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Russian Far East News

Alaska Center for International Business • American Russian Center • University of Alaska Anchorage

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New economic development master plan for the Far East

Doug Barry

Central planners have given residents of the Russian Far East a New Year's present: a master plan for economic development through the year 2005. Actually, the plan was announced on the eve of the Russian general election last year, and it's possible that the timing was no accident. President Boris Yeltsin received a majority of votes from the region. Unlike his opponents, he at least had a plan for the Far East.

The plan, written by the Council for Location of Productive Forces and Economic Cooperation, aims to deal with the current economic crisis in the region, then work on infrastructure improvements that will sustain growth into the next century.

In an English-language version which appeared in the October 1996 report of the local Japanese-government supported Economic Research Institute for Northeast Asia, the plan catalogs the region's numerous problems and unrealized potential. The problems include: a withering of central government subsidies and investments; increased transportation and energy costs; big cuts in military procurement which have devastated the main industrial base of the Far East; fracturing of Soviet era trade links with the central and western parts of Russia; and plummeting output of natural resource-based industries.

Social woes

The economic woes have created social welfare problems. Due to the high cost of living and other factors, Russian Far East residents' disposable incomes have fallen below the Russian average. Existing housing is in a mostly deplorable state. Unemployment is

growing and people, among them some of the most capable workers, are leaving. The total population of the Russian Far East and Trans-Baikal region is now 9.9 million, down 500,000 since 1989.

... the authors of the new plan ... hope to focus on fewer goals and to spend more money.

Acknowledging the failures of previous grand schemes of central government design, including one called the *Program of the Russian Far East*, which disappeared with the collapse of the Soviet Union, the authors of the new plan, among them Alexander Granberg—academician, Yeltsin economic advisor, and a former visiting professor at the University of Alaska Anchorage—hope to focus on fewer goals and to spend more money. The new plan will also have two additional features: frequent rejiggering of program goals ("the principle of 'sliding' realization"); and a greater effort to integrate the economy of the Russian Far East with those of Japan, South Korea, and China.

Opportunities for foreign suppliers

The plan has a number of specific goals. One is to overcome fuel shortages by increasing local coal production. Second, enterprises

continued on next page



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Please note: Russian words for administrative units are translated as: krai-territory; oblast-province; okrug-district. Adjectival endings (ii in Khabarovskii, aya in Khabarovskaya, etc.) have been eliminated, except for addresses.

We welcome articles and letters from our readers. We reserve the right to edit submissions. Please include a telephone number and a short biographical note.

From the editor

This month's biggest news is Russia's oil spill off the coast of Japan (see *Environment*). The Japanese are already unhappy about Russia dumping liquid nuclear waste in the Sea of Japan. Now they have the second-largest oil spill in their nation's history to contend with. Besides being a foreign relations nightmare for Russia, the spill means even worse energy shortages in the Russian Far East. One possible silver lining in this cloud is that Russia might move a bit faster to approve Sakhalin oil and gas development plans and production-sharing agreements. The tanker that broke apart in rough seas was carrying fuel oil from Shanghai, China, according to the Associated Press. If that fuel oil was available locally, there would be no need to be transporting it from Shanghai.

Another possible scenario, though, is that the Russian government approvals process will slow considerably, as officials check whether

tankers that will transport oil and liquefied natural gas from Sakhalin to export markets are sea-worthy.

In any case, relations with Japan, already strained over ownership of the Kurils Islands, may take a turn for the worse. With the nuclear waste dumping problem, Japan responded by funding a nuclear waste processing facility in Primorye. Will they respond now with funds to increase the sea-worthiness of Russian tankers, if a lack of sea-worthiness was the problem in this case? Somehow, after seeing photographs of Japanese workers thigh-deep in sludge, it's hard to imagine. We may, instead, see Japan spending considerable funds on oil-spill clean-up materials and technologies. ☐

Anne Sudkamp

New economic development master plan, cont.

supplying power will get tax breaks and local governments will get more subsidies to help lower costs to consumers. Third, deeper cuts in transportation costs to and from the Far East will be proposed, and the government may encourage more food imports from neighboring countries as one way of putting cheaper, higher quality food in the marketplace. These bits of the plan—more help generating fuel supplies and imported food—may create more business opportunities for U.S. suppliers in Alaska and Washington.

Another area in the plan for possible increased foreign participation is in seafood, mining, and timber. The plan boldly calls for the expeditious removal of many barriers to offering up more natural resources for sale in Russia and to countries in the Asia Pacific region. On offer will be the following: development of oil and gas fields in Sakhalin and Sakha; diamond deposits in Sakha; gold in Kamchatka; tin in Khabarovsk and Primorye; timber in Khabarovsk; seafood in the eastern seas; and tourism in Kamchatka.

Foreign investment is to be enthusiastically courted and barriers to foreign participation removed, including onerous permitting,

licensing, and import/export tariffs. In addition, cash handouts and cheap credits may be available to local enterprises for purchasing foreign equipment and technology.

Billions needed

Foreign investment in a country without much so far is seen as key because the plan has the Russian federal government ponying up only 49% (a Russian-language version of the plan put the government's share at 90%) of the estimated \$82 billion needed to reverse the Far East's present fortunes (see tables on page 3).

What is the likelihood that the plan will get off the ground and what do residents of the Far East think of it? At first blush, the plan resembles the grand state plans of the old Soviet system. A major difference may be that central planners have perhaps made a greater effort to include local government officials in the process and seem sincere about making the Far East more autonomous.

The plan as published in the Japanese and local Russian press, however, seems remarkably free of specifics, cannily suggesting in language sure to be included in future parodies of government bureaucrats that results are

New economic development master plan, continued

Master plan financing (by %)

Source	1996	1997	1996-2005
Federal budget of Russia	20.7	36.0	23.0
Federal target programs	29.9	22.0	26.0
Federal highway fund	5.3	3.0	4.0
Other federal sources	14.7	13.0	13.0
Local sources	9.3	5.0	8.0
Investor's money	20.1	17.0	20.0
Program implementation fund	-	4.0	5.0

Money needed for plan (in billion 1995 rubles)

1995	8,995.6
1996-1997	75,942.4
1998-2000	144,998.9
2001-2005	150,470.8
1996-2005	371,411.6

Money needed for plan, 1997 (in billion 1995 rubles)

Total	40,974.5
Federal budget financed	23,828.9

Source: Alexander N. Pilyasov

subject to the "principle of sliding realization." This caveat suggests that if goals prove to be pie in the sky, the door is left open to blame others or to claim symbolic successes.

As a practical matter, it is unclear how the central government will raise its share of the funds required, and centrifugal forces at work within individual ministries overseeing various kinds of development projects and between and among central and regional government authorities could turn implementation into a nightmare. Critics of the plan point to the Nakhodka Free Economic Trade Zone, which they say has been a big disappointment because of meddling from Moscow.

"Cynical sand castle"

One Magadan economist pronounced the plan *deja vu* all over again, and called it a "cynical sand castle guaranteed to disappoint the long-suffering residents of the Far East." Still, a grand state plan may be better than no plan at all. And the plan's call for creation of a development bank in the Far East to be run like a business suggests that at least some of the grand planners have looked outside Russia for some potentially-useful models. Also, the planners are shopping their schemes for the Far East to government and business leaders in Asia, particularly Japan, which is anxious to get the Kuril Islands back and may be ready to strengthen its bargaining position by dangling some serious money for Russian Far East development. It may be no coincidence that a draft of the plan was reportedly shared with an audience in Northern Japan before it was circulated in Russia.

Building better castles

The cynics might also admit that they're living in a different country now, one that this year will be in a better position to fund sand as well as other kinds of castles. For one thing, some western economists predict that Russia will reverse years of economic decline, and GNP will grow 3% in 1997. ☐

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About Sources

American Russian Center offices in Khabarovsk, Magadan, Yakutsk and Yuzhno-Sakhalinsk provide weekly information on the business climate in the Russian Far East. The American Russian Center is funded by a grant to the University of Alaska Anchorage from the U.S. Agency for International Development. The center's mission is to assist Russia in its transition to a market economy by providing comprehensive training in business operations. Contact the Anchorage office. Tel.: (907)786-4300. Fax: (907)786-4319.

BISNIS, the Business Information Service for the Newly Independent States, provides reports from a variety of U.S. government sources, including BISNIS specialists, the American Embassy in Moscow, and the U.S. & Foreign Commercial Service in Vladivostok. BISNIS is a division of the U.S. Department of Commerce, International Trade Administration. Tanya Shuster is the BISNIS trade specialist who focuses on the Russian Far East. Tel.: (202)482-4655 ex. 23. Fax: (202)482-2293. E-mail: shuster@usita.gov.

World Trade Center Alaska (WTCAL) provides information on international trade through its weekly publication *Trade Winds*. WTCAL is a membership organization based at the University of Alaska Anchorage. Its mission is to promote Alaskan member companies in the international trade arena. Tel.: (907)278-7233. Fax: (907)278-2982.

Troika Alaska is a program of the World Trade Center Alaska that operates offices in the RFE in Khabarovsk and Yuzhno-Sakhalinsk. The Yuzhno-Sakhalinsk office publishes the *Sakhalin Oil & Gas Report*, a weekly information brief on the status of the oil & gas development projects on Sakhalin Island. Troika Alaska also leads trade missions to the RFE and provides representative office services for companies interested in establishing a presence there. Contact Kathy Beeck, program manager. Tel.: (907)278-7233. Fax: (907)278-2982. E-mail: 75362.1020@compuserve.com.

Career Opportunities

Vostokles seeks manager

Vostokles, a Russian joint-stock company owned principally in Homer, AK, seeks a business manager to be stationed in Khabarovsk. Vostokles manufactures wood products for export to Pacific Rim countries. Manager must be fluent in Russian and English and must have demonstrated experience in business management. Tel.: (907)235-8141. Fax: (907)235-8590. E-mail: vostokls@ptialaska.net.

Communications

Khabarovsk exhibition

On December 15 an annual exhibition on telecommunications opened in Khabarovsk. One of the companies that is participating in the exhibition is Daltelecom International, a Russian-American joint venture. It is the only company in Khabarovsk that provides cellular communication. At the moment, about 500 people have cellular phones. *Pacific Star* (12-17-96) by American Russian Center, Khabarovsk.

Cellular service in Primorye

Cellular telephone service is now available in several cities in the RFE, including Vladivostok, Khabarovsk, Yuzhno-Sakhalinsk, and Petropavlovsk-Kamchatskiy. In Primorye there are currently two operational cellular systems, Primtelefon and AKOS. Another one, NTK, is in the works.

Primtelefon is a joint venture between CommStruct International, a subsidiary of Global TeleSystems Group of the U.S., and Electrosvyaz of Primorye. It holds the NMT 450 license, covers Vladivostok, Artem, and Nakhodka, and has acquired 2,000-2,500 subscribers since it went into service in late 1995. Initial cost of service ranges from \$1,500 to \$3,000. The company has the advantage of effectively unlimited growth thanks to ease of interconnect resulting from Electrosvyaz's participation.

AKOS is two-thirds owned by Russian Telecommunications Development Corp., primarily owned by US West; the remainder is owned by local investors. It operates a Hughes ETDMA digital system on the GPS 800 standard, has been in service since early 1995, and has a similar number

of subscribers as Primtelefon. AKOS, however, is constrained by interconnect considerations—not all of its subscribers can be provided access to the city telephone network and the quality of the interconnect is relatively low. The problem has plagued the company for some time.

In 1993 the right to a GSM 900 license was awarded to United Telecom, a joint venture between US West and Rostelekom, but it did not implement the system. The license was rescinded in 1995 and awarded to New Telephone Co. (NTK). Shareholders of NTK include a Singapore-based holding company (49%) and ACFES of Vladivostok. NTK is a 22% shareholder of Electrosvyaz.

NTK has been a player in the Primorye telecommunications market since at least 1993, when it received from Electrosvyaz the right to provide local wireline service in districts of Vladivostok. The company installed a switch from South Korea two years ago and currently provides wireline service to 20,000 customers. NTK is planning to provide GSM 900 cellular service in 1997. *BISNIS* (12-19-96).

Conferences, Trade Missions, & Shows

In the U.S.

Construction, Oil and Mining Exposition (PAC COM Expo). February 11-12. Sullivan Arena, Anchorage. Russian representatives including Sakhalin Governor Igor Farkhutdinov and Sakhalinmorneftegas Deputy Director Sergei Zyemiliyuk will participate in round-table discussions with Alaskan businesses. Contact: Sourdough Productions. Tel.: (907)277-7469. Fax: (907)272-7372. E-mail: sourdo@alaska.net.

Pacific Rim Coal Conference. May 10-13. Anchorage. This twelfth annual conference will feature Alaska and the RFE. Contact: World Trade Center Alaska. Tel.: (907)278-7233.

To Russia

Trade Mission to Yuzhno-Sakhalinsk. Tentatively February 23. Troika Alaska is organizing this trade mission which will include briefings and meetings with oil consortium and Sakhalin administration officials. Tel.: (907)278-7233. E-mail: 75362.1020@compuserve.com.

State of AK Trade Mission to Yuzhno-Sakhalinsk. Tentatively in March. Governor Tony Knowles will lead this mission open to Alaskan companies. Tel.: (907)465-3500.

In Russia

Please note: most contact information is given at the end of this list.

Computer-Soft '97. February 3-10. Khabarovsk. Computer hardware and software; office equipment. Organizer: FEITC.

Architecture, Construction & Design '97. March 24-31. Khabarovsk. Building products, equipment and services. Organizer: FEITC.

Moscow International Oil and Gas Exhibition MIOGE '97. April 7-10. Moscow. World Trade Center Alaska is organizing a delegation to this fourth annual exhibition. Contact: World Trade Center Alaska. Tel.: (907)278-7233.

Dallesexpo '97. April 21-28. Khabarovsk. Timber and wood products and processing equipment. Organizer: FEITC.

Fair organizers

FEITC (Far Eastern International Trade Center). Contact: Evgeniy V. Panasenkov, President. Address: Russia; 680038 Khabarovsk; 60 Seryshev St., Office 101. Tel.: 7(4212)343-967. Fax: 7(4212)332-999 (ask operator for #403096).

In other countries

Financing Mining Projects in the Emerging Markets. February 24-25. London. Euromoney Seminars and Interfax News Agency will sponsor this conference which will include presentations on Russia, Uzbekistan, Poland, and other emerging market countries. Tel.: 44-171-779-8793. Fax: 44-171-779-8795. E-mail: emp.seminars@dial.pipex.com.

Oil & Gas Pipelines in the Former Soviet Union. February 26-27. Vienna. Organized by the Adam Smith Institute. Contact (in London): Ailsa McNeal. Tel.: 44-171-490-3774. Fax: 44-171-490-2362.

Fourth North Pacific Rim Fisheries Conference. April 22-24. Tokyo. The Alaska Center for International Business, University of Alaska, Anchorage, the Ministry of Foreign Affairs of Japan, Ministry of Agriculture, Forestry and Fisheries of Japan and the Japan Fisheries Assn. will sponsor this conference which serves as a focus for government managers and industry representatives to discuss

management and marketing developments in the North Pacific. Contact: Shawneen Conover at the Alaska Center for International Business. Tel.: (907)786-4300. Fax: (907)786-4319.

Economy

Notes on Magadan

Molly Davenport, director of the American Russian Center-Magadan from 1994-1996 and an intern for Audubon in Magadan in 1991-1992, offers the following observations on changes there (see also *Politics*):

- For a city of its size, 120,000-130,000, Magadan has a large number of scientific research institutes. With the decrease in funding from Moscow over these five years, many of these institutes are floundering.
- Magadan is more active in its ties to the U.S. than any other RFE region, and connections to Alaska are especially strong. The region has had ties to the University of Alaska since 1989-1990, which has spurred steady growth in Alaskan connections ever since. Two notable Alaskan companies in Magadan are Alaska Russia Company and N.C. Machinery. Still, some U.S. companies are coming in with unreasonable expectations and little understanding of the region, and are losing their shirts.
- In 1991, foreign goods were not available in the city of Magadan. Today plenty of foreign goods, especially food from the U.S., is available.
- Few residents of the city of Magadan are aware of the Kubaka project or seem to be affected by it.
- In general, gold mining is not as profitable as it used to be. Much of the region was developed for gold mining, and now there is a lack of support for maintaining the infrastructure needed for mining. The question remains how to revive the economy.
- The region has seen a shift in its population, as Ukrainian nationals and people originally from Western and Central Russia left for home in 1991-92, and residents of smaller communities in the region moved to the city of Magadan.
- Energy problems have not reached the crisis stage of some other RFE regions. Apartments in the city of Magadan still have electricity and hot water at most

times, although heat is supplied at a lower level than in 1991-1992.

- The biggest problems for foreign companies in Magadan are that the tax, business, and customs laws and regulations are changing constantly. Customs especially seems to be trying to pull in more revenue (see also *Travel*).
- It has become much easier to change money, although even now banks may be closed when they are listed as open, or they may say they do not have the money to change—arbitrariness still plays a role.
- In 1991-1992 with the recent break-up of the Soviet Union and the country reeling in hyper-inflation, Magadaners seemed shell-shocked. Today morale may not be high, but people have adjusted to the changes.
- Socio-economic stratification is occurring. For the first time you can see visible signs of wealth among a few Magadaners—foreign vehicles, especially. For people who have been drilled all their lives about the virtues of equality, this change is hard to take.
- Crime has increased over these five years. Now many people have heavy metal doors and massive locks on their apartments and businesses. People talk about crime more now.

Consumer prices in Yakutsk

Following are prices in rubles for food and consumer goods in Yakutsk in early January. The ruble: 1 dollar exchange rate was approximately 5.895.

10 eggs	15,000
1 liter milk	5,800
1 loaf bread	5,800
1 kilo apples	18,000
1 kilo rice	7,900
1 kilo sugar	6,100
1 liter gasoline	3,600
.5 liter Stolichnaya vodka	21,500
1 pack Marlboro cigarettes	7,500
1 Snickers bar	4,500

Total 95,700 (\$16.23)

Also note the following totals for these items in 1996 in Yakutsk:

early Jan.	83,900-85,800 (\$18.24-18.65)
early March	75,613 (\$15.70)
early April	79,150 (\$16.28)
early Dec.	90,700 (\$16.49).

Sakha American Business Education Center (American Russian Center).

Inflation down sharply

Russia's yearly inflation fell to 21.8% in 1996, down sharply from 133% in 1995.

said the State Statistics Committee. The 1997 federal budget assumes a rate of 11.8% for 1997. The government's tight money policies, sanctioned by the International Monetary Fund, are largely regarded as the reason for the drop.

Still, the picture is not completely rosy, as industrial output is expected to have fallen 5% for 1996, slightly sharper than the 3% fall in 1995. *Associated Press* (1-7-97) and *Capital Markets Report* (12-12-96).

Some economic crime statistics

In its December 1996 issue, CIS Law Notes offers the following notes on economic crime in Russia:

- Russia has a prison population of 1.3 million, giving it the highest incarceration rate in the world. Approximately 800 per every 100,000 Russians are presently incarcerated; the Western European average is 50 per every 100,000 persons.
- About 50 trillion rubles a year are currently laundered through illegal commercial structures.
- Laundering money is the source of most illegal incomes in Russia and a kind of system has involved. First, the illegally-obtained money is deposited in a foreign bank, then it is transferred to a second bank, and then to a third, and so on. After several transfers, the money is invested—most often in activities that further criminal activity.
- At present, only 16% of all Russian companies pay taxes regularly. As of October 1, 1996, tax arrears in Russia had reached \$24.4 billion.

Energy

See also *Environment*

Energy crises

All the thermal power plants in the coastal region are in critical condition. On top of the lack of crude oil, consumer debts have increased, amounting to 1 trillion rubles as of January 10. The plants are prepared to cut off power for a time in the coastal region after January 10.

The temperature for early morning January 10 in Khabarovsk was minus 30 degrees Celsius. At present electricity to

continued on next page

Energy, continued

homes is stable, but the thermal power plant in Ushakovsk has only enough coal to last another week. *Dalnevostochnaya radio* (1-10 & 1-11-97).

Environment

Oil spill off Japan

On January 2 the oil tanker *Nakhodka*, traveling from Shanghai, China to Kamchatka with 5 million gallons of fuel oil, broke apart and sank in rough seas about 90 miles off Japan's western coast, spilling 962,000 gallons into the Sea of Japan. Thirty-one crew members were rescued, but the ship's captain is missing. The cause of the accident is not known.

By January 7 the oil had fouled about three miles of beach at Mikuni, a summer tourist spot about 200 miles west of Tokyo, and several other large slicks were still moving. The drifting bow of the ship ran aground off Mikuni and may hold some fuel oil, but the still-sunken stern is believed to hold most of it. Stormy weather hampered efforts to prevent the oil from reaching beaches.

By January 9 dead birds were washing up on the oil-covered beaches.

By January 12 the oil had soiled a 125-mile stretch of shoreline. It had also reached a barrier set up around the Takahama nuclear power plant, threatening operations there and at several nearby reactors. Plant officials said that, as long as the amount of oil entering the area remained small, they would be able to prevent damage. The plants use sea water to cool their steam-generated turbines.

Fishermen fear the spill will ruin the seaweed, abalone and shellfish cultivated in the area. Tourists are already canceling reservations for the summer season.

The spill is the second-largest off Japan, eclipsed only by a 1971 spill of 1.87 million gallons near Niigata port.

The sinking has worsened an energy crisis in the RFE. Another tanker bound for Petropavlovsk-Kamchatskiy is not expected to arrive before January 11; until then power to homes and businesses on Kamchatka will be limited to 6 hours a day.

The Russian government has also promised to send immediately 10 thousand metric tons of fuel oil from the Pacific Fleet's reserves to Kamchatka. *Associated Press* (1-5, 1-6, 1-8, 1-9, 1-10, & 1-13-97) and *Dalnevostochnaya radio* (1-8-97).

More reindeer die

More than 10,000 reindeer out of a population of 240,000 have starved to death in Chukotka after about 70% of pastures on the peninsula became encased in ice after heavy rains in November were followed by extreme cold. Regional defense chief Yuri Zhulin said that losses have reached more than \$1.2 million. *Associated Press* (12-15 & 12-24-96).

Finance

Ruble continues slow fall

Following are ruble: 1 dollar exchange rates:

December 4	5.515
December 11	5.524
December 18	5.540
December 25	5.553
December 30	5.555
January 6	5.895

Capital Markets Report and *Sakha American Education Center* (American Russian Center).

IFC to add Russia to index

As of February 1, the International Finance Corporation (IFC) will add Russia to its family of investable indexes, a move considered to herald a new level of legitimacy for the Russian financial markets. One IFC index, the Russian Global Index, has advanced 144.5% since December 31, 1995, illustrating Russia's position as the world's top performing emerging market. *Capital Markets Report* (12-19-96).

Information Resources

Troika Weekly Report is no more

Due to a lack of financial support, the *Troika Weekly Report* will no longer be published. Troika, though, will begin publishing *Sakhalin Oil & Gas Report*, a weekly briefing from its Yuzhno-Sakhalinsk office. Contact Kathy Beeck, Troika

program manager. Tel.: (907)278-7233. Fax: (907)278-2982. E-mail: 75362.1020@compuserve.com.

Economic cooperation with the RFE

The American Chamber of Commerce in Russia has prepared a White Paper on Economic Cooperation between the Russian Far East and the U.S. West Coast and Alaska. Contact the American Chamber. E-mail: amchamru@online.ru.

Investing in Russia's Securities Market

Investing in Russia's Securities Market: An Independent Assessment of the State of Play is the Geonomics Institute's most recent publication. It discusses investment options in Russia, their safety, and how to invest. Appendices includes directories of Russian brokers-dealers, banks, internet and other information providers, and other useful information. Tel.: (802)388-9619. Fax: (802)388-9627.

Mining articles

- In *Unraveling Russian law*, Mining Journal (11-29-96) discusses legal issues in Russia pertaining to mining.
- In *Russian technical and economic assessments*, Mining Magazine (12-96) discusses differences in western and Russian approaches to estimating resources and reserves.
- In *Russia's diamond production*, Mining Journal Diamond Supplement (11-22-96) provides an overview of the diamond industry in Russia.

For all publications, contact: Tel.: 44-171-216-6060. Fax: 44-171-216-6050. E-mail: mjournal@easynet.co.uk.

Smart Link catalog

The company offers Russian fonts, translation software, electronic dictionaries, etc. Tel.: 1-800-256-4814.

BISNIS reports

Following is a list of reports BISNIS has recently prepared and/or distributed that may be of interest to a company doing business in the RFE:

- *Key Contacts for U.S. Business in the Russian Far East*. Includes contact information for American Russian Center offices, American Business Centers, U.S. government agencies, and other organizations that can help a U.S. company;
- *Overview of Major Ports and Port Projects in the Russian Far East*. Includes

comprehensive contact information for RFE ports and maritime agencies, and U.S. shippers and freight forwarders; *International Money Transfers*. A how-to guide on transferring money in and out of Russia;

- *Moving your Money*. A how-to guide to sending money back and forth between Russia and the U.S. Printed in the December 1996 issue of *BISNIS BULLETIN*.
- *A Shipping Guide to Russia*. Includes information on freight forwarding; export documentation; shipping air freight; freight insurance; customs bonded warehousing; and import licenses, passports, duties and taxes.
- *Overview of the Timber and Wood Processing Industry in Khabarovsk Territory*. Includes a section on timber exports and includes contact information for Khabarovsk government officials and timber companies;
- *U.S. Trade and Investment Days in Nakhodka and Vostochniy, January 13, 1997*. From their visit in early October 1996, BISNIS officials provide an overview of the two cities with information on opportunities and a list of key contacts.

Most, if not all, of these reports are available both on-line or in hard copy. Tel.: (202)482-4655. Fax: (202)482-2293. E-mail: bisnis@usita.gov.

International Update

General

Foreign missionaries encountering resistance. At the break-up of the Soviet Union, foreign missionaries flocked to Russia and they were warmly received. Now interest among Russians has faded some and the Russian Orthodox Church has become increasingly critical of the foreign influx. Currently the Vladivostok region is home to 130 registered churches, temples, and other religious centers, including a traveling Danish Buddhist lama to a Hare Krishna cafe to a small congregation established by Sun Myung Moon's Unification Church. *Associated Press* (12-30-96).

Japan

Kuril officials to visit Tokyo. A group of representatives from the southern Kuril Island district will visit Tokyo to discuss

visa-free exchanges. The group will also confer with the Foreign Ministry about the following three proposals: the construction of a regional culture center, a credit grant for the building of a hotel, and the establishment of air service between Kunashir and Hokkaido. *Sakhalin T.V. and Radio Company* (1-13-97).

United States

Tim Smith goes to Moscow. Tim Smith, U.S. Commercial Service Officer for the Russian Far East, is heading for an assignment in Moscow. His replacement is Richard Steffens, who is arriving in Vladivostok from Moscow. E-mail: steffens@usita.gov. *World Trade Center Alaska* (12-16-96).

Provideniya requests donation of an x-ray machine. Former Nome, Alaska resident Dazee' Listenkova, who now lives in Provideniya, notes the town needs a portable x-ray machine of some sort with film or access to purchase film. There is no modern (30 years or newer) x-ray machine available. Contact the World Trade Center Alaska. Tel.: (907)278-7233.

Group wants to swim across the Bering Strait. The Universal Marathone Cold Swimming Association in Moscow has requested visa invitation letters from the Nome, Alaska city council so that a group of its members can attempt a swim from Cape Dezhnev, Chukotka to Cape Prince of Wales, Alaska in July and August. Nome officials were cautious in their response because the city has dealt with a number of Russian citizens needing more hospitality than Nome expected. *Associated Press* (1-16-97).

BISNIS seeks success reports. BISNIS is conducting an assessment of its role facilitating U.S. business successes in the NIS. If any of BISNIS' trade/partner leads or reports led your company to a fruitful commercial transaction, BISNIS would appreciate hearing about it. BISNIS will strictly guard any business-sensitive information and will not use direct references to your company without your clearance. The information BISNIS seeks is: your company name; source/date of BISNIS information; Russian/NIS company; any dollar figures/results, including projected figures; and whether you grant clearance to include your company name in reference to a BISNIS "success story." Tel.: (202)482-4655. Fax: (202)482-2293. E-mail: bisnis@usita.gov.

Mining

See also Information Resources

Coal

Coal funding shortfall. Rosugol, the national coal company, estimates that the industry needs a minimum of 18.4 trillion rubles in federal subsidies. The 1997 federal budget, however, contains only 6 trillion rubles of subsidies. Nationwide coal miners are owed an average of three months' back-pay, amounting to a total of 2.4 trillion rubles, and they have held a number of strikes in 1996 protesting non-payment of wages. *Mining Journal* (11-29-96).

Six killed in explosion. Six coal miners were killed in an explosion at the Kadychan coal mine in Magadan Province. The explosion is thought to have been caused by either coal dust or methane. *Mining Journal* (11-29-96).

Diamonds

Caterpillar sells in Sakha. Caterpillar Overseas has sold 40 Caterpillar machines and spare parts worth \$36.5 million to Almazy Rossii-Sakha (ARS). The U.S. Export-Import Bank provided a \$54.4 million loan guarantee to support the sale of \$60 million of U.S. mining equipment and services to be exported by Caterpillar and several other manufacturers. ARS purchased its first Cat machine, a mining truck, in 1988. Since then Caterpillar has supplied more than 70 pieces of equipment. Contact: Caterpillar Overseas. Address: Case Postale 6000.; 1211 Geneve 6; Switzerland. Tel.: 41-22-849-4432. *Mining Magazine* (12-96).

Diamond agreement awaits approval. De Beers and Almazy Rossii-Sakha (ARS) reached an agreement on marketing Russian diamonds in September 1996 and now are awaiting approval from the Russian government. The last formal agreement expired at the end of 1995, but De Beers has continued to buy diamonds from ARS under the old agreement while negotiations continued. De Beers has stated, though, that it will not continue to do so after the end of 1996.

Under the agreement, Russia again may keep 5% of its uncut diamonds for its domestic diamond-cutting industry, and it may also sell up to 20% of its cut diamonds within a range of \$550 million to \$1.3 billion from existing stockpiles.

continued on next page

Mining, continued

Some Russian authorities, however, wish to develop the country's diamond-cutting industry and would like a greater share of uncut diamonds. Evgeny Bychkov, president of the Russian Association of Diamond Manufacturers, even suggested that the industry could grow enough in one year's time to absorb the whole of the country's production of rough diamonds.

For their part, De Beers is unwilling to see as many Russian diamonds leak out onto the market outside its deal with Russia. In the past six months or so, there have been large leakages of Russian rough diamonds onto the market, and in the past three years, Russia has sold about \$550-\$800 million a year in diamonds from its stockpile, also outside the contract. De Beers hopes that Russia will see the advantage that a 'bankable' contract with its Central Selling Organization will have for attracting foreign investment to upgrade Russian mines. *Mining Annual Review* (1996), *Mining Journal* (11-29 & 12-20/27-96) and *Mining Journal Diamond Supplement* (11-22-96).

Gold and silver

Kubaka almost complete. Construction of the \$180 million gold and silver mine in Magadan Province is 98% complete. The operation is expected to begin commercial production early in 1997. At full capacity, it is expected to produce 310,000 oz/y of gold and 235,000 oz/y of silver over a seven-year mine life. Omolon Gold Co., a joint venture between Amax Gold and several Russian organizations, is developing the mine. *Mining Journal* (12-13-96).

Gold output down; reserves up. The Russian Ministry of Industry reports that official Russian gold output is expected to be 100 metric tons in 1996, down from 122 metric tons in 1995 and 132 metric tons in 1994. Producers estimate that up to 5% of Russia's output is sold on the black market, where producers can receive cash rather than wait months for payments from the central government.

The Central Bank purchased about 100 metric tons of gold in 1996, boosting reserves to around 400 metric tons. *Mining Journal* (12-20/27-96) and *Capital Markets Report* (12-19-96).

Taxes swallow earnings. An analysis in 1995 of the cost structure of gold mining in

Russia demonstrated that, even with a fairly high efficiency (production costs in Russia account for about 60% of the received gold price), earnings are swallowed up by taxes—which averaged 37% of the selling price in 1995. In comparison, tax rates in South Africa, Australia and Canada were quoted as 12%, 17% and 21% of selling prices, respectively, in 1995. *Mining Journal* (11-29-96).

EBRD finances mines in Buryatia.

Two gold mines in the Republic of Buryatia (Eastern Siberia) are to be upgraded and expanded with a \$17.5 million finance package which the European Bank for Reconstruction and Development (EBRD) is extending to the mine owner and operator, Buryatzoloto, a recently-privatized Russian joint-stock company.

The two mines, Zun-Holba and Irokinda, are located in separate and remote areas in the southwestern and northeastern regions of the Republic of Buryatia. The proceeds of the financing will be used to install new technology, allowing the company to produce gold ore at the Zun-Holba mine, open new veins at both mines and fund environmental clean-up at Irokinda. Once upgraded, the mines should produce 75,000-90,000 ounces of gold a year.

The total project is expected to cost about \$59.5 million. The EBRD is providing a \$10 million loan. It is also making a further \$7.5 million equity investment in the company, equal to 19.6%. An additional \$7.5 million in financing is being raised through a private placement of new equity with institutional investors and a Canadian company, High River Gold Mines Ltd., which owns 22.9% of Buryatzoloto.

Buryatzoloto has calculated its total gold reserves at about 280,000 kg, of which approximately 37% is proven reserves. About 90% is in the Zun-Holba deposit. *BISNIS* (1-3-97).

Politics

Nazarov reelected

Chukotka governor Alexander Nazarov was reelected in late December. It seems Chukotka has recently isolated itself somewhat from Alaska. Because it had not paid its membership fees for more than a year, as of December Chukotka is no longer a member of The Northern Forum, an international organization of northern and arctic regions.

It also has closed its trade office in Anchorage (see also *Travel*).

Tsvetkov wins in Magadan

Molly Davenport, director of the American Russian Center-Magadan from 1994-1996, notes the following political changes there (see also *Economy*):

The first elected governor, Governor Valentin Ivanovich Tsvetkov, won his seat by a very small margin in November 1996, a surprise to many. He has no previous political experience and was a general director of a large state-owned gravel enterprise. The smaller communities surrounding the city of Magadan gave him enough votes to take the seat. [Ed. note: Mr. Tsvetkov is also a business partner of Earl Romans of Fairbanks, a business pioneer in the RFE.]

Governor Tsvetkov shocked many Magadaners by replacing many regional administration officials with his own people, a practice common in the U.S., but fairly new to Russia. Many former officials just packed up and left Magadan.

A factor in incumbent Governor Viktor Mikhailov's defeat was mounting unpaid wages for workers—as much as three month's worth for many people. It was a problem largely out of Mikhailov's control. Unpaid wages were a factor in elections throughout Russia.

Ishaev and Biryukov reelected

Khabarovsk Territory Governor Viktor Ishaev was reelected with the following slogan for his campaign: "I need a mandate of popular trust in order to speak with Moscow on equal terms."

Kamchatka Governor Vladimir Biryukov was also reelected. *OMRI Report* (1-8-97) and *The Northern Forum*.

Nikolaev reelected

At the end of December, President Mikhail Nikolaev was reelected to a second term in the Sakha Republic, carrying 64% of the vote. In one speech to voters he insisted on state regulation of the economy, at least during the transitional period. *The Northern Forum* and *Capital Markets Report* (12-19-96).

Sakha up, Primorye down

Looking at Russian regional politics, *Capital Markets Report* (12-19-96) cited the Sakha Republic as an interesting place to invest, but commented that Primorye is a place to avoid.

The newsletter said that Sakha is marked by extreme independence from Moscow and is far wealthier than the national average. It also cautioned that murky ethnic and clan trends are more important than any particular ideology there and direct investors should have outstanding contacts with the local political leadership before proceeding.

As for Primorye, the newsletter commented that it is a region with rapidly falling production and that the region's administration is extremely authoritarian and widely considered corrupt.

Yeltsin sick; Lebed attacks; troops leave Chechnya

While President Boris Yeltsin has been hospitalized with pneumonia, his chief political rival and former national security advisor, Alexander Lebed, declared on Moscow television, "I want to become president and I will." Lebed has called Yeltsin an "old, sick man" who should resign for the good of the country. President Yeltsin underwent quintuple bypass surgery on November 5, and, by all accounts, had made a good recovery. Doctors said the pneumonia is unrelated to his heart trouble.

Still, the country is heartened by the completion of troop withdrawal from Chechnya. Russia has been withdrawing troops gradually since a peace deal was reached in August. The pullout clears the way for general elections in Chechnya in late January. *Associated Press* (1-6 & 1-3-97).

Russian Legislation

Export passports needed

The order, *Customs control over goods crossing the border of the Russian Federation*, came into being November 25. It obligates businesses involved in international transactions to have a passport confirming the transactions.

The Ministry of Foreign Economic Relations (MFER) can provide the passport. In Khabarovsk, Nikolai Selutin, a representative of MFER, can issue the document, although if the transaction is for more than \$200,000, businesses will have to go to Moscow to get it.

The order was issued to keep money from leaving Russia. The first regulation designed to retain money in Russia came in January 1994; it provided controls over

money exporters transfer abroad. In January 1996 the same was done with Russian businesses dealing with imports. Some traders, however, just went around the system by going to barter transactions. During the first nine months of 1995, these exports came to \$9.3 million. *Pacific Star* (12-17-96) by *American Russian Center, Khabarovsk*.

Food imports must have Russian labels

The Russian Government plans to impose, effective May 1, a regulation requiring that all imported food products be labeled in Russian. Russian officials described the resolution as a way to protect consumers who can not read the foreign-language packaging on imported products. Products without label information in Russian will reportedly be restricted from distribution.

Information likely to be required about imported products—either on labels or enclosed descriptions in Russian—includes ingredients, nutritional value, date of production and shelf life, weight and volume, calories, materials injurious to health, price, guarantee period, conditions of storage, expiration dates, "best before" dates, and instructions for use.

This list should not be considered exhaustive. U.S. companies should consult the relevant Russian authorities, as well as competent legal counsel, for further information.

For more information, contact: Dr. Sergei Ryabov, Gosstandart (in Moscow). Tel.: 7(095)236-4044. Fax: 7(095)236-6231. Or contact Igor Moskovich, Rostest Moskva (in Moscow). Tel.: 7(095)129-3200. Fax: 7(095)124-9996. Or contact Dr. Sergei Tarasov, Russian Federation Chamber of Commerce and Industry (in Moscow). Tel.: 7(095)209-9697. Fax: 7(095)921-5675. *BISNIS* (1-10-97).

Alcohol tax enforcement coming

President Boris Yeltsin will soon sign a decree introducing tight controls for Russia's approximate 700 distillers and strict licensing rules for producers, sellers and importers. The decree will especially enforce payment of duties; each bottle of spirits is supposed to yield the treasury an 85% excise tax, 20% VAT and several additional taxes, but smugglers, moonshiners and bootleggers are cheating the state out of about \$350 million a month. *Capital Markets Report* (1-2-97).

Focus on Sakhalin

Economy

School employees strike in Kholmsk.

A number of workers from elementary and junior high schools in Kholmsk went on strike January 14. Elementary School #8 entered an all-out hunger strike on January 15. If unpaid wages are not remunerated by January 20, more school personnel are expected to go on hunger strikes. *Sakhalin T.V. and Radio Company* (1-15-97).

Energy

Energy shortages. All energy-related facilities in Sakhalin began the year in critical condition. Yuzhno-Sakhalinsk's Heating Power Plant #1 is especially in dire straits. *Sakhalin T.V. and Radio Company* (1-8-97).

Investment Opportunities

Yuzhno-Sakhalinsk seeks investors.

The city administration of Yuzhno-Sakhalinsk seeks U.S. joint venture partners/investors for the following projects: construction of a mini-brewery; construction of a plant to produce animal fodder additives; and construction of a plant to produce baby food.

Contact: Sergei V. Vlasov, Head of Foreign Economic Relations, Yuzhno-Sakhalinsk City Administration. Address: Russia; 693000 Yuzhno-Sakhalinsk; 173 Lenin St., Office 10A. Tel.: 7(42422)232-19. Fax: 7-50441-62222. *BISNIS* (1-1-96).

Transportation

Alaska Airlines applies for route. The company has applied for authority to fly direct Anchorage to Yuzhno-Sakhalinsk.

Sakhalinaviatrassy rates up. A one-way ticket from Khabarovsk to Yuzhno-Sakhalinsk now costs \$360 on this airline. There are some other flights from Khabarovsk to Yuzhno-Sakhalinsk on Aeroflot that now cost \$150 one-way.

Airport seeks foreign investment. Sakhalin Airport director V. Bagrov confirms that airport authorities are seeking foreign investment to reconstruct the Yuzhno-Sakhalinsk airport for international flights and are actively negotiating with several Japanese firms. The estimated cost of the airport project is \$55 million. The Sakhalin Regional Administration provided

continued on next page

Focus on Sakhalin, continued

\$3 million for airport construction in 1996. The federal government has designated funds for the airport but has yet to provide them. Some construction has begun, including reconstruction of the fuel storage facility, upgrading of the runway, and excavation for a new international terminal. The airport expects to begin construction of a centralized refueling facility in 1997.

Contact: V. K. Bagrov. Tel.: 7(42422)3-48-78. Satellite fax: 7(504)41-6-2205. *BISNIS* (1-7-97).

PRISCO to transport oil and gas. Primorsk Shipping Company (PRISCO), the second largest shipping company in the RFE, is negotiating an exclusive contract to transport oil from Sakhalin, and also is interested in transporting natural gas produced there. The company seeks partners for the project. PRISCO is a joint-stock company and more than half of its stock is held by U.S. and European companies. It employs more than 2,000 people.

Contact: Yevgeny Kozmin, Deputy General Director, PRISCO. Address: Russia: 692904 Nakhodka; Administrative Building of PRISCO. Tel.: 7(42366)546-15 or 444-29. Fax: 7(42366)546-55 or 429-95. Telex: 213812 PSC SU. *BISNIS* (1-13-97).

U.S. activity

Representation services available.

Troika Alaska offers business representation services in Yuzhno-Sakhalinsk for Alaskan firms and organizations. Contact Kathy Beeck, Troika program manager. Tel.: (907)278-7233. Fax: (907)278-2982. E-mail: 75362.1020@compuserve.com.

State of Alaska contracts with ABC.

Governor Tony Knowles has appointed Dinty Miller, director of the American Business Center in Yuzhno-Sakhalinsk, to represent the state in promoting business ties. About 50 Alaskan companies are registered in Sakhalin now, and about half of the U.S. companies showing interest in Sakhalin are from Alaska.

New Rotary club. The Alaska and Yukon Territory Rotary District is working to establish a Rotary club in Yuzhno-Sakhalinsk that may be chartered by May or June. Contact: Steve Yoshida. Tel.: (907)235-5255. E-mail:

4472.3376@compuserve.com.

Sales Opportunities

Magadan

Voskhod. a supermarket in Magadan, seeks to buy about \$100,000 a month worth of lipstick, eye make-up, and shampoos. It also seeks to buy \$200,000 a month of household appliances, including vacuum cleaners, electric food mixers/processors, and microwave ovens. All appliances must be 220V, 50/60HZ. Voskhod was established in 1966, has 84 employees, and has annual sales of \$3 million. Best way to respond is by fax and mail.

Contact (possible in English): Olga Volkova, Director. Address: Russia: 685000 Magadan; 38 Karla Marxa St. Tel.: 7(41322)295-03. Fax: 7(41322)280-98. *BISNIS* (1-9 & 1-10-97).

Nakhodka

Nakhodka Can Manufacturing Plant seeks to buy tin-plate and various packaging equipment. The plant is a manufacturer established in 1953, has 1,189 employees, and has annual sales of more than \$10 million. It manufactures tin, plastic, and paper-packing materials for fishing, food-processing, and other industries in the RFE and Siberia. The company is also participating in development of an industrial park within the Nakhodka Free Economic Zone and seeks opportunities for joint manufacturing of packing materials. Best way to respond is by fax and/or telex.

Contact (possible in English): Garriman Vorobyev, General Director. Address: Russia: 692911 Nakhodka; 1 Astafieva St. Tel.: 7(42366)234-84. Fax: 7(42366)236-67. Telex: 213828 CAN RU. *BISNIS* (12-13-96).

Vladivostok

ACFES Group seeks to buy 5-6 sets each of restaurant equipment, including ovens/stoves; food processing/packaging equipment; fast food counters; automatic coffee and soup vending machines; and cash registers. It also seeks to buy 5-6 sets of restaurant tables and chairs. ACFES Group is the largest importer of food products and consumer goods in the RFE. It consists of 52 companies and represents several foreign manufacturers including Toyota and Coca Cola. Its founders include several of the largest companies in the RFE, such as FESCO and PRISCO (Primorsk Shipping Co.). ACFES Group was established in 1989, has 1,614 employees, and has annual

sales of more than \$50 million. Best way to respond is by fax.

Contact (possible in English): Nikolai Matvienko, Head of Strategic Planning Department, ACFES Group. Address: Russia: 690600 Vladivostok; Prospekt 100-let Vladivostoku, 103. Tel.: 7(4232)318-757 or 318-510. Fax: 7(4232)318-311. Telex: 213115, MRF RU for ACFES. Sprint mail: CUSSRASOVMAIL.OVLAD.WOOD.UNACHES. *BISNIS* (12-10 & 12-16-96).

Svetinform seeks to buy one production line of printing equipment for high-quality publishing. Svetinform is an advertising firm established in 1991, has 10 employees, and has annual sales of \$400,000. Best way to respond is by fax.

Contact (possible in English): Vadim Volkov, Manager. Address: Russia: 690091 Vladivostok; 23 Aleutskaya St., Office 10. Tel./fax: 7(4232)266-219 or 266-265. *BISNIS* (12-9-96).

Capital Trading Corporation seeks to buy 5,000 to 10,000 metric tons monthly of gasoline and low-sulfur-content diesel fuel and fuel oil. Capital is involved in the wholesale trade of fuel products in the RFE. Volume of annual sales is 100,000 metric tons. It was established in 1995, has 8 employees, and has annual sales of more than \$20 million. Best way to respond is by fax.

Contact (possible in English): Viktor Chudinov, Deputy General Director. Address: Russia: 690001 Vladivostok; 17 Slavyanskaya St., Office 25. Tel./fax: 7(4232)287-319 or 263-159. *BISNIS* (12-13-96).

Timber

Ex-Im Bank finances equipment purchases

The U.S. Export-Import (Ex-Im) Bank and Roslesprom, a Russian state timber company, have finalized an agreement which will provide loan guarantees and possibly direct loans to Russian timber enterprises to buy U.S. equipment and services. Russian timber companies can apply for financing directly through Ex-Im Bank or through Roslesprom.

Application forms and supporting documentation are available from Ex-Im Bank's Business Development office in Washington, D.C. Tel.: (202)565-3900. Fax: (202)565-3931.

Contact for Roslesprom (in Moscow):
Andrei V. Frolov, Head of Foreign Economic Relations. Tel.: 7(095)208-0461.
Fax: 7(095)208-0339. *BISNIS* (1-7-97).

Prices up

According to Interfax News Agency, Rosexportles has raised prices by 5% for the pine and fur lumber it will ship to Western Europe in the first quarter and expects prices for those products and others to continue to climb throughout the first half. Rosexportles official Andrei Ochkov told Interfax that contracts for pine and fur lumber had already been signed in Greece and Italy.

Ochkov said that prices were also gradually increasing for sawlogs. Russia exports small quantities of sawlogs to Sweden, Finland and Belgium. Rosexportles now plans to make a tangible increase in its profits by shipping sawlogs to several major sawmills in Austria. Prices for the commodity could reach \$80 for a square meter in the first quarter, much higher than in the fourth quarter of 1996, Ochkov said.

Prices for round timber are also expected to rise this January. Prices for round timber shipped to Japan through the Far Eastern ports of Nakhodka, Vostochny, Vladivostok and Posiet to Japan in January 1997 will amount to \$133 per cubic meter for fur, over \$140 per cubic meter for pine and \$111 per square meter for deciduous wood. That is up from \$127.5, \$138 and \$108.9 per square meter respectively in December 1996.

Ochkov said that prices will stabilize in February and March as Russian yards start felling more timber. The main markets for Russian timber are Japan, Britain, Spain, Belgium and Denmark and, to a lesser extent, France and Germany.

Vera Golubovich, another Rosexportles expert, said she expected demand to remain at what she called a "good level" for cellulose. Demand will start to rise for the commodity at the beginning of the second quarter, when prices will reach \$600-\$650 per tonne, she said. Golubovich reckons prices will close 1997 at \$675-\$700 per tonne. She said there was a distinct downward trend for newsprint prices in 1996, mostly because of high stocks of the commodity. Prices for standard paper dropped from \$750 per tonne at the beginning of the year to \$550-\$570 in the fourth quarter. Prices may stabilize at around \$400-\$500 per tonne by the end of the year.

Analysts reckon that Russia exported 15 million cubic meters of round timber and 4.4 million-4.6 million cubic meters of coniferous lumber, down from 19 million cubic meters and 5 million cubic meters respectively in 1995. *BISNIS* (1-10-97).

Nakhodkales selling stock

Nakhodkales, one of Russia's leading timber exporting companies, is offering Russian and foreign investors an opportunity to purchase controlling ownership (50.1%) in the company. The estimated \$8 million which will be raised through the sale of stock will be used for construction of a new timber port in Nakhodka.

The company was established in 1992 as an open joint-stock company. It handles more than 10% of Russia's total annual timber exports, or about 1.1 million cubic meters.

The new timber port in Nakhodka will have annual turnover capacity of 2 million cubic meters. When the port is operational, Nakhodkales hopes to double its share of Russia's timber exports, with shipments largely to Japan, China, and other Asian Pacific Rim countries. The first phase of the port project, including a railway spur, roads and two moorings, is scheduled for completion in December 1997 and will require total investment of \$36 million.

The Nilin Investment Company will distribute 12,341,200 shares of Nakhodkales-registered stock with a nominal cost of 1,000 rubles each. Foreign investors may purchase the stock through a contract with Nilin Company.

Contact: Vladimir Voronkov, General Director, Nilin Investment Company.
Address: Russia: 692900 Nakhodka: 17-1 Gagarina St. Tel.: 7(42366)256-77. Fax: 7(42366)705-14. Homepage: <http://itl.pacific.ru>.

Contact for Nakhodkales: Vitaliy Teteryuk, Chairman. Address: Russia: 692900 Nakhodka: 13/A Astafieva St. Tel.: 7(42366)423-49 or 434-41. Fax: 7(42366)434-52. Teletype: 213849 BEREZA RU. Inmarsat tel.: (872)140-3330. Inmarsat fax: (872)914-03330. *BISNIS* (1-16-97).

Saving valuable trees

Beginning January 1, 1997 in Khabarovsk Territory there will be limits for cutting and quotas for selling Manchzhursky Ash trees. The Khabarovsk Territory Administration is also to prepare and give to the Territory

Duma suggestions for increasing taxes on valuable trees. The measures are part of a larger order the Khabarovsk governor passed to control the activities of entities cutting, sawmilling and selling timber in Khabarovsk Territory. Some entities which cut trees do so inaccurately and often break the law. Sometimes they even sell non-coniferous timber for cash. *Pacific Star* (12-20-96) by American Russian Center, Khabarovsk.

Finnish equipment in Khabarovsk

Finland has recently sent 12 railcars with five sawmills to Khabarovsk. The sawmills offer high output—up to 4,000 cubic meters per worker per year. Next year Khabarovsk Territory plans to get 15 sets of this equipment and in future years 20-25 sets per year, which will help it increase output of high-quality timber.

Khabarovsk territory has about 18 million cubic meters of timber to process while now only 3 million cubic meters are being processed per year. *Pacific Star* (12-5-96) by American Russian Center, Khabarovsk.

Travel

New visa regulations

According to a new regulation, a Russian host organization must be registered with the Russian Foreign Ministry (MID) to be able to apply for a business visa for any foreigner to Russia, and any visa invitation letter must be signed and approved by MID. Because these regulations change often, be sure to call a Russian consulate to receive the latest requirements.

An Associated Press article mentioned a new law requiring all foreign visitors to Chukotka to obtain permission from Chukotka Governor Nazarov's office before entering the region and special visa fees of as much as \$250, but the Russian consulate in Seattle was not aware of the law or fees. It seems that once tourist or scientific groups reached Chukotka, they were charged the local visa fees (see also *Politics*).

continued on next page

Travel, continued

Following is contact information for Russian consulates in San Francisco and Seattle:

In San Francisco: Consulate General of the Russian Federation. Tel.: (415)929-0862. Fax: (415)929-0306.

In Seattle: Consulate General of the Russian Federation. Tel.: (206)728-1910. Fax: (206)728-1871.

Traveler insurance

International SOS Assistance, Inc. sells emergency medical, personal, and travel assistance services for world travel, including to all parts of Russia. Tel.: 1-800-523-8930.

Magadan assessing more duties

According to Molly Davenport, director of the American Russian Center-Magadan from 1994-1996, the Magadan Airport Customs has been closely screening everyone entering the region and assessing high duties on baggage over a certain weight. These "excess weight" duties do not correspond to airlines' concepts of or restrictions on baggage weight (see also *Economy*).

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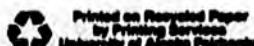
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Certification requirements for exporters to the Russian Far East— Reprinted with permission from Russian Customs News

Certification issues are increasingly cited by exporters as a primary obstacle in selling processed foods to Russia, including the Russian Far East. This report provides an overview of current certification requirements and procedures for exporters seeking to take advantage of the growing demand for imported food products in the Russian Far East.

Certification requirements are becoming a key means employed by the Russian government to regulate food and other imports and are in some cases replacing quotas and other restrictions. During recent years, certification requirements and procedures have grown increasingly complex, and it is expected that the lead Russian certifying authority, Gosstandart, and other agencies will introduce more changes in procedures, particularly for food products, cosmetics and medicines. New procedures may include:

- certification of manufactured products;
- certification of quality systems;
- labeling requirements (see *Russian Legislation* for text of labeling in Russian decree); and
- pre-contract certification.

Gosstandart also is expected to establish standards for faster product identification methods.

Food product importers currently need to obtain a minimum of two certificates: a sanitary certificate and a safety certificate. Importers of animal products also are required to obtain a veterinary certificate. Each of these certificates is issued by a separate authority.

The sanitary certificate, which grants permission for the product to enter Russia, is issued by SANEPIDNADSOR, the sanitary and

epidemiological oversight body of the Russian Ministry of Health Care, and is required for all food products, medicines, and electric appliances imported into Russia. The Centre of Standardisation, Metrology and Certification (CSMC), an agency subordinate to Gosstandart,

Certification requirements are... in some cases replacing quotas and other restrictions.

issues a safety certificate confirming that the imported product corresponds to Russian and international standards. A safety certificate is not issued without a sanitary certificate.

A veterinary certificate is required for each shipment of animal products (including meats, offal, fats, poultry, fish, dairy products, lard, baby food containing animal products, honey, and other animal products). The certificate includes procedures for import and distribution of the product in Russia as approved by the Russian veterinary department. Regional veterinary services control distribution of these products locally.

Procedures

SANEPIDNADSOR recommends that exporters begin the certification process upon signing a sales contract. The company must submit the following documents to

continued on next page



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Please note: Russian words for administrative units are translated as: krai-territory; oblast-province; okrug-district. Adjectival endings (ii in Khabarovskii, aya in Khabarovskaya, etc.) have been eliminated, except for addresses.

We welcome articles and letters from our readers. We reserve the right to edit submissions. Please include a telephone number and a short biographical note.

From the editor

While I was in Khabarovsk in early February, one U.S. citizen described the time and energy it took to file the 19 different categories of taxes—for local, territory and federal taxes—he was required to pay to run a company in Khabarovsk. Every form had to be filled out in triplicate. Every tax organization had different forms. Some of the tax payments were for as little as \$1 or \$2. The taxes had to be paid in person, and there were long lines every time. No matter how much time company accountants poured over the massive amounts of tax paperwork, tiny non-intentional mistakes would appear, and the company would be subject to fines.

Besides the bureaucratic inefficiency described above that Russia inherited from her past, part of the problem is that so many

Russian companies are reluctant to pay their taxes. The federal government has been short on revenue and unable to pay state workers across the country. The International Monetary Fund only recently released loan payments to Russia it withheld in November and December until "monetary and fiscal targets were met," including "efforts to improve tax collections." In the short-term anyway, "aggressive" will be the word to describe the tax authorities.

Some recent news, though, is heartening for trade. The Ministry of Foreign Economic Relations has announced that joining the World Trade Organization was Russia's primary trade policy now and pledged that import duties would not increase. ■

Anne Sudkamp

Certification requirements, continued

SANEPIDNADSOR, with Russian translation, to obtain a sanitary certificate:

- a letter of application;
- certificate of origin;
- copies of the contract, invoice, and packing list;
- safety certificate issued by the competent authorities in the country of origin;
- safety certificate from the manufacturer;
- list of product ingredients;
- date of manufacturing or expiration; and
- samples (if required by SANEPIDNADSOR).

The following additional documents are required for vegetable or plant products:

- sanitary certificate of the exporting country;
- information on fertilisers, pesticides and chemicals used; and
- harvest date

SANEPIDNADSOR issues a sanitary certificate on the basis of documents submitted and may require laboratory testing in instances where documentation is incomplete, the product was exported from the country of origin without a sanitary certificate, the product has no analogue in the Russian market, or the product was supplied by a manufacturer who is new to the market. Samples for laboratory tests are selected by SANEPIDNADSOR experts. A final decision on issuance of the sanitary certificate is generally issued within two weeks from the date of application and the certificate

is valid for a limited period which varies depending on product. Certificates issued in one region, for example by SANEPIDNADSOR in Primorye Territory, are valid throughout Russia. Manufacturers planning to export large quantities of a specific product to Russia may wish to invite SANEPIDNADSOR experts to inspect their production facilities. In this case, a general sanitary certificate may be issued for a period of one to three years.

To obtain a veterinary certificate, a company must submit the following documents to the Russian veterinary department through its appropriate regional office:

- application (including product description; intended use of product; country of origin; point of entry into Russia; and place of storage and processing);
- certificate of quality from the appropriate authorities; and
- veterinary certificate of the exporting country.

The veterinary department typically provides a list of product requirements within 30 days. When the veterinary authorities in the exporting country confirm that the established requirements have been met, the Russian veterinary department issues a veterinary certificate permitting import of the product. The certificate is also required for transit shipment. At the border, the border veterinary inspection service exchanges the veterinary certificate for

Certification requirements for exporters, continued

• veterinary permit (also known as Form 2), which requires approval of the regional veterinary service. The regional veterinary generally administers laboratory testing, which is normally completed within three days. After laboratory testing, the regional veterinary service registers the veterinary certificate.

In Primorye Territory, safety certificates are issued by the Primorsky Centre for Standardisation, Metrology and Certification (CSMC). When an application is received, CSMC establishes testing procedures, selects test samples, and conducts testing prior to issuing a certificate. Test samples range from 3-10 kilograms, and the process typically takes 1-3 days to complete. The final decision on issuance of the safety certificate depends on the test results and additional information available from the following documents:

- certificate of test selection;
- test record;
- sanitary certificate;
- documents certifying the origin of the product (contract, bill of lading, certificate of quality etc.);
- quarantine certification for plants issued by the Department of Agriculture; and
- veterinary certificate for animal products.

Packaging for processed food products should contain the following information which is required by the Russian Federation *Law On Protection of Consumer Rights*: weight, volume, content, nutrition, name and address of manufacturer, expiry date and storage instructions. Effective as from September 1996, this information is to be provided in Russian. Safety certificates are generally not issued for products with no or overdue expiry dates.

A safety certificate for a shipment is valid for 6 months. In some cases, for example, for large shipments of products not likely to be sold within this period, the validity of the safety certificate may be extended for up to an additional six months by applying to CSMC.

Exporters distributing assorted products well-known to the local market or products in large quantities are recommended to obtain a safety certificate for the whole range of products to be imported into Russia. This can be arranged by the manufacturer inviting 2-3 CSMC experts to visit the premises to review storage and use of inputs, technical specifications, product safety, sanitary and temperature controls,

and storage facilities. The cost of a general certificate is \$3,000-5,000, in addition to which the U.S. company is required to pay travel expenses for the CSMC experts visiting the facility. The certificate will be valid for all products manufactured by the company for a period of one to three years.

CSMC plans to introduce a new type of safety certificate, the "Contract Certificate," in 1997. This certificate will be given only to companies which have been importing large amounts of food products to the local market for several years and which have a good reputation, and only for those products which are well-known in the local market. After successfully testing the first shipment, CSMC will issue a certificate for all further shipments of the same products. ■

Contacts

Primorye Territory

- Alexander Feigin, Centre of Standardisation, Metrology and Certification. Address: 690600 Russia; Vladivostok; 54 Praporchika Komarova St. Tel.: 7(4232)223-639. Fax: 7(4232)264-728.
- Galina Andreeva, SANEPIDNADSOR. Address: 690600 Russia; Vladivostok; 3 Selskaya St. Tel.: 7(4232)293-666 or 292-921. Fax: 7(4232)293-144.
- Mikhail Omelchenko, Veterinary Service. Address: 690000 Russia; Vladivostok; 2 Pervaya Morskaya St. Tel.: 7(4232)225-309.

Sakhalin

- Yuriy Nogin, Centre of Standardisation, Metrology and Certification. Address: 693000 Russia; Yuzhno-Sakhalinsk; 5/A Pobedy St. Tel.: 7(42422)355-35 or 303-40. Fax: 7(42422)303-17.
- Yevgeny Papirenko, SANEPIDNADSOR. Address: 693000 Russia; Yuzhno-Sakhalinsk; 30/A Chekhova St. Tel.: 7(42422)229-18. Fax: 7(42422)220-41.
- Nelli Plyaskina, Veterinary service. Address: 693000 Russia; Yuzhno-Sakhalinsk; 107 Mira Ave., office 35. Tel.: 7(42422)234-09; Fax: 7(42422)234-09.

Sakha Republic

- Vladimir Btyansky, Centre of Standardisation, Metrology and Certification. Address: 677000 Russia; Sakha Republic; Yakutsk; 26 Kirova St. Tel.: 7(4112)433-902. Fax: 7(4112)434-183.

- Ivan Egorov, SANEPIDNADSOR. Address: 677000 Russia; Sakha Republic; Yakutsk; 9 Oyunsogo St. Tel.: 7(4112)251-645. Fax: 7(4112)250-955.
- Tamara Karataeva, Veterinary service. Address: 677000 Russia; Sakha Republic; Yakutsk; 28 Kurashova St. Tel.: 7(4112)240-022.

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About Sources

American Russian Center offices in Khabarovsk, Magadan, Yakutsk and Yuzhno-Sakhalinsk provide weekly information on the business climate in the Russian Far East. The American Russian Center is funded by a grant to the University of Alaska Anchorage from the U.S. Agency for International Development. The center's mission is to assist Russia in its transition to a market economy by providing comprehensive training in business operations. Contact the Anchorage office. Tel.: (907)786-4300. Fax: (907)786-4319.

BISNIS, the Business Information Service for the Newly Independent States, provides reports from a variety of U.S. government sources, including BISNIS specialists, the American Embassy in Moscow, and the U.S. & Foreign Commercial Service in Vladivostok. BISNIS is a division of the U.S. Department of Commerce, International Trade Administration. Tanya Shuster is the BISNIS trade specialist who focuses on the Russian Far East. Tel.: (202)482-4655 ex. 23. Fax: (202)482-2293. E-mail: shuster@usita.gov. BISNIS reports are available through its home page on the

continued on next page

About Sources, continued

World wide web: www.iep.doc.gov/bisnis/bisnis.html.

World Trade Center Alaska (WTCAL) provides information on international trade through its weekly publication *Trade Winds*. WTCAL is a membership organization based at the University of Alaska Anchorage. Its mission is to promote Alaskan member companies in the international trade arena. Tel.: (907)278-7233. Fax: (907)278-2982.

Troika Alaska is a program of the World Trade Center Alaska that operates offices in the RFE in Khabarovsk and Yuzhno-Sakhalinsk. The Yuzhno-Sakhalinsk office publishes the *Sakhalin Oil & Gas Report*, a weekly information brief on the status of the oil & gas development projects on Sakhalin Island. Troika Alaska also leads trade missions to the RFE and provides representative office services for companies interested in establishing a presence there. Tel.: (907)278-7233. Fax: (907)278-2982.

Open Media Research Institute (OMRI) publishes the *Russian Regional Report* and distributes it by e-mail. OMRI is a nonprofit organization with research offices in Prague, Czech Republic. For more information about OMRI, please write to info@omri.cz.

Agriculture

Primorye rice output plummets

According to Interfax, last year Primorye produced just 8,000 metric tons of rice, way down from 64,000 metric tons in 1990 because farmers are no longer getting any money to shore up crumbling irrigation systems. Alfred Viksne, head of the Department of Melioration and Water at the Ministry of Agriculture and Food, told a recent meeting of senior ministry colleagues that, thanks to underfinancing for repair work, the total paddy area had shrunk from about 94,000 acres to about 22,000 acres. Viksne said that the average yield had dropped from 1.08 metric tons per hectare (2.47 acres) in 1986-90 to 0.9 metric tons per hectare in 1996 as agrochemical

applications fell and physical depreciation for machinery reached 70%.

The Primorye government has drawn up proposals to raise the rice area to about 105,000 acres and increase yields to 2.5 metric tons per hectare by the end of the century. To meet that target the region will have to repair 86,450-98,800 acres of irrigation and drainage systems, develop a workable system of crop rotation and provide an annual 2,800 metric tons of mineral fertilizer and 85 metric tons of crop protection chemicals.

Viksne praised the Primorye government for raising financing for the rice industry. Federal financing of the project, he said, was still at issue. Russian output of rice has fallen from 896,000 metric tons in 1990 to 389,000 metric tons in 1996. Consumption is measured at 750,000 metric tons. *BISNIS* (2-5-97).

Business Opportunities

Khabarovsk

Private Collection, a private publishing house in the city of Khabarovsk which specializes in historical materials, seeks U.S. writers and publishers interested in joint publishing projects on the history of Russian America, and Alaska and the Russian Far East. Private Collection was established in 1996, employs 10 professionals, and uses modern computer publishing systems. Contact: Olga P. Burya, General Director. Address: 680020 Russia; Khabarovsk; PO Box 2004. Tel./fax: 7(4212)71-35-85. E-mail: rvm@rvm.khv.ru.

Petropavlovsk-Kamchatsky

Rloko-Trust seeks to buy eight refrigerators for use in retail establishments. The company is a wholesale and retail trading company established in 1993. It employs 14 and has annual sales of more than \$750,000. Best way to respond is by fax or e-mail. Contact (possible in English): Dmitriy Shustov, Director. Address: 683000 Russia; Petropavlovsk-Kamchatsky; 10-1 Lenin St. Tel.: 7(41522)282-50 or 234-48. Fax: 7(41522)282-50. E-mail: gorry@rtrust.kamchatka.su. *BISNIS* (2-11-97).

Vladivostok

The Women's Business Club seeks to buy crepe-making equipment and is also

interested in receiving information on ice cream-making equipment and restaurant equipment for fast-food cafes. Several members of the club plan to open fast-food cafes in the city. Respond by fax or e-mail. Contact (possible in English): Olga Belous, Manager, Women's Business Club. Address: 690013 Russia; Vladivostok; 31/1 Shepetkova St., office 8. Tel.: 7(4232)265-789. Fax: 7(4232)234-326. E-mail: wbclub@bwm.marine.su. *BISNIS* (2-7-97).

Primorsk Regional Exporters' and Importers' Assn. seeks to buy from manufacturers two 20-foot containers monthly of a variety of motor oils. Respond by fax. The assn. was established in 1990, employs 15, has annual sales of \$700,000 and distributes motor oils, car care products and automotive parts. Contact (possible in English): Konstantin Gunin, Chairman. Address: 690068 Russia; Vladivostok; 10/A Kirova St., Suite #22. Tel.: 7(4232)473-395. Fax: 7(4232)315-376. *BISNIS* (2-7-97).

Yakutsk

Stimex seeks to buy food-processing equipment, haying machinery, and sawing machinery. Stimex is a private company engaged in wholesale and retail trade of agricultural and wood-processing equipment. It was established in 1994, employs 24, and has annual sales of \$2,500,000. Respond by fax. Contact (possible in English): Stepan Moskvitin, General Director. Address: Russia; Yakutsk; 24/1-2 Dzerzhiskogo St. Tel.: 7(4112)453-038. Fax: 7(4112)453-038 or in Moscow: 7(095)230-2919. *BISNIS* (2-10-97).

Yakutgazprom, a joint stock company, seeks a joint venture partner to help it construct a station in Yakutsk to re-equip automobiles to use liquefied gas, and to service them. Contact: Viktor Bolonov, General Director. Address: Russia; Sakha Republic; Yakutsk; Petr Alekseev St. 76. Tel.: 7(4112)44-81-27. Fax: 7(4112)44-80-59. *Sakha-American Business Education Center (American Russian Center)*.

Delegation seeks technology and investment. A delegation from the Sakha Republic attended the *Construction, Oil and Mining Exposition* in Anchorage in February, seeking new technologies, joint venture partners, and investment. Representatives came from:

- **Villuigesstroi.** This construction company is building a large hydro-electric station. Address: Russia; Sakha Republic; Yakutsk; Tsilkovskogo St., 14. Tel.: 7(4112)62-146 or 62-237.

- **Kustuk.** This ceramic and brick-manufacturing company also seeks construction materials. It has a government guarantee. Address: 677011 Russia; Sakha Republic; Yakutsk; Lenin Prospect, 30, office 419. Tel./fax: 7(41122)42-23-65.
- **Yakutskenergo.** Address: Russia; Sakha Republic; Yakutsk; Popov St., 14. Tel.: 7(41122)49-86-25 or 46-05-33.

Conferences, Trade Missions, & Shows

In the U.S.

Pacific Rim Coal Conference. May 10-13. Anchorage. This twelfth annual conference will feature Alaska and the RFE. Contact: World Trade Center Alaska. Tel.: (907)278-7233.

To Russia

State of AK Trade Mission to Yuzhno-Sakhalinsk. Tentatively April 14-15. Governor Tony Knowles will lead this invitation-only mission open to Alaskan companies involved in oil and gas development. Contact: Becky Beck, AK Division of Trade and Development. Tel.: (907)269-8102.

In Russia

Please note: most contact information is given at the end of this list.

Mining and Exploration, international exhibition. March 18-21. Moscow. Contact: International Trade & Exhibitions Group. Address: Byron House; 112a Shirland Rd; London W92EQ; UK. Tel.: +44-171-286-9720. Fax: +44-171-286-0177.

Architecture, Construction & Design '97. March 24-31. Khabarovsk. Building products, equipment and services. Organizer: FEITC.

Moscow International Oil and Gas Exhibition MIOGE '97. April 7-10. Moscow. World Trade Center Alaska is organizing a delegation to this fourth annual exhibition. Contact: World Trade Center Alaska. Tel.: (907)278-7233.

Dallesexpo '97. April 21-28. Khabarovsk. Timber and wood products and processing equipment. Organizer: FEITC.

Fair organizers

FEITC (Far Eastern International Trade Center). Contact: Evgeniy V. Panusenko.

President. Address: 680038 Russia; Khabarovsk; 60 Seryshev St., Office 101. Tel.: 7(4212)343-967. Fax: 7(4212)332-999 (ask operator for #403096).

In other countries

Fourth North Pacific Rim Fisheries Conference. April 22-24. Tokyo. The Alaska Center for International Business, University of Alaska, Anchorage, the Ministry of Foreign Affairs of Japan, Ministry of Agriculture, Forestry and Fisheries of Japan and the Japan Fisheries Assn. will sponsor this conference which serves as a focus for government managers and industry representatives to discuss management and marketing developments in the North Pacific. Contact: Shawneen Conover at the Alaska Center for international Business. Tel.: (907)786-4300. Fax: (907)786-4319.

Economy

Notes on Khabarovsk

Nancy Luther, director of the American Russian Center-Khabarovsk since 1994 and a Russia specialist who has lived and worked in the Soviet Union and Russia for numerous stints since 1978, notes the following changes in Russia in general and Khabarovsk in particular:

- In general Russian people are more stressed now than they were under the Soviet system. They accept that the Soviet Union is over and they know they can't go back to the social safety net they once had, but the new uncertainties are still hard to cope with. They find it hard to make plans for their lives when economic changes are happening so fast.
- Many people are worse off economically because of the changes. For example, many people can't afford vacations now, whereas everyone used to be able to go on some kind of vacation before.
- People are working harder and don't have as much time to get together and socialize with friends now.
- The infrastructure isn't working as well. There are more potholes, housing isn't as clean, and things don't run as well as they did even during the Soviet Union.
- The flip side is that many people are energized with the new economic possibilities, especially the possibility to

develop and fulfill yourself. For example, there are new possibilities now for men to provide a good life for their families and achieve higher self-esteem than they could under the Soviet system. Business people, especially, aren't disillusioned.

- The scary side, though, is that people have to create their own opportunities now, and without a social safety net.
- With the greater political freedoms there are more possibilities to be yourself. Freedom from repression is a very big deal, but things could still change for the worse politically. At least the political situation is much more stable than it was two years ago—there has been a break-off point since the election and an understanding that now Russia will not go back to communism.
- Many more consumer goods are available now, so shopping has become much easier. The flip side is that more and more is imported now and less and less is grown locally. Even since 1994 a number of small local stores have gone out of business.
- Russian consumers have become much more discriminating in their buying habits. Business people have become much more savvy about business. People are also much more knowledgeable about the U.S.
- In general, women are adapting faster to the changes.
- Overall, life in Russia is better now, but it's not more pleasant.

Khabarovsk statistics

GosKomStat provides the following statistics on the 1996 performance of the Khabarovsk Territory economy:

The territory's gross manufactured product fell 10%, totaling 11,507 billion rubles. Services comprise 51.6% of the gross product.

Overall industrial output totaled 12,755.9 billion rubles—13% lower than during 1995. The iron and steel industry produced 34,400 tons of rolled metal—27% of 1995. The machine-building, chemical industry and construction materials sectors also suffered a significant decline. The drop in copper and tin production was 40% and 30% respectively. Gold output was 0.6% higher. Output of coal dropped from 1,528,000 metric tons in 1995 to 1,450,000 metric tons in 1996. Timber companies

continued on next page

Economy, continued

produced 4.5 million cubic meters of oil. The decline in energy production was not considerable. Volume of consumer goods manufactured fell 13% from twelve months of 1995 to 2,352.8 billion rubles.

Approximately one half of regional enterprises was running at a loss, with total losses amounting to 1,068.0 billion rubles. The most unprofitable sectors were transport (69% of all companies operating in the sector), metallurgy, machine-building, timber and pulp production. Debts totaled 1,172.5 billion rubles, and 56% of debts were overdue. Total capital inflow, including foreign and government investment, amounted to 28,650.0 billion rubles (down by 13%).

45 enterprises were privatized in 1996. 39 of them had belonged to the municipal government, 4 to the regional government and 2 to the federal government.

According to customs data, Khabarovsk's international trade turnover was \$1,051.5 million, of which export amounted to 77.1%. Exports of fish and sea products came to \$31.2 million. 58.8% of fish and sea products was sold to Japan, 19.1% to the Republic of Korea, 15.1% to U.S., and 6.7% to New Zealand.

According to preliminary figures, as of January 1, 1997, the population of the Khabarovsk region was 1,555,500, which is 1% less than in the beginning of 1996. 80.5% of the population is urban. During 1996, 22,527 people moved to the region, and 28,951 left for mostly western regions of the country. The number of patients with tuberculosis increased 26%, and syphilis 80%. *Pacific Star* (2-5-97) by *BISNIS* (2-12-97).

Life expectancy down

According to the World Health Organization, life expectancy now for Russian men is 57.7 years, down from a peak of 65 years in 1987. Life expectancy for Russian women is 71 years, down from 74 years in 1987. The agency blamed the decrease on the collapse of the country's health care system. In the U.S. today, men can expect to live 72 years and women 79 years. *Associated Press* (2-15-97).

Environment

Oil spill notes

Spill has increased. The amount of oil estimated spilled now reaches 1.2 million gallons. The slick has now reached beaches in seven prefectures along a 500-mile stretch of coast. *Associated Press* (1-27-97).

Services sought. The U.S. Embassy in Tokyo is compiling names of U.S. firms capable of providing oil spill services or equipment. Companies interested in being included on the list should fax the embassy as soon as possible. Contact: Mr. Aomori or Mr. Tasharski. Tel.: 011-81-3-3224-5086. Fax: 011-81-3-3589-4235. *World Trade Center Alaska* (2-3-97).

Captain found and buried. The body of Valerii Melnikov, captain of the *Nakhodka*, washed ashore the Japanese coast January 26. *Associated Press* (1-27-97).

Melnikov was buried with full honors in the city of Nakhodka. According to crew members, Melnikov fought to the last minute to save his tanker and was the last man to abandon ship. *Priamurskie News* (2-8-97).

Phenol found in Amur

Priamurskie News (2-8-97) reports that phenol has been found in elevated concentrations in the lower reaches of the Amur River, especially at villages not far from Nikolaevsk-na-Amure.

WWF grant for Sakha Republic

Under an agreement signed February 11, the Swiss-based World Wide Fund for Nature (WWF) will allocate about \$350,000 to fund conservation projects in the Sakha Republic. The republic has suffered severe environmental degradation in Soviet times, when it was plundered for its diamond, oil, and gold reserves. Diamond and gold processing, for example, have polluted the Vilyui River with traces of thallium and other toxic chemicals. In the 1970s and 1980s, the republic experienced 12 underground nuclear explosions, seven of which had a yield equal to or greater than that of the bomb dropped on Hiroshima, according to Sakha officials. Dead forests now surround the explosion sites, and the permafrost is radioactive. Sakha President Mikhail Nikolaev said that his administration wants to improve the situation and is creating a system of nature reserves protected by the government. *Penny Morvant, OMRI Russian Regional Report* (2-12-97).

Investors sought

The Siberian Forests Protection Project at the Pacific Environment and Resources Center and the RFE Association for the Use of Non-Timber Forest Products are looking for potential investors and partners to work with enterprises to promote and develop the RFE non-timber forests products (NTFP) industry. Contact: Sarah Lloyd, NTFP Initiative Coordinator, Siberian Forests Protection Project, Pacific Environment and Resources Center. Address: 1055 Fort Cronkhite, Sausalito CA 94965. Tel.: (415)332-8200. Fax: (415)332-8167. E-mail: percsiberia@igc.apc.org. *BISNIS* (1-24-97).

Finance

Ruble rates

Following are ruble: 1 dollar exchange rates:

January 30	5,627
February 5	5,636
February 14	5,652

Capital Markets Report

EBRD Update

Contact information for the RFE regional representative office of the European Bank for Reconstruction and Development (EBRD) has been changed as follows: Contact (in Vladivostok): Elena Danysh. Tel.: 7(4232)43-07-50. Fax: 7(4232)43-09-49.

EBRD's Russia Small Business Fund began functioning in the RFE at the end of January. It has \$300 million to lend throughout Russia. Small loans up to \$75,000 are available for a two-year term; micro-loans up to \$30,000 are available for a six-month term.

EBRD has also provided \$30 million for the RFE to the Daiwa Far East and Eastern Siberia Fund, a regional venture fund managed jointly by Daiwa Securities and Itochu Corporation. *BISNIS* (2-11-97).

New TUSRIF information

The U.S. Russia Investment Fund (TUSRIF) has appointed Derek Norberg as its new RFE regional director. TUSRIF is a private investment firm capitalized with \$440 million from the U.S. government to assist in the development of a market economy in Russia. To date it has committed over \$9 million to seven projects in the RFE. Contact information for TUSRIF's

office in Khabarovsk is: Address: 680000 Russia; Khabarovsk; 5A, Tolstogo St.; Amethyst Hotel. Tel./fax: 7(4212)22-77-14.

The U.S. office has relocated: Address: 345 Fifth Ave., Suite 300; New York, NY 10017. Tel.: (212)818-0444. Fax: (212)818-0445.

Information Resources

Guide to Doing Business in the RFE has been published by the U.S. Department of Commerce's American Business Center in Vladivostok. Address: American Business Center; U.S. Consulate General-Vladivostok; c/o State Department; Washington, DC 20521-5880. Fax: 011-7509-851-1212. E-mail: csvlad@online.ru.

Vladivostok: Your Essential Guide comes to you from Erik and Allegra Azulay, residents of Vladivostok and authors of *The Russian Far East*. It is available in Vladivostok at the Vlad Motor Inn, the American Business Center, and Nostalgia. To get a copy in the U.S., send an e-mail to: JoanAz@aol.com.

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U.S. Trade and Investment Days in Yakutsk, Republic of Sakha (Yakutiya), a report from BISNIS' September visit to Yakutsk, has been made available by BISNIS. See *About Sources* for BISNIS contact information.

International Update

South Korea

Disputes with Nakhodka Free Economic Zone. Primorye governor Yevgenii Nazdratenko slammed South Korean companies for demanding extra tax benefits in order to begin construction work on an industrial park in the Nakhodka Free Economic Zone, ITAR-TASS reported on February 7. Nazdratenko said that the existing tax benefits in the zone comply with international standards and that the Russian government has allocated 88 billion rubles in 1997 for the construction of a power station and a water supply system for the park. According to Nazdratenko, in 1996, Russia's contribution to the South

Korean economy totaled \$2.5 billion, largely as a result of placing contracts for the construction and repair of merchant ships with Korean companies.

Meanwhile, the administration of Vladivostok has announced its intention to set up its own free economic zone in order to attract more investment and stimulate economic growth. ITAR-TASS reported on February 12. *Natalia Gurushina, OMRI Russian Regional Report* (2-12-97).

United States

President Clinton requests increased NIS funds. On February 6 the president presented his FY 1998 budget to Congress. Included is a request for an increase of NIS funds from \$625 million budgeted for FY 1997 to \$900 million for FY 1998. The emphasis of U.S. aid to the NIS will also change, from technical assistance to partnership activities.

American General shuts down. American General Corporation, a U.S. company based in Khabarovsk and set up as a bridge company to distribute Western Family foods, and, to a lesser degree, computer disks and over-the-counter pharmaceuticals, has shut down. American General began activities in Khabarovsk in 1992. At the height of its operation, the company had 100 distributors and/or retailers under contract; 150 smaller-scale regular buyers; 1,500 stores, 1,000 kiosks, and numerous small outdoor market vendors carrying its food products; and penetration throughout Khabarovsk Territory to Novosibirsk, Vladivostok and Yuzhno-Sakhalinsk. United Grocers out of Portland will now provide Western Family products in the RFE, but not on the same scale as American General.

AOL cuts off Russia. A large number of aol users in Russia had managed to hook up for free, through fake credit card numbers or various types of hacking, so the company cut off the country's local telephone numbers. To connect at all now, users in Russia must make a long-distance call to a U.S. number and pay Russian long-distance rates. *Allegra Azulay*.

Order of Lenin recipient dies. Clyde Armistead, a former Fairbanks airplane mechanic who in 1934 helped save the lives of Soviet scientists stranded on an ice floe in the Arctic Ocean near Chukotka, died February 11. He was the last living recipient of the Order of Lenin—the highest civilian honor the Soviet government bestowed. *Associated Press* (2-16-97).

Mining

Dispute over Kamchatka

The Environmental Defense Fund, Sierra Club, and Pacific Environment and Resources Center have called on the U.S. Overseas Private Investment Corporation (OPIC) to reject providing financing for the Aginskoye gold mining project on Kamchatka. They are concerned about possible pollution of the *Volcanoes of Kamchatka* World Heritage Site, a site designated recently by the United Nations Educational, Scientific, and Cultural Organization.

The protected site consists of five parks: Bystrinsky Park, Kronotsky Nature Preserve, South-Kamchatsky Park, Nalichevsky Park, and the Tundra Nature Preserve.

The environmental groups argue that Aginskoye could pollute Bystrinsky Park, and also argue that Asachinskoye and Rodnikovoye mine sites threaten South-Kamchatsky Park.

Aginskoye is being developed by Kamgold, a joint venture between Canada-based Kinross Gold Corporation, U.S.-based Grynberg Resources, and Russia-based Kamgeo. Asachinskoye and Rodnikovoye are being developed by Canada-based TVX Gold.

The Kamchatka Environmental Control Committee of the Russian Ministry for Environmental Control and Natural Resources supports the Aginskoye mine development, as does the governor of the Bystrinsky Region. In letters to OPIC they brought up the project's economic benefits to the region and environmental controls in place.

Gold market in the works

Russia hopes to establish both a physical and a futures market for gold within the next few months. Since November 1996, when Roskomdragmet was dissolved, gold producers have been unable to sell their gold and an estimated 45 metric tons of metal lies in stock at mines and refineries. Mines have been unable to pay their employees for 2-3 months and production has been effectively suspended.

From February the central bank will once again purchase all gold production and act on behalf of the commercial banks. Thereafter the central bank will participate

continued on next page

Mining, continued

in the proposed new gold market alongside commercial banks and, it is hoped, Western dealers. With gold production running at about 120 metric tons/year, about 90 metric tons/year could come into the market after satisfying local fabrication demand of 30 metric tons/year. Bar sizes will correspond with the 400 oz bar in London, but will also be available in small sizes to encourage private ownership. *Mining Journal* (1-31-97).

Oil, Gas & Energy

Coal might stop

Primorskugol coal company is threatening to stop coal deliveries to the Dalenergo power-generating company in February until the latter pays its 300 billion ruble debt. Primorskugol miners have not been paid since last September—wage arrears come to 180 billion rubles of the total debt. *Capital Markets Report* (2-6-97).

Fuel shortages in Nakhodka

Nakhodka mayor Victor Gnezdilov declared the current fuel shortage an emergency. According to the city administration, heating systems for 80% of residential houses are non-operating. Liquid fuel supplies for boiler rooms, which are the major heat-providing systems in the city, will last only four days. At present, the city administration is negotiating with exporters of liquid fuel to the Asian-Pacific Rim for help in directing some of that fuel to the city in order to patch the problem. *Pacific Star* (1-23-97) in *Sakhalin Oil & Gas Report* (1-29-97).

Russian Legislation

Decree on food labeling

Following is the text of the decree requiring that food products imported to Russia be labeled in Russian by May 1: "With an aim to strengthen the quality and safety control of imported goods, the Government of the Russian Federation approved on December 27, 1996, Decree

No. 1575. *Rules on Ensuring the Availability on Imported Foodstuffs of Information in Russian*, effective as of May 1, 1997.

The Ministry of External Economic Relations, State Committee on Standardization, Metrology and Certification, Ministry of Health Care, and Ministry of Agriculture and Foodstuffs shall ensure the fulfillment of the Decree and introduce necessary changes to appropriate normative acts, regulating wholesale and retail sale of foodstuffs.

The present Rules are developed pursuant to Decree No. 799 of the Russian Federation Government of July 12, 1996, *On Measures to Protect the Russian Federation Consumer Market Against the Penetration of Off-Standard Import Goods*.

Organizations importing foodstuffs into Russia shall provide in the contracts on their delivery as one of mandatory conditions the availability on foodstuffs of information in Russian about structure, food value, period of validity, conditions of storage and application.

Individual entrepreneurs shall not buy import foodstuffs without the information on them in Russian.

The information shall be located on a package or label. In case of small sizes of a package or label on which it is impossible to place the necessary text completely, it is allowed to enclose the information about the good, or part of it, on a supplementary sheet attached to each unit of the good.

The information on foodstuffs should contain the following data:

- name of a product and its kind;
 - country and manufacturer (name of firm may be printed in letters of Latin alphabet);
 - weight or volume of product;
 - names of main ingredients of product, including food additives;
 - nutrition facts (calories, availability of vitamins for products intended for children, remedial and diet nourishment);
 - conditions of storage (for products having limited periods of validity or requiring special storage);
 - period of validity (final date of use or date of manufacturing and term of storage);
 - method of preparation (for semifinished items and products intended for children's nourishment);
 - recommendations for use (for biologically-active food additives); and
 - conditions of application, including contraindication because of any diseases."
- BISNIS* (1-27-97).

Licensing of imported alcohol

Russian prime minister Viktor Chernomyrdin has signed a resolution introducing the licensing of imported alcohol from February 1. Under the new regulations, the customs committee will levy the value-added tax and customs duties in advance. *Capital Markets Report* (2-6-97).

The Russian government had planned on implementing import quotas on strong alcoholic drinks and ethanol, but instead ordered the licensing. It also may increase its tariffs on alcohol and tobacco 20-30% in 1997. *Russian Customs News* (1-97).

New border fees

Under amendments to the law *On the State of the Border of the RF*, individual travelers crossing the Russian border will pay \$10-12 per person, all trucks will be subject to a \$180 levy, and fees on motor vehicles, trains, aircraft, and cargo will be calculated by formula. The fees took effect December 10, but cannot be enforced until border procedures are in place, which is likely to occur during the first quarter of 1997. *BISNIS BULLETIN* (1-97).

On overweight baggage

According to new customs regulations, passengers flying in to Russia must pay \$5 per kg. for any baggage over a 50-kg. limit. The regulation is aimed at collecting money from people who buy goods abroad for resale in Russia. *American Russian Center, Khabarovsk*.

Focus on Sakhalin

Economy

Statistics. At the end of 1996 the Sakhalin region had 180 large and medium enterprises, of which 16% were state enterprises, 3% municipal, 29% private, and 52% mixed enterprises. The largest are JSC Sakhalinugol employing 13,111; JSC Sakhalinlesprom employing 10,396; and JSC Sakhalinmorneftegaz employing 5,160.

Last year industrial production amounted to 6 trillion rubles (in 1996 rubles), 90.7% of 1995 levels. The largest reductions were in timber and mill industries, which came down 29% from 1995 levels; in the construction industry-22%, in food and light industries-23%, and in flour-grinding,

cereals and mix fodder industries-50%. *Free Sakhalin* (1-10-97) by *American Russian Center, Yuzhno-Sakhalinsk.*

Infrastructure development

Construction of Nogliki power station stops. At a late January meeting called by Sakhalin governor Igor Farkhutdinov, construction of the Nogliki Gas Power Plant was officially halted until environmental and local concerns can be addressed. Local dacha owners claim the site is being located closer to them than the 500-600 meters originally planned in order to adhere to environmental regulations. Concerns were also voiced about the plant's proximity to rail tracks, about noise, and about pipe height and quality in order to prevent leaks.

Contractor Sakhalinmorneftegas has not moved forward with construction since December 1996 because sufficient funding has not yet been secured. Officials hope the plant, when completed, will supplement the local economy and decrease power shortages throughout the region. Nogliki is located on north-eastern Sakhalin Island near the off-shore fields. *Free Sakhalin* (2-11-97) in *Sakhalin Oil & Gas Report* (2-13-97).

Water system upgrade. The Sakhalin Regional Administration has budgeted money from oil bonus funds for a water system upgrade in Yuzhno-Sakhalinsk. As we reported in our January issue, water problems are acute in the city. Water is currently only available for limited periods of time each day, particularly in the newer southern regions of the city. Water quality is also a concern, with hepatitis outbreaks and increased levels of harmful chemicals and insect larvae.

Now problems have cropped up in paying for the project. The administration transferred half of the money for the upgrade in August, but delayed transferring the balance until December. The money moved through a bank that went bankrupt, and so was not received. As a result construction companies involved in the project have not been paid. The federal government also promised \$1.4 million but has not yet delivered it. *Sovietsky Sakhalin* (1-21-97) in *Sakhalin Oil & Gas Report* (2-5-97).

International

Japanese ambassador visits Sakhalin. Japanese Ambassador to the RFE Takahero Togo recently visited Sakhalin for the first time. Sakhalin residents expressed displeasure at the Japanese government's decision to host U.S. and NATO military games on Hokkaido. Mr. Togo said that increasing forces there allows Japan to move some of the burden of U.S. military troops from Okinawa. He emphasized the passing of the Cold War and that the Japanese-U.S. alliance provided a stabilizing force in the Pacific Rim. Mr. Togo also discussed the proposed future construction of a bridge or tunnel to connect Sakhalin and Japan. *Free Sakhalin* (2-7-97) in *Sakhalin Oil & Gas Report* (2-13-97).

Gore & Chernomyrdin investment initiative. On February 7 at the eighth meeting of the U.S.-Russian Joint Commission on Economic and Technological Cooperation, U.S. vice-president Al Gore and Russian prime minister Viktor Chernomyrdin issued a joint statement on a regional investment initiative in Russia. They noted that the U.S. and Russia will focus special attention on the RFE and on key U.S.-Russian energy projects involving Sakhalin Island.

Oil and gas projects

An update. Dinty Miller, general director of the American Business Centers in Khabarovsk and Yuzhno-Sakhalinsk, provides the following notes on the Sakhalin off-shore oil and gas projects and the business climate on the island:

Sakhalin I (Exxon Neftegas Ltd., SODECO, Rosneft-Sakhalin, and Sakhalinmorneftegaz Shelf) will continue to do survey work this summer to confirm reserves. Work will include running two platforms. The project will also be constructing western-style single-family and multiple-resident housing in Yuzhno-Sakhalinsk for expatriate employees and Russian employees transferring from Western Russia.

Sakhalin II (Sakhalin Energy Investment Company Ltd. (Marathon Oil, McDermott, Shell, Mitsui and Mitsubishi)) is having a spacer (an understructure) for the Molikpaq mobile drilling and production facility built at the Amur Shipbuilding Plant in Komsomolsk-na-Amure. The company is also having a production unit for the side of the Molikpaq built in Japan. The Molikpaq will drill and produce the oil and then a short pipeline will transport the oil to a

single anchor leg mooring buoy and a storage tanker. In the initial phase of the project, tankers will fill up right there, rather than from an on-shore facility. Sakhalin Energy hopes to have these facilities in place by the summer of 1998 and to produce first oil by 1999. The company also plans to begin construction of a western-style office building and western-style housing in Yuzhno-Sakhalinsk this summer (see following *Sakhalin Energy housing tender* report). Finally, Sakhalin Energy will be doing land survey work this summer in preparation for later-phase land-based facilities.

Sakhalin III Tender (Exxon Neftegas Ltd. has a 100% interest in the Ayashskiy and East Odoptinskiy blocks; Mobil-Texaco have rights to the Kirinskiy block) The companies are still waiting for ratification of their production-sharing agreements.

The business climate. The "boom" is happening slowly. Currently there isn't a lot of building activity in Yuzhno-Sakhalinsk. It may take 1-2 years for many joint-ventures to begin working well. There is also still some caution until normative acts that support the PSAs pass the federal legislature. Timing is critical for U.S. companies coming to Sakhalin—it's an expensive place to do business.

Those companies arriving include international transport companies, engineering firms, and construction firms—especially larger firms are becoming established and setting up offices.

Sakhalin is not the easiest place to live and do business. Food prices are currently rising and selection is going down. Tax and customs authorities are getting more aggressive in collecting money—there are 44 different tax agencies in Yuzhno-Sakhalinsk now. Energy problems on Sakhalin are also worse now and blackouts are common. The general business climate is more difficult than even two years ago. Still, tax reform will happen—it's just a question of time.

Sakhalin Energy housing tender. Sakhalin Energy will hold a tender probably in March for a housing construction project. To qualify, Russian and foreign contractors must be on a pre-qualification list. Sakhalin Energy Infrastructure Manager Stephen R. Cravey said that although it would be difficult for other companies to get on the list at this point, it might not be impossible.

continued on next page

Focus on Sakhalin, continued

The houses are likely to be wooden, two-story pre-fabricated units. The project will start as soon as weather permits this spring and will be carried out in stages over about a three-year period. The end result will be housing for approximately 250 people, about 150 homes. The project will be located on land procured by the contractor from the Sakhalin government.

Preference will be given to joint ventures. Sakhalin Energy maintains a database of Russian and U.S. companies interested in bidding on projects involved with Sakhalin II. Contact: Sakhalin Energy Investment Company Ltd. Address: 693000 Russia; Yuzhno-Sakhalinsk; 32 Kommunisticheskoy Ave.; Sakhalincenter #550. Local tel.: 7(42422)2-39-42 or 7-35-51. Intl. tel.: 7-504-41-62013. Local fax: 7(42422)2-35-61. Intl. fax: 7-504-41-62012. *Sakhalin Oil & Gas Report* (2-19-97).

OPIC protocol with Sakhalin Energy. At the eighth meeting of the U.S.-Russian Joint Commission on Economic and Technological Cooperation held in Washington D.C. February 7, Ruth R. Harkin, President and CEO of Overseas Private Investment Corporation (OPIC), signed a protocol with Sakhalin Energy for \$116 million in project financing for the Sakhalin II project. U.S. vice-president Al Gore and Russian prime minister Victor Chernomyrdin witnessed the signing. Under the protocol, Sakhalin Energy will proceed on an expedited basis to complete its application with OPIC for project financing, and U.S. partners Marathon Oil and McDermott International Inc. may consider applying for OPIC political risk insurance. Tel. for OPIC: (202)336-8636. *OPIC* (2-7-97).

Strike at Amur Shipbuilding Plant. *Pacific Star* (2-8-97) reports that three hundred workers at the Amur Shipbuilding Plant in Komsomolsk-na-Amure staged a one-hour strike protesting non-payment of wages for four months now, low wages and lack of safety clothing needed for work. Employees shut down work both on the spacer (understructure) for Sakhalin II's Molikpaq mobile drilling and production facility and on the refitting of a barge with a nuclear waste processing facility for Primorye.

An update on Petrosakh. In March Mahfood Binhameed, vice-president of operations for the past two years, will succeed Laszlo Karoly, Petrosakh president since September 1995.

Petrosakh is currently the only international petroleum operator producing and refining oil on Sakhalin—in the Okruzhnoye field in the Pogranichni basin mid-way up the western side of the island. Petrosakh is 95% owned by Nimir Petroleum Limited and 5% by Russian partner Sameco.

In 1994 the company constructed a refinery on the island which, under the terms of the licensing agreement, refines for local consumption 40% of the oil it produces. At 3,800 bpd, this oil meets 25% of Sakhalin's need for refined products. The rest comes from the mainland. Because, however, mainland supplies are often interrupted by shipping service problems brought about by strikes, fuel shortages, etc., Sakhalin power plants often call on Petrosakh to supply fuel oil on credit in order to bring relief to frequent power shortages. Refinery output is 9% kerosene, 20% diesel, 35% gasoline and 36% fuel oil.

In 1996 Petrosakh drilled three new development wells and one exploration well and completed the construction of a new marine terminal.

Petrosakh currently produces about 6,400 bpd of crude. It exports the 60% not refined on the island via the Okruzhnoye sea terminal during the summer and the port of Korsakov during the winter. China is a major customer. Another noteworthy customer is Tesoro Alaska. It transports local fuel oil by road to the town of Pervomaik and then by train to final destinations on the island. The company employs about 500, 96% of whom represent local skilled labor.

With exploratory drilling completed in December, the Pogranichni basin is fully explored, and the Okruzhnoye field is considered mature. Ten production wells are currently in operation and, due to a fractured reservoir, no additional wells are required. The use of secondary recovery techniques is deemed too expensive for the small Okruzhnoye field.

The future of Petrosakh is uncertain at present. Nimir originally made the decision to invest on Sakhalin in the hopes that the tax atmosphere in Russia would improve. The tax burden, however, has continued to increase. Petrosakh is currently required to pay 38 different taxes, 45% of which are

local and 65% of which are federal. Total taxes paid in 1996 exceeded \$14 million, even though the project lost \$1 million.

Unlike the upcoming offshore projects, Petrosakh is not protected by a Production Sharing Agreement (PSA). The company is seeking such an agreement, but no legislation currently exists to allow a company to convert from a joint stock company to a PSA.

As one of the only operating companies on the island to pay full taxes on time, Petrosakh is a major source of tax revenue and receives a great deal of support from the Farkhutdinov administration.

Petrosakh is also required to pay taxes on profits at the point of sale. Doing so is not a problem when exporting crude, but the products the company is required to sell domestically are often not paid for in a timely manner. Thus, the company is required to front not only the cost of producing the product, but the tax on unreceived profits as well. Debt from local customers presently exceeds \$4 million.

Another growing concern is increased taxes and certification regulations on food supplies imported for camp consumption, even though they are not for resale. One shipment was held for two months at a storage cost to the company of \$18,000.

Petrosakh is currently seeking to cut costs and to lower tariffs in order to decrease the need for parent-company financing. For the company to continue to operate much longer under the current conditions, it would need to be awarded new fields. Otherwise, increasing costs and decreasing profit potential may force it to evaluate other options, one of which would be to reorganize as a new company, allowing it to seek a PSA. *Sakhalin Oil & Gas Report* (1-29-97).

Exploration licenses lost. In December several Sakhalin companies lost exploration licenses to oil and gas fields offshore Sakhalin because they had not begun research and exploration of the fields. According to Peter Sadovnik of Sakhalingeolcom, the fields are located on the east and west coasts of Sakhalin, encompass an area of 500 sq. km., and may contain ten million tons of fuel. Samir and Sameto had their licenses revoked; oil joint stock company Shelf voluntarily gave up its license.

The companies were not able to begin research and exploration mainly because they lacked financial means. According to Peter Sadovnik, the current tax policy is to

blame for discouraging investment in research and exploration. *Free Sakhalin* (1-17-97) by *American Russian Center, Yuzhno-Sakhalinsk*.

Politics

Sakhalin Duma cuts money to Moscow. On February 11 the Sakhalin Regional Duma passed a resolution halting the transfer of all payments to the federal treasury because of non-payment of wages owed to Sakhalin workers by the Ministry of Finance. The Sakhalin government has, though, fulfilled its financial obligations to the federal government for 1996. The Ministry of Finance first responded with threats and then with a promise to transfer 126 billion rubles to Sakhalin for 1996 debts, and earmark an additional 10 billion rubles for Sakhalin. *Sovietsky Sakhalin* (2-13 & 2-19-97) in *Sakhalin Oil & Gas Report* (2-13 & 2-19-97).

Travel

Alaska plans to fly to Yuzhno. Pending approval by Russian authorities, Alaska Airlines has announced that it will begin direct service from Anchorage to Yuzhno-Sakhalinsk on May 15. Alaska plans to fly to Yuzhno-Sakhalinsk on Thursdays (arriving on Fridays) and return to Anchorage on Mondays (arriving on Sundays).

Alaska Airlines began regular service to Russia in 1991 and currently flies to Khabarovsk, Magadan, Petropavlovsk-Kamchatsky and Vladivostok. For reservations and more information, contact Alaska Airlines' international desk at 1-800-308-0101.

ABC Yuzhno is agent for Alaska Airlines. The American Business Center (ABC) in Yuzhno-Sakhalinsk is the booking agent for Alaska Airlines on Sakhalin Island. Alaska Airlines passengers there may contact the ABC for travel assistance. Local tel.: 7(42422)2-31-42. Intl. tel.: 7-509-95-1545. Intl. fax: 7-509-95-1540. E-mail: abc@abc.sakhalin.su.

Fuel shortages grounding SAT flights. Fuel shortages on the island grounded Sakhalinsk Aviatrassy (SAT) flights for a number of days in early February. SAT arranged a special flight Friday February 7 to get Sakhalin Duma members and PAC COM conference participants off the island and on their way to Anchorage, but several travelers remained stranded on Sakhalin.

Passengers to Burivestnik in the Kuril Islands were unable to leave Yuzhno-Sakhalinsk for an entire week due to the

lack of fuel. SAT is the only company servicing the Kurils from Sakhalin.

SAT has resumed regular service to Khabarovsk, but is fueling primarily in Khabarovsk through an agreement with Khabarovsk Air. It has canceled flights to the Kurils and to Okha for an indefinite period of time. The majority of SAT's fuel reserve on Sakhalin is slated for international flights. *Sovietsky Sakhalin* (2-13-96) in *Sakhalin Oil & Gas Report* (2-13-97).

Snowstorm paralyzes island. Two days of heavy snow and strong winds have paralyzed life on Sakhalin, cutting off flights and ferries between the island the mainland. About 1.5 feet fell and wind gusts reached 65 mph. One man died in an avalanche. *Associated Press* (2-19-97).

Timber

Japan offers loan

The Japanese government will provide Russia with a \$100 million credit for timber harvesting in the Far East. ITAR-TASS reported on February 4. The loan will be repaid with supplies of 3 million cubic meters of Russian timber to Japan over five years. The money will be available in the form of loans from Japan's Export-Import Bank. Japanese trade and engineering companies participating in the credit agreement are also likely to get part of the \$500 million Japanese humanitarian aid package, which was frozen in 1991 and unlocked in November 1996.

Meanwhile, Russian financial authorities have expressed concern that Russian timber exporting companies are concealing their income from tax collectors. A spokesperson for the Far Eastern Tax Service said that timber exports to Japan topped 450,000 cubic meters in 1996, a 36% increase over the previous year. A large proportion of this amount was sold through barter deals which are often used as a way of concealing export revenue and taxes from authorities. *Natalia Gurushina, OMRI Russian Regional Report* (2-5-97).

Canada sells equipment

Amurskiy Furniture Combinat, a joint stock company, has signed a \$421,000 contract with Morbach of Canada for timber-processing equipment to arrive in Amursk in May. With this equipment the factory will be able to increase its output and

quality of export products which it ships mainly to Japan and South Korea. *Pacific Star* (2-15-97) by *American Russian Center, Khabarovsk*.

Lumber plant in Poronaik

The board of directors of Sakhalinlesprom joint stock company recently approved an investment program for construction of a lumber plant at Poronaik, Sakhalin. The plant will manufacture prefabricated homes, export-quality lumber and particle board. The project will be part of a federal program to develop the timber industry in the RFE. Loans to cover purchases of U.S. equipment and technology will come from the U.S. Export-Import Bank. The total project is estimated at \$100 million. *Znamya Truda* (2-6-97) in *Sakhalin Oil & Gas Report* (2-13-97).

Transportation & Shipping

Air traffic control modernization

A \$30 million project is in the works to modernize air traffic control in the RFE. It will involve procurement and installation of air traffic control equipment and navigational aid systems in the RFE.

The U.S. Trade and Development Agency funded a feasibility study on the project, which was completed in 1994 by Booz Allen & Hamilton. The European Bank and Development is considering provision of a loan to fund procurements. Final agreement with EBRD on lending terms and announcement of a tender have been delayed by personnel changes and structural reorganizations at Rosaeronavigatsiya and its parent entity, the Russian Ministry of Transport.

Expected tender release is in first quarter 1997. The contracting authority is: Department of Air Traffic Control (formerly Rosaeronavigatsiya), Mikhail Ushakov, Head. Tel. (in Moscow): 7(095)155-5310. Fax: 7(095)155-5335. *U.S. Embassy, Moscow* (2-12-97).

Travel Tips

Notes on Khabarovsk

When I came down with a sinus infection during a recent stay in Khabarovsk, I made the following discoveries:

- You can get a wide variety of drugs, including over-the-counter antibiotics manufactured in Europe, at the three Dal'farma stores in Khabarovsk: 1). Karl Marks St. 45, tel.: 21-06-26, open 9am-8pm, no breaks; 2). Muravyova-Amurskogo 22, tel.: 38-83-56, open 8am-8pm, break 2:30-3:00pm; and 3). Muravyova-Amurskogo 1, no tel., open 24 hours, no breaks. You will need to be able to recognize the generic name of the drug in Cyrillic.
- The Dal'-U Sauna, a luxury bathing and sauna establishment, is a treat whether you're sick or not. Cost is 88,500 rubles for two hours; daily rates are also available. Mo. Wed. Fr. are women's days; Thu. Sat. are men's; and Tues. Sun. are family. Bathing suits are worn only on family days; bring your own shampoo. Open 11am-11pm. Located at Moskovskaya St. 7. Tel.: 33-53-89.

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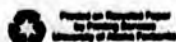


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**** SAMPLE ****

The following report is a publication of the Troika ALASKA Commercial Center in Yuzhno-Sakhalinsk, Sakhalin Island, Russia. The Director of the Yuzhno-Sakhalinsk office is Todd Crossett. The Office Manager is Elena Danilova. Robin Zerbel, Director, can be reached at 421 West First Avenue, Suite 300, Anchorage, Alaska 99501, tel: 907-278-7233, fax: 907-278-2982, e-mail: ANRRZ@uaa.alaska.edu

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**Sakhalin Oil and Gas Report
Troika ALASKA Commercial Center
Yuzhno-Sakhalinsk, Russia
February 28, 1997**

Ruble Exchange Rate: 5660

Sakhalin I Selects Kvaerner Oil and Gas Ltd. for Platform Construction

The Sakhalin I oil and gas development project has selected Kvaerner Oil and Gas Ltd. to assist in the construction of a world class production platform to be located on the Arkutun Dagi offshore field. Involved in the effort will be: project management, engineering, procurement, and construction management for the platform's jacket and topsides. The total cost, installed, is estimated at one billion USD.

A fixed jacket will support a 20,000 to 30,000 ton topside with drilling equipment, processing facilities and living quarters. The platform is expected to have a daily capacity of 115,000 barrels of oil and 360 million cubic feet of gas. The project execution team will be based in London.

Contact Information:

In USA:

Contact person: Derek Disney
Of: Kvaerner John Brown
Tel: (713) 270-2380

In UK:

Project Director: Borger Mabraten
Tel: 44 (181) 401-0695
Or: George Mowatt
Tel: 44 (181) 401-0600

In Oslo:

Vice President of Corporate Communications: Marit Ytreeide
Tel: 47-67-51-3106 or 901-28-308
(Kvaerner Press Release)

Head of Protocol Division Hired by Sakhalin II

Anatoli M. Samolenko, former Head of the Protocol Division of the Sakhalin Administration Department of Foreign Economic Affairs, has been hired by Sakhalin Energy as the Recruiting and Human Resources Coordinator for the Russian side. Vladimir Nosov is the current acting Department Head of the Protocol Division. A permanent replacement for Mr. Samolenko has not yet been named.

Mr. Samolenko said Sakhalin Energy has advertised job openings and is currently accepting resumes. In the short term, they plan to fill ten mid-management positions in technical fields, such as: environmental science, electrical engineering and process training. Priority will be given to Sakhalin residents, but it is expected that some specialists will also be relocated from elsewhere in Russia. Mr. Samolenko added that many specialists are already located on Sakhalin, but that, having mostly been involved in research, they are not yet experienced in offshore production. Specialists from FEMCO, for example, have recently been working in Vietnam as advisors for oil and gas exploration there.

(From a Troika interview with Anatoli Samolenko, February 24, '97)

Aviation Fuel Shortage - Update

An aviation fuel shortage on Sakhalin Island continues to curtail service on the Sakhalin carrier, SAT, to certain local destinations. Service remains canceled to Okha, the Kuril Islands and Vladivostok. However, SAT is still operating local flights to Khabarovsk and international flights to Hokkaido, Seoul and Pusan. A tanker of fuel is reportedly to be shipped from Nakhodka. Two hundred million rubles were granted to SAT, from the Sakhalin Regional fund, for buying fuel.
("Sovietsky Sakhalin," February 22, '97)

Sakhalin Personal Profiles

Ivan Pavlovich Malakhov, First Vice Governor of the Sakhalin Region. Also the Head of the Department of Planning and Development.

Mr. Malokhov was born in the Astrakhan Region in 1953. He attended the Leningrad Engineering College, graduating in 1977. From graduation to 1987, he served as an officer in the Soviet Armed Forces. In 1990 and 1991, he was First Vice-Chairman of the Executive Committee of Nevelsk, on Sakhalin Island. From 1991 to 1996, he was the Mayor of Nevelsk. In 1995, he earned a doctorate in economics from the Russian Academy of State Service, under the President of the Russian Federation.

Since September, 1996, he has been Head of the Sakhalin Department of Planning and Development. As such, he is also Head of the Sakhalin Infrastructure Development Committee. This committee is responsible for developing short and long term infrastructure development goals and funding priorities. Mr. Malakhov is reportedly of the personal opinion that financial priority should be given to the development of leading local enterprises and that 10 to 15 percent should go toward social development. Mr. Merkoshev is the First Deputy of Mr. Malakhov and is in charge of coordinating proposals gathered from department heads and from Mayors of Sakhalin communities.

Mr. Malakhov is married and has two children.
(Public Record)

Sakhalin Duma Delegation to Anchorage Returns

* A Sakhalin Duma Delegation, headed by Vladislav Rukavets, returned recently from Anchorage where they were guests of Sakhalin Energy. The deputies studied the preparations of the Sakhalin II project players for the development of Sakhalin shelf. They also learned about Alaskan oil and gas production and distribution - paying particular attention to how Alaskans dealt with environmental safety.

Also during the ten day trip, the Sakhalin Regional Duma and the State of Alaska Legislature signed a memorandum of cooperation. According to Zinaida Sbotova, Chairman of the Legislation Committee of the Sakhalin Region Duma, the Sakhalin Duma plans to use the experience of Alaska's Legislature while preparing Sakhalin Region draft bills related to the Sakhalin Shelf.
("Pacific Star," February 26, '97)

Yuzhno-Sakhalinsk Mayoral Candidates

The electoral committee has register the following candidates for Mayor of Yuzhno-Sakhalinsk:

- * Aldoshin, Vitaly Tikhonovich. Born June 26, 1933. Deputy of General Director of the Joint-Stock company "Sakhalinlesprom".
- * Labay, Vladimir Romanovich. Born April 10, 1955. Chairman of the Sakhalin Administration Construction Department.
- * Sidorenko, Fyodor Ilich. Born May 19, 1950. Chairman of the Sakhalin branch of Russian Federal Hard Currency and Export Control.
- * Kruglov, Vyacheslav Mikhaylovich. Born February 19, 1948. Director of a municipal enterprise, "Yuzhno-Sakhalinsk Passenger Car Transportation."
- * Vatazhnikov, Pavel Borisovich. Born 1955. General Director of the Joint-Stock company "Novoaleksandrovsk Car Enterprise."
- * Semikolennikh, Oleg Mikhaylovich. Born October 12, 1939. Chairman of the Cooperative, "Mostovik".

The City Elections are to be held on March 16.

Nogliki District Elections

On March 16, the Region of Nogliki will hold elections for Regional Council deputies and for the position of Mayor of the Nogliki District. The Mayor and seven deputies are elected for four year terms. Nogliki is located on north-east Sakhalin, and is a logical hub for offshore activity.
("Znamya Truda," February 18, '97)

Sakhalinmorneftegas Review of 1996

Rosneft-Sakhalinmorneftegas reports a successful year in 1996. Profits increased 40%, from 315 billion rubles in 1995 to 470 billion rubles in 1996. Planned drilling work for the year was actually exceeded by three percent. Sakhalinmorneftegas (SMNG) put on-shore gas fields into production and commenced work on the Sakhalin I and II projects.

The average wage for SMNG workers doubled, increasing from 1,100,000 rubles per month in 1995 to 2,100,000 rubles per month in 1996. Three billion rubles were also spent on medical equipment and approximately 700,000 rubles, per employee, on medical treatment.

Problems encountered by SMNG include still unpaid debts for oil delivered to Khabarovsk Krai and high prices for Sakhalin oil, driven by high costs. SMNG has had to work out a cost reduction program to lower prices in order to compete with Siberian oil producers.
("Znamya Truda," January 29, '97)

Local Insurance Companies Unite Against Outside Competitors

Sakhalin insurance companies are appealing to Sakhalin Governor Igor Farkhutdinov in their struggle to prevent an exclusive insurance agreement between the Regional Administration and Moscow based joint stock insurance company "Rosno". The agreement would grant the rights to insure all shelf projects. Also under the contract, the Regional Administration would cover all of Rosno's risks connected to the Shelf projects. In return Rosno would invest two trillion rubles in the Region.

Eight insurance companies held a special meeting of the "Sakhalin Insurance Companies" organization, established by Farkhutdinov. Although Rosno has opened a branch office on Sakhalin, the local companies protest that awarding the contract to the Moscow based firm will increase the flow of money off the Island. They also argue that Rosno specializes in private and medical insurance and that their service structure consists of only two percent property insurance. They feel the Shelf projects should be insured by someone with greater experience with marine and oil and gas projects.

In response, the local Sakhalin insurance companies have put their own plan before the Governor. According to this plan, one local company would serve as the coordination leader, allowing other Sakhalin insurance providers to join that company. Foreign insurance companies would then be allowed to serve the Shelf projects - but only in conjunction with Russian companies. In addition, foreign insurance contracts would be allotted through a competitive process, guaranteeing the Region the ability to choose the most profitable terms.

The reporter feels the Governor is aware of the need to keep large insurance contracts on Sakhalin but is also torn by the need to meet regional financial commitments, such as wage and pension debts.
("Svobodny Sakhalin," February 21, '97)

Sakhalin State Duma Representative Speaks Out Against PSA's

Sakhalin Representative to the Federal Duma, Ivan Zhdakaev, a Communist Party member, spoke out recently against the Production Sharing Law. His arguments are the following.

1. He feels that "supplement E" of "issue 18", will oblige Russia to reimburse oil companies all previous tax payments. He feels this would be a great financial loss to Russia.
2. He accuses Regional Duma Deputies and Sakhalin inhabitants of knowing little about the agreements of the Sakhalin Projects.
3. He does not believe there have been conclusive positive decisions by Russian ecological institutions about the proposed oil-gas pipeline construction on South Sakhalin Island.

He goes on to accuse an unknown entity of being interested in forcing inhabitants off of North Sakhalin in order to sell off its resources and that "nobody knows who will become the master of these new treasures."
("Gubernskie Novosti," February 27, '97)

Submarines Seek Work on Shelf

* Professor G. Turmov, Rector of the Far Eastern Technical University, recently addressed the Sakhalin Region Administration with a proposal to enlist submarines to carry out work on marine oil drilling platforms for the Shelf projects, including: production, installation and ice proofing. Scientists of the Marine and Construction Institutes of the Far Eastern Technical University are ready to draw feasibility studies, design a sketch project and prepare a business plan. The scientists claim their proposal will solve the following problems. First of all, a large number of aging diesel and nuclear submarines, owned by the Russian Pacific Fleet, need to be put to work. Secondly, Russian Far East ship repairing plants are facing difficulties with conversion and are currently overloaded with orders, creating a potential environmental hazard. And thirdly, they believe the use of submarines will reduce platform construction costs. The Sakhalin Region Administration plans to examine this proposition.
("Pacific Star," February 19, '97)

Sakhalin Oil & Gas Report

Sakhalin Island, located off the southeastern coast of the Russian Far East just north of Japan, is the site of enormous oil & gas deposits being developed by Exxon, Sakhalin Energy Corporation (McDermott, Marathon, Mitsui, Mitsubishi, & Shell), Mobile, Texaco, and others. **Investments by these multi-national corporations in the first two development projects alone will total over 25 billion USD.**

The SAKHALIN OIL & GAS REPORT is a **no-frills, 1-page information brief distributed weekly** (48 weeks, excluding major holidays) via e-mail from the World Trade Center Alaska's office in Yuzhno-Sakhalinsk, the capital of Sakhalin Island.

The Report will keep you up-to-date on the status of the oil & gas projects, and will include:

- information from local newspapers on oil development projects
- press releases from the energy companies located on Sakhalin
- updates from the Sakhalin Regional Administration and other players
- progress/status reports on the energy companies' current activities and time-lines
- tender announcements (when possible)
- personnel changes in the energy companies/regional administration and other similar information

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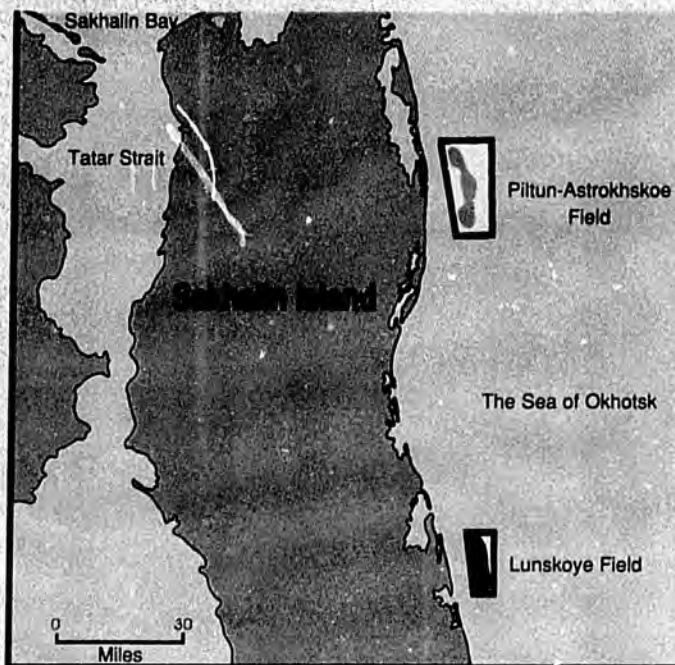
THE SAKHALIN ENERGY PROJECT



**The first project to proceed under
production sharing terms in Russia**



BACKGROUND



Region Map

Oil and gas have been produced on Sakhalin Island for more than 60 years. Most onshore fields are almost depleted. Several large hydrocarbon deposits have been discovered off the northeastern shore of the island over the last 20 years, including the Odoptu Field in 1977, Chaivo in 1979, Lunkoye in 1984, Piltun-Astokhskoye in 1986, and Arkutun in 1989.

Tender

In May 1991 an offshore tender was announced for development of the Sakhalin shelf, which attracted a number of major multinational oil companies experienced in working in harsh Arctic environments.



After winning the tender, a group of companies which later became known as the MMMMS Consortium, together with Russian experts, completed a Feasibility Study for the development of the Piltun-Astokhskoye and Lunkoye offshore fields (the Sakhalin-II Project). In March 1993, after examination of the Feasibility Study the Finance and Environment Ministries of the Russian Federation recommended the Russian Federation sign an agreement with the MMMMS Consortium to develop these fields on the basis of production sharing.

Sakhalin Energy

In April 1994, the MMMMS Consortium formed Sakhalin Energy Investment Company, Ltd. for the centralized management of the Project on behalf of its shareholders.

Shareholders in the Sakhalin Energy Project

Marathon Sakhalin Limited	(30%)
McDermott Sakhalin, Inc.	(20%)
Mitsui Sakhalin Development Co., Ltd.	(20%)
Shell Sakhalin Holdings B.V.	(20%)
Diamond Gas Sakhalin B.V., a wholly owned subsidiary of Mitsubishi Corporation	(10%)

Each of the Sakhalin Energy shareholder companies is well-known internationally and, because of their long record of successful multibillion dollar oil and gas projects, each of these companies enjoys a high reputation in the oil and gas community, and with the countries in which they work.

The Production Sharing Agreement (PSA)

Sakhalin Energy signed its Production Sharing Agreement with the Russian Federation in June 1994. The agreement gave Sakhalin Energy the right to explore, develop and operate the Piltun-Astokhskoye and Lunkoye fields.

Under the terms of a PSC, the investor is paid for his efforts through a share of the production from the project. Typically, revenues from the production are used first to pay a royalty to the host government for use of its subsoil resources. Next, the operating company is reimbursed the costs of development and operation. Remaining revenues are then split between the investor and the host government according to a sliding scale which gives the host country the greater share of revenues according to the rate of return. A scheme like this offers benefits to both the host country and the investors. It allows the host country to develop its natural resources, obtain early revenue from the development, and to maximize its share of revenue should energy prices rise or production exceed expected levels. At the same time it provides greater certainty for investors that they will recover their costs and earn an acceptable return.

Since Russian legislation governing the relationship between parties exploring for hydrocarbon resources was still in its formative stages at the time of signing the Sakhalin Energy PSC, implementation was made conditional upon the enactment of certain laws in Russia. These laws would establish a legal framework for the development of oil and gas fields under production sharing terms.

In December 1995 the Russian Federation State Duma enacted a "Law on Production Sharing Agreements." This was a key step toward the creation of a legal basis in Russia for agreements of the production sharing type. Work also began on other legislative acts needed to establish a coherent and comprehensive regime.

Licences

In May 1996 the Russian Federation issued licences to Sakhalin Energy to develop the Piltun-Astokhskoye and Lunkoye fields.

Commencement Date

On May 21 1996, Sakhalin Energy, according to terms of its PSC, notified the Russian party of an official Commencement Date for the Project. When making this announcement, Sakhalin Energy emphasized that critical elements of the legal framework for PSCs still had to be resolved, and until then development could not go forward.

BRIEF DESCRIPTION OF THE PROJECT



Geological Setting

Piltun-Astokhskoye is an oil field with associated gas. Lunskeye is a gas field with associated oil and condensate. The fields are located 13-16 km off the east coast of Sakhalin Island, in the Sea of Okhotsk.

It is estimated that the two fields contain recoverable reserves of 100 million tonnes (750 million barrels) of hydrocarbon liquids and 494 billion cubic meters (14 trillion cubic feet) of gas.

Environmental Conditions in the Sea of Okhotsk

Ice season	-up to nine months a year
Seismicity	-up to magnitude 8 Richter
Ice field thickness	-1.5 to 2 meters
Water depth	-30 to 50 meters

These characteristics of the Sakhalin shelf were given careful consideration in the Feasibility Study, and they will be taken fully into account in the preparation and approval of the detailed development plans.

Environmental Protection

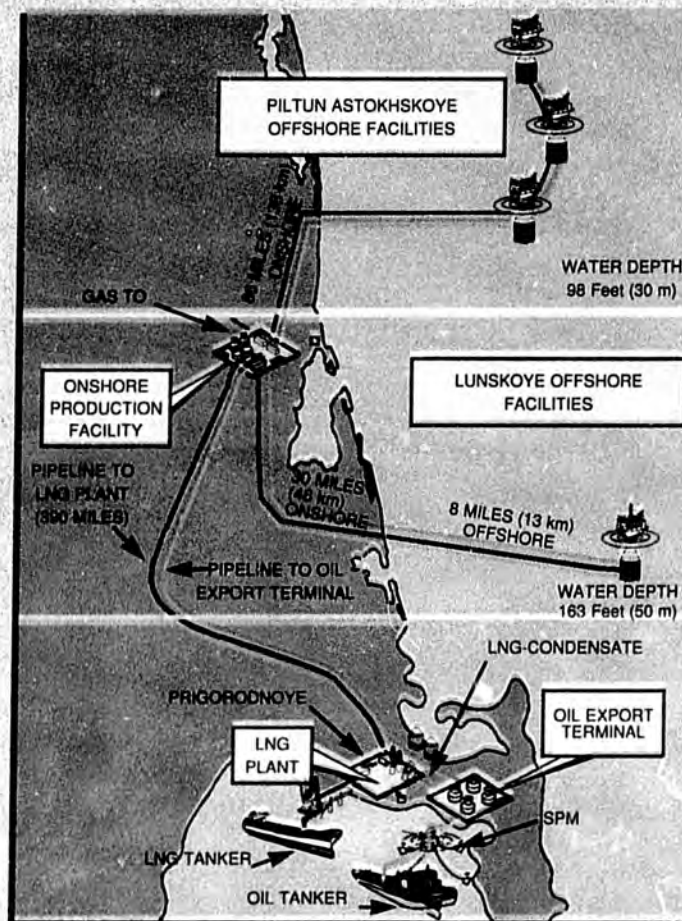
Sakhalin is an island of great natural beauty. To ensure it remains so, the Project's PSC contains detailed provisions for environmental protection. In adhering to these, Sakhalin Energy will, at all stages of development, apply standards and procedures designed to achieve the lowest possible risk for existing ecosystems.

These standards and procedures will be based on the considerable experience that the shareholders of Sakhalin Energy have gained in working in ecologically sensitive and seismically active environments such as the North Seas and Alaska. Technology that has been developed in these regions has helped to establish a balance between the needs of the environment, local inhabitants, commercial interests such as fisheries, and the oil and gas projects.

Project Financing

Given the harsh climate and difficult geological conditions in both field areas, comprehensive implementation of the Sakhalin Energy Project will require considerable capital, estimated in excess of \$10 billion.

When fully implemented, the Project will be one of the largest private investment ventures in Russia. In addition to shareholders' capital, project financing will be sought using international credit agencies such as the World Bank, European Bank for Reconstruction and Development, US Eximbank and the Japanese Export-Import Bank.



The Project Concept

Development Scheme

Since completion of the Feasibility Study, Sakhalin Energy has continued to work on finding the best development schemes for both fields.

Based on available data the following options are being considered.

Molikpag Platform



Piltun-Astokhskoye Field

Given the elongated shape of the field, and the fact that geologically it divides into two parts, the most economic solution is a phased development.

Sakhalin Energy has prepared a proposal for a first phase development using an existing large-scale mobile drilling and production unit known as the "Molikpaq." This proposal is now under discussion with Russian specialists. Use of the Molikpaq will enable development work on the field to commence immediately, with the possibility of oil production as early as 1999. This phase alone will cost in excess of \$500 million. Discussions are underway with international lending agencies for financing a large part of this cost.

Additional appraisal work on this field will also be carried out.

Lunskoye Field

The proposed scheme for this field provides for the installation of a production platform with a yearly output of 15.5 billion cubic meters of gas.

A subsea pipeline will transport gas and condensate to an onshore facility for further processing and transportation through an onshore pipeline to the south of the island for domestic consumption and for export. The gas to be exported will be converted to liquefied natural gas (LNG) at an LNG plant and then shipped out in LNG tankers.

Many issues need to be addressed before final decisions can be made about this scheme. However, the proposal to export Lunskoye gas as LNG will require the construction of a large-scale high-technology gas liquefaction plant. This would place Sakhalin among those countries of the Pacific rim which have attained a high level of economic development thanks in part to the export of LNG in this energy-hungry region.

Immediate and Long-term Benefits for Russia

Revenues

Under the PSC, the Russian party will receive a combination of benefits in hard currency and actual production. These will be in the form of royalties, a share of production, and profit taxes. The cumulative share of revenues to the Russian party over the life of the Project will exceed 50%, and would amount to several billion dollars. If oil prices or production levels are greater than anticipated, the Russian authorities will receive the greater share of the resulting increased revenues.

Bonus Payments

Under the PSC, Sakhalin Energy is to pay bonuses to the Russian Party upon certain events occurring. The Russian Federation was paid a bonus of \$15 million when the Feasibility Study agreement was signed in 1992. A bonus payment of \$15 million was also paid when the Commencement Date was declared in June 1996. Further bonuses will be awarded upon announcement of Development Dates for the two fields (\$15 million for Piltun-Astokhskoye and \$20 million for Lunskoye).

Sakhalin Development Fund

When development of the fields commences, Sakhalin Energy will establish a Sakhalin Development Fund, to which the company will contribute \$100 million over five years. The aim of the Fund is to develop and improve the social and economic infrastructure of Sakhalin Island.

Russian Content

The PSC also provides that Sakhalin Energy will, over the lifetime of the Project, use its best efforts to maximize the use of Russian companies and specialists. Subject to meeting requirements on quality, cost and scheduling, a target of 70% Russian content is set.

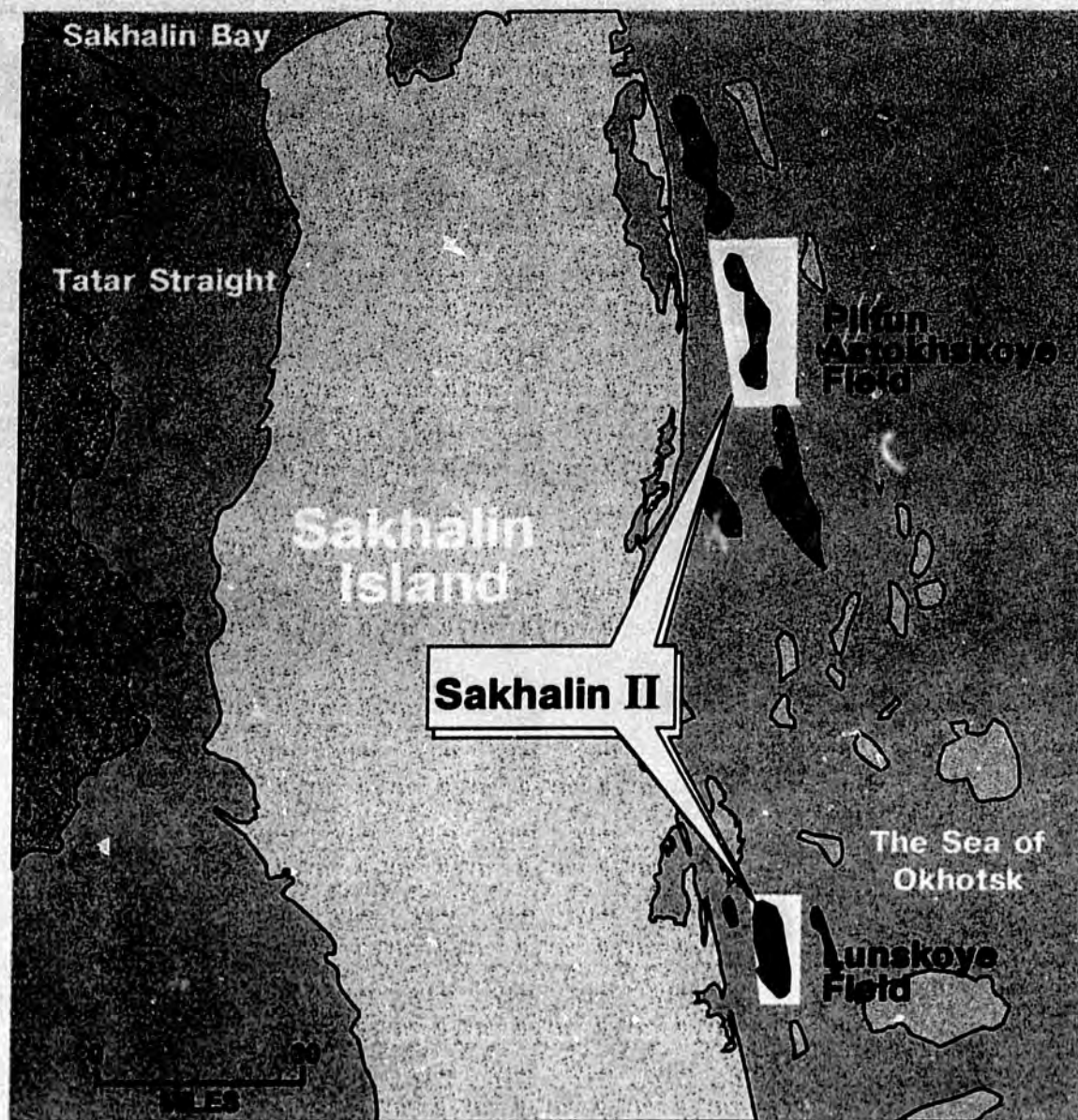
In addition Russian workers will be required by other companies that support the Sakhalin Energy Project and future large-scale offshore oil and gas projects. Experience with similar development projects in other parts of the world has proven that projects of this magnitude create additional non-project job opportunities covering a wide range of occupations, such as transportation and communications jobs to educational and social service positions. Growth in the variety and the number of available jobs will continue into the future with additional offshore developments. The Project's full benefits will be realized by Russians as they assume roles of suppliers for products and services at competitive terms of quality, price, and deliverability.

Sakhalin Energy Investment Company Ltd.

The Sakhalin Energy” Project

*The first production-sharing project to be
implemented in Russia*

Sakhalin Energy Investment Company Ltd.



Sakhalin Island

-  Gas fields
-  Oil & Gas Fields
-  Perspective Areas



Sakhalin Energy Investment Company Ltd.

SAKHALIN II PROJECT MILESTONES

22 June 1994	Sakhalin II Production Sharing Contract entered into between Sakhalin Energy and the Russian Federation
11 January 1996	Law on Production Sharing Agreements Enacted
20 May 1996	Licenses Awarded to Sakhalin Energy for Development of Piltun-Astokhskoye and Lunskeye Fields
21 May 1996	Commencement Date Declared by Sakhalin Energy for Development of Piltun-Astokhskoye and Lunskeye Licence Areas
24 June 1996	First Phase Development Proposal Announced
15 November 1996	Contract Award to Amur Shipbuilding

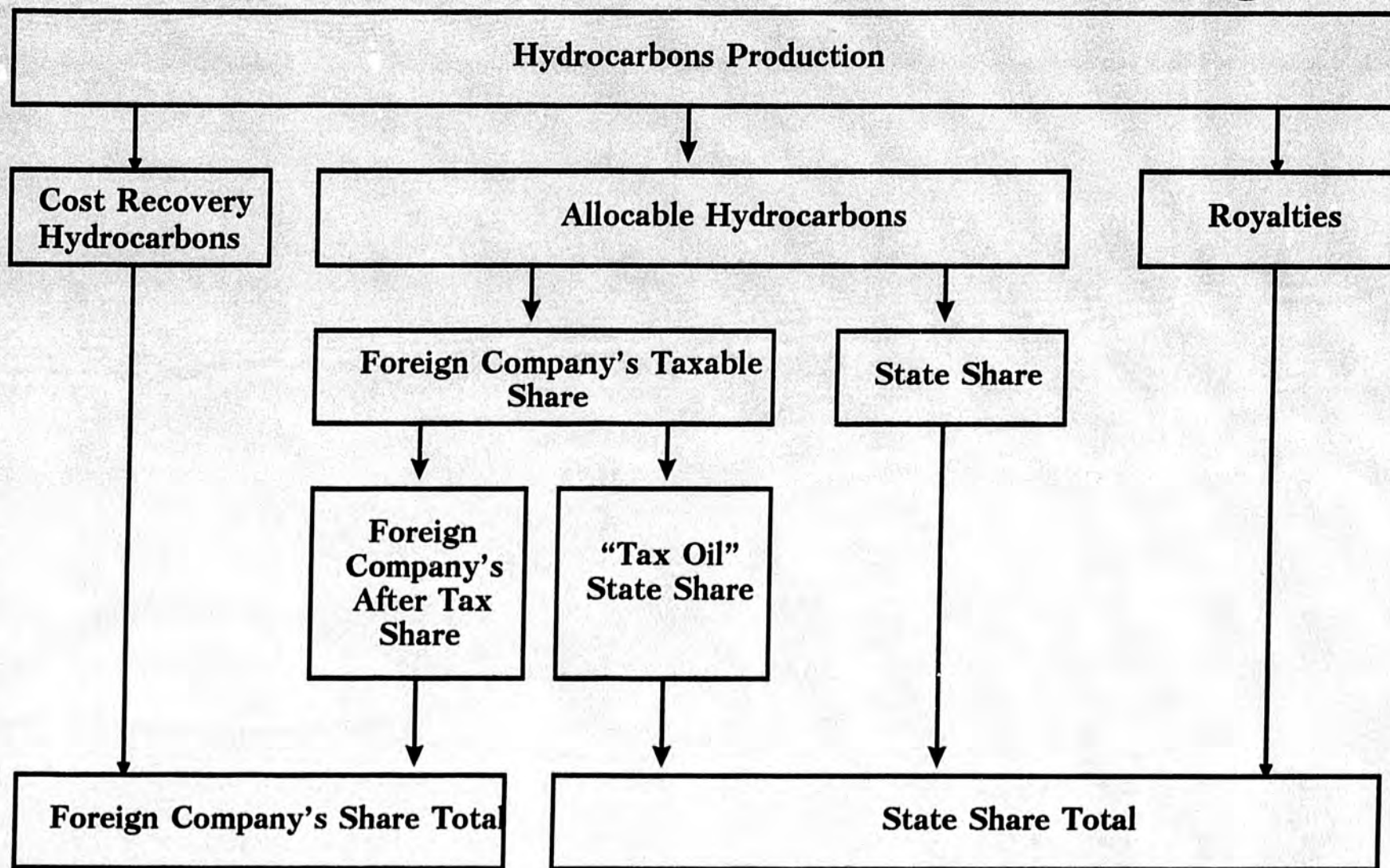
Sakhalin Energy Investment Company Ltd.

REASONS FOR PRODUCTION SHARING AGREEMENT

- ◆ Nation retains ownership of natural resource
 - ◆ Nation does not need to find development capital
 - ◆ Avoids negative impacts of new and developing taxation regimes which discourage investment
 - ◆ Investor's capital is at his own risk on his technical performance
 - ◆ Nation gets virtually all benefit of future energy price increases
-

Sakhalin Energy Investment Company Ltd.

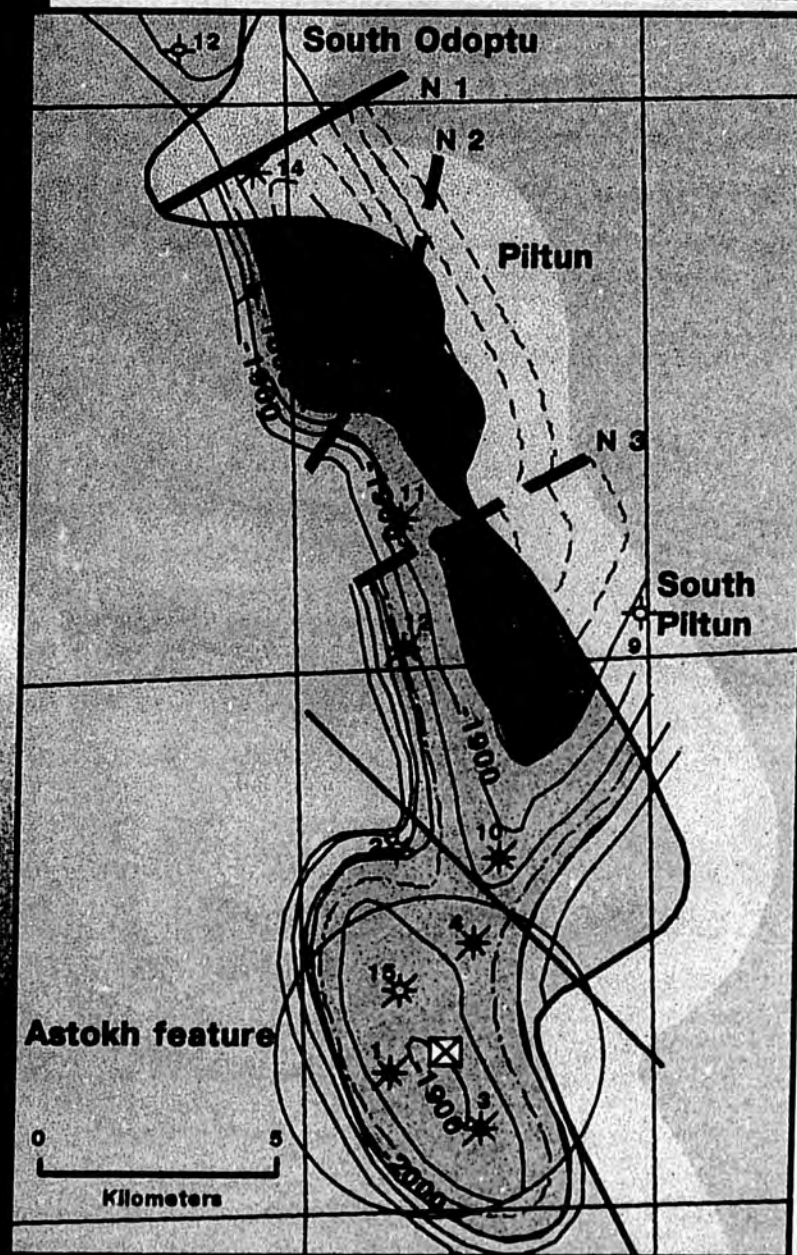
PSA Block Diagram



Sakhalin Energy Investment Company Ltd.

PA Phased Development Plan

Astokh Area:
first oil -
in 1999



☒ **Molikpaq Location**

Sakhalin Energy Investment Company Ltd.

Offshore Facilities

Molikpaq

Loading Buoy

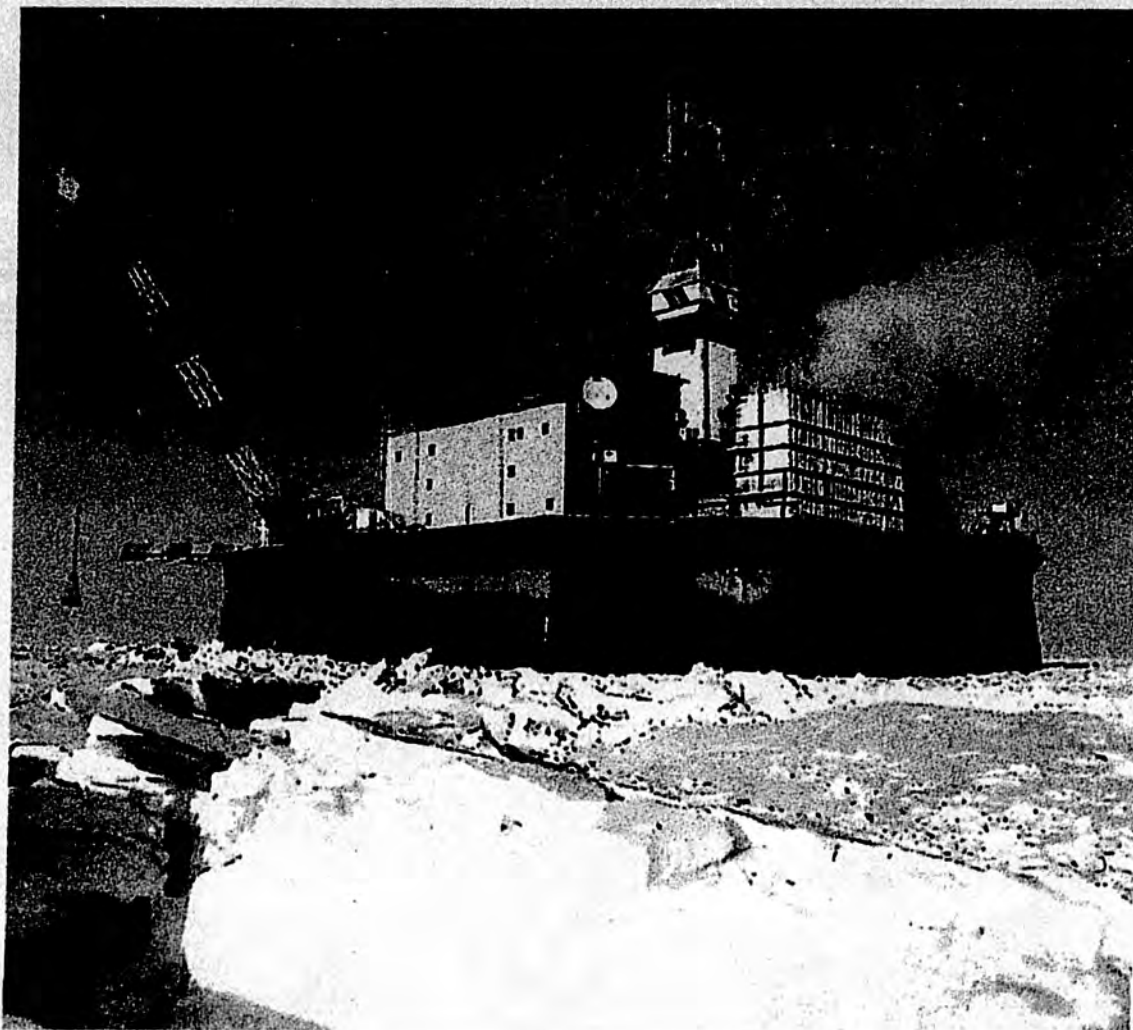
Floating
Storage

Pipeline



Sakhalin Energy Investment Company Ltd.

Molikpaq Platform



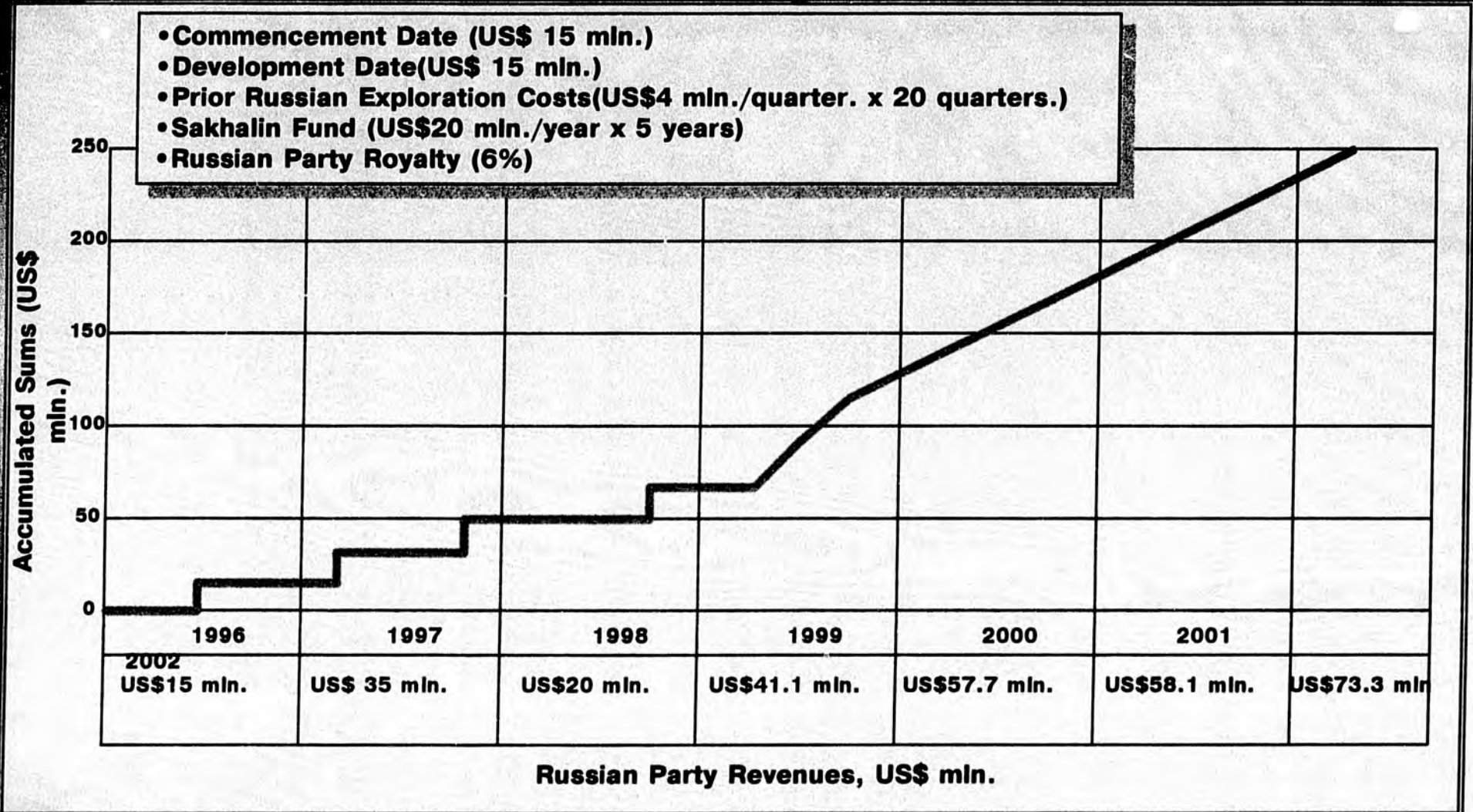
Sakhalin Energy Investment Company Ltd.

Immediate and Long Term Benefits to Russian Federation and Sakhalin Oblast

- ◆ Bonuses (Commencement Date, Development Date)
 - ◆ Sakhalin Development Fund (after first oil -1999)
 - ◆ Royalties
 - ◆ Profit Taxes
 - ◆ Recovery of Russia's Past Exploration Costs (after first oil -1999)
 - ◆ Profit Oil
-

Sakhalin Energy Investment Company Ltd.

Astokh Feature Development: Benefits to Russian Party



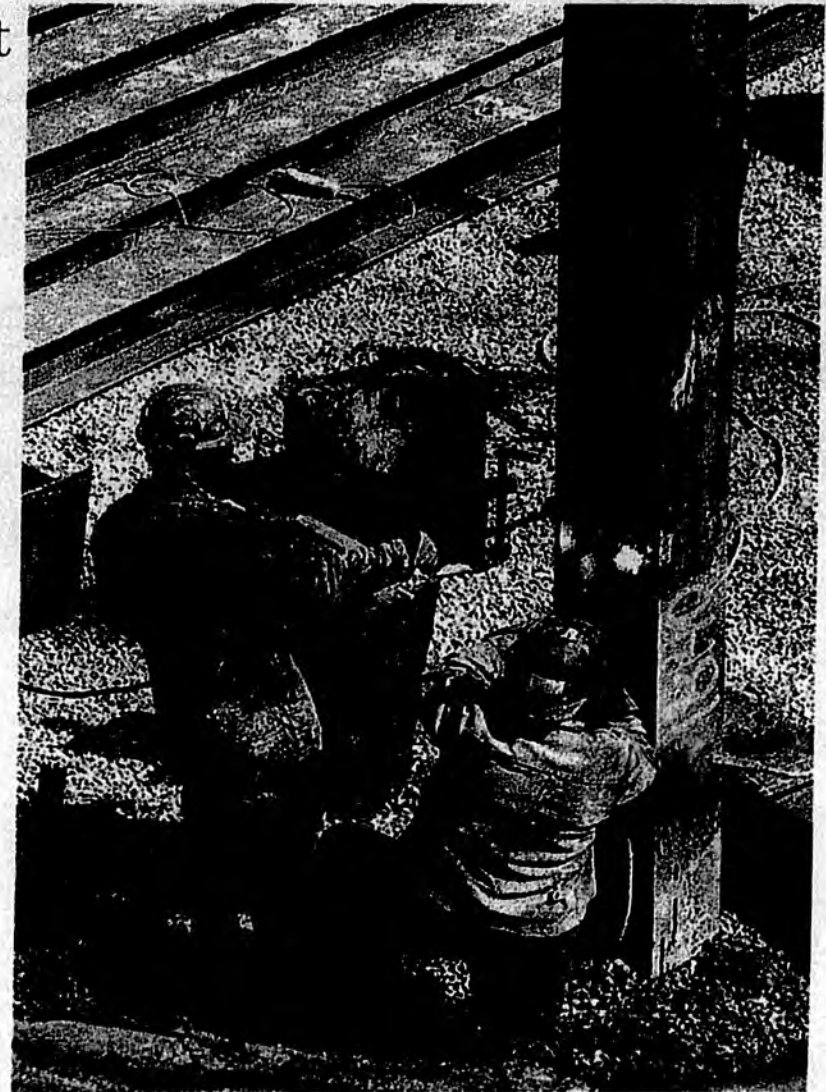
Sakhalin Energy Investment Company Ltd.

Russian Content

The PSA signed requires the best effort to achieve participation of 70% of competitive Russian contractors over the life of the Project

- ◆ As of today, more than 35 Russian organizations have performed and (or) are performing work under Sakhalin Energy Project

All other conditions being equal, Sakhalin Energy intends to give first preference to Russian suppliers and contractors



Sakhalin Energy Investment Company Ltd.

CONTRACT WITH AMUR SHIPBUILDING

- ◆ For Construction of First Large Critical Platform Component
 - ◆ Total Value of Contract is \$35.5 million
 - ◆ Requires high welding skills and several hundred qualified welders (2000 jobs)
 - ◆ Work will go on for 18 months at 2 shipyards in the Russian Far East
 - ◆ Successful performance could improve chances of winning future work on Sakhalin projects
-

Sakhalin Energy Investment Company Ltd.



- ◆ Sakhalin Energy has carried out considerable work and expenditure in response to recommendations of two State Expertise Commissions
- ◆ Despite lack of clarity in PSA Law and absence of normative acts and regulations, Sakhalin Energy continues to perform work
- ◆ As a result Sakhalin Energy is preparing to implement the first phase of development which includes a substantial contract for Russian work
- ◆ A final decision to proceed depends on further measures of legal and regulatory stabilization

THE SAKHALIN ENERGY PROJECT

GEOGRAPHY

SAKHALIN FACT SHEET

Location

Sakhalin island is a long, narrow island in the Russian Far East, 950 km in length and only 160 km across at its widest point. It lies almost 7000 km and eight time zones east of Moscow, separated from mainland Russia by the narrow Tatar Straits. The southern tip of Sakhalin is just 45 km north of the northern most Japanese island of Hokkaido, across the Straits of LaPerouse. The west and north coasts of the island are washed by the Sea of Okhotsk.

Geography

Sakhalin's climate is maritime, with average temperatures ranging from -13°C in January to +15°C in July. Summers are cool, with June and July misty and foggy, and hot weather arriving only in August. Fall is the season for typhoons and hurricane-force winds. Snow falls from November to March, and may reach up to 50 cm in the north, 70 cm in the south, and 100 cm in the east. Scrubby lowland tundra with sparse larch and cedar cover the northern third of Sakhalin; two-thirds are forested and mountainous, with spruce and fir predominating. The Tym and Poronay rivers, largest on the island, flow between two parallel ranges extending north to south. A third range, the Susunaisky, lies in the south near the capital city of Yuzhno-Sakhalinsk. Wetlands stretch along the perimeter of north Sakhalin, at the delta of the Poronay River, and near Aniva Bay. Only about 2% of the land area is suitable for agriculture.

Population

The population of Sakhalin is about 641,000, of which 88% are ethnic Russian or Ukrainian, 5% Korean and less than 0.5% indigenous (Nivkhi, Uil'ta, Nanai, Evenki). The majority of the population live in the extreme south of the island. Yuzhno-Sakhalinsk (pop.160,000) is the administrative center and a center for light industry, finance, and food processing. Kholmsk (pop.52,000) is a major port with two pulp and paper plants, a fishing fleet, and a ship-building and repair center. Korsakov (pop.46,000) is also a major center for fishing, fish processing and international shipping. Near mid-island, Poronaysk (pop.26,000) produces paper, pulp and cement. Okha (pop.36,000) in the extreme north of the island is the center of the onshore oil and gas industry. On the northeast Sakhalin coast, Nogliki (pop.11,000) is the population center nearest the offshore Sakhalin II project areas.

Ecology

Arctic and tropical varieties of certain flora can be found growing side by side in some regions of the south. High precipitation, low evaporation and mountainous relief create a high density of the lakes and streams which are important spawning grounds for many varieties of salmon. Coastal birds such as whooper swans, mergansers, sandpipers and scooters migrate to these wetlands from as far away as Australia. An enormous colony of seals and marine mammals is found on Tyuleniy island, just off the extreme eastern tip of Sakhalin in the Sea of Okhotsk. Nearby is the Poronaysk Nature Reserve, protecting the conifer forests of the

Terpeniye Peninsula. Another point of interest is Moneron island in the Tatar Straits, famed for its cliffs and waterfalls, crystal clear waters, and unique sea life, including rare many-armed starfish.

Economy

Fishing and fish processing represent 30% of the Region's total industrial activity, and 50% of its exports. The Kuril basin and Sea of Okhotsk are among the richest fisheries in the world, providing at one time about half the total seafood demand of the former Soviet Union. Forestry (including timber, pulp and paper) is the second largest industry: formerly Sakhalin accounted for almost all the paper and half the pulp production of the Russian Far East. Industrial production of coal, oil and gas is declining due to high transport costs, loss of federal subsidies, outdated machinery, and intensive resource exploitation. Sakhalin produces most of the crude oil and over half of natural gas production of the Russian Far East. Although overall industrial production dropped by one-third between 1990 and 1994, by 1995 it was already showing signs of bottoming out and recovery. Investment by Western companies in offshore oil and gas development is expected to contribute to economic growth and infrastructure improvements.

THE SAKHALIN ENERGY PROJECT

THE PROJECT FACT SHEET

Background

Oil and gas have been produced on Sakhalin Island for more than 60 years. Most of the known small and medium onshore fields are almost depleted. Several large hydrocarbon accumulations have been discovered by Sakhalinmorneftegas, the local Production Association, off the north eastern shore of the island over the last 20 years. The Odoptu Field was discovered in 1977, Chaivo in 1979, Lunskeye in 1984, Piltun-Astokhskeye in 1986, and Arkutunskoye in 1989. The Sakhalin II project fields comprise Lunskeye and Piltun-Astokhskeye (PA).

Project Description

It is anticipated the project, when completely implemented, will develop the two offshore oil and gas fields on the Sakhalin continental shelf of the Russian Far East. Plans at the feasibility stage were for production to be transported to shore and then to the south of the island, where it would be processed through an oil terminal and a liquefied natural gas plant before being exported. It was, however, apparent that more work was

needed to assess the optimal economic and technical development solutions. The proposal to undertake a first phase development of the PA Field is a result of this further work. Appraisal of the remainder of the PA Field, and of the Lunskeye Field, continues.

When completely implemented, the Sakhalin II Project will be one of the largest private investment projects in Russia, and the first to proceed under the terms of a Production Sharing Contract (PSC). A PSC is an agreement under which a company undertakes to develop oil and gas reserves owned by a host country. The company is responsible for financing and carrying out the development, and is compensated by receiving a share of the oil and gas production sufficient to cover its costs and generate an acceptable return. The remaining production remains the property of the host country, which also receives royalty and tax revenues from the developers profits.

Geological Setting

Piltun-Astokhskeye is an oil field with associated gas. Lunskeye is a gas field with associated oil and condensate.

The fields are located 13-16 km offshore east Sakhalin Island in the Sea of Okhotsk. The two fields are estimated to contain recoverable reserves of 100 million tonnes (750 million barrels) of hydrocarbon liquids and 494 billion cubic meters (14 trillion cubic feet) of gas.

Company Profile

Sakhalin Energy Investment Company Ltd. (Sakhalin Energy) was formed in April 1994 to hold the licences for use of the subsurface resources, and to manage the entire development of the Piltun-Astokhskeye oil field and the Lunskeye gas field (the Sakhalin II Project) on behalf of its shareholders.

Shareholders in Sakhalin Energy:

- Marathon Sakhalin Limited (30%);
- McDermott Sakhalin, Inc. (20%);
- Mitsui Sakhalin Development Co., Ltd. (20%);
- Shell Sakhalin Holdings B.V. (20%);
- Diamond Gas Sakhalin B.V. a wholly owned subsidiary of Mitsubishi Corporation (10%).

Project Milestones

- February 1991, Marathon, McDermott, and Mitsui form the M/M/M Consortium.

- May 1991, Sakhalin Offshore Tender announced and data packages are made available for purchase. M/M/M qualifies for bidding.

- January 1992. Russian Governmental Tender Committee declares M/M/M Consortium is the tender winner.

- March 1992. A Feasibility Study Agreement (FSA) signed for the evaluation of the Piltun-Astokhskoye and Lunskoye fields by M/M/M, Sakhalinmorneftegas and other Russia experts under the direction of joint management and co-ordinating committees comprised of both Russian and Consortium members. In addition, the FSA provided for the negotiation of an agreement to implement the development of the fields.

- December 1992. Shell joins the M/M/M group in September 1992, and Mitsubishi Corporation in December, to form the MMMMS Consortium. The joint Feasibility Study report is submitted to Russian Expertise for review.

- March 1993. Positive decisions by both the Environmental and Economic Expertise committees are handed down to the Consortium. Negotiations continue for an agreement to carry out the Sakhalin II Project.

- April 1994. MMMMS Consortium forms Sakhalin Energy Investment Company Ltd. to manage the development, production, financing and marketing aspects of the project.

- June 1994. The Sakhalin II Production Sharing Contract signed on June 22 by representatives of the Russian Federation and by Sakhalin Energy.

- December 1995. The "Law On Production Sharing" passed by the Federal Assembly and signed into law by President Yeltsin. The Law provides a basis for production sharing contract in Russia. Work begins on other necessary legislation and supporting regulations.

- May 1996. The Russian Federation Government issues licenses to Sakhalin Energy to develop Piltun-Astokhskoye and Lunskoye Fields. Sakhalin Energy on behalf of its shareholders provides notification of Commencement Date under its PSC for the Sakhalin II Project. This is the first project to proceed under production sharing in Russia.

- June 1996. Commencement Date for the Sakhalin II Project.

- July 1996. Plans for developing the first phase of the PA Field, with a potential first production date of 1999, announced.

- November 1996. Award of major construction contract to Amur Shipbuilding Plant.

Environmental Protection

The Sakhalin II PSC contains extensive provisions relating to measures, procedures and permits for ensuring the protection of the environment, and the prudent use of the natural resources of Sakhalin during development and production. The considerable experience of the shareholders in Sakhalin Energy in working in

ecologically sensitive environments - such as offshore Alaska and the North Sea - will be available to the project.

THE SAKHALIN ENERGY PROJECT

PRESS-RELEASE

May 21, 1996

SAKHALIN II PROJECT - NOTICE OF COMMENCEMENT DATE ANNOUNCED

Sakhalin Energy Investment Company Ltd. has announced an important step towards the development of the Sakhalin II oil and gas fields in Russia with the notification to the Russian authorities of a Commencement Date for its Production Sharing Contract (PSC) with the Russian Federation.

The PSC, the first ever with the Russian Federation, was signed on 22 June 1994.

The notification of Commencement Date follows the granting of licenses to Sakhalin Energy earlier this month granting the right to develop the Sakhalin II fields. This too was a pioneering event because these are the first licenses for a production sharing project to be issued in Russia.

The President of Sakhalin Energy Mr. Frank Duffield said: "We are delighted to be the first company to have been granted licenses to develop Russian oil and gas reserves on the basis of a PSC.

"Our decision to notify a Commencement Date reflects the considerable progress the Russian authorities have been making with the complex task of putting in place the necessary new laws and regulations to make production sharing contracts effective in Russia, and the particular recognition that has been given in the legislation to our agreement."

Commencement Date will occur within thirty days after Sakhalin Energy's notice or sooner, following acceptance by the Russian authorities. Upon Commencement Date, Sakhalin Energy will carry out appraisal work with the aim of submitting development plans to the Russian authorities for approval.

"Important legislative measures are still required before we can undertake development work, but we believe these will be put in place," said Mr. Duffield. "We are, therefore, ready to undertake detailed planning to assess development options. Our hope is

to agree on a development plan as early as possible."

The shareholders in Sakhalin Energy are Marathon Sakhalin Ltd. (30%), McDermott Sakhalin Inc. (20%), Mitsui Sakhalin Development Co. Ltd. (20%), Shell Sakhalin Holdings B.V. (20%) and Diamond Gas Sakhalin B.V. (10%, a subsidiary of Mitsubishi Corporation).

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THE SAKHALIN ENERGY PROJECT

PRESS-RELEASE

July 24, 1996

PILTUN-ASTOKHSKOYE FIELD PHASE ONE DEVELOPMENT

Sakhalin Energy Investment Company Ltd. (Sakhalin Energy) announced today, July 24, 1996, that it has obtained the support of the Government of the Russian Federation and the Administration of Sakhalin Region to progress a plan to start development of the Piltun-Astokhskoye (PA) field offshore Sakhalin Island. The plan is based on a phased approach to developing the PA Field which could lead to first production of oil in 1999, considerably earlier than under other development options.

The plan is based on extensive study which has shown that early economic production could be achieved through the use of an existing mobile drilling and production facility, known as the Molikpaq. The Molikpaq is a large ice-class drilling unit which has been successfully deployed in arctic drilling operations and which has been designed for operating conditions significantly more severe than those experienced offshore Sakhalin.

The plan proposes that the Molikpaq would produce oil from the Astokh feature in the Piltun-Astokhskoye Field. The oil would be transported by a short pipeline to a single anchor leg mooring buoy (SALM) and a storage tanker, for subsequent

loading onto tankers, an operating procedure widely practiced in other parts of the world.

The plan now requires formal technical approval from appropriate Russian regulatory authorities, and further progress on the achievement of legal stabilization prior to final shareholder commitment. The President of Sakhalin Energy, Frank D. Duffield, said: "We had been encouraged by the progress on legal stabilization up to the Presidential elections. With the election completed, we hope legal stabilization will proceed positively. We anticipate that key enabling legislation will be reintroduced and passed early in the new session of the Federal Assembly, and this will expedite future decisions about the project".

If it goes ahead, Sakhalin Energy's proposal would be the very first development scheme offshore Sakhalin, an area which has the potential to become a major new oil producing region. Once development begins, the Russian Federation and Sakhalin Region will benefit immediately from the payment of a Development Bonus of \$15 million, and the establishment of a Sakhalin Development fund building up to \$100 million over five years. This

would be used by the Regional Administration in improving social infrastructure on Sakhalin.

Frank Duffield said: "Our proposal could mean that, after many years of discussion, development work on the Sakhalin shelf will soon start. It would produce immediate benefits to the Russian Federation and the Sakhalin Region and would also provide the opportunity to demonstrate the viability of large development projects undertaken by foreign investors in Russia".

Sakhalin Energy is the project company established by Marathon Sakhalin Limited, McDermott Sakhalin, Inc., Mitsui Sakhalin Development Co., Ltd., Shell Sakhalin Holdings B.V., and Diamond Gas Sakhalin B.V. to undertake the development of the PA and Lunskeye oil and gas fields offshore Sakhalin.

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THE SAKHALIN ENERGY PROJECT

PRESS-RELEASE

November 15, 1996

RUSSIA
SAKHALIN

PANY WINS MAJOR \$35 MILLION CONTRACT WITH
ENERGY

Sakhalin Energy Investment Company LTD., (Sakhalin Energy) announced today it had awarded a major contract worth \$35 million to Amur Shipbuilding Plant, *Komsomolsk-on-Amur* (Amur Shipbuilding) for the construction of a substantial off-shore structure as part of the first phase of the Sakhalin II Project in the Russian Far East.

The structure is required for the first phase of the development of Piltun-Astokhskoye oil field off the North East of the Russian island of Sakhalin. The project will be the first Sakhalin off-shore development and first oil production is targeted for 1999.

Under the contract Amur Shipbuilding - a Russian Joint Stock Company and JV McAmur Construction Services T.O.O. (McAmur) will be responsible for the construction of a support base for an existing large mobile drilling unit. Sakhalin Energy plans to convert this to a drilling and production platform and install it at the Piltun-Astokhskoye Field during 1998. The Rubin Central Design Bureau for Marine Engineering and Krylov Shipbuilding Institute, both Russian organizations, will also participate in the contract.

The President of Sakhalin Energy, Mr. Frank Duffield said: "We are pleased to have reached an agreement with a Russian company for one of the largest

single contract relating to our development plan. We have looked carefully at Amur Shipbuilding's capabilities and we are satisfied that they can meet the high standards of work and the very challenging schedule we require. Successful completion of the contract will provide a solid foundation for future participation of Russian suppliers in the development of the Sakhalin Shelf."

Mr. Duffield emphasized that implementation of the development and of the Contract with Amur Shipbuilding were dependent on the Russian authorities completing the work currently being undertaken to introduce remaining legislative and regulatory measures needed to provide a legal and taxation framework for its production sharing agreement.

General Director of Amur Shipbuilding Plant, Mr. Pavel Bely stated that oil and gas development in Sakhalin opened new prospects for his company to use facilities that have been converted for civilian purposes. In addition, the involvement of Russian Design Bureaus gave an opportunity for their skills and potential to be applied in marine oil production engineering.

Mr. Bely said: "We will complete the contract within time and to a high quality of work. This will be for the Company and our subcontractors a

powerful advertisement for future Sakhalin oil and gas project work. We rely on the efforts of the Russian Government to ensure the project goes forward."

Mr. Bely also commented on the role of "McAmur Construction Services Company T.O.O." It will act as Contractor Coordinator. It combined the management expertise of western companies with Russian technical capabilities, and had already performed a great amount of preliminary work on Amur Shipbuilding's products certification to meet requirements of West Certifying Authorities. Mr. Bely said: "We are currently working on the construction of a high technology processing facility with McAmur, and this has given us recent experience of working with western contractors".

Contact:
Sakhalin Energy:

SAKHALIN II - RUSSIA'S FIRST LNG PROJECT?

By Frank Duffield

President, Sakhalin Energy Investment Company, Ltd.

Sakhalin Island is a long narrow island in the Russian Far East, 950 km in length and only 160 km across at its widest point. It lies almost 7000 km and eight time zones east of Moscow, and is separated from mainland Russia by the narrow Tartar Straits. In winter these straits freeze, and can be driven across. The southern tip of Sakhalin is just 43 km north of the northernmost Japanese island of Hokkaido, across the Straits of La Perouse. The east and north coasts off the island are washed by the Sea of Okhotsk.

Oil and gas have been produced on Sakhalin Island for more than 60 years. Most of the known small and medium onshore fields are approaching depletion. Over the past 20 years several large hydrocarbon accumulations have been discovered off the north eastern shore of the island by Sakhalinmorneftegas, the local oil and gas production association. Of these, Odoptu Field was discovered in 1977, Chaivo in 1979, Lunskeye in 1984, Piltun Astokhskeye in 1986, and Arkutun Daginskoye in 1989. The fields of the Sakhalin II Projects are Lunskeye and Piltun Astokhskeye.

The Sakhalin II Project is managed by Sakhalin Energy Investment Company, of which I am privileged to be President. Sakhalin Energy was established in April 1994. Its shareholders are Marathon Oil Company (30%), Mitsui (20%), McDermott (20%), Shell (20%) and Mitsubishi Corporation (10%).

In June 1994 Sakhalin Energy signed a Production Sharing Contract (PSC) with the Russian Federation for the development of the Piltun Astokhskeye and Lunskeye fields. I am sure it is hardly necessary to explain in detail to this audience the structure of PSCs, but a brief outline may be useful.

Under a PSC the investor in a project is paid for its efforts through a share of the production from the project. Typically, revenues from production are applied first to paying a royalty to the host government. They are then applied to reimbursing the operating company its costs of development and operation. Remaining revenues are split between the investor and the host government according to a scale which reduces the investor's share as its overall rate of return increases. This structure meets the aspirations of host governments to develop their natural resources, obtain early revenues from that development and maximize their share of revenue, should future energy prices or production exceed planned levels. At the same time it fulfills the goal of private investors to recover their costs and earn an acceptable return on capital investment. In some cases the production sharing project is overseen by a supervisory board made up of representatives of the investor and the host government. Such a board is provided for in our project.

Our PSC was subject to the conditions that the Project would not commence until the Government of the Russian Federation, the

Russian Federation legislature, and the Administration of the Sakhalin Region had taken measures to ensure the effective implementation of the agreement, and issued satisfactory licences to the Company.

Over the past two years we have been working very closely with the Russian authorities to help them meet these conditions. In December 1995 a Federal Law on Production Sharing Agreements was signed by President Yeltsin. This went a long way towards meeting our requirements. I would like to pay tribute to the Russian authorities for successfully enacting such a technically complex measure in the context of the great political and economic changes taking place in Russia. It was a remarkable effort.

However, the Law on Production Sharing Agreements was not sufficient in itself to meet our contractual requirements. It is still necessary to enact conforming amendments to existing Russian laws to provide for PSCs, and also to prepare and promulgate detailed regulations to enable satisfactory implementation and management of such agreements. Since the passage of the Law on Production Sharing Agreements considerable effort has been devoted to these further tasks. As a result a draft law containing the required amendments is to be introduced in the Russian State Duma. In fact this law is on the agenda of the State Duma for a first reading next week. Draft regulations, for promulgation once the conforming law is enacted, are also in an advanced stage of preparation. We are confident that the authorities fully understand that these further measures are critical for

triggering investment and are, therefore, committed to putting them in place.

In May of this year the Russian government issued Sakhalin Energy with exploration and production licences for its two fields. We were very proud to be the first wholly foreign owned Project to be awarded such licences in Russia.

In view of all these positive developments, we decided in June of this year to declare a commencement date under our PSC. This decision also reflected our wish to identify viable development proposals for our fields, and to implement them on the quickest possible schedule.

I would now like to outline our current thinking on development plans beginning with a description of the fields for which we now hold licences.

The Piltun Astokhskoye field (PA) is the more northern field. It is located about two thirds of the way up the east coast of Sakhalin. It is 16 kilometers offshore in 30 meters of water. The amount of hydrocarbons in place is substantial but the complex nature of the reservoir affects recoverability.

The Lunskeye field is a very large gas and condensate reservoir located 150 kilometers south of PA. It is 13 kilometers offshore in 50 meters of water. The reservoir at Lunskeye is of better quality and less complex than at PA. A daily flow rate of gas of about 1 billion cubic feet over an extended period is clearly possible, and this would support a 20 year LNG contract for 6 million tonnes per annum.

At the time we signed our PSC we estimated that the combined reserves of the two fields are in excess of 750 million barrels of hydrocarbon liquids and 14 tcf of gas, with 80% of the gas reserves located in Lunskeye. However, analysis of additional seismic data was outstanding. This work has now been done, and as a result we have just very recently been able to agree with the Russian State Reserves Committee to increase the hydrocarbon liquids reserves to 1 billion barrels. Further 3D seismic work on both fields is included in our work plans.

Although both of our fields are situated relatively close to shore and in moderate water depths, the technical challenge of developing them is significant. The area is subject to typhoon related storm conditions, and the sea is frozen for six months of the year. There is, therefore, a very short weather window for carrying out much critical development work.

The overall development concept in the feasibility study, prepared at the time of our PSC negotiations, is for the oil and gas to flow via marine pipelines from both fields to a common onshore processing facility. After processing, the oil and gas would then flow through pipelines some 625 kilometers to an LNG plant and oil export terminal in the south of Sakhalin. From there the oil and LNG can be exported year round.

Since signing our PSC, we have been reviewing these ideas in more detail. As a result we undertook discussions with the Russian authorities on a proposal to initiate development of the PA field by using an existing large drilling unit designed for Arctic

conditions. The plan is to convert this structure, known as Molikpaq, to a production unit and to place it on the Astokh feature of the PA field. Use of the Molikpaq would enable production to commence as early as 1999.

The Russian Party has approved this proposal in concept, and we are now working together closely to achieve the necessary approvals and certifications for the converted unit. Russian enterprises are also participating in project work, and last month we were able to announce the award of a large construction contract related to this development to Amur Shipbuilding Plant in Komsomolsk. However, a final decision to proceed will not be made until early next year, in the light of progress on stabilization and the approval process.

Among the many advantages of this first phase concept is the opportunity it provides for gaining early development and operating experience with Russian agencies, contractors and suppliers, and in the challenging logistical and operating environment of offshore Sakhalin. This experience will be invaluable to us, as we undertake simultaneously the detailed planning for the further development of the PA field and the Lunskeye field.

I would like to spend a few moments on the Lunskeye Project which, as a world class gas field, will be of particular interest to this audience. We are now undertaking detailed appraisal work on this project to enable preparation of a development plan. First gas delivery from the Lunskeye field will be determined by market opportunity. A very important part of our early appraisal work,

therefore, is a further careful assessment of the market opportunities for our gas.

As I have described, our scheme proposes the export of LNG from Sakhalin. The flexibility that LNG offers, with access to several potential markets in the Far East, such as Japan, Korea and Taiwan, and the greater certainty over timing of supply, compared with constructing a pipeline, were key factors in this preference. Our current view is that opportunities for supply of our gas as LNG will exist from the year 2005 in the Japanese, Korean and Taiwanese markets.

As this conference has heard, numerous projects are under consideration for the delivery of gas to Far Eastern markets by pipeline. Our current studies also include a careful assessment of these proposals and of the feasibility of delivering our gas by pipeline within the time frame that I have outlined. It is our intention to complete this assessment soon, because we need to proceed quickly with detailed design work if we are to meet our target date for first production.

Whether delivery is by LNG or pipeline, what is certain is that the Lunskeye field contains a substantial volume of gas, located close to markets with a growing demand. Sakhalin Energy has been entrusted by the government and people of Russia with the development of this attractive field. We share fully the aspiration of the Russian authorities for this field, and the PA field, to be developed on the most economically advantageous terms, within the quickest feasible time frame.

I have outlined broadly our plans for achieving this. Critical to them is the securing of sales agreements. I therefore look forward to fruitful discussions with those of you who are potential customers. Together we can make the plans I have outlined become reality.

House Speaker
Phillips

Sakhalin Overview
November 1996

Sakhalinskaya Oblast population was 673,000 as of January 1, 1995, a sharp decrease of 25,500 or 3.7 percent from the year before. About 85 percent are urban residents. Emigration to other parts of Russia accounted for about 3/4 of the decrease. About 42,000 ethnic Koreans make up about 7 percent of the population and are a legacy of Japan's previous occupation.

Sakhalinskaya Oblast administers the main island of Sakhalin and the entire Kuril Islands chain, including the Russian occupied Northern Territories of Japan, consisting of Etorofu (Iturup); Kunashir (Kunashir); Shikotan; and the Habomai islands. The Oblast covers an area of 87,100 square kilometers; Sakhalin Island itself is 78,000 square kilometers, stretches 948 kilometers north to south, and is 9,000 kilometers distant from Moscow.

Political Situation: Appointed Governor in April 1995. Igor Pavlovich Farkhutdinov -- formerly the Mayor of Yuzhno-Sakhalinsk -- has had a difficult year, with earthquakes and cyclones causing billions of rubles worth of damage and destruction, contributing to the net exodus of people from the oblast, and complicating an already extremely difficult economic situation. According to recent statistics, 59 percent of the population is below the poverty level.

Economic Situation: Once the Sakhalin offshore natural gas and petroleum projects get underway, Sakhalinskaya Oblast could become a major producer of natural gas for export to the mainland and to Northeast Asia, thereby transforming itself as well as the economy of the RFE. Today, Sakhalinskaya Oblast's economy is based on fish and fish processing (45 percent of industrial output); logging and paper production; and fuel and energy industries. Sakhalin's rich fishing areas include those off the Kuril Islands, which alone account for 20.3 percent of the RFE catch. Although current petroleum and natural gas on land is limited, there are substantial proven and estimated reserves on the offshore shelf northeast of Sakhalin which are being developed by U.S. and other major foreign companies. Sakhalin relies on its even coal for much of its electricity production.

Commercial Situation: Sakhalin's foreign trade turnover reached \$768 million in 1995, a 33 percent increase from the previous year, with growth registered for both exports and imports. Exports were about \$475 million, comprised mostly of fish and sea food, coal and oil, while imports were about \$292 million, primarily consumer goods and machinery and equipment imports. Japan is the region's leading trade partner, accounting for about 50 percent of all trade, followed by South Korea and the United States. Foreign investment was reported at \$59.2 million in 1995 primarily in fishing and energy sectors.

There are more than 300 joint ventures (Japan - 120; United States - 51; South Korea - 49), 22 foreign representative offices, and 45 fully-owned foreign companies operating on Sakhalin. Foreign oil companies -- including Amoco, Exxon, Mobil, Shell, the Sakhalin Energy Investment Consortium -- are the most prominent commercial presence on Sakhalin. Other foreign companies are being drawn to the region, primarily by the potential oil and gas activity.

U.S. firms with offices in Yuzhno-Sakhalinsk include McDermott, Price Waterhouse, DHL, Alaska Cargo Transport, Sunmar Shipping, and Kriljon Communications.

The American Business Center (ABC), opened officially last September, has become a visible and busy hub of activity. The ABC is managed by Carol Vipperman's Foundation for Russian/American Economic Cooperation (FRAEC) under a cooperative agreement with USDOC.

Oil and Gas Projects: U.S. and other foreign oil and gas companies are still

awaiting Russian federal approval of legislation and regulations before proceeding with several long-term, multi-billion-dollar projects to develop large petroleum and natural gas reserves located off Sakhalin's northeast coast:

SAKHALIN-I: In June 1995, the Russian Federation and Sakhalin Oblast governments approved the Sakhalin-I Production Sharing Agreement (PSA) for a consortium made up of project operator Exxon-Neftegaz (30%), Japan's Sakhalin Oil and Gas Development Company - SODECO (30%), and Rosneft-Sakhalin and Sakhalinmorneftegas-Shelf (combined interest 40%). With development costs estimated at \$15 billion, the Sakhalin-1 project area encompasses the Chayvo, Odoptu, and Arkutun-Dagi fields, with total recoverable reserves of 2.5 billion barrels of oil and 15 trillion cubic feet (TCF) of natural gas. SODECO is a Japanese consortium including the Japanese National Oil Company, which gained initial rights to develop Chayvo and Odoptu in 1975.

SAKHALIN-II: On June 22, 1994, a consortium including Marathon Oil (30%), McDermott International (20%), Mitsui (20%), Mitsubishi (10%) and Royal/Dutch Shell (20%) signed a PSA with the Russian Federation. They formed the Sakhalin Energy Investment Corporation (SEIC) to manage and operate the project, which will require an investment of \$8-10 billion. This PSA covers development of the Piltun-Astokhskoye and Lunskoye oil and gas fields, with estimated resources in excess of 750 million barrels of oil and condensate and 14 TCF of gas. The first oil and gas could be produced within four years after beginning field development activity. Production could peak at 180,000 barrels a day of liquids and 1.5 billion cubic feet a day of gas.

SAKHALIN-III: In December 1993, Mobil Russia Ventures, Inc. and Texaco jointly won the Sakhalin's-3 tender and are now negotiating for the PSA to explore and develop the Kirinskiy offshore oil and gas block. Depending on the volume of reserves to be discovered and produced, Mobil and Texaco may invest several billion dollars over 40-50 years. Geological work alone will cost an estimated \$200 million and take six years.

SAKHALIN-IV: Although the first presentation of terms for the Sakhalin-4 tender proposal in September 1994 in Denver attracted 20 major oil and gas companies, interest subsequently dwindled due to continued delays in adopting needed legislation. A formal tender bid in summer 1995 ended unsuccessfully when the Sakhalin Geology Committee rejected on "economic grounds" a bid on the Shmidtovskiy block (one of three) by Exxon -- the sole party submitting the required documents. A new tender is planned.

Sakhalin and Japan: Notwithstanding outstanding problems over the Northern Territories and the occasional arrests and shootings at Japanese "poachers" by Sakhalin boarder guard patrols, Sakhalin's relations with Japan are expanding. Sakhalin's exports go mainly to Japan. Earlier this year Michinoku Bank opened a branch office in Yuzhno-Sakhalinsk and, just recently, the Japanese Government has opened a "Japanese Center" which will offer training programs and business facilitation services. The Association for Promotion of Hokkaido Business operates an office in Yuzhno-Sakhalinsk to promote commerce between the two regions.

The U.S. Government strongly supports the development of business relations between Sakhalin and American companies, and is supportive of the close cooperation between regional officials and the American Business Center. By helping U.S. firms to better understand the region and its commercial opportunities, as well as by facilitating contacts with potential Russian partners, the ABC is playing a vital role in supporting the growth of commercial relations between the United States and Sakhalin.

The U.S. Government strongly encourages formation of joint ventures to blend the expertise and strength of U.S. and Russian firms, and envisions opportunities for such partnerships particularly as the offshore oil and gas

projects move forward.

A. Background, Sakhalin Oil Production

I. Although Sakhalin oil and gas comprise less than one percent of total Russian reserves they are the only commercial fields in Russia west of Tyumen. Oil production peaked at 26 mmt in 1985 and has declined every year since to 15mmt. Gas production declined by a quarter in this period. North Sakhalin onshore fields are estimated 63% exhausted. Offshore reserves are several times larger than remaining onshore reserves.

II. Sakhalin's oil is transported by pipeline to Komsomolsk. This refinery (built 1942) and one in Khabarovsk (built 1935) have a combined capacity of 9 mmt/yr. The bulk of these refineries' feedstock is Tyumen crude long-hauled from Angarsk at great cost. Production is insufficient to meet Far East demand, and so refined products are also long-hauled by rail.

III. Existing Russian onshore industry is plagued by aging infrastructure and less-than-modern environmental protection techniques. Spills were reported along the pipeline route after the 1995 Neftegorsk earthquake. A well over the new super-deep Ust-Evay gas field, which began producing in 1958, has been burning uncontrolled since mid-1994.

IV. Primary producer is SakhMornefteGaz a division of Rosnaft: 1.5 mmt/year oil 2 bn/y gas. \$40 million this year profits, 13,000 employees. They discovered and explored the offshore fields in Sakhalin-1,2,3 tenders in the 1970s and 80's. Other companies include Saudi JV Petrosakh which operates two wells and a small field refinery near mid-island and has begun exploration drilling this year. ANK Shelf, which has also received, license to eight small onshore fields and has begun development of two, and Sakhalin Petroleum PLC, which is contracting SMNG to do exploratory drilling this year through the ice Nabri Bay near Nogliki.

B. Sakhalin-I (Larry Kennedy)

I. Sakhalin I is three fields: Chayvo Odoptu and Arkutun-Dagl, which were all discovered by SMNG. Total recoverable hydrocarbon reserves potential for the three fields is approximately 2.5 billion barrels of oil and 15 tcf of gas although extensive delineation of Arkutun-Dagl, is required.

II. Exxon Neftegas Limited (30%), Japanese consortium SODECO (30%) and two Russian companies. Rosneft-Sakhalin (17%) and Sakhalinmorneftegas-Shelf (23%)

III. In 1994, a conceptual feasibility study was approved by the Russian Federation and Sakhalin Oblast in June., 1995. Commencement Date was announced formally on June 10, 1996.

IV. During the summer of 1996 a well will be drilled and tested in the Arkutun-Dagl field using Sakhalinmeftegas OKHA drilling rig. A 3D seismic program over Arkutun-Dagi alone will cover over 1,100 km², one of the largest single surveys to be acquired by industry. This work is the first part of a US\$200-\$300 million resource appraisal program that is planned to better define estimates of reserves.

V. The development of the three fields will involve a combination of large ice-resistant platforms and subsea templates. Significant offshore facilities, pipelines and project infrastructure will have to be established on the island in order to support the project and the export of oil and gas. Portions of the offshore facilities and pipelines may be a joint industry project serving all markets. Russian members of the consortium and the foreign partners will be responsible for marketing their own respective shares of production

C. Sakhalin- III (Jan Mølle)

I. Consortium of Mobil/Texaco were awarded rights in 1993 to Klorskoye gas field. Est. reserves: 100 bcm gas; 50mmt condensate. Expect to spend \$151 million in exploration at 100% own risk. Have not signed PSC yet. Fuel and Energy Ministry and Rosneft approve of signing PSC, but SMNG director Bogdanchikov is adamantly opposed to giving away more fields to foreigners.

II. Article from 9 Aug 96 Soviet Sakhalin "Foothold" interview with SMNG director Bogdanchikov Statements: "RFE energy demand will be satisfied by Sakh-1.2 alone no

need for Sakh-3. We should limit foreign investment to absolute minimum. We can master the technology and apply for financing based on ownership of the license just like foreign companies." PSA law was signed in 1995 but neither Exxon nor other Foreign partners were in a hurry to start work until Bogdanchikov and Shafranik gave Exxon an ultimatum: "announce CD or lose fields." This applied to Sakh-2 as well. Now, administration must spend bonus dollars wisely for construction of schools and hospitals. 1996 profits approx. \$40 million (fourfold increase). Four new gas fields on line. If the administration is interested in new jobs it must pay for training \$1 million was contributed for Nogliki power station. "My goal is to make common people see real effect from shelf projects."

D. Sakhalin II Project

I. Putun-Astokhskoye (oil with associated gas) and Lunskeye (gas with associated oil and condensate) offshore fields, located 13-16 km offshore northeast. Estimated recoverable reserves of 100mmt (750 million barrels) of hydrocarbon liquids and 494 bcm (14tcf) of gas. Plans at the feasibility stage called for production to be transported to shore and then by pipeline to oil terminal and LNG plant in Prigorodnoye before being exported. However, at this early stage the best economic and technical development solution is a phased approach starting with the PA field. Appraisal of the remainder of the PA Field, and of the Lunskeye Field, continues.

II. Sakhalin energy was formed at request of the Russian Government in April 1994 as a single legal entity to hold licenses for use of the subsurface resources, and to manage development of the fields on behalf of its shareholders. Marathon Sakhalin Limited (30%); McDermott Sakhalin, Inc. (20%); Mitsui Sakhalin Development Co., Ltd. (20%); Shell Sakhalin Holdings B.V. (20%); Diamond Gas Sakhalin BV a wholly owned subsidiary of Mitsubishi corporation (10%).

III. M/M/M/ Consortium won the tender in Jan 1992. In March 1993 the feasibility study was approved by decisions of Environmental and Economic Expertise Committees. Production Sharing Contract signed on June 22 by representatives of the Russian Federation and Sakhalin Energy. In May 1996, the Russian Federation Government issued licences to Sakhalin Energy. In June 1996 Sakhalin Energy declared Commencement Date for PSC, the first project to proceed under production sharing in Russia.

IV. Immediate and Long-term Benefits to the Russian side include: Revenues: a combination of hard currency and actual production royalties a share of profit and profit taxes. Bonus Payments: \$15 million at Commencement Date in June this year. A further \$15 million when a final decision is made to proceed with PA first phase development following technical approval. Development Fund: A first development decision (possibly in 1997) will also trigger the establishment of a Sakhalin Development Fund, amounting over five years to US \$100 million, for improving social and economic infrastructure of Sakhalin. Russia Content: PSC requirement that Sakhalin Energy will use "best efforts to maximize Russian content over the lifetime of the project".

V. Sakhalin Energy has participated in community activities since arrival on Sakhalin in 1991. (1) Active support for the high school economic education program Junior Achievement (with over 100 classes now an official part of Regional education curriculum), (2) intern program with Sakhalin college students; (3) support for Regional student arts and music scholarship competitions called "Young Talent of Sakhalin" (4) support for Native Crafts vocational school in Poronalsk; (5) contributions to youth sports schools, traditional local festivals, (6) recently announced grants to Library which will total \$110,000 over five years.

VI. PRESS RELEASE: Sakhalin Energy Investment Company, Ltd. (Sakhalin Energy) announced today, July 24, 1996, that it has obtained the support of the Government of the Russian Federation and the Administration of Sakhalin Region to progress a plan to start development if the Putun-Astokhskoye (PA) field offshore Sakhalin Island. The plan is based on a phased approach to developing the PA Field which could lead to first production of oil in 1999, considerably earlier than under other development options. The plan is based on extensive study which has shown that early economic production could be achieved through the use of an existing mobile drilling and production facility known as the Molikpaq. The Molikpaq is a

large ice-class drilling unit which has been successfully deployed in Arctic drilling operations and which has been designed for operating conditions significantly more severe than those experienced offshore Sakhalin. The plan proposes that the Molikpaq would produce oil from the Astokh feature in the Pultun-Astokhskoye Field. The oil would be transported by a short pipeline to a single anchor leg mooring buoy (SALM) and a storage tanker, for subsequent loading onto tankers, an operating procedure widely practiced in other parts of the world. The plan now requires formal technical approval from appropriate Russian regulatory authorities, and further progress on the achievement of stabilization prior to final shareholder commitment.

E. Background Sakhalin political situation

I. Elections for Governor took place October 20, 1996. Ten gubernatorial candidates registered. Communist Party candidate Anatoly Chyorny, former SMNG director and now a director at Sidanko, a vocal opponent of shelf development by foreign companies, lost to the incumbent, capturing 27.5% of the vote. Another critic of the Sakhalin-2 PSC is candidate Valery Timofeyev from Koraskov. As of today, we do not have a fix on this election. Vladimir Bersenyov is Yabloko candidate and General Director of the ANK Shelf Oil Company. Incumbent governor Farkhutdinov won with 39.5% of the vote. Farkhutdinov understands the need for stabilization and understanding of the ways of Western oil business. His re-election was far from assured. He had the advantage of incumbency and the support of Yeltsin. The Sakhalin electorate, characterized by a high proportion of active voters among the military and pensioners voted overwhelmingly for Yeltsin in the last election.

II. Elections for a new Regional Duma were also conducted on Oct 20. The previous Duma was split apart last year by a power struggle and finally dissolved by the courts. Its former chairman Maksyutov emerged as one of two Sakhalin representatives to the Federation Council, the other is Farkhutdinov. The two men hardly speak, a situation which complicates joint action in supporting legislative initiatives. However, indications are that Maksyutov has been defeated. The Sakhalin representative to the lower house at the time of this writing is Zhdakayev, a Communist from Tymovsk and outspoken opponent of shelf development by foreigners.

III. Vital issues to the future of Sakhalin-2 (stabilization, land code, profits tax split) remain to be decided in Moscow. Elevation of PSC Law opponent Glazlyev to post in Ledbed's Security Council bodes ill for needed amendments to that law and prevailing attitude at Fuel & Energy Ministry is that the law in current form is sufficient to start investment. Little is known about the policies of new Minister Rodionov, except that he is a Chernomyrdin man and a Russia-Firster.

F. Sakhalin fact sheet

I. Sakhalin is 950 km in length and only 160 km across at its widest point lying eight time zones east of Moscow and separated from mainland Russia by the narrow Tatar Straite. The southern tip of Sakhalin is just 45 km north of the northernmost Japanese island of Hokkaido.

II. Sakhalin's climate is maritime. Summers are cool with June and July misty and foggy, and hot weather in August. Fall is the season for typhoons and hurricane-force winds. Snow falls from November to March and may measure up to 50cm in the north, 70cm in the south and 100 cm in the east. Scrubby lowland tundra with sparse larch and cedar cover the northern third of Sakhalin; two-thirds are forested and mountainous, with spruce and fir predominating. Wetlands stretch along the perimeter of north Sakhalin, at the delta of the Poronay River and near Aniva Bay. Only about 2% of the land area is suitable for agriculture.

III. Sakhalin is a seismically-active region which has experienced two serious earthquakes in the last two years - October 1994 in the Kuriles (12 dead) and May 1995 in Neftegorsk (2000 dead, town obliterated). Monitoring stations are closing due to lack of funds and there is no money for research.

IV. The population of Sakhalin has decreased 11% since 1992, and is about 641,000. Eighty eight percent are ethnic Russian or Ukrainian, 5% Korean, and less than 0.5% indigenous (Nivkhi, Ulita, Nanai, Evenki). The majority of the

population live in the extreme south of the island. Kholmsk (pop. 62,000) is a major port with two pulp and paper plants, a fishing fleet, and a ship-building and repair center. Korsakov (pop. 46,000) is also a major center for fishing, fish processing and international shipping. Near mid-island, Poronaysk (pop. 26,000) produces paper pulp and cement. Okha (pop. 36,000) in the extreme north of the island, is the center of the onshore oil and gas industry. On the northeast Sakhalin coast, Nogliki (pop. 11,000) is the population center nearest the offshore Sakhalin project areas.

V. Fishing and fish processing represent 30% of the Region's total industrial activity, and 50% of its exports. The Kuril basin and Sea of Okhotsk are among the richest fisheries in the world providing at one time about half the total seafood demand of the former Soviet Union. Forestry (including timber, pulp and paper) is the second largest industry: formerly Sakhalin accounted for almost all the paper and half the pulp production of the Russian Far East. Industrial production of coal is declining due to high transport costs, loss of federal subsidies, outdated machinery, and intensive resource exploitation.

G. Sakhalin Regional Budget

Interview on Sakhalin evening TV 17 July 96 with Vice-Governor Gomilevskiy- How bonus payments of \$5M and \$15M from the Sakh-1 and 2 projects will be spent \$5M will remain in dollars as hard-currency fund for the Region, \$15M will be converted to rubles and evenly distributed among districts for "important work of preparation for winter, and construction of social infrastructure." Examples: purchase turbine for Nogliki gas-fired electric plant; hospital in Korsakov; repair earthquake-damaged school in Okha; school in native village of Krasnaya Tym; bridge in Makarov; repair of steam lines in Aniya. When asked if the bonuses are important and timely, Gomilevskiy answered "yes, especially when you consider that the Region has received transfer payments for Jan-Mar, but not a ruble since." MinFin has called in all loans. Governor has made frequent trips to Moscow to solve these problems. According to Sakhalin Regional Administration as of 1 Dec 96, Regions' expenditures totalled \$265 million (including \$108 million for industry subsidies, \$122 for social spending, \$16 million for administrative costs). Income was \$301 million, half from taxes and half from transfer payments from center and other sources (that are in arrears).

H. Economy

I. Article from 15Aug96 Soviet Sakhalin, "We Only Dream of Stability". Governor's cabinet discussed socio-economic reports of first two quarters. Deficit of \$45 million due to non-collection of taxes and delays in subsidies from Moscow. GNP down 7%, 20% in consumer goods. Half of Sakhalin live below poverty level.

II. Sakhalin Radio. Morning interview with Governor, 25 Jul 96; reported on first Sakhalin-2 project Supervisory Board meeting. With approval for 1999 first oil, "the money starts in three years, not all that long," stressed to foreign partners need for "maximum participation of Russian contractors, and ecological safety of the Project, "the need for foreign investors to provide opportunities primarily for exploration companies like DMIGE, DMNG to re-equip, train and increase competitiveness. Repeated pledge of 20,000 jobs "on Sakhalin."

III. Recent articles about socio-economic situation

* Article in 22 Aug 96 Gubernskiy Vedemosti "About the Budget: Poverty Levels in region. July 1996": Poverty level reached approx. \$125 in July, up 28.3% from last year. Half of population falls below. Bread up 8%, potatoes up 40%, milk, butter and eggs down slightly. Yuzhno is one of most expensive consumer basket in all Russia.

* Article in 30 Aug 96 Soviet Sakhalin by E. Kropp head of DMNG "No turning Back": cites report showing sharp drop in real wages in 1995, avg. salary was only 20% above poverty level. Agricultural production down by half. Unemployment up 6.5-fold 80% of all ruble turnover in Moscow who live four times better than Sakhalinians. Total foreign investment in Russia in 1995 was \$2.5 billion, but Sakhalin has unique chance at \$50 billion via Sakh-1,2,3. But it can be lost. Example: Murmansk \$14 Billion foreign-consortium gas projects which were re-tendered to Rosshelf in 1992 due to intervention from Moscow.

Development was delayed. Time and markets were lost to Norway. Beware such intervention driven by selfish political or industry goals.

* Article from 2 July 96 Soviet Sakhalin "Librarians are Grateful to Foreigners, But Want More Attention From Their Own": Reports Sakhalin-2 gift of \$110,000 over five years to library. Quotes Library Director: "Regional Duma has not yet approved even one-sixth the annual budget needed, and two library development programs announced by the Governor have not been funded yet. Librarians are paid only \$80-120 per month. Library wants for more attention from local authorities. Note: According to postal data, there are approximately 31,500 subscribers of Soviet Sakhalin daily newspaper of Sakhalin. Other local newspapers (mostly weeklies) have circulations from 200-5000.

I. ISSUES

- I. Foreign and US investment is critical to economic progress in Russia.
- II. Legal instability in Russia is delaying this investment.
- III. Enabling Laws and normative acts must be passed as soon as possible.

J. Population, short facts

I. Yuzhno-Sakhalinsk: capital of Sakhalin Region and largest city, pop. 160,000. Rail and air transport hub. Airport is international, but requires modernization to accomodate larger aircraft. Primary industries include food, timber processing, construction and building materials (including concrete and panel structures), finance and banking. Higher education: State Pedagogical Institute, and three smaller business colleges. Home of Institute of Marine Geology, Sakhalin Fisheries Research Institute, FEMCO, DMNG, and other oil exploration-related firms.

II. Article from 27 June 96 Soviet Sakhalin "Marine Geophysicists Enter the Picture": Finally after negotiations and parties, work is beginning. Quotes DMNG's Lifshits that a research vessel will conduct \$15 million in contract work for Exxon and SE this summer on shelf, emphasized that all money will go through local banks and taxes paid.

III. Article from 15 Aug 96 Gubernskiye Vedemosti "You're Going Nowhere Without Some Taxes": Mayor of Yuzhno met with cabinet to discuss socio-economic situation. City owes power system \$9 million. Why? Non-payment of taxes: 8000 businesses owe a total of \$8.5 million. Tax inspectorate keeping up the pressure. However, new expenses start Sept 1 -fund for small business development.

K. Impending winter power crisis

Article from 16 Aug 96 Svobodnyy Sakhalin: "Get Your Candles and Kerosine Heater Ready for Winter, Says Coal Company". Coal company is bankrupt strike looms. They owe \$120 million, only government can bail them out. One tonne of coal costs them \$80 to produce, price on foreign market is \$30/tonne. Worker productivity and maintenance low due to non-payment of wages. We can only deliver 1 mmt this year, 1.6 mmt needed.

L. Troika Alaska Opens Sakhalin Office

On October 15, the World Trade Center Alaska announced that the Troika Alaska Commercial Center has opened a representative office in Yuzhno-Sakhalinsk. Troika, a program of the World Trade Center Alaska, is located in room 509 of the Sakhalin Centre. Todd Crossett is the Troika Assistant Manager for Sakhalin and Elena Danilova is the administrative assistant. Troika represents a consortium of Alaskan or Alaska-based businesses and provides members with exclusive business services and information about their industries and their competitors in the Russian Far East.

M. Other Cities & Resumes

Korsakov

Population, 46,000, third largest in Region. Largest port primary ocean fishing base and largest fish processing plants located here. Also corrugated cardboard, food and light industries. Prigorodnoye, east of town, is proposed site for Sakhalin-2 LNG plant and export terminal.

Igor Pavlovich Parkutdinov, Head of Administration (Governor) - Sakhalinskaya Oblast

Born: 1950, Novosibirsk

Education:

1972: Krasnoyarsk Polytechnical Institute - Engineer and Economist

Professional Career:

1972-77: Engineer in Technology-production Section; Shift Chief; Then Chief, Boiler and Turbine Section of Power Station, Tymovskoye, Sakhalinskaya Oblast

Political Career:

1977-80: Second Secretary, Then First Secretary, District Komsomol Committee, City of Tymovsk;

1980-91: Director of Section on Young Industrial and Agricultural Workers, Komsomol Oblast Committee; in Yuzhno-sakhalinsk, Capital of Sakhalinskaya Oblast

1981-85: Instructor, Section on Organizational and Party Work, Sakhalinskaya Oblast Committee of CPSU;

1985-91: Chairman of the Executive Committee (Ispolkom), of the Soviet Of People's Deputies, City of Nevelsk, Sakhalinskaya Oblast;

1991-92: Chairman of Ispolkom of Municipal Soviet of People's Deputies, City of Yuzhno-sakhalinsk;

1992: January: Appointed Head of Administration (Mayor) of Yuzhno-Sakhalinsk;

1995: April 24: Appointed by President Yeltsin as Head of Administration (Governor) of Sakhalinskaya Oblast Following Resignation of Yevgeniy Krasnoyarov;

1995: November: One-week, Economic-oriented Visit to Alaska Included Oil-refining and Extraction Facilities-

Family:

Married; One Son

Vladimir YAGUBOV (yi-GOO-boff) Mayor Yuzhno-Sakhalinsk Born 1948 in Kurgan Region, graduated Kurgan Agricultural Institute in 1971 as agronomist. Seed agronomist and later chief agronomist of Niva collective farm in Kurgan. Moved to central Sakhalin in 1975 and graduated from the Higher Party School in Khabarovsk. Named Deputy Mayor in March 1995, and two months later assumed the post of Mayor when Parkhutdinov became governor.

Valeriy Ivanovich BELONOSOV (byen-la-NOH-soff) Vice Governor for Social and Cultural Issues - Born 1942 in Irkutsk. Graduated Irkutsk Mining Institute in 1963 as a mining engineer. Assigned to coal mine in Dolinsk, Sakhalin, as a mine surveyor. After military service returned to the Dolinsk mine as head of the design bureau, then transferred to Shabunino mine as chief surveyor. He worked

there five years, later becoming party secretary for the mine company. After graduating from the CPSU Academy of Social Sciences, he was named head of Sakhalinglavsnab in 1988 he became ideology Secretary of the Regional Committee CPSU, then in 1991 the head of regional transport and communications department. He has served as Vice-governor since June 1995. He is married and has two daughters.

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Rusty Devereaux

Oil and gas: Updates on Sakhalin-1 and -2

Oil companies do a lot of advance work before putting contracts out to bid. Creating the document (called the Request for Proposal, an RFP) which solicits the bids is one important feature of this advance work. Another is prequalifying companies who will be listed to receive the RFP, and thus invited to bid on it.

All the major oil companies work with major international contractors. So, just as the oil company is preparing the information needed to put out a contract for the bidding process, the companies who wish to bid on the contract are seeking pre-qualification status and are preparing themselves, as well as they can, for the bidding process.

One large contract has been awarded to Kvaerner Oil and Gas.

Based on a competitive bid, the Sakhalin-1 consortium has selected Norwegian firm Kvaerner Oil and Gas Limited to provide design engineering, procurement, and construction management assistance for the Sakhalin-1 Arkutun-Dagi Phase I Development Project. This includes the installation of an offshore structure and its associated oil and transportation and export system. The project execution team will be based in London.

The work will be divided into two stages. Stage One will consist of preliminary study, engineering and design work, including how best to use Russian products and services. Stage Two will include detailed engineering, procurement and construction management.

Arkutun Dagi lies in 40-45 meters of water about 20 kilometers off the northeast shore of Sakhalin Island.

Operator Exxon Neftegas Ltd. has a 30 percent interest in the field, Japan's Sakhalin Oil and Gas Development Company (SODECO) has 30 percent, and Russia's Rosneft-Sakhalin and Sakhalinmorneftegas-Shelf have 17 and 23 percent respectively.

And one small project awarded: Architectural planning for a housing project for Sakhalin-1

Yost Grube Hall (YGH—Portland, Oregon) has an agreement with Exxon to plan a community development for Exxon's Sakhalin-1 project. The architectural firm is currently in the preliminary planning phase of the project, considering different sites in Yuzhno-Sakhalinsk. A scope-of-work is expected to be completed by the end of March.

"Candidate-contractors" are exploring the possibilities

This was the purpose of a recent visit to Vladivostok and Sakhalin of a delegation from Morrison-Knudsen (MK—Boise, Idaho). The company is an international contractor in mining, engineering, oil and gas project work. The delegation included the Executive Vice President for International Affairs and the Executive Vice President for Environmental and Government Affairs.

Since the need for *local content* is a policy for both Sakhalin-1 and Sakhalin-2, the western companies who are preparing to bid on these contracts are looking for candidate Russian companies to train as partners in the contract work ahead. "This was also a purpose of our visit," said a member of MK's delegation.

* * *

In the process of our conversations with several companies we asked a few other questions.

Update: What's noticeable on Sakhalin right now?

"Lots of oilpatch folks running around, that means PhD's who wear cowboy boots. Folks who have developed oil around the world."

Update: Are the projects seen as American projects?

"The projects' shareholders certainly don't present it that way. Both Sakhalin-1 and Sakhalin-2 are multinational consortia (Japanese, American, European interests). But, yes, I suppose the islanders see these as American projects."

Update: Any impact on food export business to Sakhalin?

"We're noticing lots of special orders. Sally wants this, John wants that. But these orders are handled by the oil companies as special deliveries." □

EXXON COMPANY, USA
SAKHALIN INFORMATION

EXXON COMPANY, U.S.A.

POST OFFICE BOX 199901 • ANCHORAGE, ALASKA 99519-9901 • TELEPHONE (907) 551-5351

PRODUCTION DEPARTMENT
ALASKA INTEREST

JAMES F. BRANCH
PRODUCTION MANAGER • ALASKA

March 19, 1997

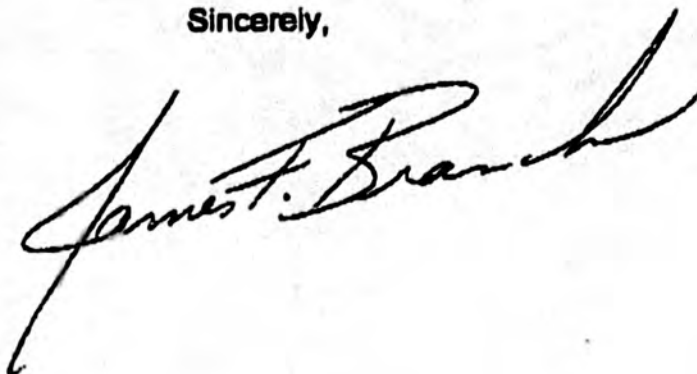
The Honorable John Cowdery
Chair, House Special Committee
on International Trade/Tourism
Alaska State Legislature
State Capital, Room 416
Juneau, AK 99801-1182

Dear Representative Cowdery:

Enclosed is a copy of Mr. Robert Olsen's speech on Sakhalin oil and gas development activities to the 1997 Alaska Support Industry Alliance. I hope you find this information useful in connection with the Committee's discussions on future economic development and government relations work on Sakhalin Island. Feel free to distribute copies of this material to the members of your Committee.

Please contact me or Mark Boudreaux at (907) 463-2577 if you should have any questions.

Sincerely,



JFB/MDB:dgo
Enclosure



SAKHALIN DEVELOPMENTS

**PRESENTED IN ANCHORAGE, ALASKA
JANUARY 18, 1997
TO THE ALASKA SUPPORT INDUSTRY ALLIANCE**

**BY
ROBERT C. OLSEN
PRESIDENT, EXXON NEFTEGAS LIMITED**

GOOD AFTERNOON. I'M PLEASED TO JOIN YOU TODAY AND DISCUSS THE CHALLENGING NEW PROJECTS OFFSHORE SAKHALIN ISLAND IN RUSSIA. YOU HAVE COME TO KNOW EXXON AS A LONG TERM INVESTOR AND BUSINESS PARTNER IN ALASKA, BUT YOU MAY NOT BE AWARE OF THE EXTENT OF EXXON'S INVOLVEMENT IN EMERGING OPPORTUNITIES IN THE FORMER SOVIET UNION.

TODAY I'LL PROVIDE AN OVERVIEW OF THE INVESTMENT ENVIRONMENT IN THE CIS AND THE MAJOR AREAS OF ACTIVITY. I'LL DESCRIBE THE PLANS FOR THE DEVELOPMENT PROJECTS IN THE SAKHALIN AREA SPECIFICALLY, AND THE CHALLENGES WHICH WILL LIKELY BE FACED BY SUPPORT INDUSTRY COMPANIES SUCH AS YOURS.

FIRST, LET'S LOOK AT THE OIL AND GAS INDUSTRY ENVIRONMENT.

CIS INDUSTRY OVERVIEW

THE COMMONWEALTH OF INDEPENDENT STATES, OR CIS, HOLDS VAST HYDROCARBON RESOURCES. ESTIMATES OF REMAINING RESOURCES (DISCOVERED AND UNDISCOVERED) HAVE BEEN PLACED AT OVER 200 GB OF OIL AND OVER 3000 TCF OF GAS. IN FACT, THE TOTAL CIS RESOURCE POTENTIAL ACCOUNTS FOR ABOUT 1/3 OF THE REMAINING LIQUID POTENTIAL AND OVER 1/2 OF THE REMAINING GAS POTENTIAL AMONG THE NON-OPEC COUNTRIES OF THE WORLD. THE CIS IS SECOND ONLY TO SAUDI ARABIA IN LIQUID RESERVES, AND SECOND TO NONE IN GAS RESERVES.

UNTIL ONLY RECENTLY, THE CIS WAS ALSO THE LARGEST SINGLE PRODUCER OF OIL AND GAS IN THE WORLD. LIQUID OUTPUT, AFTER PEAKING AT OVER 12 MBPD IN THE LATE 1980'S, HAS FALLEN TO A CURRENT LEVEL OF ABOUT 7 MBPD (~6 MBPD IN RUSSIA). PRODUCTION FROM RUSSIA, WHICH COMPRISES 90% OF THE CIS TOTAL, DECREASED BY 50%. AS A RESULT, THE CIS SHARE OF TOTAL WORLD PRODUCTION WAS REDUCED FROM 20% IN 1988 TO 11% IN 1995. THESE PRODUCTION DECLINES ARE THE DIRECT RESULT OF DECREASED GOVERNMENT INVESTMENT AND WERE AGGRAVATED BY THE DISSOLUTION OF THE SOVIET UNION.

IN RESPONSE, THE RUSSIAN GOVERNMENT HAS BEEN RESTRUCTURING THE OIL INDUSTRY SINCE 1992. LARGE INTEGRATED COMPANIES ARE BEING FORMED AND PRIVATIZED BY COMBINING ASSOCIATIONS THAT PREVIOUSLY HAD ONLY A SINGLE FUNCTION, SUCH AS EXPLORATION, PRODUCTION, OR REFINING. THE RUSSIAN INDUSTRY IS NOW FACED WITH SIGNIFICANT FINANCIAL REQUIREMENTS AND THEY ARE NOT ABLE TO FUND THE NEEDED NEW PROJECTS AND EXPLORATION PROGRAMS.

THIS HAS CREATED A NEED FOR SIGNIFICANT FOREIGN INVESTMENT AND HAS CREATED AN OPPORTUNITY FOR EQUITY PARTICIPATION BY WESTERN OIL COMPANIES. ASSUMING THAT CURRENT LEGAL AND COMMERCIAL DIFFERENCES CAN BE RESOLVED, THIS SHOULD BE A WIN-WIN SITUATION IN WHICH WESTERN OIL COMPANIES AND CONTRACTORS PARTICIPATE IN DEVELOPING THE CIS RESOURCE BASE TO THE MUTUAL BENEFIT OF ALL PARTIES INVOLVED.

AS THE NEXT SLIDE SUGGESTS, THIS RE-DEVELOPMENT EFFORT IS BEING PURSUED ON A LARGE SCALE ALL OVER RUSSIA AND THE NEIGHBORING STATES.

KEY AREAS OF CIS ACTIVITY

HERE YOU CAN SEE THE FOUR MAIN REGIONS OF NEW HYDROCARBON DEVELOPMENT WHERE THE WESTERN INDUSTRY IS FOCUSING. ALTHOUGH MANY OF YOU IN ALASKA ARE USED TO ENORMOUS GEOGRAPHICAL SCALES, SOME OF US HAVE TO REMEMBER THAT THIS MAP REPRESENTS ABOUT 1/6 OF THE WORLD'S LAND AREA, CONTAINS 12 SEPARATE REPUBLICS, AND SPANS 11 TIME ZONES.

TO THE NORTHWEST IS THE RUSSIAN REGION OF TIMAN PECHORA; TO THE NORTH IS THE HIGHLY DEVELOPED WEST SIBERIA REGION; AND THE RICH, ACTIVE BASINS OF THE CASPIAN SEA AREA ARE IN THE SOUTHWEST. TO THE EAST, IS THE SAKHALIN REGION WHERE I'LL CONCENTRATE MY DISCUSSION IN A MOMENT.

SOME OF THESE REGIONS, ALTHOUGH THEY ABOUND IN PROVEN RESOURCES, ARE HINDERED BY LACK OF ACCESS TO OUTSIDE MARKETS. WEST SIBERIA, IN PARTICULAR, HAS BEEN THE BACKBONE OF THE CIS OIL INDUSTRY SINCE THE LATE 1970'S. IN RECENT YEARS, THIS REGION HAS ACCOUNTED FOR ALMOST 70% OF TOTAL RUSSIAN OIL PRODUCTION AND OVER 90% OF GAS PRODUCTION. MUCH OF THE JOINT VENTURE ACTIVITY HAS OCCURRED HERE, BUT MOST OF THESE VENTURES HAVE BEEN RELATIVELY SMALL AND ACCESS TO EXPORT CAPACITY OFTEN DIFFICULT.

TIMAN PECHORA AND SAKHALIN, DUE TO THEIR COASTAL LOCATIONS, OFFER RELATIVELY EASIER ACCESS TO FOREIGN MARKETS. BOTH ARE REMOTE WITH LIMITED INFRASTRUCTURE, HOWEVER, AND WILL BE MORE COSTLY TO DEVELOP. THE CASPIAN SEA AREA IS VERY ACTIVE TODAY, DUE TO LARGE FIELD SIZES AND SUPPORTIVE GOVERNMENTS IN AZERBAIJAN AND KAZAKSTAN. EXXON IS PURSUING PROJECTS IN EACH OF THESE FOUR CIS AREAS.

EXXON'S INITIAL CONTACT IN THE CURRENT ENVIRONMENT OCCURRED IN 1990. BY 1992, WE HAD ESTABLISHED A REPRESENTATIVE OFFICE IN MOSCOW. TODAY, EXXON OPERATES FIVE OFFICES INCLUDING MOSCOW, YUZHNO ON SAKHALIN ISLAND, ARKHANGELSK IN TIMAN PECHORA, BAKU IN AZERBAIJAN, AND ALMATY IN KAZAKSTAN.

WITH THAT BACKDROP, LET ME NOW DESCRIBE THE SAKHALIN AREA.

SAKHALIN AREA OVERVIEW

FROM THE BEGINNING, EXXON FOCUSED ON THE SAKHALIN AREA WHICH HOLDS DISCOVERED AND UNDISCOVERED RESOURCES ESTIMATED TO BE ABOUT HALF THE SIZE OF ALASKA'S PRUDHOE BAY. IT IS NOW THE MOST ACTIVE AREA IN RUSSIA FOR MAJOR NEW DEVELOPMENTS-- LARGELY DUE TO THE EFFORTS OF THE PROGRESSIVE LOCAL GOVERNMENT, OR OBLAST ADMINISTRATION. SOME ONSHORE PRODUCTION HAS EXISTED ON THE NORTH HALF OF THE ISLAND FOR MORE THAN 50 YEARS. BUT THE OFFSHORE AREAS REMAIN UNTAPPED DESPITE EXPLORATION ACTIVITY WHICH HAS INCLUDED 25 WELLS SINCE THE 1970'S.

PHYSICALLY, SAKHALIN ISLAND IS IN A REMOTE SUB-ARCTIC REGION SIMILAR IN MANY WAYS TO THE COAST WEST OF ALASKA. THE OFFSHORE ENVIRONMENT FACES THE SAME CONDITIONS OF SEVERE SEASTATES, ICE COVERAGE ABOUT 8 MONTHS PER YEAR, AND SIGNIFICANT EARTHQUAKE ACTIVITY.

ALSO LIKE ALASKA, THERE IS CONSIDERABLE ONSHORE OIL PRODUCTION EXPERIENCE UNDER CONDITIONS GENERALLY SIMILAR TO YOUR NORTH SLOPE. THIS HAS PROVIDED A BASIC INFRASTRUCTURE, BUT IT IS NOW OLD AND CERTAINLY NOT YET PREPARED TO HANDLE THE SIZE OF PROJECTS THAT WE'RE PURSUING. THE LOCAL GOVERNMENT IS EAGER TO REVITALIZE THE SAGGING ECONOMY BY PUTTING PEOPLE TO WORK ON THESE NEW DEVELOPMENTS.

ON THIS MAP, YOU CAN SEE OUR SAKHALIN I AREAS FOR WHICH THE PSA, OR PRODUCTION SHARING AGREEMENT, BECAME EFFECTIVE LAST JUNE. THIS ALLOWED JUST ENOUGH TIME FOR US TO DRILL OUR FIRST APPRAISAL WELL AND SHOOT 3-D SEISMIC BEFORE WINTER ICE SET IN. I'LL COVER SAK I IN MORE DETAIL IN A MOMENT.

ALSO SHOWN HERE ARE THE TWO LARGE, DISCOVERED FIELDS IN THE SAKHALIN II PROJECT WHICH ARE BEING DEVELOPED BY THE SAKHALIN ENERGY CONSORTIUM OF MARATHON, SHELL, MCDERMOTT, MITSUI, AND MITSUBISHI. THE PSA FOR THESE AREAS ALSO BECAME EFFECTIVE IN JUNE 1996. THE FIELDS ARE REPORTED TO CONTAIN 750 MB OF LIQUIDS AND 14 TCF OF GAS.

SINCE IT IS IN RELATIVELY SHALLOW WATER, SAKHALIN ENERGY HAS ANNOUNCED PLANS TO USE A MODIFIED CANADIAN DRILLING STRUCTURE, THE MOLIKPAQ, AS A PRODUCING PLATFORM TO ESTABLISH EARLY PRODUCTION FROM THE PILTON-ASTOKH FIELD BY 1999. THE CONSORTIUM HAS RECENTLY LET A \$35M CONTRACT TO A RUSSIAN SHIPYARD TO FABRICATE THE BASE FOR THE PLATFORM. IN TOTAL, DEVELOPMENT OF THE TWO FIELDS IS EXPECTED TO REQUIRE AN INVESTMENT OF AROUND \$10 BILLION OVER MANY YEARS.

FINALLY, THE LARGE SAKHALIN III EXPLORATION BLOCKS ARE OUTLINED ON THIS MAP. EXXON WAS AWARDED THE TWO NORTHERN BLOCKS IN A 1993 TENDER AND THE COMBINE OF MOBIL/TEXACO PICKED UP THE SOUTHERNMOST BLOCK AT THE SAME TIME. EACH OF THESE BLOCKS COVERS ABOUT 1.1 MILLION ACRES. PSA NEGOTIATIONS WERE COMPLETED ON EACH OF THESE BLOCKS IN 1996 AND INCLUDE PLANS FOR SIGNIFICANT DRILLING ACTIVITY. AT THIS TIME, HOWEVER, THE PSA'S ARE AWAITING APPROVAL FROM THE LOCAL AND FEDERAL GOVERNMENTS AND THE PSA LEGAL FRAMEWORK IS BEING COMPLETED TO ALLOW THESE NEWER CONTRACTS TO BE VALID AND ENFORCEABLE.

LET'S NOW LOOK AT THE SAKHALIN I PROJECT MORE CLOSELY ON THE NEXT SLIDE.

SAKHALIN I

EXXON IS THE OPERATOR FOR THE 5 GOEB SAKHALIN ONE PROJECT TO DEVELOP THE ARKUTUN-DAGI FIELD AND A PROMISING GAS CONDENSATE FIELD KNOWN AS CHAYVO. IN ADDITION, ODOPTU, A THIRD FIELD THAT LIES TO THE NORTH, MAY BE COMMERCIALY DEVELOPABLE IN THE FUTURE. EXXON HAS A 30% INTEREST IN THE PROJECT, ALONG WITH AN EQUAL INTEREST BY THE JAPANESE GROUP SODECO, AND TWO RUSSIAN COMPANIES, ROSNEFT AND SAKHALINMORNEFTEGAZ, WHICH HOLD A COMBINED 40%.

ROSNEFT, ONE OF RUSSIA'S PREMIER INTEGRATED COMPANIES, BRINGS ESSENTIAL WORKING KNOWLEDGE OF THE RUSSIAN PETROLEUM INDUSTRY AND ESTABLISHED CONTACTS IN INDUSTRY AND GOVERNMENT.

SAKHALINMORNEFTEGAZ HAS 50 YEARS OF EXPERIENCE IN ONSHORE SAKHALIN OPERATIONS AND HAS OFFSHORE EXPLORATION AND DRILLING CAPABILITY.

SODECO BRINGS TECHNICAL AND MARKETING EXPERTISE, AND THE EXPERIENCE GAINED FROM OVER 20 YEARS OF ASSOCIATION WITH THE PROJECT.

CONSIDERABLE EXPLORATION WAS CONDUCTED BY THE RUSSIANS AND JAPANESE THAT RESULTED IN THE DISCOVERIES OF ODOPTU AND CHAYVO IN 1977 AND 1979, BUT THEY COULD NOT BE DEVELOPED ECONOMICALLY.

THE HIGH POTENTIAL ARKUTUN-DAGI FIELD WAS DISCOVERED IN 1989 IN WATER DEPTHS OF 65-165 FEET, ABOUT 20 MILES OFF THE EAST COAST OF SAKHALIN ISLAND. EXXON WAS SUBSEQUENTLY INVITED TO JOIN THE PROJECT AND IN 1995 THE FOUR COMPANY CONSORTIUM WAS FORMED TO PROVIDE THE STRENGTH NECESSARY TO UNDERTAKE A PROJECT OF THIS SIZE AND COMPLEXITY.

THE GREATEST CHALLENGE HAS ALWAYS BEEN TO COMMERCIALIZE RESOURCES IN THIS REMOTE AREA WITH A HARSH PHYSICAL ENVIRONMENT, LIMITED INFRASTRUCTURE, AND RESULTING HIGH

DEVELOPMENT COSTS. THE FIRST STEP IS TO GAIN A BETTER UNDERSTANDING OF THE RESOURCE POTENTIAL. THEREFORE, A 5-YEAR APPRAISAL PROGRAM WAS BEGUN WITH DRILLING IN THE ARKUTUN-DAGI FIELD LAST SUMMER USING A SAKHALINMORNEFTEGAS JACK-UP DRILLING RIG.

THE 1996 FIELD PROGRAM ALSO INCLUDED STATE OF THE ART 3-D SEISMIC ACQUISITION AND SITE SURVEYS IN PREPARATION FOR DRILLING OF 3 MORE WELLS DURING THE 1997 SEASON. THIS 1996 FIELD WORK, WHICH COST APPROXIMATELY \$30M, WAS THE FIRST PART OF A \$200-\$300 MILLION RESOURCE APPRAISAL PROGRAM THAT IS REQUIRED TO BETTER DEFINE ESTIMATES OF RESERVES IN THE THREE FIELDS.

ULTIMATELY, WE EXPECT IT WILL REQUIRE ABOUT \$15G TO FULLY DEVELOP THE THREE FIELDS. EARLY STUDIES INDICATE THAT WE MAY HAVE FOUR MAJOR ICE-RESISTANT PRODUCTION PLATFORMS WITH OFFSHORE TREATING CAPABILITY AS WELL AS SEVERAL SATELLITE DRILLING PLATFORMS OR TEMPLATES. STUDIES ARE NOW UNDERWAY TO PROGRESS THE PLATFORM, FACILITIES, AND PIPELINE DESIGN CONCEPTS.

THE CONSORTIUM IS CURRENTLY EVALUATING VARIOUS PHASED DEVELOPMENT AND TRANSPORTATION ALTERNATIVES TO ESTABLISH ECONOMICAL OIL PRODUCTION FROM ARKUTUN-DAGI JUST AS SOON AS REASONABLY POSSIBLE. UNDER CONSIDERATION FOR THE FIRST DEVELOPMENT PHASE IS AN ICE-RESISTANT PLATFORM CAPABLE OF PRODUCING MORE THAN 100 KBD AND LOCATED IN ABOUT 140 FEET OF WATER, SHOWN ON THIS MAP AS "P1". IT WOULD ACCOMMODATE BOTH DOMESTIC AND EXPORT OIL SALES WHILE GAS WOULD BE RE-INJECTED TO IMPROVE ULTIMATE OIL RECOVERY.

THE CONSORTIUM WILL UNDERTAKE ADDITIONAL ENGINEERING DESIGN WORK IN 1997 FOR THIS FIRST PHASE. IF THE RESOURCE APPRAISAL CONTINUES TO BE SUCCESSFUL AND THE