

DECREE OF THE SAKHALIN REGIONAL DUMA

05/04/2006 # 4/8/239-4

Yuzhno-Sakhalinsk

On raising of the socioeconomic effect of the Sakhalin I and Sakhalin II oil and gas projects

At the Sakhalin Region, Sakhalin I and Sakhalin II, the projects on the extraction and transport of hydrocarbon products out of Russia, are being intensively implemented.

Even before the final release of the Production Sharing Agreement was considered for signing, the population of the region supported the opinion that the mandatory conditions of the Agreement on the Sakhalin II project should include the provision of gas for the needs of southern Sakhalin in 1997, and the consideration of the final release of Agreement before its signing at the meeting of representative (legislative) body of the region (see paragraphs 6 and 8 of the Decision of Council of People's Deputies of Sakhalin Region of June 15, 1993 which was approved at 2nd session of 21st calling, "On negotiations about the Sharing Agreement under the project for development of the Piltun-Astokh and Lunsok oil and gas fields at the Sakhalin Island shelf", paragraph 3 of the Decision of Council of People's Deputies of Sakhalin Region of October 31, 1992 which was approved at 2nd session of 21st calling, "On the preparation of Feasibility Study under the project for development of the Piltun-Astokh and Lunsok oil and gas fields"). However, after the Council of People's Deputies was disbanded in 1993, control over the fulfilment of this important social component was lost.

The Sakhalin Region repeatedly made significant concessions to the projects operators. In 1994, having concluded the Agreement on Sakhalin II, the royalty rate was baselessly underestimated (it was 6% versus 8% under the Sakhalin I project that was adopted in 1995). In 1997, the Sakhalin Regional Duma adopted the Region Laws on concessional taxation for the Sakhalin I and Sakhalin II projects. Afterward, similar regulations were adopted by national legislators (the Federal Law "On Changes and Amendments to the Legislative Act of the Russian Federation derived from the Federal Law "On Product Sharing Agreements"" of February 10, 1999 # 32-FL). The Region also agreed with advance oil extraction since 1999 and with the export by the tanker shipping.

According to the agreement that has been signed by the Russian Government and Sakhalin Region Authorities, the Sakhalin Region has been recognized as "the preferable territory for the supply of natural gas delivered on the domestic market". In addition, the volume of gas that should be delivered to Sakhalin Region has been determined by the paragraph 5 of this agreement. There should be 2.5 billions cubic meters of gas in 2005, 5.25 billions cubic meters of gas in 2010, and 6.26 billions cubic meters of gas in 2015. The provision of gas for the Region has been provided by "Social and Economic Development of the Far East and Transbaikalia for 1996–2005"; a special federal program in which RUR278 billions of capital investments for the construction of gas circuits, gas-distributing stations and booths, and other facilities for the gas provision were planned. The region's gas demand was estimated as 6 billions cubic meters of gas per year. However, the Russian Federation has not met these commitments and there was no

infrastructure for the gasification of Sakhalin Region. Sakhalin Region had no chance to accomplish the provision of gas because the annual superdividend was sufficient to cover urgent needs only, and also the Russian Federation canceled the agreement on the sharing of a royalty between federal and regional budgets, and, as a result, the fiscal, budget and product-sharing agreements legislations were changed (see paragraphs 50, 56 of the Budget Code of the RF, paragraph 346.35 part II of the Tax Code of the RF, paragraph 10 of the Federal Law “On Product Sharing Agreements”). At the same time, federal law “On Federal Budget for 2006” № 189-FL, of December 26, 2005, determines the following rates for the cost equivalent of the state share of profitable products under PSA Sakhalin II: 50% to the Federal Budget and, 50% to a budget of a subject of the Russian Federation (paragraph 17). This allows either to order a detailed project for gas provision facilities or to raise loans for this project.

The operator of the Sakhalin II project, Sakhalin Energy, has not yet considered gas take-off stations to be built at the same time as building a gas pipeline to the south of Sakhalin. This situation brings sound dissatisfaction of the people. The highway Nogliki–Yuzhno-Sakhalinsk–Korsakov–Prigorodnoe, significant part of which haven’t the hard surface, in fact, was turned into an engineering route, in spite of the fact, that several bridges had been fixed by the project operators and their contractors, and the significant part of this road has been broken by heavy machineries of builders who construct the main gas pipeline from the extraction site to the Liquid Natural Gas (LNG) Plant in Prigorodnoe village of Korsakov District. Inhabitants of the municipal formation “Korsakov District,” revolted by the Sakhalin Energy treatment of highways which haven’t yet gotten a hard surface in the construction area of the major LNG Plant in the country, repeatedly blocked traffic on them.

Meantime, Sakhalin Energy is planning to double reimbursable expenses for the project. The deputies of the Sakhalin Regional Duma consider the postponement of the southern Sakhalin gasification until 2013-2014 to be inadmissible. This is in line with the proposals of the President of the Russian Federation on speeding-up the gas provision in the country, i.e., in fact, with the new State Plan.

Sakhalin Regional Duma

DECREE

1. To admit the current phase of Sakhalin I and Sakhalin II projects to be insufficiently effective for Sakhalin Region inhabitants as a result of the centralization of revenue at Federal level, as well. To note an increasing anthropogenic pressure on extremely valuable Sakhalin ecosystems caused by the large-scale construction of the key infrastructure facilities for the Sakhalin projects at the Region.

2. To make a request to the President of Russia Federation, V. V. Putin, to assume the personal control over the gas provision for the districts of Sakhalin Region along the main gas pipeline built as part of the Sakhalin I and Sakhalin II projects.

3. To suggest to the Prime Minister of the Government of the Russian Federation, M. E. Fradkov, and to the Sakhalin Region Governor, I. P. Malakhov, to entrust Russian representatives on the project managements to:

3.1) include the additional costs for development and maintenance of a hard surface of the highway, such as Nogliki–Yuzhno-Sakhalinsk–Korsakov–Prigorodnoe, caused by worsening of their technical conditions as the loading have been increased, into the Development Budget for the Integrated Development Plan when the Supervisory Council of the Sakhalin II project will

approve amendments to the Budget to complete the construction of the projects' infrastructure until the commissioning of infrastructure facilities (2008);

3.2) include the additional costs for the construction of a hard surface of the Chaivo–Nogliki road until the commissioning of oil pipeline and for the construction of a hard surface of the Nogliki–Okha road when Odoptu field development will be started at 2009–2010 into the Development Budget for the Construction and Development Plan under the Sakhalin I project;

3.3) Supervisory Council of the Sakhalin II project should include the costs for the construction of gas off-take stations at Yuzhno-Sakhalinsk and Korsakov, and for block valve stations located near the settlements which are situated along the main gas pipeline, into the Development Budget for the Integrated Development Plan;

3.4) raise the question of doubling the contribution to the Sakhalin Development Fund provided by the Product Sharing Agreement when approving amendments to the Development Budget for the Integrated Development Plan for Sakhalin II

4. To file respective appeals to the operators of the Sakhalin I and Sakhalin II projects.

5. To suggest to the Russian party in the Supervisory Council of the Sakhalin II project to raise the question of the commissioning of the main gas pipeline only if a hard surface of highways and the required number of gas take-off stations will be constructed.

6. To suggest to the Government of the Russian Federation and to the authorities of Sakhalin Region to:

6.1) to draw up the proposal on obtaining the loan for the social and economic development of Sakhalin Region which will be repaid from the Sakhalin Region Budget revenue originated from sales of products of the oil and gas projects — Sakhalin I and Sakhalin II;

6.2) to negotiate with the Sakhalin II operator about the early allocation of the Russian share of the total gas volume until the project payback;

6.3) to address the issue with regard to the possibility to sell gas to Sakhalin Region consumers at the Russian domestic market price to the benefit of Region residents;

6.4) to negotiate with the operators of the Sakhalin I and Sakhalin II project about the possibility to transfer idle capacities of self-contained energy sources built as a part of oil and gas projects into the grid of the Sakhalin Island Electric Utility.

7. The Sakhalin Region authorities together with concerned federal departments, Joint Stock Company “Rosgazifikatsia”, and Rosneft-Sakhalinmorneftegaz should develop the Regional Gasification Program in compliance with paragraph 2 of the Regulation of the Russian Government of July 24 1999, #852 “About the Gasification Program for Sakhalin Region, Khabarovsk Territory and Primorie Territory” and submit the Program to the Sakhalin Regional Duma for approval it as a regional legislation until November 1, 2006.

8. To approve the first vice -governor of Sakhalin Region, S. G. Sheredkin, (as agreed) and the deputy of Sakhalin Regional Duma, S. A. Ponomarev, as the heads of the working group for maintenance of oil and gas project (formed by the Sakhalin Regional Duma according to the Regulation #4/7/206-4).

9. To forward the Decree to the President of the Russian Federation, V. V. Putin, to the Chairman of the Council of Federation of the Federal Assembly of the Russian Federation,

S. M. Mironov, to the Chairman of the State Duma of the Federal Assembly of Russian Federation, B. V. Gryzlov, to the Prime Minister of the Russian Government, M. E. Fradkov, to the Ministry of Natural Resources of the Russian Federation, to the Ministry of Economic Development and Trade of the Russian Federation, Ministry of Regional Development of the Russian Federation, to the Plenipotentiary of the President of the Russian Federation in the Far East, K. Sh. Iskhakov.

10. To entrust the Chairman of the Sakhalin Regional Duma, V. E. Efremov, to suggest to the Plenipotentiary of the President of the Russian Federation in the Far East, K. Sh. Iskhakov, to ask the President of the Russian Federation, V. V. Putin, to assume the personal control over the gas provision for the districts of Sakhalin Region along the main gas pipeline built as part of the Sakhalin I and Sakhalin II projects.

11. To suggest to the members of the Council of Federation of the Federal Assembly of the Russian Federation, B. N. Tretiak and B. N. Agapov, to support this Decree among the federal authorities.

12. To consider the report on the fulfillment of the Decree on November 2006.

13. To publish the Decree in the “Gubernskie Vedomosti” newspaper.

14. To impose control over the fulfillment of the Decree on the Chairman of Sakhalin Regional Duma V. I. Efremov.

V. I. Efremov

Chairman of the Regional Duma