

Sakhalin II (Phase 2) Compliance Review

ASSESSMENT AGAINST ECGD POLICIES ON PROJECT ACCEPTABILITY

by

**The Corner House
Friends of the Earth (England, Wales and Northern Ireland)
WWF UK**

28th April 2006

CONTENTS

INTRODUCTION

Purpose of Report – Structure of Report – Presentation of Supporting Evidence

Section 1: Background

1.0 The Sakhalin II (Phase2) Project

1.1 Environmental, Development and Social Concerns

Impact on whales – Impact on Salmon and Fisheries – Pollution Risks – Dumping of Wastes in Aniva Bay – Physical and Economic Displacement – Damage to wetlands and migratory birds habitats – Impacts on Indigenous Peoples – Inequitable Production Sharing Agreements – Legislative and Human Rights implications of Production Sharing Agreements - Greenhouse Gas Emissions and Climate Change – Lack of Strategic Environmental Assessment

Section 2: ECGD's Criteria for Project Acceptability

2.1 ECGD's Policies

2.2 Key Undertakings

Sound Financial Management – Compatibility with ECGD's Statement of Business Principles – Account taken of UK's international policies – Compliance with World Bank policies

Section 3: Assessment of Project Compliance with Key ECGD policies

3.1 Policy Requirement One: Sound Financial Management of ECGD's Portfolio

3.1.2 Duties of ECGD: Reputational Risk as an issue

3.1.3 Reputational and Financial Risk Implications for ECGD support of Sakhalin II

Impacts of construction already completed – Outstanding legal cases – Potential reputational risks for the UK from Production Sharing Agreements – Escalating costs and SEIC's management – Shell's Corporate Governance – Shell's poor project management and

contractor control – Shareholder concerns registered for Shell's 2006 AGM

3.1.4 Conclusion

3.2 Policy Requirement Two: Compatibility with Business Principles and UK's International Policy

3.2.1 ECGD's Duties

3.2.2 Lack of Human Rights Assessment

3.2.3 Incompatibility of Sakhalin II with UK's international policies on sustainable development

Incompatibility with Johannesburg Commitments: (a) Efficient use of natural resources and reducing unsustainable consumption and production patterns; (b) Reducing biodiversity losses – Incompatibility with UK Commitments under the Ramsar Convention

3.2.4 Conclusions

3.3 Policy Requirement Three: Compliance with Safeguard Policies, Directives and Guidelines of World Bank Group

3.3.1 ECGD's Duties

3.3.2 Issue: Continuing Non-Compliance with World Bank policies

3.4 Policy Requirement Four: Compliance with Host Country Law

3.4.1 ECGD's Duty

3.4.2 Issues: Alleged Breaches of Local Law

3.4.3 Conclusions

Section Four: Conclusions and Recommendations

INTRODUCTION

Purpose of Report

This report is submitted by The Corner House, Friends of the Earth (England, Wales and Northern Ireland) and WWF UK in response to the public consultation initiated by the UK Export Credits Guarantee Department (ECGD) on the Environmental and Social Impact Assessments for Shell's Sakhalin II (Phase 2) oil and gas project (the project), now under construction on Sakhalin Island in Russia's Far East.

Structure of Report

Section 1 of the Report sets out the background to the project and summarises the concerns raised to date over its environmental, social, human rights and development impacts.

Section 2 sets out the stated policies of the ECGD (as derived, *inter alia*, from the 1991 Export and Investment Guarantees Act, the Statement of Business Principles and the Case Impact Analysis Process) in determining the acceptability of applications for ECGD support.

Section 3 assesses the project against the above policies, considering in particular ECGD undertakings to ensure:

- Sound financial management of the ECGD's portfolio
- Compatibility with the ECGD's Statement of Business Principles
- Compatibility with UK Government policies on the environment, sustainable development and human rights
- Compliance with ECGD undertakings on project screening
- Compliance with Host Country Legal Requirements
- Compliance with World Bank Group Safeguard standards

Section 4 provides a summary of areas where the project fails to comply with ECGD's stated policies for project acceptability.

Presentation of Supporting Evidence

Given the volume of material on the environmental and social impacts of the project which has been submitted by the client, consultants to potential funders, and non-governmental organizations over the past three years, and which is available to ECGD, this report references such material rather than repeating it in detail. We hope that this will enhance the clarity of the report and thus facilitate rather than hinder the ECGD in reaching a reasonable decision on whether or not to support the project. **Should the ECGD require further substantiation of any points raised in the report, The Corner House, Friends of the Earth and WWF UK will make every effort to assist.**

We would direct the ECGD in particular to the submissions made by Pacific Environment, WWF-UK and Friends of the Earth to the European Bank for Reconstruction and Development in response to its public comment period on the project. The reports are available from www.pacificenvironment.org, www.wwf.org.uk and www.foe.co.uk respectively.

Legal Note

For the avoidance of doubt, we wish to make clear that nothing in this submission is intended to suggest that we consider that compliance by the ECGD with its stated methodology in relation to projects with high impact potential would be sufficient to render lawful any decision by the ECGD to approve this application.

Section 1

BACKGROUND

1.0 The Sakhalin II (Phase 2) Project

In October 2002, the Sakhalin Energy Investment Company Ltd. (SEIC), a Bermuda-registered consortium headed by Shell¹, formally approached the UK Export Credits Guarantee Department² and other international financial institutions (IFIs)³ for funding to support the development of the Piltun-Astokhskoye and Lunskeye oil and gas fields off Sakhalin Island in Russia's Far East.

The development of the two fields forms the second phase of SEIC's operations in Sakhalin. Phase I consisted of the construction of the "Molikpaq" or PA-A oil platform in the Piltun-Astokhskoye field; oil production began in 1999 but only outside of the winter season. It was financed with \$116 million each by three public finance institutions.⁴ The second phase, for which an estimated US \$5 billion is being sought in public funds, is almost completed. It will permit extraction to take place year round and involves the building of a second off-shore oil drilling platforms (PA-B) and one offshore gas drilling platform (LUN-A)⁵; undersea platform-to-shore pipelines; on-shore oil and gas processing facilities; 800 kilometers of on-shore pipelines; one of the world's largest Liquid Natural Gas (LNG) processing and export facilities; oil export facilities; and consequent outgoing tanker traffic.

-
1. Current SEIC shareholders are: Shell (55%), Mitsui (25%) and Mitsubishi (20%). See: SEIC, Environmental Impact Assessment, p.1.9.
 2. Notification of the application was posted on the Department's website on 23 May 2003, and subsequently updated on 23 December 2005 and 28 March 2006. The name of the applicant has not been made public by ECGD, nor the nature and amount of the support requested.
 3. In addition to ECGD, the following public institutions have been approached for funding: the European Bank for Reconstruction and Development (EBRD), US Export-Import Bank (Ex-Im Bank), and the Japanese Bank for International Cooperation (JBIC). The project sponsors are also seeking additional financing from private banks. Credit Suisse First Boston is serving as the project's financial adviser. SEIC itself will invest some \$10 billion.
 4. These include the US Overseas Private Investment Corporation, the EBRD, and the Export-Import Bank of Japan (precursor to JBIC).
 5. See: ECGD, "List of projects with potentially high impacts for which ECGD support has been requested", http://www.ecgd.gov.uk/index/pi_home/cases_under_consideration.htm : "The exploitation of the Piltun-Astokhskoye and Lunskeye oil and gas fields offshore of Sakhalin Island and comprises two offshore production platforms, an onshore processing facility, onshore and offshore pipelines, a two train Liquid Natural Gas (LNG) Plant, an export terminal plus the upgrade of the associated infrastructure."

The Sakhalin II (Phase 2) project has been classified by ECGD as a High Impact Project. As such, its Environmental and Social Impact Assessment (ESIA) is subject to a 30 day public consultation period. The initial ESIA submitted by SEIC in 2003 was deemed “unfit for purpose” that year by the European Bank for Reconstruction and Development (EBRD), one of the project’s major potential funders.⁶ Subsequently, SEIC added an addendum to the SEIAs and EBRD, together with other funders that have been approached for support, announced a public comment period. ECGD set a deadline for final submissions of 28 April 2006.

This report is submitted by The Corner House, Friends of the Earth (England, Wales and Northern Ireland) and WWF UK as a response to this public consultation.

1.1 Environmental, Development and Social Concerns

The adverse social, environmental, human rights and development impacts of the Sakhalin II project have been the subject of widespread concern, both locally and internationally. Such concerns have focused on, but are not restricted to, the following documented impacts, which we have grouped into eleven categories:

- ***Impacts on Whales***

Sakhalin Island’s off-shore waters are some of the most abundant yet threatened marine environments on the Northern Pacific Rim. They contain 25 marine mammal species, 11 of which are endangered, including the world’s most critically endangered Gray Whale population, the Western Gray Whale, of which there are only around 100 remaining. Several project-related impacts could harm the Western Gray Whale, including construction and operation of drilling and production platforms and undersea pipelines, significant increases in vessel and aircraft traffic, seismic activities, and the potential for oil leaks and spills.⁷ The significant issues on which SEIC has ignored the panel means that the best scientific advice is not being followed, and as a result the whales are being exposed to unnecessary and avoidable risks. Given how close the Western Gray Whale is to extinction, any negative impact could imperil the species, a view endorsed by the Scientific Committee of the International Whaling Commission.⁸

⁶ EBRD President Jean Lemierre, EBRD AGM 2004, quoted in Pirani, S., “*Russian Rage over Sakhalin Project*” in *Emerging Markets*, 19 April 2004.

⁷ For further details see: Pacific Environment, <http://www.pacificenvironment.org>; WWF, http://www.panda.org/about_wwf/where_we_work/europe/where/russia/sakhalin/index.cfm

⁸ The 2004 report of the Scientific Committee of the International Whaling Commission states: “[T]he Committee noted with great concern that the evidence is compelling that this population is in serious danger of extinction...[and] recommends as a matter of absolute urgency that measures be taken to protect this population and its habitat off Sakhalin Island.” The Committee report also states that the: “[R]ecent onset of large-scale oil development programs off Sakhalin Island [including Sakhalin II] pose new threats to the future survival of the 100 remaining western gray whales.” Quoted in: Norlen, D., “Russia: Sakhalin II Gas and Oil Pipeline - Behemoth with a Bad

- **Impacts on Salmon and Fisheries**

The project's on-shore facilities include two 800-kilometre pipelines (oil and gas) that will cross over 1100 watercourses. Many of these watercourses provide spawning and rearing habitat for unique and important wild salmon including the endangered Sakhalin taimen. The salmon fisheries are the traditional backbone of the local economy and an important part of the culture of the indigenous peoples.

Shell proposes to cross virtually all 1100 watercourses by trenching, which involves the excavation of a trench across the bottom of a stream or river, and the placement and burial of the pipeline in the trench. Trenching of pipelines can, *inter alia*, affect fish spawning behaviour and reduce overall spawning levels, destroy salmon spawning beds, and indirectly smother those beds with suspended sediments that flow downstream from excavated pipeline trenches.

NGOs point out that this practice lags far behind the global best practice of aerial crossing, which was done on the Trans-Alaska Pipeline.⁹ SEIC proposes to use trenching on the majority of river crossings, with less destructive alternatives, such as Horizontal Directional Drilling, being proposed for fewer than ten¹⁰.

So far, over 500 crossings have already been undertaken and, according to data from SEIC, many have been crossed outside the winter season; in many cases the oil and gas pipelines have been installed at separate times, weeks and even months apart subjecting the watercourses to double jeopardy.

The construction permits require "simultaneous river crossings" of the oil and gas pipelines, yet over 60 of the sensitive rivers will not have the river crossed in the same season, let alone on consecutive days as the plans indicate. This means that over one third of the most sensitive rivers will not have the most basic mitigation measure applied to them.¹¹

Twenty sensitive rivers have also been crossed outside of the designated winter period according to SEIC's records. This is despite assurances that summer crossings would not occur being given by the company.

Trenched pipelines that leak (especially smaller, imperceptible leaks) could saturate soils and watercourses with oil long before they are noticed, and longer still before pipelines could be fixed or removed. Ironically, there are also concerns that the sensitivity of the leak detection system could mean

Attitude Shuns Best Practices, Risks Extinction, and Threatens an Island's Fisheries" in Goodland. R.(ed), *Oil and Gas Pipelines: Social and Environmental Impact Assessment - State of the Art*, Papers compiled for 2005 conference of International Association of Impact Assessment, 2005.

9. Norlen, D., "Russia: Sakhalin II Gas and Oil Pipeline - Behemoth with a Bad Attitude Shuns Best Practices, Risks Extinction, and Threatens an Island's Fisheries" in Goodland. R.(ed), *Oil and Gas Pipelines: Social and Environmental Impact Assessment - State of the Art*, Papers compiled for 2005 conference of International Association of Impact Assessment, 2005.
10. Lawler, D.M. and Milner, A.M. (University of Birmingham), "Report on Revised SEIC River Crossings Strategy Document of 6 December 2005", December 2005/Revised 13 January 2006. <http://www.ebrd.com/country/sector/natural/projects/sakhalin/river/051208.pdf>
11. Based on SEIC data at http://www.sakhalinenergy.com/en/project.asp?p=rc_list

that serious ruptures might be unnoticed for some time. A report commissioned for the Wild Salmon Center concluded:

"We highly advise SEIC to undertake a simple analysis and modification of their leak detection system to insure proper identification of rupture releases, as well as leaks, which are two very different failure phenomena on this critical pipeline system." (Emphasis as in original.)¹²

- **Pollution Risks**

No oil spill response plan is in place that is proven to work in the dangerous sea-ice conditions off Sakhalin Island, threatening the island's ecology and economy. In 1999 independent experts from Alaska and the Shetland Islands warned that the oil spill prevention and response measures leave the coastlines of Sakhalin and Hokkaido vulnerable to a catastrophic spill. The report recommended 78 specific measures, including designation of mandatory tanker routes, increased monitoring of tanker traffic, notifications to fishing vessels if a tanker is in the area, increased spill response equipment and improved access to the shoreline where it would be deployed.

The fact that Sakhalin II remains woefully unprepared for oil spills throughout its operations was recently made painfully clear. On 8 September 2004, the *Cristoforo Colombo*, a dredge contracted by SEIC ran aground at Kholmsk, a town in the south of the Island, spilling an estimated 1,300 barrels of fuel. It took nine hours for SEIC's contractor for oil spill emergency response to arrive and conduct visual observation and more than 48 hours for it to transport necessary equipment to the site. According to Russian regulations, SEIC should have localised the spill with equipment within four hours. As a result, six kilometres of shoreline, including a popular public beach, were coated with toxic oil. Dozens of residents in Kholmsk reported to hospitals with headaches and respiratory problems.

The HSE audit of phase I of Sakhalin II conducted by independent auditors also criticized the poor management of oil spill response equipment, with materials used in the response to the *Cristoforo Colombo* incident not being replaced.¹³

WWF recently commissioned a review by Nuka Research of the potential response options in ice conditions. This concluded that the Sea of Okhotsk represented the worst possible conditions for responding to a spill. The report observed that the 'response gap', when no response may be possible due to environmental (fog, waves, winds, ice, etc) or safety factors is probably more than half of the year.¹⁴

12. Accufacts Inc (2006). *Observations on Sakhalin II Transmission Pipelines*. Prepared for the Wild Salmon Center.

13. 2005 Lenders Tier III HSE Audit, RSK ENSR, December 2005

14. Full details can be found in the report "*Offshore Oil Spill Response in Dynamic Ice Conditions*", WWF 2006.

- ***Dumping of Wastes in Aniva Bay***

At the Southern terminus of the Sakhalin II on-shore pipelines, SEIC is constructing one of the world's largest Liquid Natural Gas (LNG) projects. During construction of the LNG terminal, at least 1,500,000 cubic metres of construction dredging wastes were dumped into Aniva Bay and over 500,000 cubic metres of wastewater will annually enter into this important fisheries-rich bay. A Russian court concluded that the Environmental Impact Assessment process for the dredging disposal was illegal, with a lack of public consultation and without consideration of the special economic or ecological significance of Aniva Bay¹⁵.

This also contributed to the rejection of the 2003 EIA as "unfit for purpose"¹⁶ by the EBRD, which has recently stated that "alternative sites were not properly considered".¹⁷

- ***Damage to wetlands and migratory bird habitats***

The area that the project will affect includes wetlands that are protected under the *Convention on Wetlands of International Importance, Especially as Waterfowl Habitat* (the "Ramsar Convention") and are home to protected species, including migratory birds protected under the *Convention Between the United States of America and the Union of Soviet Socialist Republics Concerning the Conservation of Migratory Birds and Their Environment*. While SEIC claims that its project will not affect these waterfowl populations negatively, non-governmental organisations contend that SEIC's response is inadequate and that project actions will decrease waterfowl populations.¹⁸

- ***Economic and Physical Displacement without adequate planning or compensation***

Calypso, a local fishing company, has been forced to make employees redundant and has lost clients in Japan who do not want fish from Aniva Bay where the oil and gas export facility is being built as the fish may be contaminated. Calypso is still waiting for adequate compensation for lost catches and the impact on its business. This issue forms the basis for a complaint to the EBRD which has been accepted by its ombudsman (Independent Recourse Mechanism (IRM)).

The Dacha communities close to the LNG plant have suffered from dust, excessive noise 24 hours-a-day, and damaged and blocked roads. They

15. The Yuzhno-Sakhalinsk Municipal Court, Case No 2-3550.
http://aa.ecn.cz/img_upload/2a47e698cb07569dfd0e077b6aad99/court_decision_01_05.pdf#search='Aniva%20Bay'

16. Sakhalin Environment Watch et al, Letter to EBRD President Lemierre of 29 September 2005;
[http://www.pacificenvironment.org/downloads/LtrLemierre_September%2029%202005%20\(2\)](http://www.pacificenvironment.org/downloads/LtrLemierre_September%2029%202005%20(2))

17. EBRD Press Release: *EBRD launches consultations on Sakhalin II oil and gas project*, 14 December 2005.

18. ECA-Watch, *Background on Sakhalin II Lawsuit*, (March 2004), <http://www.ea-watch.org/problems/russia/documents/BackgroundonSakhalinIILawsuit.doc>.

have received no compensation for loss of the local amenity of the main beach in the area where the LNG plant has been built. Nor have they received compensation for the loss of marine harvest such as scallops, molluscs and sea kale in the bay where construction and dredging is taking place.

- ***Impacts on Indigenous Peoples***

The Sakhalin II project has already caused damage to the traditional way of life of the Nivkh, Uilta (Oroks), Evenk and Nanai Peoples. In response, indigenous communities have blockaded oil and gas construction sites to protest against the project. The industry, and also the Russian government of Sakhalin, has responded to their concerns with inaction and misrepresentation of the potential benefits and impacts of the oil and gas projects. In a letter to the President of the European Bank for Reconstruction and Development, the Indigenous Congress of Sakhalin has stated:

“The Sakhalin II project is developing very fast now. We are afraid that construction activities under the project will reduce fish stocks because of pipeline trenches crossing the salmon spawning rivers, will destroy reindeer pastures and reduce the forest animal population because of onshore pipeline construction, and will pollute our environment. We take note that the harm done to the animal and plant world in traditional land-use areas takes a direct toll on the vital activities of indigenous peoples. However the damage inflicted on the traditional land-use of indigenous peoples, living a life style such as the indigenous do, is not taken into account, and isn't apparent to the management of ‘Sakhalin Energy’.”¹⁹

Although the contract for Sakhalin II was signed in 1994, it is only now – when construction is two-thirds completed – that an Indigenous Peoples’ Plan is being drawn up, leaving little scope for meaningful input from affected communities.²⁰ The failure to agree a plan *prior* to construction breaches international standards, including those of the European Bank for Reconstruction and Development, as the EBRD has itself acknowledged.²¹

- ***Inequitable Production Sharing Agreement (PSA)***

The Production Sharing Agreement (PSA) for the Development of the Piltun-Astokhskoye and Lunskeye oil and gas field, signed between Russia and SEIC in 1994, forms the legal basis for the development of both fields. SEIC has claimed that Russia will receive US\$49 billion in direct income

19. Quoted in Pacific Environment, *Impacts on Indigenous Communities* (undated).
<http://www.pacificenvironment.org/article.php?id=252>

20. ; WWF, *Sakhalin II: The Truth Uncovered*, March 2006. WWF Submission to EBRD Public Consultation on Sakhalin EIA, April 2006.

21. “The preparation of a plan for indigenous people was not prepared according to timing prescribed by the policy,” EBRD statement, December 2005, quoted in WWF Submission to EBRD Public Consultation on Sakhalin EIA, April 2006.

over the 49-year lifetime of the project.²² According to a study by economist Dr Ian Rutledge, however, this figure is unrealistic and misleading.²³ Under the terms of the PSA, which are heavily skewed in favour of SEIC, all cost over-runs are effectively deducted from the state's revenue, not the consortium's profits.²⁴ During the planning and early construction of the project, costs rose dramatically. In February 2005, the Audit Chamber of the Russian Federation found that, as a result of the terms of the PSA, cost over-runs had already cost the Russian state US\$2.5 billion.²⁵ This situation worsened further when in the Spring of 2005 SEIC announced that project costs had mushroomed from \$10 billion to US\$20 billion.

The lower than expected revenues received by the Russian side also have social and socio-economic impacts, since a percentage of the Russian-side's diminishing revenues are to be shared with regional and local authorities to provide services to support the project. Making matters worse, Russia recently enacted a policy stating that most resource rents from oil and gas projects will go to the Federal level, meaning that the regional government's share of a diminishing pie will shrink still further. Meanwhile, many environmental costs of the project are booked prior to profit sharing, providing a disincentive to adequate safeguards.

- ***Legislative and Human Rights Implications of Production Sharing Agreement (PSA)***

The Sakhalin II PSA requires the Russian Government to compensate SEIC where environmental and social laws are strengthened. The PSA states:

“(f) The Russian Party shall compensate the Company for any damage caused by the former in connection with adverse changes in Russian laws, subordinate laws and other acts taken by Government bodies after December 31, 1993 (including changes in their interpretation or their application procedure by government bodies and by the courts in the Russian Federation). Compensation shall be adequate to avoid deterioration in the commercial position of the Company in comparison to the position it would have held had there not been unfavorable changes.”²⁶

22. Sakhalin Energy Investment Company, *Environmental Impact Assessment*, para 1.3.1. The figure assumes an oil price of \$20 a barrel.

23. Ian Rutledge, *The Sakhalin II PSA – A production ‘non-sharing’ agreement*, November 2004, PLATFORM et al., available at <http://www.carbonweb.org/documents/SakhalinPSA.pdf>

24. Ian Rutledge, *The Sakhalin II PSA – A production ‘non-sharing’ agreement*, November 2004, PLATFORM et al., available at <http://www.carbonweb.org/documents/SakhalinPSA.pdf>

25. See: Associated Press, 10 February 2005, “State Audit Chamber accuses Shell consortium of overspending”.

26. *Sakhalin II Production Sharing Agreement: Legislation; Specific Rights of the Company; Result of the Approval Process* cited in Norlen, D., “Russia: Sakhalin II Gas and Oil Pipeline - Behemoth with a Bad Attitude Shuns Best Practices, Risks Extinction, and Threatens an Island's Fisheries” in Goodland, R., *Oil and Gas Pipelines: Social and Environmental Impact Assessment - State of the Art*, Papers compiled for 2005 conference of International Association of Impact Assessment, 2005.

As the UN Commission on Human Rights notes, such so-called “stabilization” clauses could have a “chilling effect” on a “State’s capacity and willingness to regulate for health, safety or environmental reasons.”²⁷ As a consequence, the human rights of Russian citizens could be violated. It could also undermine international or national environmental legislation that the host country is obliged to apply.

- **Greenhouse Gas Emissions and Climate Change Implications**

According to SEIC, the Piltun-Astokhskoye and Lunskeye oil and gas fields contain recoverable hydrocarbon volumes of more than 1 billion barrels (150 million tonnes) of crude oil and more than 500 billion cubic metres (18 trillion cubic feet) of gas.²⁸ The Sakhalin II oil and gas project will thus result in around an additional 1.5 billion tonnes of CO₂ being added to the atmosphere – approximately 0.5 billion from the oil extracted and 1 billion from the extracted gas. Operational emissions are estimated at a further 100 million tonnes.²⁹

To put this in perspective, UK emissions of CO₂ are around 550 million tonnes per year;³⁰ thus Sakhalin II will result in about 3 years’ worth of UK emissions. We note that Shell reports on the greenhouse gas emissions resulting from both its operations and use of its products at group level, so it is reasonable that both operational and product use emissions should be taken into account.

Despite the wide scientific acceptance that climate change is the most serious threat facing humanity, SEIC has not analysed the environmental impact of these emissions, stating that these are the “impacts of society’s use of the hydrocarbons”.³¹

- **Lack of Strategic Environmental Assessment**

The European Bank for Reconstruction and Development’s “Natural Resources Operations Policy” of 1999 indicates that mitigation of multiple or cumulative impacts should be addressed through Strategic Environmental Assessment.

Specifically referencing the Russian oil industry, the policy states:

“Going forward, to decrease the sector concentration risk and to increase the transition impact of Bank lending, preference should be to: [*inter alia*] ...

27 United Nations Commission on Human Rights, *Human Rights, Trade and Investment*, E/CN.4/Sub.2/2003/9, 2 July 2003.

28. SEIC, “Let the Journey Begin”,
http://www.sakhalinenergy.com/en/docs_news_stat/nws_releases_20041202.pdf

29 SEIC, EIA 2003. “*Cumulative and Transboundary Impacts*”.
http://www.sakhalinenergy.com/en/documents/doc_38_eia_7_chapter3

30. <http://www.defra.gov.uk/environment/statistics/globalatmos/gagginvent.htm>

31 SEIC, EIA 2003. “*Cumulative and Transboundary Impacts*”.
http://www.sakhalinenergy.com/en/documents/doc_38_eia_7_chapter3

- Undertake a Strategic Environmental Assessment (SEA) in those areas where multiple or cumulative impacts are unknown and not possible to undertake in individual project environmental impact assessments. SEAs may be relevant to cumulative impacts of oil developments near or on Sakhalin Island..."

Given the number of oil and gas projects underway or planned, cumulative impacts should have been considered for Sakhalin II, yet no SEA has taken place.

We note that Hilary Benn, the Secretary of State for International Development, has also endorsed the need for SEAs. Following the UK's decision to fund the Baku-Tbilisi-Ceyhan oil pipeline, Mr Benn stated:

"We made clear [to IFC] that we would strongly support the use of Strategic Environmental Assessment (SEA) for future infrastructure projects on this scale."³²

This was reiterated in evidence to the House of Commons Select Committee on International Development. Mr Benn stated:

"I think the final point that I would make on this is that one of the other things that we asked the IFC to do in the case of this project was to say that in future would it be helpful if we had strategic environmental assessments, which did not apply in this case, because the truth is that we need to learn from these projects how they go so that we can manage them better in the future."³³

32. Secretary of State for International Development (Hilary Benn),: House of Commons Hansard Written Ministerial Statement on the Baku-Tbilisi-Ceyhan Pipeline, 5 November 2003.

33. House of Commons International Development Committee, Minutes of Evidence, 6 November 2003. <http://www.publications.parliament.uk/pa/cm200203/cmselect/cmintdev/1266/3110603.htm>

Section 2

ECGD'S CRITERIA FOR PROJECT ACCEPTABILITY

2.1 ECGD's Policies

The framework and criteria that ECGD uses to decide the acceptability of projects for financial support has been set out in a number of recent policy statements and procedural documents. These include but are not restricted to:

1. The 1991 Export and Investment Guarantees Act
2. The ECGD's Statement of Business Principles
3. The ECGD's Business Principles
4. The Business Principles Unit (BPU)'s Case Impact Analysis Process
5. The ECGD's 2005 Sustainable Development Action Plan

2.2 Key Undertakings

Aside from legal questions in these respects that are mentioned in the letter of today's date from the Solicitor at Friends of the Earth to ECGD³⁴, we set out below four undertakings that have been made by ECGD that are of particular importance in reaching a reasonable decision as to the acceptability or otherwise of Sakhalin II (Phase 2) for ECGD support:

- First, the ECGD is bound by law to ensure the proper financial management of its portfolio and is committed to achieving the financial objectives.
- Second, all projects *must* be "compatible" with the ECGD's Statement of Business Principles³⁵, which summarise ECGD's policies on "ECGD in Business", "Sustainable development and human rights", "developing countries", "business integrity" and "transparency". In particular, the decision on ECGD support *must* take into account "the Government's

34. This can be obtained on request from Friends of the Earth.

35. Business Principles Unit, "Case Impact Analysis Process", ECGD, May 2004, p.1, http://www.ecgd.gov.uk/index/pi_home/case_impact_analysis_process.htm: "It is ECGD's policy to ensure that all cases supported by ECGD are compatible with its Statement of Business Principles."

international policies, including those on sustainable development, environment, good governance and trade.”³⁶

- Third, the project should “comply in all material respects with the relevant safeguard policies, directives and environmental guidelines of the World Bank Group”.³⁷
- Fourth, the UK is a signatory to the OECD’s Recommendation on Common Approaches, which obliges ECGD to ensure compliance of its projects with host country standards.³⁸

Section 3 considers the financial, social, environmental, human rights and developmental issues raised by the Sakhalin II against these four policy undertakings. We do so by first tabulating the issues in respect of each undertaking, and elaborate on each issue in the text that follows.

36. ECGD, “Statement of ECGD’s Business Principles”, *in* “ECGD’s Business Principles”, http://www.ecgd.gov.uk/index/pubs_home/pr_bp.htm: “We will promote a responsible approach to business and will ensure our activities take into account the Government’s international policies, including those on sustainable development, environment, human rights, good governance and trade.”

37. Business Principles Unit, Case Impact Analysis Process, ECGD, May 2004, p.2, http://www.ecgd.gov.uk/index/pi_home/case_impact_analysis_process.htm

38. OECD, Working Party on Export Credits and Credit Guarantees, Updated Recommendation on Common Approaches in Environment and Officially Supported Export Credits, TD/ECG (2005) 3, 25 February 2005, para 12.2.

Section 3

ASSESSMENT OF PROJECT COMPLIANCE WITH KEY ECGD POLICIES

3.0 This section assesses the Sakhalin II (Phase 2)'s compliance, on paper and in reality, with ECGD's stated requirements for project acceptability.

3.1 Policy Requirement One Sound Management of ECGD's Portfolio

The Table below itemises seven issues relevant to this requirement.

Policy Requirement	Issue
Proper financial management of ECGD portfolio, including management of reputational risks	<ul style="list-style-type: none"> Reputational risks (notably association of ECGD with possible extinction of Western Gray Whale) arising from project construction being two-thirds completed and consequent limitations on ECGD's ability to affect outcomes of project
	<ul style="list-style-type: none"> Reputational risks associated with damaging many wild salmon spawning rivers and tributaries and other fisheries that contribute to 1/3 of the island's historic economy.
	<ul style="list-style-type: none"> Outstanding legal cases against SEIC, with the courts granting admissibility, and compliance with Convention on Biological Diversity
	<ul style="list-style-type: none"> Association of ECGD with project that has angered Russian Government over one-sidedness of Production Sharing Agreement
	<ul style="list-style-type: none"> Doubling of costs casts doubt on management of SEIC
	<ul style="list-style-type: none"> Reputational risks arising from Shell's well-documented corporate management failure
	<ul style="list-style-type: none"> Shareholder concern over Shell's poor environmental and social assessments, specifically citing Sakhalin

3.1.2 Duties of ECGD: Reputational Risk Issues

The ECGD derives its powers from the 1991 Export and Insurance Guarantees Act.³⁹ The Act requires the ECGD to exercise sound financial management and grants powers to the Secretary of State "to make any

³⁹ *Export and Insurance Guarantees Act, 1991*,
http://www.opsi.gov.uk/acts/acts1991/Ukpga_19910067_en_1.htm

arrangements which, in his opinion, are in the interests of the proper financial management of the ECGD portfolio, or any part of it".⁴⁰ The ECGD acknowledges the duties imposed by "the proper financial management obligation in our Statute" on its website.⁴¹

The importance of sound financial management as a priority for all government departments is also stressed by the UK Treasury, which has been working since 1997-98 to improve ECGD's risk management systems,⁴² in its 2002 *Good Practice Guidance* report.⁴³ Risk management is also described as "a priority area across central government" by the National Audit Office.⁴⁴

Since the publication of the Turnbull Committee's Guidance on the Combined Code on Corporate Governance in 2000, the containment of "reputational risks" – defined as by the UK Treasury as "the risk that there, will be an undermining of customer/ media perception of the organisations ability to fulfil its business requirements", for example, through "adverse publicity concerning an operational problem"⁴⁵ – has been accepted by the UK Government as a key component of sound financial management. Reputational risks are now listed in the Treasury's *Green Book* as one of the risks that government departments should consider as part of their financial management practices.⁴⁶ Indeed, the containment of reputational risks is now an accepted part of ECGD's risk management procedures, as recorded in discussions of the ECGD's Export Guarantees Advisory Council⁴⁷.

⁴⁰ Ibid, Section 3 "Financial Management", para 3.1.

⁴¹ ECGD, "Sustainable Development: Debt Forgiveness",
http://www.ecgd.gov.uk/index/susdev_home/susdev_debt.htm

⁴² UK Treasury, *Chancellor of the Exchequer's Departments: The Government's Expenditure Plans 1998-99*, p.48, <http://www.hm-treasury.gov.uk/media/3DB/E8/106.pdf>.

⁴³ UK Treasury, Government Internal Audit Standards: Good Practice Guidance – The Role of Internal Audit, http://www.hm-treasury.gov.uk/media/7DB/8A/pss_GPG_resource2_080704.pdf. The Treasury notes: "The requirements of corporate governance necessitate that organisations have a sound financial system. Poor financial management within organisations impacts on the ability of government funded bodies to make best use of, and account properly for, the public funds they receive. The same weaknesses may also expose the bodies to greater risk of fraud, error or impropriety within their financial statements. Such weaknesses can undermine the integrity of financial processes and can result in funds not being applied for the purposes authorised by Parliament." The Treasury recommends that good risk management procedures are in place to ensure "that risks are identified, assessed for potential impact, that decisions are taken regarding the need for control measures to be imposed, and that controls are implemented and tested for effectiveness."

⁴⁴ http://www.nao.org.uk/guidance/focus/focus9_pp16-17.pdf

⁴⁵ UK Treasury, *Green Book*, Annex 4, <http://greenbook.treasury.gov.uk/annex04.htm>

⁴⁶ Ibid.

⁴⁷ See, for example: Export Guarantees Advisory Council, Minutes of Meeting Held 21 January 2004, and Minutes Held on 20 November 2002, both available from http://www.ecgd.gov.uk/index/pi_home/pi_ac.htm. The November 2002 minutes note that issues of reputational risk had been a major preoccupation of the Council: "The Council's time had focussed primarily on Business Principles issues, in particular environmental and reputational risk. This was reflected in the Council's Annual Report."

3.1.3 Reputational and Financial Risks Implications for ECGD of support for Sakhalin II

ECGD support for Sakhalin II would expose ECGD to a number of well-documented risks which are not contained – and cannot be adequately contained – through the existing Environmental and Social Action Plans. In addition, the corporate governance record of SEIC and its principal shareholder, Shell, raises major concerns over the financial risks associated with the project.

It should be noted that the Sakhalin II project – and specifically ECGD's possible involvement – has already been subject to adverse publicity and consequent reputational risk to ECGD. This can only increase if the ECGD actually decides to support the project. A list of some 100 press articles was submitted to the EBRD's London consultation meeting in February 2006, and therefore will be available to the lender's group, of which ECGD is a member.

The reputational risks to which ECGD would be exposed through support for Sakhalin II are elaborated upon below:

1. Uncontainable risks arising from SEIC's record of pressing ahead with construction despite advice to the contrary from independent environmental experts

As noted, the initial Environmental and Social Impact Assessments for the project were rejected by EBRD as "unfit for purpose".⁴⁸ Despite this, SEIC has pressed ahead with construction, which is now two-thirds completed. In the process, it has routinely ignored the advice of environmental experts and, indeed, the recommendations of the Russian Government's own regulatory bodies.⁴⁹ The European Bank for Reconstruction and Development (EBRD) has acknowledged that critical aspects of work to date on the project do not comply in major respects with EBRD's environmental policy.⁵⁰

Of particular concern is the siting of one oil platform adjacent to the principal feeding ground of the world's only population of the critically

48. EBRD President Jean Lemierre, EBRD AGM 2004, quoted in Pirani, S., "Russian Rage over Sakhalin Project", *Emerging Markets*, 19 April 2004.

49. For example, SEIC has continued to trench river crossings for the project's pipeline despite the Russian government recommendations for aerial crossings of 29 watercourses.

50. See, for example, EBRD, "EBRD Launches Consultations on Sakhalin II Oil and Gas Project", Press Release, 14 December 2005. With regard to river crossings and the siting one of the oil platforms, the EBRD states: ". . . the EBRD recognises that procedures prescribed in its Environmental Policy were not fully followed in the planning phases". The press release also acknowledges that "the decision-making process to choose the site [of one oil production platform] was not in conformity with the Policy". Although the EBRD argues that the issues have been addressed in the new Environmental and Social Impact Analysis, this is disputed by independent experts (see for example Accufacts Inc (2006). *Observations on Sakhalin II Transmission Pipelines*. Prepared for the Wild Salmon Center.). Elsewhere EBRD states: "While it is already clear that Shell has failed to comply with some of the EBRD's rigorous environmental procedures, it has improved practices with a view to obtaining the EBRD's financing."
<http://www.ebrd.com/country/sector/natural/projects/sakhalin/press/ft060109.htm>

endangered Western Gray Whale, despite advice from the SEIC-funded Independent Scientific Review Panel⁵¹ that further research was needed before the oil platform was erected. The Panel warned:

"The most precautionary approach would be to suspend present operations and delay further development of the oil and gas reserves in the vicinity of the gray whale feeding grounds off Sakhalin, and especially the critical nearshore feeding ground that is used preferentially by mothers and calves."⁵²

After SEIC's decision to go ahead with installation of the PA-B base, the co-chairs of the Panel wrote:

"Unquestionably, their [Shell's] decision to adhere to their predetermined construction schedule has, in some respects, obviated or undermined the utility of our review. The decision to move ahead is entirely theirs -- we do not have the authority or control to influence those decisions and the fact that they proceed with construction should in no way be taken as a sign of our concurrence with or approval of their schedule and activities."⁵³

One panel member made a direct plea to SEIC:

"I feel that the precautionary approach for Royal Dutch Shell clearly requires you to postpone the tow-out of the PA-B base until such time as independent review has been completed, SEIC has adequately responded, and all outstanding issues have been reasonably resolved."⁵⁴

The platform's concrete base is now in place, thus it is too late to undo any damage that has already occurred by towing out and anchoring the base. What's more, when SEIC installed the platform base in the summer of 2005, it did not even wait long enough for the fog to clear, thus negating the effectiveness of the on-board marine mammal observers, the only mitigation measure for collisions.

Furthermore, the Interim Independent Scientists Group (IISG) panel that has been convened to consider the Western Gray Whales is critical of plans for the 2006 construction season and warn that SEIC are continuing to ignore recommendations.⁵⁵

51. The panel was selected through the International Union for the Conservation of Nature.

52. Independent Scientific Review Panel, *Impacts of Sakhalin II Phase II on Western North Pacific Gray Whales and Related Biodiversity: Report of the Independent Scientific Review Panel*,:
<http://www.iucn.org/themes/business/>

53. Communication from ISRP co-chairs to Pacific Environment, August 2005

54. Letter from Professor Rick Steiner, University of Alaska Marine Advisory Program, to Jeroen Van der Veer, Shell CEO, 14 July 2005

55. Report of the Interim Independent Scientists Group (IISG) on Mitigation Measures to Protect Western Gray Whales During Sakhalin II Construction Operations in 2006 "“No major changes have been proposed by SEIC in the nature or design of vessel corridors in the draft 2006 MMPP. The IISG noted the company's decision not to reduce the speed limits or routes of vessels in the navigational corridors as they approach the platform areas (PA-A and PA-B). Specifically, SEIC did not accept the recommendation from the lender's workshop that the east-west portions of the navigation corridors should be treated as equivalent to construction corridors (i.e. daylight/good visibility limit of 10 knots; night time/poor visibility limit of 7 knots).”
http://www.iucn.org/themes/business/ISRP_Followup/Final%20Vancouver%20II%20report.pdf

Fourteen “skinny” whales (excluding mothers with dependent calves) were observed in 2005, which is a considerably larger number of malnourished whales than reported in any year since 2001. Again, it should be stressed, the projection is that the loss of just *one additional* female whale per year in the Sakhalin area, if it is additional to other losses, will likely cause the population to decline towards extinction. This confirms the continued importance of avoiding any additional losses in the Sakhalin area.⁵⁶

ECGD could therefore facilitate and be implicated in actions that may lead to the extinction of a whale species as a result of SEIC’s decisions to press ahead with construction. Modelling conducted by the scientific panels has confirmed that the position of the Western Gray Whale population is precarious and that SEIC has little room to manoeuvre if its activities are not to push the whales into extinction.⁵⁷

Similar concerns arise over the routing of the pipeline and its impacts on salmon runs and tributaries. These too are inadequately addressed in the Environmental Action Plan. The EBRD has noted that procedures prescribed in its Environmental Policy were not fully followed.⁵⁸ This cannot be undone.

2. Outstanding legal cases against SEIC over environmental damage caused by the project and violations of Russian law

We are aware of several cases in the Russian courts. For example local NGOs have litigated to halt construction of a jetty associated with the LNG plant, and recently won a court ruling.⁵⁹ A list of legal cases was presented by environmental NGOs at the EBRD’s Moscow consultation meeting this year and we trust that ECGD will obtain that list.

ECGD’s financing of a controversial project that is subsequently found to have broken local law would present a major reputational risk to the Department. Prudent management would suggest that any decision to finance the project should be contingent on the outcome of outstanding court proceedings (in addition to advice on Russian compliance with obligations under Articles 8 and 14 of the Convention on Biological Diversity, as to which see further below).

56 . Report of the Interim Independent Scientists Group (IISG) on Mitigation Measures to Protect Western Gray Whales During Sakhalin II Construction Operations in 2006.
http://www.iucn.org/themes/business/ISRP_Followup/Final%20Vancouver%20II%20report.pdf

57. Report of the Interim Independent Scientists Group (IISG) on Mitigation Measures to Protect Western Gray Whales During Sakhalin II Construction Operations in 2006.
http://iucn.org/themes/business/ISRP_Followup/Final%20Vancouver%20II%20report.pdf

58 EBRD Press Release: *EBRD launches consultations on Sakhalin II oil and gas project*, 14 December 2005.

59. Pacific Environment and Sakhalin Environment Watch, *Legal Violations Remain at Sakhalin II LNG Plant*, Press Release, 7 December 2005, <http://www.pacificenvironment.org/article.php?id=560>

3. Escalating Costs and SEIC's management

In the three years since an application for support was first lodged with ECGD, Sakhalin II's costs have more than doubled. In summer 2004, SEIC announced a reported 20 per cent cost increase on Sakhalin II, from US\$10 billion to US\$12 billion. Since then, a further increase in costs has been announced – to about US\$20 billion⁶⁰ Such cost escalation strongly suggests that SEIC's planning and management controls are inadequate and, as such, pose a financial and reputational risk to ECGD.

SEIC's record of pushing ahead with project activities without first undertaking the necessary studies and mitigatory planning should also be of concern to ECGD.

4. Potential Reputational Risk to UK from ECGD Support for Sakhalin Production Sharing Agreement

The Production Sharing Agreement on which the Sakhalin II project is predicated provides excessively favourable terms for Shell. Shell will recoup not just their costs but also a 17.5 per cent return on investment before the Russian state gets its share.⁶¹ This is not a typical way to divide revenues. The Russian government has expressed anger at the poor terms of the deal for Russia in terms of its share of the revenues. In particular, Russia has indicated it will not swallow any of the \$10billion cost overruns and the delay in receiving revenues.

Any future disputes between the Russian Government and SEIC over the PSA would inevitably embroil Sakhalin II's financial backers, if only through adverse and widespread press coverage. For the ECGD to back the project therefore carries foreign policy risks, which in turn may result in reputational risks for the ECGD and the UK.

5. Reputational risks arising from Shell's well-documented corporate management failures

Since 2003, Shell's corporate governance has been subject to increasing criticism, with a number of prominent socially responsible investment (SRI) firms selling their holdings in the company.⁶² Of particular concern has been the revelation that Shell inflated its figures for its proven reserves, leading the US Securities and Exchange Commission to rule:

". . . Royal Dutch and Shell Transport violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Respondents knowingly or recklessly reported proved reserves that were non-compliant with Rule 4-10, and failed (i) to ensure that Shell's internal proved reserves estimation and reporting guidelines complied with Rule 4-10 and (ii) to

60. Mathiason, N., "Shell's pipeline costs overflow to \$22 billion", *The Observer*, 16 October 2005.

61. WWF, *Sakhalin II: The Truth Uncovered*, March 2006.

62. In June 2004, leading socially responsible investment funds, including Investec Henderson Crosthwaite and Morley Fund Management, divested all their holdings in Royal Dutch/Shell over concerns about Shell's management of environmental issues including the Sakhalin II project. See: Mathiason, N. and Morgan, O., "Ethical Funds Dump Shell Shares", *The Observer*, 27 June 2004.

take timely and appropriate action to ensure that their reported proved reserves were not overstated in their filings with the Commission and other public statements."⁶³

6. Shell's poor project management and contractor control

Contractor management appears to have been a key factor in Shell failing to deliver on even the environmental measures and procedures it had set itself. A report examining thirteen projects, including Sakhalin, was leaked to the Financial Times.⁶⁴ Ed Merrow, an outside consultant commissioned by Shell to evaluate project management, found the company was "*almost wholly dependent*" on contractors for critical functions, including scheduling and cost control. Shell took a "*distinctly hands-off approach*".

Project management generally is not up to industry best practice, with Shell setting up a special new project management academy to try and improve its skills on managing mega-projects. In an interview in the Financial Time in July 2005, Shell's chief executive admitted: "*We do some projects very well, and this large Sakhalin project and some others we don't do very well*".⁶⁵

7. Shareholder concerns registered for Shell's 2006 AGM

The Ecumenical Council for Corporate Responsibility has filed a shareholder resolution in 2006, to register its concern over Shell's poor social and environmental assessment practices, citing Sakhalin and ice operations specifically as examples.⁶⁶

3.1.4 Conclusion

Support for Sakhalin II carries a number of unwarranted and uncontrollable reputational risks for the ECGD. As such, they pose a potential conflict with ECGD's legal duty to manage its portfolio responsibly. In compliance with its stated policy of being "open and honest" in its dealings,⁶⁷ ECGD should make public how it has resolved this conflict in the event of support for the project being approved.

63. SEC Order of August 24, 2004: ADMINISTRATIVE PROCEEDING File No. 3-11595]

64. Shell's 'hands off' approach pushes up costs, Financial Times, 7 November 2005

65. Interview with Jeroen Van der Veer, Financial Times, 15 July 2005

66. http://www.eccr.org.uk/docs/0603_shell_resolution_statement.pdf

67. ECGD, "Statement of ECGD's Business Principles", in ECGD's Business Principles, http://www.ecgd.gov.uk/index/pubs_home/pr_bp.htm.

3.2 POLICY REQUIREMENT 2 COMPATIBILITY WITH BUSINESS PRINCIPLES AND UK'S INTERNATIONAL POLICY

The Table below itemises six issues relevant to this requirement.

Policy Requirement	Issue
All cases supported by ECGD must be compatible with its Statement of Business Principles	<ul style="list-style-type: none"> • Environmental and Social Impact Assessment does not address human rights impacts
ECGD must take into account the Government's international policies, including those on sustainable development, human rights, good governance and trade.	<ul style="list-style-type: none"> • Non-renewable resources and climate change: support incompatible with UK's objectives in ratifying (i) UNFCCC, (ii) Kyoto Protocol and (iii) with UK sustainable development policies and commitments at Johannesburg's World Summit on Sustainable Development
	<ul style="list-style-type: none"> • Biodiversity: project incompatible with (i) UK sustainable development policies and commitments at Johannesburg's World Summit on Sustainable Development; (ii) UK sustainable development strategy to reduce biodiversity loss; (iii) obligations on Russia under Arts. 8 and 14 of the Convention on Biological Diversity (CBD); (iv) obligations on the UK under Arts. 6(b) and 11 of the CBD; and (v) strategic priority of DEFRA to protect the Pacific Gray Whale
	<ul style="list-style-type: none"> • Ramsar Convention: Incompatibility with UK and Russian obligations under Article, 3, 4 and 5 of the Ramsar Convention
	<ul style="list-style-type: none"> • Human Rights: Stabilisation clauses in PSA conflict with UK's international human rights obligations
	<ul style="list-style-type: none"> • Strategic Environmental Assessment: has not been conducted.

3.2.1 ECGD's Duties

As noted in Section 2, it is ECGD's policy to ensure that all cases supported by ECGD are compatible with its Statement of Business Principles.

The Statement commits ECGD to "taking into account the Government's international policies, including those on sustainable development, human rights, good governance and trade."

The ECGD is also committed to being "open and honest in all our dealings and [to expecting] the same from others."

The ECGD's Case Impact Handling Process is intended to "ensure that all civil, non-aerospace, transactions supported by ECGD meet these policy objectives."

3.2.2 Lack of Human Rights Assessment

The Business Principles commit ECGD to screening applications for their “human rights aspects”. The Environmental and Social Impact Assessments for Sakhalin II do not assess the human rights impacts of the project.

ECGD should make public any human rights assessment it carries out as part of its own due diligence, in order to demonstrate that any support for the project is consistent with its commitments under the Business Principles.

3.2.3 Incompatibility of Sakhalin II with UK’s international policies on sustainable development

1. Incompatibility with WSSD Johannesburg Commitments

The ECGD cites the commitments made by the UK Government at the World Summit on Sustainable Development (WSSD) in Johannesburg in September 2002 as one of the international policies against which applications will be screened.

The project is incompatible with the following Johannesburg commitments:

A. “Greater natural resource efficiency and a reduction in unsustainable consumption and production patterns”

The project will extract two non-renewable resources, oil and gas, without any accompanying programmes to ensure greater efficiency in the use of those resources or a reduction in unsustainable consumption patterns. This commitment is particularly aimed at developed countries, whose unsustainable consumption and production patterns have led to major global problems, including climate change.

But rather than addressing this, a high percentage of the oil and gas from the project will be exported to the United States of America,⁶⁸ a country which has obligations under the 1992 *United Framework Convention on Climate Change* (UNFCCC) but which has not signed the Kyoto Protocol (KP) which imposes binding greenhouse gas emission cuts on developed countries. However, many of these countries are not expected to meet their legal targets. In addition, these countries, as well as the US, also have legal obligations in respect of limiting greenhouse gas emissions under the UNFCCC.

Support for the project thus conflicts with the UK’s Johannesburg commitments and directly undermines the intent of the Kyoto Protocol through its exports to non-Kyoto countries, and conflicts

68. "Shell has sold about 75 percent of its planned 9.6 million tonnes a year of LNG from Sakhalin 2 on long-term supply contracts to Japan, South Korea and the US West Coast." See: http://www.greenmedia.info/eng/more/1419_0_5_0_M/

with the obligations of developed countries under the 1992 Framework Convention.

Any ECGD support for the project should be conditioned on the oil and gas being used by developed country KP Parties who are expected to meet their KP target and who are complying with their obligations under the UNFCCC.

B. “Significantly reducing the rate of loss of biodiversity on land by 2010 and a halt to biodiversity loss at sea”.

This commitment places a positive duty on the UK to take pro-active measures to prevent biodiversity loss at sea. The reasonable exercise of this duty should be viewed in conjunction with the UK Government’s commitment to the Precautionary Principle and to “using sound science responsibly”,⁶⁹ an approach to which the ECGD is also explicitly committed.⁷⁰

The threat of extinction to the Gray Whale population affected by Sakhalin II has been acknowledged by the Scientific Panel of the International Whaling Commission (see above para 1.1). Indeed, the Scientific Committee of the International Whaling Commission (IWC) notes “*that it is a matter of absolute urgency... to reduce various types of anthropogenic disturbances to the lowest possible level*”⁷¹ [emphasis in original].

Although it is claimed that adequate mitigation measures are in place, the SEIC-funded Independent Scientific Review Panel stated, in February 2005, that its own review of the current Environmental Impact Assessment and other available documentation gives no comfort that the threat to the Pacific Gray Whale population from construction of the project has been mitigated.⁷²

This commitment is also reinforced by the *Convention on Biological Diversity*, which has been acknowledged as applicable to the project, though without any discernible effect. In particular, as detailed in the letter of today’s date from the Friends of the Earth

69. HM Government, *Securing the Future - UK Government sustainable development strategy*, p.17, <http://www.sustainable-development.gov.uk/publications/pdf/strategy/Chap%201.pdf>. *Securing the Future* describes the “use of sound science responsibly” as a guiding policy principle of the UK government’s sustainable development strategy. Implementation requires: “Ensuring policy is developed and implemented on the basis of strong scientific evidence, whilst taking into account scientific uncertainty (through the precautionary principle) as well as public attitudes and values.”

70. ECGD, *ECGD’s 2005 Sustainable Development Action Plan*, http://www.ecgd.gov.uk/index/susdev_home/2005_sustainable_development_action_plan.htm.

71. International Whaling Commission, Report of the Scientific Committee, Section 10.7.5, July 22, 2001, p. 54.

72. Report of the Interim Independent Scientists Group (IISG) on Mitigation Measures to Protect Western Gray Whales During Sakhalin II Construction Operations in 2006. p.19: “No definitive conclusion can be drawn from the presented documents with regard to potential impacts on whales during the 2005 construction season. This is particularly regrettable considering that the most active SEIC construction season to date is slated to begin in just two months, i.e., in early June 2006.” http://iucn.org/themes/business/ISRP_Followup/Final%20Vancouver%20II%20report.pdf.

Solicitor, Russia has relevant obligations under nine paragraphs in Article 8 (in situ conservation) and under Article 14 (assessment), and the UK has obligations under Article 6(b) (integration) and Article 11 (incentives).

Further, protection of the Pacific Gray Whale is one of the strategic priorities for the UK's Department of the Environment, Food and Rural Affairs (DEFRA). In its 2005 Departmental Report, it stated:

"The UK (with support of others) successfully resisted attempts by Japan and allies and secured the adoption of an International Whaling Commission Resolution in defence of the highly endangered Western Pacific Gray Whale, threatened by oil and gas development off Sakhalin Island."⁷³

Given the concerns expressed by the world's leading marine mammal specialists and the inability to ensure that the Western Gray Whale population will survive the development and implementation of the project, ECGD support for the project would directly conflict with the UK's obligations under the Johannesburg commitments. It would also conflict with the UK's stated sustainable development strategy to reduce biodiversity loss, with the obligations on Russia under Articles 8 and 14 of the CBD, with the obligations on the UK under Article 6(b) and 11 of the CBD, and with the strategic priority of DEFRA to protect the Pacific Gray Whale from extinction.

In a letter to UK environmental NGOs, the Minister of State for Environment, stated⁷⁴:

"I can assure you that the Government will only agree to support the project if it is satisfied that, amongst other things, the best scientific advice is being followed and that the risks to the whales from the development have been minimised."

It is clear that the best scientific advice is **not being followed**; there is much evidence showing that SEIC has willfully ignored numerous recommendations, even with respect to operations affecting the Western Gray Whale. For example, the Vancouver workshop concluded:

"The approach taken to date has not always been suitably or consistently precautionary, nor has the ALARP (As Low As Reasonably Practicable) concept always been implemented in a manner that provides the least practicable risk to the whales."⁷⁵

73. UK's Department of the Environment, Food and Rural Affairs (DEFRA), Departmental Report 2005, p.115.

74. Letter of 14 February 2004 to Wildlife and Countryside Link from the Elliott Morley, MP, Minister of State for Environment. and Agri-Environment

75. Western Gray Whale Workshop, Vancouver, September 17-19, 2005

2. Incompatibility with UK and Russian obligations under the Ramsar Convention

It is well known that the project threatens a number of important wetlands, including three of five Sakhalin bay wetlands (Lunskoye, Chaivo and Piltun) proposed by the Russian regional environmental committee for designation on the list under the *Convention on Wetlands of International Importance especially as Waterfowl Habitat*, better known as the Ramsar Convention. These wetlands are habitat for protected migratory birds, including Steller's Sea Eagle, Spotted (Nordmann's) Greenshank, Osprey and Aleut Tern. The 2003-2005 EIAs submitted by SEIC do not identify Russia's obligations under the Ramsar Convention, or accurately and adequately show how project activities might contravene such obligations

The UK and Russia are Parties to the Ramsar Convention. Article 3 of the Convention requires Parties to "formulate and implement their planning so as to promote the conservation of [listed] wetlands". Article 4 places a duty on Parties to "promote the conservation of wetlands and waterfowl", and provides that where a Party "in its urgent national interest, deletes or restricts the boundaries of a wetland included in the List, it should as far as possible compensate for any loss of wetland resources, and in particular it should create additional nature reserves for waterfowl and for the protection, either in the same area or elsewhere, of an adequate portion of the original habitat." This provision has not been activated by Russia to our knowledge.

Article 5 obliges parties "to consult with each other about implementing obligations arising from the Convention . . ." and to "coordinate and support present and future policies and regulations concerning the conservation of wetlands and their flora and fauna."

Mitigatory measures proposed by SEIC are inadequate to protect the wetlands or their migratory bird populations. There is also no evidence in the project Environmental Impact Assessment that either the Russian Federation or the UK have consulted with each other about implementing the obligations arising from the Convention in light of the threat posed by the project.

If ECGD support is granted, and these wetlands are damaged, it is possible that Russia would be in violation of the Convention, and that the UK would be facilitating that violation. This is therefore a potentially very serious matter, which needs to be taken up urgently with Russia.

Further, it also appears that the ECGD would enable the Russian Federation to breach other international treaty obligations it has with

the US under the Convention Between the United States of America and the Union of Soviet Socialist Republics Concerning the Conservation of Migratory Birds and Their Environment.

3. *Incompatibility of PSAs with UK's international human rights obligations*

The UK is obliged under international law to *promote* and *respect* human rights. ECGD support for a project that undermines those obligations, either through causing human rights violations or inhibiting other states from exercising their own obligations to promote human rights, would be incompatible with the UK's human rights duties.

As noted above (para 1.1), the Production Sharing Agreement on which the Sakhalin II project is predicated contains stabilisation clauses that severely limit the Russian Federation's ability to act in the public interest with respect to new environmental and social regulations that might affect the profitability of the project. As such, the clauses conflict with the recommended best practice of the UN Commission on Human Rights, which has expressed concern over the limitations such clauses place on the ability of states to exercise their international human rights obligations.

The human rights implications of such stabilisation clauses have been raised by Amnesty International,⁷⁶ Corner House and other groups⁷⁷ in respect of the Baku-Tbilisi-Ceyhan oil pipeline, for which the ECGD provided support. In this instance, the BTC consortium agreed to a Deed Poll under which they waived their right to invoke the stabilisation clause if new legislation was introduced to protect the environment or human rights.⁷⁸

No such undertaking has been given by SEIC. ECGD support for the project could therefore result in the UK being party to a project that is underwritten by an agreement that conflicts with its international human rights obligations to promote and respect human rights. The ECGD should not support the project until this issue has been resolved.

76. Amnesty International, *Human Rights on the Line: The Baku-Tbilisi-Ceyhan oil pipeline*, May 2003, <http://www.amnestyusa.org/business/humanrightsontheline.pdf>

77. See: "Preliminary analysis of Implications of the Host Government Agreement between Turkey and the BTC Consortium, October 2002, http://www.bakuceyhan.org.uk/publications/preliminary_legal_analysis_oct_02.pdf ; "Issues arising from legal regime of BTC project", <http://ifiwatchnet.org/doc/btcch2.pdf>

78. BTC Co, *Human Rights Undertaking*, www.caspiandevlopmentandexport.com

4. Strategic environmental assessment (SEA) has not been conducted

The need for an SEA is clearly understood. It was made clear under EBRD policy. It was made clear by the Secretary of State for International Affairs, Mr Hilary Benn MP, in the aftermath of the BTC decision. The EU has adopted an SEA Directive, which has been transposed into UK law and thus would have to be complied with if the project was based in this country⁷⁹. The UK is also a signatory to the Convention on Environmental Impact Assessment (EIA) in a Transboundary Context's Protocol on Strategic Environmental Assessment (Kiev, 2003), and as such has an international legal obligation not to act in a manner to defeat the protocol's purpose (even though the Protocol has not yet entered into force).

There is no objective basis we can see for not having conducted an SEA.

3.2.4 Conclusions

ECGD support for Sakhalin II would be incompatible with the UK's international commitments on sustainable development (as identified by the ECGD), with the UK's international human rights commitments and with its and Russia's obligations under the Ramsar Convention. It would also possibly enable the violation of Russia's treaty obligations with the United States.

3.3 POLICY REQUIREMENT 3 COMPLIANCE WITH SAFEGUARD POLICIES, DIRECTIVES AND GUIDELINES OF WORLD BANK GROUP

Policy Requirement	Issue
The project should "comply in all material respects with the relevant safeguard policies, directives and environmental guidelines of the World Bank Group".	• Construction to date fails to comply in major respects with World Bank Group policies
	• Current Environmental and Social Assessment breaches World Bank policies in six World Bank Group documents relating to seven requirements
	• Mitigation Measures and Environmental Action Plan fail to address outstanding violations of World Bank Group policies

79 Directive 2001/42/EC of the European Parliament and of the Council of 27 June 2001 on the assessment of the effects of certain plans and programmes on the environment: http://europa.eu.int/eur-lex/pri/en/oj/dat/2001/l_197/l_19720010721en00300037.pdf. Transposing regulations: Statutory Instrument 2004 No. 1633: The Environmental Assessment of Plans and Programmes Regulations 2004: <http://www.opsi.gov.uk/si/si2004/20041633.htm>

3.3.1 ECGD's Duties

It is ECGD policy that the projects it supports should “comply in all material respects with the relevant safeguard policies, directives and environmental guidelines of the World Bank Group”.⁸⁰

The ECGD derogates from applying OP 4.01, the World Bank standard on Environmental Assessment, on the grounds that its Case Impact Analysis Process is equivalent (a claim contested by non-governmental organisations). It is noted, however, that ECGD took OP 4.01 into consideration when assessing the Baku-Tbilisi-Ceyhan oil pipeline,⁸¹ a precedent that should be followed in the case of Sakhalin II.

ECGD includes the safeguard policies of the International Finance Corporation within its definition of World Bank Group policies.⁸²

ECGD also gives consideration to other “benchmark” policies, including those of the European Bank for Reconstruction and Development.

3.3.2 Issue: Continuing Non-Compliance with World Bank policies

As noted above (para 3.1.3 – 1), SEIC has pressed ahead with construction despite its 2003 Environmental and Social Impact Assessment (ESIA) being unfit for purpose, and despite its application for ECGD support not having been determined. This has led to breaches of international standards, as acknowledged by the European Bank for Reconstruction and Development (see para 3.1.3 –1) and by USAID.⁸³

The “Non-Compliance Table” below sets out a detailed assessment of the current ESIA compliance with six World Bank Group standards’ documents, relating to seven requirements. Its findings are summarised in the table below. Critically, the assessment concludes that the mitigatory and monitoring measures proposed by SEIC will not bring the project into line with World Bank Group standards.

80. Business Principles Unit, Case Impact Analysis Process, ECGD, May 2004, p.2,
http://www.ecgd.gov.uk/index/pi_home/case_impact_analysis_process.htm

81. ECGD, “BPU Review of Baku-Tbilisi-Ceyhan Pipeline Project”, UC (03)79 Annex H, 3 December 2003, p.3.

82. ECGD, “BPU Review of Baku-Tbilisi-Ceyhan Pipeline Project”, UC (03)79 Annex H, 3 December 2003, p.3.3

83. Multilateral Development Bank Assistance Proposals Likely to have Adverse Impacts on the Environment, Natural Resources, Public Health and Indigenous Peoples, USAID
http://www.bicusa.org/bicusa/issues/USAID_MDB_report_Sept02-Oct04.pdf.
USAID found the following shortcomings: incorrect sequencing of decision-making and environmental assessment; no Strategic Environmental Assessment; inadequate baseline data; failure to recognise indigenous communities; failure to consider alternatives including the no project option; inability to translate consultation into project design; underestimation of major impacts on critical habitats; ignoring the need for a precautionary approach; an over-reliance on mitigation rather than prevention of impacts; incorrect implementation and inadequate contractor control.

The Non-Compliance Table

WBG Standard (1)	Requirement	Project Record	Adequacy of Mitigatory Measures	Extent of Compliance
OP 4.10 Indigenous Peoples Policy	A project that affects indigenous peoples requires: “a process of free, prior, and informed consultation with the affected Indigenous Peoples’ communities at each stage of the project, and particularly during project preparation, to fully identify their views and ascertain their broad community support for the project”; “the preparation of an Indigenous Peoples Plan”	1. No such process of consultation took place prior to project construction. 2. Indigenous Peoples Plan still not completed.	The project is substantially completed, denying indigenous communities the opportunity to shape key elements of the plan.	Non-compliance

WBG Standard (2)	Requirement	Project Record	Adequacy of Mitigatory Measures	Extent of Compliance
OP 4.04 Natural Habitats	“IFC supports, and expects project sponsors to apply, a precautionary approach to natural resource management to ensure opportunities for environmentally sustainable development.”	Failure to adopt precautionary approach. Advice of International Scientific Expert Panel on mitigating threat to whales over-ruled: e.g. noise levels for PA-B base installation, vessel speeds. ⁸⁴	Damage already done. Mitigatory measures generally unavailable. SEIC has adopted lower standards than recommended by expert advisors standards – for example on noise and vessel speeds – to	Non-compliance

84. “The construction timeline precluded adequate review of risks and noise criteria. Mitigation measures (e.g. rescheduling of work) were not fully considered prior to installation. The level and other characteristics of noise at which gray whales are affected is not yet clear.”
 “We were disappointed that SEIC decided to install the CGBS [Concrete Gravity Base Structure] in July; this implies that the Company’s commitment to temporal separation has not been taken seriously.”
 “The external audit (Doc 28) provided a review of the MMO [Marine Mammal Observers] programme but no evaluation of its effectiveness as a mitigation measure. Its effectiveness as a mitigation measure, if any, remains unquantified, and may be marginal”.
 Western Gray Whale Workshop, Vancouver, September 17-19, 2005

	<p>"[The bank] supports a precautionary approach to the management and sustainable use of biodiversity resources" (EBRD Environmental Policy)</p>		<p>enable "compliance". Precaution has not been allowed to interfere with the construction schedule or budget.</p> <p>Mitigation criteria were not agreed with experts before installation of the platform took place</p> <p>Basic mitigation approaches such as temporal separation of noise and receptors were not used.</p> <p>Mitigation measures that were used to try and prevent collisions between whales and ships were not proven to be effective</p>	
--	---	--	--	--

WBG Standard (3)	Requirement	Project Record	Adequacy of Mitigatory Measures	Extent of Compliance
<p>OP 4.04 Natural Habitats</p>	<p>"IFC does not support projects that, in IFC's opinion, involve the significant conversion or degradation of critical natural habitats."</p> <p>"The Bank does not support projects that, in the Bank's opinion, involve the significant conversion or degradation of critical natural habitats."</p>	<p>Salmon rivers, Aniva Bay and whale feeding grounds will be significantly degraded</p>		<p>Non-compliance</p>

WBG Standard (4)	Requirement	Project Record	Adequacy of Mitigatory Measures	Extent of Compliance
<p>OP 4.01 Environmental Assessment (EA)</p>	<p>IFC: "EA for a Category A project examines the project's potential negative and positive environmental impacts, compares them with those of feasible alternatives (including the 'without project' situation) . . .</p>	<p>No assessment of alternatives for dumping of wastes in Aniva Bay</p> <p>Proper consideration was not given to dumping sites offshore distant from fisheries.</p> <p>The impacts of river crossings were underestimated and down-played in the EA. Alternative methods of crossing were dismissed. There was no consideration of sharing infrastructure with other projects or taking an east-west route across the island rather than a north south one.</p> <p>No consideration of alternative locations for platform; whale panel input came after site was chosen, so environmental aspects not incorporated into assessment.</p> <p>ALARP principle not suitable for some elements of the project. The whale panel noted that they were not comfortable with only applying ALARP to a critical habitat.⁸⁵</p>	<p>Damage already done. Mitigation too late,</p> <p>Ineffective or not implemented. Submission by Wild Salmon Center and photographic evidence from Sakhalin NGOs documents damage already done.</p> <p>Project design and site selection are fundamental mitigation tools that were not used and cannot be applied now given the advanced stages of construction.</p> <p>Shell continue to apply ALARP even though what they consider practicable may not be sufficient to prevent the extinction of the WGW.</p>	<p>Non-compliance</p>

⁸⁵ "The approach taken to date has not always been suitably or consistently precautionary, nor has the ALARP (As Low As Reasonably Practicable) concept always been implemented in a manner that provides the least practicable risk to the whales." (Western Gray Whale Workshop, Vancouver, September 17-19, 2005)

WBG Standard (5)	Requirement	Project Record	Adequacy of Mitigatory Measures	Extent of Compliance
OP 4.01, Annex B	“Baseline data: Assesses the dimensions of the study area and describes relevant physical, biological and socio-economic conditions, including any changes anticipated before the project commences.”	EIA acknowledges lack of adequate assessment of baseline conditions for Aniva Bay (<i>Volume 5, para 3.12.1</i>). USAID review (2005) cited lack of baseline data as a concern. Whale panel noted lack of baseline data on benthic conditions for Piltun offshore area and Piltun lagoon. ⁸⁶ Lack of definition of baseline and monitoring since before construction for river crossings.	2005 Addendum fails to rectify inadequacy of data It is not possible to retrospectively collect baseline data after construction has started. No more data available at time of writing. SEIC continue to ignore the importance of Piltun Lagoon for the food chain. SEIC made an empty promise to have a net positive impact on salmon habitats, with no indication of timeframes, baseline or how previous damage would be addressed	Non-compliance

WBG Standard (6)	Requirement	Project Record	Adequacy of Mitigatory Measures	Extent of Compliance
IFC Guidelines: Oil and Gas Development (Offshore) (December 2000)	An oil spill response plan should be in place prior to project operations IFC: “An oil spill response plan is required (4).” ⁸⁷	No plan is in place and procedures have proved inadequate to prevent major spills	The Sakhalin II EIA contains a very brief and cursory discussion of oil spill risk and mitigation measures and provides only a	Non Compliance

86. Independent Scientific Review Panel: Impacts of Sakhalin II Phase II on Western North Pacific Gray Whales and Related Biodiversity: Report of the Independent Scientific Review Panel.
<http://www.iucn.org/themes/business/>

87. IFC Guidelines: Oil and Gas Development (Offshore) (December 2000).
“An oil spill response plan is required (4). It addresses potential spill volume, loss of a tanker or barge, and damage to a pipeline as appropriate. The plan is developed with the involvement of response parties and those communities/people who may be impacted by an incident. In addition to the requirements set forth in the Emergency Response Plan the Oil Spill Response Plan will include:

- A description of the operations, site conditions, water depth, weather patterns, and logistical support;
- Identification of those responsible for managing oil spill response efforts, their qualifications and training, and authority;

	IFC: "Management of operations must establish and maintain emergency preparedness so that incidents can be mitigated effectively and without delay. "		few paragraphs for each project element. Several paragraphs of brief discussion are not an evaluation of oil risks associated with this project or a demonstrated plan on how to reduce them. Specifically the potential impact from a spill in all conditions (including winter ice cover) for Piltiun is not assessed. Furthermore no comprehensive response system that can respond in all conditions is represented.	
--	--	--	---	--

Impacts Table

WWF UK has also documented a series of impacts in its report *Risky Business*.⁸⁸ The following table lists impacts identified by Sakhalin Energy (55% owned by Shell) and shows the continuing problems. The picture evidence referred to can be seen in the original document and is not reproduced here.

Impact identified by Shell	Impact occurring/unaddressed on Sakhalin	Evidence
Physical disturbance of soils and watercourses	River crossings conducted during the 2004/05 winter resulted in significant pollution of salmon spawning streams with suspended sediment.	EBRD & Rosprirodnadzor visits; Picture 1
Impacts to fish	See above	Picture 2
Disturbance of marine mammals	Shell's installation of the PA-B platform base in July/August 2005 resulted in noise levels exceeding the 120dB recommended by the ISRP.	Shell's acoustic monitoring of installation.
Disturbance of sediment and benthic populations	The ISRP is still concerned Shell does not understand the full benthic system, in terms of	ISRP report

- Oil spill trajectory with oil fate and environmental impact prediction: model to be used and ability to input wind and current data, maps identifying sensitive ecological areas (seasonal/monthly); etc."

Footnote 4 states: "Project sponsors need to demonstrate they have the financial capability to implement the spill response plan, including equipment, budget and insurance."

88. WWF-UK (2005). *Risky Business – the new Shell. Shell's failure to apply its Environmental Impact Assessment Guidelines to Sakhalin II*.

	ocean dynamics and the interrelation with Piltun lagoon.	
Impacts to seabirds, coastal habitats etc in event of oil spill	A dredger in the South of the island already spilt its oil in September 2004, and demonstrated Shell's failure to clean it up. Shell has not been able to demonstrate the potential extent of spills or how it would clean them up	Picture 3; ISRP report
Temporary and permanent loss of habitat and component ecological populations to temporary and permanent footprint	Degradation of salmon spawning areas and displacement of gray whales from south of feeding area	Picture 4 and WWF monitoring of gray whales, summer 2005
Soil erosion	River crossings have not had erosion control measures installed properly; areas where the pipeline has already been buried are already experiencing erosion due to ineffective restoration measures.	Pictures 5 and 6
Nuisance impacts to local communities (noise, dust, vehicle movements)	Construction traffic to and from the LNG plant construction site through local towns disrupting life and spreading dust	Picture 7
Damage to physical infrastructure (community roads)	Churning up of main routes between towns in the south due to construction traffic	Picture 8
Disturbance to sediment, benthic fauna and other seabed flora and fauna	The dumping of dredging waste in Aniva Bay has spread material further than predicted, and fish catches have already been reduced.	Shell monitoring reports and EBRD IRM complaint
Loss of seabed habitat	The ISRP has continued to raise concerns over the disturbance of sediment near the feeding area where the benthic communities are vital for gray whale feeding along the seafloor	ISRP report
Disturbance to marine mammals	The ISRP raised the key issue of collision risk between Shell vessels and gray whales. The limited scope of Shell's considerations did not originally include extra tanker traffic in the south or increased platform to shore traffic.	ISRP reports
Risk to marine and coastal resources in event of spill	Shell have still not adequately addressed winter oil spills or clean up measures.	ISRP report
Provision of artificial reef	The ISRP observes that Shell has not considered the artificial reef properties of its new platform structure.	ISRP report

3.3.3 Conclusions

The Sakhalin II project remains in non-compliance with World Bank Group standards and thus fails to meet a key ECGD requirement for support.

Mitigatory measures do not address the impacts that have been identified. Moreover many impacts –such as the damage caused by dumping in Aniva

Bay – are either beyond mitigation because the damage has already been caused, or have been denied suitable mitigation measures because of the failure to consider alternatives.

Critically, two-thirds of the project has been completed without complying with key World Bank standards. As a result, even if the project is retrofitted on paper to comply with World Bank standards, in practice many procedures that are critical to the outcome for the project will remain non-compliant.

3.4 POLICY REQUIREMENT 4 COMPLIANCE WITH HOST COUNTRY LAW

Policy Requirement	Issue
The project must comply with host country standards and laws	<ul style="list-style-type: none"> • Compliance challenged (i) in outstanding court cases in Russia, and (ii) with CBD and Ramsar Convention.

3.4.1 ECGD’s Duty

Under the OECD’s *Recommendation Common Approaches in Environment and Officially Supported Export Credits*, which sets the minimum environmental standards for all OECD Export Credit Agencies, including ECGD, “Projects should, in all cases, comply with the standards of the host country”.⁸⁹

3.4.2 Issues

Non-governmental organisations have charged non-compliance with a range of host country standards and laws. Moreover, court cases are currently being litigated (see para 1.1).

In addition, there are also legal obligations on Russia under Articles 8 and 14 of the *Convention on Biological Diversity*, and under the *Ramsar Convention* that need to be resolved. Under Russian law – unlike under UK law - the country’s treaty obligations automatically become part of the domestic law upon ratification, unless the obligations are expressly formulated as requiring national legislation.

3.4.3 Conclusion

Any decision to fund the project will reflect the ECGD’s judgement that the project complies with Russian law. Should the courts rule in favour of the applicants in the cases currently before them, or should Russia be in breach

⁸⁹ OECD, Working Party on Export Credits and Credit Guarantees, *Updated Recommendation on Common Approaches in Environment and Officially Supported Export Credits*, TD/ECG (2005) 3, 25 February 2005, para. 12.2.

of either of the two Conventions, ECGD's judgment will be revealed as, at best, flawed, and at worst complicit in violations of international law. A decision to fund the project prior to the current cases running their course, and resolution of Russian compliance with the two Conventions, would thus carry a high reputational risk for ECGD.

Section 4

CONCLUSIONS AND RECOMMENDATIONS

This report concludes that support for the Sakhalin II (Phase 2) project would conflict with ECGD's stated policies for project acceptability and would therefore, quite apart from on other grounds, be unreasonable.

In particular:

1. Support for the project carries a number of unwarranted and uncontrollable reputational risks for the ECGD. **As such, they pose a potential conflict with ECGD's legal duty to manage its portfolio responsibly.**
2. Support for the project conflicts with the UK's Johannesburg sustainable development commitments on improving energy efficiency and reducing non-sustainable production and consumption patterns. **It directly undermines the intent of the Kyoto Protocol through its exports to non-Kyoto countries, and conflicts with the obligations of developed countries under the 1992 Framework Convention.**
3. Given the concerns expressed by the world's leading marine mammal specialists and the inability to ensure that the Western Pacific Gray Whale population will survive the development and implementation of the project, **ECGD support for the project would (i) directly conflict with the UK's obligations under the Johannesburg commitments; (ii) conflict with the UK's stated sustainable development strategy to reduce biodiversity loss; (iii) conflict with the obligations on Russia under Articles 8 and 14 of the Convention on Biological Diversity (CBD); (iv) conflict with the obligations on the UK under Article 6(b) and 11 of the CBD, and (v) conflict with the strategic priority of DEFRA to protect the Pacific Gray Whale from extinction.**
4. If ECGD support is granted, and internationally-important wetlands are damaged, it is possible that Russia would be in violation of the Ramsar Convention, and that the UK would be facilitating that violation. **This is therefore potentially a very serious matter and needs to be taken up urgently with Russia.** Further, it also appears that the ECGD would enable the Russian Federation to breach other international treaty obligations it has with the US under the *Convention Between the United States of America and the Union of Soviet Socialist Republics Concerning the Conservation of Migratory Birds and Their Environment*.
5. The Production Sharing Agreement on which the project is predicated contains stabilisation clauses that severely limit the Russian Federation's ability to act in the public interest with respect to new environmental and social regulations that might affect the profitability of the project. **ECGD support for the project could therefore result in the UK being party to**

a project that is underwritten by an agreement that conflicts with its international human rights obligations to promote and respect human rights.

- 6. The Sakhalin II project remains in non-compliance with World Bank Group standards and thus fails to meet a key ECGD requirement for support.** Mitigatory measures do not address the impacts that have been identified. Moreover many impacts are either beyond mitigation because the damage has already been caused or have been denied suitable mitigation measures because of SEIC's failure to consider alternatives.
- 7. Arguments that ECGD's involvement would assist in improving the project lack credibility in light of the extent to which the project has already been implemented.** Moreover, such involvement would require ECGD to derogate on its key environmental policies, at considerable risk to its reputation and with little prospects of successfully improving the project.