

## COMMERCIAL UPDATE - SAKHALIN REGION, October 2003 (Russian Far East)

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### Oil and Gas

*\* Regional Administration delegation returned from Rijsvijk where it took part in Sakhalin-2 Advisory Council Meeting.*

The meeting took place on October 8-11 at the Sakhalin Energy headquarters. The Council is the major official body coordinating the Sakhalin-2 activities. The Sakhalin region was represented by Mr. Belozerskikh (managing construction and oil and gas sector activities) and three representatives of the regional Oil and Gas Department, including the Head of the Department Ms. Galina Pavlova. (Source –Regnum Information Agency, [www.sakh.com](http://www.sakh.com) - October 17)

*\* Russian Ministry of Natural Resources raises claims about Exxon's work.*

Deputy Minister Alexander Povolotski met with the President of Exxon Ventures, CIS and with the Vice-president, Government Relations. At this meeting he expressed his concerns about Exxon's natural resources utilization in Russia. Concerns are about the Sakhalin-1 project, namely about the cases when inspectors were not allowed to visit Sakhalin-1 sites, and the late date of the geological survey for the fields, which were granted to the investor as already surveyed and approved by the Russian Ministry of Natural Resources. A number of the questions also concern environmental issues. The Ministry representative said that Exxon rejects negotiations on integrated landfill and is transferring the faults for possible environmental consequences to its contractors.

Another topic for discussion was Sakhalin-3 status. The representative of the Ministry said that in this case, any questions will be solved by taking into account the existing practice of Exxon's work at other fields. (Source – RIA Novosti, October 17, 2003)

The comprehensive audit of Sakhalin-1 by the Federal Departments is planned for the end of this year. The perspective of Sakhalin-3 work was also discussed, and so far it is not optimistic – the Ministry does not want to issue licenses for exploration and drilling.

Pegastar (ExxonMobil, ChevronTexaco and Rosneft) was awarded Sakhalin-3 development rights back in 1993. But the Competitive Committee instead of submitting the results for the governmental approval started to coordinate the details with the winner. It took so long that the terms of agreements have changed several times since then. Amendments to PSAs in Russia made this summer almost cancelled the possibility to develop Sakhalin-3 on a PSA basis, making Pegastar apply for a national tax regime exploration license. As the Ministry representative explained to a Vedomosti journalist, at the moment they do not see the grounds for issuing the license. It is stated that the previous tender was carried out for PSA conditions and since currently the PSA is not possible the license should be auctioned in order not to infringe on other possible participants rights. Other than that, it was stated that after all, the license fate is to be decided by the Government. (Source -RusEnergy, October 20)

*\* Meeting 70% Russian content requirement is almost impossible.*

Boris Tsykalov, General Director of Transstroy Sakhalin reported at the Sakhalin mass media press-conference that it's nearly impossible to meet the 70% Russian content requirement for both Sakhalin-1 and 2 projects. According to Mr. Tsykalov, many Russian companies cannot comply with tender requirements (ecology, technical safety, term of

work, technology and other parameters). Tenders are usually awarded to large and worldwide-known Russian companies, but not all the companies meet the necessary standards – cases were noted of late project completion and late equipment delivery. According to Mr. Tsykalov, Sakhalin-based companies proved themselves as more reliable. The problem is that the local construction sphere has a lack of certain specialized foremen (there are, for instance, just several masons and stove-setters in the region). On certain sub-projects the Russian content even exceeds 70% (95% Russian contractors/labor during Sakhalin Energy office construction).

Transstroy-Sakhalin is involved into several projects for Sakhalin-1 and 2 – mancamps, temporary mooring at Prigorodnoye, and construction of offices in Yuzhno-Sakhalinsk. The company employs more than 1 thousand people. (*Source - REGIONS.RU , October 17, 2003*)

*\* Accounting Chamber of the RF elicited surplus of expenditure over income for Sakhalin-1 and 2.*

The Chamber Board at its meeting on October 31 analyzed 2003 work. The Federal budget during the past 1.5 years did not receive USD 30 million from the amount of oil extracted and sold. Amounts reimbursable to investors since 1996 made up USD 4.3 billion. The Russian side managed to cover USD 960.4 million at the expense of oil sales. Thus, the debt of the Russian side exceeds USD 3.3 billion. The existing system of VAT reimbursement does not allow meeting deadlines stipulated by the PSA, which leads to further federal budget losses. As on September 1<sup>st</sup>, 2003, Russian debt for VAT reimbursement including delay interest reached USD 67.1 million. By the end of this year the operators of Sakhalin-1 and 2 will claim USD 170 million more for reimbursement. Since 1996 different budgets of Russia received USD 431.9 million from Sakhalin shelf projects, while these projects expenses (taking into account price of oil sold, VAT reimbursed plus fines) made up more than USD 1 billion. At the moment when the audit took place the expenses excess over income made up USD 623.2 million. (*Source - <http://www.dinform.ru/>, November 03*)

*\* Australian delegation visited office of Rosneft- Sakhalinmorneftegas.*

A large delegation headed by the Australian Trade Representative in Russia visited the office of Rosneft-Sakhalinmorneftegas. The delegation, comprised of Heads and top-managers of Australian oil and gas related companies, held presentations of their abilities and offers to Sakhalin oil businesses. This was the second visit of an Australian delegation to Sakhalin organized by the Australian Trade Mission. (*Source-Gubernskije Vedomosti, October 23*)

*\* Construction of the LNG plant in Prigorodnoye started.*

About 1000 people are working during the day-shift, 200 people are working nights (12 hour shifts). 290 units of different equipment (bulldozers, dump-trucks, tractors and other) are used for this construction. Chief contractor is CTSD Limited (Chiyoda Engineering and Toyo Engineering), with major Russian subcontractor Transstroy (Transstroy in its turn subcontracted 14 companies from other parts of Russia). The road, temporary moorage, oil tanks foundations, water wells and water pipe, mancamp for 400 people (which will be expanded into a 6 thousand people camp) are currently under construction. Dredging work

is also underway (the bay will be dredged up to 9.6 meters deep – 31.5 feet). In 2004 the work will start on the LNG shipment moorage construction and the plant base concreting.

The plant will include two technological lines (total output of 9.6 million tons per year – first train to be put into operation July 2007, second – February 2008), two gas storage tanks (total capacity - 200 thousand cubic meters of gas) and the shipping system (mooring lines for tankers). The shipping terminal will be able to serve the largest LNG tanker available in the world. In the first stage two oil tanks (third will be constructed later) will be situated at the plant. In the future the third train for the LNG could be constructed as well as the third oil tanker. (*Source – TIA Ostrova, October 21*)

*\* SU-4 Construction Company built a road at Northern Sakhalin, which is unique for this area.*

SU-4 together with its partner – FSC (Ferguson Simek Clark) constructed a 20km (12.5 mile) road from Nysh village to Lunskey Bay, Northern Sakhalin. The road will be used for the future OPF (onshore gas processing facility) needs. Gas is to be delivered from Lunskey field for sweetening and will be further sent to the south of the island by pipeline.

This construction took more than a year in the marshland. Canadian partner technology and special materials were used (geotextile, which absorbs humidity). The road was constructed 24 hours a day (nearest village is situated 80 km from the construction site). More than 700 workers (all from Sakhalin) were occupied at the construction of the road; 2 million cu. meters of soil (about 2,615,000 cubic yards) had to be processed for this construction for this past year. SU-4 is preparing a site for the future OPF and the mancamp. According to SU-4 Director, Mr. Juri Kul', unfortunately this will be the last contract for the company as the rest are already distributed among other contractors. According to Mr. Kul', SU-4 obtained several proposals from other sub-contractors. SU-4 is also invited as a sub-contractor for De-Kastri (Khabarovsk Krai) construction activities, but since SU-4 is a Sakhalin-based company it wants to have maximum of its contracts be Sakhalin-based. (*Source – TIA Ostrova, October 17, 2003*)

*\* New mancamp to be constructed in Aniva District.*

The contract was awarded to Baltiyskaya Stroitel'naya Kompaniya (Baltic Construction Company). The dwelling complex, to be situated approximately 9 kilometers from Yuzhno-Sakhalinsk, will be a self-sufficient infrastructure camp. The complex will consist of 37 duplexes for 74 families, recreation area with sports sites and skiing tracks. (*Source – Deita RU/ PIA "Deima.PY", October 17, 2003*).

*\* First pipe assembling for Sakhalin-2 pipeline will take place mid-November.*

Assembly of oil and gas pipes for the trans-island line pipe will start in November, as the representative of Starstroj Company reported to the press. The pipeline is considered to be the longest in Russia (800 kilometers – almost 500 miles); the pipes have to cross more than 1100 natural obstacles - rivers, marshes, and tectonic faults; Every 30 meters will be equipped with gate valves. Diameter of oil pipe is 618 mm (24.3 inches), gas pipeline – 1220 mm (48 inches). The three-year project is divided into 4 sections, assembly work will be carried out simultaneously (Nogliki-Tymovsk; Tymovsk-Smirnykh; Poronajski-Makarovski districts; Dolinsk-Aniva district). 5 thousand people and 1 thousand units of

machinery will be utilized for construction (equipment is being delivered to Sakhalin); 11 mancamps and 6 pipe-welding stations are under construction for this project. (*Source – Regions.ru, October 16, 2003*)

*\* In the first 9 months of 2003 Sakhalin extracted more than 2 million metric tons of oil.*

Sakhalin-2 alone extracted 1 million 22 thousand metric tons. SEIC exported to Taiwan, USA, Japan and the Philippines. It is estimated that the yearly production at the Vityaz complex will be 1.44 million metric tons in 2003.

In total, the Sakhalin region extracted 2.4 million metric tons of oil –

1.2 million – Rosneft-Sakhalinmorneftegas;  
1 million 22 thousand – SEIC;  
a little less than 200,000 thousand – JSC Petrosakh.

It is estimated that the 2003 total figure for Sakhalin will be 3,2 million metric tons of oil. (*Source – Vostok-Media (Восток-Медиа) October 08, 2003*)

*\* JSC Anivagas is ready to supply Aniva, Troitskoys and Yuzhno-Sakhalinsk with gas.*

Anivagas is ready to supply boiler stations of these towns with about 120 million cu. meters of gas, as reported by Alexander Romanov, Director. Anivagas' work since 1999 consists of 12 wells, 3 trunk line pipes and 2 control valves. Estimated gas reserves are 2.5 billion cu. meters. (*Source – The Press Center of Sakhalin Regional Administration, October 02, 2003*)

*\* ABB to develop island infrastructure for Sakhalin-2.*

ABB distributed a press-release about the large infrastructure project on Sakhalin, in which the company is going to participate. The ABB share in the Sakhalin-2 telecommunication system project is estimated at more than USD 30 million, for the development and supply of telecom systems for oil & gas platforms, an 800-kilometers pipeline, equipment for 2 bays and infrastructure upgrade. It is planned to engage both Russian and Norwegian engineers for this project. (*Source – Rosbalt Agency, Sakh.com, October 02, 2003*)

*\* Sumitomo Corporation created a JV with Kriljon-Service.*

Japanese Sumitomo Corporation signed the contract with Sakhalin Energy for a telecommunications system supply (amount of contract – about USD 60 million). To work on this project Sumitomo established a JV which will act as a general contractor. The whole team includes Sumitomo Corporation (Japan), Kriljon-Service (Russia), ABB AS (Norway) and Fujikura (Japan). Sumitomo/Kriljon, as the head entity for this project will be responsible for management, services and necessary maintenance for the project. ABB is responsible for project management at the design stage, quality control and environmental impact control, engineering, supply, installation and startup. Fujikura is responsible for engineering, supply and fibre-optic cable laying. (*Source – Intrafax, October 21*)

*\* BP increases BP-TNK fields estimated reserves figure.*

BP increased the estimates for explored fields of its JV with TNK (TNK-BP Holding) from 3.2 billion barrels to 4.1 billion, according to the standards of the Federal Commission on Capital Market and Securities. Output increase for the united company will make 12-13% in 2003, 7% in 2004 and 5% the following years. TNK-BP also estimates investment of USD 850 million in 2003 and is planning to increase investment to USD 1 billion in a year. In August BP merged its Russian assets with TNK oil company, getting 50% in TNK-BP. The deal led to establishing of the third largest Russian oil company and became the largest one-time investment in Russia – BP paid USD 7 billion for the shares to TNK shareholders – Alpha-Group and Access Renova. (Source – Reuter, October 17, 2003)

*\* Vladislav Rukavets – “Foreign companies do not fulfill their promises”*

Vladislav Rukavets, the head of Foreign Economic Relations Committee said that Sakhalin-1 and Sakhalin-2 do not keep their promises and do not follow PSA rules at the press-conference on October, 14<sup>th</sup>. Mr. Rukavets is not happy that Russian companies do not obtain 70% of contracts. Mr. Rukavets declared his support for the acting Governor Malakhov, who thinks “it’s time to apply strict measures to foreign companies”. One of such measures is to change the tax regime for these companies. (Source – TIA Ostrova, October, 14, 2003)

### **Economy and Social Life**

*\* The road from the port of Korsakov to Yuzhno-Sakhalinsk was reconstructed.*

The works were carried out for 5 years. The length of the track is 31 kilometers (19.2 miles). The road construction was done by several local companies – Avtodorproject, Expromt, Dal’moststroj, Remmost, Sakhalinavtodorsnab and the Korsakov Construction Company #1407. (Source – Regions.ru, October 17)

*\* Sakhalin Electric Power Company is almost a bankrupt.*

A press conference was held with the Far Eastern Energy Managing Company General Director, Viktor Myas’nik. He reported that the company’s main goal is to decrease costs for heat and electric energy generation. According to him, the Russian energy sector is the one that can better than others show the conflict between the market economy and the State-regulated tariffs. As an example he described the case when Sibir’ Coal Company increased the coal price by 22% and Sakhalin (which is dependant on imported fuel) energy tariffs did not change.

According to the preliminary results for 2003, Dal’energo and JSC LuTEC will be cost-effective. Kamchatskenergo and Sakhalinenergo are still managed by the anti-crisis center of RAO EES (United Energy System of Russia). According to Mr. Myas’nik, Kamchatskenergo is potentially bankrupt with debts payable of RUR 7 billion (about USD 230 million), RUR 3 billion being an international debt. As for Sakhalinenergo, the company is insolvent and its financial stability is totally dependant on the next year’s anti-crisis program.

Sakhalinenergo is interested in uniting all heat and electric plants on the island, which will help to solve power outage problems in case of emergency situations but the JSC has no funds to implement this project. An opinion exists that RAO EES is not interested in investments into a Sakhalin power system as the latter is unprofitable. The only perspective project for RAO EES is the possible construction of the energy bridge between Sakhalin and Japan. At the moment RAO is preparing a feasibility study for the construction of gas turbine stations, total capacity of 4 million Kw-hr, which can supply power for Hokkaido. Estimated price for Sakhalin power sold to Hokkaido is 9 cents per Kw-hr (*BISNIS note – this is comparable to the price that Sakhalin companies pay now of RUR 2.66, which at the rate of 1USD=30RUR is also 9 cents; individuals pay RUR 1.55, which is about 5 cents*). It is also reported that RAO planned expenses for Sakhalin power Plant #1 gasification. There is a problem with estimating if the possible gas supply can cover the Plant's year-round needs. It is dangerous to make the Plant work on mazut, coal and gas in rotation during the year. (*Source – Deita Ru, October 16, 2003; TIA Ostrova, October 09, 2003*)

On October 22<sup>nd</sup> a special meeting of Sakhalinenergo shareholders held ahead of schedule elected a new Board of Directors. It was reported that the meeting was initiated by the minority shareholders. 19 candidates were proposed for 7 chairs. As a result of the vote, the number of minority shareholder representatives on the Board increased by one representative; 3 representatives of RAO EES (RAO United Energy System of Russia) and one from Fund *Institute of Professional Directors* also entered the newly elected Board. Compared to the previous one, the new does not include the representative of Sakhalin Regional Administration. (*Source- Sia Site, October, 30*)

\* *Sakhalin Civil Forum – 2003 took place on Sakhalin.*

The Sakhalin Civil Forum is a pioneer compared to regions, already holding its 3<sup>rd</sup> meeting as a preparation for the all-Russia Civil Forum. The main target of such forums is to find new forms of cooperation between the administrations and the local civil institutions. Key topics for discussion are support of youth initiatives, participation of the public in lawmaking and the budget-formation process, as well as the ecology of Sakhalin and the

Kurils. The forum took place on October 16-17<sup>th</sup>; the work was organized in working groups by topics.



*The section for Small Business Development on Sakhalin was well attended.*

The Civil Forum also hosted the second Sakhalin Business Forum which discussed SME problems, with support of *Non-Commercial Partnership – Union of Business people of Sakhalin*. The representatives of SME discussed funding problems with local banks and leasing companies representatives; district SME unions presented investment projects and ideas from local

entrepreneurs. An open tender for the best financing project was awarded to the small *Irina* tailors shop from Yuzhno-Sakhalinsk. The regional Investment Division of the Economics Committee will consider this project for financing.

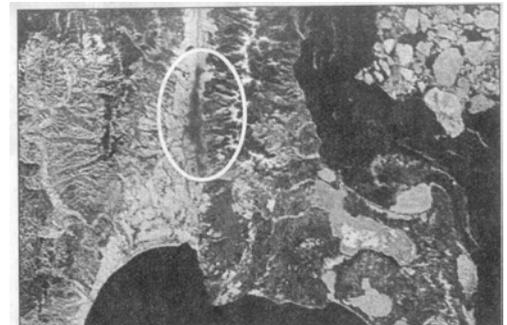
*\* New criteria for fishing company evaluation discussed at the Regional Administration.*

The Presidium of the Sakhalin Commercial Fishing Council ordered the Sakhalin Region Department of Fishing to prepare proposals on 2004 quota distribution, which further have to be discussed and approved by the Regional Administration. This decision was taken because the existing draft decree of the Russian Government envisages coastal fishing quotas distribution at regional levels. The Sakhalin Fishing Department proposed to refuse quotas for those fishing companies who officially show salaries lower than the so-called official “minimum living amount” in their accounts.

*(Source – Site Information Agency [СИА "САЙТ"](#), October 16, 2003)*

*\* Yuzhno-Sakhalinsk listed as one of the most ecologically dirty cities of Russia.*

A US non-governmental ecology organization and Sakhalin public organization Rodnik collaborated on a project entitled *Study of related profit from greenhouse gas emission reduction in the energy system of Sakhalin*. The project is a part of a program for Russia being included into Kyoto Protocol. According to the protocol some Russian regions may get investment that can be used for solving energy-related ecological problems. The two organizations held studies on Sakhalin and prepared reports which were later presented at the World Climate Conference in Moscow. The level of air pollution in Yuzhno-Sakhalinsk was characterized as extreme, leading to increasing number of ontological diseases. Major factors influencing the ecological situation are vehicles and the local Power Plant, which is not equipped with an emission clean-up system. *(Source – Vostok-media, October 15, 2003)*



*Picture from Sovetsky Sakhalin Newspaper. The black smudge in the circle is the smoke above Yuzhno-Sakhalinsk visible from satellite in winter.*

*\* A second production line of high-quality malt started to operate in a Yuzhno-Sakhalinsk malt plant.*

The increase in output is so significant that the locally produced malt can be exported to other regions of the RFE. Now the Solod (“malt”) plant is working at its full capacity. The plant was constructed in 1973 and the past decade was not the easy one. Some of the equipment was brought from Germany after the Second World War and is still in operation. In 1999 the first 500 metric tons of malt were again shipped to the customers, and today even 5,000 is not a limit for this enterprise. The grain comes from Altai (Russia). *(Source-ASTV-Inform, October 15, 2003)*

*\* The Regional Economics Committee is going to help fishing tourism development on Sakhalin.*

On October 15 the Head of Tourism Development and the Tourism Licensing Division of the Regional Economic Committee Alexander Ol'khovik together with the Chairman of the Wild Salmon Center (USA-RFE) from Magadan Mikhail Skopets held a press-conference in Yuzhno-Sakhalinsk on fishing tourism development. The project already has the world recognition and is implemented in several districts of Kamchatka, being backed up by the law and brings taxes to the local budget.

The Sakhalin Committee of Economics is going to take an active part in this project development on Sakhalin, coordinate the work of ecology specialists, tour operators and local administrations. *(Source – TIA Ostrova, October 2003)*

*\* Yuzhno-Sakhalinsk airport – 2003; 8 month transportation results.*

The airport served 270 thousand passengers in the first 8 months of 2003. The total for the year is estimated at 400 thousand passengers (360 – in 2002). The major amount consists of Domodedovo and Transaero passengers (flights Yuzhno-Sakhalinsk - Moscow). The airport plans on further runway reconstruction and improving baggage services. Plans exist for construction of a new airport hotel (the old one is primarily used for passengers of delayed Kuril islands flights and is in constant repairs). *(Source – Regions.ru, [www.sakh.com](http://www.sakh.com), October 01, 2003)*

*\* Foreign vehicles to be imported via 4 Sakhalin ports.*

As reported by the Sakhalin Customs, 4 customs posts will be able to process incoming vehicles from abroad – Yuzhno-Sakhalinsk, Korsakov, Kholmsk and Nevelsk. In total, the RFE will have 21 posts able to process imported vehicles, according to the Order #1019 of the Russian Customs Committee, issued September 15, 2003. According to this document, the number of posts in Russia able to provide clearance for imported vehicles decreased twice. *(Source – TIA Ostrova, October 13, 2003)*

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