Material Breach

Widespread non-compliance revealed in consultant report on Sakhalin II

A Review of AEA's Independent Environmental Consultant Final Report to Agency Lenders Regarding Sakhalin II Phase 2

Prepared by Pacific Environment and Sakhalin Environment Watch

November 7, 2007

PACIFIC ENVIRONMENT

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Sakhalin Environment Watch

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1) Introduction

Since 2001 the UK-based consulting firm, AEA, has worked under contract with the Bermuda-registered Sakhalin Energy Investment Company, Ltd. (SEIC) to review the environmental and social impacts of the Sakhalin II oil and gas project, located at Sakhalin Island, Russian Far East. This review is required by public financial institutions which are considering financing for the project.[1] In September, 2007, SEIC released an AEA report, entitled, "Independent Environmental Consultant Final Report – Agency Lenders: Sakhalin II Phase 2 Project Health, Safety, Environmental and Social Review" (hereafter "the Report").

At an October 8, 2007 Moscow press conference, SEIC announced that the "independent" Report gives Sakhalin II a "clean bill of health." However, a review of the Report confirms that it is neither independent, nor does it give Sakhalin II a clean bill of health.

While the Report is a requirement of potential public lenders, it is not an independent report commissioned by these lenders. Rather, the Report was financed by SEIC; it lists SEIC as its "customer;" and states that it was prepared based on a contractual Terms of Engagement issued by SEIC.[2] Efforts to obtain the public disclosure of this Terms of Engagement have been unsuccessful. While this method of developing consultant reports for lenders has become common practice, the resulting conflict of interest nonetheless renders the Report as something other than independent.

[1] Public lenders that have considered financing for all or part of Sakhalin II include the European Bank for Reconstruction and Development (EBRD), the US Export-Import Bank (US Ex-Im Bank), the Japanese Bank for Reconstruction and Development (JBIC) and the Belgian Export Credit Agency, ONDD. In 2006 ONDD withdrew export credit insurance from a Sakhalin II subcontractor due to environmental concerns. In 2007 EBRD withdrew its consideration of financing for the project in part due to environmental concerns.

[2] AEA Technology plc, Independent Environmental Consultant Final Report – Agency Lenders: Sakhalin II Phase 2 Project Health, Safety, Environmental and Social Review (2007), see Responsibility Statement and data sheet, ii-iii.

The Report suffers from a number of analytical weaknesses. These include:

- An unsubstantiated presumption that all past non-compliances can be remedied through future remediation that will eliminate long-term impacts and ongoing non-compliances;
- A tendency to respond to many environmental concerns by simply reiterating and/or concurring with SEIC arguments, without providing additional analysis or supporting evidence;
- The misidentification of a number of normal industry practices and minimal lender requirements as "best practices";
- The omission and/or misrepresentation of several critical issues identified by other experts.

Even with these shortcomings, **the Report records systematic and chronic violations of policies and standards of international lenders and other standards**. Furthermore, the Report documents how SEIC has subverted key environmental assessment processes relevant to international lenders in order to make the results of these assessments meaningless. Finally, the Report documents that if public international financing is provided to SEIC for Sakhalin II, **SEIC would be in immediate default on contractual terms of the financing due to numerous material breaches of the international lenders' policies and standards agreed to by SEIC.**

These critical findings, contained deep in the 300-page Report, are not accurately reflected in the Report's Executive Summary, which incongruently states that the project has a "high level of compliance" with various policies, that the project has been undertaken with many "examples of laudable best practice," and that "[w]here non-conformances with requirements have been identified in the documentation these are either minor in nature or else SEIC has plans in place for their resolution." The Executive Summary caveats that the Report "does not explicitly detail the areas of full compliance against agreed standards and guidelines," and in failing to do so, provides no supporting evidence to justify the claim of high compliance. Meanwhile, findings contained deeper in the Report demonstrate a dramatically worse situation. For example, the Summaries of Key Issues finds that SEIC has failed to achieve compliance on 41% of the total set of compliance issues identified in the Report. This figure will increase up to 70% if assessment and proposed mitigation measures deemed by AEA to be "insufficient" are not remedied, which is likely given that the project is already 95% completed. One specific example of failed compliance has to do with pipeline river crossings. The Report indicates that nearly half of the pipeline crossings over sensitive rivers have the potential for significantly higher impacts than would be the case "had these crossings been undertaken in full compliance with the HSESAP [Health, Safety, Environment and Social Action Plan] and international best practices."

SEIC's contention—that non-conformances are either minor or will be resolved with a plan of future action—is now taking center stage in discussions with potential lenders. SEIC and even some lenders suggest that these future promised actions will prevent serious, long-term or irreversible impacts from occurring. Yet, the Report reveals that

this contention is fatally flawed in two crucial respects. First, the Report documents SEIC's chronic failure to meet past commitments. Relying on SEIC's assertion that it will follow through on future commitments is therefore extremely dubious and risky. Second, the Report also documents SEIC's failure to conduct adequate baseline surveys and unwillingness to provide information necessary to conduct timely or proper environmental analysis. There is therefore no basis to conclude that the negative environmental impacts that professional observers agree have already occurred will not have long-lasting or irreversible effects, or that the very high risk of future impacts will not manifest into actual environmental harm.

The ubiquitous compliance failures revealed in this biased and analytically weak Report confirm that SEIC has failed to meet the financing conditions set by international public and private lenders, and that potential lenders cannot reasonably argue that Sakhalin II is eligible for their support.

2) Analytical Weaknesses

The Report suffers from a number of analytical weaknesses and errors. These include:

a) An unsubstantiated presumption that all past non-compliances can be remedied through future remediation that will eliminate long-term impacts and ongoing non-compliances;

> **Example:** The Report's Executive Summary states that "[w]here non-conformances with requirements have been identified…SEIC has plans in place for their resolution."[3] Elsewhere the Report states, "in order that the effects of these historical breaches are better understood, monitoring and post-construction analyses are required by SEIC."[4] Thus, the Report's conclusion of eventual compliance is based on three questionable presumptions: a) that all non-conformances are temporary and can be remedied; b) that post hoc monitoring and post-construction analysis can determine the extent of negative impact of the non-compliance; and c) that SEIC will follow through on its commitment to remedy past breaches. However, these presumptions are dubious for the following reasons:
>
> I. Many non-conformances (*e.g.*, the placement of the PA-B off-shore platform prior to complete analysis) represent irreversible non-compliances and, since these project elements will not be removed, their environmental impact is long-term.
> II. The capacity of post hoc monitoring and post construction analysis to accurately describe harmful impacts is greatly dependant on the adequacy of baseline data. Yet, the Report is rife with examples of absent or insufficient baseline data in project environmental assessments. The Report states that in some instances baseline data missing in earlier assessments was improved in later analyses (*e.g.*, the revised River Crossing Strategy (RCS), and the Environmental Impact Assessment (EIA) and Social Impact Assessment (SIA) addenda. However, these later assessments were completed long after project construction commenced, rendering the information gathered something other than "baseline," and compromising the quality of conclusions in subsequent monitoring and analysis.
> III. The assertion that SEIC has plans in place to resolve past non-compliances (*e.g.*, Remedial Action Plan, Biodiversity Plan) is based on a presumption of the company's willingness or ability to follow through on these plans in an adequate and timely manner. Yet, the Report is replete with examples of SEIC's unwillingness and inability to adequately implement previously established plans or to provide timely information to parties conducting assessment work supporting these plans. (*e.g.*, Resettlement Action Plan (RAP),

[3] Report, xiv.
[4] Report, xvi.

Sakhalin Indigenous Minorities Development Plan (SIMDP), River Crossing Strategy (RCS), Western Gray Whale Advisory Panel (WGWAP), *inter alia).*

b) A tendency to respond to many environmental concerns by simply reiterating and/or concurring with SEIC arguments, without providing additional analysis or supporting evidence.

Example: The Report's Executive Summary and other sections claim that it assesses the project's compliance and performance against a number of international laws, treaties and conventions covering diverse topical areas such as air and water quality, habitats, biological diversity, shipping safety, waste, human rights and other standards.[5] The Report's section on International Standards provides a list of 46 selected laws, treaties and standards (in addition to the standards of potential lenders and the EU). An assessment of project compliance against these international laws, treaties, and conventions requires more than just a list; it requires at least a description of their relevant provisions and a discussion of whether or not these provisions were met. However, the Report instead relies on an assertion by SEIC that Annex B of the HSESAP contains an "identification and justification for any area where the Project will not fully meet all aspects of these standards," while elsewhere the Report reiterates a number of SEIC commitments to comply with these selected conventions.[6] The Report includes cursory references to RAMSAR, ESPOO and International Labor Convention 169, but no description of their provisions, much less any substantiation that they have been adhered to. Moreover, *the AEA report provides no assessment whatsoever* of whether or not SEIC has complied with any of the other 46 selected laws, treaties or standards.

Example: The Report states that it "provides AEA's assessment of project performance in relation to WB/IFC requirements [including] guidelines and safeguard policy requirements of the World Bank/IFC"[7] Yet, for the most part, the Report fails to provide a description of the relevant provision of these guidelines and safeguard policies and a discussion of whether or not they were met.

AEA provides a list of safeguard policies/guideline requirements including:

- Environmental Assessment OP 4.01
- Natural Habitats OP 4.04
- Indigenous Peoples OD 4.20

[5] Report, xi, 33-35.
[6] Report, 33.
[7] Report, 3, 25.

- Management of Cultural Property in Bank Financed Projects OPN 11.03
- Involuntary Resettlement OD 4.30
- Sourcebook Update No. 18 Health Aspects of Environmental Assessment
- Pollution Prevention and Abatement Handbook (PPAH) (Includes the Oil and Gas Development (Onshore)
- Eight Environmental, Health and Safety Guidelines.
- Five ESRP Guidance Notes[8]

The Report includes 98 references to OP 4.01, IFC's Safeguard Policy on Environmental Assessment. This is not surprising, given that the Report documents a large number of instances in which SEIC failed to perform timely, complete, or adequate environmental assessments. The Report includes a much smaller number of references to specific violations of other key safeguard policies, OD 4.30 on Involuntary Resettlement and OD 4.20 on Indigenous Peoples, while incongruously referring elsewhere to SEIC's treatment of indigenous people as a best practice. What is most surprising is that the Report includes *only one* reference to OP 4.04 on Natural Habitats—the key policy intended to safeguard threatened and endangered species, natural habitats and landscapes. Given that some of the most significant environmental issues surrounding Sakhalin II include project impacts on the critically endangered Western Gray whale, other threatened and endangered species, and natural landscapes, an assessment of Sakhalin II compliance with OP 4.04 is incumbent. Yet, no assessment is provided, and the Report's sole mention of OP 4.04 is in the reference list of WB/IFC policies to be adhered to.[9]

Regarding the assertion that the Report "provides AEA's assessment of project performance in relation to WB/IFC guidance notes," the information given is similarly incomplete. For example, the Report's most extensive discussion of guidelines and guidance notes is found in the section discussing the project's public disclosure and consultation plans in the context of specific provisions contained in IFC Guidance Note F—Guidance for Preparation of a Public Consultation and Disclosure Plan. This section includes instances in which Sakhalin Energy's initial plan falls short of this guidance, and examples of additional violations of IFC Guidance Note F are also provided.[10] However, in a majority of cases, the Report simply reiterates that SEIC plans are being assessed against various WB/IFC guidelines and guidance notes with little or no description of their relevant provisions or substantiation of whether or not they have been met.

[8] Report, 35-36.
[9] Report, 35.
[10] Report 201, 202.

Meanwhile, detailed Pacific Environment reports of bank policy violations can be found at http://www.pacificenvironment.org/article.php?id=1481.

Example: The effects of dredging and dumping of dredging waste from the jetties of the liquid natural gas (LNG) plant at Aniva Bay is an issue of great concern to local environmental organizations, fishing groups and the residents of Korsakov. Despite this, the Report section on Aniva Bay is a cursory 3 pages. This section reiterates but does not provide supporting evidence for many of SEIC's assertions. For example, despite detailed concerns voiced by local organizations and Pacific Environment about the lack of baseline data and insufficient monitoring, the Report omits any reference to these concerns and states without substantiation that "the EIA addendum [released on the SEIC website in December 2005] provides a good description of the impacts associated with dredging and spoil disposal (using predictive modeling tools). We consider the assessment to be appropriate and initial monitoring results at the disposal site align with the predicted modeling results."[11]

Example: The Report reiterates but does not provide supporting evidence for SEIC's argument against the construction of above ground pipeline river crossings. NGOs have argued that the Sakhalin II pipeline should be built above ground along its entire length in order to facilitate inspections and enhance leak detection, especially given risks associated with the unstable ground that much of the pipeline traverses. The Report states, "in response to claims from NGOs and other stakeholders that an above ground pipeline would be preferable to a buried pipeline, Sakhalin Energy produced a position paper in 2003 outlining the arguments for each option. AEA has considered the arguments for and against buried and surface pipelines and it is our view that on balance a buried pipeline provides the best option, predominantly because buried pipelines reduce the risk of third party interference thereby reducing the risk of an oil spill." The Report thus reiterates SEIC's argumentation while providing no additional analysis or documentation to demonstrate that third party interference has ever been a problem on Sakhalin Island, where some pipelines have already been built above ground.

Example: The AEA report reiterates but does not provide supporting evidence for SEIC's argument against construction of pipelines above ground on flexible skids at seismic faults (See Section on Geohazards, below).

c) The misidentification of a number of normal industry practices as "best practices."

Example: The year-round use of double-hulled tankers has been normal international practice since 1992 when the International

[11] Report, 166.

Convention for the Prevention of Pollution by Ships (MARPOL) mandated new tankers to be double hulled, and old single-hulled tankers to be phased out after 1996.

d) The misidentification of a number of normal, minimal lender requirements as "best practices."

Example: The Sakhalin Indigenous Minority Development Plan (SIMDP) was developed in order to comply with World Bank/IFC minimum policy on indigenous people only after the project was deep into the construction phase, damage to indigenous peoples resources had already occurred, and local indigenous people blockaded the project (see section on Social Impacts, Indigenous Peoples, below).

Example: Delayed and minimal support for the Western Gray Whale Advisory Panel (WGWAP). IFC 4.01 on Environmental Assessment states that "[f]or Category A projects that are highly risky or contentious or that involve serious and multidimensional environmental concerns, the project sponsor should ***normally*** engage an advisory panel of independent, internationally recognized environmental specialists to advise on all aspects of the project relevant to the EA" [emphasis added]. Moreover, the Report documents many instances in which SEIC failed to comply with WGWAP recommendations (see section on Threats to Gray Whales, below).

e) The omission and/or misrepresentation of several critical issues identified by other experts:

Example: NGO experts and Russian scientists have identified a problem with SEIC's pipeline river crossing design in that it fails to account for the natural migration of several rivers away from their current paths over time. If is feared that this change in river flow patterns will result in the undercutting of pipeline segments that were not designed as river crossings, likely leading to the weakening or rupturing of these pipeline segments. The Report makes no mention of this concern. See http://www.pacificenvironment.org/article.php?id=2611 for specific pictures of meandering streams in site visit photo reports.

Example: The Wild Salmon Center, a non-profit organization with expertise in salmon conservation, has made a number of submissions to potential lenders outlining their concerns regarding methodological and implementation problems with aspects of Sakhalin II that impact wild salmon.[12] They also commissioned an independent assessment of the

[12] See http://pacificenvironment.org/downloads/WSC%20EBRD%20Sakhalin2%20comments%20april06.pdf and http://pacificenvironment.org/downloads/EBRD%20september%202006%20final.pdf.

SEIC's River Crossing Strategy, conducted by an expert with over 30 years' experience in the oil and gas industry.[13] Wild Salmon Center has also submitted letters expressing concern that AEA's representation of the Center's participation in SEIC's salmon protection activities are inaccurate. The Report mischaracterizes the Center's participation in a range of activities, including taimen research, river restoration, development of a Biodiversity Action Plan and pipeline-related anti-poaching activities, while omitting many concerns expressed by the Center and the independent expert.[14]

Example: The lack of cumulative impacts assessment for Sakhalin II has been a big concern for many environmental professionals who have reviewed the project, including the Western Gray Whale Advisory Panel. Despite this, the Report section on cumulative impacts devotes a scant half page to this topic which refers to other sections of the report, including the section on Western Gray whales. This separate section on whales highlights ongoing concerns shared by the Western Gray Whale Advisory Panel that a cumulative impacts assessment is necessary but that "important information gaps…left considerable uncertainty over many aspects of risk evaluation and the efficacy of proposed mitigation measures," and that whale panel meetings "acted more to identify issues requiring attention, rather to resolve them…" The section on Western Gray whales also calls the lack of cooperation by third parties in conducting cumulative impacts assessment "disappointing." Incongruously, the section on cumulative impacts concludes: "Overall, AEA finds that the assessment of environmental impacts in the context of both transboundary and cumulative impacts is adequate."[15]

Example: NGOs have consistently questioned the veracity of trenching pipelines across rivers, rather than using horizontal directional drilling (HDD) or aerial crossings; two alternative practices which have been successfully used elsewhere and which could have been similarly beneficial for many Sakhalin river crossings. SEIC has chosen to largely ignore these alternatives and to trench across virtually all 1000+ waterways, using HDD in only seven crossings, and using no aerial crossings whatsoever. Rather than determining whether SEIC adequately considered these other options, the Report focuses on SEIC's deliberation between wet and dry trenching techniques, and its explanation of why HDD was ruled out. While common throughout the world, aerial crossings are not even mentioned in AEA's list of "main techniques" for

[13] See http://pacificenvironment.org/downloads/Accufacts%20Final%20Sakhalin%20Report%202-24-06.pdf.
[14] See http://pacificenvironment.org/downloads/WCS%20AEA%20response%20Nov2007.pdf.
[15] Report, 188.

river crossings, and the Report omits any discussion of why this type of crossings were not considered by SEIC.[16]

3) Systematic and chronic violations of policies and standards of international lenders

Even with the shortcomings identified above, the Report documents a vast array of systematic, chronic, fundamental and irreversible violations of the policies and standards of international lenders. Many of these critical findings, contained deep in the 300-page report, are not accurately reflected in the Report's Executive Summary, which incongruently states that the project has a "high level of compliance" with various policies, that the project has instituted many "examples of laudable best practice" and that "[w]here non-conformances with requirements have been identified in the documentation these are either minor in nature or else SEIC has plans in place for their resolution." The Executive Summary provides no supporting evidence to justify these claims, and findings contained deeper in the report demonstrate a dramatically worse situation.

The Report uses color-coded charts to identify the status of non-compliance issues that have been identified through its review process (presumably since it began its contract with SEIC in 2001). Various colors correspond with the following categories:

> **Closed:** Assessment and proposed management of the issue are adequate to maintain impacts to an acceptable level and are as developed as necessary at the current stage of the project. Closed issues are highlighted in green in the significance tables.
>
> **Historical:** Any historical instance where relevant standards have not been met. This includes instances where previous construction activities have not met the required project plans and mitigation measures, including where this has led to environmental impacts or other legacy issues. Historical issues are highlighted in blue in the significance tables.
>
> **Pending:** There is insufficient evidence to demonstrate that the assessment and proposed management procedures are presently complete and adequate **but** any deficiencies are understood by SEIC and programmes for rectification are in place. Pending issues are highlighted in amber in the significance tables.
>
> **Unresolved:** Either: (i) there is insufficient evidence to demonstrate that the assessment and proposed management procedures are presently complete and adequate, or (ii) previous/ongoing construction practice falls short of the requirements of the Project plans **and further** in either case there is also insufficient evidence to demonstrate that adequate

[16] Report, 88.

> programmes for rectification are in place. Unresolved issues are highlighted in red in the significance tables.[17]

The Report records the following scores for each category:

- Closed: 31
- Historical: 32
- Pending: 30
- Unresolved: 11
- Total: 104

According to the Report's Summaries of Key Issues, issues reflecting permanent or ongoing non-compliance (historical, pending, unresolved) comprise 70% of total identified instances of non-compliance. AEA and SEIC may argue that non-compliance in the "pending" category should be removed from the non-compliance total because "any deficiencies are understood by SEIC and programmes for rectification are in place." As demonstrated elsewhere in the Report, this is a dubious and highly dangerous assumption because SEIC has a proven track record of failure to fulfill previous commitments in an adequate or timely matter. However, even allowing for this "discount," the Report reveals non-compliances in 41% of the total set of compliance issue areas identified by AEA during its multi-year review, even after several years of proactive engagement by lenders, NGOs, and international panels of experts. This clearly demonstrates that SEIC has dramatically failed the overall test of compliance on Sakhalin II.

4) Post Hoc Environmental Analysis

The Report documents chronic and systematic occurrences in which SEIC's environmental plans and assessments were completed *after* the activity being assessed had already occurred, thus rendering these plans and assessments meaningless. Indeed, the complete body of EIA information that the European Bank for Reconstruction and Development deemed fit for consultation was only completed after the project was approximately half built. The Report states that: "In some instances written plans and assessments were not completed within the required timescales. In particular, project construction activities commenced in 2003, prior to the finalization of adequate impact assessments."

> Regarding Western Gray whales: "There have been occasions on which construction has taken place before relevant recommendations of the independent scientific panel have been fully considered."[18] (See additional examples in sections below.)

[17] Report, 42.
[18] Report, 51.

> Regarding onshore pipeline construction: "…deficiencies affected sensitive river crossings undertaken prior to December 2005 (when the RCS [River Crossing Strategy] was finalized."[19]
>
> Also regarding onshore pipeline construction: "SEIC undertook a river basin assessment in order to identify any Group 1 rivers (*i.e.* rivers of low ecological sensitivity in themselves) in which sediments released during pipeline construction may have led to impacts on more sensitive receiving rivers downstream. This assessment identified 55 such tributaries and, under the RCS, these tributaries were to be treated as being of the same sensitivity as the Group 2 or 3 rivers into which they flow. However, this re-assessment of tributaries was not completed until mid-2006, by which time all 55 'upgraded' tributaries had already been crossed by at least one pipeline."[20]
>
> Regarding dumping of dredge spoil in Aniva Bay: "A full analysis of options was undertaken retrospectively."[21]
>
> Regarding the Indigenous Peoples' Development Plan: "The SIMDP [Sakhalin Indigenous Minority Development Plan] was finalised in May 2006 well into the construction period, with the result that possible impacts to indigenous people could have remained unidentified and unmitigated." [22]

Instead of being used to design the best possible project that meets international standards and appropriately mitigates social and environmental standards, SEIC's reports and assessments have instead been used to justify pre-existing decisions that were made without adequate analysis of alternatives. This practice violates both the spirit and the letter of international public and private lenders' environmental and social impact assessment requirements.

5) Threats to Western Gray Whales

The Report notes a number of significant, ongoing failures in SEIC's management of its impacts on Western Gray whales (WGW) which represents a serious violation of potential lenders' policies relating to both process and substance. In addition, the Report mentions just a few of the concerns of the Western Gray Whale Advisory Panel (WGWAP) and of preceding panels. A more comprehensive history of panel members' concerns, and of SEIC's failure to implement their recommendations can be found at http://pacificenvironment.org//downloads/Shell_s%20Failure%20to%20Follow%20Whale%20Panel%20Recommendations.pdf.

[19] Report, 51.
[20] Report, 93.
[21] Report, 51.
[22] Report, 51.

The Report also notes SEIC's chronic and systematic failure to provide adequate information to the Western Gray Whale Advisory Panel (WGWAP) in a timely manner:

> "Timely provision to the WGWAP by SEIC of all relevant materials and analyses has been an ongoing issue throughout the IISG/WGWAP process….this remains an area of general concern following WGWAP-2 in April 2007 where a number of requested documents were not made available prior to the meeting, but were rather only provided at the meeting itself…(the WGWAP has expressed its extreme disappointment at the situation regarding provision of information on work schedules by SEIC to the Panel)…Other assessments (*e.g.* noise footprint data) were provided later, either during or after the WGWAP-2 meeting."[23]

In addition, "the PA-B CGBS [Piltun field platform B Concrete Gravity Base Structure] was installed prior to full agreement with the independent scientists on these [noise] intervention criteria,"[24] thus obviating the WGWAP's attempts to mitigate the impacts of the PA-B platform to WGW. The Report goes on to quote the WGWAP, which stated: "The advice provided by the experts during the [acoustic scientists' working group] teleconferences was either not heeded or altered significantly."[25]

The Report also documents SEIC's failure to implement WGWAP recommendations for noise criteria in both the 2006 and 2007 construction seasons.

In addition, the Report acknowledges that HSESAP requires SEIC to follow all "reasonable recommendations" of the WGWAP, and confirms that SEIC failed to provide the requisite information necessary to fully perform this function. The Report states that "detailed information/arguments regarding technical feasibility have not been presented [by SEIC] to the WGWAP for consideration….Overall, AEA considers that the Panel is only in a position to fully judge the reasonableness of its recommendations if it is provided with all relevant information, including technical and logistical aspects. To date this has not been the case on this issue."[26] Certainly, given adequate information, the WGWAP would have made additional reasonable recommendations, yet the Report provides evidence of SEIC's failure to even submit to the test that lenders require.

The Report further goes on to point out that "[f]ull analysis of noise monitoring data from the 2006 season was not ready in time for submission prior to WGWAP-2," and quotes the panel as noting, "the data provided for WGWAP-2 indicate that the exposure criteria agreed by the Company were probably violated on some occasions."[27]

The Report also documents SEIC's failure to initiate noise level and shore-based behavioral monitoring of WGW soon enough in the 2006 construction season to gather

[23] Report, 68.
[24] Report, 70.
[25] Report, 70.
[26] Report, 72.
[27] Report, 73.

baseline data and monitor subsequent construction impacts, in violation of WGWAP recommendations. Also, data generated from subsequent monitoring was not assessed in real-time or even near-real time, precluding its use to trigger any necessary immediate remedial action, leading the Report to conclude that panel scientists' recommendations were not met.[28]

The Report further finds that SEIC failed to conduct a multi-variate analysis (MVA) that was recommended by the WGWAP. The Report documents that the required "2005 MVA was not completed prior to commencement of the 2006 construction activities in Piltun."[29]

The Report's documentation of the WGW processes demonstrates that SEIC has chronically and systematically failed to provide adequate information or finalize studies in time to be considered by the panel. The Report points out that "these assessments could have been completed within significantly shorter timeframes, with earlier planning and appropriate levels of resources."[30] SEIC's failure to provide the WGWAP with adequate information in a timely manner can only be seen as a systematic effort to undermine the WGWAP. In the absence of this information, SEIC can claim that it is impossible to determine whether the WGWAP recommendations are "reasonable." This approach clearly violates both the spirit and the letter of SEIC's commitments within the HSESAP.

SEIC's failure to provide requisite information in a timely manner to the WGWAP is a chronic problem that subverted the environmental assessment process and precluded the whale panel from performing the required assessment, from making determinations regarding the acceptability of project proposals, and from determining the full range of necessary mitigation measures; all profound and irreversible violations of potential lenders' policies and project conditionality.

The Report concludes: "…the possibility that impacts on the WGW are **high** cannot be entirely ruled out."[31]

6) Problems with Pipeline Construction

a. River Crossings

The Report documents chronic and systematic problems with SEIC's construction of onshore pipelines that relate to river crossings, geohazards, erosion control, and wetlands crossings. Taken together, these impacts demonstrate SEIC's inability to achieve compliance with the minimal policies of international lenders, much less to implement best international practices.

[28] Report, 76.
[29] Report, 74.
[30] Report, 75.
[31] Report, 82.

Many of these problems stem from a flawed environmental assessment process that failed to prevent project design mistakes. The Report notes that by December 2005, after the project was deep into the construction phase and pipelines had already been trenched across hundreds of waterways, "there are still limitations in the baseline data relating to the spatial extent of the site-specific surveys and identification of wintering grounds for certain species (such as the Sakhalin taimen, which is red data book listed)."[3233] Without knowing the location of taimen spawning and rearing (particularly winter) areas, SEIC could not possibly choose crossing sites or design the project to avoid and minimize impacts to taimen.

The Report further notes that SEIC made corrections to its River Crossing Strategy only after these changes were rendered meaningless due to construction that had already occurred. The Report notes: "Implementation of the river-basin analysis was not completed until mid-2006. 55 tributaries were identified for 'upgrade' to sensitive status, but all of these tributaries had already been crossed by at least one pipeline while they were still treated as Group 1 rivers."[34] The Report also points out that SEIC's original EIA had not reviewed key impacts; in particular, "the effects of sedimentation and smothering of the riverbed had not been considered."[35]

In addition, SEIC's revised RCS failed to address critical issues raised in a University of Birmingham report[36] and an Accufacts, Inc. report commissioned by Wild Salmon Center.[37] The RCS was developed after the University of Birmingham report was complete and supposedly included all its recommendations. However, the Accufacts report identified many of the same issues that were raised in the Birmingham report.

SEIC's delays in analyzing river crossing issues led to much greater impacts to Sakhalin's salmon rivers than would have otherwise been experienced. The AEA Report notes, "the RCS was finalized in December 2005, by which time 64 of the sensitive Group 2 and Group 3 rivers had already been crossed by at least one pipeline." The Report also points out that "conformance with the requirement for back-to-back installation of the gas pipeline was low," and "several rivers crossed in the winter of 2004/05 that, under the final RCS, should have been dry cut were in fact crossed using wet cuts."[38] The Report also indicates that "[s]ignificant areas of substandard construction practice were also identified by AEA during field trips undertaken between October 2004 and September 2005, including practices that did not meet international good practice…or the standards that were subsequently incorporated into the HSESAP."[39] Many of these river crossing violations were documented by other lender

[32] Report, 89.
[33] The Red Data Book is a list of rare and endangered species in the Russian Federation.
[34] Report, 90.
[35] Report, 90.
[36] See http://www.ebrd.com/country/sector/natural/projects/sakhalin/river/index.htm.
[37] See http://pacificenvironment.org/downloads/Accufacts%20Final%20Sakhalin%20Report%202-24-06.pdf.
[38] Report, 92.
[39] Report, 93.

consultants and independent non-governmental organizations. Photos and descriptions of these violations can be found at http://www.pacificenvironment.org/article.php?id=2611.

Unfortunately, similar to the situation with Western Gray whales, SEIC's lack of adequate monitoring means that the impacts from its activities will never be known and will cause on-going risks to project implementation. The Report indicates: "The risk posed by the legacy of these historical issues is difficult to gauge at this time, primarily due to inadequacies in the environmental monitoring undertaken both during and post construction."[40]

The Report points out that problems with SEIC's river crossings have continued even since the disastrous 2004/05 construction season. The Report states: "Several areas of non-compliance with HSESAP and RCS commitments continued during winter 2005/06 construction."[41] These include problems with sediment control, spoil management, construction methods, and dewatering of rivers for prolonged periods.

Problems continued into the 2006/07 construction season, particularly associated with spoil/trench water management. The Report states: "Deficiencies in spoil management were identified at a significant proportion of the 2006/07 winter river crossing by both the Golders' observers[42] (40 out of 86 crossings at which the observers were present) and AEA's continuous monitors (15 out of 26 rivers visited during actual crossing construction)."[43] The Report also mentions significant violations in the 2006/07 construction season regarding commitments to simultaneous crossings and crossing duration,[44] non-winter crossing of two rivers valuable for fisheries,[45] and blasting in the fisheries-rich Nabil River even though this had not been foreseen within the HSESAP.[46]

It is important to note that the Nabil River, as well as several other rivers negatively impacted as a result of SEIC's failure to uphold its HSESAP, provide habitat for Sakhalin taimen, a Red Data Book-listed species. The Report states: "Given the uncertainty surrounding the presence/location of taimen there is the possibility that the poor construction practices may have harmed this red data book species."[47] Impacts to Sakhalin taimen therefore violate international lenders' policies including IFC 4.04 on Natural Habits, which prohibits the degradation of critical natural habitats including habitats that are critical for endangered species.

The Report also points out that SEIC is experiencing significant problems with its restoration and reinstatement practices. The Report states: "AEA's continuous monitors found the adequacy of temporary riverbank reinstatement/stabilization undertaken

[40] Report, 93.
[41] Report, 96.
[42] After highly publicized damage to wild salmon spawning rivers occurred, SEIC commissioned the engineering firm, Golder Associates, to conduct independent monitoring of river crossings.
[43] Report, 104.
[44] Report, 106.
[45] Report, 107.
[46] Report, 108.
[47] Report, 117.

immediately after river crossings to be mixed. Deficiencies in stabilization were identified after construction in around 40% of the crossings witnessed by AEA's monitors."[48] Supposedly, SEIC is addressing this through a Remedial Action Plan (RemAP). However, the Report notes that "the RemAP was not developed prior to the winter 2006/07 river crossing season, as was originally intended."[49] This is just one more example of SEIC's chronic tendency to prepare plans only after it is too late for them to be useful in project construction.

The Report also documents SEIC's failure to conduct monitoring as required by the HSESAP, noting the existence of "[l]imitations in the environmental monitoring during the 2005/2006 construction period in terms of a lack of relevant equipment…and inadequate frequency of sampling during construction in contradiction with HSESAP Table 2.5 Commitment 141 which requires high frequency turbidity monitoring."[50]

Overall, the Report notes that "approximately half of the Group 2/3 rivers crossed by the pipeline have been exposed to the potential of significantly higher impact levels than would have been the case had these crossings been undertaken in full compliance with the HSESAP and international best practice," and that "we estimate that the overall environmental materiality of non-compliances during river crossings is potentially **moderate**."[51] Given Sakhalin's dependence on salmon for its local economy and subsistence, as well as the public's historical and stated concerns about the impacts of pipeline construction to salmon spawning streams, this level of violation is simply unacceptable. The Report notes that it is impossible to determine the scale or full impact of SEIC's failures without adequate monitoring and survey efforts. The Report states: "Overall, the impacts of the breaches of HSESAP and RCS commitments described in this section cannot be fully assessed until the above monitoring and survey works have been undertaken."[52] This lack of data exposes SEIC, other project shareholders, and financial lenders to unknown and ongoing risks. The Report notes: "Although river systems are expected to recover, there has been a prolonged duration of impact for some rivers during the construction period due to ongoing poor erosion control and multi-season river crossings, and in these cases the overall period of impairment prior to recovery could extend over several years."[53]

Also, the Report concludes that the "loss of taimen (*i.e.* a **high** environmental impact) cannot be entirely ruled out,"[54] which represents an absolute failure by SEIC to comply with WB/ IFC 4.04 Natural Habitats policy. The Report goes on to state that a taimen research project that SEIC says it is undertaking "has the *potential* to offset, at least to some extent, any historical impacts on taimen that may have occurred by enhancing the long-term sustainability of this species."[55] However, research alone does not offset

[48] Report, 109.
[49] Report, 124.
[50] Report, 122.
[51] Report, 115-116.
[52] Report, 114.
[53] Report, 118.
[54] Report, 117.
[55] Report, 119.

impacts—only action does. SEIC's historic unwillingness or inability to fulfill its previous commitments undermines the claim that the taimen research project will result in the elimination of this violation.

Meanwhile, the Report commends SEIC for its commitment to insuring "no net loss" of salmon habitat in order to offset negative project impacts. This is a curious commendation given that elsewhere the Report repeatedly states that it will be very difficult to understand the full negative impacts of the project due to SEIC's failure to collect requisite baseline data, do timely analysis, or conduct adequate monitoring. Meanwhile, under the "no net loss" approach, the loss of spawning habitat near the northern section of the pipeline could be compensated by restoration of rivers in the south. Yet, salmon runs in the northern areas constitute distinct genetic strains than those in the south. Thus, the "no net loss" approach fails to stem the decrease of genetic variation of salmon, and therefore does not correct the violation of the IFC 4.04 Natural Habitats policy which requires "minimizing habitat loss (*e.g.*, strategic habitat retention and post-development restoration) *and establishing and maintaining an ecologically similar protected area*" [emphasis added].

b. Soil Erosion

As seen in the photos available on the Pacific Environment website (see previous link), SEIC has encountered major soil erosion problems associated with pipeline construction and these issues are further highlighted within the Report. The Report notes that "[o]n Sakhalin such risks [of soil erosion] are particularly prevalent on certain portions of the onshore pipeline Right of Way, such as the Makarov region, where steep slopes and especially erodible soil layers (mudstones) are found together with adjacent sensitive salmon rivers."[56] The Report also points out that "[e]rosion control measures throughout the construction period have fallen short of the HSESAP requirements standards and this has resulted in environmental impacts, principally through the release of sediments into rivers and wetlands."[57]

The Report notes: "Following a site visit in May 2006, significant deficiencies were identified in all aspects of erosion control, including material breaches of several HSESAP commitments."[58] The Report goes on to point out that "shortfalls against the Company's remediation targets remain…Ongoing review is also required in order to monitor future progress on bringing the Project into compliance with HSESAP commitments."[59]

The Report also notes that HSESAP commitments have been violated since "stabilization has generally not been undertaken even though approximately 800km of RoW have now

[56] Report, 126.
[57] Report, 134.
[58] Report, 127.
[59] Report, 127.

been opened up and around 1,500km of pipeline has been laid and backfilled (representing 94% of the overall scope)."[60]

SEIC's efforts to rectify its erosion problems have failed. The Report points out that in the Summer of 2006, SEIC set targets for improved surface stabilization of the RoW in terms of completion before the onset of winter 2006/07. Yet only 7.3% of steep slopes (which, according to AEA, are the most significant risk areas for soil erosion) were hydroseeded prior to winter.[61] This demonstrates that assumptions in the Report concerning potential future compliance based on promised future action are flawed.

The Report notes that "efforts to segregate topsoil on the Project have generally been inadequate to meet the requirements of HSESAP commitment 60….The main onshore pipeline construction contractor estimates that topsoil has been preserved in just 212ha of RoW, out of a total of 3,000ha cleared to date. This represents a material breach of commitment 60."[62]

As with river crossings, SEIC is experiencing significant problems with reclamation and reinstatement. The Report states: "Under HSESAP Table 2.5 commitment 113 final grading, topsoil replacement and installation of permanent erosion control structures should be completed within 20 days of backfilling the pipeline trench. Pipeline construction activities commenced in 2004 and by May 2007 over 90% of the pipeline had been installed and backfilled. However, with the exception of a few limited locations, no final reinstatement has been completed on the RoW….the lack of progress made to date represents a material and ongoing breach of commitment 113."[63]

As with other areas, SEIC has yet to do necessary planning that is expected to be completed prior to the start of project construction. For example, the Report points out that "the final detailed technical and biological reinstatement plan is still in development."[64] This failure clearly obviates SEIC's ability to comply with IFC 4.01 on Environmental Assessment, which states that "EA is initiated as early as possible in project processing…" The Report goes on to point out that "detailed targets and timescales for permanent reinstatement are not available at the time of writing."[65] The Report also states: "Until final reinstatement is complete, the Project will be out of compliance with HSESAP commitments and the potential for soil erosion risks will remain."[66]

The Report also notes that SEIC needs to develop a remedial action plan for wetlands that will provide for remediation and reinstatement targets. According to the Report "it should be noted that before detailed wetland remedial actions can be defined, it is first necessary that SEIC undertakes a more detailed evaluation of the ecological sensitivity

[60] Report, 127.
[61] Report, 128.
[62] Report, 130.
[63] Report, 131.
[64] Report, 131.
[65] Report, 132.
[66] Report, 133.

(including identification of RDB species) of the wetland areas crossed by the RoW and furthermore assess the nature and extent of physical and ecological impacts resulting from pipeline construction activities."[67] The fact that SEIC must now undertake this evaluation and assessment—despite the fact that the project is 86% completed—is yet another stark example of SEIC's failure to comply with bank policies and to analyze and mitigate its environmental impacts prior to the launch of construction activities.

c. Geohazards

SEIC's lack of adequate attention to significant geological hazards, including the risks of earthquakes, soil liquefaction, and landslides, is a great worry to geologists and the public of Sakhalin.[68] The Report points out that SEIC's failure to adequately assess issues in relation to geological hazards prior to construction activities continues. The Report notes: "In particular, the EIA did not identify all geohazards, provide sufficient detail about the significance of those identified geohazards, and mapping was weak. These deficiencies were largely a result of incomplete survey work at that time."[69]

The Report indicates that these problems continued even after SEIC committed to a geohazards addendum to the EIA, stating: "At the time of the final review, a number of geological hazard investigations and engineering analyses were still in progress, and therefore the characterization of geohazards was not entirely complete."[70] The Report also notes: "At the time of the initial review, SEIC and their contractors were still in the process of conducting field mapping and geomorphological analyses to characterize landslide hazards through the key risk area of the Makarov Mountains, and to identify the need for potential re-routes if conditions were found to be unfavourable through the Makarov [sic]."[71] As a result, construction decisions were made before full information was available to SEIC. Geological experts in Sakhalin are extremely worried that poor design decisions are likely to lead to catastrophic pipeline ruptures as a result of geological hazards.[72]

Unfortunately, the Report parrots SEIC's inaccurate comparison with the Trans-Alaskan Pipeline, which "is above ground (for part of its length) because it crosses over areas of permafrost."[73] While some areas of the Trans-Alaska Pipeline are above ground due to the presence of permafrost, there are also sections built above ground on flexible skids where pipelines cross major earthquake faults in order to protect it from earthquakes. As the accompanying pictures of the Trans-Alaskan Pipeline demonstrate, this above ground design was particularly important in protecting the pipeline from the 7.9 magnitude

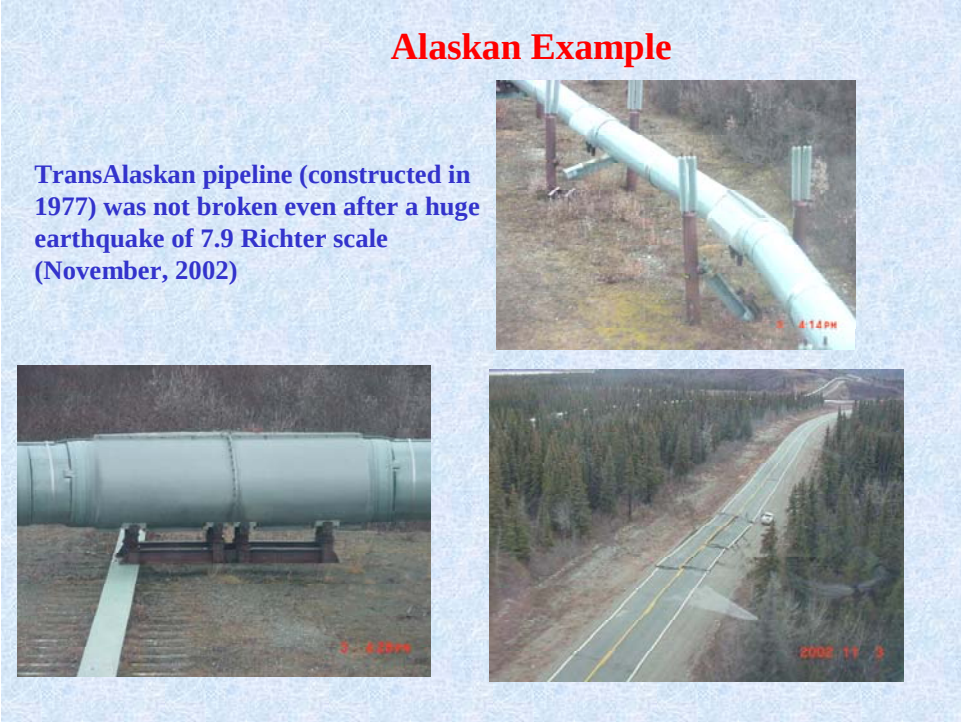
[67] Report, 141.
[68] See http://pacificenvironment.org/downloads/Kazakov%20Letter%20-%20Sakh2%20-%2013.07.doc.
[69] Report, 174.
[70] Report, 176.
[71] Report, 176.
[72] See http://pacificenvironment.org/downloads/Kazakov%20Letter%20-%20Sakh2%20-%2013.07.doc.
[73] Report, 54.

earthquake along the Denali Fault on November 3, 2002.[74] Anecdotal reports from Sakhalin suggest that SEIC is now hurrying to backfill the pipeline, without taking care to properly install engineering measures to protect the pipeline from geological hazards, including earthquakes. This exposes the pipeline, SEIC, its shareholders, and project financers to high risks in the case of a geological catastrophe such as a major earthquake.

Seismic Risks for Oil Pipeline

- **Pipeline to cross 21 active seismic faults (in contrast, Trans-Alaska Pipeline crosses 3 faults)**
- **Above ground crossing = Global best practice**
- **Shell is trenching pipelines across seismic faults**

[74] These arguments, including background on the Trans-Alaska Pipeline, are detailed at length in "Seismic Risk and the Onshore Pipeline Portion of Sakhalin Energy Investment Company's Sakhalin-II Phase 2 Project: Unanswered Questions," by Richard A. Fineberg, January 25, 2004.



7) Biodiversity Impacts

In its section on biodiversity, the Report confirms that many of the same problems that affect SEIC's performance on other key issues also affect SEIC's performance in relation to biodiversity conservation. The Report notes that SEIC's planned Biodiversity Action Plan (BAP) has not been produced in a timely manner: "The HSESAP (released December 2005) anticipated completion of the BAP by the end 2005 and therefore SEIC has not met this timeline."[75] The Report goes on to state: "The one element of the BAP likely to suffer from a delay relates to taimen because of the unknown distribution of taimen in Project affected rivers, and the potential for impact during pipeline crossings of taimen supporting rivers."[76] As noted above, Sakhalin taimen is a species protected in the Red Data Book.

The Report also notes that although the BAP will draw upon an expert panel, "the recommendations provided by the panel will be non-binding and therefore, unlike the WGW advisory panel, there is no formal requirement to accept all reasonable comments."[77] Given SEIC's failure to comply with recommendations from the WGWAP, it is even more unlikely that the Biodiversity panel will have any influence on the project.

The Report particularly criticizes construction activities in Chaivo Bay for violations of HSESAP commitments and impacts to Aleutian tern and Sakhalin dunlin. The Report

[75] Report, 149.
[76] Report, 150.
[77] Report, 151.

notes that activities related to pipeline construction continued at Chaivo Spit "for a number of weeks [after may 1] thereby overlapping with the most sensitive bird nesting period."[78] The Report also notes that financial lenders had not been informed of these activities ahead of time, and writes that it "considered it a breach of the agreement not to work outside of the winter period as defined in the December 2005 HSESAP."[79] The Report goes on to say that "[i]n AEA's opinion, the most precautionary approach would be to avoid all summer construction activity."[80]

The Report notes that SEIC revised HSESAP language regarding wetlands to make it possible to conduct some construction activities. Nonetheless, the Report points out that even with these changes, HSESAP conditions were not met. The Report indicates that "[surveys] were not undertaken and therefore in AEA's opinion this represents a breach of the refined HSESAP (Table 2.3, row 34) commitment."[81] The Report continues: "In failing to apply the precautionary principle the approach did not represent best practice and the approach was also a breach of the HSESAP."[82]

The Report also notes violations in regards to construction activities in close proximity to endangered Steller's Sea Eagles. The Report states that construction activities took place in close proximity to a Steller's Sea Eagle nest site, "contrary to a commitment in the HSESAP (Table 2.3, row 20) that requires 'Establishment of a buffer zone within which no construction activity shall be permitted during the nesting season (SEIC has ordered that the pipeline contractor maintain a buffer distance of 500m from any active Steller's Sea-eagle nests)."[83] The Report indicates that the eagles did not raise any chicks, and notes that "it is possible that construction-related activities, in excess of that allowed in the nest specific mitigation measures, contributed to, or were directly responsible for, the failure to breed."[84]

8) Aniva Bay

In its section on Aniva Bay, the Report again confirms that SEIC failed to analyze adequate alternatives prior to designing its project, despite the fact that the public raised extremely significant concerns about the impacts of dumping of dredge spoil on commercial fisheries. The Report states: "AEA had concern over the rationale behind the selection of the dredged spoil disposal site and the dredging techniques/mitigation measures used vis-à-vis those outlined in the 2003 EIA."[85]

The Report points out that "the 2003 EIA made reference to two potential disposal locations without detailed consideration of relative suitability of these sites."[86] Following

[78] Report, 156.
[79] Report, 156.
[80] Report, 157.
[81] Report, 159.
[82] Report, 160.
[83] Report, 160.
[84] Report, 160.
[85] Report, 164.
[86] Report, 165.

public complaints, SEIC developed an EIA addenda that reviewed three different sites, although the preferred option suggested by Sakhrybvod, a Russian government agency, was "dismissed," leaving only two sites fully reviewed in the addenda.[87] The Report also indicates that it "expressed concern that only two sites were fully considered and that there may be other locations within reasonable distance of the dredge site where less damage would result from disposal activities."[88] It is important to note that the potential disposal locations were not discussed with the local community, and protests were staged by local residents, fisherfolk and environmentalists when they discovered the disposal would take place in Aniva Bay.

The Aniva Bay situation demonstrates SEIC's continued subversion of international best practices and requirements for Environmental Impact Assessments. The Report notes: "The dredge spoil site selection process did not follow a rigorous analysis of alternatives,"[89] which is a violation of bank policies on the assessment of alternatives. Although AEA was eventually satisfied with SEIC's addenda, it is clear that SEIC produced the addenda merely to justify its earlier decision, rather than to help choose the site that would lead to the least environmental and social impacts. The Report states: "In some instances such as Aniva Bay dredging, there was a lack of routine and timely information provided to local communities, and dredging activities had been completed by the time the addenda was released."[90] The Report also indicates: "We do note that the addenda were published almost 3 years into construction, and as such stakeholders' ability to influence the project design at the time of the meetings was undoubtedly limited."[91]

It is worth noting that anecdotal reports from residents in Aniva Bay suggest a drop in scallop populations. These concerns further expose SEIC, its shareholders, and financial lenders to ongoing liability risks.

9) Oil Spill Prevention and Response

The Report notes that as with other areas of concern, SEIC's original analyses of oil spill and response plans in the Technical and Economic Substantiation – Construction (TEOC) were largely inadequate. The Report states: "Of note, the TEOC plans, although detailed, tended to be theoretical and to some extent unrealistic in emergency situations, falling short of best practice operational plans….We also concluded that the information provided in the 2003 EIA did not adequately address a number of areas that would be expected in the EIA."[92]

Although the Report notes that progress has been made, it must be pointed out that no effective oil spill response measures exist anywhere for responding to oil spills in ice

[87] Report, 165.
[88] Report, 165.
[89] Report, 166.
[90] Report, 210.
[91] Report, 210.
[92] Report, 247.

conditions. According to SEIC as quoted by AEA, "it recognizes that there are considerable operational constraints to controlling and recovering free oil in sea ice conditions."[93] Furthermore, the Report points out that "there will be environmental conditions, most notably foggy conditions that can occur for approximately 80 days/year, where a response might be severely hampered."[94] The Report goes on to underline this, stating: "Consideration must also be given to meteorological/safety constraints, such as poor visibility, which can prevent an immediate response (in both ice infested and open water conditions)."[95]

The Report notes that SEIC has still failed to gain government approval for all of its oil spill response plans,[96] apparently, SEIC is having difficulty meeting the Russian Federation's oil spill response requirements. This delay is particularly troubling due to SEIC's commitment to lenders and within the HSESAP that oil spill plans will be approved and in place six months prior to the first export of oil.

The Report also expresses some concerns about the adequacy of the oil spill response plans when compared to international best practices. The Report states: "In several topic areas, the draft Lunskoye OSRP [Oil Spill Response Plan] provided to the oil spill consultants falls short of meeting referenced standards and in particular the requirements of the Oil Pollution Act (OPA) (1990)."[97] The Report goes on to say that, "[t]he initial review of the draft OPF [Onshore Processing Facility] OSRP concluded that it was considerably weaker than the other OSRPs and did not comply fully with the best practice standards/references against which it was reviewed."[98]

Of particular concern, the Report does not analyze SEIC's failure to comply with lender policies regarding the prevention of oil spills from occurring in the first place. Despite repeated stakeholder concerns, SEIC has refused to implement numerous measures that are required to improve shipping safety and reduce the risk of oil spills resulting from the Sakhalin II project and oil transport. Such safety measures include a 24-hour vessel monitoring system for Aniva Bay and La Perouse (Soya) Strait, mandatory tanker traffic lanes, escort tugs for all tankers, and compulsory weather and visibility limits for marine operations.

10) Social Impacts

Regarding social impacts, the Report demonstrates that SEIC faces many of the same problems and failures to comply with lender requirements and international best practices as it does with environmental issues. The Report states that "AEA considers it important to highlight SEIC's history of delays in responding to social issues and in meeting compliance and best practice requirements."[99]

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[93] Report, 258.
[94] Report, 250.
[95] Report, 250.
[96] Report, 254.
[97] Report, 256.
[98] Report, 258.
[99] Report, 220.

Some of these delays and compliance failures resulted from inadequate planning and project design. The Report notes: "In 2005 information about some [project affected people] was missing from the baseline characterization provided in the SIA and the RAP, including non-IP fisherfolk in the north of the island, commercial fishing companies and their ancillary enterprises who will be economically displaced both in the north and south of the island and dacha residents near to the LNG site."[100] The Report points out that SEIC's lack of response to social issues is chronic: "Historically, SEIC has not been able to respond quickly to problems with aspects of its social management system that have been identified through the due diligence process."[101]

a. Indigenous Peoples

The Report contains information on the Sakhalin Indigenous Minority Development Plan (SIMDP) and includes an Executive Summary reference to the Plan as an international best practice. It is not. In fact, indigenous peoples development plans are normal, minimal requirements in bank policies including World Bank/IFC 4.20. In addition, the Report fails to mention the historical context in which the SIMDP was developed. Namely, SEIC had violated World Bank standards in relation to indigenous peoples by not adequately assessing or mitigating its impacts to indigenous peoples prior to project construction. The Report does acknowledge that SEIC's approach "did not meet all the criteria outlined for an IPDP [Indigenous Peoples Development Plan] in [World Bank] OD 4.20."[102] What's more, OD 4.20 states: "Successful planning for indigenous peoples frequently requires long lead times…." Yet, the SIMDP was developed only after the project was well into the construction phase and had already caused significant impacts in northeast Sakhalin, where most indigenous peoples live. This delay obviates the usefulness of the SIMDP and means that it is little more than a document to spell out the terms of compensation. Moreover, SEIC only agreed to develop the SIMDP after its contractors destroyed a sacred indigenous peoples' site, and indigenous peoples conducted two highly publicized blockades of a road leading to a Sakhalin II project site in January and June 2005. The Report does note that "[d]elays [in undertaking a full plan for indigenous peoples] had a negative impact on SEIC's relationship with IP and IP leadership."[103] Furthermore, the SIMDP is only valid for five years and there is no agreement or existing commitment by SEIC to continue the plan. Given these factors, the Report's Executive Summary identification of the SIMDP as a best practice is extremely dubious.

It must also be noted that indigenous peoples' primary request—that SEIC conduct an independent Cultural Impact Assessment, or "ethnological ekspertiza"—has been rejected by SEIC and has not been conducted. Without this Cultural Impact Assessment, the SIMDP cannot be seen as a development plan that truly compensates Sakhalin's indigenous peoples for damages caused by the Sakhalin II project to their subsistence

[100] Report, 220.
[101] Report, 232.
[102] Report, 227.
[103] Report, 227.

lifestyles, traditional economic activities, and natural resources as a result of the Sakhalin II project.

b. LNG Dacha Community

The Report is inaccurate in its characterization of the situation still brewing between "LNG dacha residents" and SEIC. By "LNG dacha residents," the Report is referring to residents of a dacha cooperative that has existed in Prigorodnoye for over 30 years. At a meeting with dacha community residents on October 4, 2007, residents reaffirmed that they are dissatisfied with the current state of negotiations between SEIC and the dacha community regarding compensation and are exploring legal options to defend their rights.

SEIC originally announced in its Feasibility Study (TEOC) that the Sanitary Protection Zone (SPZ) for the LNG plant would be 3.5 km wide. This original design would be appropriate, given that SEIC's own calculations indicate that the area affected by an explosion or toxic gas leak at the LNG plant would reach up to 3 km. However, after the TEOC had already been approved by the State Environmental Expertise Review (SEER) with the original 3.5 km SPZ, SEIC suddenly announced that it would only have a 1 km SPZ. The dacha community is located just over 1 km from the LNG plant, and the decision to reduce the SPZ to 1 km obviates the need for SEIC to resettle the dacha community residents. Legally, SEIC's decision means that it is not in compliance with the SEER, which in turn means that SEIC is violating Russian law.

SEIC's actions in the "LNG Dacha" case reflect its historically slow and unresponsive approach to resolving social issues. This is reflected in the Report, which states: "Historically, SEIC has not been able to respond quickly to problems with aspects of its social management system that have been identified through the due diligence process."[104]

Meanwhile, the Report also notes that these social problems continue and that "some of the milestones in the SPP related to the implementation of key parts of the social compliance management system were not achieved within the specified time frames…These delays are problematic given that the project is now well advanced into its construction phase."[105] Meanwhile, the Report notes that ongoing monitoring will continue to be a problem: "The delay in finalizing the audit plan is an issue as currently, apart from Lender visits there is limited independent verification of the whole social impact management system and its supporting data management systems."[106]

11) Consultation

The Report notes, regarding regulatory and other requirements, that "[t]he specific commitments needed to comply with these additional requirements are made in the

[104] Report, 232.
[105] Report, 231.
[106] Report, 231.

HSEAP and will be binding in the event of financing."[107] Meanwhile, we understand that the potential lenders are in discussions with SEIC about a revised HSEAP. It is not clear whether the proposed changes will mean the removal or change of this and/or any other standard. The proposed consultation window is too small given the range and extent of the issues involved and the amount of material produced.

Furthermore there are other documents referred to which are not publicly available. The Report states in section 3.6.3 -- Requirements under the Common Terms Agreement and the HSESAP: "The Common Terms Agreement, negotiated between SEIC and the Agency Lenders, sets out environmental (including Health, Safety and Social) provisions for the Project. These include the environmental representations, warranties and covenants made by the Company covering project expansions, environmental law, incident notification, reporting and audit rights of the Agency Lenders. The Company also covenants that it shall comply in all material respects with the HSESAP."[108] The Common Terms agreement is clearly stated to have environmental and social provisions, yet it is not publicly available.

In addition, the Independent Legal Advisor (ILA) report referred to on page 25 of the Report, which is critical to assessing regulatory compliance given the concerns raised in the Report, is also not publicly available.

There are aspects of the HSEAP which are not assessed in the Report. For example, there is a section on reputational risk which indicates there should not be ongoing negative international media coverage.[109] NGOs have provided a list of all the international negative media articles which show that these issues have not been addressed to the satisfaction of stakeholders.

Also, there have been ongoing failures to provide adequate information to the public before construction began and during consultations. It is clear that the material available to both potential lenders and stakeholders was inadequate to make a fully informed decision. This is confirmed in the Report: "However we do note that the addenda were published almost 3 years into construction, and as such stakeholders' ability to influence the project design at the time of the meetings was undoubtedly limited."[110] By the time stakeholders were consulted by the lenders, there was limited ability to influence these aspects of the project.

The Report appears to respond to material that SEIC provided to AEA but no survey of stakeholders to assess the adequacy of response seems to have taken place. Indeed, there is no mention in the Report that any NGOs were contacted by AEA. SEIC has also failed to consult with stakeholders and has not replied to comments sent to the lenders, *e.g.* the submissions NGOs sent to the EBRD/ECGD consultation in April 2006. Unless SEIC has responded to all the queries raised at the lender consultations, it should not claim to have

[107] Report, 25.
[108] Report, 38.
[109] Report, 41.
[110] Report, 210.

consulted by proxy using these events. NGOs have also sent specific questions to the 'Ask Sakhalin Energy' e-mail address on SEIC's website about simple factual matters such as construction schedules and have never received responses. Further, there is also no transparency regarding the issues which the potential lenders raised after these consultations, and what response SEIC gave.

Interestingly as in November 2006 (the last time the Public Consultation and Disclosure Plan was updated) SEIC fails to list WWF-UK or Cornerhouse amongst the stakeholders they consider significant for the project. This is despite these organizations having submitted detailed comments to the lenders in April 2006.

12) Conclusion

"This report makes clear that, as of July 2007, there were a number of historic and existing non-compliances with the Project's Health, Safety, Environment and Social Action Plan."[111]

"In addition to historical issues some material ongoing non-compliances with HSESAP commitments exist that are unlikely to be fully resolved prior to financial closure."[112]

"Actions to ensure full recovery to prescribed reinstatement standards may be particularly difficult to achieve."[113]

"Failure to fully action such plans could compromise the Project's ability to meet Lender requirements."[114]

A close review of the AEA Report reveals a much different picture than the one advertised by Sakhalin Energy at its recent press conference on October 8, 2007. The Report reveals chronic and systematic failures by SEIC to comply with its commitments to lenders under the HSESAP and the lenders' policies that greatly increase the ongoing risks that will be associated with the Sakhalin II project, SEIC, its shareholders, and financial lenders for years, if not decades, to come.

The Report clearly demonstrates the reasons why international lenders—in order to comply with their own standards, policies, and legal requirements—must deny financing for the Sakhalin II project.

[111] Report, 274.
[112] Report, xvi.
[113] Report, xvii.
[114] Report, xviii.