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For Sakhalin Energy and the entire oil and gas industry in Russia, 2009 represents a true watershed. Many years of hard work brought spectacular results in that one year. Russia’s first LNG plant on Sakhalin Island came on-stream, a tremendous accomplishment for Sakhalin Energy. The start-up of the plant also opened up world markets to Russian liquefied natural gas. This event, central to the Company’s development, transcends our corporate history: the launch of the LNG plant strengthens Russia’s position as a global energy supplier.

The Company’s first priority is human safety, and we are pleased to report outstanding results here: last year there was not a single fatality, and the overall lost time incident rate dropped precipitously. All year we also maintained high standards of environmental protection and safety during production.

Last year the entire massive infrastructure of Phase 2 went into operation. Sakhalin Energy started up the first LNG Train and then the second Train began operation, according to plan. Our drilling programme continued on schedule. Operations and facilities were certified as compliant with environmental management standards. We also completed an important technical innovation, a smart water injection well, which started operating on the Piltun-Astokhskoye field.

The Company can take pride in its production achievements last year. Even under the challenging conditions of a commissioning year, we far exceeded our production targets: 11% more oil and 47% more LNG were shipped than we planned.

Despite the global financial crisis, Sakhalin Energy not only posted a strong economic performance last year, the Company also secured additional project financing. The loan agreement, insured by NEXI, an Export Credit Agency owned by the
Japanese government, was a vote of confidence by international banks in our ability to implement a world-class project.

Meeting our commitments to customers and shareholders, continuously delivering oil and gas, launching innovative technologies, operating safely and reliably, maintaining the highest environmental standards, and caring for people – these are the achievements for which the Company can be proud, and that command the centre of our attention. We also aim to be a good neighbour to Sakhalin communities and contribute to the social development of the island. Our social programmes, funded by the shareholders, promote sustainable development in the region. We devote special attention to the island’s future, so many of the Company’s social programmes are dedicated to the younger generation of Sakhaliners, in whom we place our trust and pin our hopes on. They are the future of Sakhalin and our Company.

The year 2009 was full of anniversaries. Two anniversaries were noteworthy: it is 10 years since the first Russian oil was produced by the Molikpaq platform (the first ice-resistant offshore platform in Russia) and 15 years since Sakhalin Energy was founded. Over the years, Sakhalin-2 has become a major presence in the local economy and in the national oil and gas industry. Today, Sakhalin Island is steadily emerging as a new global energy hub.

Sakhalin Energy made a step change in 2009. What we used to call a “project” has evolved into a new oil and gas production system. The Company has many years of operations ahead, when it must ensure the new oil and gas infrastructure functions smoothly, and production and supplies to customers are continuous. To achieve these new business objectives, we re-formulated Sakhalin Energy’s mission and vision statements. Our goal is for Sakhalin Energy to be the premier energy source for the Asia-Pacific. Sakhalin Energy is committed to being a leading energy supplier, recognised for its operational excellence, reliability and safety. Our role is to ensure we extract and deliver hydrocarbons profitably and in an ethically, socially and environmentally responsible manner. The proposed goals and objectives have dictated the key targets that were set in the company’s Journey Book – business plan for 2010-2015, approved by the Committee of Executive Directors. The focus of the plan is how to achieve maximum production efficiency, reflecting our ambition to be the leading company in areas which are critical to our success.

We can all be very proud of what we have achieved thus far. As Russian President Dmitry Medvedev said, the project “will make a very large contribution to the development of Sakhalin, the prosperity of the entire Far East, and to the energy security of the Far East and the whole world.” This places on us a great responsibility. We accept this responsibility, and we will continue to work hard to earn the confidence of our shareholders and customers, and the leaders and citizens in the country where we operate.

Andrei Galaev
Sakhalin-2 is one of the world’s largest projects. It was designed to produce offshore oil and gas, liquefy the produced natural gas and transport and sell crude oil and LNG in the international market. Its license areas are located in the Sea of Okhotsk, off the north-eastern coast of Sakhalin Island. Geography determines the destinations of Sakhalin supply: most of the LNG and a blend of crude oil are shipped to the rapidly-growing energy markets in the Asia-Pacific region. The operator, Sakhalin Energy Investment Company Ltd., marked its 15th year in business in 2009.

June 2009 marked 15 years since the Sakhalin-2 production-sharing agreement was signed.

The Sakhalin-2 project opened up the Asia-Pacific market to Russian oil. In 2009 Sakhalin Energy celebrated its 10th anniversary of supplying oil.

The two offshore fields of the project are located approximately 15 kilometres from the coastline of the island at a water depth of 28 metres to 48 metres. The Piltun- Astokhskoye field produces mostly oil, while the Lunskoye produces gas and condensate. The combined reserves of the two fields represent about 9% of the total reserves of the Sakhalin continental shelf.

Development started in the Astokh area of the Piltun-Astokhskoye field in 1996. Sakhalin Energy began producing oil from the
Molikpaq, the first ice-resistant offshore platform in Russia, in 1999. Launched in 2003, Phase 2 was an integrated, full-scale development of the two fields. It is one of the largest oil and gas infrastructure project in the world.

The main production facilities of Sakhalin-2 are:
• the Molikpaq platform (PA-A) produces oil and condensate from the Astokh area of the Piltun-Astokhskoye field;
• the Piltun-Astokhskoye-B platform (PA-B) produces oil from the Piltun area of the Piltun-Astokhskoye field;
• the Lunskoye-A platform (LUN-A), the first and only offshore gas platform in Russia;
• the TransSakhalin system of onshore and offshore pipelines. The offshore pipelines connect the three platforms to the shore. The onshore pipelines run almost the entire length of the island – from the north to the LNG plant and the Oil Export Terminal (OET) in the south;
• the Onshore Processing Facility treats gas and condensate from the platforms for transport by pipeline to the south of the island;
• the Booster Station №2;
• the Oil Export Terminal with a Tanker Loading Unit (TLU). TLU is installed in Aniva Bay 5 km from the shore;
• the first LNG plant in Russia*. Sakhalin-2 is one of the most technically sophisticated projects ever achieved in the global oil and gas industry. The project activities were envisioned on a grand scale, requiring massive investment.

The island contains unique ecosystems. The climate is harsh. There was no oil and gas infrastructure beforehand. What is more, the project is located far from major business centres. All this meant the Company needed the best-available industry expertise, the latest technologies, and the most effective management solutions. The challenge was successfully met, thanks to the unique partnership of Sakhalin Energy’s shareholders.

The global community has recognised Sakhalin Energy’s achievements in environmental safety. In November 2009, our Oil Export Terminal won the Environmental Safety award in the 2nd International Oil Terminal contest.

* The LNG plant and the Oil Export Terminal together form the Prigorodnoye complex. The territory of the complex hosts Russia’s first specialised marine port for shipping oil and liquefied gas.
The shareholders of Sakhalin Energy are OAO Gazprom (50% plus one share), Royal Dutch Shell (27.5% minus one share), Mitsui (12.5%) and Mitsubishi (10%). These four major global companies have an enormous wealth of knowledge, experience, and expertise in constructing and operating oil and gas infrastructure and in producing and transporting hydrocarbons.

Sakhalin Energy's day-to-day management functions are handled by the Committee of Executive Directors (CED). CED members include heads of the Company's directorates, which have authority over the associated activity areas.

Committee of Executive Directors
(as of 01.04.2010)

Andrei GALAEV,
CEO

Tim HAKE,
Production Director

Erwin NIJSSE,
Financial Director

Sergey DUBYNIN,
Legal Director

Valery CHOLOVSKIY,
Technical Director

Sergey ANTONOV,
HR Director
Corporate milestones in 2009
Sakhalin Energy’s main priority is labour safety. In 2008, Sakhalin Energy identified the key risks that pose a hazard to life and introduced Life Saving Rules. Compliance with these rules is obligatory for everyone involved in Sakhalin-2 operations. The results of the focused safety effort were quick to manifest themselves: in 2009 there were no workplace fatalities, while the total number of lost-time incidents fell considerably.

To encourage and motivate employees and contractors to be highly responsible and committed to workplace safety, the CEO of Sakhalin Energy created a special monthly award. The award is given to individuals who have exhibited model actions or behaviours that show leadership and a pro-active mindset in regular and systematic efforts to improve workplace safety.

Sakhalin Energy also recorded another significant safety achievement in 2009: road accidents involving vehicles of the Company and its contractors dropped sharply. By late 2009, close to 500 motor vehicles involved in the project operated for more than 10 months free of road injuries. On 23 February 2010, the Company entered its second year without injuries from road accidents.

To chart the way forward on how to further install a culture of workplace safety, the Company conducted a survey of personnel in 2009. The results of this survey formed the basis for a 2010 action plan on labour safety.
Sakhalin Energy started producing gas from the Lunskoye field in January 2009. Lunskoye-A is the first platform to produce offshore gas in Russia.

LUN-A, the first offshore gas platform in Russia, was installed in 2006 at a water depth of 48 metres.

LUN-A is the first platform in the world equipped with friction pendulum bearings, which protect the platform from seismic loads in the event of an earthquake. The platform is designed for year-round operation in a climate with ice, wind, waves and extremely low temperatures. A similar design was used in PA-B platform.

By the end of 2009, five of the wells in Lunskoye field were producing gas. These are “big bore” wells, special technology designed for prolific reservoirs like Lunskoye that also have a very high gas flow rate. These are the largest producing gas wells in Russia.

Gas produced from LUN-A is pumped through a multiphase pipeline to the Onshore Processing Facility (OPF) installed seven kilometres inland from the LUN-A pipeline landfall.
On 18 February 2009, the first LNG plant in the Russian Federation was inaugurated in a ceremony on Sakhalin Island. Russian President Dmitry Medvedev, who addressed the audience, described the plant as “one of the most innovative, state-of-the-art production facilities that meets the highest standards.” Praising the LNG plant and the project as a whole, President Medvedev also said: “Russia is one of the world’s leading gas producers, and I am confident that this new facility will strengthen our potential for supplying gas and Russia’s position as a global energy supplier.”

The high-profile of the guests who attended the ceremony was an indication the launch of the LNG plant was a truly global event. About 500 important dignitaries were present during the ceremony. It was President Medvedev’s first visit to Sakhalin since assuming office. The presence of Prime Minister Taro As of Japan marked the first visit by a Japanese leader to Sakhalin since the end of World War II. Among the honorary guests were Prince Andrew, HRH Duke of York (UK); the Netherlands’ Minister for Economic Affairs, Maria van der Hoeven; executives of Gazprom, Shell, Mitsui and Mitsubishi; high-ranking Russian and foreign government officials; and business leaders.

Construction of the LNG plant took five years. About 10,000 workers and engineers from nearly 40 countries were employed during construction, which started in August 2003. The plant was designed and built by CTSD, an international consortium comprising Chyoda Corporation and Toyo Engineering of Japan and Nipigazpererabotka and Khimenergo of Russia.

The LNG facilities occupy a site of 490 hectares. The LNG plant consists of two gas liquefaction trains (each capable of producing 4.8 million tonnes of LNG per year), an LNG jetty, a chemical laboratory, a central control room, and LNG tanks. Gas
from the Lunskoye and Piltun-Astokhskoye fields is piped to the LNG plant after processing by the OPF for transport. The world class Lunskoye field is the main source of gas. In addition to its high heating value, Sakhalin gas is also known for its low level of impurities, and is considered a “clean gas”.

Dmitry Medvedev: The creation of this facility will deepen international cooperation, which is especially important to us today.

The LNG plant removes any water and trace impurities from the gas to prevent freezing or damage to infrastructure. The gas is then cooled to around –160°C, when it turns into a liquid, occupying about one 600th of its original volume and remaining liquid at ambient pressure. The Sakhalin-2 LNG plant uses Dual Mixed Refrigerant (DMR) technology that Shell developed for this project. It is the world's most advanced technology, saving energy by taking advantage of Sakhalin's cold climate.

LNG produced by two trains runs to LNG tanks, each with a capacity of 100,000 m³, for further export by special tankers. Due to the high level of automation of the LNG plant, a team of only 300 people is needed to operate it at the design capacity.

More than 100 journalists covered the ceremony representing more than 60 Russian and international media.
The facilities of Phase 2 were essentially completed at the end of 2008. In parallel, the process of gradually starting them up and phasing them into operation began the transition to a fully integrated functioning of the system.

**Transfer to full operation**

The completed facilities under Sakhalin-2 Phase 2 underwent testing in 2009. The test operating mode is required to tune and conduct final checks on all systems and equipment before transferring them to full operation.

In parallel, Russian authorities carried out very thorough checks of the facilities. The final inspections by state body Sakhalin Rostekhnadzor covered all the major facilities of the Phase 2 project, including: PA-B and LUN-A platforms, OPF, offshore and onshore pipelines, the LNG plant, OET, and pipeline maintenance depots. Sakhalin Rostekhnadzor issued conclusions certifying the
completed facilities complied with technical standards, other regulations, and the design documents. In February 2010, Sakhalin Rostekhnadzor issued an order approving the certificate of compliance for the onshore pipelines.

In May 2009, the Company received an award for the best innovative offshore project from the Board of Directors of the Offshore Technology Conference, a world forum for oil and gas technologies.

Issuing the certificates of compliance allows the Company to apply to state authorities for the necessary approvals for the full operation mode.

In addition to the positive outcome of the state checks, all our facilities were certified to be in compliance with the requirements of the ISO 14001:200 standard for environmental management systems.

**Molikpaq platform (PA–A)**

The Molikpaq platform (PA-A), installed in 1998 in the Astokh feature of the Piltun-Astokhskoye field, was the first fixed offshore oil-producing platform in Russia. It began year-round operations during the winter of 2008-2009. Before switching to year-round production, all oil from Molikpaq was produced seasonally.

PA-A reached its design level for oil production in 2009. Molikpaq is currently operating 14 oil production wells, four water injection wells, one gas re-injection well and one cuttings re-injection well.

In July 2009, Molikpaq achieved an important HSE milestone – five years of operating without a lost time incident.
Lunskoye–A platform (LUN–A)

Production of gas and condensate from LUN–A started in January 2009. The big-bore wells drilled from LUN–A are the largest gas wells in Russia. Each LUN–A well produces enough gas to feed a 2 GW power plant. The prolific gas bearing zone of the Lunskoye reservoir and the very high gas flow rate determine the large diameter of wells. Each well can produce up to 10 million m³ of gas per day.

Piltun–Astokhskoye–B platform (PA–B)

PA–B produced first oil in December 2008. By the end of the following year, six oil wells were operating on the platform.

The successful transportation and installation of the PA–B topsides weighing 28,000 tonnes set a new world record in 2007.

The average daily capacity of each PA–B production well is some 10,000 bbls (1.3 thousand tonnes) of oil.

Onshore processing facility (OPF)

The main function of the Onshore Processing Facility (OPF) is the primary processing of natural gas and condensate coming from the Lunskoye field for transport by pipeline to the Oil Export Terminal and the LNG plant. The OPF also includes a 100 MW power generation unit that supplies power to LUN–A.

In January 2009, gas started flowing from the OPF to the LNG plant via the TransSakhalin pipeline system.
LNG plant

The LNG plant was inaugurated on 18 February 2009. LNG train 1 produced first LNG soon after that, and the first LNG cargo was offloaded later on. LNG train 2 started operations in late May. The Sakhalin-2 LNG plant is the sixth-largest LNG facility in the world in production capacity. Sakhalin Energy plans to optimise the LNG production systems, which may allow raising plant capacity by several percent.

In June 2009, the LNG plant received an innovative project award from the Japanese Ministry of Land Use, Infrastructure, Transport, and Tourism.

TransSakhalin pipeline system

The onshore facilities of the project are linked by the TransSakhalin pipeline system, which includes over 300 km of offshore and over 1,600 km of onshore oil and gas pipelines, 104 block valve stations, and five pipeline maintenance depots. There are also two booster stations, one at the OPF and the other about halfway between the OPF and the Prigorodnoye complex in the south of the island.

The oil pipeline was commissioned in late 2008, and the gas pipeline in January 2009. In April, the operation and maintenance services of the TransSakhalin pipeline system were handed over to Sakhalin Energy’s contractor, GazpromTransgazTomsk (GTT). GTT specialists were directly involved in testing and commissioning the pipelines. Engaging GTT in these two tasks allows Sakhalin Energy to tap the wealth of experience of its major shareholder, Gazprom. GTT will also provide maintenance services to Booster Station 2, which will be commissioned in 2010.

Restoring the onshore pipeline right of way (ROW)

Construction of the onshore pipeline involved a range of activities to restore the pipeline ROW, control erosion and stabilise river banks. By 2009, these activities were almost fully completed within the pipeline ROW. High precipitation in the summer of 2009 caused minor landslips and washouts in some parts of the ROW. The heavy rainfall also caused some damage to river banks of the rivers in the Makarov district. An action plan was put in place to repair the damage from the heavy rains. By year end, all high priority repairs of the ROW were completed. Late in the year, winter works on repairs of the river banks in the Makarov district began. A complete survey of the ROW was also carried out at that time to gauge the success of biological reinstatement of the ROW, which included recultivating the grass. The survey revealed some areas requiring recultivation, and a plan was enacted to finish the work in 2010.
Drilling continued in 2009 from PA-B and LUN-A with “zero discharge”, meaning all drilling waste was injected in special cuttings re-injection wells which were completed first. No wells were drilled from the Molikpaq (PA-A) platform in 2009.

As of year end, eight wells were producing in the Piltun area: six producing wells, one dedicated cuttings reinjection well, and one water injection smart well.

As of year end, six wells of the LUN-A platform were in operation, five wells for producing gas and one well for reinjecting cuttings.

A smart well is drilled in the shape of a fish hook. Smart wells substantially reduce field development costs and increase oil production. Thanks to the unparalleled skills of the drilling crew and impeccable coordination, the drilling time of the smart well fell from a planned 77 days to a record 41 days.
Implementing plans to produce and export hydrocarbons

Crude oil

Once the PA-B offshore oil platform went into operation and the LUN-A platform started gas condensate production, crude oil exports increased. Oil produced from the Molikpaq and the PA-B is blended with gas condensate from the Lunskoye field. Gas condensate makes up 25% to 30% of the crude oil blend. Due to its low sulfur content and high amount of light and medium-light hydrocarbon fractions, this blend of crude is used to produce petrol, kerosene, diesel fuel, and source materials for the petrochemicals industry. The blend also has a low flow threshold (below –60°C) and requires no heating during transport via pipeline. The blend derives its name from “Vityaz Crude”, which has been in the market for the last decade. The new crude is called Vityaz Blend.

In 2009, the Company produced and offloaded over 5.5 million tonnes of oil and condensate, almost four times the oil export volume the previous year. The Company exceeded its 2009 targets for oil production and exports by 11%.

Buyers of Vityaz include power companies and refineries in Japan, South Korea, China, the Philippines, Thailand and New Zealand.

To transport the oil, Sakhalin Energy secured the tankers “Governor Farkhutdinov” and “Sakhalin Island” under long-term charter contracts with Primorsk Shipping Corporation. In October 2009, the Company signed a long-term charter contract with Primorsk Shipping Corporation for another tanker “Zaliv Aniva”. These three Aframax class tankers, each with a gross deadweight over 100,000 are rated Ice 2 (ICE-1C as per international classification). They are double hulled and equipped with a bow loading facility to load hydrocarbons from the Tanker Loading Unit.

In 2009, Sakhalin Energy surpassed its planned estimates for exports of crude oil by 11% and LNG by 47%.
LNG

In March 2009, the first LNG cargo was offloaded from the LNG plant for Japanese buyers Tokyo Gas and Tokyo Electric. The startup of the second process trains of the LUN-A platform, the OPF, and the LNG plant allowed the Company to gradually ramp up LNG production to 5.3 million tonnes of LNG by the end of 2009, a 47% increase over plan.

Such a successful performance while in the midst of commissioning and start up of a production facility is well above international standards. This impressive feat was achieved mostly due to the detailed and highly efficient coordination of the commissioning effort. The end result has been the reliable operational readiness of all equipment, including the process facilities of the offshore platforms, the OPF and the LNG plant. In addition, the timely commissioning of gas wells, a high drilling rate, and a better-than-expected performance of the reservoir contributed to the success of the effort.

Almost all the annual output of LNG (98% of the LNG produced by both process trains) was contracted for the next 20-25 years. A total of 13 LNG sales contracts were signed, with 10 Japanese companies and the rest with South Korean state-owned company Kogas, Shell Eastern Trading, and Gazprom Global LNG. Thanks to these last two contracts, buyers of Russian LNG last year included India, China, Taiwan, and even Kuwait.

Each “grand” class LNG tanker has four spherical tanks capable of holding 145,000 m³ of LNG. The tankers can break ice up to 40 cm thick. There are only 10 LNG tankers of this kind in the world.

When the LNG plant reaches its design capacity, Sakhalin Energy will be producing some 5% of the world’s LNG output.

Sakhalin-2 LNG is transported to customers by LNG tankers chartered by the Company under long-term charter contracts or by the ships provided by the buyers. Whenever additional cargoes are needed to transport LNG to buyers, the Company charters tankers in the spot market. Three “grand” class LNG tankers were custom-built in Japan to transport Sakhalin LNG: “Grand

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**2009 Sakhalin LNG sales by country (thousand tonnes)**

<table>
<thead>
<tr>
<th>Country</th>
<th>Sales (thousand tonnes)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>2,884</td>
</tr>
<tr>
<td>Korea</td>
<td>1,097</td>
</tr>
<tr>
<td>India</td>
<td>519</td>
</tr>
<tr>
<td>Kuwait</td>
<td>324</td>
</tr>
<tr>
<td>China</td>
<td>260</td>
</tr>
<tr>
<td>Taiwan</td>
<td>187</td>
</tr>
</tbody>
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Elena”, “Grand Aniva”, and “Grand Mereya”. The first two tankers belong to a consortium of Russia’s largest shipping company, Sovkomflot, and Japan’s Nippon Yusen Kabushiki Kaisha. The owner of the third LNG tanker is a Russian-Japanese consortium set up by Primorsk Shipping Corporation, Mitsui OSK Lines and K Line.

Sakhalin Energy sets the most stringent requirements for vessels calling at Prigorodnoye Port to take oil and LNG on board. All oil and LNG tankers must be equipped with special ice detection radar. They must also have additional chain stoppers to secure reliable mooring during cargo-handling operations. These mandatory Company requirements greatly reduce environmental risk and in some aspects are stricter than the recommendations of the International Organisation of Offshore Terminal Owners for loading safety.

To prevent alien species from dissemination with ballast waters from calling ships, the Company developed a procedure for ballast water discharge from LNG and oil tankers in Aniva Bay. Among the measures in the procedure, all calling ships are required to change ballast water offshore, also required by the International Maritime Organisation (IMO). The Company closely controls and monitors compliance with this mandatory requirement. For this task, the Company uses an integrated monitoring system, widely considered to be the most innovative in Russia and the world.

Project financing new phase

In October 2009, Sakhalin Energy and a consortium of international commercial banks signed an agreement for an additional $1.4 billion in Sakhalin-2 project financing. The loan was insured by Nippon Export and Investment Insurance (NEXI), an export credit agency owned by the Japanese government.

The funds are to finance completion of the full scope of the Sakhalin-2 Phase 2 project, including the drilling programme, enabling the project to reach full production capacity.

The project financing for Sakhalin-2 Phase 2 project including this loan now totals $6.7 billion.

Project financing is often used by the oil and gas industry to develop major infrastructure assets. Debt is repaid from the cash flow generated by the asset financed. Securing additional debt financing despite difficult financial market conditions shows the confidence a wide range of business interests and the international financial community have in Sakhalin.

The $6.7 billion financing secured for Phase 2 is the highest ever for a Russian project financing.

Energy, a confidence grounded in the viability of the project and its economic and financial strengths.
Since year-round production and export of oil has begun, the Company has ramped up hydrocarbons production, which has led to a substantial increase in revenue for the Russian Party.

Since start of the project, the amount of Russian industry content has riched over at over $14 billion.

The amount of royalty paid by the Company has increased more than sevenfold to $281 million versus $39 million the previous year.

In total in 2009 Sakhalin Energy contributed $368 million in taxes and other mandatory payments to all levels of the Russian Federation, a 75% increase from the year before.

Given 2009 revenues, overall financial proceeds of the Russian Federation from the project reached $1.299 billion.

The revenues of the Russian Federation in 2009 represent 28% of the total financial gains from the life of the project to date (1995-2009).

Sakhalin Energy paid taxes and obligatory contributions in 2009 into the Sakhalin Oblast budget of 1,792 billion roubles. Some decrease in payments to the regional budget was due to completion of the main construction and reduction in the number of construction personnel.

The contributions Sakhalin-2 makes to municipal budgets generate a large percentage of the total revenue received by the municipalities involved in the project.

% of municipality budget revenue from the project (1st half 2009)

Russian Party receipts from the project ($mn)

2009
368

1995–2008
931

Corporate milestones in 2009
Based on relevant provisions in the Sakhalin-2 Production Sharing Agreement, several years ago the management of Sakhalin Energy set a goal to fill key positions with Russian nationals. At the same time, the Company embarked on a strategy to decrease the total head count of expatriate staff and replace them with Russian personnel.

The Company launched a plan to achieve these goals which included an aggressive effort to train and promote existing Russian personnel, provide a steady stream of junior technical staff, and locally recruit apprentices and new skilled labour.

Since 2003, Sakhalin Energy has run an apprenticeship programme to strengthen local capabilities. So far, the programme has trained 150 apprentices. Many of them are now employed at the LNG plant, the OPF, and offshore facilities. A total of 10 more specialists started training in September 2009.

Training is a core activity of the Company’s human resources policy. In 2009, more than 1,800 people underwent training in educational workshops, training sessions and refresher courses. The Company also teaches skills that are new to Russia, such as how to operate gas liquefaction, which only expatriate specialists could do previously. The first three Russian nationals were certified in this job in early 2010.

With a view to creating a future talent pool, Sakhalin Energy offers practical training opportunities to senior students in Russia’s institutions of higher education. The trainees programme, available since 2000, allows students to apply their theoretical knowledge, gain practical experience, and develop their professional skills. In 2009, 45 students received offers to participate in this programme.
The Company also generously supports talented Sakhalin youths. From 2003, the top graduates of Sakhalin high schools receive education grants at the top institutions of higher education in Russia. In 2009, Sakhalin Energy offered grants not only to the students who had chosen to study oil and gas, but also to those who selected other popular branches of study, such as economics, finance and credit, nanotechnology, information technology, and international economic relations. Students studying oil and gas may undergo practical training and pre-graduation practice with the Company, and the best in the group have the opportunity to work for Sakhalin Energy. In 2009, a total of 12 Sakhalin high school graduates received education grants.
Environmental protection and social responsibility

Sakhalin Energy is committed to minimising any unfavourable impacts the project may have on health, the environment, and the social fabric of the communities of Sakhalin, while maximising benefits to these communities and other stakeholders. Our guidelines in this domain are the Company’s Health, Safety and Environment (HSE) Policy and the HSE and Social Action Plan (HSESAP). Both documents were developed based on the most rigorous international standards and with support of various stakeholders, notably financial lending institutes. The action plan includes several hundred long-term commitments the Company has undertaken on the environmental and social aspects of the project.

Environmental protection

Sakhalin Energy’s key objective during both the construction and the forthcoming long-term operation period is to minimise environmental impact. To achieve this goal, the Company has developed a Biodiversity Action Plan, as well as an Industrial Environmental Control and Local Monitoring Programme, that has already been approved by relevant supervisory and regulatory authorities and is in force.

Biodiversity

The Company submitted in 2009 the final version of the Biodiversity Action Plan to the Biodiversity Expert Group, which comprises representatives of the Sakhalin Administration, environmental and supervisory agencies, federal and regional scientific institutions, and Russian and Japanese NGOs. The Biodiversity Expert Group supported the Biodiversity Action Plan and recommended it for implementation.
Local monitoring

The implementation of the long-term local monitoring programme, approved by the government environmental authorities for the operational phase of the project, began in 2009.

The purpose of the programme is to ensure regular environmental monitoring of the soils, wetlands and vegetation, rivers and riverbeds, birds and mammals, marine biota and bottom sediments. The monitoring is done in and around the main project facilities – pipelines, the LNG plant, the Onshore Processing Facility, Booster Station 2, and offshore facilities, such as platforms, the TLU and the LNG jetty.

Results from early local monitoring show only a minor impact on the environment from the project facilities. Notably, biotic communities in the spawning rivers have successfully recovered after disturbances from construction. The species composition of plant communities around the project facilities have remained practically unchanged, and benthos in local marine ecosystems are now restored. Monitoring results are the basis for new approaches toward the ongoing reinstatement of the right of way (ROW).

Monitoring wetlands

The wetlands of Sakhalin have a unique value to the natural environment of Sakhalin. The wetlands absorb precipitation and feed water to streams and rivers, maintaining the surface water balance, and are therefore very important for migrating and spawning salmon. It is necessary for Sakhalin Energy to make sure construction of the pipeline has not affected these fragile ecosystems. The Company, pursuant to its obligations before the shareholders, monitors the reinstatement of wetlands after the construction phase of the project, and looks for any long-term impacts caused by the construction or presence of pipelines.

Monitoring rivers

In 2009 Sakhalin Energy studied the local river systems from fishery point of view. The research shows that the quality of spawning areas at these rivers markedly improved since the construction phase. The Company plans to continue these studies, to avoid any degradation in the quality of spawning areas in the rivers crossed by the pipeline.

Controlling ballast water discharge

Ballast water discharge by oil and gas tankers in Aniva Bay can potentially create serious environmental hazards. The Company has undertaken extensive measures to prevent the introduction of alien species with ballast waters from these vessels. Most important, changing of ballast waters in full ocean is one of the mandatory measures. The flora and fauna in and around Prigorodnoye has been monitored since 2008 to determine if...
the mitigation measures are sufficient. To date the results of these monitoring surveys are satisfactory.

**Sakhalin Taimen**

The Sakhalin Taimen, a rare species of salmon endemic to Sakhalin Island, is listed in the Red Book of the Russian Federation, the Red Book of Sakhalin region, and the IUCN Red List. From 2007 to 2009, Sakhalin Energy conducted special monitoring of the Sakhalin Taimen fry numbers in seven model rivers crossed by the pipeline. The information collected during the studies will be used to develop measures to preserve this rare species.

**Steller’s Sea Eagle**

The Company continued monitoring the Steller’s Sea Eagle population in 2009, in all areas where there was the potential for environmental impact of the project on the eagle population north of the OPF. Some positive changes of this protected species were observed: a higher percentage of active nests and better breeding productivity, as well as a steep drop in attacks by brown bears that destroy nests. A total of 274 nesting areas yielded 108 eaglets. More importantly, the reproduction success in the area of potential impact from the project was even higher than for the eagle population as a whole, probably due to measures put in place to protect the nesting trees.

**Monitoring other protected bird species**

Protected birds, including the Aleutian tern, Sakhalin dunlin, Siberian grouse, owl, long-billed murrelet, Japanese snipe were monitored on the Chaivo sand bar, at and around the OPF, along the pipeline corridor, and in the vicinity of the LNG plant.

The Company identified several positive developments in the Japanese snipe population, whose numbers have increased in the Dolinsk district as well as the Korsakov district, near the LNG site, thanks to an expansion of the snipe’s reinstated lands. The number of Siberian grouse has not declined over the years of OPF construction, and the birds are still in the same forest biotopes close to the site boundaries. No negative impact has been seen on the nesting colonies of migrating birds in the Chaivo area. A decrease in the number of owls, Aleutian tern and some other species is probably related to natural variations in environmental factors. Future monitoring data will help identify the true causes of the decline in these populations.

On the whole, bird communities found along the pipeline corridor at and around the OPF appeared to be in good condition, and the ecosystems in the zones of impact showed strong signs of recovery.

**Western Gray Whales**

In 2009 the Company continued to monitor the Western Gray Whale (WGW) population. This work has been carried out in cooperation with Exxon Neftegaz Limited.
The studies demonstrated no noticeable negative impact of Sakhalin Energy operations on the WGW population. After an observed decline in whale densities in 2008, distribution and photo-ID surveys conducted in 2009 demonstrated that whale abundance increased and was similar to 2007. In 2009, 138 whales from Sakhalin catalogue were identified off Sakhalin Island and the Kamchatka Peninsula. A near-record of 10 calves were photographed, demonstrating a healthy annual reproduction rate.

As part of the Marine Mammal Protection Plan, vessels operating in the whale feeding ground navigate at minimum speed in controlled corridors with dedicated observer on board.

Engagement with the Western Gray Whale Advisory Panel (WGWAP), organised by IUCN, continued in 2009. Two WGWAP meetings were held as well as various task force meetings. Work on development of the 3D Astokh seismic survey monitoring and mitigation plan continued in close cooperation with the Seismic Task Force. This seismic survey is scheduled for execution in June 2010.

**Human rights**

The Company’s core values influenced its decision in November 2009 to join the United Nations Global Compact, a strategic initiative to promote corporate social responsibility. Thousands of companies from more than 100 countries are enrolled in the initiative.

The United Nations Global Compact is both a policy platform and a practical framework for businesses seeking to align their operations and strategies with 10 universally accepted principles in the areas of human rights, labour, environment and anti-corruption.

As a voluntary initiative, it is led by companies that are committed to sustainability and responsible business practices. By joining the GC, companies demonstrate their belief that responsible business practices based on the universally accepted principles help to benefit economies and societies everywhere and contribute to a more sustainable and inclusive global economy. The UN Global Compact’s 10 principles enjoy universal consensus and are derived from the following instruments:

- The Universal Declaration of Human Rights;
- The International Labour Organisation’s Declaration on Fundamental Principles and Rights at Work;
- The Rio Declaration on Environment and Development;
Environmental protection and social responsibility

- The United Nations Convention Against Corruption.

Public engagement

Sakhalin Energy makes sustained efforts to engage with the local communities. The main objective of this awareness-raising is to help the Company foresee potential issues and address them well before they become grievances. Regular dialogue with the public is conducted by a team of five community liaison officers (CLO) based in the local communities in the vicinity of the project’s main facilities.

The CLO team in 2009 received additional support when a network of 20 information centres was established. Information centres are hosted by local libraries in residential areas close to Company facilities. The information centres function in towns, including Dolinsk, Smirnykh and Kholmsk, and in small villages with a population of only a few hundred.

Feedback makes it possible for the Company to get real-time information and respond quickly by giving assistance when necessary. On the other hand, the information centres ensure residents have permanent access to information on the activities of the Company.

In nevertheless a grievance emerges, it is addressed and resolved by following the Company’s grievance procedure. In 2009, Sakhalin Energy became one of five companies in the world to participate in a pilot project to test the Ruggie Principles. The principles concern the human rights aspects of grievance mechanisms, and were developed by Prof. John Ruggie, Special Representative of the UN Secretary-General on business and human rights as part of an approach to managing business and human rights approved by the UN Commission on Human Rights.

The Company’s continuous application of a simple and straightforward mechanism to register, review and settle grievances was the reason why Sakhalin Energy was invited to represent Russian business and the international oil and gas industry to test these principles.
The UN will use the lessons learned from the five pilots to develop recommendations for business communities around the globe.

**Engaging Sakhalin’s indigenous minorities**

Since its inception, the Company has put in place social programmes to benefit the indigenous people of Sakhalin Island. A breakthrough in the Company’s relationship with the native population of the island occurred after the creation of a trilateral Sakhalin Indigenous Minorities Development Plan. The plan has already helped in the implementation of more than 230 projects that were selected and developed by representatives of the indigenous population in education, health care, conservation and language studies, national farming, and the preservation of traditional cultures.

At the Sixth Congress of Indigenous Minorities of the North, Siberia and the Far East in 2009, Sakhalin Energy was awarded the title of Best Industrial Company.

**Charity and social investment**

Sakhalin Energy’s activities have a wide-reaching and positive impact on the society and economy of the region.

In only 15 years, Sakhalin Island has become one of the leaders in the country’s economic growth. Sakhalin Oblast is one of the first regions in Russia, where small and mid-sized businesses evolved: as of 2009, the share of small business in the Gross Regional Product was about 30%.

In 2009, the gross regional product of Sakhalin Oblast was 335 billion Russian roubles, a 106.4% increase from the previous year.

The unemployment rate of Sakhalin was 1.3% in early 2010 – among the lowest in the Russian Far East and in the country at large.

The Company develops and implements a wide range of social...
programmes that contribute to sustainable development of the Sakhalin Oblast. In 2009 alone, Sakhalin Energy spent more than $600 million to develop infrastructure for the common good: roads, bridges, airports, and seaport infrastructure were built or rehabilitated, and regional medical facilities were upgraded.

Sakhalin Energy invested a total of 65.7 million Russian roubles ($2.27 million) to implement social programmes in Sakhalin Oblast. Sakhalin Energy’s sustainable development and social programmes have received wide acclaim. The Company won regional Philanthropist of the Year once again in 2009. Sakhalin Energy’s efforts have also been recognised at national level. A corporate philanthropy study conducted in 2009 by auditors PriceWaterhouseCoopers, Vedomosti newspaper and the Donors partnership of the Russian Union of Industrialists and Entrepreneurs under the Corporate Philanthropy in Russia Research project. The study ranked Sakhalin Energy third after Transaero and Uralsib Bank. The experts noted the Company’s coherent and well-structured programme of social investments, fully transparent objectives, and clear evaluation criteria.

The Company programmes “Employees’ Charity Initiatives Support” and “What to Do in Emergency Situations” were included in the 2009 publication “Collected Social Programmes” of the Russian Union of Industrialists and Entrepreneurs (RUIE).

Sakhalin Salmon Initiative (SSI)

Sakhalin Energy, alongside the international non-profit organisation, the Wild Salmon Centre (US) and the Sakhalin Administration, were the founders of the Sakhalin Salmon Initiative (SSI). The goal of the initiative is the conservation and sustainable use of wild salmon, ecosystems, and salmon spawning rivers. The four-year budget for the initiative is $8.8 million.

In 2009, SSI organised two comprehensive scientific expeditions; conducted integrated monitoring of the local salmon population, its
biodiversity, and its habitat in the rivers of Sakhalin; supported the anti-poaching activities of basin salmon councils; and restored salmon spawning migration routes that had been destroyed by powerful cyclones and other causes. Many SSI programmes teach the youth of Sakhalin environmentally-responsible behaviours. For example, young environmentalists from the US and Sakhalin attended the first international salmon summit, that included educational tours and other cultural events, such as the children’s competition “Salmon, Live!” The initiative also developed learning programmes for kindergartens and primary schools.

**Sakhalin Road Safety Partnership**

Along with road safety actions linked to the works under the Sakhalin-2 project, the Company also conducts road safety initiatives with the communities of Sakhalin Island under the Sakhalin Road Safety Partnership, launched by the Sakhalin Administration, local traffic police, other businesses, and the general public. Established in 2005 on the Company’s initiative, the Partnership has implemented several long-term projects.

**Examples of Sakhalin Energy social programmes**

**Small Grants – Big Deeds**

The charity programme “Small Grants – Big Deeds” supports district initiatives in Sakhalin Oblast. The programme started in 2003. The Company awards grants after a competitive bidding process to action groups, non-governmental organisations, and institutions for social, environmental, cultural and educational initiatives that address specific local problems.

**What to Do in Emergency Situations**

The project “What to Do in Emergency Situations” is not only a fixture in Sakhalin, but has been taken up in many parts of the country. Started in 2005, the programme is conducted in partnership with the Sakhalin Regional EmerCom Department and the Sakhalin Department of Education. The project teaches the children of Sakhalin Oblast, an area prone to natural disasters, including earthquakes, avalanches, forest fires, major snowstorms, and tsunamis what to do in an emergency. By the end of 2009, the programme had a repertoire of 23 “Senya” cartoons on standards of emergency conduct. Outside Sakhalin, the programme has also generated a lot of interest. The cartoons are displayed in 10 Russian regions. Since 2009, the cartoons are posted on EmerCom children’s website at http://www.spas-extreme.ru/.
Environmental protection and social responsibility
Sakhalin Energy’s main operational objectives for 2010 are to complete the transfer of its newly built facilities from commissioning and test mode to full scale, steady operations, and focus on production efficiency.

The Company plans to ramp up production of the LNG plant to its design capacity, and to raise hydrocarbons production of the Piltun area and Lunskoye field to full capacity (the Astokh area reached full production capacity in 2009).

During the last stage of commissioning, all systems and equipment will receive final optimisation, and the complex infrastructure built by Sakhalin Energy will be completely synchronised, a task necessary to ensure process efficiency and reliability.

Further drilling from PA-B and LUN-A is a Company priority. In 2010, two gas wells will be drilled on Lunskoye (one of these was started in
2009), as well as an experimental horizontal well to study the oil rim. On Piltun, the Company plans to drill four operation wells (two for oil production and two for water injection), complete a water injection well begun in 2009, and start the preparation works for further drilling. Water injection is beginning at Piltun to maintain reservoir pressure.

The Company will start a major upgrade at the Molikpaq platform (PA-A), which has been working for 10 years. The upgrade will make it possible to build new wells from the Company’s first platform. The Company also plans to conduct a 4D seismic survey on the Astokh field to determine the current status of the field after 10 years of development, plan new wells, and increase future oil production.

Large-scale construction activities, required for efficient functioning and transfer of the projects into operation, are behind us. What is left is to finish in 2010 constructing and commissioning of the Booster Station 2 (BS2). BS2 will make it possible to pump additional gas by pipeline and thus increase LNG production.

In keeping with the Production Sharing Agreement, royalties and share of profits will soon be paid to the Russian Party in gas. The Russian Federation appointed Gazprom as an authorised company to manage the Russian share of the royalties and share of profits. To transfer the gas to Gazprom, the Company will build two gas transfer terminals (GTT). Construction of the southern terminal near the village of Troitskoye is already underway. Sakhalin Energy plans to complete the main scope of the work by late 2010, so the facility will be commissioned and gas transfer will start in 2011, to supply gas to the...
Yuzhno-Sakhalinsk power station. The latter will be transferred from coal to gas. Construction of the northern terminal near the village of Boatasyno is aligned with Gazprom’s development plan. Gazprom intends to transfer gas from the northern terminal to the mainland through the Sakhalin-Khabarovsk-Vladivostok pipeline, as part of the gasification programme for the Russian Far East.

Environmental and social projects will continue in 2010. We will work hard to become a world leader in meeting and even setting the highest global standards of environmental protection and corporate social responsibility. The second Sakhalin Indigenous Minorities Development Plan covering 2011 to 2015 will be elaborated in 2010. We will deepen our dialogue with society by issuing non-financial reports according to the standards of the Global Reporting Initiative (GRI).

In accomplishing all tasks, Sakhalin Energy will continue striving to maximise economic efficiency while ensuring safe and reliable production and delivery of hydrocarbons.