Годовой обзор
Annual Review

2008
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2008 will stand out in the history of the Company as a year of remarkable achievement.

We have made a step change. What we used to call a ‘project’ – something that thousands and thousands of people from all over the globe have helped to build for so many years – has evolved into a brand new oil and gas production system for the Russian Far East.

In the midst of all the construction and commissioning activity, we also secured Project Finance – a seal of quality and a landmark for the Russian Federation.

Looking forward, the priorities we have set for 2009 – Safety, Reliability, Cargoes and Cost – reflect our transition to production and greater customer focus. Safety clearly remains our top priority.

February will see the formal commissioning of the LNG plant. A historic event, not only for Sakhalin Energy and Sakhalin Island, but also for Russia and the Asia Pacific region. For the first time, Russia will process liquefied natural gas and take her place as a prominent player in the world LNG market.

As we progress through 2009, we also must ensure the safe and efficient ramp up of production across all the assets. A lot of work remains including extensive drilling programmes on the Lunskoye-A and PA-B platforms, the commissioning of the second trains at the Onshore Processing Facility and the LNG plant and the completion of Booster Station 2.

2009 will also bring us three anniversaries to celebrate: 10 years since the first Russian oil was produced by Sakhalin II, 15 years since Sakhalin II – the first Russian Production Sharing Agreement was signed, and 15 years since Sakhalin Energy was founded. So 2009 will be yet another busy and remarkable year in the Project’s history.

Together with the professional and dedicated Sakhalin Energy team, I am looking forward to Sakhalin II becoming a fully operational Russian energy source for Asia Pacific in 2009.

Ian Craig, Chief Executive Officer
Sakhalin II was conceived as a project to develop and produce oil and gas from two fields offshore Sakhalin Island for delivery into the rapidly growing Asia Pacific market. An operating company – Sakhalin Energy Investment Company Ltd. – was established in 1994 to meet these objectives. The Company’s shareholders are Gazprom (50% +1 share), Royal Dutch Shell (27.5% –1 share), Mitsui (12.5%) and Mitsubishi (10%). The total hydrocarbon resource volumes in the Project’s fields are described in the table below.

Sakhalin Energy adopted a phased approach to project implementation because of the scale of the undertaking, its technical complexity, the required investment and the harsh, remote sub-arctic environment.

Phase 1 was launched in 1996. The development of the Astokh feature of the Piltun-Astokh (PA) field was selected as the starting point with production from the Molikpaq (PA-A) platform, the first offshore oil platform in the Russian Federation. First oil from Phase 1, achieved in July 1999, was produced by the Vityaz Production Complex, the heart of which was the Molikpaq platform. Other elements of the Vityaz complex were a floating storage and offloading vessel, the FSO Okha, a Single Anchor Leg Mooring system (SALM) and the connecting undersea pipeline. In Phase 1 operations, oil was produced only during the ice-free period, i.e. approximately six months a year.

### Sakhalin II Hydrocarbon resource volumes (1 January 2009)

<table>
<thead>
<tr>
<th>Names of Fields</th>
<th>Crude oil (B + C₁ + C₂), million tonnes</th>
<th>Dissolved gas (B + C₁ + C₂), billion cubic metres</th>
<th>Free gas and cap gas (C₁ + C₂), billion cubic metres</th>
<th>Condensate (C₁ + C₂), million tonnes</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>In place</td>
<td>Recoverable</td>
<td>In place</td>
<td>Recoverable</td>
</tr>
<tr>
<td>Lunskoye</td>
<td>43.866</td>
<td>3.172</td>
<td>8.912</td>
<td>1.785</td>
</tr>
<tr>
<td>Total</td>
<td>503.855</td>
<td>118.615</td>
<td>67.393</td>
<td>16.752</td>
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The tenth and last Phase 1 production season opened in 2008 on 30 July and, at the end of the year, Molikpaq was successfully converted to year round operations utilising the new Phase 2 infrastructure. The SALM was laid down for the last time on the 8th of December with the FSO Okha sailing away from Sakhalin Island to start her new life as an FPSO in Australia.

Sakhalin II Phase 2, sanctioned in 2003, is a large oil and gas project in which oil and gas are produced simultaneously within an integrated infrastructure. Similar complexes have been built previously but over a significantly longer period of time and in a phased approach, e.g. North-West Shelf in Australia, which produced oil first, then domestic gas and then LNG. Sakhalin II Phase 2 will have achieved the start-up of a two train LNG facility through the simultaneous execution of six sub-projects – two new platforms (topsides placed on concrete gravity base structures), the Onshore Processing Facility, offshore and onshore oil and gas pipelines, a Liquefied Natural Gas (LNG) plant and an Oil Export Terminal (OET), combined with a substantial portfolio of infrastructure upgrade projects.

All these facilities were substantially completed in 2008. First oil delivery from the new export terminal took place on December 12 and some 10 days later the new PA-B platform was brought on-stream. In the first months of 2009 the Lunskoye Field will also come on-stream and the first Russian LNG will start flowing to the Asia Pacific region. Sakhalin II is growing in importance as a new source of energy for this area.
2008 Highlights
In Tokyo, on 16 June 2008, Sakhalin Energy, the Japan Bank for International Cooperation (JBIC) and an international consortium of commercial banks signed a $5.3 billion agreement to finance Phase 2 of the Sakhalin II project.

Project financing is frequently used in the world’s oil and gas industry for the development of major infrastructure assets. Repayment of the debt comes from the cash flow generated by the financed asset.

By signing this financing agreement, Sakhalin Energy set a new record for Russia in terms of the amount raised and established new benchmarks for future Russian and international oil and gas developments.

Japan’s leading financial institution, JBIC, gave strong support to Sakhalin Energy, providing $3.7 billion. The consortium of commercial banks contributed an additional $1.6 billion.

Previously, the Company funded its Phase 2 cash needs from shareholder financing and oil revenues. The project finance loan will be used primarily to replace shareholder finance for the Phase 2 final construction stage and start-up costs.

The Sakhalin II Project was the first to secure a project finance loan in the oil and gas industry in the Russian Federation. The first Sakhalin II Phase 1 financing agreement was signed in 1998 and JBIC (then the Export-Import Bank of Japan) was one of the Project lenders.

JBIC’s involvement over the years, their support and of course their challenge has encouraged Sakhalin Energy to set world-class standards for social and environmental performance and transparency in both the construction and production phases of the Project.
2008 was critical for completion of the Trans-Sakhalin pipeline system which connects the hydrocarbon fields offshore north-eastern Sakhalin with the LNG Plant and the Oil Export Terminal near Aniva Bay in the south of the Island. More than half of the Russian pipe laying capacity has been engaged on Sakhalin, indicating the scale of this project which required construction operations to be carried out in parallel throughout the 800-km length of the pipeline right-of-way (ROW).

In August 2008, construction of the fault crossings was completed. Seismic faults are hazardous areas prone to frequent earthquakes where formation rock continuity is disrupted by earth movements. The pipelines cross a total of 19 faults, and the
Company engineers had to meet the challenge of developing a special design to ensure maximum seismic resistance for the pipeline. The seismic design allows the pipe to move freely within a 5 m range inside the trench both in winter and in summer. A unique design was developed for the construction of each of the 19 fault crossings.

The outstanding feature of the fault crossing designs is that the pipe is not fixed rigidly and is allowed to move freely inside the trench in case of seismic events, retaining its strength and integrity. The trench cross-section is specially configured: it is trapezoidal and is much wider than normal. It is lined with special waterproof material and backfilled with specially selected sand and expanded clay.

In Q3 2008, the construction of the Block Valve Stations (BVS) was completed and the Company began BVS testing as part of the commissioning and start-up process.

The BVS will be used to minimise loss of hydrocarbons and environmental impact in the unlikely event of leaks from a damaged pipeline.

Along the oil pipeline RoW, 104 block valve stations were installed although only 40 were required in accordance with industry standards. An additional 64 BVS were installed in particularly sensitive areas including rivers, wildlife sanctuaries, seismic and relief...
fault crossings. In an emergency or during maintenance the BVS valve off (block) some pipeline sections, isolating them from the rest of the pipeline. The valves can be operated from the pipeline control centre at the Onshore Processing Facility.

In 2008, the Company completed the development of its pipeline maintenance and oil spill response capacity. Six Pipeline Maintenance Depots (PMDs) are installed along the pipeline route. They are designed to facilitate pipeline maintenance, as well as to provide prompt response in case of an accidental oil spill.

The Company procured over $12 million of emergency response equipment which was delivered to Sakhalin in 2008 and installed in all six Pipeline Maintenance Depots – at Nogliki, OPF, Yasnoye, Gastello, Sovetskoje and the LNG plant.

The pipes’ erosion protection system includes a special three-layer coating of two polymer and one adhesive layers, as well as cathodic protection. The final welding took place at Gastello in the Poronaisk District, at the end of October, followed by the introduction of crude oil into the oil pipeline.

During summer and autumn of 2008 the focus turned to installing permanent reinstatement and erosion control measures rather than the temporary erosion works required during the construction phase of the Project. This reflects Sakhalin Energy’s ongoing commitment to completing its Environmental Action Plan.

Auditing the Company’s progress in the Environmental Action Plan implementation, RF Minister of Natural Resources, Yuri Trutnev inspected the Trans-Sakhalin pipelines RoW on 26 September. Following that visit, the Minister noted "that within the period of two years ... Sakhalin II has in fact become an example for similar projects. It has remedied virtually all the non-compliances, and is utilising the best available world technologies in terms of water resource protection, slope stabilisation and seismic design". The Minister rated the job done as excellent.
The environmental measures, presented for the Minister’s inspection, are part of the Environmental Action Plan developed on the basis of two Rosprirodnadzor integrated compliance audits conducted in the second half of 2006.

October 2008 witnessed a new milestone on the way towards full-scale pipeline system operation. Sakhalin Energy and Gazprom Transgaz Tomsk (GTT) signed a 5-year contract for the Trans-Sakhalin pipeline system operation and maintenance.

GTT will manage the safe operation of the whole pipeline system, Booster Station 2 (BS-2), Block Valve Stations and auxiliary facilities. Its engineering and technical personnel will operate from four out of six Pipeline Maintenance Depots. GTT engineers were deeply involved in the Sakhalin pipeline system commissioning. Over the last six months, a team of more than 20 experts were busy preparing the pipeline BVS for operation, gauging detectors, programming telemetry controllers, commissioning independent power sources, fire and security alarms, as well as checking manual and automatic valve actuation.

On 24 November, an important milestone was achieved by the Sakhalin II Project when the 800-km long oil pipeline was filled with oil for the first time. The oil was first introduced into the pipeline on 31 October and travelled for 23 days from the offshore fields to the export terminal. It took some 150,000 tonnes of ‘black gold’ to fill up the 800-km long pipeline. Prior to the oil introduction, the pipeline was pigged to prove the pipeline integrity.

Through an extensive pigging programme run by the Pipeline Operations Group and the assistance of the Project commissioning group the oil was brought via Chaivo to OPF, onwards to BS-2 and finally to OET where its new tanks were in full readiness to be filled up and their floating roofs lifted.
Piltun-Astokhskoye-B
In April 2008, PA-B drilling commenced. To allow Sakhalin Energy to carry out drilling operations based on a “zero discharge” philosophy, the first well drilled was a disposal well for the re-injection of drilling waste and process liquids. In December, the first oil producing well was successfully perforated and on 23 December, Sakhalin Energy started oil production from this platform.

From PA-B, multi-zone wells are drilled with complex well trajectories in order to penetrate several formations which lie at different distances and depths, enabling the most efficient development of the field area. For the Piltun area, the water injection wells will be used that can be remotely controlled from the Real-Time Operations Centre in Yuzhno-Sakhalinsk.

As per the 2008 Plan of Development Update (as approved by the Sakhalin II Supervisory Board), aside from disposal wells, total of 17 oil producing and 16 water injection wells will be drilled. The maximum distance of the wells that have already been drilled from PA-B thus far is 1.6 km.

Molikpaq
On 30 July, following repair of the SALM which was damaged in a storm at the end of 2007, the Molikpaq platform commenced its tenth production season. After the successful commissioning of the year round oil export facilities on the platform, oil was exported for the first time on 31 October into the new sub-sea pipeline system. This was the first step in the process of Sakhalin Energy establishing year-round oil production and shutting down the SALM and tanker loading operations near Molikpaq. After filling the sub-sea pipeline and the Trans-Sakhalin oil pipeline the first historic offloading of oil from the new terminal at Prigorodnoye was carried out on 12 December.

In September 2008, associated gas from the platform, which had previously been re-injected, was routed to the OPF and PA-B, and in December reached the LNG plant.
Lunskoye–A

Lunskoye–A gas wells are the largest producing gas wells in Russia and among the largest in the world. Drilling wells with production capacities of over 300 million standard cubic feet of gas (some 9 million cubic metres) per day requires unique equipment. To accommodate such large flowing capacity, Lunskoye wellbore production tubing is nearly 10 inches (24 cm) in size, much larger than a typical oil or gas well.

At the close of April 2008, the first well (a disposal well to re-inject drilling waste) was drilled from the Lunskoye–A platform. It was directionally drilled to a vertical depth of 2,890 m with an 1,400 m outstep from the platform and a 3,720 m long borehole. Immediately after completion of the well, the Company commenced drilling of two gas wells, which were nearing completion by the end of 2008.

In December the two first Lunskoye gas wells were successfully perforated, thereby completing the last step prior to flowing these wells. The perforating operations set a new world record for the length of perforating guns when using the technique of running the guns into the well on coiled tubing. Lun-A was successfully brought on stream in January 2009 by introducing gas to the multiphase pipeline to the OPF.
The primary function of the Onshore Processing Facility (OPF) is the processing of gas and condensate received from the Lunskoye field for onward transportation by pipelines to the Oil Export Terminal and the LNG plant at Prigorodnoye. All process systems at the OPF were brought into operation in 2008 with the natural gas supply to the OPF starting in September. Molikpaq gas was used for start-up and commissioning of the facility, and from December – for production of power for the OPF’s own needs and those of Lunskoye-A.

This achievement is another important milestone in construction completion and successful commissioning of the Sakhalin II Phase 2 facilities. Not only does the OPF form a critical “hub” for the integration of the Sakhalin II oil and gas production systems, but it also provides gas compressing facilities for bringing Molikpaq gas to market which was previously re-injected.

The commissioning work at the OPF covered four power turbines, the complete Booster Station 1 facilities as well as completing process Train 1 and the mechanical completion of Train 2 which all have since been achieved. By the end of 2008 OPF was ready for the introduction of LUN-A gas, which arrived at the facility in January 2009.
On 8 April, Sakhalin Energy held a naming ceremony for the LNG carrier Grand Mereya at the yard of Mitsui Engineering and Shipbuilding Co. Ltd. in Japan. This new LNG carrier was named after the Mereya River which flows near Russia’s first LNG plant. The ship was built for the Russian-Japanese consortium of Mitsui O.S.K. Lines, Ltd (MOL), Kawasaki Kisen Kaisha, Ltd (K Line) and Primorsk Shipping Corporation (PRISCO). The vessel was purpose-designed for offshore ice and low temperature conditions. The LNG carrier was handed over to the Company at the end of October.

The Grand Mereya is the third new LNG carrier commissioned for the Project. Two other LNG carriers, Grand Aniva and Grand Elena, were delivered to the Company in 2007.

Completion of the LNG trains construction in 2008 is the culmination of a huge effort by the LNG Project Team beginning in 1997.
The successful and safe completion of LNG trains construction is a tribute to the hard work and dedication of thousands of different individuals. As for all the other newly constructed Sakhalin II facilities, Sakhalin Energy recognises the contribution of each and every one of the people involved and thanks them for completing the plant safely and with a quality that should provide for many years of continuous production.

In June 2008, the Japanese LNG carrier Dewa Maru delivered a third shipment of imported LNG which was used to continue commissioning operations. Using third party LNG is a cutting edge technical initiative that enables Sakhalin Energy to accelerate the start-up preparations for the new LNG plant. Additionally, the imported gas was used to complete commissioning and start-up of gas turbine generators, fuel gas systems, as well as commissioning and start-up activities on Train 2.
Berthing of the Japanese LNG carrier that delivered imported LNG was the first operation at the new specialised Prigorodnoye seaport for Sakhalin II oil and LNG export. The Russian Federation Government Executive Order dated 6 May 2008 had opened the Port to international traffic. The seaport of Prigorodnoye will, at peak, serve approximately 160 LNG carriers and 100 Aframax oil tankers per year.

In August 2008 mooring trials with the tanker Governor Farkhutdinov took place at the Tanker Loading Unit situated some 4.5 km from the shore in the new port of Prigorodnoye.

On 12 December, the first oil from Molikpaq was offloaded onto a tanker from the Prigorodnoye Oil Export Terminal. The project successfully moved from seasonal production, which lasted about 6 months a year, to sustainable year round oil production and export. Oil export is a very significant milestone in the commissioning of the Project facilities. First oil from the Prigorodnoye Terminal was offloaded to the tanker Governor Farkhutdinov.

On 26 December, first gas from Molikpaq was delivered to the LNG plant. Progressive introduction of Molikpaq gas allowed Sakhalin Energy to fill the pipeline and start to power the block valve stations and the LNG/OET plant on gas before the introduction of the larger volumes of Lunskoye gas early in 2009.
Workplace safety
In 2008 the overall number of injuries at all facilities was reduced, but the 2008 safety performance was marred by two recordable fatalities. A third party driver was killed in a collision with a project truck and an employee fell from the LNG loading jetty and drowned.

These sad events compelled the Company to further continually improve its safety focus, and Sakhalin Energy delivered a number of key initiatives in 2008 designed to lead to a safer workplace for everyone involved with the Project.

New Life Saving Rules were put in place for both Company staff and contractors. The Road Safety Plan which governs, amongst other procedures, the implementation of key elements such as the In Vehicle Monitoring Systems (IVMS), driver training and vehicle and contractor compliance checks, was fully implemented. The vast majority of contract holders and tender board members have been trained in management of HSES aspects for new and existing contracts.

A number of safety milestones was achieved, highlights of which are:
- LNG/OET project – 40 million km driven without Lost Time Injury (LTI); 19 million man hours without LTI.
- Project Pipelines – 6.5 million man hours without LTI.
- OPF – four million man hours without LTI.
- Onshore Operations – one million man hours without LTI.
- LUN-A – two years without LTI.

For the second year running, the Company was honoured to receive the prestigious Shell annual CEO Safety Award; the Onshore Pipeline Construction Team received the award in recognition of their impressive turnaround in safety performance in 2008.

The Company also introduced an internal monthly CEO Safety Award. In 2008, eight individuals and teams were recognised for their outstanding contributions to safety.

With Sakhalin Energy becoming a producing company in 2009 and many of the construction activity and staff demobilising, the risk profile of the company will change. Process safety – related to the presence of hydrocarbons often under high pressure – will become more important. The Company has prepared itself by comparing its process and practices in this domain against international standards and putting plans in place to close any gaps. All activities on live assets are controlled under the Company’s permit to work system, with extensive training taking place explaining the new hazards and systems for all staff working on live assets.
The Company successfully implemented the 2008 Personnel Training and Development Plan. Most of the training was carried out with Company personnel working at the production facilities in the middle of commissioning.

This training used special simulators to model real scenarios that may occur during operations.

The Company succeeded in providing 100% of Russian Federation mandatory training and HSE training in 2008.

The Company has established stable business relations with more than twenty educational institutions and training centres from the system of continuous professional education of the Company’s majority Shareholder Gazprom. Integration into the Gazprom training and development structure provided Sakhalin Energy with a wide range of opportunities to access Gazprom’s knowledge and experience.

Personnel training through distance education at the Shell Open University via SkillSoft, has proved popular and Sakhalin Energy’s training centre in Yuzhno-Sakhalinsk continued its training programmes throughout the year. In 2008, 16 trainees started their training at the Centre.

In 2008 a total of 2,271 employees underwent training through various programmes.

The Company pays special attention to the Apprentice Training Programme that has been carried out since 2003. This programme trained 140 people between 2003 and 2008. The programme graduates were employed by the LNG plant, the OPF and offshore facilities. Apprentices are active participants in the Russianisation programme. Ten graduates of the Sakhalin Fuel and Energy Technical College joined the programme in 2008.

Sakhalin Energy’s management set a goal of appointing Russian employees to the Company’s key management positions as well as scaling down expatriate personnel in favour of Russian nationals. In 2008, 306 new Russian staff were hired, exceeding target numbers in all functional divisions, including 49 in senior and mid-level managerial positions.
2008 Hydrocarbon production

Hydrocarbon production
In 2008 Sakhalin Energy produced over 10.5 MMbbls of Vityaz crude, with the 1999-2008 cumulative total reaching some 107.9 MMbbls (14.5 million tonnes). The Vityaz crude oil is a brand introduced to the market by Sakhalin Energy.

Financial proceeds
Though the Project is still on the road to full-scale operations, Russia and Sakhalin have received significant financial benefits from the Project.

From 1996 to 2008, the total revenues to the Russian Federation from Project development exceeded $900 million, out of which almost $400 mln was received by the Sakhalin Oblast, the remaining 500 mln was received by the Russian Federation Government. In 2008 the Company’s royalty and tax payments contributed approximately 10% to the Sakhalin Oblast budget. On top of that, the Sakhalin Oblast receives significant amounts of income from Sakhalin Energy’s contractors through profit tax and employee income tax paid by contractors.
Environment and People
Biodiversity

In 2008, a Biodiversity Action Plan was completed and its draft version was approved by the Company management and submitted to the Biodiversity Expert Group, which had been set up a year earlier on Sakhalin Energy's initiative. The Biodiversity Expert Group comprises representatives of the Sakhalin Administration, environmental and supervisory agencies, Sakhalin scientific institutions and Russian and Japanese NGOs, as well as the Company. The project finance lenders from Japan also attend the Biodiversity Expert Group meetings as invited participants. A meeting of the Biodiversity Expert Group was held on 20 November to discuss the Biodiversity Action Plan. This meeting also approved the Biodiversity Expert Group's Rules of Procedure.

Local Monitoring

The long-term Local Monitoring Programme for the Sakhalin II operation phase started in 2008, following its approval by government environmental authorities.

The Local Monitoring Programme's purpose is to ensure regular environmental monitoring around the main project facilities: the LNG Plant, the pipelines, the Onshore Processing Facility, Booster Station 2 and the offshore facilities. If any negative impact is indicated, a plan for elimination or mitigation of this impact can be immediately developed and realised.

The area adjoining LNG/OET facilities was chosen as a pilot site for the Local Monitoring Programme. The monitoring targets included soil, vegetation, surface waters, birds and mammals. From 2009 on, local monitoring will be extended to cover all Project assets.
Pacific Salmon play an extremely prominent role in the life on Sakhalin. Salmon is (to some extent or other) a fundamental factor in the sustenance of many species, from minor invertebrates to bears and man himself.

To support the conservation and sustainable use of the wild salmon and the ecosystems on which they depend, Sakhalin Energy, the Wild Salmon Centre (USA) and the Sakhalin Oblast Administration jointly launched the Sakhalin Salmon Initiative, the region’s largest-scale programme intended to protect and restore salmon. In February 2008, Sakhalin Energy and the Wild Salmon Centre announced the signing of an agreement regarding the financing of a three-year wild salmon conservation programme on Sakhalin Island with a budget of $8.8 million.

The strategic priorities of the Sakhalin Salmon Initiative include salmon monitoring, establishment of protected natural territories and support of educational environmental programmes promoting salmon conservation and sustainable use of marine bioresources (including the expansion of natural spawning areas and actions to stop illegal poaching), as well as assisting in the sustainable development of fishing industries.
Sakhalin Taimen is a migratory salmonid species drastically decreasing in number. It is listed in the Red List of IUCN (the World Conservation Union) and Red Data Books of the Russian Federation and the Sakhalin Oblast.

Sakhalin Energy continued its Sakhalin Taimen survey programme in 2008. Leading Russian ichthyologists collected information on the distribution, migration and spawning areas of Sakhalin Taimen from nine sample rivers crossed by the Sakhalin II pipelines. Ichthyologists from Sakhalin and students from the Sakhalin State University and Vladivostok universities were also involved in the programme. The information collected in 2007-2008 will help minimise any impact on this rare species, which is believed to be the ancestral form of the migratory salmonids.
Monitoring of Steller’s Sea Eagle population continued in 2008. The April survey assessed the Steller’s Sea Eagle population at the beginning of the nesting period and identified active nests both for Sakhalin Northeast in general – including Lunskoye, Nabil, Nyisky, Chaivo and Piltun bays – and for all the areas within the construction impact range. In July and August, at the end of the nesting period, a repeat survey was conducted, which counted the number of eaglets leaving the nests and calculated the reproductive success. The surveys located more than 30 previously unknown Steller’s Sea Eagles nests.

An impact mitigation plan was developed for each occupied nesting area within the construction impact range. During the early nesting period, permanent monitoring was organised in the most sensitive areas of the Chaivo Spit and the OPF, including day-to-day monitoring of the mitigation measures. Successful hatching in both areas was recorded.

In the Chaivo Spit area, when the nesting period was over, some improvements were made to the nesting ground – perches were put up on the Lunskoye Bay coast to facilitate prey detection and artificial nests were built in the forest away from the access road.
Monitoring of Other Protected Bird Species

Other protected bird species surveyed in the OPF area were owls, Siberian Spruce Grouse and Marbled Murrelet. The Siberian Spruce Grouse was monitored in May, during the lekking season. Males and females were registered in coniferous forests to the south and southwest of the OPF, and their feeding areas and leks were marked. The survey has shown that Siberian Spruce Grouse have not decreased in number during the Project construction period and that the birds can still be found in their forest habitats close to the OPF site.

Marbled Murrelet was monitored in June and July. During the survey, potential nesting areas were identified, as well as the corridors used by these birds to fly daily from the forest to the coastal feeding areas. Majority of the birds make these flights through the area south of the OPF.

Colonies of Sakhalin Dunlin and Kamchatka Tern, another two protected species, were monitored in Chaivo Spit area throughout the nesting period. Construction was suspended in June and was not resumed until maps of nesting areas and colonies were obtained. These maps showed that there were no nests near the access road or the pig trap construction site. Monitoring showed that the numbers of these two species did not decrease in 2008 against the numbers registered in previous years.
In 2008, the Company continued monitoring of the Western Gray Whale (WGW) population. The monitoring of noise using acoustic buoys did not detect any noise levels exceeding permissible limits. Vessel speed continued to be limited as well as navigation routes were restricted to specially identified corridors. Marine mammals observers continued to be used to prevent collisions of whales with vessels.

All the WGW monitoring activities are conducted in cooperation with Exxon Neftegaz Limited, which is also developing a hydrocarbon field near the WGW feeding area. The Western Gray Whale Advisory Panel established by the International Union for Conservation of Nature (IUCN) on Sakhalin Energy’s initiative, exercises third-party control over the WGW monitoring.

The 2008 monitoring results strengthen the evidence that the WGW population has not been affected by the Sakhalin II Project. Independent estimation of the WGW population has increased from 100 to 130 individuals since the observation started.

In December Yuri Trutnev, RF Minister of Natural Resources and Environmental Protection, presented Sakhalin Energy with an award for its protection of the Western Gray Whale population. Sakhalin Energy was announced the “Best Environmentally Friendly Project of the Year” in the category “Environmental Efficiency in Economy”. There were more than 700 submissions from various contestants, who worked really hard to promote their projects. As a result of a very strict short-listing process, only 46 companies made it to the finals to become the winners.
Any project of the magnitude of Sakhalin II considerably affects the local social sphere, especially in areas where Project activities are carried out. Sakhalin Energy is implementing a range of measures to achieve the most positive results and efficiently reduce any adverse impacts in this field.

Sakhalin Energy’s social policy is focused on a number of priority areas, namely support of sustainable development in the region, improvement of safety in Sakhalin, environmental protection projects and support of public health, children’s sports and community initiatives.

In 2008, Sakhalin Energy invested a total of $5.2 million into socially important programmes. Various healthcare projects were completed in 2008 including the financing of a new policlinic in Korsakov that was opened to the public at the end of the year, a regional children’s dental clinic, outfitting 34 remote medical stations with modern equipment (paramedical/obstetrical) in seven districts along the Trans-Sakhalin pipeline system and the provision of new equipment for the Central Regional Hospital in Nevelsk that was hit by an earthquake in 2007.

Support of sports is important for the health of local residents. Parallel to implementing other sports programmes, Sakhalin Energy shared the cost of construction of the Aniva sports school for children and youth and other sports facilities in 2008.
The Company continued to implement education projects, including programmes that provide grants for education at the best colleges and universities in Russia. The Sakhalin State University Sustainable Development Chair, established through Sakhalin Energy’s initiative, is successfully implementing post graduates’ and students’ scientific and practical projects, information and educational activities and has completed development of this new discipline.

The social programme “What to Do in an Emergency” has become popular both inside and outside Sakhalin. The programme is implemented in cooperation with the MChS Department for Sakhalin and is used to introduce modern methods of teaching safe behaviour to preschool and school-age children.

In 2008, the Sakhalin II practice of social management gained nationwide recognition in Russia. Two of the Company’s projects were among the winners in the all-Russia competition of social investments called “Corporate Donor of Russia”, and Sakhalin Energy’s experience of working with the indigenous people of Sakhalin was
highly commended by Russian law-makers and international experts.

The scope of activities within the Company’s “Sakhalin Indigenous Minorities Development Plan” (SIMDP) are worked out and selected by representatives of the indigenous people. These include programmes in education, public health, the conservation and studying of endangered languages and the support of traditional economies and lifestyles of ethnic minorities. Financing is provided for higher and vocational education for indigenous people and for the purchase of medical equipment. Multi-discipline medical crews from the Sakhalin capital of Yuzhno-Sakhalinsk conducted field medical examinations of indigenous communities in 2008.

The Company worked to stimulate growth of traditional indigenous crafts and the revival of traditional businesses. These kinds of activities include, for example, programmes for the revival of Nivkh dog breeding and support for Uilta reindeer herding.

An important goal is to study and protect native languages of the people of the north. A landmark development not only for the Uilta people, but also for linguistic science in general was the publication, with the Company’s support, of the first-ever Uilta ABC book in the spring of 2008. This first schoolbook in the Uilta language was prepared by an international group of authors.

The Company’s “Sakhalin Indigenous Minorities Development Plan” was recognised by the World Bank as complying with world best practice. The parliamentary hearings of the Federal Council of the Russian Federation recommended the
In 2009 the Company will continue to implement its extensive programme of drilling on LUN-A and PA-B. The plan is to drill five gas production wells on Lun-A. By the end of 2009 Lun-A will be able to deliver its full gas capacity of approximately 50 mln cubic metres of gas per day. The Company plan for PA-B in 2009 is five wells (four production, one water re-injection).

February will see the formal ceremony of inauguration of the LNG plant. This will be a new take off point in the history of the Sakhalin II project which is now a new energy source for Asia Pacific. For the first time, Russia will process liquefied natural gas and take her place as a prominent player in the world LNG market. The opening of the plant will be followed by first LNG export in March. The second LNG train will start production soon after it is commissioned in the first half of 2009. The ramp up of the LNG production will take several months to fully test the gas supply chain. Sakhalin Energy plans a gradual build up with full plant capacity scheduled for 2010.

The Company production in 2009 will be dependent on many factors. In 2009 there will be two platforms producing oil – PA-A (Molikpaq) and PA-B, and condensate production from the Lun-A platform. However, PA-B and condensate production from Lun-A will still be in start-up mode. The Company expects to produce more than 100,000 bbls per day by the end of the year and export some 50 oil cargo to its customers. The LNG export plans are also in the region of 55 export cargoes in 2009.
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