Contents

2 Message from the Chief Executive Officer

4 PHASE 1
Celebrating Five Years of Production
Molikpaq Tie in Project

6 PHASE 2
Introduction
Infrastructure Upgrade Project (IUP)
Offshore Platforms: concrete gravity base structures and topsides
Onshore Processing Facility
Onshore and Offshore Pipeline Projects
Liquefied Natural Gas Plant and Oil Export Terminal

16 The Markets

18 Meeting the Challenge
Russian Content
Social
River Crossings
Oil Spill Response
Western Grey Whales
Waste Management
Sakhalin Energy has achieved so many important milestones over the past eighteen months.

It has been an exciting journey to where we are today, and recalling the past year’s achievements gives us a chance to reflect on the many great things that have taken place. In early May 2003 there was the signing of our first Heads of Agreement (HoA) with Tokyo Gas. This agreement, to supply Liquefied Natural Gas (LNG) for a period of some 24 years, was followed by the Final Investment Decision (FID) - a commitment by the Company’s Shareholders to invest in the multibillion dollar Phase 2 Project.

On the 15th May 2003 Sakhalin Energy celebrated the Declaration of Development Date (DoDD) for the Lunskoye Field. The DoDD represented the culmination of many years of intense work by all parties involved in the Sakhalin II Project and paved the way for the official start of Phase 2.

As the year progressed we signed a further two HoA’s with Tokyo Electric and Kyushu Electric and awarded all of the major contracts for the development of the massive Phase 2 Project – many involving Russian enterprises. We also began early site preparation work for the Phase 2 facilities.

Towards the end of December 2003, the Russian regulatory authorities approved the Technical and Economic Substantiation of Construction (TEOC) for the Phase 2 Project; and in January 2004, the Company held a First Weld ceremony to launch the start of the construction of the onshore pipelines that will bring oil and gas from the northern production platforms to the Sakhalin Energy LNG plant and Oil Export Terminal (OET) in the south of the Island. In March 2004 we signed a fourth HoA with Toho Gas and in June our first sales and purchase agreement (SPA) was signed with Kyushu Electric.

This report provides a detailed review of the Company’s activities with specific emphasis on the Sakhalin II, Phase 2 Project. It also identifies the Company’s approach to the challenges that it encountered over the past eighteen months, and provides a look forward to what you can expect from the Company in the coming year.

The Sakhalin II, Phase 2 Project is now well underway. At sites on Sakhalin Island, across Russia and at locations around the world, the Project has begun full scale construction.

The Sakhalin II, Phase 2 Project will provide a strategic new source of natural gas from the Russian Far East to markets in Japan and the wider Asia Pacific Region. Construction of Phase 2 will take about four years to complete, and it is expected that during the peak construction period up to 15,000 people will be working on the project.

The remainder of 2004 will see a dramatic increase in construction work activity on the various project elements, including the Onshore Processing Facility (OPF), the LNG plant and the two 800 kilometre oil and gas pipelines. Work will also continue on the gravity based structures for the Lunskoye A and Piltun Astokhskoye B platforms and their associated topsides.

It pleases me to say that much of this work will be carried out by Russian enterprises or joint ventures that contain Russian partners. I look forward to the knowledge transfer anticipated through the application of leading edge technology.

Equally, building this enormous project in a way that minimises impact on the environment is of fundamental importance. Sakhalin is an island that is rich in important animal and plant species. Significant areas of Sakhalin are largely unspoilt, and it is surrounded by one of the richest seas on earth. The challenge of building this project in a way that maximises the benefits to the Island’s people and the Russian Federation, and yet has the minimum impact on the environment is one that we are determined to meet and win.

As we journey through 2004 and beyond, we look forward to working in co-operation with the Russian Federation Government and Sakhalin Oblast to deliver the Phase 2 Project. There is a lot of hard work ahead, but we are ready for it and committed to building on the achievements of Phase 1 to supply Russian Far East gas to the markets of the Asia Pacific and beyond in the near future.

We hope that you find the review a useful source of information on the Sakhalin II Project – probably the largest integrated oil and gas project in the world.

Ian Craig
Chief Executive Officer
Sakhalin Energy
Celebrating five years of production

The Sakhalin II, Phase 1 Project was responsible for developing initial crude oil production from the Astokh feature of the Piltun Astokhskoye field—the first offshore oil production in Russia.

The field was discovered in 1986 and underwent an extensive exploration programme that included a series of seismic surveys, followed by the drilling of 17 test wells and 14 development wells. There were many challenges in developing Phase 1.

The environment is harsh in the Sea of Okhotsk where the Vityaz Complex is located, and oil production is currently limited to the ice-free summer months because sea-ice prevents offshore loading operations during the winter. The Molikpaq platform, which sits at the heart of the Vityaz complex, was previously based in the Beaufort Sea as an ice-class drilling rig. It was converted by the Company for use as a production and drilling platform. The structure was specifically built to operate in severe ice conditions and to date it is the only platform to be located in such searce conditions.

The remainder of the Vityaz complex consists of a single anchor leg mooring buoy and the Okha floating storage and offloading unit.

Production commenced at the Vityaz Complex in summer 1999. Following the start of the 2004 production season at the end of May, more than 50 million barrels of oil has been produced and exported to markets in Asia and beyond.

The cumulative oil production for the 2003 season was 10.3 million barrels. Typically, most cargoes have been sold to Japan, Korea and China, but for the first time in 2003 Sakhalin Energy also supplied to Taiwan, the Philippines and the US West Coast.

During the 2003 production season—the Molikpaq’s fifth production season—crude oil production levels amounted to approximately 70,000 barrels per day. This represented a reduction in volume over previous seasons due to natural pressure reduction in the reservoir. A pressure maintenance project (PMP) is currently underway to boost production back up to earlier production levels of 90,000 b/d using water injection to repressurise the reservoir.

As part of the PMP, new water injection and power generation modules were installed on the Molikpaq during the summer of 2003 at a total cost of approximately $300 million dollars. The PMP modules were built by Amur Shipyard in Komsomolsk, and represent the first work of their type undertaken in a Russian Far Eastern shipyard. Work on the testing of the PMP facilities has been completed and water injection has commenced.

Molikpaq Tie in Project (MTI)

The Molikpaq Tie in Project (MTI), which forms part of the Phase 2 Project, is set to enable year round production from the Molikpaq. During Phase 2 the Molikpaq platform will be connected to the new pipeline infrastructure. This will involve installation of offshore pipelines to bring the oil onshore to be tied-in to the Phase 2 oil and gas export systems.
PHASE 2

Introduction

Following on from the Phase 1 Project, the multibillion dollar Sakhalin II Phase 2 Project is thought to be the biggest single integrated oil and gas project ever undertaken. It calls for the further development of the Piltun Astokhskoye field – an oil reservoir with associated gas – and the development of the Lunskoye field – a gas reservoir with associated condensate. In addition to the construction and installation of two new offshore platforms, a system of offshore pipelines will be constructed to bring the oil and gas onshore from the Company’s three platforms. The Hydrocarbons will then be sent to an Onshore Processing Facility (OPF), where the gas and condensate will be separated and further processed in order that it may subsequently be transported via two 800 kilometre onshore pipelines. These pipelines lead to an Oil Export Terminal (OET) and Liquefied Natural Gas (LNG) plant at Aniva Bay in the south of the Island, where the sea remains largely ice-free all year round.

Infrastructure Upgrade Project (IUP)

Sakhalin Energy was responsible for a series of extensive upgrades to Sakhalin Island’s infrastructure in 2003 ready for the start of Phase 2 construction activities. The upgrades, collectively referred to as the Infrastructure Upgrade Project (IUP), involved approximately $300 million worth of improvements to Sakhalin Island’s roads, railways, bridges, Kholmsk Fishing Port and Nogliki airport.

Work on the IUP began in 2002 and will be completed in 2004. In total, IUP encompassed more than 100 construction sites and employed over 2500 staff across the length and breadth of the Island.

The IUP included a number of major components, one of which was Kholmsk fishing Port. Located in the southwest of the Island, Kholmsk Fishing Port has been upgraded to allow for the inbound receipt of Phase 2 construction materials (including line pipe) and Onshore Processing Facility (OPF) cargo. As part of the port upgrade, dredging works, quayside works and installation of rail sidings and access roads have been completed. In addition, four 20-tonne and one 32-tonne gantry cranes have been erected. Ancillary works at the Port, including office and warehouse upgrades, were also undertaken.

Another component of the IUP is work on Sakhalin’s Federal roads and bridges. To cope with the increased traffic conditions anticipated during the Phase 2 Project, Sakhalin Energy is upgrading 39 bridges and associated bridge approaches. In addition to bridge and culvert construction, 16 kilometres of the Island’s federal roads are being reconstructed and a further 12 kilometres of federal carriageway is being asphalted. By the end of 2003 upgrades on these facilities were substantially complete, and roads and bridges were at a point that allowed them to carry project traffic loads. It is planned that the remaining Federal roads and bridge upgrades will be completed in 2004.
IUP has also completed upgrades to Sakhalin’s railroad system in order to support increased activity during the Phase 2 Project construction period. The upgrades included the construction of nine separate rail sidings, and two new passing loops on the main line (west coast) with associated hardstand areas.

In 2003 IUP also undertook upgrades in seven of the Island’s Municipalities (Dolinsk, Kholmsk, Korsakov, Makarov, Nagliki, Poronaysk and Yuzhno-Sakhalinsk). Work included road and bridge upgrades in the townships that will experience increased traffic flow as a result of the Phase 2 construction period. By the end of 2003, the works were complete in all seven Municipalities with the exception of minor finishing works in two locations.

The IUP was also responsible for early works on the LNG and OPF site during 2003, and for the construction of a new project office in Yuzhno-Sakhalinsk and accommodation facilities at Zima Highlands.

At the LNG site, the IUP role included preliminary site works: general site clearance, archaeological works, demolition works and the removal of submarine cables from Aniva Bay. IUP was also responsible for the removal of existing navigation polygons at the LNG site and the construction of eight new replacement Polygons at alternative sites in Taranai village, Aniva Bay.

At the OPF, the IUP team was responsible for temporary site works. These works included construction of an 11.5 hectare site construction camp area and a seven hectare temporary works area. IUP constructed a six kilometre Beach Access Road (BAR) and a 1.1 hectare Beach Laydown Area (BLA) at nearby Lunskoye beach.

As part of works at the OPF site, IUP is also constructing 76 kilometres of access roads to the OPF facility - referred to as the Southern Access Road (SAR). The SAR (0 - 57 kilometre) project, involves redesigning and upgrading 57 kilometres of road including 13 bridges, whilst the SAR (57 - 76 kilometre), involves the construction of 20 kilometres of new road. Works on both sections of the SAR have been substantially completed and are in use. Finishing works will be completed in Summer 2004.

In October 2003 the IUP completed construction activities on the new Phase 2 Project Office. The 250 person, three-storey facility is located on the corner of Khabarovskaya and Chekov Streets, Yuzhno-Sakhalinsk. The office is now fully staffed and on 28th April 2004 the building was opened by His Royal Highness, The Prince Andrew, Duke of York.
Offshore Platforms: CGBS and topsides

Sakhalin Energy’s Phase 2 Project involves the installation of two new platforms – the Piltun Astokhskoye-B Platform (PA-B) on the northern feature of the Piltun field and the Lunskeoy-A Platform (LUN-A) on the Lunskeoye field.

PA-B will be a manned integrated oil and gas platform with drilling facilities. Its oil capacity will be 70,000 barrels per day (11,000 cubic meters per day). The drilling, processing and production platform will extract oil and associated gas from the Piltun reservoir. The platform will be located in a water depth of 32 metres.

The Lunskeoy Platform will have drilling facilities, accommodation and minimum processing facilities. It will have the capacity to produce 51 million cubic meters of gas per day (1800 million standard cubic feet per day), and approximately 50,000 barrels of condensate per day (8,000 cubic meters per day). It will be located 1.5 kilometres off the north eastern coast of Sakhalin Island in a water depth of 48 metres. Separation, including gas treatment of LUN-A’s oil/condensate, will be undertaken onshore at the Onshore Processing Facility (OPF), which will also supply power to the platform via submarine cable. This platform will produce the majority of the gas for the Liquefied Natural Gas (LNG) plant.

About $300 million worth of contracts were signed for the engineering and construction of the PA-B and LUN-A Platform substructures in 2003.

Under two separate contracts, Quattro Gemini OY is responsible for the construction of the PA-B and LUN-A Platform concrete gravity based substructures (CGBS) at a Russian custom-built dry dock at Vostochny Port near Vladivostok; while Norwegian specialist Aker Kvaerner Technology AS are engaged in engineering services for the concrete substructures. The design will specifically take into account the winter sea-ice conditions and seismic nature of the area.

The Phase 2 concrete substructures, with a combined weight of approximately 200,000 metric tonne, will be the first offshore substructures of their kind to be built in Russia and with a very high percentage of Russian labor and materials. This will provide an opportunity for local industry to gain extensive experience through the transfer of knowledge and technology.

Quattro Gemini is a Finnish engineering company, leading a consortium that also includes Russian companies RRO and Astrakan Korabel. Quattro Gemini undertook and executed the construction of the casting basin and the establishment of infrastructure (offices, buildings, batching plant, roads and equipment) at Vostochny Port. As part of the early works programme they excavated more than 1 million cubic metres of soil to create a dock, large enough to enable construction of the two structures in parallel.
Construction of these substructures commenced in March 2004 when the first concrete was poured. Numerous concrete pours have occurred since this time, each taking 24 to 36 hours and typically placing between 1,200 and 1,800 cubic meters of concrete at a time. Such activity will be more or less continuous until early 2005 as the two structures grow. In testament to the site’s approach to health and safety, on 15th June 2004 the CGBS site recorded 2 million man-hours without a Lost Time Injury (LTI).

Some 1600 people are currently employed to construct the platform substructures, and significant business has also been generated for other Russian companies who are providing materials – such as steel and cement, and services to the construction site. Twenty major subcontractors and more than 100 suppliers of goods and services are engaged in the area.

The concrete gravity based substructures will be completed in 2005 and will be floated and towed to the installation sites on the Lunskoye field and Piltun feature of the Piltun Astokhskoye field offshore Sakhalin. Once on location, the concrete structures will be carefully ballasted and lowered to the seabed, where their weight will keep them firmly in place.

At the Samsung Heavy Industries (SHI) construction yard on Geoje Island (Korea), where the LUN-A and PA-B platforms are both being constructed, work is continuing to progress steadily. First cutting of steel for the LUN-A topsides was undertaken in July 2003 and in January 2004 for PA-B topsides. By the end of May 2004, SHI had achieved around 1.8 million man-hours without a Lost Time Injury (LTI) and the LUN-A topsides upper deck blocks had been completed. In addition, all four primary jacking legs had been installed, installation of mezzanine deck columns and bracing had begun and the first mezzanine deck block had been successfully installed on the lower deck.

The topsides are currently scheduled for transport to Sakhalin during the summer of 2006. Installation of the topsides onto the CGBS will be undertaken offshore Sakhalin. A special barge is under development for this work, and planning for the operations are ongoing with Saipem as a subcontractor to SHI. Planning for the commissioning of the facilities, both while the topsides are at the yard in Korea as well as after installation offshore is already in progress.
PHASE 2 PROJECT

Onshore Processing Facility (OPF)
The Onshore Processing Facility (OPF) will be located in the north east of Sakhalin Island, seven kilometres inland from the landfall of the gas pipelines from LUN-A Platform. BETS, a joint venture comprised of Russian company Technostroyexport, Turkish company Enka and US company Bechtel, were awarded the $250 million contract for the construction of the OPF in June 2003.

The primary function of the OPF is the processing of gas and condensate received from the Lunskoye field prior to pipeline transportation to the OET and LNG facilities at Prigorodnoye on the southern tip of Sakhalin Island. It will also receive oil and gas streams from the Piltun Platforms for onward transportation by pipeline to Prigorodnoye.

The OPF will include a 100 MW power plant to generate power for OPF itself, and some 18 MW for Lun-A platform.

At full capacity, the plant will be capable of processing 1,800 million standard cubic feet of gas per day (51 million cubic meters/day), and about 65,000 barrels of condensate/oil per day (10,000 cubic meters/day).

The OPF construction site team and the construction contractor started to mobilise to site in May 2003, and early construction activities commenced at around the same time.

Production startup will occur in phases from Quarter 4 2005 to Quarter 3 2006.

The construction of the OPF will use 13,600 tonnes of steel, 350,000 kilometres of cables, 88,000 kilometres of piping and 17,000 cubic metres of concrete. Some 70 permanent operational staff will operate and maintain the plant.

OPF detailed design and procurement is being undertaken in the Parsons’ office in London through 2003 and 2004. The OPF design will meet all appropriate safety and environmental standards and will include extensive fire safety equipment. By the end of May 2004, overall design and procurement progress was in excess of 70% complete and the majority of bulk purchase orders had been placed.

By the beginning of June 2004, OPF construction had achieved over 2.2 million man-hours without a Lost Time Injury (LTI). There were approximately 1,000 personnel on site and steady progress was being made on construction of the facility. Over 3,600 piles had been installed and more than 5,000 cubic meters of concrete had been poured for pipe-racks, the main sub-station/central control building and miscellaneous foundations. Beach landing operations had also been completed in readiness for the arrival of the first heavy equipment at the beach landing area in July.
Onshore and Offshore Pipeline Projects

The engineering, procurement, construction, commissioning and operation of the offshore and onshore pipelines is an integral part of the Phase 2 offshore oil and gas development, representing an investment of some $2 billion.

The pipelines will transport hydrocarbons from the three platforms off the northeast of the Island – via the OPF to the LNG Liquefaction plant and OET. The onshore pipelines (one gas and one oil) will each cover a distance of approximately 800 km, and will share a right of way that will average 50 meters in width. The total to be installed onshore pipelines length is some 1670 km. The accumulative offshore routes measure 80 km, which results in a total to be installed offshore pipelines length of some 200 km for both the oil and gas pipelines.

Russian line pipe and steel manufacturers participate in the delivery of coated line pipe. ZAO United Metallurgical Company (OMK) will produce and coat some 45,000 tonnes of line pipe at its Vyksa Steel Works pipe mill, with the major Russian steel manufacturer Severstal supplying the steel plate to a total value of some $40 million. This order is part of a joint venture with the Japanese company Mitsui & Co., Ltd. Other suppliers involved are a joint venture between Russian company OOO Transpromresurs and Metal 1 (whose major shareholder is Mitsubishi Corporation of Japan), and ILVA from Italy.

OOO Transpromresurs in partnership with Mitsubishi has constructed a new high technology pipe coating plant in Vostochny for coating the majority of line pipe. This commenced production in the first quarter of 2004. This coating plant cost approximately $15 million to construct, and will carry out pipe-coating work worth some $35 million. The total investment for supply of all onshore and offshore coated line pipe exceeds $400 million, and involves some 510,000 tonnes of steel. The various line pipe orders were all placed during 2003.

In July 2003, the engineering, procurement (excluding line pipe) and construction (EPC) contract for the Phase 2 Project’s onshore pipeline systems worth approximately $1.2 billion was awarded to a consortium comprising Russian companies Starstroy and LUKoil-Neftegazstroii, together with the European companies Saipem SA and AMEC Spie Capag following the award of an early works contract in April 2003. The majority of work will be performed by Russian companies. This contract alone is expected to provide employment for a workforce of between 5,000 and 6,000 people on Sakhalin Island and from the Russian mainland.

The offshore pipelines EPC contract worth in excess of $300 million was awarded to Saipem in December 2003, following the award of an early works contract in August 2003.

In April 2004 Sakhalin Energy announced a decision to reschedule offshore pipeline construction activities at Piltun in 2004 to allow additional studies to be undertaken, with external scientific input, and the consideration of alternative pipeline installation methods and possible routes to shore.

The decision to reschedule work in 2004 was taken as a result of detailed ice-scour studies which indicated the Piltun offshore pipeline needed to be buried more deeply than originally anticipated, and thus could potentially cause more disturbance to the Western Gray Whales during construction. The Whales are...
listed as critically endangered and migrate to the Sakhalin region
and feed offshore Piltun, in the summer months.

Offshore pipeline construction work during 2004 is
focused on the Lunskoye field and Aniva Bay further south,
previously planned for completion later in the construction period.

By June 2004 the offshore pipelines EPC contractor
SAIPEM completed the detailed design for the 2004 offshore
pipelines installation programme - in Lunskaye and Aniva Bay.
Weld procedure qualifications had been completed in Milan, Italy,
and all preparatory civil work at Aniva Bay and Lunskaye landfalls
had been completed. Vessel and spread mobilisations for pipeline
installation in these two areas had begun.

The onshore pipelines will cross a diverse terrain - from
lowland marshes to mountainous areas - and will traverse
numerous watercourses - from brooks and small streams to
moderate-sized rivers. Offshore pipeline sections in water depths
shallower than approximately 30 m will be buried to protect the
pipelines from ice scouring.

The offshore and onshore pipelines have been designed
to the highest standards, drawing on international best practice
and conforming to Russian Federation regulations. They will
be built to withstand the most serious earthquake that can be
expected in a one thousand year period.

At particularly sensitive locations onshore, such as
rivers, seismic faults, roads and railways, and in the vicinity of
settlements, the thickness of the pipeline wall will be increased,
and numerous block valves will be installed along the length
of the pipeline to optimise the control of the transportation of
hydrocarbons. The pipeline systems will also be equipped with a
highly sensitive leak detection system, and will operate under a
comprehensive maintenance programme.

By early June 2004, some 1050 kilometres out of
the total of 1670 kilometres of onshore line pipe had been
manufactured, with 670 kilometres coated and 600 kilometres
delivered to marshalling yards in Vostochny or Vanino. Some
540 kilometres of this line-pipe has been handed over to onshore
pipelines contractor Starstroy, and was in storage in laydown
yards along the pipeline Right of Way (RoW) ready for welding
and installation.

In 2003, a significant start was made on the onshore
pipelines construction with the start of pipeline RoW clearing,
following substantial completion of mobilisation and permitting
activities. A formal first weld ceremony occurred in January 2004
and Starstroy concluded six major subcontracts for construction work
along the Island with well-established Russian entities.

Onshore pipelines construction started in early 2004
and work is now ongoing in five spreads with some 3000
staff involved on-site, operating from construction camps in Val,
Nogliki, Onor, Tumanovo and Sokol respectively. By early June
2004 some 245 kilometres of RoW had been cleared for
construction, and some 22 kilometres of pipe had been welded
- of which some 9 kilometres had been installed in trenches and
backfilled.
Liquefied Natural Gas (LNG) plant and Oil Export Terminal (OET)

In June 2003 a Russian-Japanese Consortium consisting of Chiyoda Corporation, Toyo Engineering, OAO Nipigaspererabotka and Khimenorg was awarded the contract to develop Russia’s first ever LNG Plant as part of the Phase 2 Project.

The signing of the $2 billion contract at the 2003 World Gas Conference in Tokyo was the culmination of some nine years of work by Sakhalin Energy’s LNG Team.

The LNG and OET facilities will be located on the south coast of Sakhalin Island at Prigorodnoye, about 13 kilometres east of Korsakov on the Aniva Bay.

The LNG Plant will consist of two gas liquefaction process trains, which will use a dual mixed refrigerant process particularly suited to Sakhalin’s cold climate. Both trains will have an annual capacity of 4.8 million tonnes making them the largest single trains currently under construction worldwide. The LNG Plant will also consist of two 100,000 cubic metre storage tanks and a jetty, with two loading arms, that will extend some 850 metres offshore.

The OET will be located 500 metres east of the LNG Plant on the same site. Crude Oil will be exported via a sub-sea pipeline to a tanker loading unit located approximately 5 kilometres offshore. The OET will support the storage and export of 170,000 bbls/day of crude oil along with 5,000 bbls/day of condensate from the LNG facility. The OET will comprise of two floating roof oil storage tanks with export pumps and associated facilities.

The LNG Plant and OET will be self sufficient having their own integrated facilities including power, water, fire fighting, oil spill response and waste water treatment services.

2003 saw the start of an early works programme on the LNG Plant and OET site. Since that time the construction site has teemed with activity 24 hours a day and the land has quickly reshaped. The General Contractor, CTSD, is responsible for the early works programme to prepare the site for construction activities in 2004 and beyond. CTSD are being supported in this work by a number of Russian partners and various subcontractors.

As part of the 2003 early works programme, detailed site preparation commenced. This included soil works, a bypass road, on-site roads and fencing, water-well and water-pipeline facilities plus the construction of the Material Offloading Facility (MOF) and a 6,000 man site camp.
By August 2004 construction of the Bypass Road was nearing completion. The 4.6 kilometre bypass road will divert the existing public road away from the construction site and will split the construction site into two sections, the main camp, for accommodation of labour, and the LNG/OET construction site. The existing public road will not be closed until after the new bypass road is ready for use and open to traffic.

As part of the 2003 early works programme, establishment of the water-well and water-pipeline (WWPL) started approximately six kilometres north of the construction site. The WWPL is set to supply the LNG/OET plant with water during future operations, and will also supply the construction camp with potable water. By June 2004 construction work on the water-pipeline was complete.

Construction of the MOF, which is being built to enable necessary access to the sea to receive heavy equipment for the LNG/OET plant, commenced in 2003 and by June 2004 was well advanced. It is expected that the MOF will become operational this year.

By mid June 2004, detailed design of the LNG/OET facilities was 75 % complete, and some 85 % of the materials for the plant were on order. Work was also ongoing on the temporary site buildings, including on the accommodation units that are being built to house over 6000 workers.

Construction of the first of two concrete batching plants, which will supply the site with concrete, started in November 2003. Commissioning of the TOA Batching Plant occurred in April 2004, and a ceremony to open the plant was held in late April, when His Royal Highness, Prince Andrew, Duke of York visited the LNG site.

At the end of 2003 work on the OET had started and by April 2004 site preparation, including excavation of the LNG and oil storage tanks foundation bases, had been completed in preparation for tank construction later in the year.
THE MARKETS

The New Energy Source for the Asia Pacific and Beyond

The Sakhalin II Phase 2 Project is set to launch a strategic new energy source for Japan and the entire Asia Pacific Region. It will lead to the first ever supply of natural gas from the Russian Far East to the dynamic and growing economies of Asia when the first LNG cargo sales from Prigorodnoye in November, 2007. Coupled with Russia’s reputation as a reliable supplier of gas to Western Europe, the Sakhalin II Project will establish Russia as a truly global supplier of natural gas.

Together the Piltun-Astokhskoye and Lunskoye oil and gas fields contain recoverable hydrocarbon volumes of more than 1 billion barrels (150 million tones) of crude oil and more than 500 billion cubic metres (18 trillion cubic feet) of gas. These huge gas reserves mean Sakhalin Energy has the proven resources to provide reliable LNG supplies for at least 25 years to key markets in the Asia Pacific region.

Sakhalin’s reserves are well placed – the island is closer to the LNG markets of Japan, Korea, China and Taiwan than any other LNG project in the world. Surprisingly, it is also the closest LNG supply source to Mexico and the US West Coast – another probable market for natural gas from the Russian Far East.

Its proximity to Japan and the other main Asian markets offers supply diversity from a politically stable country, and significant transport cost advantages to key LNG customers.

Even Sakhalin’s cold, often severe winter climate gives the LNG plant a competitive edge by enabling higher production in the winter months – a perfect seasonal match for the peak city gas demand in north Asia.

Sakhalin II is shaping the future of the LNG market by changing the energy map of Asia.

Three Heads of Agreements have already been signed with major Japanese utilities Tokyo Gas, Tokyo Electric, and Toho Gas and a Sales and Purchase Agreement has been signed with Kyushu Electric. In total this represents sales of 3.4 million tonnes per annum (35% of total plant capacity of 9.6 mtpa). Sakhalin Energy expects to sign further sales contracts this year for long term supplies of LNG. These agreements place Sakhalin firmly on Asia’s energy map, and confirm Sakhalin Energy as a major player in the world LNG market.
Meeting the challenge –
Maximising Russian Content

Russian Content is an important element of the benefits that the Sakhalin II Project will bring to Russia and in this case, Sakhalin Energy has demonstrated a real success story. The direct benefits in revenues for the Russian Federation alone are estimated to be in excess of $40 billion dollars during the life of the project. The indirect benefits are numerous; they include improvements to the Island’s infrastructure, including the development of hydrocarbon transport and processing infrastructure that will assist in stimulating further oil and gas developments on the Sakhalin shelf.

The Sakhalin II Production Sharing Agreement (PSA) defines Russian Content in terms of manhours worked and volume or weight of materials/supplies. According to the PSA, Sakhalin Energy must use its best efforts to achieve a 70 percent target for Russian Content over the life of the project.

The PSA also states that Sakhalin Energy must show preference to Russian enterprises when awarding contracts, provided that they are duly qualified and meet the basic criteria for a competitive bidding process as described in the PSA.

Sakhalin Energy and its partners in Federal and Regional Government, working together in a Joint Committee, have made tremendous efforts to promote the involvement of Russian companies in the Sakhalin II Project. The last estimate shows that for work completed since project start in 1996 to the end of 2003, Sakhalin Energy has achieved 70 percent Russian Content for Russian man-hours (20 million man-hours), and 74 percent in materials and equipment (720,000 tonnes). In monetary terms, this is 43 percent of money spent, equivalent to $1.4 billion.

Most major contracts for the Phase 2 Project have now been awarded and are in progress. The cumulative value of these contracts is $7.0 billion. Sakhalin Energy’s efforts to maximise Russian Content through the tendering process have yielded impressive results for Phase 2. Approximately three quarters of awarded contracts qualify as Russian Content as defined by the PSA: 71 million man-hours (77 percent) and 2.4 million tonnes of Russian materials and equipment (74 percent). In monetary terms, these contracts are worth the equivalent of $2.8 billion, or 40 percent of the total contract price (total expenditure).

A number of factors have contributed to Sakhalin Energy’s success in Russian Content in the Phase 2 Project to date, at both the design and procurement stages.
At the stage of Front End Engineering Design (FEED), Sakhalin Energy’s non-Russian contractors worked with Russian design institutes to ensure that Russian capabilities and standards were accommodated. They retained native Russian speakers to facilitate communication with Russian partner companies. Russian design institutes also participated in the detailed design stage, although their involvement was not so significant as during FEED because of the nature of the design process, which relied heavily on 3-D computer-aided design.

In several instances, Sakhalin Energy and/or its design contractors made specific provisions for Russian industry, for example by stipulating that the dry dock for construction of the concrete-based gravity structures for the offshore platforms should be in Russia. The result is that Russian industry involvement in this element of the project is anticipated to be above 80 percent in man-hours and supply of materials, and about 50 percent in monetary terms. The decision to “stick build” the OPF piece-by-piece on site rather than use prefabricated modules is another such example. The latter is typical in remote, challenging working environments such as Alaska, and would have allowed better control of the schedule. It would, however, have severely limited the possibilities for Russian contractors to participate as Russian industry has very limited prefabrication capability. Instead, Parsons, the designer of the OPF, chose to accept the schedule risk associated with piece-by-piece assembly in order to maximise the possibilities for Russian components and labour.

The Vendor Assessment Programme and pre-qualification exercises helped to attain the maximum achievable level of Russian Content in contracts. High, but realistic Russian Content targets were incorporated in invitations to bid. Prospective bidders were also required to present plans for Russian Content in their tenders, and these plans were considered in tender evaluation.

In addition, Sakhalin Energy also held coaching seminars for potential Russian bidders, and allowed them extra time to prepare and submit bids. It held on-site visits and face-to-face clarification meetings with Russian companies, and provided extensive support to them after they had secured bids. For example, it worked closely with Severstal on quality control and assurance to ensure the right quality of steel was obtained.
Sakhalin Energy has also supported the development of a pipeline coating facility in the Russian Far East. This greatly increased both potential and actual procurement volumes from Russian enterprises in this region. A world-class facility of this type in the region is a strategic asset for the future: it can compete for contracts on new pipeline projects in the Russian Far East at a time when gas infrastructure needs to be developed. It can also compete in international markets, particularly in the Asia-Pacific region.

Sakhalin Energy undertook an intensive campaign to engage Russian potential suppliers of equipment and services for the Phase 2 Project. In all, 460 vendors/contractors were nominated by the Joint Committee, or considered for a total of 95 tenders valued at $900 million.

All of this work promoted a high level of Russian Content in bids. The result: Sakhalin Energy’s Russian Content targets were attained in the contracts that were awarded in 2003.

Sakhalin Energy’s performance to date demonstrates that it is well on track to achieve its targets in Russian Content over the life of the project. It has already achieved high Russian Content targets in the early construction years, and has a clear strategy for the development of Russian Content and Russian industry utilisation in the future. Sakhalin Energy is confident that with the continued support of the Russian Party and the Joint Committee, it will meet the Russian Content requirements of the PSA, and possibly even exceed them.

Russian Content will play a significant role in delivering benefits to Russia from the Sakhalin II PSA. Jobs for Russian people and contracts for Russian industry are elements of a broad array of project benefits. These range from currency revenues and gas supplies to the Russian Federation, to developments in oil and gas infrastructure that can transform the Sakhalin region into an economic hub of the Far East. Sakhalin Energy is conducting an analysis of the economic and socio-economic benefits of the project and will report on these in 2004.
Meeting the challenge – Social responsibility

Sakhalin Energy is committed to meeting the challenge of social responsibility. As part of the Environmental, Social, Health Impact Assessment for the Sakhalin II Phase 2 project, an extensive Social Impact Assessment was produced meeting international standards - major company policies and procedures to address the management of social issues are described in this review.

In efforts to ensure we are socially responsible the Company conducts Social Impact Monitoring and Public Consultation Programmes to maintain good relationships with the local communities; assists local residents to get employment with the project; resolves issues relating to settlement of claims and grievances; and assists with preserving objects of cultural and historical heritage on Sakhalin.

In mid 2003, Sakhalin Energy created a team of Community Liaison Officers (CLOs) and embedded them in regions and communities across Sakhalin Island. They play a key role in implementing social impact mitigation measures that may be required as a result of Phase 2 construction activities. In all, Sakhalin Energy has opened eight CLO offices across Sakhalin in communities impacted by the Project. These offices are used by both CLOs, and by project teams to meet with local authorities, local residents and various community groups. They also act as a centre for distribution of information related to Project construction. These offices are located in Korsakov, Kholmsk, Makarov, Poronaysk, Smirnikh, Tymovsk, Nogliki, and Val.

A Community Liaison Organisation is typical for large oil and gas projects. The key task of such groups is to be the project’s eyes and ears in communities. In addition to this, CLOs will also maintain a link between the Project and community during the entire construction stage.

Sakhalin Energy’s CLO specialists have all undergone a special three-month training course. The majority of the CLOs are embedded in the project teams working up and down the island to ensure they maintain a close link with the construction activities and the communities in which the work is being undertaken.

The CLO’s key responsibilities include:

- Addressing community grievances in line with the Company Grievance Procedure;
- Organising regular information meetings with members of the public, local authorities, enterprise heads, media representatives and other key figures in affected communities;
- Distributing information on Project status in various districts;
- Clarifying the Company policies and providing key community groups with information on different stages of Project implementation;
- Identifying and tracking actual Project impacts on the communities, as well as tracking population attitudes/expectations associated with the Project implementation and providing feedback to the Company;
- Identifying opportunities for community sustainable development;
- Providing information on Project employment and assisting in resume preparation;
- Accumulating information to develop local employment databases, contact information, etc.;
- Assisting with interface issues between population and contractors/subcontractors;
- Monitoring the relationship between contractors/subcontractors and the local population;
- Monitoring the local media;
- Developing and maintaining relationships with the media;
- Informing (by developing reports) concerned Sakhalin Energy specialists, different Project divisions as well as contractors on existing economic factors, current issues and concerns expressed by communities.

During 2003, the CLO group conducted hundreds of meetings with local authorities who required information on project construction, they worked with the Sakhalin Energy Approvals Department to help solve a number of land acquisition/approvals needs in rural locations and they met on many occasions with local populations and remote communities. In many areas, the local CLO has become the key person that local people contact on matters of supplying general project information, grievances, complaints or any needs in connection with Project activity.

In several communities, CLOs have played a significant role interfacing between contractors, the local administration and the community for resolving issues and complaints.
In addition, the CLOs have worked closely with the contractors and subcontractors and local employment offices to help local people obtain jobs. More than 200 local recipients had the chance of employment due to information and advice provided by CLOs on application/resume preparation in 2003.

Sakhalin Energy is also involved in supporting the people of Sakhalin through funding and sponsorship. For many years Sakhalin Energy has actively supported educational and cultural projects for Sakhalin youth, indigenous people and the wider community. This support includes assisting the Regional Children’s Library, providing scholarships for higher education, assisting the local Museum and supplying schools with sporting and educational materials. In addition, Sakhalin Energy has supported the ‘Young Talents of Sakhalin’ programme for the past 10 years. This programme awards annual scholarships to young artists and musicians.

**Sustainable Development**

The size and complexity of a project like Sakhalin II by its very nature contributes to the sustainable development (SD) of Sakhalin Island – through the jobs it provides, the business it brings to existing industry and the development of new businesses, the introduction of new technology and new ways of working and the contribution it makes to the overall economy of the island.

But Sakhalin Energy is seeking to contribute further to SD by looking for ways to help people help themselves into the future. In a unique move the Company organised a contractor set-aside fund, where 0.5 percent of the value of many of the major contracts has been set aside to be used for SD projects. The Company also has a social investment fund – currently running at $400,000 for 2004 and planned to rise to $0.5 million in 2005 – for grants and sponsorships.

Within the Company, we have set up a Sustainable Development Council to look for new and innovative ways to promote SD. The Council is chaired by the Phase 2 Project Director, and has representatives of all the Project’s major facilities, and the social and external affairs departments as members. Using a set of defined criteria, this Council will manage these funds – which in total add up to about $20 million – so that they are used for SD projects that will bring lasting benefits to the island’s communities.

As an example, some of the projects already underway are a conservation project for wild salmon, an initiative to help people produce better resumes and so improve their chances of getting a job, and a scheme to help improve the teaching of English on the island. Additionally, up to $8 million has been earmarked to provide training schemes that will enable people to find jobs in the island’s growing oil and gas industry and the businesses required to service the industry.

Sakhalin Energy is committed to making a contribution to island’s social and economic health for years to come, and the SD initiatives we are undertaking will help us to achieve this.
Meeting the challenge - River Crossings

Sakhalin Energy’s Phase 2 pipeline route will cross almost 1,100 watercourses, which mostly comprise small brooks and streams, but also include a number of economically significant and environmentally sensitive rivers. Sakhalin Energy recognises the importance of these watercourses to the ecology and local economy of the Island - particularly in terms of salmon fisheries - and is committed to ensuring that the impact of watercourse crossings will be as low as reasonably practicable, and will have only a minor short-term effect on the environment.

The Company has conducted three years of environmental baseline data collection and survey work along the onshore pipeline route to assess the potential impact of pipeline crossings on the environment and, in particular, our potential impacts to salmon resources. The Company is committed to minimizing impacts to watercourses with fisheries importance through a combination of:

1. Construction timing to avoid major salmon runs, migration, and spawning,
2. Application of international stream crossing standards to minimize, as much as is reasonably possible, project related suspended solids loading.
3. The use of high technology horizontal directional drilling to install pipelines underneath rivers with very high importance for salmon, which ensures such rivers are not disturbed.
In addition to Sakhalin Energy’s work to physically minimize project related impacts, Russian regulatory requirements include a system of damage assessment and monetary compensation. These calculations were carried out in conjunction with SakhNiro, the fishery regulatory agency at the regional level, and Tsuren at the Federal level. The value of the resource is established using set methods, reviewed and approved by Russian authorities and paid into a government fund, which by law must be used to improve the fishing industry.

The Company has consulted with lenders and NGOs (Wild Salmon Centre and Sakhalin Environment Watch) and is currently completing a document to describe the technical and environmental considerations for river crossings, mitigation methods and how Sakhalin Energy will endeavour to protect Sakhalin Island watercourses during construction of the pipelines. The report will be ready in later 2004.
Meeting the Challenge – prevention, preparedness and response

As part of our commitment to sustainable development, we take the issue of oil spills seriously. Consequently, Sakhalin Energy has implemented a number of measures to ensure that the likelihood of spills and the potential consequences are kept to a minimum. Our primary goal is prevention of oil spills. This is achieved through the robust design of production facilities, and sound maintenance and operating procedures. Sakhalin Energy is committed to the implementation of high international standards and best practices for the technical integrity of its facilities.

In case a spill does occur, the company maintains an efficient and effective Oil Spill Response (OSR) organisation and resources. The OSR organisation has a clear and tested chain of command, and clearly identified roles and responsibilities. A thorough training programme ensures that the response teams have the right skills, and that all potential team members are familiar with OSR procedures.

Substantial equipment resources are also on hand to tackle a spill. At the existing Vityaz complex, these are held aboard a dedicated OSR vessel, the “Irbis”. This vessel is on standby 24 hours a day in the field next to the offshore production facilities during the production season. It has a trained crew, three containment and recovery systems and two on deck vessels to assist in boom deployment. The “Irbis” is supported by additional vessels on site. Shoreline protection and cleanup equipment is located at Nogliki. This equipment is designed primarily to be deployed to protect bay mouths along the east coast of Sakhalin. The equipment is capable of being airlifted by helicopter to a spill site in case road conditions make travel difficult.

Both marine response and shoreline response equipment and personnel are deployed and exercised prior to each production season. Additional desk-top and field exercises are held throughout the year.

In 2003, Sakhalin Energy participated in two regional exercises. The first of these was a desktop exercise in June, and was managed by Emercom. The second, in August, was part of a major federal exercise undertaken by the Ministry of Defence and Ministry of Transport. Sakhalin Energy marine and shoreline resources (both teams and equipment) were fully and successfully deployed as part of this exercise.
The high standards set for Phase 1 OSR will be maintained for the Phase 2 facilities. Sakhalin Energy intend to deploy permanent OSR equipment and resources at each asset, and at strategic locations along the onshore pipeline route. Drop off points will be identified along the coast and pipeline route for the air-transportation of OSR equipment and teams to ensure that a rapid response can be achieved in the unlikely event of a spill.

Phase 2 Oil Spill Response Plans are to be extensively revised and updated through 2004 and 2005. Field surveys are planned for the summers of both years, and these will focus on general spill response planning and identification of any special strategies required for particular resources (e.g. rivers and streams). Data obtained will be added to the Sakhalin Energy Geographical Information Systems (GIS) based sensitivity maps. These already cover the coastal and lagoon areas adjacent to the Phase 1 facilities.

Sakhalin Energy’s OSR strategies are based on the principle of Net Environmental Benefit Analysis (NEBA), so as to ensure that the impact of any oil spill, and subsequent cleanup, on the natural environment is kept to a minimum. Strategies have also been, and will continue to be, developed with reference to the modelling of potential oil spill scenarios and the sensitivity maps.

Sakhalin Energy’s OSR capability is compliant with, and integrated with, the Sakhalin Oblast “Unified Command” system. This is based on a three tiered system whereby the resources deployed during a response, and the level of control, will vary according to need. This generally reflects the size of the spill, proximity to sensitive resources, oil slick behaviour and the prevailing climatic and hydro-meteorological conditions. The tiered approach enables a flexible build up of resources at regional, national and international levels, as required. For higher tiered responses, Sakhalin Energy can call upon the substantial resources of international response agencies (OSRL, EARL). Sakhalin Energy also has a memorandum of Understanding with the Marine Disaster Prevention Centre (MDPC) of Japan. Through this, MDPC agree to respond to any Sakhalin II related spills that may pass into Japanese waters.

Sakhalin Energy will continue to be involved in regional OSR workshops, and to foster regional OSR cooperation.
Meeting the Challenge – minimising impacts on the Western Gray Whale

Sakhalin Energy has been involved in the monitoring and research of the Western Gray Whale (WGW) since 1997. One of the principal aims of these studies is to gather sufficient data to allow the company to assess potential impacts and then develop effective mitigation measures to minimise impact to WGW. Since then, Russian and US scientists from a number of organisations and research institutions have carried out aerial observation surveys, vessel-based photo-ID studies, vessel-based and shore-based behaviour observations, prey studies and acoustic studies. As a result of the Sakhalin Energy and Exxon Neftegas Limited (ENL), operator of the Sakhalin-I PSA license area, jointly funded research programmes, details of the WGW population and its lifecycle offshore of Sakhalin are better understood. For instance, until recently the only known feeding ground of the WGW was a nearshore feeding ground in Piltun Bay. However, continued research undertaken by Sakhalin Energy has revealed a second offshore feeding area, which will now also be studied.

To date the ongoing Sakhalin Island WGW Monitoring and Research Programme has shown that the whales haven’t been harmed as a result of company operations in the area, and they continue to return annually. Current estimates from the research data indicate a population size in the Piltun Feeding Area of about 100 plus individuals.

In 2003 photo ID studies identified at least 10 WGW calves, which is above the birth rate witnessed in previous years. The WGW gives birth to a new calf on average once every three years. This coupled with the low population size of the whales, means that fewer new calves are expected this year but it was encouraging to see such a large number of calves in 2003.

Sakhalin Energy also announced in 2003 that it would support the establishment of an International WGW Program to investigate the species across its range and to promote data sharing and knowledge exchange of all WGW research. In late 2003 and early 2004, meetings were held in London, Tokyo, Vladivostok and Seattle. A variety of stakeholders from the international and Russian scientific communities, as well as representatives of non-government organisations attended the meetings to discuss the company’s proposals and provide feedback. Specifically, Sakhalin Energy asked for input regarding the structure of an international program. The international program structure will be developed using feedback received from these meetings, with the goal of the program being to contribute to the long-term conservation and increased understanding of this species.

Sakhalin Energy has developed a comprehensive WGW Protection Programme based on sound scientific research, which contains a range of mitigation measures to protect the whale during offshore construction and operational activities. This programme is regularly reviewed to take account of new information.

Sakhalin Energy made a decision in April 2004 to reschedule offshore pipeline construction activities at Piltun to allow additional studies to be undertaken, with external scientific input, and the consideration of alternative installation methods and possible pipeline routes to shore.

The decision to reschedule work in 2004 was taken as a result of detailed ice-scour studies which indicated the Piltun offshore pipeline needed to be buried more deeply than originally anticipated, and thus could potentially cause more disturbance to the Western Gray Whales during.

This decision is clear evidence of the Company’s commitment to ensure that the potential impacts from its activities are minimised.
Sakhalin Energy will continue to further develop and refine its mitigation measures and any changes or updates to the mitigation measures proposed by Sakhalin Energy will be announced publicly.

Sakhalin Energy has made available on its website all of its reports on the WGW and marine mammals and the WGW Protection Programme. Recently all 2002 WGW study reports were put on the public website (www.sakhalinenergy.com/environment/env_whales.asp). Also Sakhalin Energy aims to have the 2003 WGW studies reports uploaded on the website in 2004.

Sakhalin Energy and ENL continue to cooperate to assess and address cumulative impacts from industry development, and to avoid impact on the whales resulting from multiple groups performing duplicate research. The joint Sakhalin Energy and ENL WGW Monitoring and Research Programme for 2004 will contain several components, such as WGW distribution, prey studies, photo-ID studies, behavioural studies, and acoustic studies as discussed below:

**WGW distribution**

Information on the distribution and relative abundance of WGW in relation to offshore activities planned by Sakhalin Energy is being collected through aerial, vessel-based and shore-based surveys. The aerial surveys allow the detection of regional-scale spatial “shifts” of gray whales. This information is important to Sakhalin Energy for planning future exploration and production programmes, and for evaluating existing mitigation and protection measures for WGW.

Systematic vessel-based surveys complement the aerial surveys of the area. Vessel-based surveys provide more direct data on the numbers of feeding gray whales and allows the scientists to accurately count and observe whales.

The objective of the onshore based survey programme is to provide additional information on the distribution, abundance, and behaviour of WGWs relative to one of the known coastal feeding areas (Piltun Bay feeding area), and near areas of particular interest to industry, e.g., planned offshore structures or proposed pipeline routes.

**Prey studies**

The main reason that WGW are present along the north east coast of Sakhalin Island is to feed. Within and between season movements of WGW in the feeding areas along the north east coast of Sakhalin Island may be responses to changes in the distribution and abundance of their prey within the area. Therefore, studying the distribution and abundance of their prey may help to better understand the distribution patterns of WGW.

**Photo Identification Studies**

Photo identification methods have proven extremely useful for WGW studies, because individual whales have distinct marks along their sides, backs, and flukes. Photo identification surveys provide information on the annual return and site fidelity of individual WGWs, help define the local distribution and movement patterns of individual whales, establish the population size, survival, productivity, and reproductive intervals of the population, and assess the physical condition of individual whales summering off Sakhalin Island.

**Behavioural Studies**

The objectives of the WGW behaviour study are to ascertain baseline feeding and other behaviours, and behaviours potentially affected by industrial activities. The study is being carried out from shore stations along the coast of the WGW Piltun feeding area. Behaviour is being studied in relation to activities, noise levels, and other factors measured in the field.

**Acoustic Studies**

Acoustic monitoring is being carried out during 2004, including ambient noise monitoring and transmission loss experiments near the Piltun and Offshore feeding areas that will enable assessment of potential cumulative effects. The study is being conducted in conjunction with the vessel-based WGW prey, photo-identification and behavioural studies.

This joint Sakhalin Energy and ENL WGW Monitoring and Research Programme for 2004 is comprehensive, and will build on the work and expertise developed by the scientists involved in the project over the past several years. It is the most comprehensive and largest whale project funded solely by industry for whales anywhere in the world. Both ENL and Sakhalin Energy will be involved in overseeing the work so the information generated can be effectively incorporated into implementation of the respective projects.
Meeting the Challenge – Adopting Responsible Disposal Strategies

Sakhalin Energy has developed a responsible waste management strategy. Central to this strategy is an integrated approach to the management of waste, which prioritises the minimisation, re-use and recycling of waste wherever practicable, and the safe disposal of remaining materials as close to the source as possible. This approach is in accordance with international best practice, and complies with Russian Federation regulations.

The largest volume of waste to be generated in Phase 2 will be during the construction period (2002-2008). Those who produce the waste will be responsible for its management and disposal and will have a duty of care for the waste. The system will track waste generation, classification, transport, storage, treatment and disposal.

As a commitment to the management of waste as close to source as possible, each project facility (e.g. the two offshore platforms, the onshore processing facility, the liquefied natural gas plant etc) will have a specific waste management plan for the construction and operational phases of the project.

Rather than create additional waste disposal sites on Sakhalin Island, Sakhalin Energy will invest in the improvement of existing facilities. The Company has entered into a cooperative agreement with the Sakhalin Oblast Administration, under which Sakhalin Energy will provide funds for the implementation of a programme to upgrade three existing landfill facilities spread over the Island. These landfill facilities will continue to be utilised for regular municipal waste, but will also be used for the disposal of non-hazardous waste generated by the project. Two upgraded landfills will be used during the whole project lifetime for disposal of non hazardous waste for Company and municipality.

In addition to the upgrades at existing waste management facilities, Sakhalin Energy will also assist the Sakhalin Oblast Administration in the development of a hazardous waste facility. Such a facility does not yet exist within the Sakhalin Oblast. A preliminary location for this hazardous waste facility has been selected. Detailed surveys are being finalised this year and also an EIA is being developed and sent for approval to the local authorities. In this way Sakhalin Energy is pursuing a cooperative approach with local authorities to improve waste management on the island, which will be of significant benefit to local communities and the environment.