SAKHALIN II
THE TRUTH
UNCOVERED

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SAKHALIN II AND FAILING THE ENERGY CHALLENGE

• With continued economic growth in developing economies and the growing threat posed by climate change there is an urgency to seek alternatives to fossil fuels. The UK government made climate change a headline issue at the G8 Summit.

• Meeting energy needs, whilst preventing catastrophic climate change requires a change from the status quo. Governments will have to move away from using hydrocarbons (oil, gas and coal) to provide energy.

• Russia is currently a powerful player in energy politics, with western governments concerned about securing energy supplies. This project will fuel the addiction to hydrocarbons; it will not supply Russia and will not enhance the local Sakhalin Island situation.

• Sakhalin Island is the size of England but with only 1 per cent of the population. Despite there being an estimated 45 billion barrels of oil equivalent (boe) around Sakhalin, there are local communities without reliable energy supplies.

• The oil sector currently invests around $100 billion per year in exploration and production. Imagine what could be achieved if this was diverted to alternative technologies rather than condemning the world to worse climate change.

• Lessons are not being learnt on Sakhalin II – a sub-standard oil and gas project with a disastrous construction record since it began in 1994. This is a huge project that is set to blight a whole island. The lack of experience in sub-Arctic conditions gives cause for concern in this sensitive environment.

• Given its scale and complexity, Sakhalin II is a poor investment and the poor management of the project could result in Shell being denied access to other Arctic regions.

• Sakhalin II brings Liquefied Natural Gas (LNG) to Russia, but only on loan for the benefit of the west. The technology will not just be handed over for duplication around Russia. Sakhalin II demonstrates how not to manage a mega-project resulting in cost overruns of 100 per cent ($10 billion), and failure to control contractors resulting in environmental damage.

• In terms of physical infrastructure, Phase 2 already consists of:

  The base for a second platform at Piltun in addition to Molikpaq and a platform at Lunskoye; noise impact on the whales

  Preparation of the altered onshore processing site;
50 per cent of 1600 km of oil and gas pipelines completed; many watercourses spoilt

An oil export facility presenting year round risks

60 per cent of the LNG plant completed, with associated dredging and dumping affecting fisheries.

And of course island disruption such as noise, dust, degraded roads, bribery, prostitution, and sexually transmitted diseases.

Given this amount of the project is already completed, what difference can the European Bank for Reconstruction and Development (EBRD) make at this stage, and what exactly are they consulting on?

At a meeting with Shell’s CEO Jeroen van der Veer in November 2005, President Putin made it clear that the Russian administration did not accept Shell’s excuses for increased costs and would not be accepting them as part of the proposed asset swop with Gazprom.

The poor implementation of Sakhalin II is setting a bad example for other operators. Far from the EBRD’s objective to set standards for responsible operations, Shell is undermining the standards set by Russian operators. No other operator has plans to use Shell’s infrastructure. Indeed Exxon has developed completely separate facilities, without constructing offshore near the Western Gray Whales, and going east-west across the island to reduce river crossings.

Shell has been trying to replace its lost reserves, and the urgency to get Sakhalin II into its production figures is compromising Shell’s standards.

There has been no Strategic Environmental Assessment six years after the EBRD requested one as part of their Natural Resources policy. This could have helped to reduce the project’s spiralling costs and minimise its environmental damage.
SUSTAINABLE DEVELOPMENT

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MAIN POINTS

• Shell has protected its investment at the expense of the Russian party. The Production Sharing Agreement provides excessively favourable terms for Shell. Shell will recoup not just their costs but a 17.5 per cent return on investment before the Russian state get their share. This is not a typical way to divide revenues.

• The Russian government is concerned over the poor terms of the deal for Russia in terms of its share of the revenues. In particular Russia has indicated it will not swallow any of the $10 billion cost overruns and the delay in receiving revenues.

• Shell is seeking to borrow money for this $20 billion project, despite a $23 billion profit last year. The European Bank for Reconstruction and Development (EBRD) is considering lending to a company that made record profits to supply hydrocarbons primarily to Japan. This is not consistent with the EBRD’s mandate to only finance where sufficient funding is not available elsewhere.

• On the island, construction is causing the usual temporary inflation of wages and costs, which cannot be sustained.

• Whilst some locals are capitalising on construction opportunities, this is not sustainable. Meanwhile existing industries such as fishing are concerned over the long term impact on their activities.

• The lack of benefits for local communities has seen ongoing protests against the developments. Fishing companies are still waiting for compensation resulting from the damage caused to their industry.

• Shell’s claimed Sakhalin Development Fund has seen money misappropriated for building new housing for construction workers, whilst local people live in run-down housing stock. Shell is determining expenditure rather than local people.

• The project is already more than two-thirds built with all key decisions made. There is very little room for EBRD to influence this project at this stage. It is impossible to have a meaningful consultation when Shell decided everything a long time ago. WWF has had seven years of consultation with Shell and it still has not incorporated our inputs into their project.
FREQUENTLY ASKED QUESTIONS – SUSTAINABLE DEVELOPMENT

Why doesn’t Sakhalin II supply gas to the island?
In a region that regularly experiences temperatures of -40°C, and has an unreliable energy supply EBRD refuse to acknowledge the development benefits this might have. There is a clear opportunity to enhance access to energy, yet apparently the EBRD considers it should promote exports to Japan rather than assist Russians in gaining access to their own resources.

Are there still disadvantaged people on the island?
The majority of people will not benefit from the project, but will have to watch as Shell burns through $100 every second to export their resources. The average wage on the island is $200 per year. Protests continue on the island, most recently at the LNG plant on 28th January 2006.

Will the Sakhalin II project fall foul of the resource curse as has been seen around the world in regions suddenly exposed to mineral wealth, who cannot convert this into poverty alleviation?
Yes

Does this project meet the poverty alleviation and sustainable development objectives of the potential lenders?
No

Can EBRD improve this project?
No – we are at the stage of construction dialogue not constructive dialogue. EBRD will inherit all the risks and negative impacts the project has already developed if it attaches itself through finance. In doing so it would have to lower its own environmental and social standards and credibility, not to mention those of other banks which use it as a reference point. It is time the EBRD accepted that pieces of paper cannot retrospectively bring a project into compliance. EBRD should not forget the three years of inadequate efforts Shell has already made since starting construction.

What has happened to the Sakhalin fishing industry?
Calypso, a local fishing company, has been forced to make employees redundant and has lost clients in Japan who do not want fish from the bay where the oil and gas export facility is being built as they may be contaminated. Calypso is still waiting for adequate compensation for lost catches and the impact on its business. This issue forms the basis for a complaint to the EBRD which has been accepted by its ombudsman.
WESTERN GRAY WHALES

MAIN POINTS

- Shell cannot prove there has been no discernable change in behaviour in or impact on the western gray whale from Sakhalin Energy operations at the existing Piltun Platform, which has been producing oil since 1999. However 14 skinny whales have been observed last year alone, indicating that some new human factor is depriving whales of food. Shell has not heeded these warning signs and has carried on with the second phase.

- Shell has still not established a long-term Western Gray Whale Advisory Panel (WGWAP). The membership and funding of this group is not assured. There have been further meetings of whale experts, who are still not satisfied with the answers and information Shell has provided.

- The panel’s overarching objective is the conservation of the western gray whale population. This can only be achieved with co-operation from all parties operating on Sakhalin. Shell has promised several times to bring other operators to the table but has failed. Without a joint approach the cumulative impacts and risks of all operations on the whales cannot be assessed.

- Shell rerouted the offshore pipeline which should never have been planned in to go through the critical habitat. Moving the pipeline outside the feeding area limits direct impact, but still exposes the whales to the same risks from oil spills, noise and collisions.

- Last summer Shell installed the platform base without waiting to conclude their discussions with whale experts. Shell installed the platform base and exceeded the noise level they had previously agreed with the whale scientists. Shell merely increased their limits from 120dB, so that their activities fitted within them.

- WWF and IFAW monitored noise levels and whale behaviour during the platform installation. This analysis confirms that noise was even louder than Shell indicated and the whales did not spend as long in the southern end of the feeding area near the platform.

- Shell has not incorporated most of the science the panel have offered as it was set up far too late and therefore is able to have little influence on decisions.
FREQUENTLY ASKED QUESTIONS – WESTERN GRAY WHALES

How endangered are the whales?
There are only around 100 left and only a quarter of these are breeding females. They are listed as critically endangered on the international list of endangered species (the IUCN’s red data list).

How did Shell select the platform location?
The location was determined by technical, economic and safety considerations. Environmental aspects could not have been properly assessed as the whale panel had no input into the platform location.

Does this meet EBRD policies requiring consideration of alternatives including the no project option?
No. EBRD stated in December 2005 that it “recognises that procedures prescribed in its Environmental Policy were not fully followed in the planning phases”.

Does installing the platform base and topside result in excessive noise around the feeding area?
Shell’s Marine Mammal Protection Plan indicates a noise limit of 120dB. Shell’s own acoustic monitoring indicates that 140dB was exceeded on several occasions. The logarithmic scale of noise, the ease of transmission of noise through water, and the sensitivity of marine mammals to noise add up to great concern. Even Shell’s own monitoring has been criticised by the whale experts for being insufficient in showing the true impact of the construction noise.

Why did Shell install the platform in July 2005 rather than wait and conclude discussion over noise impacts?
Shell is on a predetermined construction schedule that they will not alter for environmental reasons. Despite fog reducing visibility to zero, it installed the platform base, preventing monitoring and putting the whales at risk.

Why has Shell not avoided the peak whale season?
This is another example of the disjointed approach to operations and decision-making that Sakhalin Energy is making - the environment will pay the price. The whale experts see the separation of peak whale feeding time and when construction takes place as the most obvious mitigation measure but Shell have ignored this recommendation. The oil giant plans its most intensive work to date during this year’s peak whale feeding season from July to September 2006.
Are the mitigation measures Shell has proposed to protect the whales adequate?
Shell cannot even demonstrate they met their own criteria for low impact on the whales during operations last summer. The use of observers to prevent collisions between ships and whales has been evaluated and described as ineffective due to Shell operating during zero visibility periods. The burden of proof is on Shell to show there is no impact.

Is the Piltun lagoon system important for the western gray whale?
The whale scientists say yes but Shell has not included this in its assessments so far, having already planned and conducted construction in the Piltun area.

Are the whales now even more vulnerable than before?
The whale panel has reaffirmed that losing one extra reproductive female per year over the next three years would cause their extinction.

The findings of the panel are not binding so what happens if Shell disagrees with its recommendations?
Shell can do whatever it wants. The whale panel is in danger of becoming window dressing, buying Shell time to complete construction whatever the cost to the whales. Shell has ignored the panel’s recommendation to reduce vessel speeds in navigational corridors to the platform, as well as ignoring noise limits and timings suggested by the panel.

Has a Strategic Environmental Assessment been carried out to address the social and environmental implications of hydrocarbon development across Sakhalin?
No. This was a specific objective of EBRD’s natural resources policy in 1999, and would be a requirement if the project were to meet the EU standards it claims to adhere to.

Can Shell prove its Summer 2006 activities did not impact the whales?
No. The scientists consider Shell’s claims of no impact to be unfounded, and Shell’s monitoring results to be uninformative, substandard and incomplete.

Can Shell guarantee its operations will not result in the extinction of the western gray whale?
No.
RIVER CROSSINGS

MAIN POINTS

• Of the 1,000 watercourses, Shell originally identified 63 as highly sensitive, compared to the 663 identified by the local fisheries agency, VNIRO. Shell have now tripled the number of rivers they recognise as sensitive to 180, indicating the flawed nature of the original baseline data.

• Halfway through construction Shell has made a paper promise of no net loss of habitat. It is not clear over what time period or how this would be measured. The company does not have adequate monitoring in place and cannot quantify previous damage. The salmon on Sakhalin spawn every two years; it is not enough to merely talk of restoring habitat at a later date. By talking of net loss, Shell is admitting the damage its river crossings will cause, seeking to rectify it elsewhere or sometime in the future.

• Shell produced many versions of a river crossings strategy in late 2005. The University of Birmingham reviewed all except the final one. The resulting strategy has therefore not been subject to ultimate approval by an independent body. This rushed effort is less than ideal and indicates Shell’s reluctance to deviate from its construction schedule. The Wild Salmon Center proposed a more fundamental review which Shell declined.

• Erosion control has been lacking on river crossings and intermediate sections of pipeline in steep terrain.

• In December a consultants’ report highlighted that Shell did not manage contractors effectively on a number of projects, including Sakhalin. There is a disconnect between the required practices of the environmental documentation and implementation on the ground. The new documents do not even deal with contractor control on river crossings.

• EBRD and Shell admitted there was a problem with river crossings last year which resulted in several inspections by the bank. Where there is such a lack of trust with a potential client that constant monitoring is necessary, the deal should not progress.
FREQUENTLY ASKED QUESTIONS – RIVER CROSSINGS

Sakhalin Energy is supposed to construct river crossings during winter – is that always the case?
Shell’s own website shows that it has not achieved this, with 20 sensitive rivers crossed outside of the December to April period. This includes several crossings in Summer 2005 despite giving assurances to concerned organisations that there was a moratorium on river crossings after the poor environmental management the previous winter.

Sakhalin Energy is supposed to construct oil pipeline and gas pipeline river crossings simultaneously, as the most basic mitigation measure to reduce impact – is this always the case?
At least 40 rivers have had the oil and gas crossings during separate seasons. An even larger number of rivers have had the two crossings done weeks or months apart, rather than on consecutive days as desired. Sakhalin Energy’s construction permit requires the two pipelines to be constructed simultaneously.

What is the impact of sedimentation of rivers during construction?
Several types of salmon are very sensitive to cloudy waters, and will not spawn in these conditions, and may not even pass through such water to get to their spawning grounds. Salmon were found in 2005 that had died prior to spawning.

How is Shell monitoring sediment in rivers now?
Shell indicated they would use turbidity meters at all river crossings. By February some sites started to receive the meters and training to use them. A number of crossings were done without these meters, meaning that there was no instant indicator of excessive sedimentation.

What damage was done before the new river crossings strategy?
Over 60 sensitive rivers were crossed before the new document was produced. It is too early to tell the full effect this may have had on salmon spawning and future populations.

Have the river crossings breached EBRD Environmental Policy?
EBRD stated in December that it “recognises that procedures prescribed in its Environmental Policy were not fully followed in the planning phases”.
Sakhalin Energy selected an offshore disposal site prior to understanding the hydrodynamics and significance of Aniva Bay. As with other predetermined aspects, the company has been trying ever since to justify its decision.

Yet again the company has not conducted an adequate assessment of alternatives. Proper consideration was not given to sites offshore distant from fisheries.

Sakhalin Energy has given many excuses for its decisions. Ironically it has claimed it is concerned about the extra emissions from going further out to sea. This does not fit with a company that is so desperate to extract oil, it is willing to put a species of whale at risk.

The company has sought to accelerate and enlarge its dumping schedule rather than wait and resolve the issues. As a result huge amounts of material were dumped at the end of 2005, leaving nothing for EBRD to try and influence.

Sakhalin Energy initially stated that the material would sit in a pile on the bottom of the sea. When the majority of the first million tonnes they dumped disappeared it demonstrated how little the company understood about the environment it was operating in. The company can not therefore say it has only had a limited impact, as they do not even know where most of the material is.

Local communities are now wondering where their shellfish have disappeared to. Previously they were able to gather them on the shore.

The EBRD Independent Recourse Mechanism (IRM) has accepted a complaint from a local fishing company that saw its catch reduce by 70 per cent (1000 tonnes) in 2005. Furthermore Japanese buyers are refusing to take any fish that are caught in Aniva Bay for fear of contamination.

The EBRD should be concerned that the IRM has already received cases from Sakhalin Island before any funding has been agreed. This does not bode well for the future.
Sakhalin has seen several oil spills. A Sakhalin energy contractor ran a dredger, the Christopher Columbus, aground in September 2004, spilling its fuel oil. Eyewitness reports from Summer 2005 indicate an oil spill was seen near Molikpaq oil rig, which the company has never reported on.

Japan is currently seeing birds washing up on its shores covered in oil. These carcasses have been under the winter ice for weeks. Some of the birds include rare species listed on the IUCN red data list, for example dead Steller sea eagles have been found with oil in their stomachs. Investigations as to the exact source continue. This highlights the risk of trans-boundary impacts to Japan, and the problems of oil under ice. This also shows how the impacts of oil spills can be delayed. For example an oil spill under the Piltun ice could result in ice being trapped in the ice until it melts, when the gray whales start arriving.

Shell has still not provided maps of the expected spills in winter sea ice conditions for the Piltun operations. Therefore for 6 months of the year they cannot even predict what will happen.

Similarly Shell cannot respond adequately to an oil spill in the gray whale habitat during winter ice conditions. Proven technologies are not available for all of the ice conditions experienced on Sakhalin. Safety concerns often preclude any attempt to clear up oil spills in these conditions anyhow. Shell is trying to hide just how large this response gap is.

Problems of oil in ice are demonstrated in Alaska, where there are long-term impacts of spills in ice off the North Slope. The recent spill from a BP pipeline on the North Slope demonstrates how even with the latest spill detection technology, significant leaks may remain undetected under ice
FREQUENTLY ASKED QUESTIONS – OIL SPILL RESPONSE IN ICE

Are there proven techniques to clean up oil spills in all ice conditions?
No, there are conditions and types of ice cover where response is not possible. There are experiments and trials occurring to improve understanding, but a critical habitat with a species on the brink of extinction is no place to experiment with this.

So what happens in the event of an oil spill?
It will be an unmitigated disaster. Safety concerns are likely to prevent any kind of response. If the “wrong” kind of ice is present there will be no effective response mechanisms available. The oil or potential responses could affect the whales’ feeding habitat. The oil may even not emerge until the ice melts and the whales arrive.

Do potential lenders know what risk they would be taking on?
No. Without being able to quantify the extent of a winter spill, be certain a response is possible and given the priceless nature of what is at risk, this is an unknown for lenders that they should not accept.

Why is there no prediction of the size and spread of a potential oil spill from a range of platform locations for all seasonal conditions?
Shell has not provided winter oil spill scenarios. The whale panel asked for these in 2005, as they are concerned over this issue. Modelling is not well-developed for these conditions hence Shell’s reluctance to provide the information. Repeated requests have not produced any satisfactory response.

Why should these plans be available now?
It is not possible for stakeholders or potential lenders to take a considered view of the full implications of this project without full information on spill and response scenarios. Due to the extreme location of the project there is little experience of working in the environment under such harsh conditions.

Do the whale experts have oil spill expertise?
The previous whale panel did have an oil spill expert from Alaska in Professor Rick Steiner, until he quit the panel in July 2005. His resignation was prompted by Shell’s installation of the platform base despite the ongoing discussions with whale scientists. Since then the lenders have not had any independent advice on oil spills.
The Sakhalin II project operates in an area of very high earthquake activity. The 800km of on-shore pipeline crosses seismic faults on 24 locations (by comparison, the Trans-Alaska Pipeline crosses only 3 fault lines).

**Have there been any major seismic events on Sakhalin?**
More than 2,000 people died when 17 residential buildings collapsed during a major earthquake that struck Neftegorsk, in northern Sakhalin, on May 27, 1995. The Neftegorsk earthquake struck in a zone “considered to be inactive,” causing a rupture 46 kilometres long with an average slip value of 3.9 metres. Following the devastating 7.6 Richter Scale Neftegorsk earthquake, the seismicity rating for much of the pipeline route was raised from one magnitude 6-7 event every one thousand years to one magnitude 8-9 event every one thousand years.

**What would happen to the pipeline in the event of an earthquake?**
A severe earthquake could cause a failure of the Sakhalin II pipelines (as happened with the Neftegorsk earthquake), potentially creating a catastrophic oil spill that could harm or destroy terrestrial or aquatic habitats.

**How much of the pipeline is exposed to seismic risks?**
Our review of SEIC data indicates than 25 percent of the pipeline route is to be buried in ground that bears a seismic intensity rating of 9 or higher on the MSK 64 scale. (A level 9 earthquake is liable to result in considerable damage to buildings and reservoirs, ground cracking and some underground pipes broken.)
COMMUNITY IMPACTS

Sakhalin Energy has experienced protests over the last few years from indigenous groups, local residents and the fishing industry. Sakhalin Energy has a poor record in responding to stakeholders which was captured in the Health, Safety & Environment Audit of Phase 1 in 2005. This is further confirmed by the ongoing disputes with local fishing companies.

Sakhalin Energy’s promises of local development are now being questioned by local officials and residents. The Major of Korsaklov and the Governor of Sakhalin have both spoken publicly of their dissatisfaction with SEIC’s actions.

In the long term it is the local communities who will suffer – exposed to a new heavy industry and its workforce. Fishing is their way of life and it is being destroyed by SEIC. This is captured in the sustainable development section.

**Has Sakhalin Energy addressed indigenous peoples issues?**
Far too late. The indigenous peoples plan is still being developed as construction goes past half-way. They can have very limited input at this stage. The UN and World Bank standards both call for a free prior informed process. There is not way this process can be described as prior to decision-making, and therefore cannot be considered best practice or compliant with EBRD policy.

**Does Sakhalin Energy have stakeholder support?**
Russian NGOs have united in their position on Sakhalin II. In 2003, over 50 Russian groups agreed a set of common demands. The company has not satisfied the stakeholders that it has done everything it can to address these issues. The groups became frustrated with the lack of action from Shell on the issues and believe that Shell’s dialogue has not been constructive. Shell missed its chance to improve the project years ago, when it ignored NGO warnings. Without NGO backing, EBRD cannot demonstrate the important social license to operate for the project. The continuing dissatisfaction has been expressed at EBRD’s consultations.