

Russia – Sakhalin II On and Off-Shore Oil and Gas

Project Summary

A consortium led by Shell Ltd. is operating the Sakhalin II oil and gas project offshore Sakhalin Island in the Russian Far East. Sakhalin II threatens one of the most plentiful marine environments on the Pacific Rim, providing rich fisheries that support the local economy and the indigenous Nivkh people, and vital habitat for marine mammals including the critically endangered Western Pacific Gray Whale. Already in the first phase of the project, fishermen have reported declining catches and fish kills and the Gray Whale population may have been weakened by platform installation and other industrial oil and gas activities.

Now, the proposed second and significantly larger phase of Sakhalin II threatens this environment with the world's largest LNG plant that would dump massive wastes in the Gulf of Aniva, on-shore pipelines to be trenched through wild salmon streams, an off-shore undersea pipeline



*Sakhalin II and Sakhalin Island
Graphic: Foundation for Russian American
Economic Cooperation*

Human Rights and Environmental Issues:

- Threatened extinction of endangered Western Pacific Grey Whale
- Degradation of fisheries and threatened damage to wild salmon runs
- Threatened livelihood and cultural identity of Nivkh indigenous peoples
- Failure to adequately consult project-affected populations
- Manipulation of scientific research

Population Affected:

Nivkh indigenous people and Russian fishing communities on Sakhalin Island

ECAs and investment insurance agencies involved in phase one:

- EBRD (Europe - \$116 million)
- JBIC (Japan - \$116 million)
- OPIC (US - \$116 million)

ECAs potentially involved in Phase two:

- Exim Bank (US)
- JBIC (Japan)
- ECGD (UK)
- SACE (Italy)
- COFACE (France)
- NCM (The Netherlands)

Status:

Sakhalin II Phase One is already producing oil. Project proponent is currently seeking \$5 billion in financing for Phase Two

crossing the benthic feeding habitat of the Gray Whale, along with platform dredging, and the dumping of drilling and other industrial wastes into the sea. Sakhalin II does not apply many important international standards. It could critically impair heretofore healthy Sakhalin fisheries and spell the extinction of the Western Pacific Gray Whale.

Project Description

The Sakhalin Energy Investment Company, a consortium led by Royal Dutch Shell and

including Mitsubishi and Mitsui, began commercial oil production of the controversial first phase of Sakhalin II in 1999. SEIC is now seeking a reported US\$5 billion in financing¹ to construct the additional platforms and undersea pipeline to shore, approximately 800 kilometers of on-shore pipeline down the length of Sakhalin Island, and the world's largest liquid natural gas plant and oil terminal at the island's Southern end.

700,000 people live on the island of Sakhalin, most of them on the southern tip. Island residents include the native Nivkh peoples, who depend on fishing for their livelihoods and traditional culture. The waters offshore of Sakhalin include abundant crab, herring and cod, and one of the few healthy wild salmon fisheries left in the world. The area is also home to 25 marine mammal species, including 11 endangered species, most notably the world's most critically endangered gray whale population, the Western Pacific Gray Whale.



Critically endangered Western Gray Whale with oil platform in the background
Photo: Sakhalin Environment Watch

ECA Support

In 1997, Shell and other project sponsors received a total of US\$348 million from the U.S. Overseas Private Investment Corporation (OPIC), the Export-Import Bank of Japan (JEXIM, now JBIC) and the multilateral European Bank for Reconstruction and Development (EBRD) in first phase financing.

Shell and other project sponsors now reportedly seek a US\$5 billion in financing for the significantly larger second phase of the project. Reports indicate that the project consortium has approached the US Export-Import Bank (Ex-Im) and the Japan Bank for International Cooperation (JBIC). It has also expressed an interest in approaching Italy's Sezione Speciale Per l'Assicurazione Del Credito All'Esportazione (SACE), France's COFACE, the Dutch Nederlandsche Credietverzekering Maatschappij NV (NCM) and the United Kingdom's Export Credit Guarantee Department (ECGD) for phase 2 financing.

Impacts

Environmental Impacts

Whales threatened with extinction.

The icy sea around Sakhalin is teeming with life and creates the perfect, and only, feeding grounds for the endangered Western Pacific Gray Whale. Recent scientific evidence suggests that less than 100 individuals, and possibly fewer than 20 reproductive females capable of bearing calves remain.² The birth rate of Western Pacific Gray Whale exceeds the death rate by only 1%,³ meaning that additional negative impacts from Sakhalin II risks pushing this species over the brink of extinction.

According to a *Wall Street Journal* report, Sakhalin II has dumped toxic drilling muds into these shallow waters off Sakhalin, while the practice is prohibited in

much of coastal Alaska.⁴ It has also carried out underwater seismic blasts as part of their exploration activities. The impact on the whales has been profound. In 1999, scientists for the first time reported "skinny whales," or whales that were showing visible signs of malnourishment. By 2000, 27 - more than a quarter of the population - skinny whales were identified. Scientists fear that continued and expanded oil drilling projects may stop any chance the whales have for recovering.

Sakhalin II fails to meet the World Bank policy on Natural Habitats.⁵ The Natural Habitats policy states, "The Bank does not support projects that, in the Bank's opinion, involve the significant conversion or degradation of critical natural habitats," including "sites that are critical for...vulnerable, migratory, or endangered species," such as the critically endangered Western Pacific Gray Whale. Russian Academician and ichthyological expert M. E. Vinogradov has stated, "Without designing special measures for gray whale conservation, the continuation of the 'Sakhalin-II' project can lead to extinction of this unique population."⁶

While the first phase of Sakhalin II fails to meet World Bank policy on natural habitats, impacts from the enormous second phase is widely expected to be much worse. Degradation of

critical natural habitats associated with the next phase of Sakhalin II include:

- The risk of extinction of the critically endangered Western Gray Whale and other marine species with construction and operation of an additional platform directly adjacent to whale habitat.
- An undersea pipeline routed directly through whale feeding grounds
- Roughly 800 kilometers of pipeline crossing 1100 watercourses along nearly the entire length of Sakhalin Island, to be trenched directly through ecologically and economically vital streams bearing salmon and other salmonid species, including the endangered Sakhalin taimen
- Pipelines will cross 24 seismic faults in this heavy earthquake zone (by comparison, the Trans-Alaska Pipeline crosses 3 seismic faults)
- Construction of the world's largest liquefied natural gas processing facility and oil terminal at the Southern tip of Sakhalin Island which will dump 500,000 metric tons of waste annually into the Gulf of Aniva
- Exponentially higher risk of oil spill associated with the additional drilling platform and increased tanker traffic at the Southern terminus of the island

Irresponsible risk of spills.

SEIC has done little to ensure its oil spill prevention and response system meets recognized international standards. Sakhalin II depends primarily on emergency response equipment stored on the north side of the island, roughly 50 miles from the oilfields and including about 30 miles of often-impassable dirt roads.⁷ Independent experts from Alaska and the Shetland Islands issued a report in 1999 called "Sakhalin's Oil: Doing It Right" warning that the current oil spill prevention and response measures leave the coastlines of Sakhalin and Hokkaido vulnerable to a catastrophic spill.⁸ The report recommended 78 specific measures, but SEIC hasn't implemented most of them.

Human Rights

Saffron cod and herring stocks are a key food source for the native Nivkh peoples. As the *Wall Street Journal* report indicates, local fishermen report that "[i]n 1999, the first year of commercial oil production, herring by the thousands washed

up dead on local beaches, and local schools of saffron cod have since shrunk dramatically."⁹ These collapses have particularly negative impacts on native inhabitants, who depend on fish as a basis of their economy and traditional culture.

Financial

Sakhalin II project sponsors originally indicated that the first phase of Sakhalin II would yield profit, yet official project documents for the second phase of the Sakhalin II project now state that "economic analysis shows that Phase I by itself will not be profitable."¹⁰ SEIC further admits that a proposed second phase of the project will only be profitable if, in addition to the oil, they are able to sell a minimum of nine million tons of gas annually. News reports indicate that, despite years of efforts, the project sponsors have been unable to conclude contracts for the sale of gas.¹¹ Hence, project sponsors' previous representation of project's financial health has been inaccurate and ECAs' requirement that project sponsors prove credit-worthiness has not been met.

Worse, economic benefits to Russia are in question. EBRD's Establishing Agreement directs the Bank to give support to sound and economically viable projects.¹² But according to a report of the Auditing Chamber of the Russian Federation (March, 2000),¹³ the project has had no economic benefit for the budget of Russia. According to this report, due to provisions in the Production Sharing Agreement, project sponsors will pay US\$ 19 billion less in taxes than they otherwise would have over the life of the project under normal contracting procedures. As such, Sakhalin II fails to meet this international standard.

Disclosure and public consultation

Despite repeated promises by project sponsors for ongoing consultation and access to information, consultation has been inadequate, and in 2002 NGOs were compelled to file a lawsuit against the Russian government and project sponsors to obtain public-interest information about this project. On January 8, 2003, 50 environmental organizations from Russia, the U.S., Japan, and Europe sent written common demands to Shell and other project sponsor, other area operators, government agencies, international financial institutions and company shareholders.¹⁴ These organizations demand that the project proponents use the best available technology, meet the highest international environmental standards and comply with Russian law. Until they are met, Sakhalin II

and other Sakhalin projects should not be allowed to move forward, they argue. SEIC has refused to meet these conditions.

Violations of host country law and treaties

Russian law forbids carrying out any work that negatively impacts an endangered species. However, the Russian government has been slow to enforce these laws, and the big oil companies are taking advantage of this legal vacuum.

The indigenous Nivkh peoples' food source, livelihoods and traditional way of life are being threatened by this project. Article 11 of the International Covenant on Economic, Social and Cultural Rights (ICESCR) states that all people have the right to adequate food. Russia ratified the ICESCR in 1976. Any government program that jeopardizes people's access to adequate food constitutes a direct violation of Russia's treaty obligations. Russia has also ratified the International Convention on the Elimination of all Forms of Racial Discrimination (March 6, 1969), which prohibits any action which harms ethnic minorities. Since the project's impact on fish stock have a disproportionate impact on the Nivkh people, this constitutes a form of government-sanctioned discrimination. Thus, the project leads to violations of two international treaties.

Shell and other project sponsors have worked actively to weaken Russian environmental standards. The *Wall Street Journal* report detailed how oil company-funded research led to the downgrading of the area fisheries classification, clearing the way for Sakhalin 2 to dump drilling wastes into the seas, which had theretofore been illegal under Russian law. The *Wall Street Journal* article quotes a chief Russian fisheries authority as saying, "I don't believe we can get an objective opinion from scientists who are dependent on companies."¹⁵

A federal court's ruling to block Exxon Mobil from dumping drilling mud at the Sakhalin I project didn't apply to the Shell-led consortium because it had a Production Sharing Agreement with the Russian government, according to the Sakhalin Environment Watch group.¹⁶ Thus, Shell and other project sponsors' bilateral investment agreement with Russia superceded host country law and this court ruling.

In 2001 Russian NGOs filed an environmental lawsuit against the Russian government to halt any construction or industrial development in the defined Gray Whale habitat area, naming Sakhalin Energy Investment Company, Ltd. as a third party

defendant. Russian law clearly prohibits harm to the habitat of listed endangered species such as the Sakhalin Taimen, a salmonid species threatened by the proposed 800 kilometer pipeline.

OECD Common Approaches Rev 6

Sakhalin II is under active consideration by as many as six ECAs, despite clear evidence that it should not be approved under the OECD Draft Recommendation for Common Approaches on Environment and Officially Supported Export Credits: Revision 6 of December 2001:

- It involves a project in a sensitive sector and area; negatively impacting the habitat for a critically endangered species, and of crucial importance to an ethnic group, the indigenous Nivkh peoples. Yet, it fails to even approximate international standards for the industry and World Bank Group standards and safeguard policies regarding the oil and gas sector, natural habitats, and indigenous peoples. Compliance with these international standards should be implicit under the Revision 6 benchmarking recommendations for environmental review;
- It violates host government law on endangered species and international treaty obligations regarding indigenous peoples' right to adequate food and freedom from racial discrimination. Compliance with host country standards is an approval criteria under Revision 6 provisions;
- Project proponents have failed to consult with project-affected populations as suggested by Revision 6

While the earlier phase of Sakhalin II was approved prior to Rev 6, the current phase should be held to the provisions of the Common Approaches, weak and voluntary as they are. Thus, the voluntary nature of Revision 6 could fail halt this project and prevent irreparable harm to critical habitats, indigenous peoples and endangered species. This case has been forwarded to the European Court for Human Rights.

Conclusion

As currently designed and operated, Sakhalin II poses a major and unacceptable hazard from its platform dredging, undersea pipeline through endangered Western Pacific Gray Whale feeding grounds, on-land pipelines trenched through wild salmon-bearing streams and crossing 24 seismic

fault lines, the continuous dumping of wastes into the sea and the Gulf of Aniva, and potential catastrophic oil spills into this delicate terrestrial and marine environment. Sakhalin II presents these risks without adhering to internationally accepted safeguards and inadequate consultation with project-affected peoples.

Sakhalin II meets neither the Draft Recommendation for Common Approaches on Environment and Officially Supported Export Credits: Revision 6, nor the environmental policies of the specific ECAs currently considering the project.

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Endnotes:

¹ Sakhalin Energy Seeks US\$5 Billion In Financing From Lenders, *FSU Oil and Gas Monitor*, June 11, 2003.

² Webster, Paul, *Will Oil Spell Trouble for the Western Pacific Gray Whales?* *Science*, May 30, 2003

³ Spiridonov, Vassily, *Can Whales Survive in the Vicinity of Drilling Platforms*, INFORMNAUKA Russian Science News Agency, March 21, 2003.

⁴ Jim Carlton, *Stymied in Alaska, Oil Producers Flock to a New Frontier*, *The Wall Street Journal*, September 4, 2003.

⁵ World Bank Operations Manual, Natural Habitats, OP 4.04.

⁶ Letter to Academician Yu.S. Osipov, President of the Russian Academy of Sciences, B.A. Yatskevich, Minister of Natural Resources, and E.I. Nazdratenko, Chairman of the State Committee of Fisheries, #1-33/149 on June 6, 2001.

⁷ Carlton, 2003.

⁸ Lawn, Steiner & Wills, *Sakhalin's Oil: Doing it Right*, Pacific Environment and Sakhalin Environment Watch, 1999.

⁹ Carlton, 2003.

¹⁰ Preliminary Environmental Impact Assessment for Phase II of the Sakhalin-II project, Sakhalin Energy Investment Company, November 2001, p. 8-5 of Russian version.

¹¹ *Vedomosti*, July 12, 2002 and others.

¹² Agreement Establishing the European Bank for Reconstruction and Development, Article 2. Functions (vi).

¹³ "Report adopted at the Collegium of the Auditing Chamber of the Russian Federation on April 17 1998 based on the results of a thematic evaluation of the organization of levying of taxes and payments into the budget during the execution of the Production Sharing Agreement in correspondence with the federal law 'About Production Sharing Agreements' at enterprises and organizations of Sakhalin Region," Auditing Chamber of the Russian Federation, March 21, 2000

¹⁴ <http://www.pacificenvironment.org/russia/sakhalin/demands.htm>

¹⁵ Carlton, 2003.

¹⁶ Carlton, 2003.