

SBM Offshore

Overview of controversial business practices
in 2008

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Overview of Controversial Business Practices in 2008

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Amsterdam, May 2009

Colophon

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Cover Design: Annelies Vlasblom

Funding

This publication is made possible with co-funding from the Vereniging van Beleggers voor Duurzame Ontwikkeling (VBDO)

Published by



Stichting Onderzoek Multinationale Ondernemingen
Centre for Research on Multinational Corporations

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Introduction

This company briefing has been prepared by SOMO (Centre for Research on Multinational Corporations). It provides an overview of business practices that could be considered as unsustainable or irresponsible which occurred (or might have been addressed) in 2008. In addition, it may describe developments on some issues identified in a similar overview for 2006, which was also prepared by SOMO.

The overview below describes only controversial practices that were identified and not the positive achievements of a company in the same year, except for positive developments related to some of the practices from the overview for 2006. Information on positive achievements can usually be found in a company's annual and/or sustainability report and on the company's website. The purpose of this report is to provide additional information to shareholders and other stakeholders of a company on controversies that might or might not be detected and reported by the company itself.

This report does not contain an analysis of a company's corporate responsibility policies, operational aspects of corporate responsibility management, implementation systems, reporting and transparency, or total performance on any issue. For some controversies, it is indicated which standards or policies may have been violated and a brief analysis is presented. Apart from this, the report is mainly descriptive.

The range of sustainability and corporate responsibility issues eligible for inclusion in this overview is relatively broad. The assessment is mainly based on issues and principles as outlined in the OECD Guidelines for Multinational Enterprises. These Guidelines are used as a general frame of reference in addition to company-specific standards.

Sources of information are mentioned in footnotes throughout the report. The main sources were obtained through SOMO's global network of civil society organisations, including reports, other documents, and unpublished information. Media and company information databases and information available via the Internet are used as secondary sources where necessary. A draft version of this report was sent to SBM Offshore for review of factual accuracy. The company was given two weeks to respond.

The overview of controversial practices in this report is not intended to be exhaustive. Instead, it focuses on a limited number of issues and cases that might merit further attention or reflection. Where information about the latest developments, either positive or negative, was unavailable, it is possible that situations described in the overview have recently changed. Taking into account these limitations, SOMO believes that the briefing can be used to address areas that need improvement and for a more informed assessment of a company's corporate responsibility performance.

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Cases

Environmental, socio-economic and health impacts of the Kashagan oil project

Kashagan project

The Kashagan oil field is located in the northern Caspian sea, off the shore of Kazakhstan. With its estimated reserves of between 38 and 50 million barrels of oil, it is the largest oil field in the world discovered since the 1960s. The higher-end estimate would make this the second largest oil field in the world after the Ghawar field in Saudi Arabia.¹ Potentially, 13 million barrels would be recoverable, and at its peak the field is expected to generate 1.5 million barrels of oil per day. However, no oil drilling has yet taken place.

Since 1994, a number of large oil companies have shown interest in the oil field. A consortium of companies, currently led by Eni, formed the joint venture (JV) Agip KCO for the future drilling of oil in Kashagan. The other oil companies involved in the JV include ExxonMobil, Shell, ConocoPhillips, Total, JSC and INPEX. Agip KCO has negotiated with the Kazakhstani government for exclusive rights to the appraisal, development, and future drilling of the Kashagan oil fields.

The oil would be extracted from the field using the technique of gas re-injection. In this process, gas is injected into the oil field, thereby facilitating the pumping out of the oil. The actual start of production has been delayed several times due to a number of technical difficulties. First, the oil present in the Kashagan field has a very high concentration of hydrogen sulphide, reaching levels up to 20%. The production of oil would co-produce so-called 'sour gas', with some of the highest levels of hydrogen sulphide encountered in the offshore industry. The processing and storage of this highly toxic and corrosive substance is challenging, and the proposed solution lies in the re-injection of this sour gas.²

Secondly, the northern Caspian Sea area has an extreme climate, with temperatures ranging from 40°C in summer to -40°C in winter. This fact, in combination with the very shallow waters of the Kashagan field, means that the drilling area is covered in ice for 4-5 months per year. The production of oil in such extreme climates requires the use of untested technologies. Other technical difficulties include the extremely high reservoir pressure, the depth of the reservoirs, and the storage of by-products such as sulphur.³

¹ D. Urbaniak, E. Gerebizza, G. Wasse, M. Kochladze, "Kashagan oil field development, Kazakhstan; extractive industries: blessing or curse?" Friends of the Earth Europe, Friends of the Earth France, CEE Bankwatch, Campaign for the Reform of the World Bank (Campagna per la Riforma della Banca Mondiale) and Globus, December 2007, <www.foeeurope.org/publications/2007/KashaganReport.pdf> (09-04-09).

² R. Chellini, "Kashagan Sour Gas Reinjection Project", Compressor Tech Two, April-May 2005, <www.geoilandgas.com/businesses/ge_oilandgas/en/downloads/ct252_lorez.pdf> (09-04-09).

³ D. Urbaniak, E. Gerebizza, G. Wasse, M. Kochladze, "Kashagan oil field development, Kazakhstan; extractive industries: blessing or curse?" Friends of the Earth Europe, Friends of the Earth France, CEE Bankwatch, Campaign for the Reform of the World Bank (Campagna per la Riforma della Banca Mondiale) and Globus, December 2007, <www.foeeurope.org/publications/2007/KashaganReport.pdf> (09-04-09).

The Kashagan oil project has been criticised by a number of local and international organisations.⁴ In research reports and on their websites, these organisations describe the actual and potentially harmful effects of drilling for oil in the Kashagan field. In particular, the combination of the technical difficulties described above with the use of new and untested production technologies severely increases the risks of disasters during the extraction and transport of oil. For example, gas-reinjection can cause so-called technogenic earthquakes, as has happened in the past in the Karachaganak field in 2007 and the Tengiz field in the 1980s.⁵ This could have disastrous effects for the region.

Other controversial aspects of the Kashagan oil project include⁶:

- ❑ Environmental damage
 - Effects on the endangered sturgeon that migrates through the area
 - Effects on the whelping grounds of the Caspian seal
 - A conflict between Agip KCO and the Kazakhstan Ministry of Environment regarding a waste management plan.
 - Increased tanker traffic without a proper oil spill response plan.
 - Sharp declines in fish, migrating bird and marine mammal populations
- ❑ Social impacts
 - Lack of proper community engagement in all phases of the project
 - Oil development places the tourism and fishing industries at risk and prevents investment in other more sustainable economic ventures
 - Loss of livelihoods due to declining fish stocks
 - Potential exposure to toxic gases and lethal sulphur spills
 - Relocations of communities
 - Increased levels of poverty due to a rise in costs of living without a corresponding increase in wages
 - Lack of sufficient investment in public infrastructure and services
- ❑ Health impacts
 - The risk of exposure to the highly toxic gaseous form of sulphur is greatly increased by the lack of proper storage facilities
 - High concentrations of the extremely toxic mercaptan gases in the oil extracted from Kashagan
 - Increase in cardiovascular and respiratory diseases in surrounding communities
 - Increase in ailments such as diarrhoea, skin diseases, headaches, nose bleeds and cases of anaemia and leukaemia in surrounding communities

The role and responsibility of SBM Offshore

In 2004, SBM Offshore received the order from Agip KCO for “the design and construction of three flash gas compression barges for the Kashagan field in the shallow waters of the Northern Caspian sea offshore Kazakhstan”.⁷ According to a glossary published on SBM’s website, ‘flash gas’ refers

⁴ Ibid.

⁵ Telephone conversation with Elena Gerebizza, Campaign for the Reform of the World Bank (Campagna per la Riforma della Banca Mondiale), 09-04-09.

⁶ For a full description of these aspects and issues, see D. Urbaniak, E. Gerebizza, G. Wasse, M. Kochladze, “Kashagan oil field development, Kazakhstan; extractive industries: blessing or curse?” Friends of the Earth Europe, Friends of the Earth France, CEE Bankwatch, Campaign for the Reform of the World Bank (Campagna per la Riforma della Banca Mondiale) and Globus, December 2007, <www.foeeurope.org/publications/2007/KashaganReport.pdf>(09-04-09).

⁷ SBM Offshore, Annual Report 2005, <<http://www.sbmoffshore.com/PDF/annrep2005EN.pdf>>(12-04-07), p.22.

to “the gas that is separated from the oil flow at the low or medium pressure separators”.⁸ Two of the three barges were finalised and delivered in April 2007. The third barge was delivered in March 2008.

The three barges will be used during the initial experimental phase of the Kashagan project. The purpose of the barges is to “compress the associated gas from the LP and MP separators located elsewhere for further treatment in the Dehydration Unit and final compression and re-injection”.⁹ The sour gas re-injection process is risky, and the risks are exaggerated by the extreme climate and vulnerable biodiversity. In such a context, small accidents might potentially have enormous negative impacts. This has been one of the major objections of the environmental organisations to the entire Kashagan project.

According to the OECD Guidelines for Multinational Enterprises (Chapter II.10), a company has the obligation to “encourage, where practicable, business partners, including suppliers and sub-contractors, to apply principles of corporate conduct compatible with the Guidelines”. No documentation was found of any consideration by SBM Offshore of the controversial issues of the project, or that it had engaged with Agip KCO about the environmental and socio-economic risks involved in the use of SBM’s barges in the sour gas re-injection process. The company has listed the challenges as they relate to the design of the barges, but has not provided any public documentation of how it dealt with these challenges.¹⁰

Sakhalin project

The Sakhalin II project in the Russian Far East is said to be the largest integrated oil and gas project in the world.¹¹ The project involves three offshore oil and gas platforms and subsea pipelines to shore. The oil and gas will be transported via 800 km of onshore pipelines to what will be one of the world’s largest natural gas liquefaction and export terminal and oil export facilities at Prigorodnoye, in the south of Sakhalin Island.

Sakhalin II was designed and constructed by the Shell-managed Sakhalin Energy Investment Company, Ltd., (Sakhalin Energy). In April 2007, Russia’s Gazprom acquired a controlling share of the project, but Shell retains control over most day-to-day management decisions, particularly those related to environmental issues.¹²

Controversies

The project has seen significant criticism from international organisations, who have targeted Shell as the leader of the consortium, as well as the western banks financing the project, as the controversies surrounding the project make investments in the project a violation of the Equator

⁸ <<http://www.sbmoffshore.com/DOCS/GlossaryEN.pdf>>

⁹ GustoMSC, “Inside: foresight in offshore,” Vol.6, April 2006, <<http://www.gustomsc.com/download/Inside%207%20-%20April%202006.lowres.pdf>>(09-04-09).

¹⁰ Ibid.

¹¹ BankTrack website, Dodgy deals, “Sakhalin II oil and gas project - Russian Federation”, no date, <http://www.banktrack.org/show/dodgydeals/sakhalin_ii_oil_and_gas_project>(09-04-09).

¹² The agreement saw Shell’s share in the Sakhalin Energy joint venture reduced from 55% to 27.5%. See Shell, “Responsible energy: The Shell Sustainability Report 2007”, <<http://sustainabilityreport.shell.com/2007/>> (6 April 2009), p.33.

Principles. The controversies mostly centre on biodiversity issues, although attention has also been given to the risks of oil spills and the threat to livelihoods of indigenous people.¹³

Sakhalin II is situated adjacent to the principle feeding grounds of the critically endangered western gray whale, of which only approximately 130 individuals remain. In 2004, at the insistence of prospective project financiers, Sakhalin Energy agreed to commission the International Union for the Conservation of Nature (IUCN) to assemble an expert Independent Scientific Review Panel (ISRP) to review the project's impacts on the western gray whale. Since then, the ISRP and its successor panel, the Western Gray Whale Advisory Panel (GWAP), have consistently warned that Sakhalin II and other projects in the area "pose potentially catastrophic threats to the [western gray whale] population".¹⁴ Concretely, the most eminent threats of the industrial activities in Sakhalin include the disturbance of feeding patterns due to ship noise, possible collisions between ships and whales, and the contamination of the whale population by oil spills.¹⁵

Sakhalin Energy's lack of cooperation and commitment to putting protection of the western gray whale population before profits led the GWAP-5 to question the future of the Panel's important work:

"The lack of recent progress on various matters, primarily as a result of inadequate provision of data and information, has led Panel members to question whether the process is serving its central purpose: to promote the necessary protection for this critically endangered whale population and thus improve its chances for full recovery. As a result, unless there is significant and immediate improvement, members are increasingly reluctant to continue investing their time and energies in a process that seems to be of questionable effectiveness".¹⁶

According to BankTrack, the refusal to deviate from planned construction to wait for scientific analysis, and the refusal to adopt the recommendations of the IUCN constitute a violation of the precautionary principle.¹⁷

The role and responsibility of SBM Offshore

SBM Offshore has been involved in the Sakhalin II project through the lease of the Okha, a Floating Storage and Offloading vessel (FSO), since 1999.¹⁸ An FSO is a ship that is used as storage for the oil produced by a nearby platform and for further transport of the oil through tankers or pipelines. The Okha was leased by SEIC and operated by SBM Offshore. In December 2008, the FSO Okha left the Sakhalin II project and is currently under construction to be transformed into

¹³ CEE Bankwatch network, NGOs Issue Paper; EBRD Annual Meeting, Beograd, May 2005, <http://bankwatch.org/documents/sakhalin_1.pdf>(09-04-09).

¹⁴ For more on the impacts of the Sakhalin II project, see the Pacific Environment website <<http://www.pacificenvironment.org/section.php?id=135>> (7 April 2009) and ISRP, "Impacts of Sakhalin II Phase II on Western North Pacific Gray Whales and Related Biodiversity: Report of the Independent Scientific Review Panel", 2005, <http://cmsdata.iucn.org/downloads/impacts_of_sakhalin.pdf> (7 April 2009).

¹⁵ IUCN, public letter addressed to His Excellency Mr. Valery Loshshinin, Ambassador of the Russian Federation to the United Nations, <http://cmsdata.iucn.org/downloads/letter_v_putin_jul08.pdf> (09-04-09).

¹⁶ Ibid, p.34

¹⁷ BankTrack website, Dodgy deals, "Sakhalin II oil and gas project - Russian Federation", no date, <http://www.banktrack.org/show/dodgydeals/sakhalin_ii_oil_and_gas_project>(09-04-09).

¹⁸ SBM Offshore website, Activities, Lease and Operation, "FSO Okha / Sakhalin Energy Investment / Russia", no date, <<http://www.sbmoffshore.com/PAGES/?id=D42EA8C5-5B93-46A7-AA25-B2C9E970A3CE>>(09-04-09).

a Floating Production Storage and Offloading vessel (FSPO) to be used in the North West Shelf Venture in northern Australia.

SBM Offshore's Okha forms part of the sea traffic that is likely impacting the western grey whale population. However, SBM Offshore does not appear to have considered how the noise created by the operation of its ship affects the western grey whales. As in the case of the Kashagan project, no information was found on whether SBM Offshore considered the negative effects of its role in the project, or whether it encouraged its business partner, in this case Sakhalin Energy (Shell), to conduct its operation in accordance with the OECD Guidelines, as is required by the Guidelines' paragraph on supply chain responsibility (Chapter II.10).

Concluding remarks

The two cases described above were both concluded in the course of 2008. As both the vessels for Kashagan have been delivered, and the FSO Okha is no longer active in the Sakhalin II project, the role of SBM Offshore in these projects is no longer relevant. However, these cases do seem to indicate a lack of proper consideration of the environmental and social implications of the company's involvement in such controversial projects. The fact that SBM Offshore has been involved in two of the most controversial oil projects of recent years, without well formulated policies to ensure compliance with international norms such as the OECD Guidelines, should raise red flags among shareholders, stakeholders and company managers about future operations. SBM Offshore has never publicly announced that CSR issues play a role when deciding about its involvement in a certain project, nor have there been any indications of SBM Offshore using its role as a service provider to the oil industry to call for more sustainable practices among its business partners.

In a response to a draft version of this overview, SBM Offshore indicated the following:

However, we would like to mention that for our projects our clients have to obtain licenses to operate their platforms. These licenses address environmental issues which have to meet the local laws and environmental requirements are incorporated in their specification. SBM designs and constructs their products as per client specification and consequently the environmental requirements of the country and project are met.

The notions of supply chain responsibility and due diligence have become mainstays in the discussions regarding corporate social responsibility. The OECD Guidelines for Multinational Corporations make mention of these principles and the latest report by the Special Rapporteur to the UN Secretary General on business and human rights, John Ruggie, pays particular attention to the issue of due diligence. Given these principles, SBM Offshore should take a more proactive approach to its supply chain responsibility by evaluating the larger social and environmental effects of the projects it is involved in and encouraging its business partners to act responsibly. Such an approach would move beyond merely accepting their clients' operating licenses and adherence to local legislation.

In some ways, the position of SBM Offshore as the provider of equipment used in the oil industry can be compared to that of the international banks who finance oil extraction projects. On the basis of the Equator Principles, several international banks have already decided not to finance projects such as the Kashagan and the Sakhalin II project. These banks perceive the risks for environmental or social damage to be too large to get involved. These considerations are made

prior to involvement in any project, but also during the course of financing. SBM Offshore should also consider make such evaluations.