



## Sakhalin Energy Investment Company Ltd.

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### **First Weld event launches construction on major onshore pipeline project on Sakhalin Island**

**Sakhalin Island, Russian Federation, 23 January 2004:** Sakhalin Energy launched the start of construction for its onshore oil and gas pipelines at a special First Weld event on Sakhalin Island today. One of the largest oil and gas pipeline projects currently under development worldwide, the two 800 km oil and gas onshore pipelines will be constructed by Russian company Starstroi during the next two years.

The start of onshore pipeline construction follows another major milestone for the Sakhalin II Phase 2 Project - the approval by the Russian authorities of the Technical and Economic Substantiation for Construction (TEOC) for the Phase 2 development, which allows further activities on the project to commence.

In another important development, the Supervisory Board – a high level committee of Russian Federal, Sakhalin Administration and Company Shareholder representatives that oversee the Sakhalin II Project – approved the Company's 2004 annual Work Programme and Budget. The budget will see in excess of \$2.5 billion being spent during the coming 12 months as full construction activities rapidly build up.

Steve McVeigh, Chief Executive Officer of Sakhalin Energy said: "This event marks a significant step forward in our development of the enormous Sakhalin II Phase 2 Project – the development of these key pipelines that will bring the oil and gas to the south of the island for processing and export to customers in the Asia Pacific and beyond."

The First Weld ceremony was led by Governor Ivan Malakhov, who was joined by Steve McVeigh and Felix Makhamedov, General Director of Starstroi for the celebration.

Governor Malakhov said: "This is a significant moment in the development of the Sakhalin II project. It is particularly pleasing to see that a Russian company, Starstroi, will be undertaking the construction of these pipelines, which represent one of the largest aspects of the Phase 2 project in both scale and budget.

The construction of these oil and gas pipelines will bring significant opportunities for the people of Sakhalin, both through employment and business opportunities. We will be working with Sakhalin Energy and Starstroi to ensure that these opportunities are maximized."

David Greer, Deputy Chief Executive Officer and Phase 2 Project Director of Sakhalin Energy said: "The Sakhalin II Phase 2 project has now entered a new and

challenging phase. Although we have been undertaking some early preparation work for the project, the First Weld event marks the start of major construction activities on the island.

Sakhalin Island will now begin to see a rapid build-up of activity as our contractors mobilise the staff and workforce that they need to undertake this enormous project. Our primary focus will be to ensure that the construction work is carried out safely, on time and in a way that minimises impact on the environment”.

The onshore pipeline contract, worth approximately US\$1.2 billion, involves the engineering, procurement (excluding linepipe) and construction of two 800km onshore pipeline systems – one for oil and one for gas. A consortium led by Starstroi and including LUKoil-Neftegazstroi together with the European companies Saipem SA and AMEC Spie Capag will undertake the work. They will utilise six Russian pipeline construction companies as sub-contractors: SMU-4, Kubaneftegasstroi (KNGS), Lizingstroimash (LSM), Svarochno-montazhniy Trest (SNT), Omsknefteprovodstroi (OmskNPS) and Vostoknefteprovodstroi (VNPS).

Felix Mukhamedov, General Director of Starstroi, said: “Russian companies are the most experienced in the construction of pipeline systems in the sort of severe weather conditions that Sakhalin is subjected to. The fact that Starstroi has won this contract is also a tribute to our design capabilities, and our ability to match the quality and price required in an internationally competitive market.

These pipelines will be amongst the most advanced in the world, and will use the latest construction, coating and monitoring systems to provide pipelines that are safe and minimise environmental impact. Design expertise by ourselves, other Russian institutes and local and international experts will ensure these pipelines have minimal impact on sensitive areas such as salmon spawning rivers, yet they will be safe and strong enough to withstand the seismic conditions on the island”

Russian companies will perform the majority of the onshore pipeline project’s works, which will include detailed design, engineering and construction. The contract will provide employment for a workforce of between 5,000 and 6,000 people from both Sakhalin Island and the Russian mainland.

Mr McVeigh added: “This contract again demonstrates Sakhalin Energy’s commitment to maximising Russian content in the Sakhalin II project. Our PSA calls for us to use best efforts to achieve 70% Russian content expressed as manhours and quantity of materials - over the life of the project. I am pleased to report that up to October last year, we had achieved 70% in terms of manhours and 80% in materials and equipment.

“Our projections show that for the major contracts awarded for the Phase 2 project, we will achieve 77% in manpower terms and 74% for materials and equipment. Sakhalin Energy is meeting its commitments, and with the continuing drive and cooperation of Russian industry we will continue to do so.”

The Sakhalin II Phase 2 Project, at a cost of approximately \$10 billion, represents the largest foreign direct investment currently underway in the Russian Federation. The Sakhalin II PSA is the first to be signed and go into operation in Russia.

Sakhalin II will provide a strategic new source of natural gas from the Russian Far East to markets in Japan and the wider Asia Pacific Region. Construction of Phase 2

of the project will take about 4 years to complete, and will result in up to 15,000 people working on the project on Sakhalin Island during the peak construction period.

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## **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 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 and Co., Ltd.) and Diamond Gas Sakhalin B.V. with 20% (parent company - Mitsubishi Corporation).

The Sakhalin II 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 1 of the Sakhalin II Project.

Phase 1 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 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.

Molikpaq's fifth production season has just been completed, resulting in the production of 10.3 million barrels of crude oil - about 70,000 b/d. This represents a reduction in volume over previous seasons 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.

As part of the PMP new water injection and power generation modules were installed on the Molikpaq in summer 2003 at a total cost of about \$300 million. The PMP modules have been built by Amur Shipyard in Komsomolsk, and represent the first work of their type that has been undertaken by the Russian Far Eastern shipyard. Work on the testing of the PMP facilities has been completed and will be ready in time for the 2004 production season.

Phase 2 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 and an oil rim.

**End**