



September 4, 2002

Mr. Eduardo Aguirre
Vice Chair
US Export-Import Bank
Washington, DC

Mr. James Mahoney
Vice President
Engineering and Environment Division
US Export-Import Bank
Washington, DC

Mr. Aguirre and Mr. Mahoney,

Today's **Wall Street Journal** front page feature article, entitled, **Stymied in Alaska, Oil Producers Flock To a Newer Frontier**, documents that the oil and gas projects off-shore of Sakhalin Island in the Russian Far East are proving to be environmental and developmental catastrophes. As world leaders concerned about sustainable development conclude meetings at the Earth Summit in South Africa, we find it disconcerting that the US Export-Import Bank (Ex-Im Bank) is now considering support for the dubious and risky Sakhalin II project. Accordingly, we call on Ex-Im Bank to reject support for Sakhalin II.

There are a number of significant insurmountable environmental and financial problems associated with Sakhalin II that should compel Ex-Im Bank to reject support for this enormously risky scheme. We write to reinforce these and previous expressions of concerns made by NGOs on this project,¹ and to indicate our intention to provide more detailed input in the future. Problems that should compel Ex-Im Bank to reject the project include, but are not limited to:

Insurmountable adverse environmental impacts: The waters off-shore of Sakhalin are among the richest fisheries on the Pacific Rim with one of the few healthy wild salmon fisheries left in the world. It is also home to 25 marine mammal species, including 11 endangered species, most notably the critically endangered Western Pacific Gray Whale. Yet, the Sakhalin II project presents insurmountable adverse off-shore environmental impacts through myriad sources including construction disruption, seismic testing, potential catastrophic oil spills and ongoing discharge of production wastes into a delicate marine environment in the absence of adherence to required safeguards and in difficult climate and seismic conditions (including high earthquake activity, heavy ice pack, frequent storms and fog).

Dmitry V. Lisitsyn
Chairman
Sakhalin Environment
Watch
Phone/Fax:
+7 (4242) 23-21-53
Email:
watch@dsc.ru

David Gordon
Associate Director
Pacific Environment
Phone:
+1 (510) 541-5334
Email:
dkgordon@pacificenviron
ment.org

Doug Norlen
Policy Director
Pacific Environment
c/o CIEL
1367 Connecticut Ave., NW,
Ste.300
Washington, D.C. 20036
USA
Phone:
+1 (202) 785-8700
Mobile:
+1 (202) 465-1650
Email :
dnorlen@pacificenviron
ment.org

¹ See December 10, 2002 letter from Sakhalin Environment Watch and seventeen other NGO to existing and potential lenders including Ex-Im Bank.

Regarding the threats from Sakhalin II to the Western Pacific Gray Whale population in particular, the Scientific Committee of the International Whaling Commission (IWC) notes “that it is a **matter of absolute urgency** [emphasis maintained]...to reduce various types of anthropogenic disturbances to the lowest possible level.”² Russian Academician and ichthyological expert M. E. Vinogradov has stated, “Without designing special measures for gray whale conservation, the continuation of the ‘Sakhalin-II’ project can lead to extinction of this unique population.”³

Despite the threats that Sakhalin II poses to the Western Gray Whale, and Ex-Im Bank’s imperative to reject transactions that present insurmountable significant adverse environmental impacts, the project sponsor, Sakhalin Energy Investment Company, Ltd., has not taken effective action to avoid or mitigate them. In 1997, the US Overseas Private Investment Corporation (OPIC), the European Bank for Reconstruction and Development (EBRD) and the Export-Import Bank of Japan (JEXIM) required project sponsors to adopt a Habitat Conservation Plan for the Western Pacific Gray Whale. However, instead SEIC produced for the lenders a legally and scientifically insufficient Western Grey Whale Protection Plan, which was only approved by the lenders until December 2001, four years after project approval.⁴ SEIC then withheld the plan from the public until March 2002. According to expert input submitted by twenty five independent NGOs, this plan lacks scientific credibility due to:

- The refusal of the project sponsor to vet the draft plan for public comment prior to its approval by OPIC and the company’s refusal to disclose critical comments submitted on the draft plan from cetacean experts;
- The lack of independent scientific review and public access of data and research results;
- Inaccurate representation of scientific data as a result of financial pressure by the project sponsor on scientists involved in whale research;
- The lack of information about mitigating adverse effects;
- The lack of review of potential and likely impacts to Gray Whales from the expansion of the second phase of Sakhalin-II and cumulative impacts of other oil development in the area;
- The lack of review of impacts on a proposed whale reserve in the area.⁵

² Report of the Scientific Committee, International Whaling Commission, Section 10.7.5, July 22, 2001, p. 54.

³ Letter to Academician Yu.S. Osipov, President of the Russian Academy of Sciences, B.A. Yatskevich, Minister of Natural Resources, and E.I. Nazdratenko, Chairman of the State Committee of Fisheries, #1-33/149 on June 6, 2001.

⁴ “Western Gray Whale Protection Plan: A Framework for Monitoring and Mitigation Measures Related to Sakhalin Energy Oil and Gas Operations on the Northeast Coast of Sakhalin Island, Russia,” Sakhalin Energy, March 2002.

⁵ August 15, 2002 letter by Sakhalin Environment Watch and twenty four other NGOs to Sakhalin Energy Investment Company Limited regarding the “Western Gray Whale Protection Plan: A Framework for Monitoring and Mitigation Measures Related to Sakhalin Energy Oil and Gas Operations on the Northeast Coast of Sakhalin Island, Russia.”

Meanwhile, SEIC has done little to ensure its oil spill prevention and response system meets US or international standards. Independent experts from Alaska and the Shetland Islands issued a report in 1999 – called "Sakhalin's Oil: Doing It Right" -- warning that the current 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 such basic recommendations as mandatory tanker routes, increased monitoring of tanker traffic, notifications to fishing vessels if a tanker is in the area, and increased spill response equipment and improved access to the shoreline where it would be deployed -- but these have not been acted upon by SEIC. As a result, Sakhalin and Hokkaido remain vulnerable to a catastrophic spill, made even more likely by increased tanker traffic foreseen under phase II of the project. As the Wall Street Journal article indicates, "Spill response in Canada, Norway and Britain is generally far more comprehensive," and in Alaska, following the disastrous Exxon Valdez spill, "state and U.S. officials ordered the industry to set up a massive spill-response system for Prince William Sound." SEIC's lack of action to increase its oil spill prevention and response measures -- despite repeated requests from the public to do so -- further underscores its lack of attention to environmental standards and the project's insurmountable significant adverse environmental impacts.

Irrespective of these flawed plans, OPIC violated the Foreign Assistance Act when it approved the first phase of Sakhalin II. Applicable guidelines that confirm this include World Bank environmental, health and safety guidelines that applied to OPIC at the time,⁶ such as the World Bank Group policy on Natural Habitats,⁷ which OPIC incorporated into its Environmental Handbook as a partial means to assure adherence to its statutory requirements. The Natural Habitats policy states, "The Bank does not support projects that, in the Bank's opinion, involve the significant conversion or degradation of critical natural habitats." This policy defines "critical natural habitats" as "areas with known high suitability for bio-diversity conservation; and sites that are critical for rare, vulnerable, migratory, or endangered species," which certainly includes habitat for the critically threatened Western Gray Whale. The policy defines "degradation" as modification of a critical or other natural habitat that substantially reduces the habitat's ability to maintain viable populations of its native species," which Sakhalin II is documented to do. It is therefore clear that under its statutory imperative to decline support for projects that pose a major or unreasonable hazard to the environment and its obligations with regard to endangered species OPIC should never have approved the Sakhalin II project.

Moreover, when OPIC conducted environmental due diligence on the first phase of Sakhalin II, the project sponsor's representation to OPIC of the proposed next phase was incomplete, and indeed materially different in many important respects. These insurmountable impacts include:

⁶ OPIC Environmental Handbook, Environmental Standards, Overseas Private Investment Corporation, December, 1996.

⁷ World Bank Operations Manual, Natural Habitats, OP 4.04.(note that the operative provisions in this policy remain the same as those of the previous policy issued in 1995)

- The risk of extinction of the critically endangered Western Gray Whale and other threatened and endangered marine species with new seismic activities and construction of additional platforms adjacent to whale habitat area;
- An undersea pipelines routed directly through whale feeding ground, and other impacts;
- Exponentially higher risk of oil spill associated with the expanded number of drilling platforms in the absence of adequate revisions to the Oil Spill Response Plan (the existing plan for the first phase was heavily criticized by international experts);
- Roughly 800 kilometers of pipeline down nearly the entire length of Sakhalin Island to be trenched directly through ecologically and economically vital streams bearing salmon and other salmonid species, including the Sakhalin taimen, listed as endangered in the Russian Federal Red Book;
- Construction of the world's largest liquefied natural gas processing facility and oil terminal at the Southern tip of Sakhalin Island.

This expansion was not assessed by OPIC, EBRD and JEXIM during the first phase, and will dramatically increase the project's major and unreasonable hazard to the environment. These dramatically greater impacts indicate gross violations of the World Bank Natural Habitats and other policies, and a clear and equally distinct signal that the qualitative and quantitative measures of adherence to Ex-Im Bank's environmental guidelines cannot be met.

Meanwhile, OPIC, approved the Sakhalin II project in the absence of an Environmental Impact Statement (EIS), in violation of the National Environmental Policy Act.⁸ As a lawsuit filed last week by Friends of the Earth US, et.al. indicates, OPIC illegally contributes to global climate change through its financing of projects including Sakhalin II.

Unacceptable and unavoidable significant adverse socioeconomic and sociocultural impact: Ex-Im Bank's Environmental Guidelines state that one of its objectives is the development of the project to avoid or mitigate significant adverse socioeconomic and sociocultural impacts.⁹ Adverse socioeconomic impacts resulting from the first phase, and exacerbated under the second phase include the documented decreases in fisheries populations, including a sharp decline in saffron cod and herring stocks that are a key food source for the native Nivkh peoples.¹⁰ As the Wall Street Journal article indicates, local fishermen report that "(i)n 1999, the first year of commercial oil production, herring by the thousands washed up dead on local beaches, and local schools of saffron cod have since shrunk dramatically." These collapses have particularly negative impacts on native inhabitants, which depend on fish as a basis of their economy and traditional culture.

Meanwhile, beneficial socioeconomic impacts to mitigate adverse impacts are not forthcoming. According to a report of the Auditing Chamber of the Russian Federation

⁸ Friends of the Earth, Greenpeace, City of Boulder, CO, v. Peter Watson, OPIC, August 22, 2002.

⁹ Ex-Im Bank Environmental Guidelines – Annex A, Environmental Objectives #6.

¹⁰ Ibid #1

(February 2000),¹¹ the project has had no economic benefit for the budget of Russia. According to this report, due to provisions in the Production Sharing Agreement, project sponsors will pay US\$ 19 billion less in taxes than they otherwise would have over the life of the project. In addition, current and potential losses to local fisheries that potentially result from the project will have an additional negative impact. Moreover, project sponsors' promise that Sakhalin II will help gasify Sakhalin Island has been broken. Hence, the project clearly has adversely affected host country development.

In the context of the Former Soviet Union, transparency and citizen participation in government decision-making are paramount sociocultural values to covet. However, SEIC, and the public international finance institutions supporting it, are undermining this progress. This includes a failed commitment to provide related environmental monitoring information to government agencies and the public; inadequate access to public-interest environmental information and lack of transparent monitoring despite commitments to ongoing public consultation.

Taken together, the history of the Sakhalin II project provides clear indication that these socioeconomic and sociocultural impacts are adverse and significant. Indeed, they are severe. Project sponsors have shown neither a willingness to avoid or mitigate these impacts, nor a propensity to include communities in decisions that directly affect their lives. Therefore, Ex-Im Bank must include this among the list of insurmountable environmental problems, leading to rejection of the project.

Lack of Credit Worthiness: Ex-Im Bank is required to assess the credit worthiness of the transactions it is considering for support. Project sponsors originally indicated that the first phase of Sakhalin II would yield profit, which reflects on credit worthiness. However, according to official project documents for Phase II of the Sakhalin II project, the project sponsor now states "economic analysis shows that Phase I by itself will not be profitable."¹² SEIC further admits that a proposed second phase of the project will only be profitable if, in addition to the oil, they are able to sell a minimum of nine million tons of gas annually. News reports indicate that, despite years of efforts, the project sponsors have been unable to conclude contracts for the sale of gas.¹³ Hence, project sponsors' previous representation of project economics has been inaccurate and Ex-Im Bank's requirement that project sponsors prove credit-worthiness has not been met.

Violation of Host Country Laws: According to Ex-Im Bank's Environmental Guidelines, "Ex-Im will assume that host country regulatory environmental standards and

¹¹ "Report on the results of a complex evaluation of the use of government property provided on the basis of the right for use of mineral resources to subjects of entrepreneurial activity on the basis of retribution, in particular the payment of taxes, collections, and other payments to the federal budget, as well as insurance payments to government non-budget funds during the execution by them of the Production Sharing Agreements 'Sakhalin-1' and 'Sakhalin-2' and the fulfillment of the conceptions of the Auditing Chamber, adopted at the Collegium of the Auditing Chamber of the Russian Federation on April 17 1998 based on the results of a thematic evaluation of the organization of levying of taxes and payments into the budget during the execution of the Production Sharing Agreement in correspondence with the federal law 'About Production Sharing Agreements' at enterprises and organizations of Sakhalin Region," March 21, 2000

¹² Preliminary Environmental Impact Assessment for Phase II of the Sakhalin-II project, Sakhalin Energy Investment Company, November 2001, p. 8-5 of Russian version.

¹³ *Vedomosti*, July 12, 2002 and others.

procedures as applicable are met.”¹⁴ However, this and other assumptions are wrong. Russian NGOs have filed an environmental lawsuit against the Russian government to halt any construction or industrial development in the defined gray whale habitat area, naming Sakhalin Energy Investment Company, Ltd. as a third party defendant. Russian law clearly prohibits harm to the habitat of Red Book (listed endangered) species. Meanwhile, the massive die-off of herring and steep decline of saffron cod population potentially linked to the project leads local citizens to continuously request information from OPIC, EBRD and JEXIM on the ongoing operations of Sakhalin II. Despite repeated promises by project sponsors for ongoing consultation and access to information, NGOs have been compelled to file a lawsuit against the Russian government and project sponsors to obtain public-interest information about this project due to the company’s lack of releasing information or working cooperatively with local concerned citizens. It should also be noted that on the first phase of the Sakhalin II project, activation of financing by OPIC, EBRD and JEXIM was delayed nearly a year due to project sponsors’ failure to comply with Russian environmental legislation at the time it sought Board approval from these institutions.

Conclusion: The dubious phase II of Sakhalin II presents several obvious, significant, severely adverse and insurmountable environmental effects and violations of Ex-Im Bank’s Environmental Policy, Procedures and Guidelines. Moreover, the ability of Ex-Im Bank’s environmental and financial due diligence to ensure compliance with the agency’s policies is compromised through its dependence on assumptions based on representations made by project sponsors. As we have seen, the Sakhalin II project sponsor’s shifting depiction of ultimate project scope, pledges of project profitability, promises of adequate public consultation, transparency, and credible scientific analysis, and assurance of compliance with the law continue to be proven wrong. Together with the enormous underlying risks of Sakhalin II, this renders Ex-Im Bank’s ability to assure policy compliance and to protect its institutional reputation untenable.

Accordingly, we call upon Ex-Im Bank to act with due dispatch to decline support for the Sakhalin II project.

Sincerely,

Dmitry V. Lisitsyn
Chairman
Sakhalin Environment Watch

Doug Norlen
Policy Director
Pacific Environment

David Gordon
Associate Director
Pacific Environment

CC: Distribution

Attachment: September 4, 2002 Wall Street Journal article

¹⁴ Ex-Im Bank Environmental Guidelines – Annex A Introduction