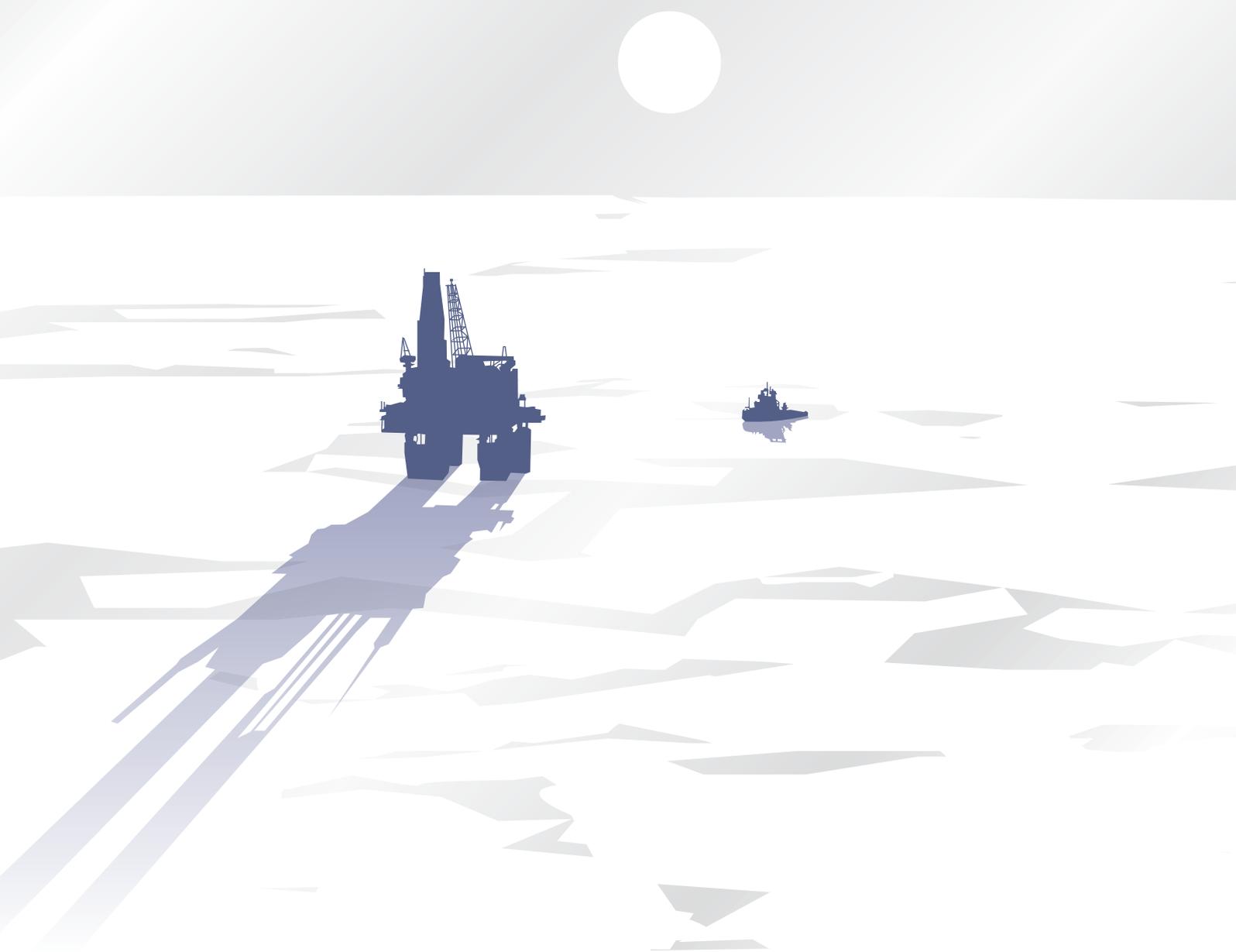


# ANNUAL REVIEW



Sakhalin Energy Investment Company Ltd.

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2010



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## 2010



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## MESSAGE FROM CHIEF EXECUTIVE OFFICER



**2010 – the final year of the 21st century's first decade – is sure to go down in Sakhalin Energy's records as a very successful year.**

The Company completed the transition from the testing of facilities, built and commissioned at the earlier stages, to their operation. The final adjustment of all systems and equipment was completed, and operation of all production infrastructure was synchronised. Thanks to the coordinated and focused effort, we managed not only to bring the first Russian LNG plant to full capacity, but also to nameplate its design capacity in less than a year and a half after launch. Management structure optimisation, debottlenecking and fine-tuning of equipment allowed Sakhalin Energy to produce more than 10 million tonnes of LNG in 2010. In addition to fact that it is a world class achievement, the importance of this event is that it strengthens the position of Russia as a global energy supplier and, as practice shows, contributes to the security of energy supply in the region.

We are proud of our production achievements. Yet safety has always been and will be our priority: labour, i.e. personal safety, and process and environmental safety. In 2010, Sakhalin Energy scored the lowest accident record in the world oil industry. In 2010, there were no job-related fatalities, we set a record in the number of worked LTI-free man-hours.

Achievements in road safety were outstanding: given that the vehicles involved in the project travelled in total nearly 9 million km, not a single incident with lost time injury from a road accident was recorded in 2010. By February 2011 the company had worked for two years without injuries from road accidents. Not only we saved the life and health of our employees and other road users, but showed an example of responsible attitude to road safety.

We are doing everything in our power to uphold a high level of operational safety and to avoid harming the unique environment of the Sakhalin island. Not a

single serious process safety incident was registered at the Company facilities in 2010. A lot of hard work goes into preventing oil spills. For many years, Sakhalin Energy has been a global industry leader in minimising oil spills.

Our Company is a responsible community member. We implement a wide range of social and environmental programmes designed to promote sustainable development of Sakhalin Island. Having joined, in the end of 2009, the UN Global Compact, an initiative which brought together hundreds of companies worldwide committed to strictly and consistently abide by the principles of that treaty related to the environment, human rights, labor and anti-corruption, our Company has already secured a leading position in the Global Compact Russian Network. We extend the scope of social investments, implement partnership projects, contribute to the development of Sakhalin indigenous minorities potential, design and implement environmental programmes including those to conserve Sakhalin biodiversity. The Company's effort has earned much praise at home and internationally. This Annual Review features all these programmes. But since it mainly focuses of the production operations progress, more details of the Sakhalin Energy sustainable development effort can be found in another important Company document, the 2010 Sustainable Development Report.

Today, Sakhalin Energy has set an important objective to reach. At the close of 2010, the Company embarked on an operational excellence journey. It is a journey in which we have mapped out the first five years and developed Sakhalin Energy's Operational Excellence Journey for the period of 2010-2012. The Operational Excellence Journey is based on five key directions to improve our business which are based on world's best operational experience: total reliability, lean execution, world-class well and reservoir management, best practice in contractor management, and excellence in people.

Operational Excellence cannot be achieved in a single year; it is also a moving target. To deliver on the aforesaid target, Sakhalin Energy intends to provide top quartile performance in the world oil and gas industry, which will enable us to fulfil of our responsibilities to shareholders, customers and society, working for the benefit of those and for the benefit of Sakhalin and Russia.



Andrei Galaev  
**Chief Executive Officer**  
**Sakhalin Energy Investment**  
**Company Ltd.**

# INTRODUCTION: SAKHALIN ENERGY

Sakhalin Energy Investment Company Ltd. ('Sakhalin Energy' or 'Company') is implementing the Sakhalin-2 Project on the basis of the Production Sharing Agreement with the Russian Federation. The Company was established in 1994 for the purpose of developing Piltun-Astokhskoye and Lunskeye oil and gas fields off Sakhalin Island in the Okhotsk Sea, Russian Far East. The development of these two fields involved the construction of a new

or 1,565 people, were Russian Nationals. Out of this total number, 1,803 employees were based in Sakhalin, working at production sites and offices, and the rest were working in the Moscow office. To date, more than 55% of the Company personnel are Sakhalin region residents.

Strategic governance is executed jointly by Sakhalin Energy, the Russian Party and shareholders. They set appropriate policies, establish accountability and appraise

all the shareholders operating through their subsidiaries.

Sakhalin Energy operates within a three-tier management structure where:

1. Certain key decisions are reserved for the shareholders.
2. The Board of Directors (BoD) is responsible for the overall management of the Company.
3. The day-to-day management and operations of the Company are delegated to a Committee of Executive Directors (CED).

Supervisory Board is the Company's strategic management body established and operating in accordance with the Production Sharing Agreement. The Supervisory Board supervises the fulfilment of the PSA terms and approves the Company's long-term development plans and budgets, annual work programmes and budgets, LNG sales agreements, procurement procedures, Russian National employment and training plans, etc. The Supervisory Board also reviews

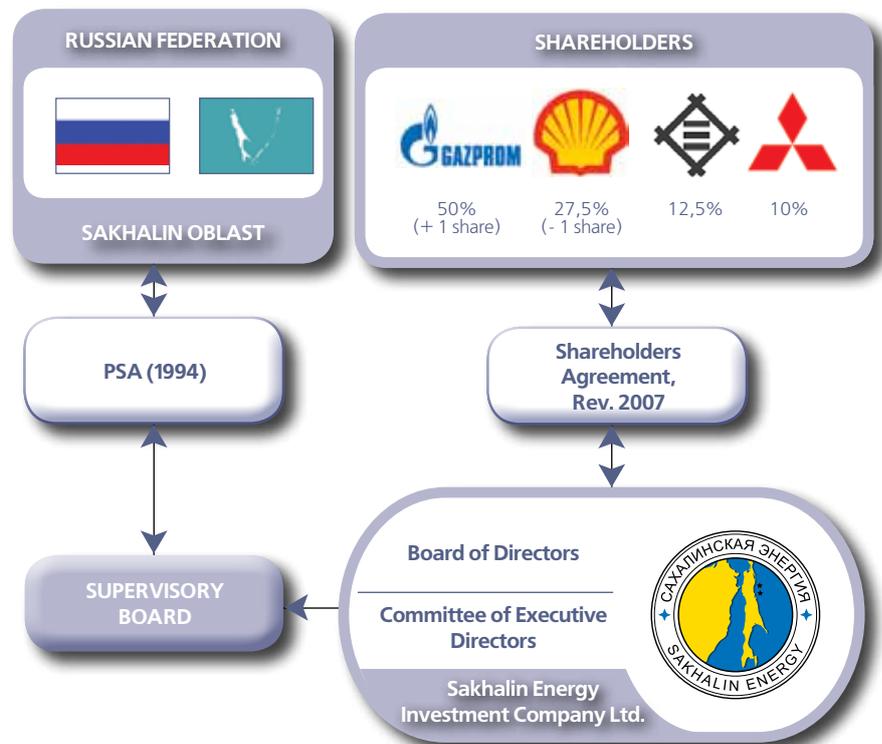
Sakhalin Island has become the world's new oil and gas province. Hydrocarbon reserves offshore Sakhalin are estimated at 45 billion barrels in oil equivalent, which is close to the overall volume of unexplored reserves in the North Sea.

integrated infrastructure for offshore production, offshore and onshore transportation, processing and sales of hydrocarbons. This infrastructure includes three offshore platforms, offshore and onshore pipelines, an onshore processing facility, a booster station, an oil export terminal with a tanker loading unit and Russia's first LNG plant. This is one of the most technically challenging projects that have been developed in the world oil and gas industry in the past decade. The scope of the project targets, work and investment, the severe climate and unique ecosystem of Sakhalin, the lack of the required transportation and other infrastructure on the island at the time of the project launch, and the project's geographical remoteness from traditional Russian economic hubs called for the industry's best practices, technological innovations and efficient management solutions to be applied to the project. This challenge was successfully met by the unique co-partnership of the Sakhalin Energy shareholders.

At the end of 2010, the total number of the Company employees was 1,848, of which 84.7%,

performance, including in sustainable development.

Under the shareholding structure of Sakhalin Energy, which has not changed since 2007, Gazprom holds 50% plus one share, Shell 27.5%, Mitsui 12.5% and Mitsubishi 10%,



Sakhalin Energy governance model



Andrei Galaev  
Chief Executive Officer



Erwin Nijse  
Finance Director



Tim Hake  
Production Director



Sergey Dubynin  
Legal Director



Sergey Antonov  
Human Resources Director



Valery Cholovsky  
Technical Director



Andrei Okhotkin  
Commercial Director

Committee of Executive Directors (as of 31 December 2010)

the Company's annual reports and appoints the Russian Party auditors. The Supervisory Board is made up of six members from Sakhalin Energy and six members from the Russian Party, including two from the Sakhalin Oblast Government and four from the Government of the Russian Federation.

Board of Directors (BoD), a body appointed by the Company shareholders, is responsible for the overall governance of the company and for key decisions regarding economic, environmental and social activities, as well as strategy and business direction of the Company. The BoD members in 2010 included seven Executive Directors, eight Principal Non-Executive Directors and eight Alternate Non-Executive Directors. Charles Watson was the BoD Chairman in 2010.

The BoD activities are supported by the functions of several committees, including:

- Commercial Committee consists of representatives of the Company headed by the Commercial Director, who is also the Commercial Committee Chairman, and representatives

of the shareholders, who meet to discuss commercial issues. The Commercial Committee also includes observers from the Company shareholders;

- Technical Committee is a committee consisting of representatives of the Company headed by the Company Technical Director, who is also the Technical Committee Chairman, and representatives of the shareholders, who meet to discuss technical issues. The Technical Committee also includes observers from the Company shareholders;
- Financial Advisory Committee comprises representatives of the Company headed by the Finance Director, who is also the Finance Committee Chairman, and representatives of the shareholders, who meet to discuss financial issues. The Financial Advisory Committee also includes observers from the Company shareholders;
- Board Assurance Committee consists of representatives of the Company (members should not be Executive Directors) and

representatives of the Company shareholders, who meet to discuss the assurance issues;

- External Affairs Committee is an advisory committee to BoD consisting of representatives of the Company, headed by the External Affairs Manager, (simultaneously the External Affairs Committee Chairman), and representatives of the shareholders, who meet to discuss the external affairs issues.

Committee of Executive Directors (CED) is responsible for the direct management of the Company. The Committee of Executive Directors sets, directs and controls the daily activity of Sakhalin Energy through business plans and strategies, as well as decisions on their implementation. In 2010, the Committee of Executive Directors was made up of seven members: Chief Executive Officer (who heads the committee), Production Director, Technical Director, Human Resources Director, Commercial Director, Finance Director and Legal Director.

Executive Directors head the respective functional subdivisions and are responsible for the Company's day-to-day operation and management.

# MAIN ACHIEVEMENTS IN 2010



## LABOUR SAFETY AND PROTECTION

To implement and operate large-scale projects successfully, a special effort has to be focused on labour safety and protection. Sakhalin Energy is committed to the principle of doing no harm to people and industrial safety.

For this purpose, the Company applies a complex approach to HSE management. This approach is designed to ensure both compliance with the law and risk management in order to achieve a continuous improvement of HSE performance. We also require our contractors to manage HSE

to follow by clarifying those mandatory requirements which ensure personnel and operations safety. We updated the HSE risk analysis and controls description for each facility by including in them all HSE-critical operations which are supervised by competent specialists. Vast experience was gained from the development and implementation of combined HSE management systems which include audits of all levels, investigation of incidents, safety and health training, occupational hazard analysis, emergency

involved in the project travelled some 9 million km in 2010. In 2010, Sakhalin Energy continued to implement the Road Safety Programme launched in 2007. Its main elements are regular inspections of vehicle condition by traffic monitoring divisions and implementation of 10 Life Saving Rules. These are a set of 10 compulsory rules, developed and adopted by the Company, which include the Alcohol and Drugs Policy, strict speed limits compliance, safety belts, prohibition to speak on the cell phone while driving and availability of a journey plan and a defensive driving course certificate.

In addition to implementing the standards and strict control over their compliance, Sakhalin Energy is also pursuing an educational and communication programme on road safety. The programme includes quizzes, presentations, information booklets and videos on road safety, as well as road safety weeks, one of which was held in 2010 from 27 September till 1 October.

In 2010, the Company was certified for compliance with Occupational Health and Safety Management Standard (OHSAS 18001).

issues in line with this policy and international standards, accepted by the Company. Our main spheres of HSE activities remain:

- industrial safety;
- road safety;
- safe behaviour.

The 2010 results in the Company's safety performance were remarkable, having set a record in the number of worked LTI-free man-hours. The number of incidents determined on the basis of such indicators as the total reportable case frequency (TRCF) has decreased approximately by 50%. In 2010, this indicator was 0.57. The best annual result in the industry was 0.8.

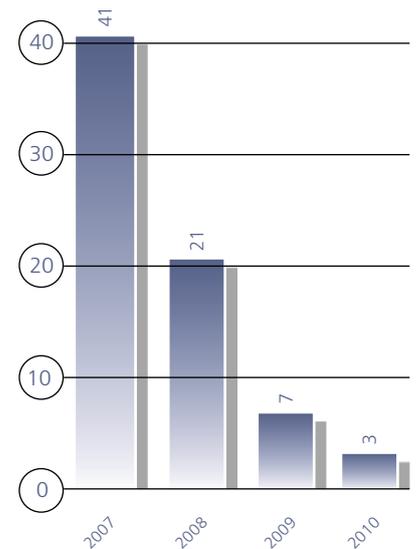
In 2010, there were no job-related fatalities in Sakhalin Energy, and only three LTI incidents were recorded.

State-of-the-art technologies and systems were successfully used to start production. In 2010, we made our standards easier

response, integrated operational safety systems and many other instruments of safety management at all the facilities.

With the transition from construction to operations, the risk profile of Sakhalin Energy changed, but the industrial risk level did not become lower. Sakhalin Energy employees and contractors place high emphasis on HSE communication and awareness, training in work place risk management, compliance with the 10 Life Saving Rules, permit-to-work system and ignition source control. All this is done to create a feeling of ongoing concern which results in a strong safety culture and prevention of careless behaviour.

The 2009 achievements in road safety were confirmed in 2010: no LTI incidents were recorded in the reporting year. By February 2011 the Company had worked for two years without injuries from road accidents given that the vehicles



Lost-Time Incidents Rate

## MAIN ACHIEVEMENTS IN 2010

### ASSETS AND COMPANY'S OPERATIONS IN 2010

#### **MOLIKPAQ (PA-A) PLATFORM**

In 2010, the Molikpaq well stock remained unchanged, with 13 oil production wells, four water injection wells, one gas reinjection well and one waste disposal well. The average production rate was about 45 thousand barrels of oil and about 1.5 million cubic metres of gas per day.

Intensive rejuvenation work was carried out on the platform throughout 2010, enabling the Company to drill new wells and increase production efficiency in the future. The Molikpaq rejuvenation project continuing into 2011 is expected to be completed by December 2010, following which the Company intends to start additional drilling from the Molikpaq.

To debottleneck the existing wells' operation and improve the future Molikpaq wells' lay out and trajectories, the first-ever 4D seismic in Russia was successfully carried out in the Astokh area to study changes occurring in the field after 12 years of oil production. The seismic data was processed and issued for interpretation, which is expected to be finished by the end of 2011.

#### **PILTUN-ASTOKH-SKOYE-B PLATFORM (PA-B)**

At the end of 2009 the PA-B platform had six production wells and one waste disposal well. Two oil production wells and three water injection wells were additionally drilled in 2010. The latter are expected to increase the oil production rate through the pressure maintenance programme



Molikpaq, the first stationary offshore platform not only for Sakhalin Energy, but for Russian offshore oil and gas industry in general, was installed near Sakhalin in 1998.

in Piltun area. With that aim it is planned to drill two new water injection wells in 2011.

#### **LUNSKOYE-A PLATFORM (LUN-A)**

Gas is produced from the largest diameter wells ever drilled in Russia. Two new gas production wells were completed in 2010, which brought the total number of wells to seven.

The Company also drilled wells to the oil rim in 2010. Production of oil from the oil rim is technically a very complicated task, because

of the formation thickness and geometry parameters. The oil rim well was completed in January 2011, and after that the Company embarked on assessment of the Lunskoye oil rim commercial development feasibility.

#### **ONSHORE PRODUCTION FACILITY (OPF)**

The main purpose of the Onshore Processing Facility (OPF) is to process gas and condensate from the Lunskoye field before hydrocarbons are pumped into the pipelines for transportation to

The LUN-A gas production rate is up to 10 million cubic metres of gas per /day per/ well. It means that the gas amount supplied by each of the LUN-A wells can feed a 2GW power plant at full operation.

the Oil Export Terminal and LNG plant. The oil and associated gas from Piltun-Astokhskoye field are also processed at the OPF. Both OPF trains were put on stream in late 2008. The OPF daily processes 51 million cubic metres of gas and about 60 thousand barrels of oil/condensate.

The OPF currently employs 250 Russian personnel in winter and 400 in summer.

### TRANS-SAKHALIN PIPELINE SYSTEM

All project facilities are integrated via the Trans-Sakhalin Pipeline System, which comprises some 300 km offshore pipelines and over 1,600 km oil and gas onshore pipelines, as well as 104 block valve stations, five pipeline maintenance depots and two booster stations, of which one is installed at the OPF and the other about halfway between the OPF and Prigorodnoye asset in the South of the Island.

The day-to-day operation and maintenance of the Trans-Sakhalin Pipeline System is provided by Sakhalin Energy's contractor, Gazprom Transgaz Tomsk (GTT).

All reinstatement activities for the pipeline right of way, erosion control and stabilisation of river banks that commenced in 2009 were completed during the spring of 2010. After that the right of way was subject to routine surveillance and geotechnical surveys. The findings are subject to evaluation and inclusion into work scopes and work schedules.

All routine maintenance activities scheduled for 2010 were successfully completed on time, before snow season.

Damages to the river banks caused by the heavy rainfall in the summer of 2009 were assessed and engineering solutions



developed or implemented. Work was executed and completed successfully in the winter of 2009-2010.

Surveys conducted during 2010 identified further river bank protections requiring remedial work or upgrades. Engineering solutions have been developed for these river banks and all work has been scheduled for execution during the 2010-11 winter period.

The requirement for reseeded was clarified (in Tymovsk, Smirnykh, Makarov, Dolinsk, and Korsakov Districts) through a survey in late spring of 2010 and a reseeded programme was developed. The reseeded campaign was successfully completed late in summer 2010. New reseeded survey is scheduled for late 2011.

The programme for monitoring and mitigation of adverse impact on the Western gray whales that was developed jointly with the Western Gray Whale Advisory Panel (WG-WAP), provided implementation of unprecedented measures in the course of seismic profiling and contributed to success of the operations, which both WGWAP and IUCN acknowledge (<http://www.iucn.org/wgwap/wgwap/>). Being an example of best practices, this programme will be used as a basis for future marine seismic profiling to be carried out in the area of the WGW feeding grounds.

## MAIN ACHIEVEMENTS IN 2010



GTT also provides the operation and maintenance services for Booster Station 2 (BS2), which was put on stream in 2010. In June 2010, the Company received a certificate of conformity certifying BS2 compliance with the design documentation. The BS2 final commissioning and hand-over to GTT for operation and maintenance was an outstanding result of successful cooperation between Sakhalin Energy and GTT in 2010.

In 2010, the Company started the construction of two gas transfer terminals required for gas deliveries to Gazprom, which was nominated a party responsible for gas supplies to the Russian Far East.

After the two gas transfer terminals are put on stream and reach full capacity, they will throughput around 2 billion cubic metres of natural gas every year.

### PRIGORODNOYE COMPLEX

The Prigorodnoye assets, operating in the south of Sakhalin, on the shore of Aniva Bay that actually stays ice-free nearly year-round, comprise an LNG plant with an LNG Jetty, and an Oil Export Terminal (OET) with a Tanker Loading Unit (TLU) installed 5 km into the sea.

The LNG plant was inaugurated on 18 February 2009. It occupies 490 hectares of land and has two trains, each with a nameplate capacity of 4.8 million tonnes of LNG per year. The LNG facilities also include an LNG jetty, a laboratory, a control room and LNG storage tanks.

In terms of capacity, the Sakhalin LNG plant ranks sixth among all the LNG plants operating in the world. During 2010, Sakhalin Energy implemented a debottlenecking programme,

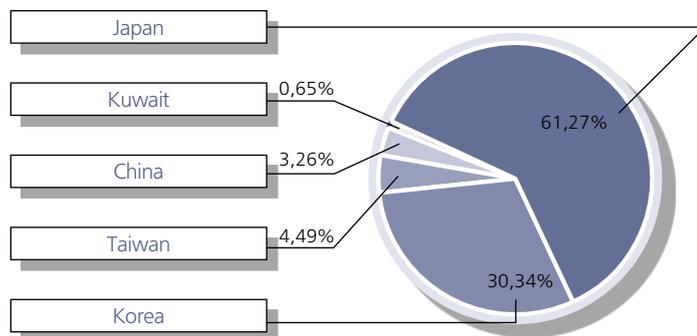
which increased the plant's capacity by several percent. The debottlenecking programme will continue.

The LNG plant celebrated two milestones in 2010. In January 2010, the Company successfully delivered the hundredth LNG shipment from Prigorodnoye asset (symbolically, this shipment was carried by the Grand Aniva, the same LNG carrier that shipped the first LNG cargo from Sakhalin), and as soon afterwards as October 2011 the two hundredth cargo set off to its destination. These achievements speak loudly of the fact that the Company's entire production chain running from the offshore platforms in the Island's North to the LNG terminal in the South, is operating in a reliable and safe way. Sakhalin Energy, with its 5% of the world LNG production, has become a significant element of the regional energy security system.

# HYDROCARBON PRODUCTION AND EXPORT

## LNG

The LNG plant reaching full production capacity and providing reliable LNG supplies to buyers were Sakhalin Energy's key achievements in 2010, the first full year of the LNG production. Due to the management structure optimisation, successful debottlenecking and equipment adjustment, the LNG plant reached and even exceeded its design output



Sales of Sakhalin LNG in 2010

Liquefied natural gas (LNG) is a colourless odourless liquid, less than half the density of water, consisting mainly (~90%) of methane, the simplest hydrocarbon and a commonly used fuel (CH<sub>4</sub>). After being cooled to approximately -160°C (-250°F) at standard ambient pressure, natural gas converts to liquid and shrinks to 1/600th of its initial volume, becoming suitable for sea shipment.

Natural gas and its components are used as a fuel for electric power generation and as a

feed material for a wide range of products, from fabric fibres to plastic articles used in public health, computer hardware and furniture manufacturing.

Natural gas is one of the cleanest fuels. The CO<sub>2</sub> emissions from the production of one thermal unit from coal are 67% higher than from the burning of an equivalent amount of natural gas.

Liquefied natural gas is as still cleaner fuel, because the liquefaction process involves additional cleaning of natural gas.

by producing over 10 million tonnes of LNG in 2010. The Company's LNG shipments in 2010 were to Japan, Korea, China, Kuwait and Taiwan.

The Sakhalin-LNG was delivered to destinations either by the buyers' ships or by the LNG carriers – Grand Elena, Grand Aniva and Grand Mereya – owned and operated by two Russian-Japanese consortia and provided to the Company under long-term charters.

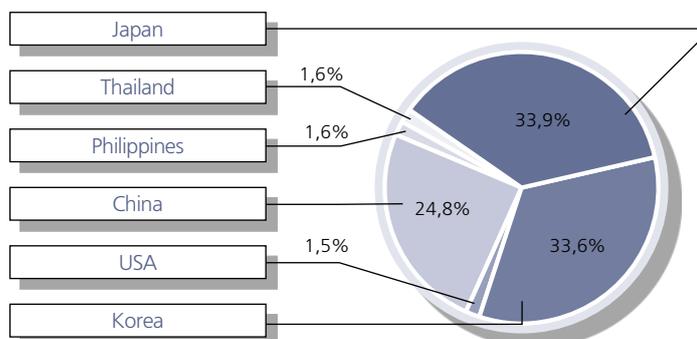
The Vityaz Blend is a new oil grade introduced by Sakhalin Energy. It is a light semi-sweet grade similar to the light oil produced in Oman.

## OIL

Sakhalin Energy produced and exported over 6.1 million tonnes (47 million barrels) of Vityaz Blend from the Prigorodnoye terminal in 2010. That is 10% higher than in 2009 (5.5 million

tonnes), irrespective of the fact that the oil production was slightly below the annual target, set by the Company.

Vityaz Blend was supplied in 2010 to 14 buyers in Japan, Korea, China, the Philippines and Thailand.



Sales of Vityaz Blend in 2010

## MAIN ACHIEVEMENTS IN 2010

### OIL SPILL PREVENTION/RESPONSE PREPAREDNESS

Oil spill prevention and oil spill response (OSR) preparedness are top priority with Sakhalin Energy. The Company comprehensively addresses this challenging mission. The changeover to year-round production required a review of potential oil spill risks and resulted in definition of more sophisticated and larger-scale tasks designed for oil spill prevention and response. Accordingly, the Company revised its planned requirements in special-purpose equipment and trained personnel, developed OSR plans for new production assets, as well as new oil spill response procedures for swamps, wetland, coastal strip and ice conditions.

In accordance with the Russian law requirements Sakhalin Energy submits its OSR Plans for approval to Russian state agencies detailing the techniques and procedures to be used for response operations. The OSRP approvals process had been completed before full-scale start-up of the Sakhalin-2 facilities and the Company today is fully compliant with the OSR statutory requirements.



Sakhalin Energy has vast experience in oil spill prevention and has achieved an impressive record in these activities. From commencement of oil production through present, the Company has produced almost 200 million barrels of oil spilling only about 25.8 barrels (approximately 3.5 tonnes). Over all these years there

has been no oil or petroleum product spill which could be graded as an emergency situation. The Company continues to maintain preparedness of its resources and facilities to respond to accidental oil spills onshore and offshore.

The Company has developed, obtained approval for and implemented OSR Plans for all of its production assets. Asset OSR Plans of the Company, as well as the Oiled Wildlife Response Plan are available on the Company's official website ([www.sakhalinenergy.ru](http://www.sakhalinenergy.ru)).

To ensure OSR ongoing preparedness, Sakhalin Energy has contracted companies which provide professional emergency response and rescue services for the Company's onshore and offshore assets. Sakhalin Energy also maintains non-professional emergency response teams at its facilities – at Prigorodnoye complex, OPF, BS2, on all of its offshore platforms and onboard Smit Sakhalin and Smit Sibiu



vessels. Personnel of these teams are well trained and are prepared to respond to oil spills immediately.

To maintain its OSR preparedness on an annual basis, Sakhalin Energy carries out various exercises at its assets, including OSR equipment drills, tabletop

exercises, and various level training drills including biannual corporate level mandatory drills. These allow testing preparedness of all oil spill response chain elements. In 2010, the Company held about 800 activities, including some 180 OSR drills at

production assets, a corporate exercise at the BS2 and Lun-A Platform, a training course for on-duty personnel of emergency and crisis management units on OSR activity planning; as well as an oiled wildlife rehabilitation exercise, etc.

## SOCIAL AND ECONOMIC IMPACT

### BENEFITS FOR THE RUSSIAN FEDERATION

The Russian Party's (Russian Federation) take from the Sakhalin-2 Project includes various fees, taxes and royalty and Sakhalin Oblast payments, the Russian Party's share of profit production and the profits tax payments by the Company. The latter two types of payment occur after full recovery of the Project costs.

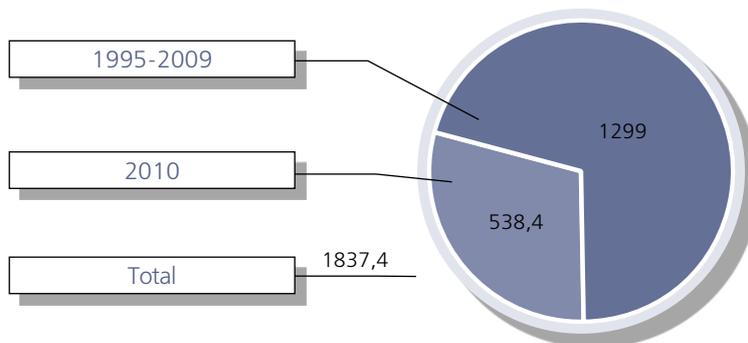
In 2010, the second year of year-round oil production and the first year of LNG production, the royalty payments went up \$200 million from the 2009 level, reaching almost \$481 million.

In 2010 Sakhalin Energy's contributions to the Russian Federation budgets of all levels totalled \$538.4 million paid in taxes and other mandatory payments. This exceeds the amount paid in 2009 by 46%.

Inclusive of the proceeds from the Sakhalin-2 Project in 2010, the total amount of payments from the Sakhalin-2 PSA to the Russian Party for the entire lifetime of the Project (1995-2010) is in excess of \$1.8 billion.

Taxes and other mandatory payments by Sakhalin Energy have accounted for a significant part of the revenues received by a vast majority of the municipalities affected by the Project. The Company paid \$59.8 million taxes and other mandatory payments

- \$1.837 billion aggregate payments to the Russian budgets from the launch of the Project to the end of 2010;
- Access to new technologies and business development opportunities for Russian companies;
- \$15 billion in contracts awarded to Russian companies and organisations;
- Experience in managing an integrated high-tech project in a remote location in sub-Arctic conditions;
- \$100 million payments to the Sakhalin Development Fund under the Sakhalin-2 PSA;
- Significant payments to the budgets of Sakhalin Oblast and local municipalities;
- Significant upgrades of the Sakhalin infrastructure (ca. \$600 million);
- Notable increase in local employment (both direct and indirect effect) and local workforce quality;
- Increase in salaries and living standards on Sakhalin;
- Many contracts and subcontracts awarded to Sakhalin companies, enhancing their opportunities and competitiveness;
- Extensive implementation of the Company's social and public initiatives in the region.



Total Russian party take, million dollars

## MAIN ACHIEVEMENTS IN 2010

to Sakhalin Oblast and local municipalities in 2010.

Taxes and other mandatory payments by Sakhalin Energy have accounted for a significant part of the revenues received by a vast majority of the municipalities affected by the Project. The Company paid \$59.8 million taxes and other mandatory payments to Sakhalin Oblast and local municipalities in 2010.

### RUSSIAN CONTENT

Meeting the Russian Content requirements for the Sakhalin-2 Project is one of the Sakhalin Energy's strategic priorities. Russian companies involved in the Project have unique access to the world best practices, international business opportunities and management skills.

The Russian Content is the use of Russian labor, materials, equipment and contract services. The Sakhalin-2 PSA requires the Russian Content to be measured in labour input (in man-hours) and the volume and quantity of materials and equipment (in

Sakhalin Energy's work on the Sakhalin-2 project boosted development of many local, regional and national enterprises, giving them potential access to non-Russian markets, and generating more employment, higher salaries, increased retail trade, better social programmes and larger tax payments. The Project has contributed to a wide-ranging revitalisation of the economy on Sakhalin Island, generally referred to as the 'multiplier effect'

weight units) delivered by Russian contractors. Sakhalin Energy will use its best efforts to achieve a level of Russian content of 70% over the life of the entire Sakhalin Project. The utilization of Russian Content in 2010 was 94% in man-hours and 96% in materials and equipment.

Sakhalin Energy keeps up intensive effort to increase Russian Content in the Sakhalin-2 Project, being guided in this work by the Russian Content Policy and Russian Content Development Strategy (both documents are available at the website of Sakhalin Energy). These efforts mainly consist in the long-term planning of the procurement and contracting

demand of the Sakhalin-2 Project, timely identifying any opportunities for the Russian Content development and providing targeted assistance to Russian companies so as to increase their competitive potential.

Russian Content can also be measured in value terms, which is also taken into account by the Company. The Company demonstrated very good Russian Content performance in value terms as well. The total value of contracts awarded to Russian companies from the Project start till the end of 2010 is \$15.1 billion. In 2010, the value of new contracts and amended contracts with Russian companies was \$788.12 million, or 66% of the total contract value.

In addition to job creation (especially in the construction phase) and personnel and capacities' development, Russian companies also benefit from the following:

- improvement of quality of services and materials, as well as safety standards;
- access to new technologies and unique experience;
- doing business with international partners and setting up joint ventures;
- higher competitiveness as bidders in other project operators' tenders, both in Sakhalin and internationally.



## VENDOR DEVELOPMENT PROGRAMME

The long-term Vendor Development Programme is a unique programme developed by Sakhalin Energy, intended to increase the competitiveness of Russian companies and share the unique experience of the international oil and gas project. The Programme contains a number of training modules and informs Russian vendors about various ways of cooperation with Sakhalin Energy and other major project operators.

The Vendor Development Programme implements the following training modules:

- health, safety and environment;
- quality assurance;
- bidding.

The Vendor Development Programme held 14 workshops in 2010 for current and potential contractors of Sakhalin Energy, which were attended by 80 people from 45 Russian companies.

Examples of the contracts awarded in 2010:

- Contract with SakhalinShelfService for the Kholmsk support base services;
- Contract with Transstroy Sakhalin for the construction of Gas Transfer Terminals in Dalneye and Boatasino;
- Contract with Vakkor (Korsakov, Russia) for demolition of temporary structures on the LNG site;
- Contract with SOGAZ for physical damage insurance of the offshore facilities.



## PERSONNEL DEVELOPMENT AND TRAINING

Development of Sakhalin Energy staff at all levels is a key element used to achieve and maintain a highly professional level and motivate personnel with a purpose to ensure maximum production efficiency, at the maximum labour potential applying the policy of diversity and inclusiveness.

The Company's comprehensive approach in personnel development includes the following:

- training planning and implementation;
- uninterrupted cycle of planning and regular Goals and Performance Appraisal;
- career planning and development;

- recruitment and development of talent pool;
- development of scientific potential;



# MAIN ACHIEVEMENTS IN 2010



- traineeship and pre-diploma internship programme.

Based on the personnel performance appraisal and career development plans, the Company annually prepares strategic plans for personnel training and professional development. Implementation of these plans is monitored both by employees and their managers, on one side, and by the HR Directorate and top company management, on the other side.

Forms of training comprise on-the-job training, distant learning, conventional training courses, workshops and case studies. 1875 staff attended training at workshops, class training and advanced training courses (including distant learning) in 2010 (including

training at two or more courses). Sakhalin Energy's investment in personnel training amounted to more than RUR 250 million.

Sakhalin Energy training resources are unique and cover the possibilities of both Russian and foreign providers of training services.

As for disciplines, Sakhalin Energy top priorities in its training policy are as follows:

- health, safety and environment (HSE);
- specialised technical training courses and courses in other professional areas (finance, contracts, HR, etc.);
- management and business administration;
- PC skills, Internet and Intranet training, other IT courses;

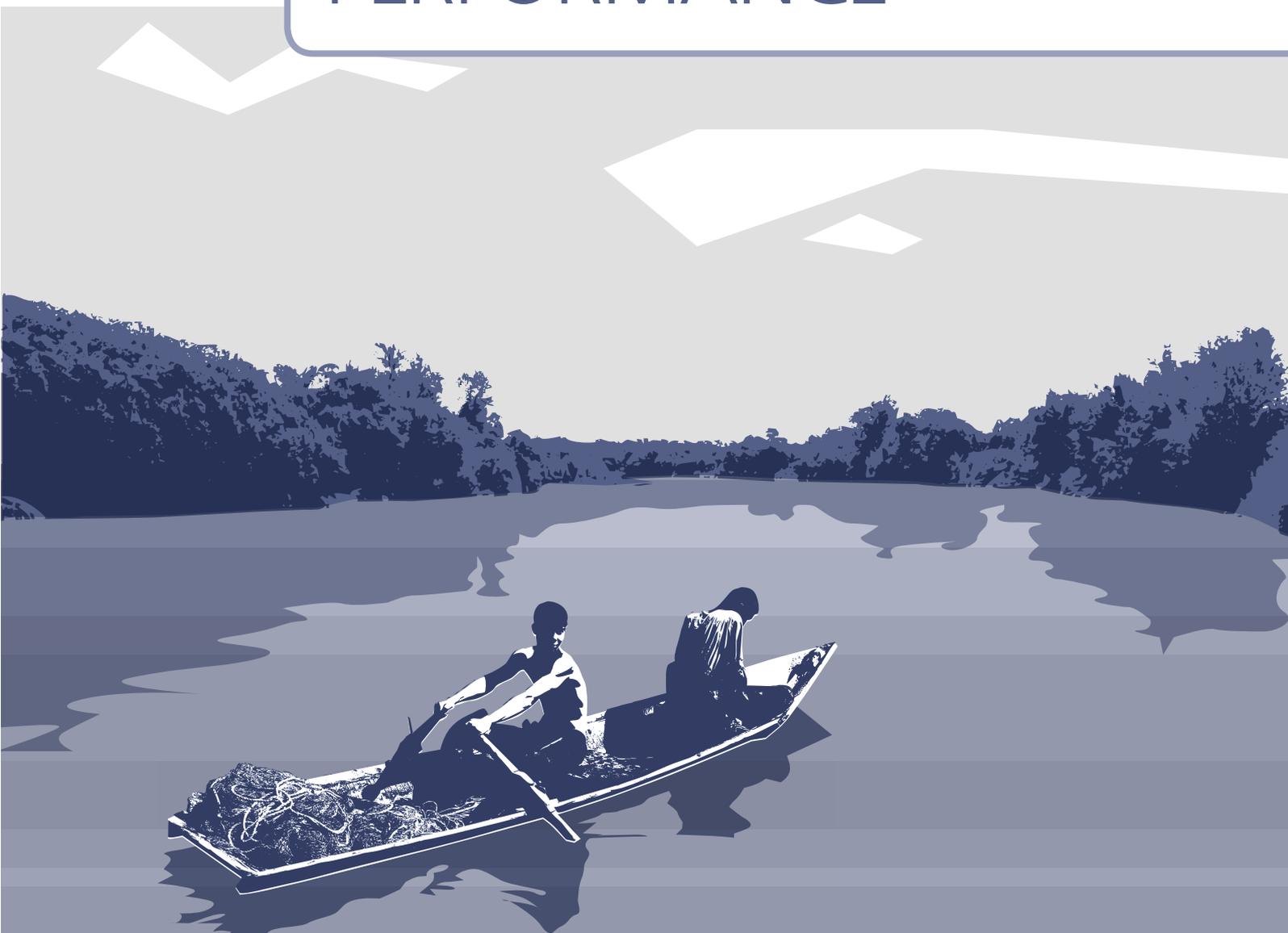
- long-term educational courses for professional certification (CIMA, ACCA, CIPS, etc.);
- a range of professional development training courses;
- language courses for Russian Nationals and expatriates.

Another way of personnel development is on-the-job training under the Apprenticeship Programme, which has been in place since 2003 and is aimed at supporting the development of Sakhalin residents' potential. 150 people have been trained under this programme. Another 20 individuals began their training in 2010. Many of the trained workers are now employed at the LNG plant, the OPF and the offshore assets.

It has been for 5 years now that Sakhalin Energy has been financing its employees training at the Chartered Institute of Management Accounting (CIMA). CIMA qualifications are strategic knowledge, future financial leaders need for successful business understanding and management. Over the years that the CIMA training support policy has been in place, the Company has acquired 25 highly qualified financial managers, many of whom have become team leaders and heads of departments. Another 40 people are on their way to CIMA certificates.

Since 2006, the Company has been similarly supporting the CIPS (Chartered Institute of Purchasing and Supply) students. CIPS qualifications are a perfect tool for logistics and procurement specialists to reach top managerial positions in transportation, storage and supplies management. The Company gets highly qualified specialists – analysts and strategists and thus optimises a good number of work activities. Over the entire period the programme has been in place, 10 people have received certificates from the British Royal Commercial Institute.

# HSE AND SOCIAL PERFORMANCE



## ENVIRONMENTAL PROTECTION

Sakhalin Energy manages its health, safety, environment (HSE) and social issues within the framework of its business activities. The Company pursues the goal of no harm to people, protecting the environment and contributing to sustainable development.

The management system is based on the Plan-Do-Check-Act methodology of ISO 14001 and OHSAS 18001 management system standards.

Internal and external audits are conducted pursuant to the approved annual inspection plans, to review the integrated management system performance. The Company's shareholders and lenders, as well as external certification authorities, are invited to perform external audits. Internal audits are carried out by the properly trained auditors – the Company's properly skilled personnel and the shareholders' experts. Apart from the ISO 14001 and OHSAS 18001 audits, the following additional audits were carried out in 2010:

- Three external audits of the HSE and social performance were conducted by AEA Technology, an independent HSE consultant of the Company's shareholders (the audit reports were published at the Company's website and distributed to the Sakhalin communities through Sakhalin Energy's information centres);
- Internal audits of the HSE Management System performance and HSE checks during aircraft flights and diving operations.

### INDUSTRIAL ENVIRONMENTAL CONTROL

Sakhalin Energy applies industrial environmental control to ensure compliance with the requirements set by Russian environmental protection laws and environmental standards, and to ensure efficient use of natural resources and environmental impact mitigation measures.

The Company performs its industrial environmental control along the following lines:

- air emissions control;
- water use and discharge control;
- waste management control.

The Company has developed and is implementing Air Emissions and Energy Management Standard, Water Use Standard, and Waste Management Standard.

### ENVIRONMENTAL MONITORING AND BIODIVERSITY CONSERVATION

Sakhalin Energy operates an environmental monitoring and biodiversity programme comprising a number of surveys, each of which relates to actual or potential impacts of the Company's activities on the environment. This programme was reviewed by external stakeholders.

In 2010 environmental monitoring covered the following targets:

#### Floral and Vegetation Monitoring

Sakhalin Energy performs environmental monitoring of vegetation in order to assess any negative impact from production facilities on natural environment. This is achieved by studying the condition of flora and vegetation in the reference areas along the pipeline route and in the vicinity of OPF and Prigorodnoye complex.

The results of monitoring show the following:

- Generally, the structure and species composition of the



overwhelming majority of vegetation communities near Sakhalin Energy's production facilities remain unchanged;

- The rate of recovery of vegetation cover in the right-of-way is low;
- At this point in time it is impossible to fully assess the long-term impact on the vegetation. Long-term monitoring is required to identify the nature of impact and develop adequate measures.

**Soils Monitoring**

The objective of soils monitoring is to assess the impact of the Company's production on the soils in adjacent ecosystems.

The first years (2009–2010) of monitoring revealed neither radical changes in the soil condition, nor soil contamination.

**River Ecosystems Monitoring**

The monitoring of ecosystems in the watercourses crossed by the Company onshore pipelines show the extent of impacts from the pipelines and production facilities on the aquatic environment as a whole.

To summarise, the monitoring results provide no indications of impacts on the water quality, flora or fauna from the pipeline crossings.

**Offshore Monitoring**

In 2010 Sakhalin Energy continued qualitative monitoring of the marine biota and habitats in the areas of offshore production facilities.

The 2010 monitoring results give grounds for the following key conclusions:

- Hydrochemical measurements in the offshore facilities areas were within baseline values and below the



- maximum permissible concentrations set for fisheries;
- Concentrations of petroleum hydrocarbons and heavy metals in bottom sediment were either within the baseline range or significantly below the permissible concentrations;
- The monitored areas showed high species-level diversity in the benthic and plankton communities, which is evidence of environmentally healthy habitats;
- Impact from construction (platforms and pipelines) can be described as insignificant and residual;
- Well drilling, oil and gas production and export operations had no effect on the examined parameters;
- No accumulation of petroleum hydrocarbons was registered near wellheads of appraisal wells.

**Small Mammals Monitoring**

The Company monitors the species structure of small

mammals' communities in the Prigorodnoye complex, BS2 and OPF areas, determines species abundance and diversity indicators, as well as morphophysiological and demographic characteristics of indicator species of small mammals. Small mammals (rodents and insect-eating mammals) are sensitive to human-induced impacts and respond quickly to environmental changes. For this reason they are considered to be indicative of the environmental conditions in the areas of production facilities.

The studies conducted at the above sites within two years revealed no significant deviation from the norm in small mammal's communities in the area of Sakhalin Energy's production facilities. Some changes were observed that are due to intra-population dynamics of certain species. However, to confirm conclusions about the indicator species' stability and to identify inter-annual trends, it is necessary that the monitoring continues.



### BALLAST WATER CONTROL

The LNG carriers and oil tankers arriving at the port take on ballast water in other parts of the world where marine flora and fauna differ from those in Aniva Bay. The Company has developed and introduced a range of measures to protect local valuable flora and fauna from invasive organisms' penetration. This system of measures is the most comprehensive and stringent in Russia. One of the Company's requirements is mandatory changing of ballast water offshore. The Company carries out continuous monitoring of both ballast water and Aniva Bay water. Sakhalin Energy's programme of the ballast water monitoring includes sampling from ballast tanks of the LNG carriers and oil tankers chartered by the Company. In addition, Sakhalin Energy conducts surveys of aquatic biota in the LNG Plant/OET berthing area in Aniva Bay. The main purpose of this monitoring is to control the condition of aquatic biota near the Prigorodnoye Port and to minimise the probability of hazardous invasive organisms' penetration to this area when ballast water is dumped from tankers.

The 2010 surveys were carried out from May to November. Monthly samples were taken of the following groups of organisms in the Aniva Bay water column: phytoplankton, zooplankton and ichthyoplankton.

This work resulted in obtaining new data on structural characteristics of phytoplankton, zooplankton, ichthyoplankton and benthos. Species novel to Aniva Bay were found, but they were not invasive. Qualitative and quantitative changes were assessed for the jetty zone (coastal area) and the oil export zone. No invasive species were found in the zooplankton of the areas monitored in 2010. All the identified phytoplankton species were also typical of Aniva Bay.

### BIODIVERSITY CONSERVATION

At present, Sakhalin Energy is a leader in the global oil and gas industry in terms of biodiversity conservation. In particular, in compliance with the best international practices, the Company has developed and approved a Biodiversity Action Plan

(BAP), in which it describes how it is going to meet its obligations with respect to minimising impacts on biodiversity and environment at the operational phase.

The Sakhalin Energy BAP was approved by the Working Group of Experts of Environmental Council of the Sakhalin Oblast and was highly praised by independent international experts and the Company's lenders. The BAP implementation is supported by all stakeholders at both national and international levels.

In 2010, in accordance with the priorities set in the BAP, the Company carried out monitoring of the Western Gray Whales, Steller's sea eagle, protected (Red Book) bird species and wetlands.

### Western Gray Whales Monitoring

The Western Pacific (also known as Okhotsk-Korean) population of gray whales is one of the two existing populations of this species. The population is listed in the Red Book of the Russian Federation and is classified by IUCN as critically endangered. Currently, the population numbers about 130 whales. This count is based on data collected in the course of monitoring conducted off the coast of Sakhalin Island by foreign and Russian scientists, financed by Sakhalin Energy and Exxon Neftegas Limited since 1997. The results of the studies are submitted to IUCN's Western Gray Whale Advisory Panel (WGWAP). The Panel was initiated by Sakhalin Energy in 2004, an unprecedented action in the history of global oil and gas industry.

Studies of the Western gray whales include five main directions:

- photo-identification;
- distribution;
- studying the behaviour of whales;

- acoustic studies;
- studying of feeding (benthos).

Work along each of these directions continued in 2010. The work showed that the Company's efforts to reduce impact on Western gray whales were successful, there was no adverse impact on the whales and the whale population was quite stable. There is another important result: absolute majority of the information that is currently available on the Western gray whale population has been obtained from Sakhalin Energy's studies and monitoring. The studies brought surprising data about the wintering behaviour of some Western gray whale individuals in 2010. The satellite tagging system tracked one whale to move from Sakhalin via the Pacific Ocean to the migration corridor of the other grey whale population (Chukotka-Californian). Of course, from the behaviour of just one whale it is difficult to judge about the wintering habits of the entire population and especially that there is a single population, in which some individuals tend to spend part of their time at the West coast of the Pacific Ocean. However, the migration of this one whale at least shows that the two populations are not isolated as it was previously believed.

The programme of the WGW studies and cooperation with experts for development and use of best practices to reduce impacts on the whales is unique, Sakhalin Energy takes pride in it and intends to continue this practice.

### Protected Birds Monitoring

In 2010 monitoring of protected bird species continued within the two-kilometre corridor along the pipeline route and in the OPF, BS2, and Prigorodnoye complex areas.



The life of gray whales is spent in migration, which results from the seasonal changes in availability of food in arctic waters. It was believed that the Western gray whales winter and breed in the coastal waters of the South China Sea, most likely near the coast of the Guangdong Province and the water area adjoining Hainan Island.

In order to monitor the migration routes, in September 2010 the programme on satellite tagging of the Western gray whales was implemented by A.N. Severtsov Institute of Ecology and Evolution of the Russian Academy of Sciences. The research was contracted through the International Whaling Commission and IUCN with funding from Sakhalin Energy and Exxon Neftegas Limited.

The tagging of whales has shown that the assumption that the Western Gray Whales winter and breed in the coastal waters of the South China Sea was probably not true – one tagged whale migrated to California. Moreover, that whale registered in the Sakhalin catalogue was included into the photo-identification catalogue of the Eastern gray whale population.

The monitoring covered the following key species: Japanese snipe, Japanese robin, cinnamon russet sparrow, mandarin duck, white-tailed and Steller's sea eagles, European hobby, Siberian spruce grouse, black-billed capercaillie, Sakhalin dunlin, Aleutian tern, long-toed stint,

great grey owl, Eurasian pygmy-owl, boreal owl and northern hawk owl.

Surveys were carried out in the main habitats preferred by the protected bird species. Also, the condition of habitats and ornithological complexes was assessed.

Sakhalin Energy has an oiled animals rehabilitation programme in place. A bird rehabilitation centre – the only facility of this type in Russia – has been set up as part of this programme. In 2010, the Company together with Exxon Neftegas Limited held an Oiled Wildlife Response course, using the Company’s bird scaring equipment and equipment for catching and stabilising oily birds. The training involved employees of both companies, as well as people from the government institutions and private businesses specialising in wildlife protection.

As a whole, the monitoring programme continues to show that the Company’s production facilities have had very minor impact on the Red Book birds’ population as a whole.

### Steller's Sea Eagle Monitoring

The Steller’s sea eagle, as one of the largest birds, occupies a special place in the multitude of protected species. In Japan, this species is considered a 'natural monument' and is protected in accordance with the law On Conservation of Species.

Sakhalin Energy’s programme for conservation of the Steller’s

sea eagle and the white tailed sea eagle that are listed in the Red Books of Sakhalin and the Russian Federation was launched in 2004. An important component of the monitoring is to reveal any population-characteristic-

Quote from Dr. Saito, coordinator of the Sakhalin Japan Wildlife Network, during his visit to Sakhalin: 'I am pleased to be able to say that the Steller’s Sea Eagle is now in very capable hands'.

changing trends and their dependence on the changes in natural or induced factors, as well as to identify factors that increase nestling loss and reduce reproduction in the population. Surveys were performed in North-Eastern Sakhalin, including lagoon areas and lower parts of rivers crossed by the onshore pipelines.

Generally, 2010 was not a good year for eagles, because of late egg-laying due to the lingering cold and snowy spring, late hatching and, to top it off, shortage of food resources due to abnormally high temperatures in June. All these factors lead to a drop in the population’s reproduction rate. The reproduction rate drop was registered both in the affected area and in the reference zone, which

shows the changes were due to natural reasons. The total number of eagles remained unchanged.

### Wetlands Monitoring

Wetlands are one of the most common and complex ecosystems of Sakhalin that plays an extremely important role in water protection and conservation. Sakhalin Energy has a long-term programme of wetlands monitoring, the scope of which includes:

- control of wetlands recovery within the pipeline right of way and in adjacent territories;
- assessment of all potential negative impacts on wetlands as a result of pipelines construction and operation; and
- mitigation of such impacts.

Wetlands are very delicate ecosystems and understanding of their processes is extremely important for their conservation. A special focus on wetlands is also due to the fact that in case of disturbance they take long time to recover. At the moment, it is difficult to determine the nature and scale of long-term impacts of the pipeline construction on the wetlands. Preliminary results of the monitoring show that the process of soil and vegetation recovery in the pipeline right of way is going as slowly as it was expected, while in the adjacent areas negative effect of construction turned out to be lower than expected. The Company plans to continue the monitoring of wetlands so as to be able to mitigate any potential negative impacts.



# SOCIAL RESPONSIBILITY

## HUMAN RIGHTS

Respect for human rights is one of the underlying core values and an important business principle as set forth in the General Business Principles of Sakhalin Energy.

In 2009 Sakhalin Energy joined the UN Global Compact and committed to strictly and consistently abide by its ten principles, including the human rights principles, which the Company shares and supports:

**Principle One:**

Businesses should support and respect the protection of internationally proclaimed human rights; and

**Principle Two:**

Make sure they are not complicit in human rights abuses.

The human rights principles are set forth in the following main documents of the Company, which provide basis for the human rights compliance in everyday business.

- Sakhalin Energy Statement of General Business Principles;
- Sakhalin Energy Code of Conduct;
- Whistle Blowing/Grievance Procedure;
- Sustainable Development Policy.

Appropriate training and awareness sessions are held at the Company offices and assets to ensure compliance with the human rights principles and procedures as set forth in the above documents.

The human rights principles control system requires that the Company management provide the employees with safe and confidential means of raising any concerns and reporting any non-compliance. On the other hand, all Sakhalin Energy employees are

to report to the Company of any identified violations of the General Business Principles.

The Whistle Blowing Procedure is an open and easily available document. Each whistle-

In November 2010, a workshop called 'Addressing Public Grievances in Sakhalin Oblast: Theory and Practice' was held in Yuzhno-Sakhalinsk. The workshop was organised by the Sakhalin Oblast Government. The Company made a presentation on the mechanisms and practices of addressing grievances, reported to Sakhalin Energy.

The Whistle Blowing/Grievance Procedure is a key mechanism to implement that.

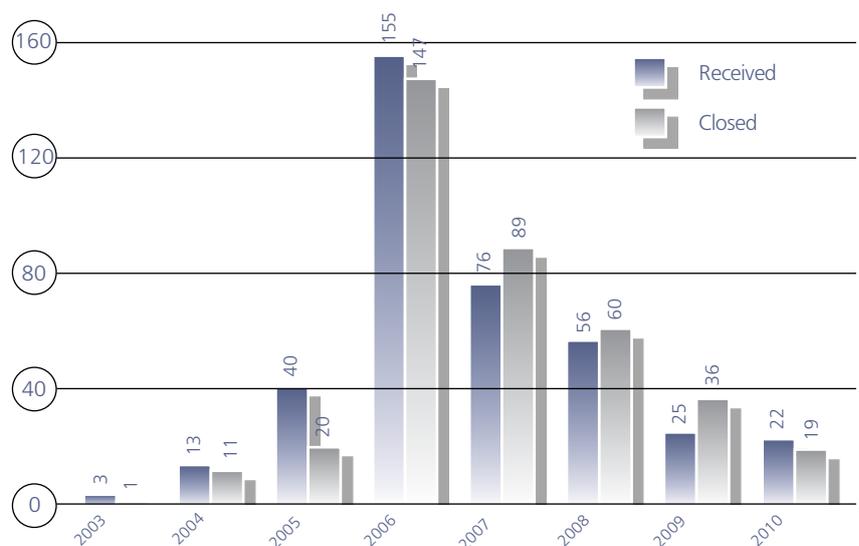
The Procedure gives employees, contractors, suppliers, joint venture partners and members of the community a safe means to raise any concerns in connection with the business principles violations which potentially can generate social or environmental impacts for the island.

The Procedure also encourages suggestions to improve the Company performance.

blower is guaranteed protection against any risk of persecution or punishment.

Grievances are accepted via a range of channels to ensure maximum accessibility of the Company for complainants. The Company uses public consultations to see how efficiently the grievance reporting channels work.

The Company received 22 grievances in 2010. This is 12 percent lower than in 2009 and only half of the number of grievances received in 2008. One of the reasons for the reduction



19 grievances were closed in 2010, with a statement of satisfaction signed by each complainant

# HSE AND SOCIAL PERFORMANCE

In 2009, Sakhalin Energy together with four other companies worldwide was chosen to test the so-called Ruggie Principles set out by Special Representative of the UN Secretary-General for Business and Human Rights, Professor John Ruggie. The Ruggie Principles are expected to become a grievance-handling guidance for businesses around the world. Sakhalin Energy represents Russian businesses and oil and gas community in the Ruggie Principles testing process.

Dr Ruggie's representatives visited Sakhalin in 2010 to familiarise themselves with the Company's Grievance Procedure and issue appropriate recommendations. Sakhalin Energy's Grievance Procedure and its implementation were highly appraised.

- Information sharing through the following resources: Sakhalin Energy website, Energy weekly TV programme broadcast in Sakhalin, Vesti monthly newspaper, information letters and other materials distributed in communities, media (radio, newspapers and TV), etc.;
- Indigenous people engagement in the framework of the Sakhalin Indigenous Minorities Development Plan (SIMDP) and preparation of the new 5-year SIMDP for 2011-2015;
- Company information centres set up in local libraries.

was a significantly smaller amount of construction work carried out in 2010, which stopped the inconveniences for local residents. Prompt identification and addressing potential issues also played a significant role. Of all the grievances received in 2010, about 50% were connected with the Project impacts on local residents and 27% with the employment relationships (contractors).

Nineteen grievances were closed in 2010, with a closure report signed by each complainant.

## ENGAGEMENT WITH COMMUNITIES

In 2010 the Company continued its systematic and continuous engagement with communities.

According to the Public Consultation and Disclosure Plan, the key engagement activities in 2010 included:

- Meetings with community members, groups and individuals to update the participants on the latest developments and other

aspects of the Company activities, and receive feedback. A total of 10 public engagement meetings were held in 2010, attended by over 200 members of the Sakhalin communities;

In addition, special consultations with stakeholders were held as part of the preparation process of the non-financial reports. These consultations were attended by more than 50 representatives of local,

The Vesti newspaper and the Energy TV programme cover the most important events in the Company life. Twelve issues of the newspaper and 51 issues of the TV programme were delivered in 2010. Both of Sakhalin Energy's media resources were declared winners in December 2010 in Silver Threads, a national corporate media competition, for excellence in achievement of corporate targets (Vesti) and as the best corporate TV programme (Energy).



regional and international NGOs (including environmental and social NGOs), representatives of the indigenous people of Sakhalin, Sakhalin legislative and executive authorities, social services, etc.

### Information centres

Operation in 2010 of twenty information centres revealed that this network is an efficient, available and important tool for the Company's interaction with local communities.

The information centres were set up in district and village libraries in communities along the route of the Trans-Sakhalin pipeline system and in the vicinity of other project facilities. The information centres are equipped with display stands and office equipment and have Internet access, which also enhances functional capabilities of the libraries.

Information centre visitors are served by library employees during the usual library hours. In October 2010, these employees attended a training seminar organised by the Company in Yuzhno-Sakhalinsk.

The total of 3,753 people visited Sakhalin Energy's information centres in 2010. The focus of the people's interest was on employment opportunities, additional information on Sakhalin-2, as well as participation in the Company social programmes and public campaigns.

### COOPERATION WITH SAKHALIN INDIGENOUS PEOPLES

In 2010, the Company continued regular engagement with the Sakhalin Oblast indigenous peoples in areas of their traditional residence and business.

Two new websites dedicated to partnership programmes were launched in 2010 – one for Sakhalin Indigenous Minorities Development Plan ([www.simdp.ru](http://www.simdp.ru)) and the other for Korsakov Council of Sustainable Development ([www.korsakovsovet.ru](http://www.korsakovsovet.ru)).



A highlight of 2010 was the development of the second Sakhalin Indigenous Minorities Development Plan 2011-2015. As part of this programme, extensive and detailed consultations were held with indigenous people and stakeholders. Two rounds of consultations were held: in spring and autumn 2010 with more than 500 people attending.

implementation, is based on efficient involvement of the Sakhalin indigenous peoples in its management on the following principles:

- Consultations and interaction with the account of cultural differences;
- Admit the need for public consent to be achieved in the context of traditional and

In the period of 2006 – 2010 over 300 projects, worth of over RUR 40 million, were implemented under the SIMDP.

Active involvement of Sakhalin indigenous peoples is critical to the approach inherent in the trilateral programme (involving the Company, the Regional Council of Authorised Representatives of the Sakhalin Indigenous Minorities and the Sakhalin Oblast Government) aimed at the development of Sakhalin indigenous peoples. The Plan, including the process of its preparation and

innovation structures, values and practices;

- Admit the fact that achieving consent takes time;
- Plan and use multi-aspect approach with ethnic, geographic, age-related, social, organisational and gender differences taken into account;
- Attach utmost importance to transparency of actions and timely exchange of information

## HSE AND SOCIAL PERFORMANCE

On 14 December 2010, in Moscow, Sakhalin Energy, the Regional Council of Authorised Representatives of the Sakhalin Indigenous Minorities and the Sakhalin Oblast Government signed an agreement on implementation of the second SIMDP for 2011-2015.



through the whole period of the Plan implementation;

- Promote open exchange of information;
- Rely on joint responsibility with the indigenous minorities.

The Second SIMDP was developed with a 'free prior and informed consent' (FPIC) of the indigenous people, as this principle was set forth in the United Nations Declaration on the Rights of Indigenous Peoples (2007). What makes the Second SIMDP really unique is that for the first time ever an industrial company used the FPIC principle in its interrelations with the local community.

### SOCIAL INVESTMENT

Sakhalin Energy's operations influence significantly the development of Sakhalin Oblast. Since its establishment in 1994, the Company has paid a lot of attention to the socially signifi-

cant programmes in Sakhalin. Investments – sizable and consistent – in the social area, as well as a long-term policy focused on addressing social issues making a difference in Sakhalin, have become the Sakhalin Energy's characteristic.

In 2010 the Company made over RUR 61.8 million (\$2.06 million) total investment in community social programmes in Sakhalin Oblast.

The social investment programmes are linked to the long-term objectives of the Company in the region where it

operates. Such programmes are coordinated with local authorities and integrated into the general business strategy of the Company. Main focus of the Company's social investment activities is on implementation of flagship long-term partnership projects with external stakeholders. Priority is given to programmes with clearly spelt out objectives, targets and deliverables.

The following social investment targets are Sakhalin Energy's priority:

- Education;
- Health;
- Safety;
- Environment and biodiversity;
- Culture and arts;
- Sakhalin indigenous peoples;
- Infrastructure upgrades.

The Company's methods of developing and implementing projects and programmes are based on a transparent and unbiased approach. This approach is applied to the process of evaluation of the best local initiatives as part of the Company's grants programmes, as well as to selection of nominees for Sakhalin Energy's scholarships. For some programmes, such as 'Small Grants – Big Deeds', the Company invites third-party experts to evaluate the projects submitted for sponsorship.

The system the Company uses for social investment management is similar to managing its other activities – by applying a clear

As part of the project 'Involvement of Russian Businesses in Sustainable Socio-Economic Development on the Basis of the UN Global Compact Principles', United Nations Development Programme Russia (UNDP) and Sakhalin Energy worked in 2010 to implement an applied project aimed at further improvement of Sakhalin Energy's initiatives in the area of sustainable development.

prioritisation technique and providing detailed descriptions of the programme implementation plans, decision-making processes and social investment management procedures.

### Highlights of Company Performance in 2010

#### Social Programme 'My Victory'

This programme of Sakhalin Energy dedicated to the 65th anniversary of the victory in World War II known in Russia as the Great Patriotic War was planned as an integrated programme comprising the following components:

- social – providing for sponsorship of various projects, various initiatives and celebratory and congratulatory events involving war veterans;
- information – special media and information projects; and
- St George Ribbon campaign.

A special contest within the Small Grants – Big Deeds Programme was held under the motto '65 Good Deeds for 65 Years of Great Victory'. The

Sakhalin Energy came out a winner in the Russian Festival of Social Programmes 'SoDeistviye', which offers a competing ground for the best national practices and achievements in social responsibility. The Company received awards for its programmes – Sakhalin Indigenous Minorities Development Plan ('Cultural Renaissance' Contest), Sakhalin Salmon Initiative ('Clean World' Contest) and 'What to Do in Emergency Situations' ('Best Creative Programme' Contest).

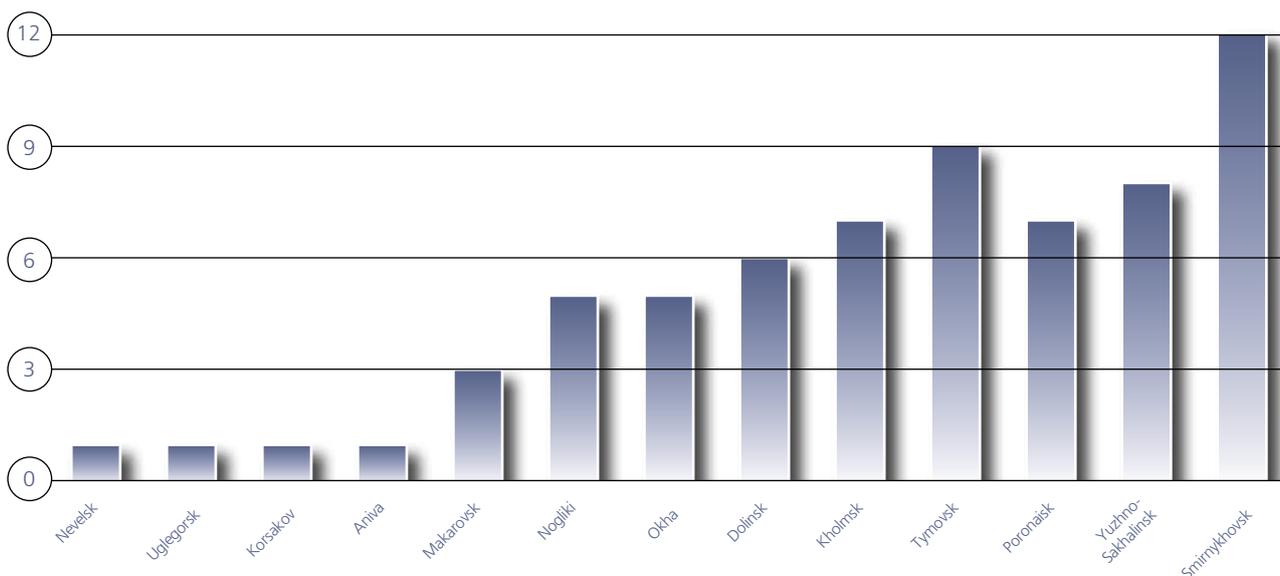


expert panel shortlisted 65 projects, which received Sakhalin Energy's sponsorship support. The projects were implemented in 35 communities of 13 Sakhalin municipalities. The Company provided RUR 3.7 million financing for the 65 selected projects.

#### What to Do in Emergency Situations Programme

What to Do in Emergency Situations is a corporate project aimed at setting up a system of providing basic safety training to school children. The Programme is implemented in partnership

Sakhalin Energy participated in the 'Best Russian Companies – Dynamics, Efficiency, Responsibility Contest' at the Russian Business Week forum and received a 'Best Social Investments and Projects Award' from the Russian Union of Industrialists and Entrepreneurs for its social projects.



Projects implemented in each of the Sakhalin municipalities in 2010 with a sponsorship support from Sakhalin Energy under the special contest of the 'Small Grants – Big Deeds' programme

## HSE AND SOCIAL PERFORMANCE

with the Sakhalin EMERCOM and Sakhalin Ministry of Education.

In 2010 Sakhalin Energy continued to support the shooting of new cartoon episodes for children illustrating what they should do in emergency situations. A new DVD was produced, containing a series of cartoons demonstrating safe behavior in various types of emergencies. Senya, the safety cartoon character, continues to

to issue an exegetical edition of Chekhov's book 'Sakhalin Island'.

A new exegetical edition of Chekhov's 'Sakhalin Island' was published to celebrate the 150-th anniversary of the writer. The work scope involved digitalisation of all the papers which the great Russian writer used whilst getting ready for his journey to Sakhalin and writing 'Sakhalin Island' book. Those documents (about 100) of great

### Sakhalin Salmon Initiative

The Sakhalin Salmon Initiative was jointly launched by Sakhalin Energy, the international NGO Wild Salmon Centre (USA) and the Sakhalin Oblast Government to support conservation and sustainable use of the wild salmon and ecosystems, which it depends on.

A number of activities implemented in 2010 included the following:

- International environmental salmon camp in Sakhalin in August;
- The 8-th Sakhalin Salmon Festival traditionally held under the aegis of Artek summer camp and attended by 17 teams of young ecologists;
- Sustainable fishing industry certification workshops;
- Teachers workshop for implementation of 'Droplet' and 'Salmon Watch' education and awareness programmes (these programmes have been incorporated in curricula of more than 40 local schools);
- Children's art contest 'Salmon, Live!' and an exhibition of the winning art works in the Sakhalin regional art museum;

In May 2010 the Company received a diploma at the annual social advertisement competition 'New Russian Horizon' for 2009 – 2010. Sakhalin Energy received this award for the series of 'Safety Is Important' cartoons in the nomination 'Contributing to Emercom: Emergency Phone 01'.

teach safe behavior to Sakhalin children, while the closing slogan of each cartoon episode – 'Safety is Important!' – has become a rule for more young residents of Sakhalin and Russia.

The 'Take a Hike with Senya' contest and a grant project 'Safety Route' were held for children in 2010. The contests reviewed more than 500 artistic and literary works submitted by children, including various drawings, cartoon strips, posters, rhymes, poems and fairy tales.

### Chekhov and Sakhalin

The 150-th anniversary of Anton Chekhov, a famous Russian writer, was celebrated in 2010. It was also an anniversary of Chekhov's visit to Sakhalin Island. These two dates were commemorated by the project which the Company started to finance and implement back in 2009. The preparation of the electronic full-text 'Chekhov and Sakhalin' database was part of the integrated project intended

historic and ethnographic value were made available in the public domain in an electronic form. The documents were posted at the 'Chekhov and Sakhalin' website ([www.chekhov-sakhalin.ru](http://www.chekhov-sakhalin.ru)), developed and launched as part of the commemorative project. The website has become a sort of virtual guide on all the locations related to Chekhov's journey to Sakhalin.



- Nine projects were implemented within the framework of the competitive grant scheme, etc.

**'Hurry Up for Good Deeds!' – Company Staff Philanthropy**

The 'Hurry Up for Good Deeds!' programme to support philanthropic initiatives of the Company workers has been implemented since 2003.

The Company has implemented 'Regulations on the Support of Philanthropic Initiatives'. This document regulates the procedure for collecting charitable donations and specifies the purpose of the donations and how the Company can match them. The fact that the Company doubles individual contributions of its workers is an important evidence that the Company shares moral values of its staff.

The following initiatives were implemented in 2010:

- 'Do-It-Yourself Holiday' – is a colourful New Year celebration arranged for children from the Juveniles Rehabilitation Centre (Yuzhno-Sakhalinsk) and from an orphanage in Pravda in the Olympia Park amusement centre. The children had a chance to watch a play with their favourite fairy-tale characters and kind wizards who were played by volunteers from the Company workers. Children also took part in sports events and art contests which were held by the Company;
- 'Theatre for Children': over 100 children from various social rehabilitation centres watched the play There Was Once a Russule, one of the best shows of the regional drama theatre;



- One more New Year surprise was the sweet gifts that were presented by Sakhalin Energy to the children from Preodolenie Rehabilitation Centre for handicapped children. Besides handsets, the Company also presented materials and tools for arts classes.

**Sakhalin Energy Award Ski Race**

The 6-th regional ski race was held in Nogliki in April 2010 in partnership with the Nogliki municipal administration and Nogliki children's sports school. Traditional annual ski races are held for students of children's and youth sports schools and groups. Besides individual trophies for race winners, the Sakhalin Energy presented sports equipment and facilities to the Nogliki ski school. For the first time in the ski race history field judges used an electronic start/finish system which was purchased specifically for this race.

**Celebration of the Oil and Gas Worker's Day**

Celebration of the Oil and Gas Worker's Day in Sakhalin is

becoming a welcomed tradition. The experience of Sakhalin Energy was also viewed quite favourably by governmental authorities. Heads of the Oblast took an active part in the informational and holiday activities.

According to unofficial figures, about 15,000 residents and guests of the Sakhalin Region participated in the 2010 Oil and Gas Worker's Day celebrations. Analysis of the results of this professional holiday and the tendencies show that the initiative of Sakhalin Energy facilitates creates a new emotional climate around the oil and gas industry in the south of the island where the holiday events take place.

**Global Road Safety Partnership**

An important element of the road safety programme is sharing the high corporate road safety standards in the communities we work in. In cooperation with the Global Road Safety Partnership, the Company established the Sakhalin Road Safety Partnership and is its active member. This initiative brings together the

## HSE AND SOCIAL PERFORMANCE

Government of Sakhalin Oblast, State Traffic Safety Inspection and the public and is the first consolidated public and private partnership in Russia aiming at promotion of road safety.

In 2010 the Sakhalin Road Safety Partnership incorporated approximately 30 organisations representing commercial, state and public sectors. The Partnership is officially supported by the State Traffic Safety Inspection.

The Partnership successfully implements projects in the following four areas:

- Seat belt campaign;
- First aid treatment to road traffic incident victims;
- Reduced accident rate among children through 'Safe Journeys to School';
- Improvement of high risk roads in Yuzhno-Sakhalinsk.

### INFORMATION SHARING AT REGIONAL AND INTERNATIONAL LEVELS

Sakhalin Energy worked hard in 2010 to promote its reputation as a socially responsible company, both in and outside Russia.



tal authorities, as well as from business communities, international organisations, expert communities, human rights organisations and NGOs attended the forum. The objective of the forum was to accumulate and summarise the human rights practices and approaches in the context of business development. Sakhalin Energy made a report describing its experience in that area;

87 countries, including the President of the Russian Federation, governmental and parliamentary officials from various countries, heads and representatives of international organisations, businessmen, experts, scientists and public figures;

- The UN Global Compact Summit chaired by the UN Secretary-General Ban Ki-moon in New-York in June 2010<sup>1</sup>. The New-York jubilee summit discussed the accumulated experience and the ways to accelerate the spreading of the UN Global Compact principles to as many as possible business strategies and practices. The purpose of the forum was to boost activities of the corporations in support of the Millennium Development Goals. The only Russian company at the summit, Sakhalin Energy, was represented by its CEO Andrei Galaev;

On 16 June 2010 the Sakhalin Road Safety Partnership celebrated its fifth anniversary. The Road Safety Partnership Programme and Sakhalin Energy's internal road safety programme were highly praised by the International Energy Institute and honoured with an award as the best international project in terms of safety. They also won recognition from the RF Government.

- International forum 'Business and Human Rights: Protect. Respect. Remedy' held under the UN auspices in Moscow on 16 March 2010. Delegations from the RF Ministry of Foreign Affairs and other governmen-
- The 14th St. Petersburg International Economical Forum was held on 17-19 June 2010, under the motto 'Laying Foundation for the Future'. The forum attendance was over 4,200 people from

<sup>1</sup> The UN Global Compact Summit is held once in every three years. The 2010 summit celebrated the 10th anniversary of the UN Global Compact establishment.

In 2010 the Company together with UN Global Compact Sustainable Development Project Russia initiated a panel discussion of the business-stakeholder engagement mechanisms and practices. The panel met in the UNDP office in Moscow on 2 November 2010. The Company presented its experience in stakeholder engagement – from the identification of stakeholders and selection of engagement mechanisms and tools to the description of the practical use of such mechanisms and tools. The panel was attended by representatives of Russian business, Russian Union of Industrialists and Entrepreneurs, NGOs specialising in corporate social responsibility and indigenous people issues, UNDP and UN Global Compact, etc.

- First International Workshop 'Sustainable Development of Territories – From Theory to Practice' was held in Yuzhno-Sakhalinsk on 24–26 March 2010. The workshop was
- sustainable development principles in their practice;
- Sakhalin Oil and Gas Projects Safety Forum in Wakkanai, Japan. The Company specialists attended the



**Ban Ki-moon, UN Secretary General and Andrei Galaev, Sakhalin Energy CEO, at the UN Global Compact Summit**

organised by the Sakhalin State University together with the Sakhalin Governor, Sakhalin Oblast Government and Sakhalin Energy. The workshop was attended by Russian, Japanese and Korean scientists using the

- Wakkanai forum on 4 and 5 September 2010. The forum involved a joint drill of Russian and Japanese oil spill response units;
- 14th International Conference Oil and Gas of Sakhalin was held in Yuzhno-Sakhalinsk on

- 29-30 September 2010, which attracted the operators of major oil and gas projects, the representatives of Russian regional and federal authorities and the leading oil and gas experts and analysts;
- Russian-Korean Business Dialogue forum was held within the framework of the G20 Summit in Seoul in November 2010. Speaking at the forum, Sakhalin Energy CEO Andrei Galaev noted a high level of partnership between the Company and Korean business communities, promoting stability in South Korea's energy market, as well as the sharing of experience and technologies between the two countries;
- Oil and Gas Outlook Arctic 2010 was held in London on 16 November 2010. The Sakhalin Energy CEO addressed the forum with a speech describing the Company's achievements in the area of corporate social responsibility;
- 4th World Forum in Lille. The Company participated in the annual World Forum in Lille, France, on 24-26 November 2010. That was a set of events pursuing one goal – exchange of best business practices. Five thousand participants from over 50 countries attended the forum, represented big and small businesses, NGOs and public interest groups. Sakhalin Energy was the only Russian company to be invited to present its experience to the plenary meeting of the forum. For the majority of the forum participants it was the first time ever they heard about Sakhalin and the corporate social responsibility practices in Russia.

# 2011 PLANS AND DEVELOPMENT STRATEGY TO 2015



The 2011 objectives of the Company are determined by our priorities. They are safety, reliability, cargoes and cost. As before, the corner-stone of our business is safety. The Company will have to maintain a consistently high level of hydrocarbons and LNG production, optimise drilling on all the offshore platforms, define the South Piltun development concept, improve contractor management and focus on personnel training and development.

In 2010 the Company developed a strategy to reflect the Company's mission, and committed itself to the maximum operational excellence and to becoming an oil and gas producer in the top quartile internationally, focusing on the areas which require improvement.

Operational Excellence can be implemented in many different ways, but in our context, the Operational Excellence means:

- Delivering sustainable top quartile performance, whether it is in technical areas or non-technical such as Human Resources, Financial, Commercial and Contracting, External Affairs;
- Being recognised as 'best in class' in comparison to our competitors;
- Above all, Operational Excellence in terms of safety and all aspects of production activities, as well as cost and profitability.

Operational Excellence cannot be achieved in a single year. It is also a moving target, because just like us, our competitors are also seeking improvements so the bar keeps getting raised. It is therefore a journey in which we have attempted to map out the first five years. Each year we will review the progress, consult and then re-affirm or reset the targets for the following years.



Five key directions to improve our business

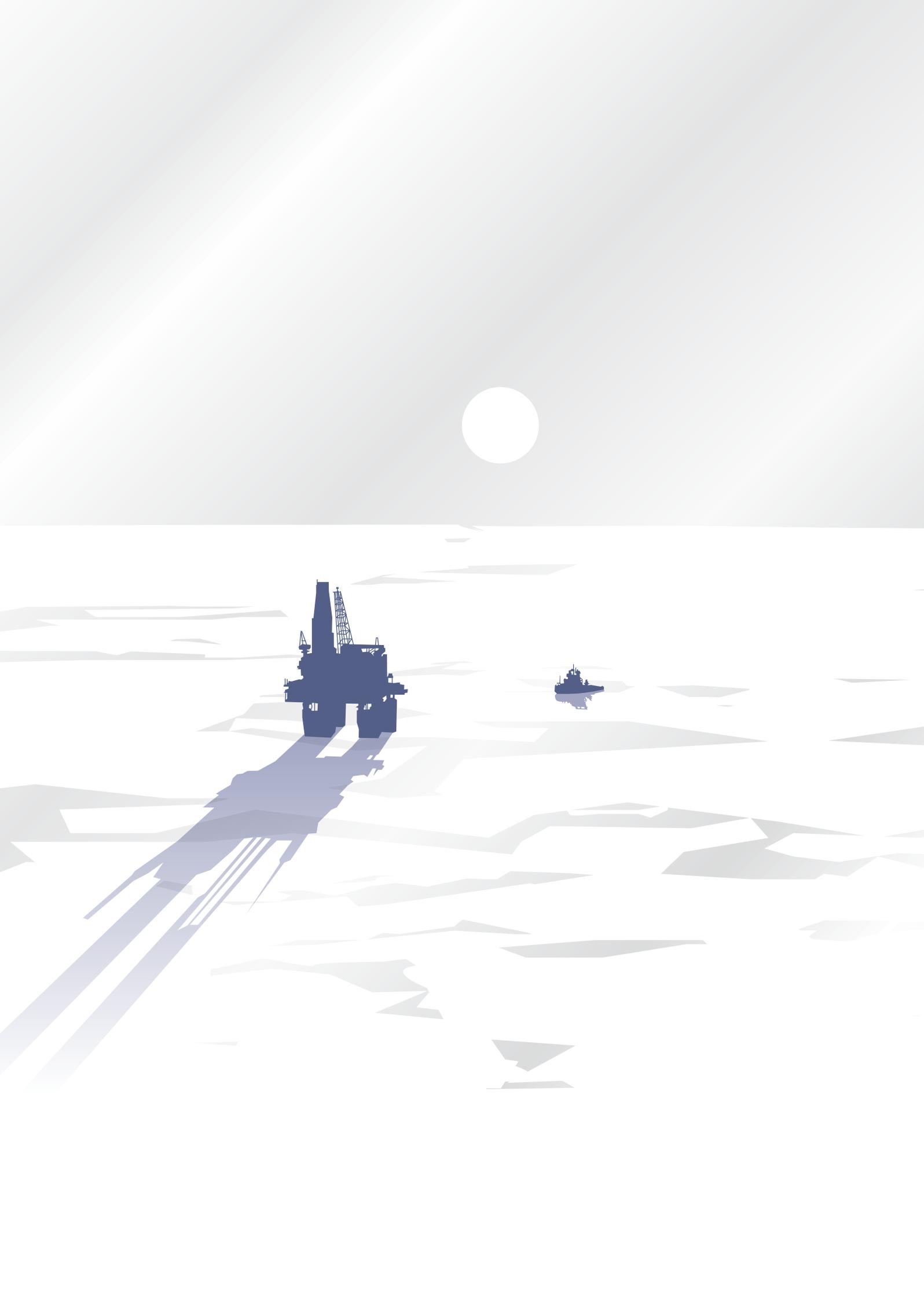
The Company has developed Sakhalin Energy Operational Excellence Journey for the period of 2010-2012. The implementation of this strategy will be observed by the Operational Excellence Steering Committee which commenced its activities in October 2010.

The Operational Excellence Journey implies a strong focus of all

efforts on most business-critical lines of activity. The Operational Excellence Journey is based on five key directions to improve our business which are based on world's best operational experience.

Each direction includes certain business improvement initiatives that in total will lead us to delivering sustainable top quartile performance.









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