



LUKOIL

SUSTAINABILITY REPORT
FOR OPERATIONS IN THE RUSSIAN FEDERATION

2003 — 2004

DECLARATION BY BUREAU VERITAS RUS



We have reviewed the contents of the LUKOIL Sustainability Report 2003–2004 for operations in the Russian Federation for the purpose of assuring the validity of the information and the reliability of statements, declarations and data contained in it.

The text of the official Assurance Statement by Bureau Veritas Rus is published on page 96. Commentaries by Bureau Veritas Rus are located on the appropriate pages of the LUKOIL Sustainability Report and are based on the data gathered by the auditors during ISO 9001, ISO 14001, and OHSAS 18001 certification and compliance audits of the management systems of LUKOIL and of its subsidiaries and also on an analysis of corporate policies and other documents concerning social and environmental issues provided by the Working Group during the preparation of this Report.

THE LUKOIL SOCIAL CODE IN ACTION

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INTRODUCTION BY THE PRESIDENT OF LUKOIL



During its ten-year history while making the transition from a state-run concern to a major joint stock company, LUKOIL has been guided by the motto "Always on the Move."

The very highest degree of responsibility falls to a large oil company, as its task is to utilize natural resources with care and to efficiently turn them into an end-product for consumer use. The scale of this work, both in geographic and financial terms, is so significant that it inevitably has an impact on the life of the entire country. LUKOIL has always been strategically guided by the national interest and consequently its concept of sustainable development makes the growth of Russia's economic potential its ultimate goal.

Throughout its history, LUKOIL has repeatedly affirmed its commitment to the principles of socially responsible business practice. We view sustainable development as simultaneous and interrelated growth of resources and production capacity, enhancement of financial results, and assurance of social and environmental safety. The Company is committed to active participation in social life and compli-

ance with the interests of the state, shareholders, investors, employees, consumers and other stakeholders. Such an approach makes the growth of corporate financial results secure.

In recent years, the Company has standardized its social and environmental policies. In 2001 and 2004, LUKOIL was awarded ISO 14001 and OHSAS 18001 certification after successfully passing audits of its environmental, industrial, and occupational safety management systems.

In 2002, LUKOIL adopted its Social Code which describes the commitments undertaken by the Company with respect to its employees and to society as a whole along with the economic mechanisms for their fulfilment. In 2004 the Company adopted its Environmental Safety Programme for 2004–2008.

Today, we are presenting the LUKOIL Sustainability Report to the public for the first time. This document covering the period of 2003–2004 has been prepared based on the Global Reporting Initiative Sustainability Reporting Guidelines and the AA 1000 framework. The Assurance Statement has been completed by our longstanding partner, Bureau Veritas Rus.

The preparation and publication of the Sustainability Report is an important milestone on the path to a new level of corporate management.

We also hope that the publication of this Report will carry forward the dialogue between the Company and civil society. This objective has already been achieved in part: while preparing the report, we have not merely systematized information about LUKOIL's participation in the life of society, but we have also identified the expectations of Russian citizens about the work of our company.

Every reader of this Report will find comprehensive information about our corporate economic, social, and environmental policies that will enable him to judge our contributions to social development. We hope that it will contribute to increasing the confidence of Russia's population in LUKOIL and in the whole corporate sector as well.

President
Open Joint Stock Company LUKOIL



V. Yu. Alekperov

»»» CORPORATE PROFILE

OUR MISSION

Our purpose is to harness natural energy resources for human benefit.

The open joint stock company "LUKOIL Oil Company" is the largest national corporation operating in 60 Russian regions and 30 foreign countries on four continents. In 2002 LUKOIL became the first Russian oil company to be listed on the London Stock Exchange. Today the Company's shares are a highly liquid financial instrument in demand on international equity markets.

The Company explores for oil and gas, produces and refines them, and sells petroleum products. The Company's output is over 19% of all the oil produced in Russia and 19% of the oil refined in this country. The Company's distribution network spans 17 countries and includes 10 organisations distributing petroleum products in Russia. The LUKOIL retail network in Russia is comprised of 1,456 petrol stations owned or leased along with 276 franchised ones.

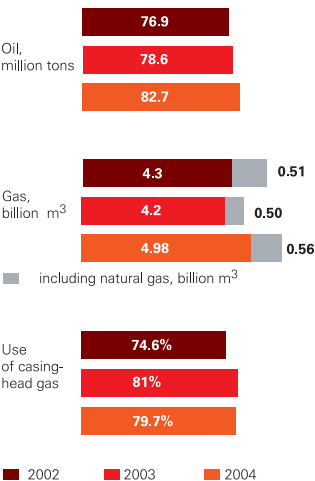
The corporate business strategy is aimed at a balanced development of oil and gas production, refining and distribution of petroleum products. LUKOIL's hydrocarbon reserves grow from year to year, and oil reserve replacement approaches 100% and more.

LUKOIL refineries were among the first to completely stop production of leaded petrol. Corporate investment in refining produced a significant modernization of operations which enabled the Company to produce motor fuel complying with international standards, including low-sulphur diesel fuel. The Company plans to expand the variety and improve the quality of its petroleum-based products in response to market demands and in compliance with European quality standards.





Main indicators for industrial oil and gas production (in Russia)



LUKOIL's petrochemical output covers a significant part of Russian domestic demand for a number of chemicals which are also exported to over 50 foreign countries.

LUKOIL has its own tanker fleet including arctic tankers. Reinforced ice-class tankers permit transportation of four kinds of various cargoes at the same time, including crude oil and gas condensate.

The new LUKOIL Strategic Development Programme, which extends to 2013 aims for the Company to become one of the leading oil and gas companies in the world, which would make it the second in gas sales only to Gazprom. LUKOIL is already developing fast in that respect: the Company has four gas refineries.

During the reporting period, the Company has had a number of achievements. Among the most significant are the start of industrial oil production at the Kravtsovskoye oil field on the Baltic shelf and the launch of the first unit of the distribution and transshipment plant in Vysotsk, Leningrad Oblast. In 2004 the American company Conoco-Phillips became LUKOIL's strategic partner, and both corporations plan to actively cooperate in Russian and international oil and gas production projects.

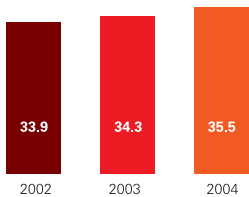
In 2004 the structure of share capital for the Company changed: the last state-owned block of shares was privatized, which means that state participation in the Company has gone from 91% in 1993 to zero. At the same time, LUKOIL continues to adhere to the principle of balancing the interests of the Company with those of the state in its projects and in the general direction of its development.

Improvements in the quality of corporate management and increased transparency were important factors that contributed to the Company's development. The Head Internal Audit Department has been created for the assessment of daily activities. The position of the Board of Directors is being continually strengthened. Currently, the Board includes four independent members who chair the Strategy and Investment Committee, the Audit Committee, and the HR and Compensation Committee. One distinction of LUKOIL is that it does not have a majority shareholder, which means that the rights of minority shareholders are guaranteed.

The Company consistently wins domestic and international competitions. In 2003 it was declared the best issuer on the Russian stock mar-

Oil refining (in Russia)

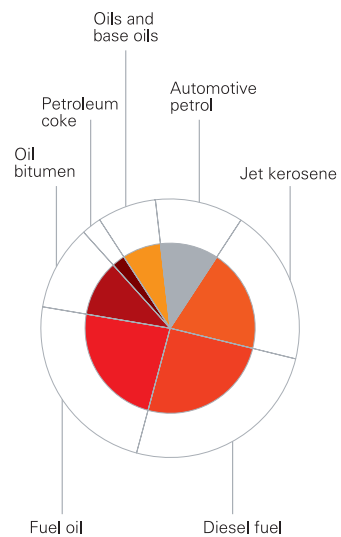
Volume of oil refining, million tons



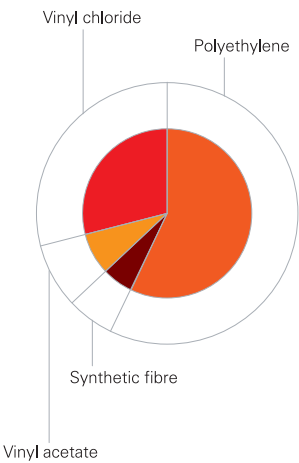
Source: LUKOIL Annual Reports

ket. In 2004 the American magazine *Global Finance* named LUKOIL the best oil and gas company in Russia, and the international credit rating agency Standard & Poor's rated the company number one among Russian oil companies for transparency of information. LUKOIL became Company of the Year in the Business Reputation category of the Sixth National Business Prize awarded by the informational agency RosBusinessConsulting. The Company was one of the winners of the Seventh Competition of Annual Reports and Corporate Websites in the category "Best Level of Disclosure of Information for Investors" conducted by the RTS Stock Exchange and the magazine *Rynok Tsennykh Bumag* (Equity Market).

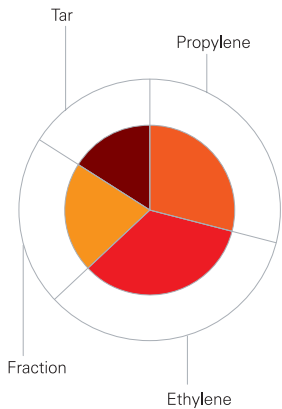
Products of oil refining (in Russia)



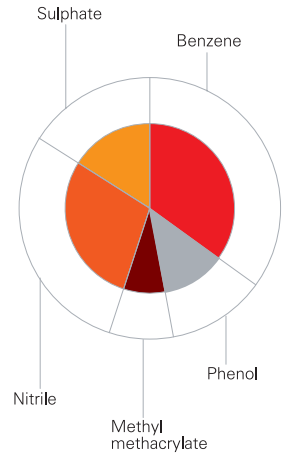
Petrochemicals
Polymers



Pyrolysis products



Organic synthesis products



»»» LUKOIL'S APPROACH TO SUSTAINABILITY REPORTING

PRINCIPLES OF CORPORATE SOCIAL RESPONSIBILITY

We believe that Russian companies have a historical tendency toward social responsibility; however, the previous relationship between enterprises, personnel and society had a paternalistic character. The social functions of enterprises and state guarantees were aspects of a single state social policy. The market economy has shifted the roles of businesses and of the state system of social protection. LUKOIL considers it necessary to regularly review its social role, to introduce new approaches and to abandon outdated functions that are not appropriate for a business. We believe that this approach will promote the birth of a unique culture of social responsibility in Russia that will combine historic traditions with universal human values.

In accordance with its mission and strategic objectives, the Company has the following priorities with respect to social responsibility:

- » The Company's dynamic and successful development is essential to securing it a suitable position at an international level. The Company cannot be socially responsible unless it achieves excellent industrial and financial results.
- » We value people. The Company must make its decisions in a manner that takes into account the interests of all stakeholders and that is understandable to them. The Company strives to find optimal choices through its internal social policy and charitable programmes.
- » Recognizing the undeniable fact that production cannot occur without an impact on ecology, the Company takes practical steps to lessen or prevent possible negative environmental effects and to ensure industrial health and safety.

In 2002, LUKOIL adopted its Social Code as a guideline for socially responsible operation. The Social Code specifies corporate commitments and priorities in terms of the corporate social and charitable policy, as well as directions for its environmental work. The Social Code is based





on international documents ratified by the Russian Federation supplemented by voluntary principles proclaimed by the UN in the Global Compact. The Social Code was adopted by the Board of Directors and is binding for all enterprises of the Company. The Social Code is subject to periodic reconsideration. The Company has also adopted internal policies and regulations which will be covered in subsequent sections of this Report.

NON-FINANCIAL REPORTING

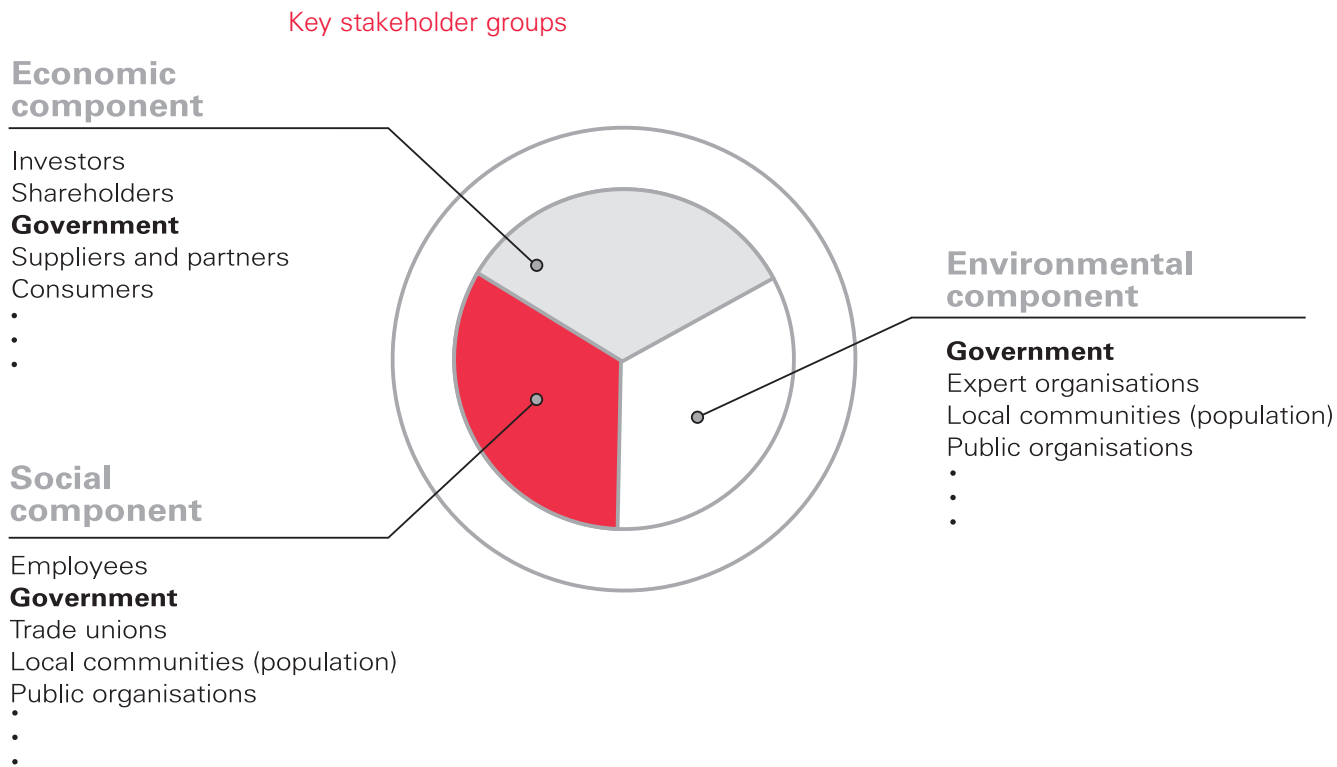
The commitment to report voluntarily and regularly on sustainable development was made by the Company's top management. This is our first report, and in it we have attempted an analysis of the Company's economic, social and environmental achievements during the past two years. The reporting process has helped the Company to adjust its concept of sustainable development and its approaches to non-financial reporting in general.

The Report is based on widely used international standards (the Global Reporting Initiative [GRI] Sustainability Reporting Guidelines and the AA 1000 framework). We believe it is important to use methodological and conceptual approaches accepted by the professional community: both standards have undergone extensive development through the efforts of various professionals from different countries.

LUKOIL shares the key principles of the Global Reporting Initiative, which are compatible with the information disclosure policy of the Company. At the same time, some of the reporting principles were not fully used in the first report. This primarily concerns the level of stakeholder engagement in the reporting process. The Company participates in conferences and forums; it is involved in the legislative process, regularly meets with representatives of Russian regional governments, and conducts public hearings with ecological organisations. The Company and its employees regularly negotiate with the active participation of the trade union association. However, the stakeholder engagement does not have a systematic character at this point: the Company is just beginning that process.

An open dialogue with stakeholders is a new cultural element in this country, and one which has not yet sufficiently developed. We find this





approach promising as it enhances the skills of talking and listening. Using it in the future would help the Company to have a better idea of the completeness and relevance of information expected from it. The first Report uses only the indicators that are related to the work of the Company and which can be assured at this time.

A Working Group has been created to manage the reporting process. It consists of managers and staff of those departments of the Company whose purview includes social responsibility. The Working Group is guided by its Regulations. One of the Working Group members performs the functions of an internal auditor to ensure the completeness and accuracy of non-financial reporting.

Consultations with the corporate management resulted in a resolution to prepare the first Sustainability Report for 2003–2004. The geographic scope of the Report spans all the key Russian regions where the Company operates, and these regions represent all types of LUKOIL's industrial operations. The new project for developing the Kravtsovskoye oil field in the Baltic Sea has also been included because of the increased public attention it attracts and also because this is the

first time that a Russian company has worked on the Baltic shelf.

Bureau Veritas Rus has provided an independent assurance of the Company's non-financial reporting and of its first Sustainability Report. The Assurance Statement is included in the Report.



Dialogues with stakeholders were arranged and conducted on a highly professional basis by an independent facilitator, the Agency for Social Information (ASI)

REQUESTS FOR INFORMATION: DIALOGUE RESULTS

While preparing its first Report, the Company engaged in an open dialogue with legislative and executive authorities. They were chosen following an analysis of the Company's stakeholder categories and groups (see the diagram on p. 11); of the character of discussions of corporate social responsibility; and of the roles of companies and the state. Another reason for choosing this group was that it is one of the most important with respect to the Company's operation. Participants in the dialogue were: representatives of the State Duma, the Federation Council, the Ministry of Industry and Energy, the Ministry of Economic Development and Trade, the Ministry of Natural Resources, the Ministry of Foreign Affairs, the Ministry of Transportation, and others. The dialogue was held in an independent setting. The Agency of Social Information acted as a facilitator. Also present were auditors from Bureau Veritas Rus.

The following topics were discussed during the dialogue:

1. Preparation, content, and distribution of the Report.
2. Environmental protection issues.
3. Charity and social investments.
4. Economic input of the Company.

A number of proposals were made regarding those topics. All of those proposals were considered by the Working Group and the Company followed up by setting forth its position and making commitments for the next reporting period.

The summary of proposals on the first topic is below:




The Assuror was not in any way restricted by LUKOIL in terms of its ability to observe the dialogue and confirms that there was no coercion of stakeholders during the dialogue on the part of the Company or the independent facilitator.

1. To analyze the Company's socially responsible business in the context of current social and economic reforms.
2. To report on the indicators of social stability, social risks, and the indicators of sustainable social development.
3. To assess the effectiveness of the Company's socially significant programmes.
4. To report on the Company's ecological safety policy in detail.
5. To inform the international and domestic public through the Company's reports about major environmental problems successfully resolved through the cooperation between the state and the Company.
6. To demonstrate in the Report the linkage between the Company's ecological and environmental work and its economic component in relation to the Kyoto Protocol.
7. To engage public and state institutions in analyzing the Company's work during the social reporting process. To create a Social Reporting Coordinating Council within the company.

Some of the proposals (##1–3 and 6) require that a thorough examination and appropriate methodology be implemented, and for that reason information on those issues is not provided in this Report. The Company accepts the proposals and plans to use them during the preparation of the next report. Information on Proposals 4 and 5 is provided in this Report. Specific suggestions were also made regarding recipients of the first Report. All these proposals have been taken into account and the recipients have been included in the mailing list.

In accordance with Proposal 7, the Company pledges to continue interactions with various stakeholders during the reporting process. LUKOIL engaged research, public and expert organisations in the preparation of the first Report and will be guided by the principle of stakeholder engagement in the future. The Company will further develop various forms of interaction and will use them flexibly. However, the creation of a Coordinating Council at this stage does not appear to be practical.



Information provided to the Assuror for an analysis of the compliance of the reporting process with the dialogue stage requirements was complete and objective. The information is presented in a clear, precise and comprehensible way. It allows all stakeholders to see which economic, social and ethical commitments LUKOIL has made as a socially responsible company concerning the interests and expectations expressed by stakeholders and society as a whole during the dialogue.

The Assuror was present during the dialogue between the Company and stakeholders on March 29, 2005, in Moscow.





The issue of reporting frequency was also discussed during the dialogue. Participants suggested a two-year reporting period because a high-quality analysis of non-financial results for a single year would be quite difficult to perform. The Company management reviewed the suggestion, and the decision was made to set a two-year reporting cycle.

Proposals made on the topic of environmental protection were as follows:

8. To disseminate information on environmental management procedures used by LUKOIL and also the Company's experience in dealing with accidents.
9. To accompany report publications by forums or conferences with the Company enterprises held in independent settings.

LUKOIL regularly takes part in conferences, seminars, and forums, making presentations on the topics mentioned in Proposal 8. Information on the number of accidents is provided to governmental bodies in accordance with the law. The Company will devote an appropriate space to that topic in its reports. As concerns special events, the Working Group will endorse that proposal when talking to the Company's management. Expectations concerning specific locations (the Kravtsovskoye field) have been taken into account in this Report.

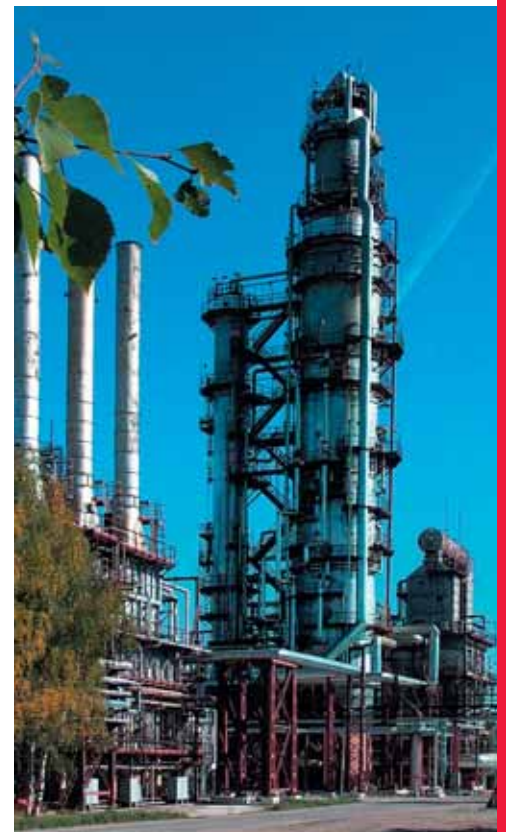
The following proposals were made regarding charity and social investments:

10. To provide assistance to veterans of the Great Patriotic War in view of the 60th anniversary of the victory.
11. To provide assistance to organisations and staff of the Defence Ministry of the Russian Federation.
12. To determine the Company's role in supporting education while it undergoes current reforms.

Per Proposal 10, the Report describes the Company's charitable programmes that reach out to veterans. Information about the programmes dedicated to the 60th anniversary of the victory celebration

will be published in the next report, as it is outside of the current reporting period which covers only the years 2003 and 2004. Dialogue participants also inquired about the funds earmarked for social purposes, and this Report provides the absolute values for them. In line with Proposal 12, the Company will conduct consultations and an analysis, whose results will also be published in the next Report. The kind of assistance envisioned in Proposal 11 is already customary in LUKOIL's social partnership programmes.

The economic component of the Company's work was the subject of a proposal that the Company elaborate on the collective contribution of major Russian companies to the growth of gross domestic product. The Company views that topic as very important and timely, particularly in conjunction with current public discussions of the role of large companies in the economic development of the country. However, that proposal faces the Company with an inappropriate task. That kind of activity properly belongs to public associations of businesses. In this Report, the Company has attempted to present LUKOIL's contribution to development in the regions where it operates.



>>> COMPANY CONTRIBUTION TO ECONOMIC DEVELOPMENT OF THE RUSSIAN REGIONS

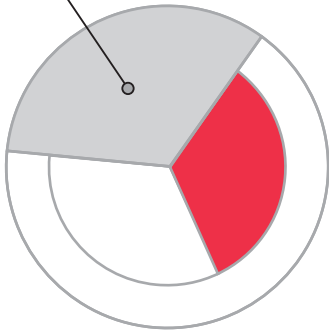
"As an efficient owner and a bona fide participant in free competition, the Company takes on social and ethical commitments that are economically justified"

Social Code of OAO LUKOIL, Part III

Economic component

Stakeholders¹

- Legislative authorities
- Regional authorities
- Municipal authorities
- Corporate managers
- Employees
- Suppliers and contractors
- Indigenous ethnic groups of the Far North



Corporate management
(key documents and policies):

- Strategic Development Programme Through 2013
- Restructuring Programme for 2002–2010
- Programme for Gas Component Development
- Programme for Quality Improvement
- Cooperative Agreements with Russian regions

The corporate strategy for sustainable development sets out major commitments and is founded on an understanding of the part that the oil and gas industry plays in the country's economy. Our approach uses traditional professional techniques and managerial experience accumulated over dozens of years in conjunction with cautious evolutionary changes. The regions where the Company operates vary greatly in the structure of their economy, workforce, and social well-being. The LUKOIL strategy is in line with regional economic development policies both in the regions where the Company is just launching its projects and in areas where it has long been active.

¹ Hereinafter the list of stakeholders includes groups described in this Report.





The Company's Annual Reports provide a detailed analysis of business strategies and financial and industrial achievements. This Report covers only the aspects that are significant for the industry as a whole, as well as for stakeholder groups.

Key regions of corporate activity in Russia

Operations	Regions
Geological exploration	Timano-Pechora
	North Caspian Sea
	Western Siberia
	Yamalo-Nenents Autonomous District
Production	Western Siberia
	Timano-Pechora
	Cis-Urals
	Povolzhye (Volga region)
	Kaliningrad Oblast
Oil and gas refining	Western Siberia
	Timano-Pechora
	Cis-Urals
	Povolzhye
Petrochemistry	Saratov Oblast
	Stavropol Kray
Distribution of petroleum products	Territory of the Russian Federation



The Company's history begins in 1991 with the creation of an oil concern involving three oil and gas enterprises located in the West Siberian towns of Langepas, Urai and Kogalym. Two years later, the President of the Russian Federation signed a decree that marked the official founding of OAO LUKOIL from those subsidiary enterprises. Other enterprises from various regions of the country subsequently joined the Company. Museums and displays on view at LUKOIL and its subsidiaries explain the key points in the progress of the Company and its enterprises, as well as their current direction, the technology employed and samples of their products, etc.

In certain regions, including Western Siberia and the European North of the Russian Federation, the Company has traditionally been the largest land user. Those regions hold the greatest part of LUKOIL's

reserves (53%). LUKOIL's reserves in other regions are between 0.6% and 18%. Most of the Company's gas reserves (79%) are located in the Yamalo-Nenets Autonomous District and on the Caspian shelf.

Oil extraction in the regions of Company activity, %

Western Siberia	65.4
Povolzhye	3.7
Timano-Pechora	13.6
Cis-Urals	11.7

Source: LUKOIL Annual Report 2004

Gas extraction in the regions of Company activity, %

Western Siberia	54.2
Timano-Pechora	
Cis-Urals	45.3
Povolzhye	

Source: LUKOIL Annual Report 2004

Ninety-six percent of all oil extracted by LUKOIL is produced within the Russian Federation.

The oil and gas industry dominates the economy of the **Khanty-Mansi Autonomous Okrug**: over 70%² of tax revenue comes from five oil companies including LUKOIL. In 2004 the Company was the third largest producer of oil and gas in that region³. The budget structure of the Khanty-Mansi Autonomous Okrug makes it one of Russia's leaders in terms of gross regional product and local tax revenue per person.

The OOO LUKOIL-Zapadnaya Sibir (LUKOIL-Western Siberia) is one of the most dynamically developing enterprises in the region. Its territorial industrial subdivisions are located in the "base-towns" of the Company (Langepas, Urai, Kogalym and Pokachi) whose population exceeds 155,000. The total number of LUKOIL enterprise employees is around

² Here and below the data is quoted from official websites of oblast and okrug local governments unless specified otherwise.

³ At the beginning of 2005, LUKOIL was the second largest oil producer in the region.





40,000, which means that the Company employs one person out of four in that region. They value the opportunity offered by the Company as the number of other employment choices in the region is limited.

Industry in the **Komi Republic** is also largely based on fuel and natural resources: over half of the total industrial output is from that

Indigenous ethnic minorities

A specific feature of the Company's work in Siberia and the Far North is that its operations may have a significant influence on the lives of indigenous ethnic minorities. Any growth in oil and gas production means that their vital interests—such as reindeer breeding, fishing and hunting—will be affected by the active extraction of resources. Changes in the traditional lifestyle create social and economic problems for those ethnic groups. LUKOIL's approach to this concern is to shift gradually from charity to techniques based primarily on economic partnership.

The Company develops and runs special programmes for working with owners of ancestral plots. An agreement "On Mutual Cooperation for the Social and Economic Development of Indigenous Settlements" and economic treaties with heads of ancestral plots in the Khanty-Mansi Autonomous Okrug, include the following commitments accepted by LUKOIL-Zapadnaya Sibir:

- Construction of cottages and providing people with good quality housing;
- Payment of compensation for the use of land plots (compensation can be monetary or in-kind: snowmobiles, boats, chain saws, hunting and fishing gear, and fuel and lubricating oils).

In the Nenets Autonomous Okrug, the Company together with the Yasavey Nenets Association runs social assistance programmes and a project to increase production in traditional crafts and reindeer breeding. (The programmes include purchasing reindeer and veterinary supplies, fuel and spare parts.) The most significant project called Red Igloo (Krasny Tschum) provides assistance and health checkups to reindeer breeders in the Kanino tundra, conducts Reindeer Days, supports the Nenets community and runs publication programmes.

source. A significant part of the oil reserves there (around 70%) are in the hard-to-recover category, and some of the old fields had deteriorated. However, during the past five years, the oil and gas industry has experienced rapid development which is directly attributable to the arrival of LUKOIL in the region in 1999.

Most of the oil extraction in the Komi Republic (around 60%) is done by enterprises affiliated with OOO LUKOIL-Komi. The Company came to the region at a time when 60% to 100% of basic production assets were extremely worn, no drilling had been performed in six years, 40% of wells were not used, in-field roads required major renovation, and the level of social tension in the workforce was high. As a result of the measures taken by the Company, the situation changed markedly over a short period of time. A redirection of the flow of raw materials allowed the Ukhta Oil Refinery to reach its full capacity and create new jobs. Today, the Company employs over 13,000 people, and Usinsk has turned into an economically attractive town. The Republic has been able to meet all of its outstanding obligations.

The structure of the economy in **Perm Oblast** is more diversified with the fuel and chemical industry comprising 40% of regional production. OOO LUKOIL-Perm is a major source of tax revenues in the oblast with its share of the regional budget running as high as 10% .

From its creation through a complex restructuring in 2003, LUKOIL-Perm has positioned itself as a "company with regional mentality". Its main principles are: complete transparency, 100% payment of taxes, participation in the region's social and economic development, and environmental safety. LUKOIL-Perm was one of the companies that initiated the payment of taxes locally. This has enabled two districts of the oblast to become sources of tax revenue rather than recipients of it.

Numerous awards received by the company confirm that LUKOIL-Perm has succeeded: it won an award for the Best Russian Enterprise on five occasions, and was winner of the Management Leader of the Prikamye (Kama region) Competition several times.

In 2004 another enterprise, OOO LUKOIL-Permnefteorgsintez, which is the Company's largest Russian refinery, launched a unique



complex for advanced oil refining which permits production of EURO-4 diesel fuel. This is the first such complex in Russia and the seventh in the world.

In the **Povolzhye Region**, fuel and chemical industry represents 3–7% of the economy in Nizhny Novgorod Oblast and up to 60% of the economy of Astrakhan Oblast.

In **Volgograd** and **Nizhny Novgorod** oblasts, the output of the Company's refineries has a major impact on regional budgets. For example, in 2004 a growth of the output at OAO LUKOIL-Nizhegorodnefteorgsintez and in sales at OAO LUKOIL-Volganefteprodukt produced an increase in oblast and local tax revenues of up to 1.5 billion roubles (or 3%). "Those assets allowed us to pay salaries in the budget sector and to carry out social programmes," acknowledged the Governor of Nizhny Novgorod Oblast, G. Khodyrev.

OAO LUKOIL-Nizhegorodnefteorgsintez is a winner of the fourth annual national competition, Russian Organisations with Beneficial Social Impact. The factory received an award "for significant input into the Nizhny Novgorod Oblast and Russian economy, payment of taxes, revenues and other contributions to budgets at all levels in 2004."

LUKOIL's development strategy places great importance on **Astrakhan Oblast**. During the last five years, the Company discovered a new oil field there. The Company is performing exploratory drilling, and production will start in 2008. Once pumping starts on the Caspian shelf, the budget of Astrakhan Oblast will increase by 40% and 5,000 new jobs will be created. The Company's plans also include large commissions for the shipbuilding and ship repairing enterprises of the region. The oblast government sees LUKOIL not only as its trustworthy strategic partner but also as an element of state policy in the Caspian region.

Kaliningrad Oblast has significant low-sulphur oil resources. OOO LUKOIL-Kaliningradmorneft is developing 25 of the 30 fields discovered in the region. In July 2004, LUKOIL-Kaliningradmorneft started industrial production at the Kravtsovskoye field (Project D-6). Exclusive engineering solutions that make the project environmentally safe and economically efficient are being used on the production platform.



ООО LUKOIL-Volgogradneftepererabotka, a major producer of fuel and lubricating oils, has been working in Volgograd for almost half a century. The refinery's affiliation with LUKOIL is considered to be its second birth. Today, that enterprise is the largest taxpayer in Volgograd oblast: its tax contributions amount to 12% of total revenues. While at the end of the '80s workers were eager to leave the enterprise because of its debts and industrial problems, today there is competition between applicants to be hired.

The workforce takes as its main task the implementation of the refurbishment and modernisation programme which spans the period ending in 2010. The programme's first stage was environmental and was completed in 2001 when the enterprise eliminated a source of pollution of the Volga, launched a hydrotreatment unit for diesel fuel, a complex of gas processing facilities, etc. The enterprise now monitors soil, waste water runoff, and atmospheric conditions around the clock. Petrol stations in the oblast use only ecologically clean diesel fuel. The factory began production of liquefied propane, butane and their mixtures for everyday use. The quality of petrol has improved and waste gas flaring has been cut in half.

The second stage of the programme, which commenced in 2002, targets a drastic improvement in the quality of petroleum products and reduction in production costs. In 2002 the refurbishment of the KM-3 unit allowed production for the first time in Russia of isoparaffin base oil using Chevron Chemical S.A. technology. Production of motor oils, including brands that enjoy the largest demand and sales, the so-called "popular brands", has expanded.



INDUSTRIAL ASPECTS OF THE COMPANY'S ACTIVITIES

The oil and gas industry like any other develops according to its own principles. Among topics widely discussed in the international community are: the sufficiency of oil reserves already explored and alternative energy strategies; the impact of geopolitical processes on the industry's future; the character of state regulation of oil and gas companies; etc. LUKOIL does not remain outside the influence of these external

processes and takes them into account as it outlines its development strategy. This Report covers three considerations that the Company believes to be important for long-term development:

- strategies for oil production and exploration;
- diversification of the Company's business: development of the gas component of the industry;
- legislative regulation of the industry.

Oil production and exploration

Oil reserve replacement is an absolute necessity in the oil business for sustainable and long-term corporate development. Significant investments in that area have brought the Company to the lead position in exploratory drilling and effectiveness of geological surveys in Russia

However, depletion of resources at some enterprises of the Company ranges from 1% (OAO Arkhangelskgeoldobycha) to 87% (OOO LUKOIL-Nizhnevolzhskneft). Reserves in deposits with depletion under 20% comprise over half of total reserves, and reserves in deposits with depletion over 80% are around 4%. Hard-to-recover oil amounts to over half of total reserves, and almost one fifth of total reserves of the Company are in the form of oil with over 80% water cut.

The Company believes that it is possible to sustain the current volume of production by two different means. The first one is the exploration and acquisition of locations where new resources may be discovered. From its founding the Company has consistently increased its exploration. Replacement operations at some points amounted to 195% of production. As a result, the Company was able, in a rather short amount of time, to accumulate a reserve base in very promising new areas (the Caspian, the Timano-Pechora oil and gas province, and the Bolshekhetsk depression) that represent alternatives to old, depleted ones. From 2002 on, geological surveys have been undertaken using only the Company's own assets. In addition, newly discovered smaller deposits in previously worked areas usually go into production immediately and become profitable. Thus, small deposits in Perm,

Volgograd, and Kaliningrad oblasts start producing in the second or third year after their discovery.

The second way to keep up the current production volume is by increasing reserve productivity by using new technologies. In 2002, the Company developed and adopted its Comprehensive Programme for Optimization of Oil Exploration and Production in 2003–2005. The main aims of the programme are: to increase the efficiency of production; and to introduce very efficient resource-saving technologies while complying with Russian laws governing the protection and rational use of resources. The Company employs advanced technologies and innovations from Russian scientists and leading international companies. Thus, wells are drilled using the up-to-date technologies of Halliburton, Schlumberger, Baker Oil Tools and other corporations. The company uses modern production techniques, including hydraulic fracturing of reservoir rock, sidetracking in inactive wells, horizontal drilling, etc., as well as informational technologies for gathering and storing information on geological structures and the deposit exploration process.

The Company's strategy in exploration and production has a significant social effect as it makes people have more confidence in the future especially in the regions where the oil and gas industry is dominant in the economy.

Gas strategy

However, the general depletion of explored oil reserves accompanied by sharp price fluctuations on the international market have prompted the Company to investigate other means for achieving sustainable development, such as natural gas production and refining. In accordance with the LUKOIL Strategic Development Programme Through 2013, gas production is planned to increase by almost eight-fold. Most of the increase will be achieved through the development of new gas and gas condensate deposits in Western Siberia and the Caspian Sea. By 2014 gas would amount to 30% of the total hydrocarbon production of the Company. LUKOIL is to form a joint system of gas production, transportation and refining with subsequent production of gas fuel, liquefied gases and gas condensate, materials for the production of petrochemicals and gas chemicals, and electric and heating energy based on gas fuel.



These plans require large investments. For example, capital investment in the Bolshekhetsk depression (Western Siberia) has already amounted to USD 4 billion, and investment in the Northern Caspian deposit (within the Russian Federation) has required USD 2.9 billion. Future development of gas production is also contingent upon how the system of domestic gas price regulation will shape up and upon how the issues of gas transportation to domestic and international markets will be handled.

Increased utilization of casinghead gas is another part of the Company's gas strategy. That would help improve ecological indicators and use natural resources in a more rational way. However, some related tasks still need resolution, particularly, the utilization of casinghead gas and its delivery to main pipelines. Those issues can be resolved only through the combined efforts of the state, market participants, experts and specialists.

Legislative regulation of the industry

The Company meets its tax obligations promptly and completely. In 2003 and 2004 taxes on Russian operations represented over 80% of the Company's tax expenses.

The growth of tax payments was largely caused by an increase in the rates of so-called "resource" taxes: the mineral extraction tax (NDPI), export duties and the excise duty on petroleum. Compared to 2003, average tax rates underwent the following changes: NDPI up 31.4%, oil export duty up 83.5%, export duty for petroleum products up anywhere from 33.9 to 38.6%, excise duty up approximately 12%.

Taxes paid by the Company in Russia, USD billion

2003	2004
5.23	8.64

Note: These taxes include retained earnings tax, NDPI, social taxes and contributions, property tax, other taxes, excise tax, and export duties.

The Company's specialists share their experiences of operating under the new, market conditions in order to assist the development of a legal environment for Russian business. They participate in parlia-



mentary hearings, sit on expert committees created by public organisations and government, act as consultants for draft laws on the activities of the fuel and energy complex and other industries.

During the reporting period, the Company's experts worked on draft changes to the law "On Mineral Resources" which was to construct a relationship suitable for current conditions between the state as the owner of resources and the organisations that use them. In the summer of 2004 some of the conceptual points repeatedly voiced by LUKOIL representatives were reflected in changes to the current law. Specifically, a resource user who has discovered a deposit automatically receives the right to develop it following its exploration and evaluation. This will stimulate more activity in geological surveying by producing companies. Another amendment to the law stipulates that a period of resource use may be extended beyond the time specified in the license at the initiative of a resource user if there is a need to finish exploration and evaluation unless the user has breached conditions of the license.

The Company's experts participate in drafting improvements to tax legislation. The opinion of oil and gas business specialists based on precise financial and economic calculations is relevant when decisions are made about the optimal level of taxation in the industry. Such decisions should consider not only the state's fiscal interests but also the industry's development prospects.

In recent years the tax system for the oil business has undergone major changes and has become simpler as well as more transparent. The turnover tax, which had a depressing effect on economic activity, has been abandoned. During the three years since the introduction of the new system, its disadvantages have also become apparent: tax deductions become too extreme when the world price of oil goes beyond USD 25 per barrel; and there is no differentiation in the tax burden related to the geological, economic and geographic conditions at the deposits under exploration. The Company's specialists together with representatives of other oil companies and the federal government continue their work to improve the system of oil industry taxation.

The new Customs Code of the Russian Federation came into effect in 2004. Even though not all proposals made by the working group (in which LUKOIL specialists participated) were taken into account





in its final version, the Code nevertheless deserves to be treated as a contribution to the liberalization of economic relations as it provides a legal foundation for the establishment of favourable conditions for international commercial activities by Russian companies.

The Federal Assembly of the Russian Federation has since 2003 been working on the proposal made by the business community to introduce a strict regimen of procedures for raising prices and tariffs for services provided by natural monopolies. Today, limits for those prices and tariffs – including those for electric and heating energy, natural gas, and railroad and pipeline transportation – are set by the Russian government prior to the first reading of the draft federal budget for the next fiscal year and become effective as of the first of the fiscal year. Implementation of that regulation promotes economic stability and predictability of development among producers and service providers within natural monopolies.

Of all the laws prepared with the involvement of LUKOIL specialists and signed by the Russian President, those that create favourable conditions for investments in the Russian economy are particularly significant, including:

- › changes in legislation aimed at protecting shareholder interests in joint stock companies;
- › adoption of the law on investment funds that creates a convenient mechanism for attracting investments into the productive sector of economy;
- › inclusion of some resource locations under Russian jurisdiction on the continental shelf of the Russian Federation and on a portion of the Caspian Sea bottom in the list of resources that may be developed through production sharing agreements. The locations of interest here are the Central and Yalamo-Samur prospective deposits that LUKOIL is directly involved in exploring.

It is important to note that an agreement on production sharing between a resource user and the state is practically the only way to achieve an acceptable rate of return for investors on shelf deposits that require significantly larger investments than those located on shore.

One of the obstacles to the vigorous development of the country's oil and gas complex is the deficit in the capacity for transportation of oil and petroleum products. Resolution of that problem is complicated by deficiencies in the legislation that regulates the development and functioning of main transportation pipelines. That has prompted more active work on the draft law "On Main Pipeline Transportation". Specialists of the Company participate in drafting of that law. Among the key points of the draft law are: creation of conditions for attracting private investments to the construction of main pipelines; enabling equal access to pipeline systems controlled by the state; and taking into account the characteristics of raw materials supplied to the main pipeline transportation system.

The Company's specialists have contributed to the drafting and expert evaluation of other legislation including the new Labour and Land Codes, a set of laws on electric energy reform, and others. Of special note is an amendment to the law "On Natural Monopolies" which affirms the principle that export opportunities should be made available on a non-discriminatory basis to oil-producing organisations in proportion to the volume of oil delivered to the main pipeline system.





SOCIAL AND ECONOMIC PARTNERSHIP WITH REGIONAL AND MUNICIPAL GOVERNMENTS

"In response to the new social responsibilities of business while equality of access to acceptable employment and benefits is diminishing, the Company voluntarily commits itself to socially responsible participation in the life ... of the local population in the regions of its operation..."

LUKOIL Social Code, Part II

The Company signed its first Cooperative Agreements with Kray, Oblast and Local Administrations several years ago. Usually an Agreement confirms a previously existing participation of the Company in regional social and economic development. Parties to an Agreement annually analyze the progress of its implementation and prolong the Agreement by special protocols, or negotiate a new one. In 2003 the Company spent over 955 million roubles on partnership and charity, and in 2004 over 1,051 million roubles.

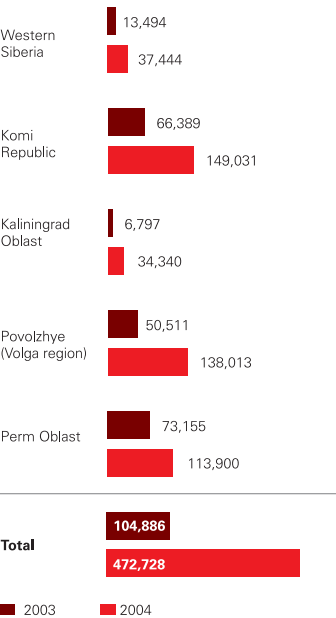
Pursuant to its Agreements, the Company funds institutions for healthcare, education, mass sports, culture, housing and utilities, and important municipal institutions, as well as a number of earmarked programmes that complement the social policies of regional administrations. This is the approach the Company finds appropriate at this stage. Total funding for social infrastructure institutions provided by the company in 2003 was 1,480 million roubles, and 1,364 million in 2004.

In accordance with its Agreements, the Company also participates in federal and regional programmes to supply petroleum products to consumers involved in providing vitally important services to the region, that is, to enterprises operating in agriculture, forestry, utilities, transportation and road-maintenance. Petroleum products are





LUKOIL Group expenditures for social partnership and charity in key regions of its operations, thousand roubles¹



¹The Company's expenditures for social partnership and charity in key regions of its operation are included in the total expenditures presented in this section of the Report.

provided to agriculture and forestry enterprises at discount rates and with a late-payment option.

The results of this cooperation in several main categories are illustrated by the following examples.

SUPPORTING HEALTHCARE INSTITUTIONS

The level and quality of healthcare is an important issue in Russia: the state of free healthcare delivery in some regions needs improvement. The system of paid medical services is not uniformly developed; the quality of these services is inconsistent, and there is little access to them for the ordinary consumer.

The Company promotes the development of medical services in the regions of its operation. Cooperation with healthcare institutions open to the public is based on contracts that allow all LUKOIL employees regardless of their location to receive medical assistance. These contracts also provide healthcare institutions with a source of stable additional funding for renovation of buildings, purchase of medication and equipment, and higher earnings for doctors. In addition, access to the Company's own sanatoria and health resorts, which were formerly restricted to LUKOIL employees, has been extended to local residents.

New healthcare institutions are being built with the Company's help. In 2004 wellness centres were built in Zhirnovsk and Kotovo (Volograd Oblast). LUKOIL enterprises in Volgograd combined their efforts to carry out a major renovation of the main building of the Children's Hospital #21 for Infectious Diseases.

The Company pays special attention to children's healthcare. In 2004 the LUKOIL Charity Foundation contributed to the reconstruction of the Stavropol Kray Maternity Home. Volgograd subsidiaries of the Company provided up-to-date equipment for the Volgograd Oblast Children's Hospital and also donated to the Hospital an intensive care ambulance for newborns, which was built in Germany for that purpose. Modern medical equipment for heart surgery on babies with cardiac malformations was purchased for the Volgograd Oblast Cardiology Centre. The Kstovo District Hospital received help with major renovations to its Children's Department.



URBAN DEVELOPMENT AND ECOLOGICAL IMPROVEMENT

Numerous surveys show that city dwellers in almost every Russian region believe that urban development is a primary goal. For that reason the Company is very responsive to development expectations in discussions of its regional Agreements.

In a telephone survey that was part of a live show by the Volga TV company, the people of Nizhny Novgorod expressed their opinion that LUKOIL's charitable contribution should be used for lighting Bolshaya Pokrovskaya Street, and the Company acted on this request.

The 45th birthday of the town of Kstovo, Nizhny Novgorod Oblast, was the occasion for reconstructing a children's park and for refurbishing sports grounds in various sections of the town.

For its City Day, LUKOIL reconstructed Engels Boulevard for the city of Volgograd.

In Kotovo, the Company built a health and wellness complex with a swimming pool, a stadium, and also renovated the town's central district.

In Zhirnovsk, LUKOIL refurbished the town park including its rides, sports grounds and an open-air cinema

In Frolovo, Volgograd Oblast, the Company installed street lighting, renovated the House of Culture and the central square, and repaired the facades of apartment buildings.

An example of the Company's contribution to the environment is the planting of trees in West Siberian towns. Together with the administration of Kogalym, OOO LUKOIL-Zapadnaya Sibir planted 65,000 trees in 2003 and an additional 10,310 in 2004. Planting will continue through 2008.

AN INNOVATIVE APPROACH: DEVELOPMENT OF THE LABOUR MARKET AND SELF-EMPLOYMENT

Long-standing cooperation between LUKOIL and the Perm Oblast administration has demonstrated that the most effective model for

Medical centres and hospitals receiving help from LUKOIL:

- Research Centre of Obstetrics, Gynaecology and Perinatology, Moscow
- Haematology Research Centre, Moscow
- Central Research X-Ray and Radiology Centre
- Sixth Central Military Hospital, Moscow
- Russian Research and Industrial Cardiology Complex, Moscow
- Leningrad Oblast Hospital



social partnership stresses a joint determination of social policy priorities and also the beneficial effects of the Company's long-term participation.

The Company's presence in Perm Oblast has some unique features because its enterprises are located in twelve out of the region's eighteen historic settlements⁴. Only Moscow and Leningrad oblasts are ahead of the Perm region in the number of such settlements. Most of them are agricultural districts with a specific structure in the labour force. Representatives of the regional administration and of OOO LUKOIL-Perm analyzed the situation and decided that the quality of life in those areas could be improved through development of folk crafts and peasant households. The programme "Supporting Folk Trades and Crafts" was designed with this goal.

Oil producers do not directly subsidize the craftsmen but instead encourage the development of various artistic approaches and help them earn a living. A project-based approach is used. Craftsmen must prepare applications and bid for funding (funding for the programme is a separate line in the corporate social project competition budget). Funding is then provided to the most professional projects that have a real chance to go forward on a "firm footing" and possibly turn into a small family business. One project funded within this programme resulted in the opening of a folk crafts school in the village of Bolshaya Pashnya, and another helped establish a folk crafts salon in the Cherdyn district. The creation of the Peasant World exposition in the Ilyinsky Museum of Local History is also a result of a project implemented by a grantee. In addition, the premises of a former Land School in the village of Ashap were rebuilt, and the Orda Art School opened a branch there.

To help make the projects truly sustainable, folk craftsmen are invited to seminars on design, effective distribution channels, marketing and organisation of new production. Exhibits of their crafts



⁴ Historic settlements are urban or rural settlements where objects of importance to the cultural heritage are located: monuments, architectural ensembles, historic sights and other cultural objects created in the past and which have archeological, historical, architectural, urban-planning, esthetic, scholarly or socio-cultural value and are important for the preservation of unique qualities of the peoples of Russia and their contribution to the world civilization.

are on view each year at the Perm Fair exhibition complex. The fair has already become traditional and has been nicknamed the "oil fair". In three years, the number of districts of the oblast participating in the fair has grown from 7 to 22. That means that every year the number of craftsmen who have reached a professional level grows.



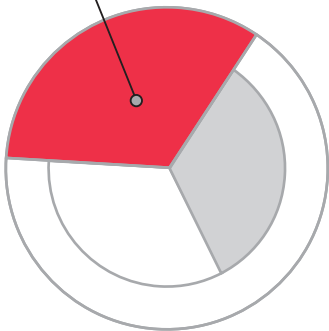
>>> SOCIAL POLICY

"In addition to observing fundamental principles and rights in labour relations while conforming to international labour standards and complying with the labour legislation of the Russian Federation and other countries where it operates, the Company aims for higher social goals..."

LUKOIL Social Code, Part I

Social component

- Trade unions
- Employees of the Company
- Young employees
- Employee families and children
- Retired individuals formerly employed by the Company



Corporate management
(key documents and policies):

- LUKOIL Social Code
- Agreement between the Employer and the LUKOIL Trade Union Association for 2003–2005
- Policy of Industrial, Occupational and Environmental Safety in the 21st Century
- LUKOIL Personnel Management Policy as the main document on human resources
- Programme for Development of a Health System for LUKOIL Group Employees
- Corporate pension system
- Documents on relations between the employer and employees (LUKOIL Regulation on Employee Performance Evaluation; Programme for Employee Acquisition of Shares at LUKOIL and Its Subsidiaries; etc.)

As of January 1, 2005, the number of LUKOIL employees in Russia was 131,426: 20.7% of those are under 30 years old and 29.6% are aged between 30 and 40; 53% have a vocational school or higher edu-





cation. LUKOIL employs 446 people with a master's degree and 57 with a doctorate. Over 60% of the Company's employees have been employed with LUKOIL for at least five years.

In the period since the adoption of the LUKOIL Personnel Management Policy in 2003, the validity of the chosen HR approach has been confirmed.

The year 2004 marked a new stage in the systematisation of personnel management processes at LUKOIL organisations which included improved regulations along with better forms and methods for human resource management. The functional scheme of personnel management that was designed is operating successfully.

The Board of the first Russian competition, The Best Human Resources Service 2005, awarded the LUKOIL HR Service the title of the Best Russian HR Service 2005 based on the opinions of Russian and international experts and on an analytic study of results in 2004.

Our Company was among the pioneers of active involvement in social issues in Russia through creation of a system for social protection of employees. The effectiveness of that system is confirmed by the first place awarded to LUKOIL in the II National Competition "Russian Organization of High Social Effectiveness."

However, now that social responsibility is becoming an integral part of businesses, a fundamentally different system is required where social policy will serve both as a means for accelerated economic growth and also as an important factor in social stability. The Company's significant experience in this area was used as a foundation for key policies and documents most of which were developed during the reporting period.

Our research and analysis of existing approaches and best practices has resulted in the development and adoption in 2002 of a unique corporate document, the LUKOIL Social Code. Its purpose is to increase the effectiveness of corporate social programmes and consolidate the means and assets (including financial ones) necessary to meet the Company's goals and objectives.

The Social Code is a document setting out the Company's social responsibility commitments to all of its stakeholders. These commitments are voluntarily accepted by the Company, and most of



them go beyond the requirements of Russian laws and international standards.

The Social Code demonstrates that overall the Company:

- acknowledges social responsibility of business and is not shirking it;
- accepts realistic commitments without losing sight of what makes them viable, that is, the Company's own economic effectiveness;
- is prepared to take decisions that will optimally balance various interests of shareholders, employees, veterans, partners, the state, public, etc.

The economic component of the Code reflects the Company's policy for managing social expenses and instituting a stricter control over them. That is achieved through the introduction of up-to-date market mechanisms:

- employee participation in the funding of corporate pension and social insurance systems;
- joint payment for the use of social infrastructure by employees, their families and the local population;
- long-term mortgage loans instead of direct subsidies of housing purchases;
- establishment of a joint centre that would keep track of all social expenditures;
- possible outsourcing of social services rather than keeping them within the production structure.

Issues related to implementing the social policy for LUKOIL employees and veterans lie in the competence of the Chief Personnel Department which includes a number of subdivisions responsible for staffing, personnel development, remuneration and motivation, social programmes, etc.

The Public Relations Department is responsible for relaying the results of the corporate social policy to governments in the countries and regions of LUKOIL's operation and to the public.



We have received objective proof that the provisions and principles of the corporate policies and documents (LUKOIL Social Code; Industrial, Occupational and Environmental Safety for the 21st Century; Programme for Development of a Health and Safety System for LUKOIL Group Employees; Environmental Safety Programme for 2004–2008; etc.) are being implemented. This is one of the examples of the Company's adherence to the principles of social responsibility.

EMPLOYEE PARTICIPATION IN CORPORATE MANAGEMENT

"The implementation of commitments is the subject of collective negotiations with the Company's trade unions and is fixed in the Agreement between the Company and the trade union, as well as in local regulatory documents."

LUKOIL Social Code, Part I

Opinions of employees on issues directly concerning their interests and rights, as well as on decisions made by the Company, are taken into account in the course of constant negotiations and consultations through the representative body of Company employees, the International Association of LUKOIL Trade Union Organisations (MOPO). Cooperation with the Association has resulted in signing of the Three-year Agreement between the Employer and the Trade Union Association. The Agreement serves as a foundation for collective bargaining agreements between the management of LUKOIL Group organisations and their trade union committees.

The Agreement is a legal document setting general principles for regulation of social and labour relations between employees and the employer based on their mutual interests. The Agreement contains basic commitments that are subsequently specified in collective bargaining agreements depending on the financial capabilities of LUKOIL Group organisations. Such an approach allows for recognition of specific regional and industrial factors while achieving a balance between an organisation's or enterprise's normal functioning and social protection of its employees beyond their entitlements under current laws. During the three-year period of operation of the Agreement it may be amended if necessary because of changes in laws, in the financial and economic results of the Company or in the general situation in the industry.

Key principles of the Agreement:

- › The employer and employees believe that collective bargaining agreements should be concluded at all organisations controlled by the Company.



- Collective bargaining agreements should discuss the improvement of labour conditions and the work environment, social aid to workers, remuneration and other issues that depend on local conditions. Compensation, benefits and guarantees set by the collective bargaining agreements of LUKOIL subsidiaries cannot be below those specified in the Agreement.
- Laws and other legal regulations that are adopted during the effective period of the Agreement and that improve upon the social and economic situation of employees as provided for under the Agreement shall supersede the corresponding articles of the Agreement from the moment the external laws or regulations become effective.
- Should a law or another legal regulation worsen the situation of employees, the provisions of the Agreement shall remain valid.

The Agreement covers all organisations that voluntarily became a party to it. The fourth Agreement was signed in 2002. It was accepted by almost 95% of the Company's Russian enterprises, which at that time employed over 150,000 workers.

The Company has an effective system of three-level social partnership at whose foundation are the Social Code⁵, the Agreement between the Employer and the Trade Union Association, and LUKOIL's collective bargaining agreements.

UNIQUE ROLE OF THE TRADE UNION ASSOCIATION

OA LUKOIL is one of the few companies where trade unions act as an independent and equal social partner. In 2004, MOPO celebrated its 10th birthday. Throughout those years, it has been guided by the motto "LUKOIL Is One Family" and the principle "Reaching Out to Each Employee". MOPO membership in Russia exceeds 142,000. The members are both employees of the organisations in the LUKOIL Group and the staff of the entities that were removed from the Company as non-core assets during restructuring. Currently MOPO also includes 1,267 students and 31,456 retired pensioners.

⁵ The Social Code is posted at the Company website: www.lukoil.ru.



MOPO includes 282 grassroots trade union organisations and 29 trade union associations in 37 regions of the Russian Federation⁶. MOPO is vertically integrated: its Council (the head body of MOPO) represents the grassroots organisations. This format allows MOPO to adhere to the scheme of "for one employer only one union association" and corresponds to the general structure of the Company. The Russian part of MOPO (the Inter-Regional Trade Union Organisation) is affiliated with the Trade Union of Oil, Gas and Construction Workers of the Russian Federation.

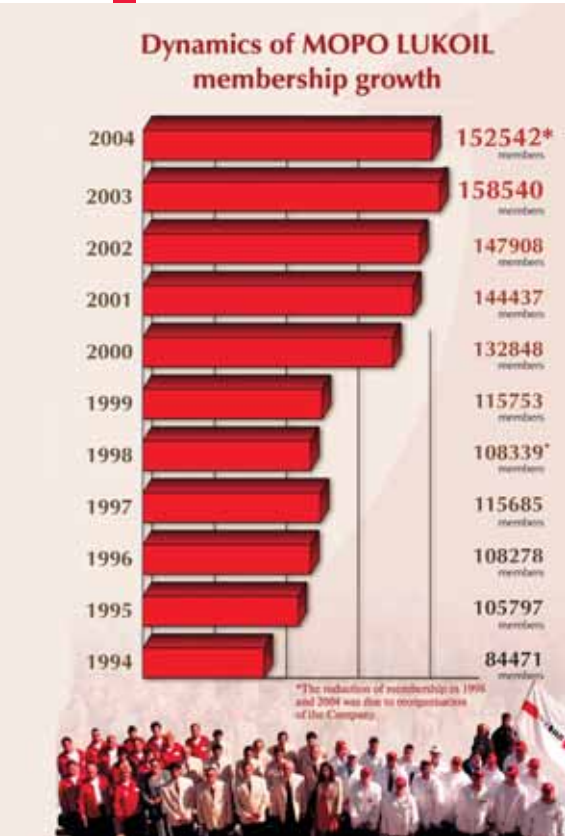
The process of integration was not easy either for the enterprises or for the union. MOPO had to find innovative approaches. The main purpose of MOPO was to consolidate the efforts of LUKOIL union organisations which had been working each on its own. Therefore association was a logical step, but a dialogue between employees and the employer seemed impossible. With the arrival of MOPO, the principles of economic effectiveness and social responsibility were consolidated.

The main mechanism of interaction between the employer and MOPO is social partnership. This means not only that the union performs its basic representative function but also that it understands the corporate development strategy and practical demands arising at its different stages because the well-being of each employee is ultimately contingent on the Company's business success in general. The principle of social partnership prescribes mutual respect of each party's rights and consequently a resolution of any issues and problems in a civilized fashion.

MOPO representatives participate in industrial management processes of the Company and in meetings of its governing bodies where they have the right to vote and make proposals. The MOPO Council has the right to initiate meetings with the Company's top administration and management to discuss issues that fall within the scope of trade union responsibility. The dialogue has an ongoing nature and involves all departments and specialists of the Company.

The MOPO leadership has a multi-faceted view of its role as a union.

⁶ MOPO has an international status because it also includes employees of enterprises located in the foreign countries where the Company operates.



MOPO results:

- MOPO was directly involved in the adoption of most corporate programmes and fundamental documents and in the development of the Company's policy concerning certain categories of employees (women, young workers, people with disabilities, pensioners, etc.).
- MOPO has initiated and organised annual contests of professional competence, The Best in Profession. The contests bring employees together to exchange best practices and improve their qualifications.
- Sporting events and amateur arts festivals conducted at LUKOIL enterprises help to establish a healthy lifestyle and develop creativity.
- Good working conditions at the Company's enterprises have been established: enterprise territories have been improved, cafeterias opened, and workplaces have been equipped with modern equipment.
- MOPO has broadened its employees' and their families' opportunities to improve their health and enjoy recreation.
- Publication of the magazine *Social Partnership* encourages awareness of the partnership concept.

MOPO is:

- A representative of employees that oversees implementation of labour laws by the employer.
- A party to negotiations that advocates employee labour and social rights.
- A participant in the legislative process. Through the industrial union, MOPO participates in the work of the State Duma, the Federation Council, etc. In this fashion MOPO's positive experience can be used to improve the social and economic situation of employees at other companies.



- A social partner of the Company. MOPO participates in the search for solutions of the most complicated social and economic issues pertaining to relations between the employer and employees. It clarifies what is happening within the Company and explains why, and outlines how the employees' situation depends on the results of the Company as a whole.

MOPO has developed its strategy and regularly analyzes its achievements as well as any unresolved partnership issues. It conducts training programmes and advanced courses for leaders and activists in trade union organisations.

Feedback from employees is received through grassroots organisations; each union member can communicate with a local union leader. This process is a channel through which trade union members bring forward their problems or issues of concern. The MOPO Council analyzes the feedback and presents results of the analysis to the President of the Company. Similarly, main new developments in the Company's life are related to each employee. Conferences with the top managers of LUKOIL are conducted in the regions where the Company operates on a regular basis.

An event unprecedented in the history of the Russian trade union movement took place in 2004: the Company signed an Agreement on Cooperation with the International Federation of Chemical, Energy, Mine and General Workers' Unions (ICEM)⁷ and with the Trade Union of Oil, Gas and Construction Workers of the Russian Federation (ROGWU)⁸ which is the industrial union with which MOPO is affiliated. MOPO initiated work on this document and after consultation the management of the Company supported the initiative. To ensure that cooperation is not on paper only, an ICEM network operates in the Company's organisations helping them to exchange information and watching the implementation of commitments by the Company.

⁷ ICEM has 20 million members in 20 countries (<http://www.icem-cis.ru/ICEMcis.htm>.)

⁸ ROGWU includes over 3,200 grassroots organisations, 32 territorial and 4 inter-regional trade union organisations in various companies, including LUKOIL and Gazprom (<http://www.rogwu.ru/>).



REGULATION OF LABOUR, EMPLOYMENT AND RELATIONS OF PRODUCTION

Restructuring

"Taking into consideration the scale of employment in LUKOIL Group organisations and the single-industry economy of many regions in which they operate, the Company takes a socially responsible approach to restructuring its units, as well as to de-localization of the production facilities."

LUKOIL Social Code, Part I. p. 1.1.1.

In 2002 LUKOIL adopted its Restructuring Programme through 2010 aimed at cutting the Company's expenses and increasing its competitiveness⁹.

Following the reorganisation of structural units and removal of non-core assets from the Company's subsidiaries in 2004, the number of staff members in the exploration and production section was reduced by almost 7,640 people (or 8.1%) compared to 2003 and in oil refining by 1,980 (or 8.7%). At the same time, the number of employees in oil distribution grew by 4,480 people (or 15.9%) compared to 2003 because of the expansion of the petrol station network.

Any changes due to closure, merger or reorganisation naturally cause social tension among workers, especially in the regions where the Company is a sole employer. MOPO is very helpful in that respect, but the process is still not painless. During mass employee dismissals, in addition to observing the law the Company takes steps to moderate the consequences of dislocations in regional labour markets. Below are some of the best solutions discovered by joint efforts:

- employees are notified of upcoming reorganisations and receive explanations in advance;
- new hiring stops well in advance of reorganisation;

⁹ The concept is presented at the website www.lukoil.ru.





Employees of OOO LUKOIL-Zapadnaya Sibir and their families comprise 38.9% of the total population of the region. Below is the percentage of LUKOIL employees out of total population in several towns:

Langepas – 42.7%

Urai – 29.5%

Kogalym – 37.4%

Pokachi – 45.9%

The restructuring of 2003–2004 reduced the number of enterprise structural units from 50 to 38. Preparatory measures were taken prior to restructuring at every unit.

Advance termination of hiring allowed transfer of dismissed employees to positions vacated naturally. That practice was used by LUKOIL-Zapadnaya Sibir twice during major structural reorganisations. In the first instance, hiring was terminated for six months beginning in March 2002. The second time there was a freeze on new hires between June 2003 and February 2004. In 2003 that experience was helpful in transferring the technological transportation staff and in-house agricultural workers of OOO Yugraneft.

In addition, employees received re-training at the Company's training centres. For example, workers of LUKOIL's auxiliary agricultural enterprises during the restructuring were re-trained in occupations with vacancies: boiler operators; injector operators; pump operators; commodity workers; etc.

As a result the staff of OOO LUKOIL-Zapadnaya Sibir was reduced by 1,741 in 2004, and labour costs were cut by 3%. Work productivity grew by 17% compared to 2003.

- vacant positions are eliminated first;
- employees receive re-training and can change their qualification;
- qualified employees have priority when vacancies are being filled;

- dismissals take place in stages;
- when employees are to be dismissed, they receive upon their consent assistance in finding employment with other organisations, including those in other locations, and are then compensated for relocation;
- those notified of a dismissal receive at least 8 hours a week of paid leave (at their average rate) to look for new employment.

It is also helpful to employees that they retain some of their benefits (their place on a housing waiting list, health insurance, etc) after dismissal.

Such methods were used, for instance, during the reorganisation of LUKOIL Group enterprises in the Perm region. A special Programme for Employment and Compensations for Dismissed Employees of OOO LUKOIL-Perm provided for additional social support to dismissed workers of pre-retirement age beyond the guarantees provided by the applicable labour laws. Specifically, they were awarded a monthly bonus of at least 2,500 roubles to be paid until they reach the age of retirement. In addition laid-off workers had help in finding employment with subsidiaries.

Remuneration and motivation policies

"Taking into account the fundamental nature of its labour remuneration and motivation policies in employee relations, the Company shall base this policy on the following principles: integrity of ... policies; transparency; use of flexible bonus systems..."

LUKOIL Social Code, Part I, p.1.1.2

The Company has established a corporate system of remuneration whose purpose is to ensure a decent standard of living for its employees and their families while at the same time encouraging higher productivity and economic effectiveness. The level of pay remains one of the key factors in social perception of well-being. Therefore the Company employs a systemic approach to issues of remuneration



and gradually introduces new methods that are discussed with employees through their trade union organisations.

The system combines centralized regulation by the Company with local regulation by its subsidiaries. The latter are notified of the maximum level of average income per employee indexed to consumer prices in their region on a monthly basis. Subsidiaries set their wage rates and salaries and determine systems of remuneration and motivation based on the minimal wage rate and within the limits of the funds set aside for salaries. The minimal wage rate is established by the Agreement Between the Employer and the Trade Union Association.

In 2004 the average income per employee was about 20% higher than in 2003. Every quarter the Company reconsiders the minimal guaranteed wage rate for a first grade worker. In most of the organisations, that rate exceeds not only the level specified in the Agreement but also the subsistence level in the region.

The Company constantly engages in systematising the processes of remuneration and motivation improvement thereby ensuring:

- › uniformity of remuneration and motivation policy for all LUKOIL Group organisations;
- › a minimal level of guaranteed pay in LUKOIL Group organisations to provide for basic vital needs and ensure some disposable income;
- › transparency, objectivity and competitiveness in the system of remuneration and motivation;
- › regular indexation of wages based on the index of consumer prices;
- › flexible bonus systems that fully reflect individual contributions of employees;
- › periodic wage raises related to productivity growth.



The main problems the Company faced in the Komi republic were the poor development in the main cities and towns and worn industrial equipment; these circumstances led to poor living conditions, unemployment and social unrest. At the time of the Company's acquisition of assets in the republic, workers were making no more than 1,500–2,000 roubles, about 2,500 workers were on forced or unlimited leave, and the accumulated budget debt had reached 1.218 billion roubles.

Only huge capital investment could help. Two programmes of gradual investment were adopted. The first programme cost 13.406 billion roubles, and the second 15.2 billion. As a result, production is growing, tax contributions are increasing, and the well-being of employees and of the entire region is improving.

Main results:

Indicators	2003	2004
Oil production, million tons	8.59	9.52
Tax contributions, billion roubles	8.7	15
Social aid to workers and their families, million roubles	160	352
Social aid to retired pensioners, million roubles	26	55

Assets were earmarked for essential programmes in healthcare (employee voluntary health insurance fees; payment for health resort vouchers; etc.), social assistance to women and families with children, payment of allowances and aid to employees. All workers formerly forced to work a part-time schedule or to take a forced leave have been returned to a full-time schedule. The average monthly wage has grown significantly.



Health and safety

"LUKOIL's highest priority is the establishment of safe working conditions and protection of the health of its employees and of community members in the regions where LUKOIL operates..."

LUKOIL Policy of Industrial, Occupational and Environmental Safety for the 21st Century



In the course of our work at the Headquarters and with individual subsidiaries, we received proof that the Policy of Industrial, Occupational and Environmental Safety for the 21st Century is implemented through management programmes developed by and adopted within the Company.

The corporate Policy of Industrial, Occupational and Environmental Safety establishes the priority of employees' lives and health over industrial results. The policy is largely implemented through programmes developed by and adopted within the Company¹⁰. Chief objectives for 2001–2005 are as follows:

- reduction of the incidence of workplace injuries and occupational diseases;
- preservation of employees' lives and health at the workplace;
- bringing all aspects of industrial activity in line with requirements of current Russian legislation and with best international practice.

Implementation of occupational safety programmes and regular measures have helped to reduce the incidence of accidents and injury to a level significantly below the average for the industry and comparable even with leading international oil companies¹¹ (see the section "Industrial and Occupational Safety").

A technological upgrade, strict adherence to safety rules and regulations, and sufficient means of collective and individual protection would help bring the level of workplace injuries down and limit the number of workers subject to hazardous and harmful industrial factors.

¹⁰ See also the section "Environment, Safety and Health". The Policy and programmes are also published on the Company website (www.lukoil.ru).

¹¹ Except for mortality, the relevant data is analyzed in the chapter "Reduction of the Incidence of Injuries and Industrial Accidents".

Public control

The trade union association has created a technical labour inspection group which oversees health and safety together with ombudsmen. Ombudsmen are the most numerous link in the chain of public control. They are always stationed in operational areas and can intervene immediately to prevent violations. Their work is guided by the Statute on Ombudsmen for Occupational Safety. In addition, the Council of the trade union association has adopted the Statute on the Independent Technical Labour Inspectorate of MOPO. In 2002 and 2003, the Council of the union association trained a group of safety ombudsmen and external inspectors at the Advanced Training Institute of the Russian Energy Ministry. Ombudsmen receive 40 hours of training at enterprises and in specialized training centres under a programme approved by the MOPO Council. To aid them in their work, the union has developed and published the Guidelines for Safety Ombudsmen.

Extra Insurance

In addition to the compulsory state accident insurance, the Company provides personal insurance for its employees. The Company implements the Insurance Programme for LUKOIL and Subsidiaries which covers some of the life and health risks resulting from workplace accidents.

Junior employee policy

The Company has a special programme for junior employees which includes recruiting, training and working with personnel. There is a system for the training and professional development of junior specialists, and the most skilled and successful of them have a chance to move into top level positions in the Company. During the last three years, around 500 employees have improved their qualifications, and most of them are in the pool of candidates for higher positions.

Junior specialists intern with best enterprises within the Company. The number of interns grows every year. While in 2002 it was 78, in 2003 it became 120, and 2004 it was 170. There is a Council of Junior Specialists which includes the chairs of similar councils among subsidiaries.

A special goal of the programme is finding innovative employees, and this is done during conferences and competitions for applied research



where awards are given to employees involved in studies and innovation. The best of their proposals are implemented. Conferences and competitions help the Company to identify the leaders of future domestic and international projects.

Training and education

All of the Company's employees, not only junior specialists, have opportunities for career growth through additional education or re-training. The Company uses the entire scope of modern training formats: seminars, trainings, international internships, distance computer learning, and MBA courses. The LUKOIL Group has 17 training centres and 5 classes that constantly improve their training capabilities. On average each year every third employee receives advanced training in Russia or abroad; among the Company's pool of employees suitable for promotion that figure is over 50%.

Quality of working and living conditions

"Recognizing its responsibility for providing adequate working and living conditions to its employees and members of their families, the Company takes initiatives..."

LUKOIL Social Code, Part I. p. 1.2

In addition to observing fundamental principles and rights at work and paying its employees adequate and regularly indexed wages, the Company stimulates its staff by providing a broad spectrum of social benefits, guarantees, and compensations.

The corporate system of social protection helps recruit qualified specialists, reduces the rate of personnel turnover, and strengthens corporate morale. It also provides a foundation for successful industrial operation. The main components of the system are: health and wellness services; sports, physical culture and recreation; housing policy; non-state retirement benefits; etc.



Health care

The Company adopted a programme for creation of a healthcare system for LUKOIL Group employees. The system includes measures for maintaining physical and psychological health for employees. Its three main components are: development of occupational medicine; elements of the state social security and insurance system; and voluntary insurance.

Occupational medicine

The Company performs ongoing laboratory control of compliance with sanitary regulations and monitoring of work conditions; it also examines employee health through a network of medical offices, provides emergency medical assistance, offers immunisation and conducts periodic and pre-admission medical exams.

State social security and insurance programmes

The Company attempts to make the best use of state social security and insurance programmes. Since those programmes are funded in part by employer contributions, any high quality medical services received by the personnel represent rational use of the organisation's money.

Voluntary medical insurance

Voluntary insurance programmes used by the Company are an important addition to compulsory medical insurance as they allow employees to receive extra services not supported by compulsory insurance or otherwise unavailable to them because of restrictions in time or location. Voluntary insurance also pays for additional consultations and costly check-ups.

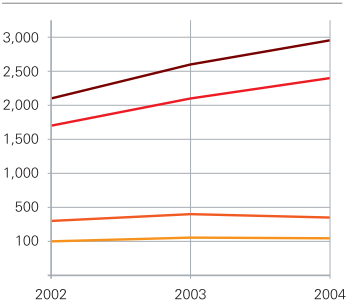
Voluntary medical insurance

	2002	2003	2004
LUKOIL Group expenses for voluntary medical insurance, million roubles	434	485	534

Wellness, sports, physical culture, and recreation

The mission of sports is to bring people together regardless of their age, race or gender, and it agrees with LUKOIL's corporate philosophy.

Dynamics of the Company's expenditures for social benefits, guarantees, and compensations, million roubles



Total expenditures for social benefits, guarantees, and compensations, including:

Social aid to employees and their families

Non-state pension contributions for employees

Social aid to retired pensioners



The Company permanently monitors observance of sanitary rules and working conditions at its enterprises. Procedures for periodic evaluation of compliance with laws are in place.

The Company was among pioneers in the revival of the local Spartakiade sports tradition. In 2003, LUKOIL conducted the finals of the Second International Corporate Spartakiade in Perm with 10,000 participants. In 2004 the LUKOIL mini-soccer, volleyball and soccer cup was held in Kstovo. Such sports events attract broad interest in the towns, and sometimes across whole regions, where they are conducted.

The Company has a tradition of annual sports festivals for employees and their families and of corporate championships in various sports: the winter sports festival, LUKOIL Skiing Track; Families for Sports "Papa, Mama and I"; and championships in mini-soccer, volleyball, darts and swimming.

As part of its encouragement and support of a healthy lifestyle, the Company provides its employees with discount trips to resorts and sanatoria. During the last 3 years, these discounted vouchers were provided to almost 25,000 employees and over 10,000 of their children. In 2003 in response to a MOPO proposal, a corporate children's health resort was opened at the Izvestia sanatorium in Sochi on the Black Sea. Around 1,500 children of the Company's employees have visited it over three summers.

Housing policy

The Company helps its employees resolve their housing issues. The kinds of help offered depend on industrial needs and on the region.

For instance, organisations in exploration and production segment provide their employees with beds in dormitories or with "corporate housing" (living premises owned or leased by an organisation) to rent for a fee or free of charge. Employees of some organisations in that business segment who are listed as needing improved housing are put on waiting lists to receive outright subsidies or no-interest loans for the purchase of housing.

Nevertheless, housing problems remain acute as they are across the whole country. Almost 25,000 employees need to improve their housing conditions to some extent.



Neither the market nor existing housing legislation require that an employer provide free housing because a different sort of relationship is presupposed. In view of the economic ineffectiveness of resolving the costly housing problem entirely at employer account, the Company is trying to depart from the old practice of providing free housing and involves employees themselves in funding their housing. During the last three years, employee housing costs underwritten by the Company changed significantly from outright subsidies to loans.

Outright subsidies

	2003	2004
Percentage of outright subsidies in LUKOIL Group expenses for employee housing	74%	61%

A corporate housing programme now in development prescribes the use of market economic mechanisms: long-term mortgages and savings plans. The Company expects to fund the housing programme together with employees and is prepared to help first of all those workers who are willing to contribute to a resolution of the housing problem themselves.

Non-state retirement benefits

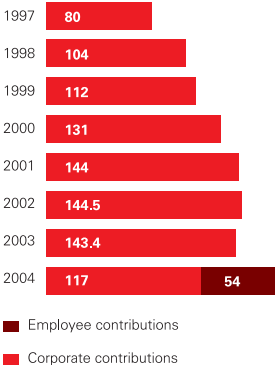
Up to the beginning of 2004, the Company had a unified system of corporate pension coverage in which pensions were paid exclusively out of the employer's funds. That markedly restricted growth of pensions, and today an average pension amounts to 1,100 roubles. In December 2003, the Company decided to replace its retirement plan¹². The new plan allows employees to contribute part of their wages to the retirement plan and have their contribution matched by the Company (up to 7% of an employees' annual wage). The employee contribution will collect investment income which exceeds inflation.

The new retirement plan would permit a 60–80% replacement of income after retirement compared to only 5% today. That opportunity

¹² Information on the new retirement plan is published on www.lukoil.ru.



Employee participation in the joint non-state pension system, thousand people



Employee pension savings in individual retirement plans
thousand roubles



Number of participants: 54,000 employees
Total contributions: 228 million roubles
Average contribution: 2% of wages

will be available to those who participate in the new retirement plan for an uninterrupted period of 25–30 years.

Employees eligible to pensions under the old retirement plan (a total of 117,000 people) retain their eligibility and will be awarded pensions at retirement.

The number of workers who voluntarily joined the new retirement plan in 2004 reached 54,000. With an average employee contribution at 2% of income, accumulated pensions on individual contracts amounted to 228 million roubles.

Contributions to the non-state programme for retirement benefits, million roubles

	2002	2003	2004
Contributions by LUKOIL Group organisations to the non-state retirement fund	293	390	378
Employee contributions to the non-state retirement fund according to individual retirement contracts	–	–	228

Social aid for retired pensioners

"Taking into account the socially vulnerable position of persons receiving state pensions and the relatively low level of pensions at the initial stage of development of the corporate pension system, the Company conducts a policy aimed at providing social support to non-working pensioners..."

LUKOIL Social Code, Part I

Whenever it is financially feasible, LUKOIL Group organisations pay their employees a one-off bonus at the time of retirement and provide earmarked social aid for retired pensioners. The social aid includes financial contributions for various purposes, gifts for holidays, etc.

Corporate expenses for pensioner support, million roubles

	2002	2003	2004
Total expenses for pensioner support	106	157	149

The Company pays significant attention to providing moral support to retired pensioners and using their professional experience. Those efforts are coordinated by the Council for LUKOIL Veterans' Affairs created in 2003.

Social infrastructure

LUKOIL social infrastructure facilities provide additional bonuses and services to employees and their families. In order to compensate for the inadequacy of municipal social infrastructure in the regions, organisations have had to build and maintain social facilities and make significant investments in them. At present social partnership with regional and local governments leads to a division of responsibility for the infrastructure and to joint participation in social development of the regions.

Costs of social infrastructure maintenance, million roubles

Expense	2003	2004
Total costs of social infrastructure maintenance,	1,480	1,364
including:		
maintenance of facilities on the balance of organisations	1,269	1,134
maintenance of facilities under contract with earmarked (joint) funding and other kinds of contracts	211	230



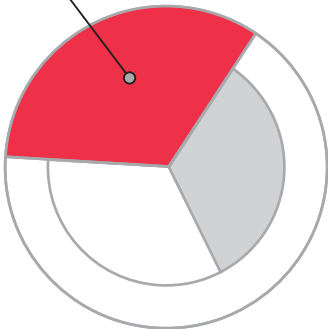
>>> CORPORATE PARTICIPATION
IN THE LIFE OF SOCIETY

"The Company recognizes the enduring value of charitable activities in any society and the fact that certain organisations and people in particular are in need during this difficult transition period, and therefore the Company uses all available opportunities to provide charitable help..."

LUKOIL Social Code, Part II

Social component:

- Local governments
- Public and municipal organisations
- Cultural institutions
- Colleges and universities
- Institutions for children's sports
- Local population
- Mass media



Corporate management
(key documents and policies):

LUKOIL Social Code

Social and charitable programmes are a component of the corporate strategy and help maintain constructive cooperation with the state, business community and society. Corporate programmes have specific target groups and are supported by professional experience and human potential available in the regions. At the same time, the Company is aware that charity must not breed social dependence. For that reason, alongside traditional forms of charity LUKOIL employs programmes of strategic charity and social investments that link resolution of social problems with corporate strategic objectives. A necessary feature of that approach is cooperation between business, non-profit and state sectors for the solution of urgent social and economic problems in local communities. The Company uses the following processes for this work:





> Bidding

In Perm Oblast a bidding process in which professionally mature organisations defend their projects in a competition is working successfully. The project approach is one of the ways to increase the economic effectiveness of social sector organisations. Therefore the Company plans to continue working in that direction as other regions become ready. Accordingly, a competitive bid process was conducted in Volgograd Oblast in 2004.

> Long-term partnerships with municipal and public organisations

In the regions of corporate activity, there are a number of organisations that require earmarked assistance either because of the absence of alternative providers of similar services or for reasons beyond their control. The Company wants the assistance it provides to such organisations to help their internal development and promote their success and professionalism, as the quality of their work ultimately has an impact on people's well-being and social position.

> Targeted assistance

Assistance to specific target groups that have the greatest need for help will remain an urgent task until smoothly working mechanisms of state support are in place. The Company helps those who because of their age, health or other reasons can no longer provide a decent living for themselves in present conditions. Even though it would be extremely difficult to measure the effectiveness of such support, the Company places great value on its humanitarian aspect.

The LUKOIL Charity Foundation, which celebrated its tenth birthday in 2003, plays an important part in corporate social programmes. Each of the Company's subsidiaries has a specific department responsible for charity and sponsorship. Some of the programmes are carried out by the LUKOIL Charity Foundation, while others are run by headquarters or regional subsidiaries.

The Company's inter-regional programmes are constructed along two strategic lines:

- > social investments;
- > sponsorship and traditional charity programmes.



The LUKOIL Charity Foundation and the corporate headquarters monitor social investments in all regions of the Company's activity. The Company is indeed switching from unfocused charity to strategic charity and to social, targeted investments which are in line with the needs of business and society. A mechanism for evaluating the effectiveness of social investment remains to be worked out.

SOCIAL INVESTMENT PROGRAMMES

Helping children

Helping children is the Company's top priority which is a part of all of its programmes, including charity, sponsorship, and development of junior sports and culture. Social investments in human capital are extremely justifiable under contemporary conditions. The Company tries to balance its approach by helping both underprivileged children who are experiencing a family or health crisis and also children with favourable backgrounds who need assistance to develop their abilities and talents.

Helping children from orphanages and boarding schools

Through this programme LUKOIL, its subsidiaries and the LUKOIL Charity Foundation provide assistance to children from over 50 orphanages and boarding schools. The Company helps their graduates receive an education, improve their health, acquire a profession and find their place in society.

Budgets of orphanages and boarding schools are tight, and the Company helps them renovate their premises and improve their grounds. It also helps them to buy equipment and appliances for bedrooms and classrooms so that these children get a better start in life. The Golden Drop (Zolotaya Kapelka) orphanage in Kotovo, Volgograd Oblast, was built entirely with oil workers' money and the boarding school in the village of Bolshoye Isakovo, Kaliningrad Oblast, was similarly renovated. Orphanages also receive funding for medical supplies, training materials, textbooks and recreational literature.

In Syktyvkar, LUKOIL supports a unique agricultural boarding school named after A.A. Katolikov. In addition to secondary education, graduates of that school are trained in a profession: boys learn to drive tractors, and girls become specialists in plant propagation. Since the agricultural school has 227 hectares of land, greenhouses, bird and animal farms, their training is practical as well as theoretical. Students are also involved in research work on commissions from the Biology Institute of the Urals branch of the Russian Academy of Sciences.

LUKOIL Charity Foundation gives children annual summer trips to the Black Sea and educational tours. In Perm, the Company helped organise an exhibition on Tsars' Hunts from the collections of the Moscow



Kremlin. The exhibition was accompanied by a competition "Drawing the Kremlin" for children from Perm Oblast orphanages supported by the LUKOIL Group. Winners were awarded trips to Moscow. The best drawings were shown at an exhibition of children's art in the Armoury and museums of the Moscow Kremlin.

The Company welcomes new professional approaches to the solution of the orphan problem from the organisations it helps. For example, the Little Squirrel (Belchonok) social rehabilitation centre for children and adolescents in the town of Langepas followed a progressive model of family placement and family support so that most of the children there have been placed with families. Similar forms of placement are used in the Orphanage #1 in Kirov. The graduates' lives are the best test of a useful approach. Several orphanage graduates chose a professional military career, one became an oil worker, some are continuing their education at colleges, and one of the girls has graduated from the Tobolsk Pedagogical Institute and teaches English.

The Company pays special attention to children in need of medical assistance. For several years the programme "Illustrated Books for Small Blind Children" has been running a project "The Gift of a Book for Every Blind Child". In 2003 books were given to six specialized schools in Kaliningrad, and in 2004 a similar gift was sent to Perm.

The Company supports a rehabilitation centre for children with disabilities in Langepas, Western Siberia, which is a unique institution in that region. The centre has been a pilot setting for a TACIS project since 2002. Our cooperation has resulted in the creation of an optimal version of a rehabilitation centre and in proposals for improvements in the legislation covering services to children with disabilities provided by three kinds of agencies (educational, health care, and social protection). The centre has been awarded the status of a regional experimental setting for the development of innovations.

Educational programmes

The Company's concern here is assisting the next generation and training young qualified specialists for the Russian oil industry. LUKOIL helps a number of higher education institutions that train oil and gas specialists.



Stipend programmes

In 2002, the Company began paying individual stipends for college students studying petroleum and technology¹³. Currently, corporate stipends from LUKOIL of 700 and 1,250 roubles per month are paid to 120 students in different cities.

The Company plans to extend its support to high school students thus making it comprehensive. However, the high school programme is just beginning to work. LUKOIL classes are to be opened at the Moscow Gymnasium #45 as a pilot project. If the project proves a success, it will be extended to other cities.

The Company is open to social initiatives that promote career advancement of talented youths. One of those initiatives was the national festival "Roads of Hope", an inter-regional social project that helped young men and women from the regions and from socially vulnerable families enter colleges¹⁴.

Teaching staff as a foundation for preservation of research schools

In 2004, the Company launched a new grants programme to support young professors. The bidding resulted in an award of 45 grants to the most talented young professors of the leading colleges for petroleum studies in Russia

Development of material and technical resources for colleges

Assistance provided to colleges so that they could improve their training and technical resources allows them to conduct training on an up-to-date level. The Company helps them purchase laboratory equipment. At the I.M. Gubkin Russian State Oil and Gas University LUKOIL helped open a training and research Centre for Geological Modelling of Hydrocarbon Deposits whose facilities are the most up-to-date in Russia. A petrophysics lab was equipped at the Perm State Technological University, and a training simulator for oil well overhaul was purchased. The Ukhta State University of Technology received equipment for its oil and gas petrophysics laboratory along with a test bench used for practical training of specialists in deep drilling.

¹³ The list of colleges is published on the website www.lukoil.ru.

¹⁴ The Company awarded on a competitive basis 750 grants in culture, education, pre-school upbringing and health care.



In 2004, the Company helped open a new school in Perm, the Oil and Gas Institute. The institute will provide higher education as well as advanced training to oil and gas specialists.

Targeted assistance

Helping war and labour veterans, people with disabilities, and socially vulnerable groups

Oil workers who are World War II veterans of combat and labour enjoy the Company's special care and attention. Every year on the eve of Victory Day they receive financial bonuses and gifts. The company also helps families of servicemen killed in local conflicts.

With regard to people with disabilities, the Company does not merely provide financial aid, but also helps them to feel needed by society and achieve financial independence. In the town of Urai, the Company equipped a special sewing shop where people with disabilities can work. Earmarked assistance was also provided to the Langepas City Public Organisation of People with Disabilities: the Company bought exercise equipment for them. A nursing home for senior citizens in Usinsk has been renovated and equipped.

SPONSORSHIP AND CHARITY PROGRAMMES

Preservation of cultural heritage

"The Company greatly appreciates the additional opportunities given to the Company by the rich national and cultural diversity of its employees and of the population in the regions where the LUKOIL Group organisations operate."

LUKOIL Social Code, Part II

Large Russian companies have traditionally supported culture through charity and sponsorship. Such support is comprehensive in its character: it is not merely pure sponsorship (funding new shows, exhibitions, etc.) but also charitable assistance. The Company's priority is to support classical art of various kinds.



The Company also responds to individual proposals coming from unique publishing projects. Thus, an edition of "Pechora Tales" which had been conceived by Pushkin was published in commemoration of the poet's 200th birthday. With help from the Company, the International Pushkin Foundation "Classika" has embarked on publication of the complete works of Fyodor Tyutchev on the eve of his 200th birthday.

LUKOIL contributed to the celebration of Saint Petersburg's 300th anniversary by funding two exhibits at the Russian Museum: "Petersburg: City and Citizens" and "Russian Museum in Moscow: Petersburg, My Love..." The company also contributed to the municipal festival "Opening of Children's Book Week", to the International Navy Show, and to a free concert "Petersburg in Waltzes" performed by the Tchaikovsky Large Symphony Orchestra in front of the Mikhail Castle. In addition, the Company contributed to the restoration both of the monument to Catherine the Great and of the Konstantin Palace in Strelina. Its donations helped the Institute of Russian Literature and the "Classika" Foundation publish art albums "Pushkin House" and "Peter's City". The former tells the history of a major centre of Russian academic science, while the latter is a collection of Russian poetry devoted to Saint Petersburg.

Religious traditions and culture

The Company participates in the revival of religious traditions and spiritual culture. LUKOIL is particularly keen on supporting those institutions whose work includes serving society. For a number of years, the Company has helped the Moscow branch of the Pyukhta Women's Monastery of St. Assumption, and it contributes to the reconstruction of the 15th century Optina Pustyn Monastery, an ancient sacred place and the destination of Orthodox Russian pilgrimages. Thanks to the Company's assistance, Orthodox churches were built in Kogalym, Urai, Langepas, Pokachi, and Usinsk. Mosques were constructed in Kogalym and Ufa. The chapel of Sacred Springs in the Trinity-Sergius Lavra and the Saint Pokrov Cathedral in Novorossiysk have been restored.

Regional subsidiaries of the Group also take an active part in revival and development of the centres of religious and spiritual life of the country. Their donations were used to restore or rebuild the churches

LUKOIL works on projects

with the following museums:

- A.S. Pushkin State Museum of Fine Arts
- Moscow Kremlin museums;
- State Russian Museum;
- Malyye Karely: Arkhangelsk State Museum of Wooden Architecture and Folk Art
- Ukhta Museum of Regional History
- Astrakhan Kremlin.

LUKOIL has long-standing

cooperation with:

- P. I. Tchaikovsky Large Symphony Orchestra, Chief Conductor V. Fedoseev
- Dance Ensemble "Beriozka"
- Academic Choir of Russian Singing
- Perm State Opera and Ballet Theatre
- Volgograd Children's Theatre

The Company is on Board of Trustees of:

- State Academic Bolshoi Theatre
- Moscow Tchaikovsky State Conservatory.

of Archangel Michael and the Konstantino-Yelenin Cathedral (in Volgograd Oblast); the Ferapont Monastery, a masterpiece of Russian architecture; the Church of Vera, Nadezhda, Lyubov, and Sofia Their Mother (in Kaliningrad Oblast); the Belogorsk St. Nicholas Monastery, the Perm St. Trinity Stephan Monastery, the Obvinsk St. Assumption Monastery, the Saint Nicholas Cathedral (in Perm Oblast); and other buildings.

Sports as a foundation of a healthy lifestyle

"Recognizing the fundamental role of patronage and sponsorship in developing culture and sports in a market economy, the Company seeks opportunities to provide material support..." in those areas.

LUKOIL Social Code, Part II

The Russian Olympic Committee is the Company's key partner in the development of sports. In 2004 they signed a Cooperative Agreement which gave LUKOIL official partner status. In particular, the parties agreed to promote the development of the Olympic movement in Russia and to expand charity programmes in physical culture and sports.

LUKOIL is the primary sponsor of the Spartak soccer club (Moscow) and supports one of the largest children's sports organisations, the Children's Soccer League.

A number of Russian professional teams compete under the corporate flag. They are the handball team, LUKOIL-Dinamo (Astrakhan); the water polo club, LUKOIL-Spartak (Volgograd); the cinder track speedway team LUKOIL-Bashkiria (Bashkortostan); and the LUKOIL Racing Team.

LUKOIL IN THE REGIONS

LUKOIL regional subsidiaries have their own traditions of participation in the social life of their territories. They develop their own unique programmes and accumulate best practices.



Western Siberia

This region is the most natural source of personnel for the Company, and therefore education is a local priority. The Statute on Individual Bonuses has been in effect at OOO LUKOIL-Zapadnaya Sibir since 2001. Bonuses and diplomas are awarded to the most promising and goal-oriented secondary school students in Langepas, Urai, Kogalym, and Pokachi, and awards were made to 202 students in 2004. Students regularly meet with the Company's veterans and specialists and visit enterprises of LUKOIL-Zapadnaya Sibir.

LUKOIL has been working with the Gubkin Russian State Oil and Gas University since 1993. A regional preparatory department of the university was opened in Kogalym. The department's best students compete to enter the university either on a tuition basis or without tuition. The school, the Company and a student sign a three-party agreement which guarantees the students practical training and subsequent employment with LUKOIL enterprises. In 2004 there were 42 students in the preparatory group. Seventeen of them passed the tests and were enrolled at the University. The total number of students sent by LUKOIL to various Russian universities is 229. The Company organises internships every year, and in 2004 alone 1,497 students interned (as part of their practical courses or graduation requirements) with LUKOIL enterprises.

Perm Oblast

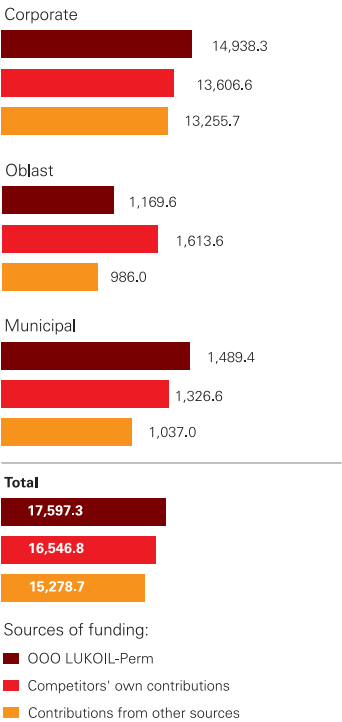
Enterprises of Perm Oblast (OOO LUKOIL-Perm, OOO LUKOIL-Permnefteprodukt, OOO LUKOIL Permnefteorgsintez, and others) are leaders in the advancement of social project techniques, and not just among LUKOIL organisations. The cooperation between the local government, the Company and the public sector has unique features.

LUKOIL-Perm has been active in oblast and municipal grant competitions since 2002, but the most notable event is its own corporate competition for social and cultural projects. Over the past three years these corporate competitions had hundreds of entries from municipal and public organisations that offered highly competitive, professional and sometimes innovative projects that targeted various social issues.

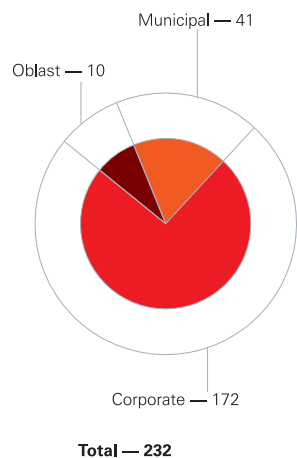
The 2003 competition had 57 winning projects of which the most noteworthy were those for the categories "My City – My Home", "Protecting Indigenous Nature", "Children Are Our Future", and "Healthy



Funding competitions for social and cultural projects in Perm Oblast in 2002–2004, thousand roubles



Winning projects



Parents – Healthy Children". In 2004 LUKOIL-Perm held the third competition expanding its scope to 23 districts of the Perm oblast and the Komi-Permyatsky autonomous okrug.

The competition procedure is outlined in the Statute on Social and Cultural Grant Competitions which is approved by the LUKOIL-Perm Director General and amended annually. The competition commission not only considers applications and makes decisions about them but also monitors projects that receive funding and analyzes their results. The monitoring includes a series of roundtables "Usolye Dialogue", public evaluation of the projects funded, surveys of representatives of the groups targeted by projects, monitoring of the mass media coverage of competition results, etc. The commission includes specialists from LUKOIL-Perm responsible for relations with local communities, trade union leaders together with deputies of the State Duma and of the Perm Oblast Legislative Assembly.

Povolzhye
Volgograd oblast

Events devoted to the 60th anniversary of the defeat of fascist forces in Stalingrad and the 60th anniversary of victory in the Great Patriotic War took place in Volgograd oblast in 2003–2004. War and labour veterans received Oka automobiles and hearing aids. A building was donated to the Volgograd Oblast Veterans' Council. The personnel of OOO LUKOIL-Nizhnevolzhskneft took the initiative and used their own resources to renovate monuments to those killed in the war. These were located in the towns of Zhirnovsk, Frolovo, Kotovo, the village of Krasnyi Yar and at the Soldiers Field memorial. The organisation also initiated reconstruction of a house where Mikhail Sholokhov once lived in the Nikolaevsky district of Volgograd Oblast.

Cooperation with local communities reached a new level in 2004: for the first time in Volgograd Oblast, the LUKOIL Charity Fund and LUKOIL-Nizhnevolzhskneft held a competition for social and cultural projects. The competition's objective was to support socially significant initiatives in the areas where the Company operates. The competition was divided into the categories of ecology, culture and sports, and charity. Projects that participated in the contest proposed applying scientific discoveries in ecology, staging shows, conducting sports events as well as creating organisations dedicated to children, culture and education.

The competition attracted entries from non-profit non-governmental organisations; state and municipal institutions; cultural centres and research organisations; municipal and local governmental bodies; and from mass media. Each applicant was required to pledge an additional contribution equal to 30% of the amount requested with the matching contribution to come from the applicant's own resources or from other donors.

Applications were evaluated by a competition commission which determined the twelve winning projects. The commission included the heads of the Company's subsidiaries in Volgograd Oblast and of the LUKOIL Charity Foundation; heads and specialists from oblast, municipal and district legislative and executive authorities; and directors of enterprises and public organisations.

Nizhny Novgorod Oblast

At the sixth traditional closing ceremony of the Nizhny Novgorod Charity Season 2004, which was conducted by a number of public organisations with the support of the Oblast Legislative Assembly, OOO LUKOIL-Volganefteprodukt was awarded the Goodwill Company prize.

Northwest region

Kaliningrad Oblast

OOO LUKOIL-Kaliningradmorneft takes part in the fight against drug addiction and AIDS. It also supported the charitable event "Children of Russia Travel in Russia": in the summer of 2004, 150 Kaliningrad children aged 11 to 14 went from Baltyisk to Saint Petersburg and on to other Russian cities. The most talented and active students from all districts of the oblast have already travelled half the country. The event has already taken place three times.



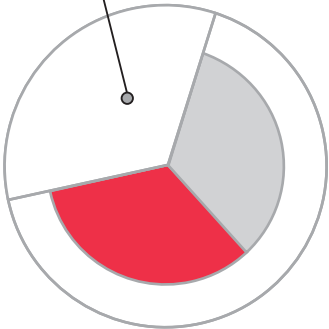
>>> ENVIRONMENT, SAFETY, AND HEALTH

"The Company is a major user of subsoil assets and recognizes its social responsibility to preserve favourable environmental conditions and ensure the rational use of natural resources. The Company also assumes that society understands the complexity and magnitude of the tasks facing the Company in this field..."

LUKOIL Social Code, Part II

Environmental component

- Legislative authorities
- Executive authorities
- Supervisory bodies
- State authorities in the regions of the Russian Federation
- Municipal governments
- Corporate management
- Employees
- Suppliers and contractors
- Ecological organisations
- Research institutions
- International organisations
- Partners
- Mass media
- Affiliates
- Consumers, etc



Corporate management
(key documents and policies):

- Policy of Industrial, Occupational and Environmental Safety
- Safety Concept for Marine and River Terminals of LUKOIL Subsidiaries
- LUKOIL Environmental Safety Programme for 2000-2003
- LUKOIL Environmental Safety Programme for 2004-2008
- Programme for Industrial Safety, Improvement of Work Conditions, Prevention and Liquidation of Emergencies at LUKOIL Enterprises in 2001-2005





ORGANISATION OF OPERATIONS

Because its operation is directly associated with the use of natural resources, the Company acknowledges its responsibility for the rational use of those resources and for the preservation of good environmental conditions.

The risk of possible negative impact from the Company's operations varies significantly across the regions where the Company works: those areas include both highly urbanized regions (Volgograd, Saratov, and Perm oblasts) and regions with extremely delicate ecological systems (the Far North, the Volga and Pechora basins, and aquatories and shelves of the Caspian and Baltic seas).

In order to define corporate priorities in environmental protection and safety, the Company in 1999 adopted its first Industrial, Occupational and Environmental Safety Policy which was revised by the Board in 2002.



The independent certification body, BVQI, has certified management and occupational health and safety systems at eleven subsidiaries of the LUKOIL Group, including its Headquarters, as to their compliance to the international standards ISO 9001, ISO 14001, and OHSAS 18001. Results of the certification and compliance audits indicate that the Company practices the principle of continual improvement of management systems which has a positive impact on the economic, ecological and social situation in the regions of its operation.

The Department for Industrial Safety, Research Operations and Ecology within the corporate management structure deals with issues of environmental and industrial safety. Similar departments operate at all subsidiaries. The duties and responsibilities of personnel throughout the management hierarchy are defined for the purpose of implementing the Policy. From conception to implementation, procedures for ecological evaluation of decision-making are in place at all stages of an investment project. Detailed and elaborate mechanisms for identifying high-priority ecological considerations are the basis for planning environmental activities. Funding and technological resources are then allocated to those activities. (For more information on environmental and safety plans and programmes and their results, see the section "Continual development and consistent improvement".)

Improvement of management systems is one of the best mechanisms for increasing the efficiency of the corporate Policy. Industrial, occupational and environmental safety management systems are in place for all LUKOIL organisations.

¹⁵ The LUKOIL Policy for Industrial, Occupational and Environmental Safety is published on the website: www.lukoil.ru.

In 2001 LUKOIL became the first Russian oil company to obtain ISO 14001 and OHSAS 18001 certifications. LUKOIL's systems of industrial, occupational and environmental safety were recertified in October of 2004,.

List of organisations with ISO 14001 and OHSAS 18001 certification

#	Organisation	Certificate information	
		ISO 14001	OHSAS 18001
1.	ОАО LUKOIL	Certification on January 12, 2001, by BVQI; recertification on April 15, 2004; expires April 14, 2007	Certification on January 12, 2001, by BVQI; recertification on April 15, 2004; expires April 14, 2007
2.	ООО LUKOIL-Nizhnevolzhskneft	October 19, 2004, by TUV; expires October 18, 2007	November 2, 2004, by TUV; expires November 2, 2007
3.	LUKOIL-Overseas Holding Ltd.	September 18, 2004, by BVQI; expires September 13, 2007	September 18, 2004, by BVQI; expires September 13, 2007
4.	ООО LUKOIL-Volgogradneftepererabotka	October 19, 2004, by BVQI; expires October 19, 2007	November 2, 2007, by BVQI; expires October 19, 2007
5.	ООО LUKOIL-Permnefteorgsintez	February 3, 2003, by BVQI; expires February 3, 2006	January 2, 2004, by BVQI; expires January 1, 2007
6.	ОАО LUKOIL-Nizhegorodnefteorgsintez	October 17, 2003, by BVQI; expires: October 6, 2006	October 8, 2003, by BVQI; expires October 7, 2006
7.	ООО LUKOIL-Permnefteproduct	BVQI, following a compliance audit, issued a recommendation for ISO 14001:2004 certification.	December 12, 2004 by BVQI; expires November 25, 2007
8.	ООО LUKOIL-Kaliningradmorneft	BVQI, following a compliance audit, issued a recommendation for ISO 14001:2004 certification.	BVQI, following a compliance audit, issued a recommendation for OHSAS 18001:1996 certification.

The Certification Programme for LUKOIL subsidiaries continues. By the end of 2004, seven Russian organisations in the LUKOIL Group and the Company itself had received ISO 14001 and OHSAS 18001 certification¹⁶. By 2007 the Company plans to have the management systems of all subsidiaries certified. Among Russian oil companies, LUKOIL

¹⁶ A total of 11 enterprises of the Company have these certificates (4 of them are located outside of the Russian Federation).

is a leader in the introduction of up-to-date management for environmental, industrial and occupational safety systems.

In 2004 the Board of the Company approved the Safety Concept for Utilization of Sea and River Terminals of LUKOIL Subsidiaries. The Company is currently working out its Programme for Improvement and Development of Resources and Tools for Primary Response to Oil and Petroleum Product Spills at Sea and on Rivers.

Continual development and consistent improvement

The main tool used by the Company for implementing its ecological policy are medium- and long-term corporate programmes for environmental safety that are developed both for the Company as a whole and for its subsidiaries.

The Environmental Safety Programme at LUKOIL enterprises for 2000–2003 was completed in 2003. Its main result was that environmental impact indicators were reduced to a level significantly below the average for the industry in Russia (For more information on reducing environmental impact, see the section "Corporate Environmental Impact".)

The LUKOIL Group set aside 26 billion roubles for ecological safety and environmental protection in 2000–2003. In 2003 alone the Company spent 6.8 billion roubles for those purposes. Funds earmarked for the ecological safety from 2004 to 2008 amount to 33.5 billion roubles, 8.2 billion of which were spent in 2004. The cost of the Programme for Industrial Safety and Improvement of Work Conditions and Safety was over 5.3 billion roubles in 2003, and over 6.2 billion in 2004.

In 2003 the Company put in place the LUKOIL Group Environmental Safety Programme for 2004–2008, which includes around 400 steps. Those steps are grouped into 8 basic blocks or sub-programmes: Clean Air; Clean Water; Waste; Recultivation; Prevention and Liquidation of Emergencies; Research, Testing and Design; Environmental Management; and Environmental Monitoring. Implementation of the Programme will permit a significant reduction in adverse environmental impact, in losses of petroleum products,



We have received proof of the Company's success in bringing down environmental impact indicators, which confirms both the high level of ecological effectiveness of the environmental management system and compliance with legal requirements.

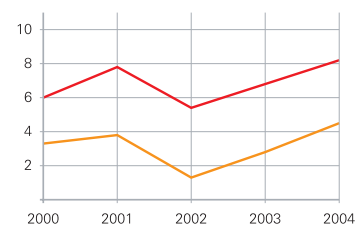
and also in water consumption. Another priority is improving the waste management system so that by 2008 waste accumulated over dozens of years at the Company's enterprises will be completely eliminated.

The Programme will have the following specific results:

- reduction of the annual emissions of atmospheric pollutants by 148 thousand tons as compared to 2002 emissions;
- reduction of emissions at oil and gas production enterprises by 31% (to 3.5 kilograms per ton), at refineries by 19% (to 1.8 kilograms per ton), and at oil distribution enterprises by 57% (to 0.2 kilograms per ton);
- increasing utilization of casinghead gas to 87%;
- reduction of petroleum product loss by 6.7 thousand tons a year;
- reduction of annual water consumption for the organisations' own purposes by 10.2 million cubic meters compared to 2002;
- reduction of the water consumption indicator at oil and gas production enterprises by 7% compared to 2002 (to 1.4 cubic meters per ton) and at refineries by 16% (to 0.43 cubic meters per ton);
- reduction of waste water dumping at oil producing enterprises by 69% compared to 2002 (to 5 litres per ton), at oil distribution enterprises – by 25% (to 15 litres per ton), and at refineries – bringing wastewater quality to approved norms;
- utilization of 1.3 million tons of new and previously accumulated hazardous waste;
- reduction of the volume of accumulated hazardous waste by 750,000 tons;
- restoration of 10.65 thousand hectares of disturbed or polluted lands, and liquidation of 143 waste-handling pits.

The Programme for Industrial Safety, Improvement of Work Conditions, and Prevention and Liquidation of Emergencies at OAO LUKOIL

Expenditures for environmental protection, billion roubles

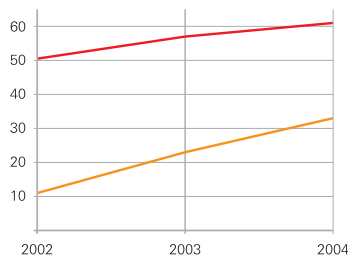


Total LUKOIL Group expenditures for environmental protection

Including: investments in core environmental funds



Growth of high-quality output, %



Percentage of high octane petrol in total automotive petrol output

Percentage of diesel fuel with 0.05% sulphur content in total diesel fuel output

Enterprises for 2001–2005 is being implemented to meet the requirements of the corporate Industrial Safety Policy.

Product environmental safety

LUKOIL Group makes significant investments in production of environmentally safe fuel.

The Company is convinced that national corporations, as well as all Russian citizens, must be interested in modernising Russian refineries. These days petroleum products are used primarily in transportation, including privately owned vehicles, and therefore quality requirements must be significantly higher. The use of more environmentally safe fuel is good for the health of the nation. It follows that the introduction of new fuel quality standards is a task of national importance which should be undertaken by means of consolidated efforts. Russia must follow the rest of the world in implementing strict measures to reduce hazardous emissions from motor and heating fuels.

The Company is prepared to deliver a steady supply of petroleum products of the highest quality to the domestic market. LUKOIL refineries were among the first ones to stop completely the production of leaded petrol. The Company has invested substantial amounts of money in equipment capable of producing motor fuel that complies with international standards, including high octane automobile petrol, low sulphur diesel fuel (with sulphur levels at or below 0.05% by mass), Jet A-1 fuel, and universal motor oils.

An advanced refining unit was launched at OOO LUKOIL-Permnefteorgsintez in September 2004. The unit produces petroleum products whose quality and environmental characteristics meet future European requirements. Reconstruction of the petrol reprocessing and reforming units at OOO LUKOIL-Volgogradneftepererabotka resulted in petrol components with a higher octane number, and as a result the use of high-octane toxic additives has been reduced by 2.2 times.

In 2003, LUKOIL products for the second time were winners in the Best Motor Oil category at the nation-wide Popular Brand competition.



Interaction with stakeholders

The Company acknowledges society's right to live in a safe environment and believes that unavoidable conflicts of interests must be resolved through a compromise respectful of the public interest.

The Company aims to be open, to respond to requests for information and to discuss existing problems in good faith. The Company fully demonstrated its methods of interaction when it launched new projects in the Baltic Sea (see the insert on page 89).

Specialists from the Department for Industrial Safety, Research Operations and Ecology constantly participate in considering draft laws concerning environmental protection at sessions under the auspices of the Russian Union of Industrialists and Entrepreneurs and the Russian Chamber of Commerce and Industry. Together with governmental bodies and research and public organisations, the Company has taken part in international and domestic conferences, seminars and symposia on environmental safety, waste utilization, and rational use of water resources among other topics.

ENVIRONMENTAL IMPACT OF THE COMPANY

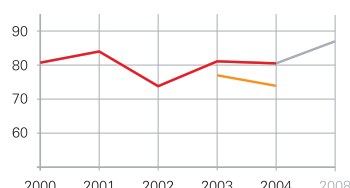
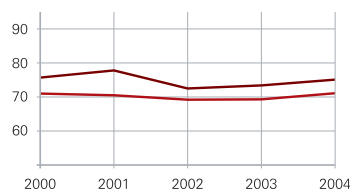
Priorities and results

The company has defined its priorities for improving the environmental situation in the territories of its operation. It has identified ecological considerations and target indicators to be reached in order to reduce the negative environmental impact of LUKOIL Group operations as a whole, as well as the impact of each of its separate operations: oil and gas production, oil refining, petrochemical production, gas refining, and distribution of petroleum products. Those aspects were taken into account during the preparation of the LUKOIL Group Environmental Safety Programme for 2004–2008.

The Company has been successful in reducing most of the elements of environmental impact both in proportional terms (per ton of oil produced and refined, etc.) and also in gross quantity (for all Russian enterprises of the Company). This is particularly significant as



Degree of oil refining and the use of casinghead gas, %



Degree of oil refining and the use of casinghead gas at Russian LUKOIL Group enterprises

Average degree of oil refining across Russia

Use of casinghead gas at Russian LUKOIL Group enterprises

Average use of casinghead gas across Russia

Target figures specified by the LUKOIL Group Environmental Safety Programme for 2004–2008 (hereinafter “target figures”)

the Company's productive capacity continues to grow (including oil and gas production; launching production at new deposits; increased volumes of refining and petrochemical output; greater sales; and expansion of the Company through acquisition of oil and gas enterprises and companies).

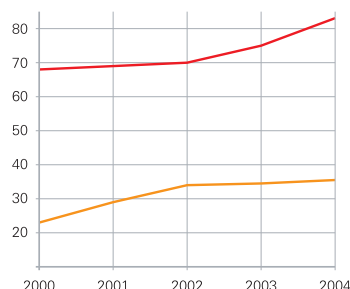
More effective use of raw materials

The quality of the end product depends on the degree of refining. The refineries of the Company are already well ahead of average figures in that respect, even though there is still potential for growth. The use of casinghead gas is already much higher than the industry average. Moreover, the LUKOIL Group Environmental Safety Programme for 2004–2008 sets a target of bringing the use of casinghead gas to 87%.

Rational use of energy

The Company conducts energy audits to find ways to save fuel and energy resources. OAO LUKOIL has devised its own regulatory and methodological energy audit base suitable for its range of operations. Examination of technological units based on measurements taken and on an analysis of energy balances offers an opportunity for discovering wasteful use of fuel and energy and for identifying its causes. This system is also useful for selecting possible solutions that will increase energy efficiency.

Use of reserves, million tons



Oil production by LUKOIL Group Russian enterprises

Oil refining by LUKOIL Group Russian enterprises

The Company has introduced a system of apportioning fuel and energy resources and implements comprehensive measures to save energy. In the case of refining this is accomplished through heat utilization at the refining units. Lower energy consumption in oil production is achieved through intensified production at producing wells and through tighter controls on the flood pattern used for maintaining reservoir pressure. An additional effect of these controls is that the water consumption for maintaining reservoir pressure is reduced (see the section “Optimization of Water Consumption.”). The Company is introducing highly effective technology such as an automated system using commercial energy accounting and equipment with dedicated software for apportioning the use of fuel and energy.

Optimization of water consumption

Production facilities have the highest water consumption; some of the water is used to maintain reservoir pressure. Oil-producing organisations have carried out significant renovations at facilities that receive and treat produced water, and this has increased produced water as a share of total water consumption for maintaining reservoir pressure.

Water consumption in refining has remained stable in general. The use of water in the Company, both for production and refining, is significantly lower than the average across the Russian oil industry.

The reduction of oil consumption in production has allowed the Company as a whole to end 2004 with a somewhat lower consumption level than it had in 2000–2001 despite its growing production volume in all categories of its operations.

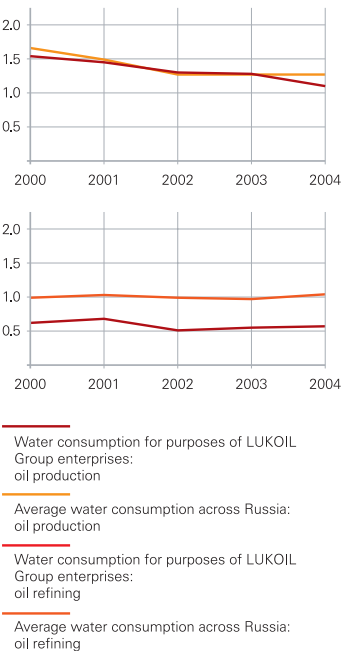
Atmospheric emissions

The total atmospheric emissions from LUKOIL enterprises are mostly attributable to emissions during production (around 75–80%), and therefore this indicator changes in step with the use of casinghead gas and increases in oil production. The bulk of these emissions are in the form of carbon monoxide and hydrocarbons. The Company strives to increase the use of casinghead gas even though that usually requires coordinating efforts with gas refineries and gas consumers. Thus, a reduction in the use of casinghead gas to 74.9% in 2002 was caused by the lack of access to the gas transportation infrastructure. However, by 2008 the Company aims at utilizing 87% of casinghead gas.

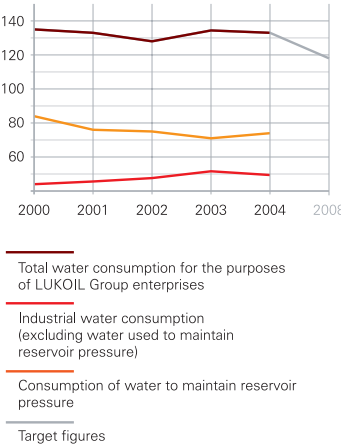
The Company does not use ozone-depleting substances in its operations (including industrial refrigeration units).

The Company has been successful in reducing emissions per ton of refined oil. Despite growth in refining volume and the introduction of advanced refining facilities in recent years, there was not only no increase in gross emissions, but emissions were actually somewhat reduced. On the whole, emission figures at production and refining enterprises of the Company are significantly lower than the average across Russia (by 40–45%).

Dynamics of water consumption, cubic meters per ton of produced oil

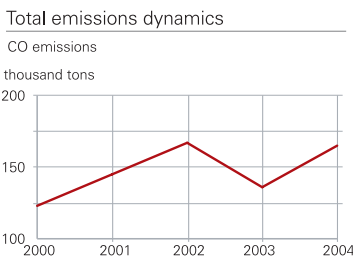
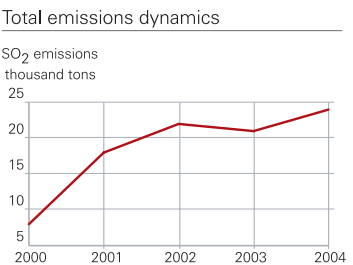
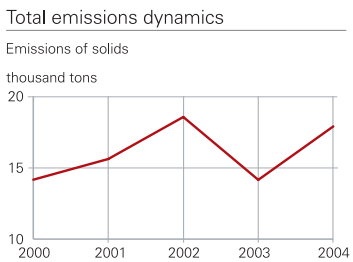
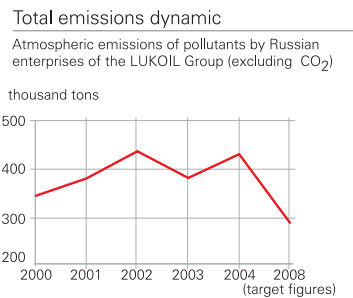


Total water consumption, million cubic metres



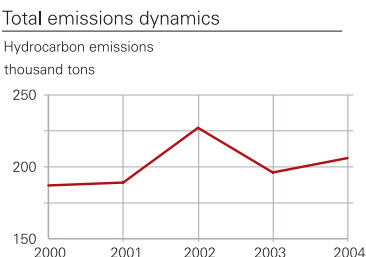
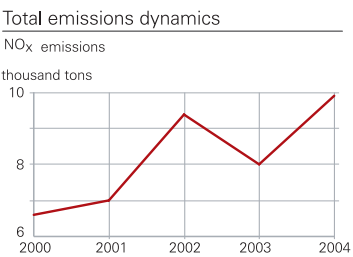
The percentage of sulphur oxide in total emissions grew in 2001–2002 due to the launch of production at a number of deposits with high hydrogen sulphide content in casinghead gases. One additional reason for the growth in sulphur oxide emissions is that the Company was joined by OAO LUKOIL-Nizhegorodnefteorgsintez, which produces oil with high sulphur content (up to 1.6% by mass).

In distributing petroleum products, the Company actively installs tools for preventing and reducing pollutant emissions in tank farms and loading/unloading systems at terminals and petrol stations. New petrol stations, as well as stations that are being renovated, are equipped with vapour retention devices that return petrol vapours from the storage tank to the mobile tank during unloading. In addition, petrol stations are being upgraded with a system to prevent overfilling and with devices that automatically shut down the flow of fuel when the tank is full. The Company's terminals are regularly reconstructed and equipped with automated control systems.



Discharges into surface waters

The Company's environmental impact is not accurately described by either the quantitative characteristics of the volume of discharged produced water or the volume of insufficiently treated produced water. There are several reasons for this discrepancy. The purification units of many enterprises accept waste water produced by neighbouring communities with the result that the share of industrial water in the total volume of discharge is rather small. In addition, in some regions the surface water used by the Company has levels of certain components that are already above the maximum permissible in waste water. Finally, various approaches to keeping track of storm water runoff have been used over the years. The LUKOIL Group



Environmental Safety Programme for 2004–2008 includes measures to tackle this problem.

At oil production locations, most of the insufficiently treated waste water is discharged by OOO LUKOIL-Komi. The tight restrictions on discharges into the Pechora River basin are difficult for the organisation's treatment facilities to meet at this time. The LUKOIL Group Environmental Safety Programme for 2004–2008 includes a plan to modernize those facilities.

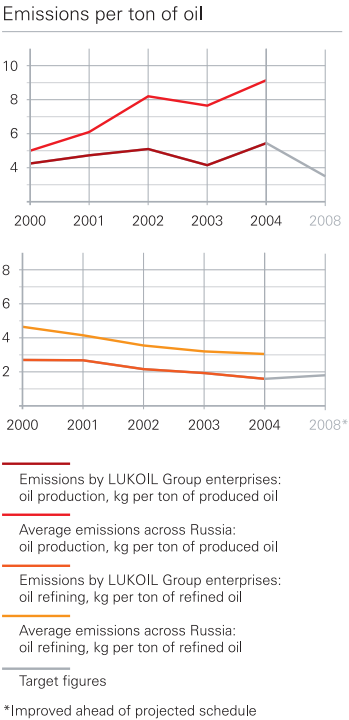
With the 2004 launch of ultraviolet disinfection units at OAO LUKOIL-Nizhegorodnefteorgsintez and OAO LUKOIL-Ukhtaneftepererabotka, the Russian refineries of the Company no longer release polluted waste into the water supply. Of all the refineries and petrochemical enterprises of the Company, only OOO Saratovorgsintez currently discharges insufficiently treated water (but within limits temporarily agreed upon for these discharges). Treatment facilities are operating at their projected pace. Moreover, discharged water is cleaner than river water in some respects. Measures to resolve the issue are set forth in the LUKOIL Group Environmental Safety Programme for 2004–2008.

Hazardous waste utilization

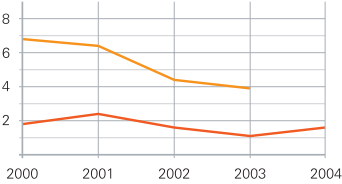
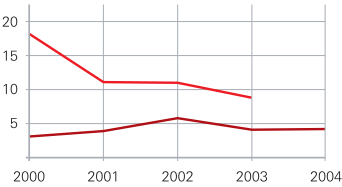
The figures for the creation of hazardous waste by LUKOIL Group production enterprises and refineries are significantly lower (half or less) than the average across Russia

The negative statistics for hazardous waste handling result from increased industrial volume and also from governmental regulations that change the required classification of waste, its placement, etc.

The Company has reduced the quantity of accumulated hazardous waste. Most of this waste had been accumulated during intensive production development in the '70s and '80s at the facilities that are now part of the LUKOIL Group. Most of the waste belongs to Class 3 and Class 4 and includes sludge generated at biological treatment units, drill cuttings and drilling mud. Total volume of waste is also significantly increased by those instances where LUKOIL Group enterprises are responsible for municipal treatment facilities.



Hazardous waste accumulation



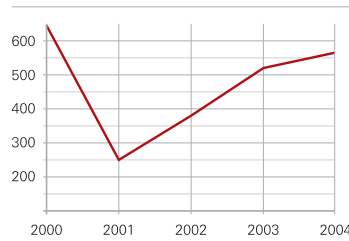
Hazardous waste accumulation at LUKOIL Group enterprises: oil production, kg per ton of produced oil

Average hazardous waste accumulation across Russia: oil production, kg per ton of produced oil

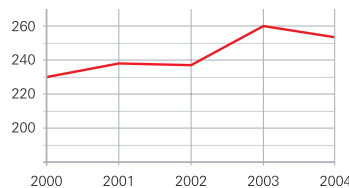
Hazardous waste accumulation at LUKOIL Group enterprises: oil refining, kg per ton of refined oil

Average hazardous waste accumulation across Russia: oil refining, kg per ton of refined oil

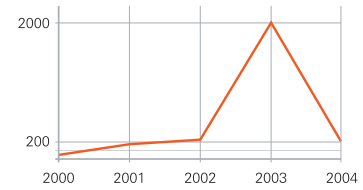
Hazardous waste handling, thousand tons



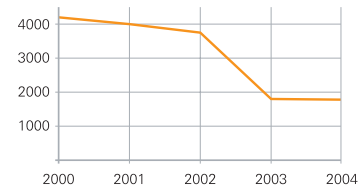
Hazardous waste accumulation at LUKOIL Group enterprises



Hazardous waste utilized (used and treated) at the Company's utilities



Hazardous waste utilized (used and treated) by specialized enterprises



Waste left at the end of the year

Recultivation of disturbed and polluted soils

In recent years the Company has been successful in narrowing the areas disturbed and polluted through its activities: at the end of 2004 these areas were around 24,000 hectares of which 279 hectares were oil-polluted¹⁷.

The company received invaluable experience while recovering oil-polluted soils in the Komi Republic upon its acquisition of OAO KomiTEK. The Company involved six research and ten specialized organisations from Russia, the Czech Republic and France in the recultivation of over 740 hectares of oil-polluted soil in the Far North. A number of documents came out of this process including: Requirements for Recultivation Techniques of Oil-Polluted Soils; Procedures for Verification of Land and Water Recovery; and Instructions for Gravimetric Assessment of the Content of Petroleum Products in Soil. All these documents currently constitute a legal regulatory foundation for environmental safety management in the Komi Republic. The emergency zone status which was established in the Usinsk district of



While visiting oil producing enterprises and refineries of the Company, we obtained evidence that the Company works with specialized enterprises to reduce the volume of accumulated hazardous waste through utilization and treatment.

¹⁷ In addition, through an agreement with the Komi republic, the Company will recultivate 104.6 hectares of polluted soils in the Usinsk district that are not part of its specific responsibilities.

the Republic after a major accident at the Vozei-Head Structure pipeline in 1994 was lifted in 2004.

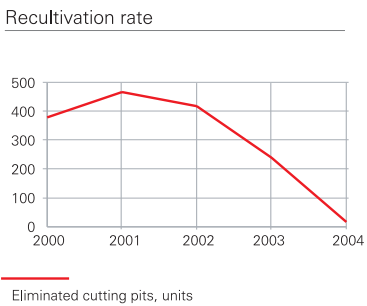
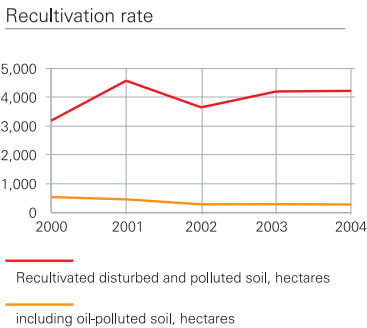
In October 2004 the State Duma Ecology Committee discussed the ecological rehabilitation of oil-polluted territories in the Komi Republic. Members of the Committee commended the comprehensive approach to ecological rehabilitation of oil-polluted northern territories, the effectiveness of the measures, and the cooperation between the Komi government and OAO LUKOIL. The Committee's resolution was forwarded to the government of Russia which mandated that federal executive authorities disseminate the Komi experience.

Recultivation of disturbed soils has been conducted each year at closed sites that had been used by the Company over short periods for preparation, construction, and other jobs. The drop in annual recultivation of oil-polluted soils is due to the diminishing scale of the problem. Elimination of unused cutting pits has decreased because LUKOIL has begun to outsource those jobs to a subcontractor responsible for the restoration of well sites (the current subcontractor had previously been a part of the LUKOIL structure).

INDUSTRIAL AND OCCUPATIONAL SAFETY

According to the Rostekhnadzor (Gosgortekhnadzor of the Russian Federation), the Russian technological supervisory body, the Company "has a favourable record in industrial safety, accidents and injury, and a system of industrial safety management is being actively implemented." In 2000 LUKOIL became the first Russian oil company to receive OHSAS 18001 certification, and its industrial safety management was recertified in 2004. Control of enforcement of security procedures is particularly important for improving this system. Control and identification of failures is currently carried out by trained auditors working at LUKOIL; in some cases, outside experts are also involved. The creation of the industrial safety management system has resulted in higher effectiveness for the comprehensive inspections.

LUKOIL Group organisations have over five years of experience in the preparation of industrial safety programmes and in quantitative evaluation of risks. In compliance with the law "On Industrial Safety



Object in focus: Petroleum spill clean-up in the vicinity of Yugo-Kamsk village, Perm Oblast

At 9:27 pm on April 23, 2002, a leak opened up at the 38th kilometre of the oil pipeline Perm-Andreevka (serviced by OOO LUKOIL-Permnefteproduct) near the village of Yugo-Kamsk, Perm district. The control board at the head pumping station recorded a sharp pressure drop; pumping was automatically shut down and the hazardous section was sealed off. After the leak was precisely located, the staff began emergency localization of the spill and elimination of the consequences of the accident. The state investigation commission determined that the accident was caused by an unauthorized attempt to cut into the pipeline.

One hundred and fifty cubic metres of diesel fuel spilled over 2.4 hectares of land. Rapidly melting snow carried the pollutant to the shores and surface water of the Severnaya and Malaya Severnaya rivers, tributaries of Severinsky Pond which is the central water supply to the village of Yugo-Kamsk with its population of 9,000.

The concentration of petroleum products above the allowable maximum was registered in the water on April 30, but the villagers received their first delivery of potable water in cisterns as early as April 26. They were advised to use tap water only for non-drinking purposes.

From the moment the leak was discovered, OOO LUKOIL-Permnefteproduct together with contractors took steps to clean up soil, prevent water contamination and recover the water supply for the village. The list below outlines the measures taken in Yugo-Kamsk:

- Recovery and disinfection of public drinking wells and construction of new wells;
- Installation of 8 local water post-treatment units at social service facilities;
- Main and distribution networks were cleaned up; plumbing was repaired where necessary;
- The filter station was repaired and improved.



The following work was done in the areas neighbouring the accident site and the aquatory of Severinsky Pond:

- removing contaminated soil from the surface of the site under recultivation;
- land shaping with installation of drainage and aeration systems;
- intensive washing of the surface of the site under recultivation;
- land shaping for recultivation; plant life restoration and prevention of erosion of the recultivated surface by water.

Only a month after the spill, tap water in the village was declared safe for drinking with oil content below the norm. By the end of August 2002, source water in the village water supply was also up to the norm. During the following autumn to spring period, the content of contaminants fluctuated, but never reached dangerous levels.

By the middle of December, the work on the village water supply was completed. Operations to prevent re-contamination continued the following spring. By the end of 2003, the programme of environmental clean-up was completely fulfilled: disturbed and polluted soils were recultivated and returned to their users; water supply and treatment facilities were repaired; and Severinsky Pond was stocked with fish.

The total cost of clearing up the spill was 40.8 million roubles.

at Dangerous Industrial Facilities", the Company has prepared and regularly updates declarations of industrial safety for all of its dangerous facilities.

The next step in the improvement of legal compliance with industrial safety laws planned for 2004–2005 is summarising accumulated information on the qualitative evaluation of risks and on enhancing the accuracy of its results.

Recording and reporting accidents and occupational diseases is an integral part of the health and safety management system of the LUKOIL



Results of comprehensive inspections

Number of comprehensive inspections concerning industrial safety



Number of discovered industrial safety violations

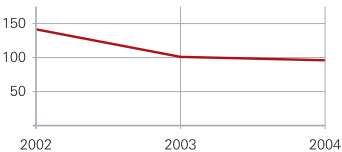


Violations discovered per inspection

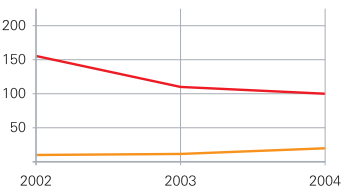


■ 2003 ■ 2004

Number of accidents and persons injured



Number of accidents



Number of persons injured

Fatalities (included in the total)

Group. In accordance with the International Labour Organisation guidelines for recording and reporting work-related accidents and occupational diseases, the Company has introduced internal standards: "Recording and Analyzing Accidents and Occupational Diseases", and "Investigation and Recording of Minor Injuries". The procedures set up for recording and investigation of accidents fully comply with Russian laws. Results of these investigations are thoroughly analyzed and employed in decision-making processes.

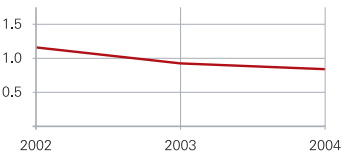
Reduction of the incidence of accidents and injuries

The incidence of industrial accidents in the Company is significantly lower than the average for the industry across Russia. During the last two years there were no industrial accidents at LUKOIL Group petrochemical enterprises. A general reduction of the number of work injuries is demonstrated both by the number of workplace accidents and injured employees in the Company as a whole and by specific statistics (see diagrams). Unfortunately, there has been no significant reduction in fatal accidents.

An analysis of workplace injuries from 1995 to 2003 identified several factors that hinder their reduction. The first and most significant of them is the human factor (violation of work discipline; violation of health and safety rules, job instructions, procedures, etc.) The second factor is insufficient attention to health and safety from enterprise management. The third factor is superannuated equipment which experiences more frequent breakages (especially at pipelines). Special attention should be paid to the selection of contractors. For example, an accident fatal to a group of three individuals occurred in 2003 during an emergency situation at Kama-Neft which is a subsidiary of ZAO LUKOIL-Perm. A gas mixture exploded during welding setting the oil emulsion on fire. The work was performed with grave violations of safety rules on an unprepared tank and without authorizing documents.

The situation calls for better staff training and improvements in safety supervision. In order to allow systematic training in health and safety for the maximum number of employees, the Company created a test site for a distance learning system in 2003. At present training courses on industrial safety management and fire safety and a training

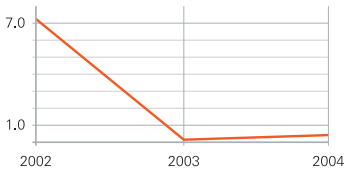
Injuries at LUKOIL Group organisations



Injuries at LUKOIL Group organisations:
oil production, incidents per 1 ton of produced oil



Injuries at LUKOIL Group organisations:
oil refining, incidents per 1 ton of refined oil



Injuries at LUKOIL Group organisations:
petrochemistry, incidents per 1 ton of produced oil

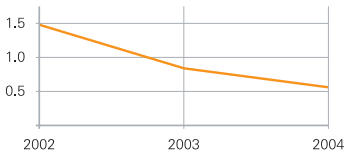
programme "Staff Response to Industrial Accidents" have been prepared for this system.

Prevention and minimization of the environmental impact of industrial accidents

Several factors are responsible for the lower volume of oil and oil products spilled following a peak in 2002¹⁸ even while the number of industrial accidents with environmental damage remains approximately constant. The majority of industrial accidents and incidents (situations where an accident might have happened) are associated with oil spills from pipeline leakage. Measures taken by the Company to locate and respond to emergency spills faster have resulted in a 2.5 time reduction in the volume of spilled oil. Accordingly, less than 2% of emergency situations cause negative consequences for the environment.

One of the main reasons for the increased number of accidents is the aging of pipeline systems along with a simultaneous increase in aggressive corrosion by the liquids pumped because of a higher water content in the oil. In addition, a significant percentage of leakages is caused by mechanical damage to pipelines by outside organisations and individuals, particularly during unauthorized intrusions. Recovery costs in such cases are paid by the culprits if they can be identified.

¹⁸ In addition to other factors, this peak was caused by an unauthorized intrusion into the pipeline of OOO LUKOIL-Permnefteproduct discovered on April 23, 2002, which resulted in the spillage of 120 tons of petroleum products (see: "Object in focus: Petroleum spill clean-up in the vicinity of Yugo-Kamsk villages, Perm Oblast").



Injuries at LUKOIL Group organisations:
oil distribution, incidents per 1 ton of refined oil



Number of industrial accidents with environmental damage

Accidents and incidents (including pipeline transportation malfunction)



Number of industrial accidents with environmental damage

Accidents with environmental damage



Number of industrial accidents with environmental damage

Oil and petroleum product spills, tons



Preventive measures on pipelines include both diagnostics and repair; older pipes are replaced with new ones that have an anti-corrosion coating. Regrettably, this work is not being done with sufficient speed. One reason is that there is a backlog of pipes installed in the '80s which often age prematurely because of their poor quality or improper pipeline construction.

The Company conducts drills and training in the proper response to emergencies and in the prevention and minimization of negative environmental impact.

It is difficult to make contractors observe safety regulations even though the number of their violations is quite significant. This situation calls for expanding and revising the standards that contractors must meet, and they must also be made accountable for any violations.

Preventive approach: minimization of impact at the planning and design stage

The Company implements "Guidelines For the Development of Industrial, Occupational and Environmental Safety and For the Prevention and Handling of Emergencies Within Draft and Project Documents for Construction, Reconstruction, and Technological Refurbishment of LUKOIL Group Industrial Facilities". The Guidelines introduce the Institute of Corporate Expert Evaluation and the Annual Workplan which covers the Company's major investment projects.

OA O LUKOIL also implements the standard "Preliminary Design and Project Documentation: Content Requirements and Guidelines for Managing the Issues of Industrial, Occupational and Environmental Safety, and Emergency Preparedness". The standard sets forth requirements for preliminary designs and project documents concerning:

- effective protection of staff, population, the Company's facilities and the surrounding areas from natural or technological emergencies;
- effective resolution of civil defence issues;
- compliance with environmental safety requirements for facilities being designed and providing for rational use and recovery of water resources;

Object in focus: Offshore ice-resistant stationary platform at the Kravtsovskoye (D-6 oil deposit) in the Baltic Sea

The Kravtsovskoye oil deposit is located on the Baltic shelf 22.5 km offshore from Kaliningrad Oblast. Geological reserves in the deposit are estimated at 21.5 million tons, while production reserves amount to 9.1 million tons of oil. Complete production lifespan for the deposit is estimated to be 30–35 years.

The decision to go forward with the D-6 development project followed a quite lengthy period of ecological and economic research. The Company took several years to study the Baltic Sea and shoreline ecosystems, including the national park on the Kurshskaya Sand Bar. Research performed by scientists of the Institute of Ocean Studies of the Russian Academy of Sciences and Kaliningrad State University provided information about the situation prior to implementation of the project. This data was used to design measures for preventing negative environmental impact during both construction and development. In addition, the data obtained by researchers presents a basis for thorough comparative analysis and for identifying any significant alterations during ecological monitoring of that Baltic area.

In 2003–2004 marine surveys assessed and measured the configuration of the bottom and the contents of its sediment along the pipeline route and at the platform site. The content of oil hydrocarbons, heavy metals and surfactants in the water and in bottom sediment received special attention. At the same time, researchers studied the population and variety of zooplankton, fish fauna, and benthos, and assessed the process of microbial destruction of oil hydrocarbons. The data obtained was used in designing the project and also during the evaluation of its environmental impact; specifically, it was used as the basis for a bio-geochemical model of the marine ecosystem in order to assess the marine ecological situation in the event of an emergency discharge of cuttings or drilling mud.

In compliance with the requirements of Russian legislation and international agreements (specifically, the Convention on the Protection



of the Environment of the Baltic Sea Area – HELCOM) the Company assessed the environmental impact of its planned operations. Possible damage to the environment during construction and production was assessed using the most pessimistic criteria. The Company developed a recovery plan, and funds were allocated for its implementation before construction began.

The Company respects Russian and international public opinion regarding the project. In response to the concerns raised, including objections made by ecological organisations, the Company conducted a public hearing to which it invited representatives of public organisations from the region and neighbouring countries, journalists, the consuls of Lithuania and Poland, and members of local communities. Notification of the hearing was published in the newspapers Kaliningradskaya Pravda and Rossyiskaya Gazeta, and posted on the internet. The Company accepted proposals and comments about the project. A roundtable for scholars, public and the mass media was conducted in towns of the oblast along with a survey of the local population. A science conference was held at Kaliningrad State University. At the request of the Lithuanian government, OOO LUKOIL-Kaliningradmorneft was visited by Lithuanian experts who were shown project documents, the plan for preventing and managing oil spills at the D-6 offshore facilities, the programme for industrial ecological monitoring, results of baseline surveys, and other materials.

The project was approved by all authorities and in January 2003 received a positive assessment from a state ecological expert council at the federal level.

Construction of the platform was completed within a year. In February 2004 the state commission chaired by the oblast Vice Governor noted the high degree of environmental and industrial safety of the platform and signed approval for its launch.

Starting in the second half of 2004, the Company has monitored the Baltic southwest from a satellite. This monitoring provides information required for decision-making in all instances of oil pol-



lution in the operation area of OOO LUKOIL-Kaliningradmorneft together with data on approaching spills from external sources.

A special vessel capable of extinguishing fires, saving people and collecting spilled oil is constantly on duty near the platform for prompt response to possible emergency leaks. The Company has also contracted a special unit of the Transportation Ministry's State Marine Rescue Service to localize and eliminate oil spills.

In 2004, the Emergency Situations Ministry conducted an exercise for its command and staff together with the LUKOIL Emergency Commission. During the exercise and drills participants practiced primary response techniques. The exercise underscored the staff's high level of professional and emergency skills.

At the invitation of the Natural Resources Ministry of the Russian Federation and OAO LUKOIL, a delegation of the Helsinki Commission Secretariat visited the oil platform, the oil collector in Romanovo, and the terminal in Izhevsky from September 29 to October 1, 2004. The experts focused on the ecological safety of the facilities and expressed a favourable opinion of the zero-discharge policy for the oil platform and of the up-to-date ecological monitoring system.

The platform at the Kravtsovskoye deposit and related facilities operate in full compliance with international and Russian legislation. Compensations for negative environmental impact are used to replenish the fish population. From the beginning of construction and production at D-6 in the Baltic Sea there has been no incident that could have had a negative environmental impact.

- providing healthy and safe work conditions for the staff.

Those documents prescribe evaluation of environmental impact during the reconstruction of existing facilities as well as during construction of new industrial facilities of the Company. Corporate approaches and standards concerning the evaluation of environmental impact comply with Russian legislation and international practice.



Object in focus: Operations in the North Caspian aquatory

The Company's special pride is the discovery of a new oil and gas field in the northern Caspian. Only a few years ago it was thought that most hydrocarbon resources were located in the Azerbaijan, Kazakhstan and Turkmenistan sectors of the Caspian Sea and this weakened Russia's position. During the last five years, LUKOIL discovered five large deposits with total reserves of over 100 million tons of oil and 650 billion cubic meters of gas in the Russian section of the Caspian. The new geological information prompted a very speedy agreement on delimitation of marine borders between Russia, Kazakhstan and Azerbaijan.

OOO LUKOIL-Nizhnevolzhskneft, which is responsible for the project, implements a number of technological and logistical measures to minimize negative impact on the water ecosystem during exploratory drilling. The drilling platform Astra used by the Company for oil exploration in the Caspian aquatory is equipped with a circulating system for drilling fluid, drainage systems for polluted waste discharges, and a reservoir for utility waste water. Wells in the North Caspian are drilled using oil-free drilling mud and therefore excess mud and cuttings contain no oil hydrocarbons. The closed-loop mud circulating system allows their reuse after treatment. Drilling cuttings are placed in metal containers and recycled at onshore facilities.

The company performs comprehensive toxicological testing to evaluate the impact of drilling and production on the marine environment. Specialists study the speed of self-purification and biodegradation of contaminants, the assimilative capacity of the marine ecosystem, and they prepare mathematical models to assess possible emergencies, predict their likely consequences and design scenarios for their management.

The marine area being surveyed is 30,000 square kilometres. The company conducts two annual comprehensive marine expeditions on the research vessels of the Caspian Fishery Institute and the Dagestan Centre of Hydrometeorology and Environmental Monitoring. The condition of the marine ecosystem is evaluated according to a 300-item checklist.



Prior to industrial production at the North Caspian deposits, the management of OOO LUKOIL-Nizhnevolzhskneft conducted a public hearing as required by Russian environmental legislation. The discussion dealt with the technical commission for developing environmental impact evaluation guidelines, a report on the evaluation of the impact, and the materials for environmental monitoring.

OAO LUKOIL understands its responsibility for preserving the unique Caspian ecosystem and its valuable biological resources, and it will implement all necessary environmental safety measures as the work on the shelf progresses. Within its ecological improvement programme the Company annually funds breeding of 2.5 million sturgeons.



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OFFICIAL ASSURANCE STATEMENT BY ZAO BUREAU VERITAS RUS CONCERNING THE OAO LUKOIL SUSTAINABILITY REPORT

INDEPENDENT ASSURANCE STATEMENT

To: OAO LUKOIL

Introduction

ZAO Bureau Veritas Rus provides independent assurance services to OAO LUKOIL. This Assurance Statement applies to the LUKOIL Sustainability Report for 2003-2004 for operations in the Russian Federation (hereinafter "Report"). It assures compliance of the Report and the underlying sustainability reporting process with the assurance standard AA1000 AS, the GRI Sustainability Reporting Guidelines, and the requirements of the reporting process standard AA1000. The preparation of the Report and its content is the responsibility of OAO LUKOIL. The responsibility of Bureau Veritas is to provide assurance of the reporting process, including assurance of the Report. The assurance was performed from December 2004 through August 2005.

Scope of the assurance

The scope and method of our work were determined through discussion with OAO LUKOIL and are as follows:

- (1) to provide assurance of the Report based on the AA1000 AS principles: materiality, completeness, and responsiveness;
- (2) to assure compliance of the Report with the GRI Guidelines;
- (3) to assess compliance of the social reporting process with the AA1000 Standard;
- (4) to provide recommendations for further development of corporate management within the scope of sustainability reporting.

Methods of assurance

Interviews with chief officers, management and staff of OAO LUKOIL. Attendance at sessions of the dialogue between the Company and representatives of federal executive and legislative authorities held in Moscow on March 29, 2005. Review of systems for quality management, for health and safety, and for environmental protection as part of the certification audit of OAO LUKOIL and its subsidiaries to verify compliance with the standards ISO 9001, ISO 14001, and OHSAS 18001. Analysis of sustainability reporting documents. Verification of statements, declarations and data included in the Report. Review of the dialogue transcript prepared by an independent facilitator, the Agency for Social Information (ASI). Study of stakeholder opinions about the OAO LUKOIL sustainability reporting process. Discussion of information on social reporting with stakeholders to verify its validity where necessary. Study of information on the economic, social, ethical, and environmental aspects of the Company's operations on the websites of OAO LUKOIL and its subsidiaries. Verification of data samples. Analysis of compliance of the reporting process with the AA1000, and its quantitative evaluation through the Bureau Veritas assessment tool VeriSEAAR®. Analysis of compliance of information in the Report with the AA1000 AS and GRI Guidelines. Analysis of compliance of information in the Report with the GRI Performance indicators.

Limitations

The following kinds of information are beyond the scope of our work and were not verified:

- (1) information on activities outside of the current social reporting period of January 2003-December 2004 with the exception of the information and data received during certification and compliance audits of management systems related to environmental and occupational health and safety issues;
- (2) statements expressing opinions, beliefs or intentions of OAO LUKOIL to perform certain activities in the future;
- (3) financial information on the Company's operations.

Basis of our opinion

Our purpose was to provide substantiated, rather than absolute, assurance. We believe that data collected in the course of this assurance

process using the methods described above provides a sufficient foundation for our conclusions. We have relied on information provided to us during the assurance process by OAO LUKOIL management, subsidiaries and by the independent social reporting facilitator, the Agency for Social Information.

Our opinion

We believe that:

- › the Report as a whole provides an adequate representation of OAO LUKOIL activities concerning corporate sustainability reporting during the period of January 2003 through December 2004;
- › the Report is presented in a clear and comprehensible form and is informative;
- › information in the Report largely complies with AA1000 AS;
- › OAO LUKOIL processes of accountability, assurance and reporting concerning corporate social reporting on the whole comply with key requirements of AA1000;
- › OAO LUKOIL has the capability to identify economic, social, ethical and environmental issues, to understand them and to manage related processes, as well as the capability to understand stakeholder expectations related to those issues and respond to them;
- › managerial supervision of the reporting process is sufficiently supported by the organisational policy and resources.

Compliance of the Social Report with the AA1000 AS principles

Materiality

The Report is material for stakeholders because:

- › it contains detailed responses and commitments made by the company concerning expectations articulated and recorded during the dialogue with representatives of federal authorities;

- › it contains significant information on the Company's industrial operations and on its contribution to social and economic development of the regions;
- › it explains the essence of the Company's social policy in the context of the OAO LUKOIL Social Code;
- › it provides information on implementation of programmes within the corporate Policy for Industrial, Occupational, and Environmental Safety;
- › it contains information on a number of key economic, social and environmental elements and GRI performance indicators;
- › it provides information on the Company's compliance with international product quality and management systems standards.

Completeness

- › The Report contains exhaustive information on key directions and indicators of the Company's industrial, social and environmental activities within the specified temporal and geographic reporting boundaries.
- › The Report contains an evaluation of the Company's environmental impact indicators and the scope of industrial accidents in comparison to average figures across the Russian oil and gas industry.
- › The Report provides information about major incidents with ecological impact.
- › The Report contains incomplete information on the internal social reporting assurance performed by the Company.
- › The Report leaves out a number of topics, including interaction with suppliers, and employee and customer satisfaction.

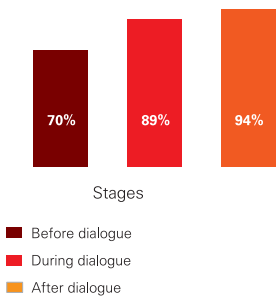
Responsiveness

- › Responsiveness has been demonstrated by acceptance of social commitments for 2005–2007 in response to proposals and expectations articulated by representatives of federal authorities during

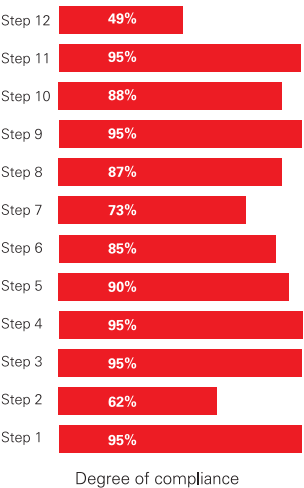
the Dialogue. It has been further shown through substantiated explanations made by the Company concerning those proposals and expectations for which the Company is unable to make a commitment. It has been noted that certain expectations are already being answered through events conducted or being conducted.

- Responsiveness has been express through responding to the needs of citizens through the mechanism of Cooperative Agreements with regional and local authorities in the regions of Company's operation.
- Responsiveness is supported by the OAO LUKOIL Social Code which contains the Company's commitments to its employees and society as a whole.
- Responsiveness is exercised through existing quality, environmental and occupational safety and health management systems.
- Responsiveness is reflected in the development of social partnership with trade union organisations.
- Stakeholder engagement did not include dialogues with a number of important stakeholder groups, such as investors, service providers, consumers, and employees.

Degree of stage compliance with AA1000



Degree of step compliance with AA1000



Assessment of compliance with AA1000

The diagrams illustrate the assessment for the social reporting process of its compliance with AA1000 for each of the three stages of a full reporting cycle (before dialogue, during dialogue and after dialogue) and for each of the twelve AA1000 process steps. The assessment was made using the VeriSEAAR® tool. The social reporting process largely complies with AA1000 requirements.

Assessment of compliance with GRI Guidelines

The Report was prepared using recommendations from GRI Guidelines and contains information on a number of relevant GRI reporting elements and performance indicators (over 50%).

Recommendation for development of corporate management of the social reporting process

- Development and implementation a social reporting management system;
- implementation of mechanisms for consistent engagement of all stakeholders in the corporate social reporting process;
- development, together with stakeholders, of a list of performance indicators specific for the oil and gas industry;
- identification of a strategy and development of criteria for evaluating the cost effectiveness of corporate social programmes and projects;
- expansion of the geographic scope of the reporting process at the Stakeholder Dialogue stage;
- conducting an internal assurance of the social reporting process with publication of results during the current reporting cycle;
- systematization of information on the dynamics of corporate social, economic, and ecological indicators;
- including information about corporate investor attractiveness in future reports;
- including stakeholder commentaries on previous cycle reports in future reports.

Bureau Veritas statement of independence, impartiality and competence

ZAO Bureau Veritas RUS is an independent professional service company that specializes in quality, health, safety, social and environmental management with over 180 years of experience in independent assurance services and annual revenues of over 1.4 billion euros in 2004.

Bureau Veritas Rus has implemented a Code of Ethics throughout the organisation which is intended to ensure that all our staff maintain high

ethical standards in their day-to-day business activities. We are particularly vigilant in the prevention of conflict of interest.

Bureau Veritas Rus has an independent certification unit, BVQI, with a team of social report auditors who have extensive experience in evaluation of quality, occupational and industrial safety, ecology and social responsibility information, systems and processes. They have an excellent understanding of best practices in corporate responsibility reporting and assurance.

Bureau Veritas testifies that this Assurance Statement contains an independent evaluation by a social assesor (third party assurance).

Bureau Veritas has no commercial or other significant interest in the operation of OAO LUKOIL aside from assurance services.

*ZAO Bureau Veritas Rus
August 8, 2005*

ADDITIONAL INFORMATION

The Report is published on the website of the Company: www.lukoil.ru (in Russian) and www.lukoil.com (in English).

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TERMS USED IN THIS DOCUMENT

The words "OAO LUKOIL", "LUKOIL Group", "the Company", "LUKOIL Company", "we", and "our" are used in this text as synonyms and denote organisations of the LUKOIL Group as a whole, and OAO LUKOIL and/or its subsidiaries, depending on the context.

