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Sakhalin II was conceived as a project to produce oil and gas from the Piltun-Astokhskoye (PA) and Lunskoye fields in the Sea of Okhotsk offshore Sakhalin Island and sell it into the rapidly growing Asia Pacific market. An operating company — Sakhalin Energy Investment Company Ltd. — was established in 1994 to meet these objectives. Today the Company’s shareholders are Gazprom (50% + 1 share), Royal Dutch Shell (27.5%), Mitsui (12.5%) and Mitsubishi (10%).

The two fields are located some 15 km offshore North-East Sakhalin in water depths of 30 to 50 metres. The total hydrocarbon resource volumes in both fields are described in a table below:

### Sakhalin II Hydrocarbon resource volumes (1 January 2008)

<table>
<thead>
<tr>
<th>Names of Fields</th>
<th>Crude oil (B + C₁ + C₂), million tonnes</th>
<th>Dissolved gas (B + C₁ + C₂), billion cubic metres</th>
<th>Free gas and cap gas (C₁ + C₂), billion cubic metres</th>
<th>Condensate (C₁ + C₂), million tonnes</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>In place</td>
<td>Recoverable</td>
<td>In place</td>
<td>Recoverable</td>
</tr>
<tr>
<td>Piltun-Astokhskoye</td>
<td>461.421</td>
<td>116.875</td>
<td>58.734</td>
<td>15.22</td>
</tr>
<tr>
<td>Lunskoye</td>
<td>43.866</td>
<td>3.172</td>
<td>8.912</td>
<td>1.785</td>
</tr>
<tr>
<td>Total</td>
<td>505.287</td>
<td>120.047</td>
<td>67.846</td>
<td>17.005</td>
</tr>
</tbody>
</table>

Sakhalin Energy adopted a phased approach to the project implementation.
Phase 1 was launched in 1996. The development of the Astokh feature of the PA field was selected as the starting point, with production from the Molikpaq (PA-A) platform. First oil from Phase 1, achieved in July 1999, was a major milestone: for the first time, oil was produced commercially from Russia’s offshore continental shelf. The heart of the operation was the Molikpaq platform, the first offshore oil platform in the Russian Federation.

Since the waters of the Sea of Okhotsk are covered with ice for six months a year, oil is produced only during the ice-free period, i.e. approximately six months a year. Nine production seasons (1999-2007) yielded a cumulative total of some 13.2 million tonnes of oil production (the Vityaz crude oil was a new brand introduced to the market by Sakhalin Energy). Since production commenced, crude oil has been exported to Japan, Korea, China, Taiwan, the Philippines, Thailand, Alaska and Hawaii.

The Molikpaq’s ninth production season opened in 2007 in June at some 90,000 barrels of oil per day. In 2007 Sakhalin Energy produced 1.68 million tonnes (12.4 million barrels) of oil, 100 thousands tonnes (800 thousand barrels) more than in the previous year. This was delivered to customers in Japan, Korea, and the USA.

The Molikpaq system for minimal flaring of associated gas is the first system of this kind ever used in Russia. In 2007, as in previous production seasons, the produced associated gas was re-injected.

At the close of 2007, due to harsh weather the Company chose to temporarily suspend production and disconnected FSO Okha from the Single Anchor Leg Mooring system (SALM). When the weather had improved and the crew was preparing to reconnect the FSO, it was discovered that the SALM was damaged. Due to the need for SALM repairs, a decision was made on 25 November to close the ninth oil production season earlier than planned.
Sakhalin II Phase 2, sanctioned in 2003, is one of the largest integrated oil and gas projects in the world. For the first time in its history Russia’s oil and gas industry witnesses the simultaneous implementation of several large interconnected green field sub-projects in a remote region with hardly any infrastructure and in a harsh sub-arctic environment.

The development is a multibillion-dollar project in a sensitive frontier environment, requiring the simultaneous execution of several projects. These include:

- Two new production platforms: **Lunskoye-A (Lun-A) platform** at the Lunskoye gas field, which will produce most of the gas for the LNG plant. The platform production capacity is more than 50 million m³ of gas per day and some 50,000 barrels of condensate per day (8,000 m³ per day) and **Piltun-Astokhskoye-B (PA-B) platform at** the Piltun feature of the Piltun-Astokhskoye Field, which will have the capacity to produce up to 70,000 barrels/day (11,000 m³/day) of oil and 2.6 million m³/day of associated gas.

- **300 km of offshore pipelines**, and tying in the existing Molikpaq platform to the new Piltun-Astokhskoye field offshore pipeline system, in order to enable year-round hydrocarbon production.

- **An onshore production facility (OPF)** located near the north-east coast of Sakhalin, 7 km inshore from the landfall point of the gas pipeline from Lun-A platform. Its main purpose is to process gas and condensate produced at the Lunskoye gas field before pumping them into the pipeline system for transportation to the oil export terminal and LNG plant. Oil and gas produced by the Piltun-Astokhskoye platforms will also be transported to the OPF to be subsequently transported by pipeline to an essentially ice free location at Prigorodnoye in the south of the Island. In addition, the OPF supplies power to Lun-A.

- **Trans-Sakhalin onshore pipeline system** which will carry hydrocarbons from the fields in the north of Sakhalin via the onshore processing facility (OPF) near the Lunskoye field to the LNG plant and oil export terminal in the south of the Island at Prigorodnoye. The oil and gas pipelines share a single pipeline corridor (“Right Of Way” or ROW) varying in width depending on the terrain. The total length of the two pipelines is 1600 km. The onshore ROW crosses more than 1,000 water courses and 19 seismic faults. Halfway between the onshore processing facility in the north and the oil export terminal in the south, a booster station (Booster Station 2 / BS 2) is situated near the village of Gastello. It comprises crude oil booster pumps, gas compressors, and auxiliary equipment.
The first LNG plant and associated export facilities in Russia. The plant for production of liquefied natural gas (LNG) is located near Prigorodnoye on the south coast of Sakhalin. The plant is designed to produce 9.6 million tonnes of LNG per annum (4.8 million tonnes of LNG per year from each of the two identical process trains). A Double Mixed Refrigerant (DMR) gas liquefaction process was developed specifically for the Sakhalin plant. The DMR process, which currently is the most advanced liquefaction technology, was fine-tuned for best performance in Sakhalin’s cold climate and optimised for compressor efficiency.

A new crude oil export terminal (OET) is located at Prigordnoye in Aniva Bay on the same site as the LNG plant. The OET will be used to store oil in two oil storage tanks. The tanks have a total net operating capacity of 1.2 million barrels (190,000 m³) and can accommodate six days worth of the onshore pipeline’s throughput. Crude oil will be exported via a subsea pipeline to the tanker loading unit (TLU) located some 5 km offshore in Aniva Bay.

LNG and oil export facilities are part of the infrastructure of Russia’s first specialised seaport at Prigorodnoye. The port’s loading terminal will comply with the International Maritime Organisation’s standards.

Such a huge development also required a significant upgrade of some of Sakhalin Island’s general infrastructure. The programme that Sakhalin Energy is implementing covers construction and reconstruction of roads, bridges, seaports and airports, telecommunications and other public infrastructure facilities. The Company has budgeted about $500 million for this purpose.

This work scope required the efforts of some 25,000 people at peak activity, most of whom (about 70%) were Russian nationals. Once fully launched, the Sakhalin II Project will become a key new source of energy for the Asia Pacific region. Sakhalin Energy strives to achieve performance which meets or exceeds its PSA commitments to the Russian Party, and to be acknowledged by buyers and competitors as a world class, high performing energy supplier.
Highlights for 2007
On 18 April 2007 Shell, Mitsui and Mitsubishi signed a Sale and Purchase agreement with OAO Gazprom, according to which Gazprom acquired a 50% plus one share stake in Sakhalin Energy for $7.45 billion. The current shareholding structure of Sakhalin Energy is as follows: Gazprom holds 50% plus one share, Royal Dutch Shell 27.5%, Mitsui 12.5% and Mitsubishi 10%.

The entry of Gazprom as the majority shareholder in April 2007 was a landmark development. The vast experience of the Russian shareholder put the Company in a position to more effectively address many of the remaining challenges. With the entry of Gazprom, Sakhalin II became de facto a Russian strategic project.

In the autumn of 2007, Gazprom set up a representative office in Yuzhno-Sakhalinsk with a range of aims, including facilitating cooperation between the main shareholder and the Company management. Managers and experts from the Russian gas giant visited Sakhalin and Japan on a number of occasions to discuss various issues. Gazprom specialists toured the Project sites to offer advice and expertise for future safe and efficient Project development.

Royal Dutch Shell remains Sakhalin Energy’s lead Technical Advisor. The agreements in place with Shell cover advice and services related to exploration, development, transportation and production of oil and natural gas, as well as advice and services in respect of the design, engineering, construction, commissioning, start up and operation of the LNG Facilities.

In accordance with the amended Shareholders Agreement, Gazprom nominees were appointed to the Committee of Executive Directors, the body responsible for the day-to-day management and operations of the Company. Four of Sakhalin Energy’s nine Executive Directors are currently nominated by the lead shareholder, including the Deputy CEO, the Director External Affairs / Government Relations, and the Commercial and HR Directors.
The Committee of Executive Directors (CED)

As of 1st March 2008

CEO
Ian Craig

THE DEPUTY CEO
Andrey Galaev

PHASE 2
PROJECT DIRECTOR
Jaap Huijskes

PRODUCTION DIRECTOR
Tim Hake

TECHNICAL DIRECTOR
Robert Ryan

COMMERCIAL DIRECTOR
Viktor Snegir

GR/EA DIRECTOR
Igor Ignatiev

FINANCE DIRECTOR
Erwin Nijsse

HR DIRECTOR
Vladimir Penkin

GENERAL COUNSEL
Ute Joas-Quinn
Completion of the Offshore Pipelines

The installation of the offshore pipelines was completed in 2006. 2007 saw the successful final connection of the lines to the PA-B and Lun-A platform.

Diving operations for the connection of four offshore pipeline systems to the platforms at water depths of 30 to 50 m commenced in June 2007 and lasted two months.

Pressure testing of the TLU export pipeline at Aniva Bay was conducted in June, while pipeline pressure testing at PA-B and Lun-A was successfully completed in August 2007. Thereafter the offshore pipelines were dewatered and dried with nitrogen and prepared for future testing and commissioning.
In 2007, to support Lun-A commissioning, the accommodation support vessel Sanko Angel was deployed near the platform. A ‘frog’ personnel transfer unit and a crane were used to transfer workers between the platform and the accommodation vessel.

In 2007, the new cyber drilling rig unit on Lun-A was successfully commissioned and tested. Drilling of the first well, a cuttings re-injection well, commenced in August, upon issuance of a Rostekhnadzor permit. No waste was discharged into the sea during well drilling. Solid wastes were placed in containers at the platform and liquid wastes were delivered to Molikpaq to be injected into a disposal well.
In July 2007, Sakhalin Energy successfully completed the installation of the PA-B production platform topsides, manufactured in Korea.

For transportation of the massive topsides a special barge (190x192 m) was built. Upon arrival the barge was carefully manoeuvred between the four legs of the gravity base substructure and the massive topsides were precisely ballasted and, with pinpoint accuracy, lowered onto the substructure legs. By successfully ‘mating’ the 28,000 tonne topsides to its gravity base, Sakhalin Energy broke its own world record set by the Lun-A topsides installation operation the previous year. The entire operation was executed to the highest safety standards, within the Company’s established noise limits and with no discernable impact on the Western Gray Whales, whose feeding grounds are located just 7 km from the platform.

The PA-B topsides, similar to Lun-A, were connected to their concrete gravity base substructures via a cradle system (friction pendulum bearings) that will allow the platforms to withstand, without any serious consequences, a massive earthquake of the kind that only occurs once in 3,000 years.

Soon after the topsides were installed the PA-B hook-up and commissioning process was initiated by Samsung Heavy Industries, together with a 550-strong, international group of specialists. This important project stage could not have been achieved without the Safe Bristolia flotel (floating hotel), which accommodated many more assembly and pre-commissioning personnel than the platform ever could. In November 2007 Safe Bristolia demobilised from the site. From that time on the platform operated on its own, with 140 commissioning personnel on board.
In January 2007 the OPF commenced supplying power to the Lun-A platform. During the year the process equipment was upgraded. In September 2007, commissioning activities were started at the OPF site. By this time, a permanent accommodation and office building was built and put into operation, and the first group of OPF personnel moved in.
In 2007, the Company started commissioning activities at the LNG plant in parallel with the on-going construction.

Due to its large size and complexity, the plant cannot be handed over by CTSD, the general contractor, to Sakhalin Energy, the future owner, as a single entity. To ensure smooth handover, all the facilities were divided into groups to be handed over in a phased manner. The first facility handover ceremony was held in January 2007. Facility handovers continued throughout the year.

A major milestone was the import of two large LNG cargoes to the construction site of the first Russian LNG plant. The decision to import LNG for commissioning purposes resulted in accelerated preparation of plant production systems for subsequent operation.

On 5 July 2007, the LNG carrier Granosa with approximately 135 thousand cubic metres of LNG from Bontang (Indonesia) moored alongside the LNG jetty. After the systems had cooled down, the natural gas was transferred from the carrier to two LNG storage tanks. The process of storage cooling and LNG offloading took 10 days.

The second LNG cargo (85 thousand cubic metres) was imported to the LNG plant at Prigorodnoye from Alaska on 10 October by the LNG carrier Arctic Sun and offloaded in two days.
The LNG delivered by the carriers was used for cooling of loading lines, equipment and LNG storage tanks. The low temperature will now be maintained until the first LNG export. The imported LNG was also used for commissioning of the flaring system, gas turbine generators, boil off gas compressors and other major elements of the process trains.

Gazprom, the majority shareholder of Sakhalin Energy, rendered considerable assistance. Specifically, the LNG import operation, the first ever in Russia, required issuing a special executive order by the RF government and obtaining approvals from a number of authorities, including customs and the border service.

In 2007, the state-of-the-art LNG/OET laboratory successfully passed certification tests to the requirements of Gosstandart and the international ISO17025 standard. Laboratory specialists are now analysing samples of oil, gas, chemicals and wastewater entering the LNG/OET site. In addition, the laboratory will be used to analyse, as required, samples brought from the OPF.
In May 2007, representatives of Sakhalin Energy and CTSD, the general contractor, signed a ready-for-operation certificate for the oil export terminal (OET) and the tanker loading unit (TLU). The construction of these facilities is fully completed.

The TLU is designed to operate in low temperatures, stormy seas, strong winds, seismicity and possible collision with vessels. The TLU is a tower-type outlet with a turning tanker mooring head on top and an oil loading arm with mooring lines. The TLU, designed by Sandwell Engineering, received in 2007 the most prestigious award granted by Canadian Consult Engineers Journal for the world’s best engineering projects.
Facilities for export of oil and LNG form part of the infrastructure of a new specialised sea port. In October by a special decree of the Russian Government the port was named “Prigorodnoye”.

Prigorodnoye Port will be operated by a joint venture between Sakhalin Energy and Sovcomflot established by an appropriate agreement signed in late 2007. The new company will provide expert pilots for LNG carriers and oil tankers, and manage the port operations. At peak the new port will serve approximately 160 LNG carriers and 100 Aframax oil tankers each year, which is approximately 4 to 5 vessels per week. The port facilities will allow a tanker to be loaded within 16 hours and turned around within 24 hours.

2007 has seen the commencement of the site preparation for the construction of the marine administration building. The Marine Administration Building will accommodate Port Administration staff, Pilot services, Marine and LNG Facilities coordination, OSR Team, State Port Authorities and the Technical Services staff.
LNG carriers

Three LNG carriers were specially built in Japan for shipping Sakhalin II LNG to customers. The capacity of each of the tankers is over 145,000 m³ of LNG. Two new LNG carriers The Grand Elena and The Grand Aniva were built at Mitsubishi Heavy Industries shipyards (Nagasaki). Their christening ceremony was held in October 2007. The Grand Elena LNG carrier was named after Elena Anatolievna Zolotareva, who headed the Moscow office of Sakhalin Energy for more than ten years. The Grand Aniva was named after the bay where the first Russian LNG plant being built by Sakhalin Energy is located. The Grand Elena was delivered to Sakhalin Energy at the close of October 2007. The two vessels are jointly owned by a Russian–Japanese consortium comprising OAO Sovcomflot and Nippon Yusen Kabushiki Kaisha (NYK). In July 2007, a third LNG carrier charted by the Company on a long-term basis was formally launched at the Mitsui Engineering and Shipbuilding shipyards in Tokyo. The carrier is owned by Primorsk Shipping Corporation and two Japanese companies, Mitsui O.S.K. Lines Ltd. and Kawasaki Kisen Kaisha Ltd.
By late 2007, pipeline construction was substantially complete with only about 100 km remaining to be welded out of a total length of 1,600 km. Installation of oil and gas pipelines across some of the most difficult terrain of Sakhalin was the achievement of the year.

The 2006-2007 season scope of work envisaged construction of 88 winter river crossings and was the second season when the work was supervised by independent inspectors. The inspectors' report showed considerable improvement in work quality compared to the previous season. Considerable difficulties had to be overcome and non-standard technologies had to be applied during the construction. For example, a dry crossing method (using flume pipes) was extensively used during the 2006-2007 winter season and helped mitigate the impact on spawning rivers. All winter river crossings were successfully completed in April 2007.

Construction of seismic fault crossings began in mid-2007, and by the end of the year, two out of 19 crossings were completed. Special shelters were built, tents put up and heating installed to allow operations to proceed in the winter season.

An impressive scope of technical and biological remediation activities was completed in 2007. Technical restoration was completed on 404 km (51% of the Right Of Way (ROW) against 50%
planned), biological restoration — on 242 km (31% of the ROW against 30% planned). The banks of 502 rivers were reinforced and reinstated (62% of all the rivers crossed against 50% planned).

During 2007, installation of block valve stations (47 on the gas pipeline and 104 on the oil pipeline, including 45 integrated and multi-phase stations) took place. The stations are designed to minimise the impact from hydrocarbon leaks in case of pipeline damage. By the end of the year 127 block valve stations were assembled and pre-tested, and 107 were tied-in
into the pipeline. The work programme also included the installation of five pig traps along the pipeline route, intended for pipeline pigging.

Russian contractors completed, on schedule, the construction of all five pipeline maintenance depots (PMD) along the length of the onshore pipelines. These facilities will become hubs for all types of onshore pipeline maintenance activities. They will also be used for storage of oil spill response equipment.

The main 2007 milestone of the Booster Station 2 project was the successful completion of the assembly, operability testing and delivery of all gas compression equipment for the process line. By December 2007, both gas cooling plants, the first gas turbine unit and first compressor were installed on the BS 2 site.
Personnel Development and Training

To assist with training offshore drilling technicians, the Company installed a Drilling Advanced Rig Training (or DART) simulator in Yuzhno-Sakhalinsk. It uses 3-Dimensional graphics, sound effects and real time simulations to enable users to develop skills and test various drilling techniques. There are only five other simulators like this in the world.

Sakhalin Energy’s training centre in Yuzhno-Sakhalinsk runs training programmes that are structured to take into account an individual’s work place, role in the organisation, baseline qualifications and the specific experience required for their job. 93 trainees continued their training in the Centre in 2007. Over 70 graduates have already joined operations teams as technical specialists.

The Company’s management set a goal of appointing Russian employees to the Company’s key management positions as well as scaling down expatriate personnel in favour of Russian nationals. In 2007, Sakhalin Energy doubled the number of Russian nationals in senior and mid-level managerial positions. 260 new Russian staff were hired, exceeding target numbers in all functional divisions.

The training plan objectives were also met with almost 36,000 man-days of training achieved. In 2007, under the Personnel Development Programme 1,867 Sakhalin Energy employees went through various training courses.
In 2007 the Company was able to reduce the total number of injuries at all facilities, but the year was marred by a number of road traffic related fatalities. These sad events resulted in even greater focus on road safety in the onshore pipelines construction project in particular. As a result, the Company trained over 2,000 drivers in defensive driving, inspected over 3,000 vehicles, installed 450 IVMS (In-Vehicle Monitoring System) units in high risk vehicles, and trained over 800 supervisors in safety intervention techniques.

In contrast to the vehicular traffic performance there are a number of outstanding achievements in both project and operations. The most impressive accomplishment was the 20 million manhours without a lost time injury at the LNG plant construction. The LNG/OET team won the prestigious annual Shell Chief Executive’s HSE Award for this performance.

The onshore processing facility (OPF) Team also scored highly with its achievement of just under 10 million man-hours without a lost time injury. An excellent job under very tough schedule and climate constraints was done on the pipeline maintenance depots project, which was completed safely with no LTIs (Lost Time Incidents) recorded after more than 2 million manhours of work.

The Molikpaq platform crew also demonstrated sustained exemplary performance as they achieved more than three years with no lost time injury incidents.

Many “frog” lifts were completed on the Lun-A platform during the summer campaign. More than 1600 lifts, both with 3-man Frog and 6-man Frog, transporting over 10,000 passengers to and from the accommodation vessel, were completed safely during a three month period, which is a world record.
In 2007, Sakhalin Energy executed two new LNG sales agreements with Japanese buyers Osaka Gas and Chubu Electric Power Co., Inc. These deals effectively complete the contracting out of the entire Sakhalin II LNG plant capacity to 11 LNG buyers. The Sakhalin II overall long-term LNG contractual commitments now cover 98% of the future LNG plant trains 1 and 2 capacity for 20 or more years ahead. The remaining uncommitted 2% will be used to ensure operational flexibility.

Financial proceeds

Sakhalin II main facilities are still to be brought online, however, despite the ongoing construction and seasonal oil production, Russia and Sakhalin currently receive significant financial benefits from the Project.

In 1996 — 2007, the total revenues to the Russian Government from the project development had exceeded $800 million, including $100 million in profit tax paid in Q1 2008.

Russian Content

The Company continues to provide assistance to potential vendors in Russia and Sakhalin by raising Russian companies’ awareness of the Project’s future and current requirements for contracted work/services and materials/equipment. A list of future Sakhalin II tenders (for 2007–2011) was developed and published on Sakhalin Energy’s public website. In 2007 the Company held 11 workshops that were attended by around 40 Russian companies, and two trade fairs which attracted more than 80 participants representing various Sakhalin companies.

The Project’s Russian content measured as manhours of services provided and as the volume of material and equipment delivered, exceeded 80% in 2007. The value of new contracts together with the 2007 change orders, awarded to Russian companies added up to 68% of the overall value of 2007 contracts.
ENVIRONMENT AND PEOPLE
In 2006 the RosPrirodNadzor (RPN, the Russian environmental authorities) required that Sakhalin Energy should pay more attention to environment safety in respect of the Sakhalin II Project pipelines system construction. Sakhalin Energy acknowledged the findings of environmental compliance inspections in 2006 and used them to develop and implement respective corrective plans.

A revised version of the Environmental Action Plan (EAP) was submitted to RPN in March 2007 and was officially endorsed as a «basis for future implementation, provided it is further detailed and updated in view of the results of our joint effort». A new revision of the Plan and a progress report were submitted to the RPN in October 2007.

On 26 October 2007, Ian Craig, Sakhalin Energy’s CEO, reported to Yuri Trutnev, the RF Minister of Natural Resources, on the response to RPN findings and on EAP progress. The Minister expressed satisfaction with the results of the Company’s efforts and noted with confidence that the Project should become an example of the highest respect for Russia’s natural environment.
Independent environmental assessment

In October 2007, AEA, in its capacity as an independent consultant to potential lenders of the Sakhalin II Phase 2 Project, produced a final report on the project’s commitments as laid out in the publicly available Health, Safety, Environmental and Social Action Plan, and assessed Sakhalin Energy Investment Company Ltd. against a comprehensive set of standards, guidelines, legislative requirements and international treaties and conventions.

The AEA report states that “there is a high level of compliance for most of the Project’s facilities/assets”, and that “there are examples of laudable best practices”. “Where non-conformances with requirements have been identified in the documentation these are either minor in nature or else Sakhalin Energy has plans in place for their correction”.

The report renders full support to Sakhalin Energy’s philosophy of meeting the challenges it is facing. The report contains recommendations for improvement in certain areas, and yet its conclusions are essentially positive.

Western Gray Whales

Sakhalin Energy’s programme of mitigating potential negative impacts on western grey whales engages highly skilled experts in marine mammals and acoustics from leading Russian research institutes. The Company works closely with the Western Gray Whale Advisory Panel established by the International Union for Conservation of Nature (IUCN) at the initiative of Sakhalin Energy.

In 2007, as in previous years, Sakhalin Energy continued to monitor noise levels, throughout the entire period of marine activities, with acoustic buoys along the perimeter of the whale feeding area. The noise monitoring data obtained during installation of the PA-B topsides in 2007 showed that the Company’s thres-
hold noise standards were not exceeded. When installation was completed, the whales were observed in the part of the feeding area closest to the platform.

Noise monitoring was only one of a system of measures designed to minimise impacts on whales. Other mitigation measures included reduced vessel numbers and optimised timing of operations and distance to the whales. In addition, the Company operates vessels equipped with low-noise machinery and engines, mandates speed limits for vessels and establishes special navigation corridors.

Sakhalin II operations have been conducted in the area adjoining the gray whale feed zone for nearly 10 years with no visible signs of impact on gray whales. According to independent scientific estimates, the whale population increased within the observation period from 100 to 123 animals.

Steller's Sea Eagle

Several dozens of Steller's sea eagles' nests fall within the project impact area — in the vicinity of the OPF and the northern pipeline segments.

In 2007 surveys were made in April (early nesting period) and in August and then again in September (late nesting period). The resulting information was used to develop and implement impact mitigation measures for all nests that fall within the project impact zone.

The data collected during the spring and summer surveys were used to assess the Steller's sea eagle breeding success. 13 nesting places within the construction area produced 11 nestlings hatched by September. The population productivity therefore increased by 35% on a year-to-year basis. The breeding success is a testimony to the effectiveness of the construction impact mitigation programme and other measures to protect the sea eagles' nests from predation by brown bears.

Other rare birds

Siberian spruce grouse numbers were monitored from 2006 till the spring of 2007 to establish the population of these rare and vulnerable birds and their settlement areas around the OPF.

In June and July, 2007 long-beaked murrelet were also surveyed. The survey established their abundance and identified flyways between the near shore feed zones and inland nesting areas.

The survey results were used to develop mitigation measures to reduce disturbance of this species during the construction period.
Sakhalin Taimen

Sakhalin taimen is a rare protected species of the salmon family.

In 2007 Sakhalin Energy launched a research programme to identify river systems along the pipeline route where the taimen dwell. The Company sponsored the project to learn more about the species occurrence pattern and the abundance of taimen in rivers with pipeline crossings, and to make certain that our activities do not endanger the species.

In the summer and autumn of 2007 top-level taimen specialists together with ichthyologists and students of Sakhalin State University mounted a large-scale study of taimen in eight model river basins — from Aniva Bay to the northern part of the Nogliki district.

Salmon

To support conservation and prudent commercial use of the wild salmon and its sustaining ecosystems, Sakhalin Energy, the international NGO Wild Salmon Centre and the Sakhalin Oblast Administration jointly launched the Sakhalin Salmon Initiative.

In 2007, the Sakhalin Salmon Initiative embarked on implementation of plans drawn by an international conference in the autumn of 2006. The strategic priorities of this public-private partnership headed by the Sakhalin Salmon Initiative — an NGO specially set up for this purpose — include salmon monitoring, establishment of protected natural territories and support of educational environmental programmes. In February 2008, Sakhalin Energy and the Wild Salmon Centre signed a landmark strategic agreement to co-finance a three-year wild salmon protection programme with a budget of $8.8 million.

The 2007 fishing season was a record year on Sakhalin and according to official statistics Sakhalin fishermen caught some 147,000 tonnes of Pacific salmon. This indicates that oil and gas development on the Island can take place alongside a continuing and successful fishing industry.
Biodiversity

In 2007 the Company made considerable progress in developing the Sakhalin II Project Biodiversity Action Plan (BAP). This plan includes data acquisition and consolidation, development of a biodiversity database, monitoring and the involvement of many stakeholders.

In August 2007, Sakhalin Energy came together with the Environmental Council of Sakhalin Oblast to establish a biodiversity expert working group. Its main objective is to deliver professional advice to the Company in BAP development. Furthermore, the biology experts included in the group will be monitoring rehabilitation of the animal and bird habitats previously exposed to any kind of impact from Sakhalin II construction activities. The initial meeting of the group, which included representatives of regional environmental entities, researchers and ecologists, was held in December 2007.
In 2007 Sakhalin Energy invested $6.5 million into socially important programmes. The Company’s efforts were formally recognised by both the Sakhalin Oblast Administration and the city government of Yuzhno-Sakhalinsk.
Social activities undertaken by the company in 2007 included:

- Nevelsk earthquake emergency relief efforts. SEIC staff also made a significant contribution to this worthy cause.
- Investment of $3.3 m in the construction of a children’s dental clinic in Yuzhno-Sakhalinsk.
- The continuation of the successful Senya TV cartoon programmes which teach children how to behave in emergency situations.
- Supporting the opening of Information Resource Centres which concentrate on drug abuse and the prevention of HIV/AIDS.
- Donating medical equipment to the Regional Central Hospital in Korsakov.
- Implementing a partnership project with Kidsave NGO (USA) supporting foster care development.
- Supporting Sakhalin’s Indigenous Minorities through the Sakhalin Indigenous Minorities Development Plan (SIMDP). In 2007 equipment was purchased for remote medical stations and a new mobile dental clinic was established. The Company also provided support for Uilta reindeer herders and a programme for the renewal of Nivkh dog breeding.
- Cooperating with the Sustainable Development Department of Sakhalin State University in implementing sustainable development programmes on the Island and raising awareness of Sakhalin communities about sustainable development issues.
- Implementing Small Grants — Great Deeds programme in all Sakhalin districts. The programme is aimed at supporting social, cultural and educational initiatives of local communities.
- Organising master-classes for young Sakhalin hockey players taught by Russia’s Hockey Legends team members.
- Awarding 21 higher education grants to Sakhalin high school graduates.
2008 will be the most critical year for the Company, covering the completion, testing and commissioning of our major assets, including the commissioning and start up of the LNG plant by the end of the year. Accordingly, the Company’s key objective is ‘Safe, reliable delivery of LNG’.

The Project construction phase is nearing completion and migration to the full-scale operational phase is underway. Below are some of the main 2008 activities with a view to moving to full year round hydrocarbons production and the manufacture of LNG.

**Look ahead to 2008**

**«project to production»**

**MOLIKPAQ**

- The summer season will see the reinstallation of the SALM and start up of production of oil from the Molikpaq.
- The final acceptance and commissioning tests of the oil and gas processing modules will be conducted in 2008, and with that behind us, we will move to the next stage of year-round Molikpaq operation. Production will initially be through the SALM but later in 2008 oil will flow to Prigorodnoye.
- Associated gas is planned to be transported via the offshore pipeline system to OPF where it can be used to switch the OPF generators from diesel fuelled power generation to gas powered.

**LUN-A**

- The CRI well — the first well to be drilled from Lun-A — will be completed by April 2008.
- Drilling operations on the first gas well from Lun-A will then commence. A total of three gas wells out of the planned total of 11 will be drilled in 2008. The first two of these wells will be used to commission the 1st LNG train.

**PA-B**

- Following completion of commissioning, it is planned to start drilling the CRI well on PA-B platform in early 2008.
- Drilling of the first oil well will commence in mid-year.
Look ahead to 2008

OPF

- Construction of the third line for MEG (mono-ethylene-glycol) will continue.
- All process systems inside the OPF fence will be commissioned.
- Construction teams will complete the Waste Transit and chemical storage area.
- Construction teams will start demobilisation.
- Gas from PA-A then LUN-A gas will be introduced to Train 1.

LNG/OET

- Train 1 will be completed and handed over to operations staff. The third importation of a cargo of commissioning LNG will take place early in summer. Train 2 final construction followed by commissioning later in 2008.
- Start-up of the LNG plant using feed gas from the north is expected by 2008 year end.
- The permanent accommodation unit in Korsakov is planned to be completed and operations staff to move in.
- The Marine Administration Building will be completed.
- Following TLU commissioning, crude oil will be offloaded at the rate of about 50,000 barrels per hour (8,000 m³/ hr).

The oil tanker The Governor Farkhutdinov will be joined by her sister ship The Sakhalin Island to commence crude oil operations from Prigorodnoye.

TRANS-SAKHALIN ONSHORE PIPELINE SYSTEM

- The remaining fault crossings will be completed and final welding will take place.
- The pipelines will be pigged, gauged, hydrotested, and cleaned and dried in readiness to receive hydrocarbons.
- The fibre optic communications cable will be completed, then tested and commissioned.
- The remaining block valve stations will be tied in and commissioned.

Final reinstatement of the river banks, the ROW and other sites will be substantially complete. Construction of Booster Station 2 will continue in 2008, followed by commissioning in 2009.
As the phase 2 construction nears completion in the first half of 2008 the Production directorate will interface closely with the Project to ensure a smooth transition and handover for the hydrocarbon start up phase. The final training of the operations and maintenance personnel will take place to ensure full familiarity with their facilities and their roles in the start up and post start up periods. Great emphasis is placed on adherence to start up procedures and in preparing and carrying out drills for emergency situations. To ensure compliance, structured pre–start up audits and inspections involving the Company, shareholders, government agencies and lenders will take place. Additional commissioning and start up specialists from vendors and technical service providers will also be brought on board to support the start up.

Final implementation of processes covering communication protocols and command and control structures will be carried out. The hydrocarbon start up will take place over several months in the second half of 2008 beginning with the Northern gas systems. The integrated start up logic, covering parallel and sequential steps, has been developed to optimize the schedule taking account of construction completion and the offshore drilling program. Final contracts for the production phase will be let and checks and reviews will be carried out to ensure materials and spares inventories are in place. Implementation of management systems covering HSE, maintenance, plant integrity, product quality and fiscal metering will be finalised for the production phase. The Sakhalin Energy corporate systems to ensure effective management of the company post start up will also be embedded in the system. The customer interface is also being carefully managed and the final arrangements for the Port at Prigorodnoye and the shipping will come into place during 2008.

A busy year ahead, but Sakhalin Energy will build on its achievements, meeting challenges associated with the transition from project to production, with safety and reliability, as always, the main priorities.

After the years of design and construction, the aspiration of the Company to become a leading energy provider for the Asia Pacific region is coming ever closer. 2008 will indeed be a pivotal year for Sakhalin Energy in making this a reality!