Sakhalin Energy
Investment Company Ltd.
35, Dzerzhinskogo, Yuzhno-Sakhalinsk, 693000, Russia
Tel.: (7 4242) 73 2000 Fax: (7 4242) 73 2012

693000, Россия, г.Южно-Сахалинск, ул.Дзержинского, 35
Тел.: (7 4242) 73 2000 Факс: (7 4242) 73 2012

Press Release

Sakhalin Energy signs major LNG supply deal with Tokyo Gas

Yuzhno Sakhalinsk, Russian Far East, 12 May 2003: Sakhalin Energy has achieved a key milestone in the development of the Sakhalin 2 Phase II project with the announcement today that it has reached an agreement to supply Tokyo Gas with up to 1.1 million tonnes a year of liquefied natural gas (LNG) for a period of some 24 years.

The landmark deal marks the beginning of Sakhalin Island as a strategic new source of gas for Japan and confirms the wider Asia Pacific region as a major new market for Russian energy supplies. It also heralds the start of Russia and Sakhalin Energy as a major new player in the worldwide LNG market.

Steve McVeigh, Chief Executive Officer of Sakhalin Energy, and Hideharu Uehara, President of Tokyo Gas, signed a Heads of Agreement (HoA) for the long-term supply of LNG, and first deliveries are expected to start in 2007. The two companies will now continue negotiations to enable a full sale and purchase agreement (SPA) to be signed in 2004.

The Tokyo Gas agreement represents one of the key steps on the road to the Company's shareholders – Shell, Mitsui and Mitsubishi – confirming a positive investment decision to proceed with the development of the US$ 9 billion Sakhalin 2 Phase II integrated oil and gas project. The HoA is also contingent on a formal Declaration of Development Date for the Lunskoye gas and condensate field, which will be the main supply of feedstock natural gas for the LNG plant. Announcements regarding both these major decisions are expected shortly.

"We were always confident that the Asia Pacific was a major new market waiting to be tapped by Russian gas," said Sakhalin Energy Chief Executive Officer Steve McVeigh, "and we were equally confident that customers in Japan would launch the Sakhalin 2 Project with its associated LNG development."

"We are extremely pleased that a leading Japanese energy company Tokyo Gas has become our first long-term customer, and the agreement we have reached with them represents a substantial amount of LNG over a long period of time. We look forward to building a strong relationship with Tokyo Gas based on Sakhalin Energy as a long term reliable supplier of LNG," added Steve McVeigh.

The LNG market is fiercely competitive at the moment, with many other suppliers competing for business, coupled with uncertainties over deregulation and slow economic growth in the region. The Tokyo Gas deal marks a major breakthrough for Russia and Sakhalin Energy in the LNG business.

Steve McVeigh added: "Sakhalin Energy and Tokyo Gas have worked hard together to reach agreement on this deal, and it is immensely satisfying that Tokyo Gas has become our foundation customer. We continue in discussions with a number of other customers in Japan and elsewhere in the Asia Pacific."

Hideharu Uehara, of Tokyo Gas said: "Given that Sakhalin natural gas has advantages - such as abundant reserves and proximity to Japan, and carries optimal conditions from the perspective of diversification of supply sources – Tokyo Gas determined Sakhalin LNG as a strategically important supply source, and we have been discussing the possibility of its introduction.

“Given our decision today to introduce Sakhalin LNG with high competitiveness, we are confident that this will realize further expansion in the demand of natural gas. We hope this will greatly contribute to the development of a better and stronger relationship not only between Sakhalin Energy and Tokyo Gas, but also between the Sakhalin Region and Japan and between Russia and Japan.”

Sakhalin Oblast Governor Igor Farkhudinov commented: “We are pleased with this announcement of positive LNG sales progress of the Sakhalin 2 project. We hope this first long-term sales of LNG to Tokyo Gas brings the development of the Lunskoye gas/condensate field closer to reality, and to establishing the Sakhalin Region of Russia as a strategic energy supplier to the Asia Pacific. We look forward to this LNG supply agreement acting as a springboard to developing closer ties between Russia and Japan.”

LNG will be supplied from Sakhalin Energy’s major new LNG plant, which is planned for construction at Prigorodnoye on the southern tip of Sakhalin. Front-end engineering design work on the plant has been completed, and full construction activities on the plant are expected to commence within the next three months subject to final approvals from the Russian authorities. The LNG plant is a major part of the Sakhalin 2 Phase II project, and will have a total capacity of 9.6 million tonnes per annum (mtpa). The plant will have two gas liquefaction process trains, each with a capacity of 4.8 mtpa – currently the largest LNG trains planned in the world.

Inquiries:

Sakhalin Energy
(Yuzhno-Sakhalinsk)
Valentina Kiseleva
+7 4242 73 2000

Sakhalin Energy
(Moscow)
Ivan Chernyakhovsky
+7 095 956 1750

Notes for editors

Sakhalin Energy Investment Company Ltd. is an incorporated company, established in April, 1994 and based in Yuzhno-Sakhalinsk, Russia for the purpose of the implementation of and development of the Sakhalin 2 integrated oil and gas project. The shareholders in Sakhalin Energy are: Shell Sakhalin Holdings B.V. with 55 % interest (parent company – Royal Dutch/Shell), Mitsui Sakhalin Holdings B.V. with 25% (parent company – Mitsui & Co., Ltd.) and Diamond Gas Sakhalin B.V. with 20 % (parent company – Mitsubishi Corporation).

The Sakhalin 2 development represents the largest single foreign direct investment project underway in Russia at the moment. It is the first Production Sharing Agreement (PSA) to be signed in Russia and the first PSA to go into operation following commencement of oil production under Phase I of the Sakhalin 2 Project.

Phase I has been successfully producing oil from the Vityaz Complex offshore Sakhalin since July 1999. The Vityaz complex consists of the Molikpaq production platform, a single anchor leg mooring buoy and the Okha floating storage and offloading unit, and is located on the on Astokh feature of the Piltun Astokhskoye (PA) reservoir offshore Sakhalin. The Molikpaq is the first offshore oil production platform in the Russian Federation.

Production is currently limited to the ice-free period during the summer months. Production during the 2002 season amounted to 10.8 million barrels, which has been exported to customers in Japan, China, and Korea.

Operations are well advanced to commence the Molikpaq’s fifth production season at the beginning of June. Target crude oil production this season is 9.7 million barrels – about 70,000 b/d. The reduction in volume over previous seasons is due to natural pressure reduction in the reservoir. A pressure maintenance project (PMP) is currently underway to boost production back up to early production levels of 90,000 b/d using water injection to re-pressurise the reservoir.

The PMP calls for the installation of new water injection and power generation modules on the Molikpaq this summer at a total cost of about $300 million. The PMP modules have been built by Amur Shipyard in Khomsomolsk, and represent the first work of their type that has been undertaken by the Russian Far Eastern shipyard. Work on the installation and testing of the PMP facilities is expected to be completed by the end of the year in time for the 2004 production season.

Phase II of the project is thought to be the biggest single integrated oil and gas project ever undertaken, and calls for the further development of the PA field – an oil reservoir with associated gas – and the development of the Lunskoye field – a gas reservoir with associated condensate. Apart from the LNG plant, the project also calls for a new oil and gas production platform on the PA field, and a new platform on the Lunskoye field.

An onshore processing facility will be built to separate gas and condensate from the Lunskoye field. More than 800 km of pipelines will transport the oil and gas to an oil export terminal and the LNG plant at Prigorodnoye at the southern end of Sakhalin Island – which remains largely ice free year round. The Phase II project will also enable year round production from the Molikpaq following the installation of offshore pipelines that will bring the oil ashore at Piltun Bay.

Additionally, the project will require major upgrades to the island’s infrastructure – including roads, bridges, railways and Nogliki airport and Kholmsk port – which will be funded by Sakhalin Energy in support of both the project and the island. Work on the infrastructure upgrades has already commenced, and is expected to cost about $300 million.

Construction activities of the project elements are dependent on Government final approvals, which are expected to be completed within the next three months. Subject to the approvals, year round oil production is expected in 2006, with first gas production from Lunskoye in 2006. First LNG delivery will be scheduled according to customer requirements, but is currently planned for 2007.

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