed the question of IFC's project categorization and its involvement in the Russkiy Mir project. Although participants in the assessment interviews agreed on the importance of the issue, they concurred it was somewhat unrelated to the larger social concerns of the community and should be handled as a separate matter by the NGO *North Caucasus Environmental Watch*, the company, and the IFC.

V. Response and perspectives of Russkiy Mir

From the company's perspective, Russkiy Mir has consistently complied with IFC's social and environmental requirements, and also is abiding by all applicable Russian legislation. They believe the issue of how the loan was categorized is between the IFC and its Board and internal auditors, but will nonetheless cooperate with any audit appraisal that may be undertaken.

Despite its disagreement with the charges in the complainant, Russkiy Mir management says the company has been open and engaged in discussions with the complainants and others in the community. The same complainants have been raising similar issues for several years, both directly to the company and also to the IFC prior to formally filing a complaint with the CAO.

Company officials say they are frustrated by the way the NGOs have responded to what they believe are genuine, direct and sustained offers of engagement. After significant investments of time and resources in addressing the concerns of NGOs, and following a series of inclusive

dialogs, the company believed the parties were jointly committed to addressing the issues and working together on strategies for improving social development planning in the region. Prior to the CAO complaint, the company said members of *Save Taman!* and *North Caucasus Environmental Watch* had indicated their appreciation for the opportunity to engage, and agreed to further conversations with the company. However, company officials did not hear from the NGOs again until the complaint was filed with the CAO.

Russkiy Mir believes the NGOs' concerns about sustained environmental damage are unfounded. On the contrary, they say, the project should minimize the risk of catastrophic oil spills by providing a safer method of storage and transport in accordance with the highest safety standards, with Russian legislation, and with World Bank and IFC guidelines for community interaction and environmental protection.

The company says it is unrealistic for Russkiy Mir to establish a long-term profit sharing scheme, as it is still in construction and not currently making a profit. Supporting development of a tourist infrastructure is also unrealistic, they say, because the company has neither the sector expertise nor the confidence that tourism would be a financially viable undertaking in this area.

Regarding social investment in the community and nearby region, Russkiy Mir says its annual monetary contributions have been significant and are decided each year in consultation with local and regional authorities. Although the company sees its social investments as key to building a vibrant community and good corporate citizenship, it also acknowledges that the current approach to social investment is somewhat haphazard. In the absence of long-term or systematic planning, the existing decision making process involves local officials producing requests for funding of disparate projects. Russkiy Mir says on several occasions, after the requested funding was debated, agreed and disbursed, those projects were not implemented properly, and the company was unfairly blamed.

The company is in the process of establishing a forum – which they describe as a non-commercial partnership – to serve as an instrument for community members and other interested stakeholders to express their interests and concerns about the environmental and social impacts of the project.

Russkiy Mir officials say their future success lies in part with identification and formulation of an effective framework for cooperation with the public sector – including the council and administration of Taman and Temryuk; with robust community engagement; and with improving the company's disclosure of information.

On the recommendation of IFC, Russkiy Mir sought technical assistance from IFC in 2007 to contract with a social development consultant. The company 'Ecopromsystems' was hired to undertake a stakeholder analysis and provide recommendations for how to address the investment strategy more broadly, and how to engage a broader section of the population that is impacted by the company's operations. They are currently awaiting a final draft of the Ecopromsystems report.

VI. Response and Perspectives of IFC

In April 2005, a group of concerned residents and local government leaders appealed to the IFC and World Bank Board to postpone the decision to fund the project; to categorize the loan as an "A" project, rather than a "B"; and to undertake more thorough public consultation, including a

referendum with the local authorities of Krasnodar Krai and Temyruk regions. The IFC Russkiy Mir project team responded to the NGO's appeal with a memo to the President and IFC senior managers justifying the categorization decision and addressing each of the points in the appeal. Since then, the IFC has received a number of concerns from the same complainants and others about this project, and has met on various occasions with the NGOs and with Russkiy Mir to attempt to resolve the issues.

IFC has consistently reported that the company is in compliance with World Bank requirements and Russian legislation. Regarding categorization of the loan, IFC maintains that the potential environmental and social impacts are "largely reversible" and can be addressed through properly implemented mitigation measures. Project team members say that although the project received a "B" categorization, the project environmental documents were disclosed for 60 days prior to Board approval – "similar to the period required for category 'A' investments."

The IFC acknowledges that environmental and social impacts of the Russkiy project are an ongoing concern for local stakeholders, and that there is a need for the company to develop systematic and constructive engagement with various stakeholders – including community members, environmental groups, and municipal administrations. A September 2007 IFC visit to the site involved a Technical Assistance project aimed at ensuring better representation of community interests and improving the company's approach to information disclosure.

In conjunction with the local Russian consulting firm Ecopromsystems, IFC and Russkiy Mir undertook a series of four stakeholder capacity building events to address the ongoing concerns of NGOs and other local stakeholders. In its summaries of that site visit and other interactions with Russkiy Mir and the NGOs, IFC has encouraged productive engagement with the various NGOs in the area, and the company's adoption of a common framework for addressing the issues and establishing clear lines of communication with stakeholder groups.

IFC says Russkiy Mir has responded positively to these recommendations, and that the technical assistance support to improve opportunities for dialog and constructive engagement has been an important step toward addressing the broader social and environmental concerns.

VII. CAO Ombudsman Assessment of Opportunities and Next Steps

Following the CAO assessment trip to Taman in March 2008, the CAO received two letters from the signatories to the complaint – dated March 27, 2008 and April 5, 2008 – regarding CAO's involvement in the case. In both letters, the complainants stated they did not wish to negotiate the issue of IFC's categorization of the project, as they do not believe it is an appropriate decision for the wider community or for a collaborative stakeholder group.

Given the NGOs' refusal to negotiate, the complaint was transferred to CAO Compliance for appraisal – in accordance with CAO's Operational Guidelines – and the Ombudsman concluded its involvement in the case.

Prior to transferring the complaint to CAO Compliance, however, the CAO Ombudsman team had several additional discussions with the signatories about the interests of the wider community, and the apparently strong support for establishing a multi-party forum to discuss a long-range, sustainable development plan for the Taman region. The signatories acknowledged the potential value of such a process, but re-iterated their insistence that a compliance appraisal be performed in response to the categorization issue.

Although the CAO Ombudsman concluded its involvement in this case following the transfer to CAO Compliance, the Ombudsman assessment indicated there is strong support for community engagement among the impacted stakeholders who did not sign the complaint – including other NGO and community members, the company, and local government leaders. Their shared common interests in current and future development issues facing the region underscore the timely opportunity that exists for a multiparty forum focused on planning and decision making for the Peninsula.

To improve the likelihood that such a stakeholder forum would result in meaningful, durable agreements, the parties should consider engaging a neutral convener or facilitator who can help them develop goals, ground rules and work plans that are acceptable to all the stakeholders. Experience in similar contexts has shown that when parties to a conflict also serve as conveners of a solutions-seeking process, confidence and full participation by key stakeholders is often compromised. The involvement of a third-party neutral can often help to equalize any perceived power imbalances among stakeholders, and engender trust among parties who may be reluctant to participate.

During the assessment, the CAO team proposed to the parties in Taman several possibilities for how the Ombudsman might assist in resolution of the complaint. These included:

- A) Working with the parties to convene a community-wide workshop or ‘development fair’ to solicit ideas and input from a large cross-section of residents and other stakeholders. From this input, the Ombudsman team would help identify and rank the community’s overall development goals, and a set of potential processes for how they might work together to prioritize and achieve those goals;
- B) Working with the parties to conceptualize and facilitate a longer-term stakeholder forum with goals, ground rules and work plans;
- C) Assisting the parties in identifying a neutral facilitator with appropriate linguistic and cultural skills, who would work closely with stakeholders over the longer term to help them pursue their expressed common interests.

There appeared to be strong support for these proposals at the time of the assessment interviews. In the event the parties wish to pursue or further explore these or alternative strategies for community engagement, a written request should be submitted to the CAO.

With regard to the complaint involving IFC’s categorization of the Russkiy Mir project, the CAO Ombudsman has formally concluded its involvement by transferring the case to CAO Compliance.

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