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**Friends of
the Earth**

**FRIENDS OF THE EARTH
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BY POST AND EMAIL

28 April 2006

Dear Mr Crawford,

Sakhalin II, Phase 2: application for ECGD support

The ECGD is in the process of deciding whether to grant support from the UK taxpayer for the substantial Sakhalin II Phase 2 oil and gas project (“the project”), which has been classified by the ECGD as a “high potential impact” project.

In determining the application for such support, and pursuant to section 13(1) of the Export and Investment Guarantees Act 1991, the ECGD is exercising and performing the functions of the Secretary of State under Part I of that Act.

ECGD has and will receive several submissions relating to the environmental, human rights and sustainable development impacts of the project, including (under separate cover) from Friends of the Earth. I do not intend to reiterate them here, save to say that they relate to what I am instructed are many potential and **already-occurring** impacts, several of a serious nature, and including several examples of non-compliance with international standards, legal obligations and UK government policies to which ECGD has committed itself.

On the basis of my instructions, this letter raises, and seeks reassurances on, ten legal, policy and procedural considerations in respect of the application, in respect of (i) sequencing; (ii) need; (iii) methodology; (iv) climate change; (v) sustainable development; (vi) the Western Pacific Gray Whale; (vii) the Convention on Biological Diversity; (viii) the Ramsar Convention; and (ix) honesty and openness.

This letter in no way deals with all of the considerations bearing on this matter, and it might become necessary for me to write to you further.

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I. Sequencing: assessing the environmental impact of a project where construction of that project is substantially complete, makes that assessment little more than a charade

The effectiveness of environmental impact assessment procedures requires that they are conducted **in advance** of a proposed activity, in order to inform the decision-making in respect of which they are undertaken. This sequencing is well understood and has been for decades, not least because it enables the proposed activity to be scoped, designed and implemented, in a way that minimises environmental damage. It also helps to give interested parties an opportunity to participate in these aspects, and to consider alternatives.

In respect of the project, I am instructed that the applicant has chosen to proceed with it with the result that its construction is now **substantially complete**. For example, by January 2006, building work on the LNG terminal was 80% complete, 65% of onshore pipeline had been welded and completed (1050 km. out of 1620 km. required for oil and gas transportation), whilst 1930 km of “linepipe” had been manufactured, and 1825 km coated and delivered to the island (company information). This was preceded by completion of the installation of the concrete bases of the LUN-A and PA-B platforms which had occurred in July-August 2005. These, and, I am instructed, other, environmentally-damaging activities have already occurred. I am further instructed that ECGD is under political pressure to grant its support.

However, the applicant’s choice is not without potential legal effect (in this country), and such pressure is not without potential legal constraint. The legal relevance of the applicant’s choice for ECGD is that it has put ECGD’s decision-making out of sequence with the assessment of environmental impacts, thus ensuring that the environmental assessment process is now little more than a charade, and renders substantially meaningless ECGD’s policy commitments in respect of international standards and policies on the environment, human rights and sustainable development. In addition, public law would require judicial supervision in the event of executive abuse.

We would therefore be grateful for ECGD’s assurance that it cannot approve the project as prior substantial completion of project construction makes the environmental assessment process now little more than a charade.

In the event that ECGD decides that it cannot give us that assurance, we would be grateful if ECGD would (1) specify the factors that it would have considered, which ECGD considers enable it to continue to consider granting support in accordance with its policy commitments, and in good faith; (2) confirm that it would have taken into account the perception of the good faith of ECGD’s adoption of such commitments, including reputational risk; and (3) set out its reasons for fulfilling the public law requirements of rationality and good faith.

The following matters raised in this letter are made on the assumption that ECGD will proceed to consider approval, and are without prejudice to the view that ECGD cannot lawfully approve the project.

II. Confirmation of need

I am instructed that the company applying for ECGD support for the project is known as Sakhalin Energy Investment Company Ltd. (SEIC), registered in Bermuda.

The shareholders are Shell (55%), Mitsui & Co., Ltd. (25%), and Mitsubishi Corporation (20%).

The Table below shows the revenue, income and cash flow of Shell for 2004 and 2005 in US dollars (company figures).

	2004	2005
Revenue	\$266.4 billion	\$306.7 billion
Income	\$19.3 billion	\$26.3 billion
Cash flow from operating activities	\$26.5 billion	\$30.1 billion

Below are the opening words from Mr. Shoei Utsuda, the President and CEO of Mitsui & Co. Ltd in his company's 2005 Annual Report:

“Record performance, and more growth to come

In the year ended March 31, 2005, we achieved net income of ¥121.1 billion, reaching and exceeding - a year ahead of plan - the target of ¥100 billion contained in our Medium-term Strategic & Financial Plan Global Growth 2006 ('Mid-term Plan') for the two-year period ending March 2006. A number of factors have worked in combination to produce this result. Key among these is the effort we have made over the past two years to strengthen our asset base, including a thorough review of our subsidiaries and associated companies. As a consequence, we have been in the position to benefit from a very favorable business environment - driven by economic growth in the United States and in rapidly emerging economies such as China - of expanding global trade, along with major increases in international commodity prices in response to strong demand for minerals, energy and other natural resources."

Below is a Table containing some of Mitsubishi Corporation's 2005 'Financial Highlights' (company figures):

	Operating transactions	Operating income	Income from consolidated operations before income taxes	Net income
2005	17,132,704	183,365	209,799	182,369
2004	15,177,010	130,523	150,119	116,020

Figures in Millions of Yen

These 3 companies are clearly amongst the largest and richest in the world.

We would be grateful to receive ECGD's assurances that before granting support the ECGD will (1) assess the capacity of these shareholders and of SEIC to finance the project from their own resources, or from the private sector; and (2) specifically address why the applicant needs the support of the UK taxpayer.

We would further be grateful if you would provide assurances (1) that in the event that ECGD might decide to grant support, it will demonstrate transparently, and in a timely manner, the results of that assessment; and (2) as to how that assessment indicates that the support of the UK taxpayer is needed.

III. Confirmation of methodology to be adopted in determining this application

The ECGD's Business Principles Unit: Case Impact Analysis Process, May 2004 ("CIAP") document contains an outline of the methodology "usually followed" by ECGD on applications of this nature, though this is said not to be a statement of what will be done in every case.

In particular, the CIAP states that:

“2.5 The method used by ECGD to determine the acceptability of the impacts of a project

is to compare them with the relevant international standards [of the World Bank Group and others].

- 2.7 Projects that comply with the relevant international standards will normally be considered acceptable on environmental and social grounds...
- 2.10 In processing applications for support, ECGD will also take account of applicable Government policies and initiatives on the environment, sustainable development and human rights.”

We note from the above that the ECGD does not commit itself to determine the acceptability of the impacts of a project by comparing them with or on the basis of applicable Government policies and initiatives on the environment, sustainable development and human rights.

This is not a semantic distinction. For example, we note that in the BPU Review of the BTC Pipeline Project, “international standards”, and not government policies or initiatives (*a fortiori* not government obligations), were specifically listed in the ‘Main criteria for acceptability’ section.

I am further instructed that the project does not comply with six specified international standards itemised in the Non-Compliance Table in section 3.3.2 of the submission sent to you today by Friends of the Earth, The Corner House and WWF UK.

We would be grateful for your assurance that the acceptability of the impacts of the project **will** be determined by ECGD by comparing them with, and on the basis of compatibility with, applicable Government policies, initiatives and **legal obligations** on the environment, sustainable development and human rights, as well as international standards.

Further, we would appreciate your confirmation that:

(1) the methodology outlined in the May 2004 CIAP will be followed by ECGD in deciding this application; or, if not, that you will inform us of the areas in which ECGD does not intend to follow that methodology, and, in respect of any such areas, provide an explanation as to why;

(2) assessment of compliance will include assessment against the six international standards itemised in the Non-Compliance Table in section 3.3.2 of the submission sent to you today by Friends of the Earth, The Corner House and WWF UK; and

(3) ECGD will transparently, and in a timely manner, identify (in the event that it decides to grant support) which of the (i) international standards, (ii) legal obligations and (iii) UK government policies and initiatives on the environment, human rights and sustainable development it would (in that event) have decided need not be complied with.

IV. Granting support for the project would conflict with the UK’s international legal and policy commitments on climate change, under both the 1992 United Nations Framework Convention on Climate Change and the 1997 Kyoto Protocol

Climate change is the most serious environmental threat facing the planet, and the emission of greenhouse gases, particularly carbon dioxide and methane, as a result of human activities is the primary cause.

The cause, nature, severity, and urgency of this threat has been amply demonstrated over recent years, for example by the Intergovernmental Panel on Climate Change’s Third Assessment Report (2001), and more recently by the national scientific academies of the G8 nations along with those

of Brazil, China and India (May 2005).

The UK government has also been at the forefront of policy efforts at the international level aimed at tackling the problem. In the words of the Prime Minister – words which ten years ago would have mainly come from organisations such as Friends of the Earth:

“Climate change is probably the greatest long-term challenge facing the human race. That is why I have made it a top priority for this government, at home and internationally.

“The scientific evidence is now overwhelming. Since 1990, global temperatures have risen by 0.2C and atmospheric carbon dioxide concentrations have increased from 354 parts per million to over 380 parts per million and are still rising. If the anticipated growth in emissions is left unchecked, global average temperatures could be as much as 5.8C higher by the end of this century, with a devastating impact on our economy and natural world, in the UK and, above all, in the most vulnerable developing countries.

“We have to accept that some climate change is now inevitable. We must adapt to this and provide greater support for the poorest nations. We can, however, avert the worst global scenarios if the world acts decisively, but there can be no delay. The longer we put off action, the more dramatic and costlier the changes we will have to make.....

“Our emissions goals require leadership and action, by government and by us all. This programme will move us closer, and we will go further. But the solution is in the hands of us all – as businesses, citizens and consumers. Let’s achieve this together.” (Climate Change: The UK Programme 2006, Prime Minister’s Foreword, emphasis added)

In addition to the scientific imperative, and political commitment to the need, for urgent action to reduce greenhouse gas emissions, the UK government has international legal obligations that bear on this issue and thus on ECGD’s decision.

Under the 1992 UN Framework Convention on Climate Change (UNFCCC), the UK has specific obligations to:

- **“[f]ormulate, implement, publish and regularly update national and, where appropriate, regional programmes containing measures to mitigate climate change by addressing anthropogenic emissions by sources...”** (Article 4.1(b));
- **“[t]ake climate change considerations into account, to the extent feasible, in [its] relevant social, economic and environmental policies and actions”** (Article 4.1(f)); and
- **“adopt national policies and take corresponding measures on the mitigation of climate change, by limiting its anthropogenic emissions of greenhouse gases”** (Article 4.2(a)).

In addition, Article 2 of the UNFCCC provides as follows:

“The ultimate objective of this Convention and any related legal instruments that the Conference of the Parties may adopt is to achieve, in accordance with the relevant provisions of the Convention, stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system. Such a level should be achieved within a time-frame sufficient to allow ecosystems to adapt naturally to climate change, to ensure that food production is not threatened and to enable economic development to proceed in a sustainable manner.”

In conjunction with international law on treaties, which requires that States do not act in such a way as to defeat the object or purpose of treaties, and that States implement them in good faith, we submit that Article 2 also imposes on the UK an international legal duty to prevent climate change (See further Climate Change Damage and International Law: Prevention Duties and State

Responsibility, by Dr. Roda Verheyen, Martinus Nijhoff, 2005).

The UK also has obligations arising out of the Kyoto Protocol (KP) that bear on ECGD's decision.

The UK has an obligation to meet its own greenhouse gas emission reduction target under the KP of an 8% reduction over 1990 levels by 2008-2012. In addition, in achieving this target, the UK must implement policies and measures such as “[p]rogressive reduction or phasing out of..... subsidies in all greenhouse gas emitting sectors that run counter to the objective of the [UN Framework] Convention and application of market instruments” (Article 2.1(a)(v)).

Assessment of compliance with these specific KP obligations by themselves would not include emissions from the project, to the extent that the oil and gas involved is not burned by the UK. However, it is clear that the purpose and object of both the UNFCCC and the KP (agreed “[i]n pursuit of the ultimate objective of the [UN Framework] Convention as stated in Article 2” (KP Preamble, second paragraph)) would be undermined if the UK's ECGD actions, policies or measures facilitated an increase in greenhouse gas emissions, at least in developed countries.

Moreover, this undermining would be all the more serious to the extent to which the oil and gas from the project was burned in developed countries that are not Parties to the KP, such as the United States and Australia, or to those developed countries which are not expected to meet their KP targets or are not complying with their obligations under Article 4(1)(b), Article 4.1(f) and Article 4.2(a) of the UNFCCC.

The UK is obliged under the KP to “[f]ormulate, implement, publish and regularly update national and, where appropriate, regional programmes containing measures to mitigate climate change and measures to facilitate adequate adaptation to climate change: (i) Such programmes would, *inter alia*, concern the energy, transport and industry sectors....”. (Article 10(b)). This obligation is expressed as “reaffirming existing commitments under Article 4 paragraph 1, of the [UN Framework] Convention, and continuing to advance the implementation of these commitments in order to achieve sustainable development” (Article 10, *chapeau*). **This KP obligation in respect of mitigation is not confined to emissions that are directly accounted for in assessing compliance with the binding emission targets.**

In these circumstances, we would be grateful to receive your assurances that:

(1) you agree that the obligations under Article 4(1)(b), Article 4.1(f) and Article 4.2(a) of the UNFCCC are relevant considerations for the ECGD in this decision; that these obligations will be taken into account by ECGD in coming to its decision; and that ECGD will demonstrate transparently at the time of its decision how these obligations have been taken into account;

(2) you agree with us that Article 2 of the UNFCCC imposes on the UK a duty to prevent dangerous anthropogenic interference with the climate system; that this duty will be taken into account by ECGD in coming to its decision; and that ECGD will demonstrate transparently at the time of its decision how this duty has been taken into account.

(3) you agree with us that the purpose and object of both the UNFCCC and the KP would be undermined if the ECGD's actions, policies or measures facilitated an increase in greenhouse gas emissions, at least in developed countries; that this undermining would be all the more serious to the extent to which the oil and gas from the project was burned in developed countries that are not Parties to the KP, or to those developed countries which are either not expected to meet their KP targets or are not complying with their obligations under Article 4(1)(b), Article 4.1(f) and Article 4.2(a) of the UNFCCC;

(4) that ECGD will ensure that it understands the country destinations of the oil and gas involved with this project; will assess whether these countries include developed countries that are not Parties to the KP, or developed countries which are not expected to meet their KP targets or are not complying with their obligations under Article 4(1)(b), Article 4.1(f) and Article 4.2(a) of the UNFCCC; will take account of the results of this assessment in its decision; and will demonstrate transparently at the time of its decision how the results of that assessment have been taken into account;

(5) that if ECGD decides to grant support for the project, it will impose conditions on the support aimed at ensuring that the oil and gas from this project is not burned by those developed countries mentioned in paragraph (4) above which are identified by the ECGD assessment under that paragraph;

(6) your confirmation that the duty under Article 10(b) of the KP is relevant to the decision on this project; that this duty will be taken into account by ECGD in coming to its decision; and that ECGD will demonstrate transparently at the time of its decision how it has been taken into account.

V. The ECGD is not (yet) in a position to comply with its commitment to take into account government policy on sustainable development and must not make a decision on this application until it is

This application goes to the heart of the UK government's, including the ECGD's, policy relating to sustainable development.

In December 2000, the ECGD adopted a statement of Business Principles. The Secretary of State described the Business Principles as an **"ethical code"** (Foreword, second paragraph), and their opening sentence states that they **"will guide our practice and policies"**.

In particular, the statement proceeds to state that the:

"Business Principles set out our approach to achieving our goals:

- **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."**

Moreover, the ECGD has committed itself, in exercising and performing the functions of the Secretary of State under Part 1 of the 1991 Act, to a:

"policy to ensure that:

- **all cases supported by ECGD are compatible with its Statement of Business Principles; and**
- **all decisions on ECGD support have taken into account Government policies on the environment, sustainable development, and human rights."** (Business Principles Unit: Case Impact Analysis Process, May 2004 ("CIAP").

In March 2005, the UK government set out its sustainable development strategy (*The UK Government Sustainable Development Strategy* ("Securing the future"), Presented to Parliament by the Secretary of State for Environment, Food and Rural Affairs by Command of Her Majesty, March 2005, Cm 6467). In the Foreword, the Prime Minister said that:

"Make the wrong choices now and future generations will live with a changed climate, depleted resources and without the green space and biodiversity that contribute both to our standard of living and our quality of life. Each of us needs to make the right choices to secure

a future that is fairer, where we can all live within our environmental limits. That means sustainable development...

“Over the past six years scientific opinion has moved decisively to an almost universal consensus that climate change is happening and is the result of human activity. That means we can move the debate from whether there is a problem to how to deal with it. Yes, climate change represents a potentially catastrophic threat, but it is within our control to address it – and address it we must...”

“We have spent a long time getting to grips with the concept of sustainability. I want to declare a moratorium on further words. I want this new strategy to be a catalyst for action to secure our future.” (emphasis added)

The strategy promises that:

“All departments will produce a Sustainable Development Action Plan by the end of 2005.”

and that:

“Government departments and their executive agencies will produce Action Plans Setting out how they intend to implement the commitments in this strategy...”
(*Securing the future*, pages 146 and 165, respectively).

In December 2005, the Department of Trade and Industry published its Sustainable Development Action Plan “drawn up to meet the Prime Minister’s commitment in his Foreword to HMG’s Sustainable Development Strategy” (Minister for Energy, Foreword). In the words of that Plan:

“For DTI Sustainable Development demands a sea change in the way we develop, implement and communicate policy. It requires us to widen our traditional economic approach to decisions so that they are seen to encompass the requirements of social equity and the environment.....” (page 4, emphasis added)

The DTI Plan states that the ECGD has published its own plan. Indeed it has, but I am instructed that ECGD needs to make certain staffing changes in order to enable it to comply with the commitment, and thus the ECGD Plan states:

“Due to the diversion of internal resources, required to effect a challenging reorganisation affecting the whole Department during the summer and autumn, ECGD was unable to develop a comprehensive SDAP during 2005. Therefore, this document, ECGD’s 2005 SDAP, is primarily a scene-setting document that sets out the actions, and associated time schedule, that will be undertaken in 2006 to produce a comprehensive SDAP before the end of 2006. ECGD’s Management Board, the export Guarantees Advisory Council (EGAC) and the Sustainable Development Commission have endorsed this approach.” (paragraph 5, emphasis added).

The ECGD 2005 Plan sets out a schedule for publishing a full plan in 2006, with comments on the 2005 Plan scheduled for April-May and ministerial endorsement and publication due in October 2006.

The fact that the 2005 SDAP simply states that “facilitating exports that benefit the UK and overseas economies” (paragraph 20), as the first way in which ECGD contributes to sustainable development, appears to indicate that the ECGD has not understood the **“sea change”** needed in ECGD policy, as a result of the government’s commitment to sustainable development. The ECGD has committed itself to taking the government’s sustainable development policy into account, but cannot comply with that policy until at least publication of the 2006 SDAP.

In these circumstances, we consider that it would not be compatible with its commitments to take account of government policy on sustainable development if ECGD was to proceed to determine this application in advance of the 2006 SDAP, and in accordance with that commitment. We would therefore welcome your assurance that ECGD will not determine this application until it is in a position to comply with its commitment to take into account government policy on sustainable development.

VI. Biodiversity (1): Overriding the threat of extinction of the Western Pacific Gray Whale

ECGD will be aware that protection of the **critically endangered** Western Pacific Gray Whale is part of the strategic priorities of 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.” (page 115).

We do not repeat here the large amount of evidence that justifies DEFRA's position, and which has been submitted and will be submitted to ECGD in this regard. Suffice it to say that my instructions indicate that there appears to be general agreement that there are probably less than 100 left, with recent calves being only or overwhelmingly male, and that the additional loss of just one female could make this species become extinct. **I am instructed to inform you that Friends of the Earth cannot over-emphasise the strength of its opposition to extinction of the Western Pacific Gray Whale.**

We therefore ask ECGD's assurance that:

- (1) you agree with us that the threat of extinction to the Western Pacific Gray Whale is a relevant consideration for your decision;
- (2) you agree, in addition, that the reputational risk to the ECGD and to the United Kingdom of such an irreversible, but potentially still-preventable, extinction occurring, is also a relevant consideration for your decision; and
- (3) if ECGD decides that the threat of extinction of the Western Pacific Gray Whale is not sufficient to warrant rejection of the application, ECGD will make transparent, in a timely manner, how this threat has been traded-off against other considerations, including reputational risk.

VII. Biodiversity (2): The pre-eminent Convention on Biological Diversity imposes legal obligations on both Russia and the UK that are relevant to ECGD's decision on the project

I have been instructed on the past and potential biodiversity damage of the project, including those that conflict with a number of international agreements.

There are, in particular, specific provisions in the 1992 Convention on Biological Diversity (CBD) that impose legal obligations on both Russia and the UK that are relevant to ECGD's decision on the project. It is also important to note the **pre-eminence** of that Convention where the exercise of any rights and obligations under other international agreements “would cause a serious damage or threat to biological diversity” (Article 22.1). There is no shortage of serious damage and threats in

respect of the project.

Russia's CBD obligations relevant to ECGD's decision

The Health, Safety, Environment and Social Action Plan 2005 acknowledges the applicability of this Convention to the project. Russia (whose treaty obligations, we are advised, are directly binding under Russian law, without further domestic transposition unless the obligation in question is so qualified), has extensive obligations, including in respect of indigenous communities, under the following nine paragraphs of Article 8 of the Convention, and under Article 14, whereby Russia is obliged:

“as far as possible and as appropriate [to]:

- (a) Establish a system of protected areas or areas where special measures need to be taken to conserve biological diversity;**
- (b) Develop, where necessary, guidelines for the selection, establishment and management of protected areas or areas where special measures need to be taken to conserve biological diversity;**
- (c) Regulate or manage biological resources important for the conservation of biological diversity whether within or outside protected areas, with a view to ensuring their conservation and sustainable use;**
- (d) Promote the protection of ecosystems, natural habitats and the maintenance of viable populations of species in natural surroundings;**
- (e) Promote environmentally sound and sustainable development in areas adjacent to protected areas with a view to furthering protection of these areas;**
- (f) Rehabilitate and restore degraded ecosystems and promote the recovery of threatened species, inter alia, through the development and implementation of plans or other management strategies;...**
- (j) Subject to its national legislation, respect, preserve and maintain knowledge, innovations and practices of indigenous and local communities embodying traditional lifestyles relevant for the conservation and sustainable use of biological diversity...**
- (k) Develop or maintain necessary legislation and/or other regulatory provisions for the protection of threatened species and populations;**
- (l) Where a significant adverse effect on biological diversity has been determined pursuant to Article 7, regulate or manage the relevant processes and categories of activities.”** [Article 8]

and is further obliged under Article 14:

“as far as possible and as appropriate, [to]:

- (a) Introduce appropriate procedures requiring environmental impact assessment of its proposed projects that are likely to have significant adverse effects on biological diversity with a view to avoiding or minimizing such effects and, where appropriate, allow for public participation in such procedures;**
- (b) Introduce appropriate arrangements to ensure that the environmental consequences of its programmes and policies that are likely to have significant adverse impacts on biological diversity are duly taken into account;”**

In order to comply with ECGD's policy commitments, including, but not limited, to compliance with host government laws, and bearing in mind that Russian groups and communities have already successfully challenged the project in the Russian courts, and that litigation is continuing, we would be grateful to receive ECGD's assurance that it will seek independent Russian legal advice on the extent to which Russia has complied with these obligations, in the context of the project, including the extent to which ongoing litigation demonstrates unlawfulness on the part of Russia and/or SEIC.

We also seek ECGD's reassurance that (1) it will make that advice publicly available; and (2) that in the event that ECGD decides to approve the application, and that such advice indicates legal non-compliance on the part of Russia and/or SEIC, ECGD will make transparent, in a timely manner, those aspects of non-compliance that it has traded-off.

The UK's CBD obligations relevant to ECGD's decision

Conservation of biological diversity is a strategic priority of the UK government, via DEFRA, but it is also critical to note that there are two particular obligations on the UK, under Articles 6(b) and 11 of the Convention, that cannot be left to DEFRA alone.

Article 6(b) requires each Contracting Party:

**“in accordance with its particular conditions and capabilities [to]:
(b) Integrate, as far as possible and as appropriate, the conservation and sustainable use of biological diversity into relevant sectoral or cross-sectoral plans, programmes and policies.”**

Article 11, entitled 'Incentive Measures', provides:

Each Contracting Party shall, as far as possible and as appropriate, adopt economically and socially sound measures that act as incentives for the conservation and sustainable use of components of biological diversity.

Supporting a project that has already caused, and will cause, serious biodiversity damage would clearly indicate that Article 6(b) integration had not occurred, either effectively or not at all. Further, incentives for the project in the form of UK taxpayer support would be the antithesis of Article 11.

We therefore seek ECGD's assurance that (1) it considers that these two legal obligations are relevant considerations for ECGD in determining this application; and (2) in the event that ECGD decides to grant approval notwithstanding, it will make transparent, in a timely manner, how it has traded off these obligations.

VIII. Biodiversity (3): The Ramsar Convention imposes legal obligations on both Russia and the UK that are relevant to ECGD's decision on the project, including possible facilitation by the UK of a breach of international law by Russia

I have been instructed with respect to the threats posed by the project to a number of important wetlands, including three of five Sakhalin bay wetlands proposed for listing under the Convention on Wetlands of International Importance especially as Waterfowl Habitat, better known as the Ramsar Convention.

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”. 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.”

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.

We would be grateful for ECGD's confirmation that (1) Russia's and (2) the UK's obligations under the Ramsar Convention are relevant considerations for the ECGD decision on the project.

We would further appreciate ECGD's assurance that before deciding on ECGD support for the project, ECGD will:

(1) (via the usual channels, as appropriate) request Russia to inform the UK what steps it has taken to comply with (i) Article 3 and (ii) Article 4 of the Ramsar Convention, in the context of the project;

(2) make publicly available the response from Russia in advance of a decision by ECGD;

(3) make clear now whether any consultations have taken place between Russia and the UK under Article 5;

(4) make publicly available in advance of the decision the contents and results of any such consultations; and

(5) in the event of approving the application, will make transparent, and in a timely manner, how it considers that (i) the UK will not thereby be facilitating a breach of international law by Russia and (ii) the UK will not itself be in breach of international law.

IX. ECGD must satisfy itself that SEIC has been honest and open with ECGD, and must take into account other considerations relating to honesty and openness

In August 2004, the US Securities and Exchange Commission (SEC) found that the Royal Dutch Petroleum Company and The "Shell" Transport and Trading Company, p.l.c. (together, Shell) had violated four sections of the Securities Exchange Act of 1934, and four of the rules made thereunder, as a result of Shell's over-statement of its proven oil and gas reserves by about 25%.

Shell consented to the entry of a judgment by the U.S. District Court for the Southern District of Texas, Houston Division, to pay a US \$120 million civil penalty. (*SEC v. Royal Dutch Petroleum Company and The "Shell" Transport and Trading Company, p.l.c.*, H-04-3359 (S.D. Tex.) (August 24, 2004)).

The following extract from the SEC Order in respect of two of the violations reflects the gravity of Shell's behaviour:

"LEGAL ANALYSIS

A. Violations of Section 10(b) and Rule 10b-5

"Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibit the employment of a fraudulent scheme or the making of material misrepresentations and omissions in connection with the purchase or sale of securities. To violate these provisions, the alleged misrepresentations or omitted facts must be material. Information is material if it would have assumed significance in the investment deliberations of a reasonable investor. *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988).

"Violations of these provisions require proof of *scienter*. *Aaron v. SEC*, 446 U.S.

680 (1980). *Scienter* is the “mental state embracing intent to deceive, manipulate or defraud,” *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976), which may be established by showing that the defendants acted intentionally or with severe recklessness. See *Broad v. Rockwell International Corp.*, 642 F.2d 929 (5th Cir.) (en banc), cert. denied, 454 U.S. 965 (1981). To establish *scienter* on the part of a company, the mental state of the company’s officers is imputed to the company. *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1089 n.3 (2d Cir. 1972).

“Based on the conduct described above, Respondents 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 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.” (UNITED STATES OF AMERICA, Before the SECURITIES AND EXCHANGE COMMISSION, SECURITIES EXCHANGE ACT OF 1934, Release No. 50233 / August 24, 2004, ACCOUNTING AND AUDITING ENFORCEMENT Release No. 2085 / August 24, 2004, ADMINISTRATIVE PROCEEDING File No. 3-11595, In the Matter of Royal Dutch Petroleum Company and The “Shell” Transport and Trading Co., p.l.c. Respondents, ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER, Section IV.A, emphasis added.)

At the same time, and in respect of the same issue, the UK’s Financial Services Authority (FSA) imposed a financial penalty of £17 million on the same two companies “for market abuse by Shell” under section 123 of the Financial Services and Markets Act 2000 and for breaches of the FSA’s Listing Rules.

In its Final Notice dated 24th August 2004, the FSA said that it considered “Shell’s actions were particularly serious and merit a substantial financial penalty”. In particular, the FSA found that Shell had “announced false or misleading proved reserves and reserves replacement ratios to the market throughout the period 1998 to 2003”; that this information was not corrected until January-May 1994, the corrections amounting to 25% of Shell’s proved reserves; and that “Shell’s false or misleading announcements of proved reserves were made despite indications and warnings from 2000 to 2003 that its proved reserves as announced to the market were false or misleading”.

We consider that the ECGD’s commitment to expect honesty and openness from applicants must be addressed in the light of Shell’s behaviour in respect of its reserves, as evidenced by the findings of these official bodies. This is a particularly relevant issue in respect of the project in view, for example, of the escalation in costs since the application (reported to be from US \$10 billion to around US \$20billion); and undertaking most of the construction of the project long before determination of the application for support. It might also be relevant to the extent that any (re)payments may be required to be made by the applicant in respect of any taxpayers’ support that ECGD might grant.

We also note that the US Congress has recently enacted a number of legislative provisions (in the Fiscal Year 2006 Foreign Operations Appropriations bill), some of which we set out below. These, of course, are not binding in their terms on ECGD.

However, we consider that they are relevant in the context of this application for at least two reasons. First, as they will be applied in the context of ECGD’s potential co-financiers of the project, such as the European Bank for Reconstruction and Development and the US Ex-im Bank. Second, they appear consistent with UK government and ECGD policy commitments in the relevant sphere (as far as they go), and indicate the nature of the practices that the ECGD needs to

adopt in order for its decision on the project not to conflict (in these respects) with its policy commitments.

We set out three of the key policy requirements below, in an extract from the recent US legislation:

“(c) EXTRACTION OF NATURAL RESOURCES.--

(1) The Secretary of the Treasury shall inform the managements of the international financial institutions and the public that it is the policy of the United States that any assistance by such institutions (including but not limited to any loan, credit, grant, or guarantee) for the extraction and export of oil, gas, coal, timber, or other natural resource should not be provided unless the government of the country has in place or is taking the necessary steps to establish functioning systems for: (A) accurately accounting for revenues and expenditures in connection with the extraction and export of the type of natural resource to be extracted or exported; (B) the independent auditing of such accounts and the widespread public dissemination of the audits; and (C) verifying government receipts against company payments including widespread dissemination of such payment information, and disclosing such documents as Host Government Agreements, Concession Agreements, and bidding documents, allowing in any such dissemination or disclosure for the redaction of, or exceptions for, information that is commercially proprietary or that would create competitive disadvantage.”

And we refer you to a further four (of a further twelve) requirements here:

“PROMOTION OF POLICY GOALS AT MULTILATERAL DEVELOPMENT BANKS

SEC. 599B. Title XV of the International Financial Institutions Act (22 U.S.C. 262o, et seq.) is amended by adding at the end the following:

“SEC. 1505. PROMOTION OF POLICY GOALS.

“(a).....It is the policy of the United States that each bank should--

“.....(7) require each bank borrower and grantee and each bidder, supplier and contractor for MDB projects to comply with the highest standard of ethics prohibiting coercive, collusive, corrupt and fraudulent practices, such as are defined in the World Bank's Procurement Guidelines of May, 2004;...

“(9) require that each candidate for adjustment or budget support loans demonstrate transparent budgetary and procurement processes including budget publication and public scrutiny prior to loan or grant approval;

“(10) require that for each project where compensation is to be provided to persons adversely affected by the project, such persons have recourse to an impartial and responsive mechanism to receive and resolve complaints. The mechanism should be easily accessible to all segments of the affected community without impeding access to other judicial or administrative remedies and without retribution;

“(11) implement best practices in domestic laws and international conventions against corruption for whistleblower and witness disclosures and protections against retaliation for internal and lawful public disclosures by the bank's employees and others affected by such bank's operations who challenge illegality or other misconduct that could threaten the bank's mission, including (1) best practices for legal burdens of proof, (2) access to independent adjudicative bodies, including external arbitration based on consensus selection and shared costs, and (3) results that eliminate the effects of proven retaliation;”

We therefore seek ECGD's assurances that:

- (1) it will assess the honesty and openness of Shell in respect of this application, including an assessment of whether there might be any exposure to the public purse; that it will take these considerations into account when determining the application; and that it will demonstrate transparently at the time of its decision how these considerations have been taken into account; and
- (2) you agree with us that the recent US legislation extracted above reflects (as far as it goes) the ECGD policy on this matter; that ECGD will take the seven exemplar considerations into account when determining the application; and that ECGD will demonstrate transparently at the time of its decision how these considerations have been taken into account.

I would appreciate your response to this letter as soon as possible.

Yours sincerely,

Phil Michaels
Solicitor

cc. Minister for Trade
Minister for Energy
Minister for the Environment
Parliamentary Under Secretary of State, Department for International Development
Secretary of State for Foreign and Commonwealth Affairs
Secretary of State for Trade and Industry
Secretary of State for International Development
Secretary of State for Environment, Food and Rural Affairs
Chief Secretary to the Treasury
Select Committee on Trade and Industry
Environmental Audit Committee
Chair, Export Guarantees Advisory Committee
Shareholders Executive, DTI
David Allwood, Business Principles Unit, ECGD
Martin McKee, Business Principles Unit, ECGD