

**SAKHALIN ENERGY
INVESTMENT COMPANY Ltd.**

**SAKHALIN INDIGENOUS MINORITIES
DEVELOPMENT PLAN 2**

**EXTERNAL MONITOR INCEPTION REPORT
April 2011**

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SIMDP 2 Inception Report

April 2011

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Abbreviations

| | |
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| EC | Executive Committee |
| EM | External Monitor |
| GB | Governing Board |
| MGF | Mini-Grant Fund |
| PCR | Plan Completion Report |
| RAIPON | Russian Association of Indigenous Peoples of the North, Siberia and the Far East |
| RCAR | Regional Council of the Authorized Representatives of the Indigenous Minorities of the North of Sakhalin Oblast |
| RUR | Russian Rubles |
| SB | Supervisory Board |
| SDF | Social Development Fund |
| SDP | Social Development Programme |
| SIM | Sakhalin Indigenous Minorities |
| SIMDP | Sakhalin Indigenous Minorities Development Plan |
| SOG | Sakhalin Oblast Government |
| TEASP | Traditional Economic Activities Support Program |

SIMDP 2 External Monitor Inception Report, April 2011

Introduction

The Sakhalin Indigenous Minorities Development Plan 2 (SIMDP 2) succeeds the first SIMDP which was implemented between May 2006 and December 2010. The SIMDP 1 was introduced by Sakhalin Energy Investment Company Ltd. ("Sakhalin Energy") with the support of Sakhalin Island's Indigenous Minorities and the Sakhalin Oblast Government (SOG). By 2010, Sakhalin Energy, the Regional Council of Authorised Representatives of Sakhalin Oblast (RCAR), and the Sakhalin Oblast Government had established a smooth working relationship to supervise and implement the SIMDP. Multiple rounds of consultations with Indigenous Minorities communities and other stakeholders were held and a new SIMDP developed by the fall of 2010.

The draft SIMDP 2 was distributed in the areas of traditional indigenous residence during the first week of November to be considered by the indigenous population, followed by a special conference in Yuzhno-Sakhalinsk on November 17 called by the RCAR to approve and/or amend the draft SIMDP 2.

At that conference the indigenous delegates declared that they gave their free, prior and informed consent to the Plan and to their representatives' signing of a new Tripartite Agreement to implement the Plan. This signing took place at a ceremony in Moscow in mid-December with Sakhalin's Governor Alexander Khoroshavin, Sakhalin Energy's CEO Andrei Galaev, and the RCAR's Chair Sergey Kurmanguzhinov all personally representing their SIMDP partner organizations in a public pledge of support to the renewal of the SIMDP.

External Monitor Inception Report Methodology

The SIMDP 2 lays out a dual process of internal (partners) and external monitoring. This Report summarizes the observations and recommendation of the External Monitor (EM) at the beginning of SIMDP 2 implementation. As the opening and preliminary assessment, this report has two goals: to review early implementation planning and to advise the stakeholders on some issues to attend to during the Plan's initial year.

The External Monitor attended the first meeting of the Plan's Governing Board on 25 February, 2011 remotely. Sakhalin Energy's Indigenous Peoples Unit shared the same package of documents with the External Monitor that the Governing

Board received as well as related committee meeting minutes. In addition, each Plan partner was given an opportunity to respond in writing to EM inquiries.

The First SIMDP

The first SIMDP was launched on May 25, 2006, in Yuzhno-Sakhalinsk, capital of the Sakhalin Oblast in the Russian Federation. The product of a year of collaboration between Sakhalin's Indigenous Peoples (called Indigenous Minorities at their own request) and Sakhalin Energy, the Plan was administered by the Company with the close involvement of both Indigenous Minorities and the Sakhalin Oblast authorities.

The Plan incorporated measures to mitigate negative effects on the lives and livelihoods of Sakhalin Indigenous Minorities (SIM) in the project area of the Sakhalin-2 oil and gas Project, as well as measures to share project benefits with Indigenous Minorities throughout the Island. The latter was delivered by way of programs of economic development (the Traditional Economic Activities Program [TEASP]), health, education, culture, and training (the Social Development Program [SDP]), along with a stand-alone, indigenous-directed Mini-Grant Fund (MGF). Yearly funding of the Plan was approximately USD\$300,000, which added up to a 5-year US\$1.5 million commitment by the Company. In addition, administrative costs for the Plan (including staff salaries and costs for the operation of governance bodies) as well as other SIM-related projects were supported by Sakhalin Energy from non-SIMDP allocated funds.¹

The Plan early on emerged as a good practice model on both international² and national levels, with perhaps the most telling endorsement by the Russian Association of the Indigenous Peoples of the North, Siberia and the Far East of the Russian Federation (RAIPON), Russia's preeminent Indigenous Peoples organization. RAIPON recommended that the Plan be used as a model for other regions in the country for Indigenous Peoples in their relations with industrial companies, particularly when there is foreign investment. Many observers, including the Russian national Ministry of Regional Development, also believe that the SIMDP can serve as a model for domestic companies.

According to the SIMDP 1 Plan Evaluation Report, "The SIMDP is a pioneer indigenous development plan which grants real decision-making power to

¹ See SIMDP 2, Annex 3, for a listing of SIM-related projects supported by Sakhalin Energy beyond the SIMDP between 2004-2010.

² Presented as a good practice example of stakeholder engagement by the International Finance Corporation in their 2007 *Stakeholder Engagement* guidebook, while the World Bank also uses the SIMDP as a good practice example of Indigenous Peoples plan implementation (World Bank, in press).

Indigenous Minorities and which is based on an effective partnership between governments, company, and indigenous representatives. Sakhalin's Indigenous Minorities run this Plan for better or worse: the chair of the Supervisory Board (SB) is indigenous while only two members of the SB are Company representatives." With majorities on all governance bodies (and sole representation on the MGF board), indigenous representatives needed to develop answers to the practical questions that Plan implementation raised daily:

- The SIMDP performance was quite responsive to community input, as was seen when the Plan's governing bodies overturned unpopular TEASP committee decisions after receiving negative community reactions which held that indigenous norms of "fairness" had been violated.
- The Plan built trust among Sakhalin's governments, its indigenous communities, and Sakhalin Energy. Each learned the other is a partner they can work with. For the government-indigenous axis, the SIMDP modeled a somewhat different relationship from other plans and places. Instead of the norm of paternalism, the SIMDP called for a reconsideration of business-government-SIM relations with Indigenous Minorities cast as active agents. For some, this caused some getting used to.
- Sakhalin Energy also acted somewhat as a facilitator in this three-cornered relationship, helping to mediate between i) SIM and governments and ii) different groups of SIM as well. The Company could assume this role to some degree because it was the new player on the scene. This occurred despite periods of tension and mistrust between the Company and its indigenous partners. Both sides learned to work with the other, however, to accomplish mutually desirable goals.

The Plan, though, was not without its weaknesses, challenges and failures. Internal monitoring was not effectively employed for the TEASP and this helped contribute to some of the reputational problems with the TEASP that the Plan from time to time suffered from. In addition, occasional conflicts of interest, lack of transparency, and inadequate reporting also plagued Plan implementation.

See Annex 1 for a summary assessment of the first SIMDP.

SIMDP 2

Objectives and Innovations

With the successful completion of SIMDP 1, the SIMDP partners prepared the SIMDP 2 to build upon the collective experience of the Plan and its implementers.

The key objectives of this second Five Year Plan are:

- Improving the lives and livelihoods of the Indigenous Minorities of Sakhalin Oblast through support for the delivery of benefits (social development programmes) in a culturally appropriate and sustainable manner.
- Enhancing the capacity of indigenous communities and individuals to actively participate in the management of the SIMDP and, by extension, similar socio-cultural and economic intervention strategies.
- Assisting Sakhalin's Indigenous Minorities to prepare for the eventual establishment of an independent Indigenous Minorities development fund.
- Avoiding or mitigating in an environmentally sustainable manner any potential negative effects caused by the operation of oil and natural gas pipelines and associated Sakhalin-2 Project facilities.

Key innovations of the SIMDP 2 are:

- The application of the positive experiences of the Mini-Grants Fund of SIMDP 1 to extend indigenous-only programme committee membership to the Social Development Fund Council and Traditional Economic Activities Support Programme (TEASP) Committee of SIMDP 2
- The application of the positive experiences of the Mini-Grants Fund and the Social Development Program of SIMDP 1 with the use of an Experts Group to initiate a similar assessment process for grant applications for the TEASP
- Incorporation of the MGF's focus on direct application for small grants by community groups into the SDP, as the MGF—having fulfilled successfully its experimental purpose—is eliminated as a separate Plan component
- Increased indigenous communities' representatives on the Plan's governing bodies
- Internal monitoring of the Plan undertaken jointly by representatives of the three Plan partners
- An increase in annual funding from Sakhalin Energy from USD 300,000 to USD 312,000 for five years.

SIMDP2 Governance

Governance in the SIMDP 2 reflects lessons learned during SIMDP 1. One oft-repeated criticism of the first Plan's governance was the perception that some individuals had too much personal influence over the Plan due to the multiple positions they held in the various Plan coordinating bodies. The new SIMDP 2 explicitly rules out the holding of such multiple positions, with the exception of the GB and its Executive Committee. Taking this feedback fully to heart, the Plan partners arranged to staff not only all committees in line with this proviso but to extend the principle voluntarily to the EC and GB as well. This approach not only responds well to community and stakeholder input to Plan design but also reflects an indigenous preference for the dispersal of power and authority rather than its concentration.

A parallel new approach to staffing committees has removed Plan partners from formal representation on the TEASP and SDF supervising organs with community representatives. With each of the seven recognised Sakhalin districts with concentrated indigenous communities having but one representative on these bodies, the Plan moves a step closer to full indigenous oversight of the Plan and also resolves Plan1's problem with the TEASP Committee when there was a widespread perception that Nogliki District was over-represented.

This has introduced both new members to the Plan's governance bodies as well as bringing in some former external critics of the Plan within the Plan. This is a healthy development as it widens indigenous community participation in the Plan. Yet, not all of the new people are as aware as the Plan veterans of the key principles, approaches, and experiences of the Plan. This has the potential for conflict or tension as the Plan's emphasis on self-reliance and on capacity-building is sometimes at odds with the paternalistic patterns of reliance on outsiders (government or corporate) that many indigenous community members have become accustomed to.

Transparency has also been bolstered in this second Plan, again responding to the experience gained during the first Plan, though the provision in the Plan's regulations that all Governing Board (GB) members are entitled to attend meetings of the Executive Committee (EC) or of the SDF Council or TEASP Committee. This should help with sharing of information between the Plan's different components and bodies, an issue which was occasionally a problem during SIMDP 1.

The Company has stepped back as well from its position of sole administration of the Plan. Under SIMDP 1, in addition to Sakhalin Energy's own head of its Indigenous Peoples Unit, there was a dedicated Plan Assistant which the Company hired. Under SIMDP 2, the position title has been upgraded to "Plan

Coordinator” and the position filled by an open hiring process controlled by all three Plan Partners (while funding remains a Sakhalin Energy commitment). During the start-up period of the Second Plan, the first Plan’s Assistant will help ease the transition for the new Coordinator. This needs to be handled with sensitivity so as to not give the appearance that the Plan has two competing heads.

Regulations for all SIMDP 1 coordinating bodies other than the GB also display one other indigenous approach to governance. Rather than expect decision-making to be by voting, regulations set a norm of attempting to achieve consensus, with voting only reserved for “exceptional cases.”

Governing Board

On 25 February, 2011, the first meeting of the SIMDP 2’s Governing Board was held, following on opening meetings held earlier for the TEASP Committee and the Social Development Fund Council and training sessions for all participants. Nearly a dozen documents were distributed to Board members, indicating the high level of preparation, efficiency, and sophistication that Plan partners have achieved. These documents covered regulations for each of the key Plan governance bodies, including their general operating procedures, their 2011 work plans, and specialised guidance for the expert advisory bodies for both the TEASP and the SDF. The Board approved these guiding documents, while some further documents for the SDF were prepared later, after training for Council members was carried out.

The half day-long meeting also discussed in turn some key issues which the experience of the SIMDP 1 had raised, including the sensitive and often contentious issue of conflicts of interest. During SIMDP 1, questions of conflicts of interest had arisen primarily in the context of the allocation of TEASP Business Grants and Self-Sufficiency Grants. During their meeting the day before the GB meeting, TEASP Committee members had adopted committee regulations which allowed committee members with projects before the committee to participate in committee discussions about the proposal but be prohibited from voting on their own proposals. After a vigorous discussion, the Board voted to reject the TEASP Committee regulation which allowed committee members to discuss their own proposals and made this approach the rule for all SIMDP 2 bodies.

Another discussion pertaining to an on-going SIMDP 1 problem was the issue of what to do if a grantee individual or organisation—or even a participating partner organisation—did not file the necessary narrative or budget reports required by SIMDP regulations. The GB decided to allocate this issue to the Executive Committee, with particular attention paid to delinquent holdovers from SIMDP 1.

The Governing Board also voted to explicitly empower the EC to approve or cancel decisions of the TEASP Committee and SDF Council, with final review of such decisions the prerogative of the GB itself. This issue arose out of some felt ambiguity in SIMDP 1 regulations as to the authority of the EC vs. the GB. This action responded directly to the SIMDP 2 proviso that the GB would need to provide guidance on this critical governance issue.

SIMDP Components

The SIMDP 2 comprises two separate development programmes, both successors to the first Plans' programmes. Whereas the SIMDP1 was composed of a Social Development Programme (SDP), a Mini-Grant Fund (MGF) and a Traditional Economic Activities Support Programme (TEASP), the Second SIMDP will only support two programmes. The first, the Social Development Fund (SDF), will cover all non-economic development initiatives, while the second, the TEASP, will operate similarly as its first Plan predecessor, emphasising economic development.

TEASP

The 2011 work plan for the TEASP crafted by the TEASP committee and approved by the GB, has a budget of USD 156,000. In addition, the committee has access to 1,080,000 RUR, the amount allocated but unspent for micro-credit in the 2010 TEASP budget.

For the SIMDP 2, micro-crediting will be a significant new sub-component in the TEASP to complement the original TEASP sub-components of Business Planning Grants and Self-Sufficiency Grants. Some of the regulations for the TEASP include provisions aimed at responding to problems or criticisms the TEASP experienced during the first SIMDP, including clear guidelines for who can apply for the non-commercial Self-Sufficiency Grants and which commercial enterprises can apply for the Business Planning Grants. Both types of grants now emphasise the applicant's own contributions as well as the prior possession of all necessary permits and licenses, while the Committee is committed to providing feedback on all applications. Another new emphasis is the TEASP's goal of job creation in indigenous communities and on supporting sustainable economic enterprises.

Social Development Fund

Like the TEASP, funding for the SDF is at 50% of the 2011 total, for USD156,000. Unlike for the previous SIMDP, however, the SIMDP 2 has not

predetermined the funding for the different social development fund components, which are expected to be education, health, culture, and training (capacity-building), as previously. Key innovation for the SDF is its adoption of the SIMDP 1 Mini-Grants Fund model of indigenous only committee, or Council, membership, replacing the representation of Plan partners on the previous Social Development Program committee. With nearly all members of the SDF Council new to their service positions, they will have a steep learning curve.

SIMDP 2 Implementation Challenges and Recommendations

The SIMDP 2 begins with some noticeable strengths, among them the solid base of experience gained by its continuing participating members, its emerging consistency of approaches, and the high level of trust developing among its partner organisations. New challenges will no doubt in time arise; anticipating them, there is an awareness among those involved of the need for training for newer participants and for clarifying new and revised initiatives, particularly the micro-credit fund.

Training

In contrast with the experienced members of the Governing Board and Executive Committee, the majority of SDF Council members and TEASP Committee members are new to working with the SIMDP, as are the community representatives on the Governing Board. Training for the new members as regards the objectives and principles would be helpful, emphasising both capacity-building and sustainability. Such training could be arranged to precede the next meetings of the Committee and Council with previous members of the committees in attendance to share their experience.

Consultation Inputs

The two rounds of consultations with indigenous communities held during the preparation of SIMDP 2 raised many suggestions for SIMDP 2 design and implementation. Both the SDF Council and TEASP should review the reported consultations as to relevance for their component and sub-component planning in 2011.

Micro-credit Funding

Sakhalin Energy needs to clarify how it will respond to the request by the TEASP Committee for Sakhalin Energy to fund the administrative expenses to implement a micro-credit program. Such funding for micro-credit administration costs will

either be provided by a voluntary Sakhalin Energy contribution and/or budgeted as part of TEASP expenditures.

Annex: SIMDP 1 Summary Evaluation³

A Critical Time

Whereas earlier [prior to 2005] the Company [Sakhalin Energy] partook of the typical patronizing attitude of the corporate world to indigenous populations wherein the Company itself decided on a benefits package for indigenous groups after a modest round of consultations, with the SIMDP the Company transitioned to partnership in 2006, providing conditions for the Indigenous Peoples to make decisions on their own.

With its support for positive trends in the indigenous communities of Sakhalin such as rising pride in indigenous heritage and by serving as a venue for island-wide discussion of indigenous issues, the SIMDP has entered indigenous life at a critical time in indigenous history. "Much of our culture has been lost due to the *internat* (boarding school) system and so now we are trying to revive our culture," said one Okha region indigenous fisherman. He went on, "We were separated from our culture and now we are trying to relearn how to fish and gather wild plants." One elderly *babushka* (grandmother) added, "We old people should hurry to teach our young people about our traditions; they know nothing about our heritage." They both credit the SIMDP as helping in that cultural and ethnic struggle to maintain their heritage.

But cultures are ever-changing patterns as the social contexts they exist in are always changing, so "revival" of traditions always means reinvention of traditions. This is precisely what the SIMDP is helping the community do as individuals struggle with answering the question as to what it means to be both "Nivkh" (or Uilta, etc.) and "modern." What values and behaviors should the community promote? Competition or cooperation? Should SIMDP funds be divided equally and thus "fairly" or should competition and activity be rewarded? By raising these questions on an island-wide frame, and by supporting both elderly and youth groups, the SIMDP is aiding the revival, continuation, and reinvention of Sakhalin's indigenous cultures.

This is not to say, as this evaluation has noted above, that the SIMDP was without its weaknesses. Internal monitoring, primarily of the TEASP, was often inadequate...while occasional conflicts of interest...also plagued Plan implementation.... Transparency could also have been more consistently delivered, whether with information as to application procedures, who was successful, or how and why decisions on grant applications were made. Despite

³ Section VI, Plan Completion Evaluation Report, G. E. Guldin, O. V. Kapkaun, A. T. Konkov. October 2010, Sakhalin Energy Investment Company: Yuzhno-Sakhalinsk.

these faults, however, the evaluation team believes that the SIMDP brought significant benefits to the Indigenous Minorities of Sakhalin.

Dual Benefits

Positive results of the SIMDP can be seen in two dimensions: one in terms of the very positive material benefits conveyed by the SDP, MGF, and TEASP, and another in terms of the strong capacity-building support the Plan has offered. The Survey conducted found that while people don't see the Plan as having led to dramatic improvements in the SIM standard of living on the island (an improbable objective considering the Plan's limitations in time and resources), there is widespread acknowledgement that many benefits have been received. People are quick to give many examples of concrete benefits received, as when the head of the RCAR, S. K. Kurmanguzhinov, reported, "Across Poronaisk we can frequently see people driving their boats and their snowmobiles with the Sakhalin Energy/SIMDP logos; the Plan has been a major support to our people. But aside from that direct support, the Plan has also helped we SIM find our own way in this life."

Capacity development in dealing with indigenous issues can also be seen in the very hands on approach all three partners have taken to preparations for the second SIMDP. Whereas five years ago Sakhalin Energy clearly led the process, this time around, indigenous representatives have clearly articulated opinions based on experience as to the second Plan's governance and component approaches. But it is not only the indigenous representatives which have had their capacities raised: both government and corporate representatives involved with the Plan have also acknowledged that their understanding and respect for Indigenous Minorities' cultures and approaches have also been improved greatly.

E. A. Korolyeva, the head of the SOG Indigenous Peoples Department, summed up the impact of the SIMDP: "Thanks to the SIMDP, people changed. The Plan helped unite people and give them some direction for the future. The Plan also helped improve relations with government agencies at all levels as SIM and governments both learned more about each other. Significantly, Sakhalin's Minorities now have more experience running programs and have greater awareness of their rights and the laws which affect them—all due to participation in the Plan. Now when we attend regional or national conferences with other Indigenous Minorities of the RF, people comment on how progressive we are!"

SIMDP Distinctive Aspects

- The SIMDP is a pioneer indigenous development Plan which grants real decision-making power to Indigenous Minorities and which is based on an

effective partnership between governments, company, and indigenous representatives. Sakhalin's Indigenous Minorities run this Plan for better or worse: the chair of the Supervisory Board is indigenous while only two members of the SB are Company representatives. With majorities on all governance bodies (and sole representation on the MGF board), indigenous representatives need to develop answers to the practical questions that Plan implementation daily raises.

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Was the SIMDP money well spent?

Yes. Not every *kopek* to be sure, but, yes, the SIMDP was money well spent from the point of view of Sakhalin's Indigenous Minorities, its governments at the oblast and district levels, and last but not least, Sakhalin Energy. Yes, too, the money was well spent considering that capacity-building was the central goal of the Plan and that a good dose of capacity-building was accomplished during Plan implementation. Through such a perspective it can be seen that mistakes or some difficulties were inevitable but don't detract significantly from the Plan's overall success as a benefits-providing mechanism, a capacity-building exercise, and as a qualified model for similar projects.