

## CHAPTER 4

### THE TIMOR GAP (ZONE OF CO-OPERATION) TREATY

#### Introduction

4.1 The Timor Gap Treaty is a unique arrangement for enabling petroleum exploration and exploitation in offshore areas, subject to competing claims by two countries, and for the sharing of the benefits between those countries.<sup>1</sup>

4.2 The Treaty between Australia and Indonesia was signed in December 1989, and deals provisionally with the gap in the seabed area not covered by the 1972 Seabed Agreement between Australia and Indonesia; that is, the seabed area between Australia and East Timor. When the 1972 seabed agreement was negotiated, East Timor was not part of Indonesia and, as a result, a ‘gap’ was left between the eastern and western parts of the Australia-Indonesia seabed boundary: the ‘Timor Gap’. The Treaty establishes a Zone of Co-operation comprising three distinct areas—Areas A, B and C. It creates a regime that allows for the exploration and development of hydrocarbon resources in the Zone. Area B lies at the southern end of the Zone and is administered by Australia. Area C lies at the northern end of the Zone and was administered by Indonesia. Area A is the largest area and lies in the centre of the Zone. The rights and responsibilities of Australia and Indonesia in relation to Area A were exercised by a Ministerial Council and a Joint Authority established by the Treaty. The Joint Authority is responsible to the Ministerial Council.<sup>2</sup>

4.3 The Treaty was entered into for an initial term of 40 years, with provision being made for successive terms of 20 years, unless by the end of each term, including the initial term of 40 years, the contracting states should have concluded an agreement on the permanent delimitation of the continental shelf between Australia and East Timor—a seabed treaty.<sup>3</sup>

4.4 The Treaty was challenged by Portugal in the International Court of Justice when it entered into effect in 1991 on the grounds that it violated the rights of the people of East Timor to self-determination and violated Portugal’s rights as the administering power of East Timor. As Indonesia declined to consent to the jurisdiction of the Court, the Court was unable to adjudicate the matter.<sup>4</sup>

4.5 The Treaty arrangements proved to be beneficial to both Indonesia and Australia. Within the Zone of Co-operation, an exploration program, which involved

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1 Mr Payne, *Committee Hansard*, 11 November 1999, p. 873.

2 Attorney-General’s Department, submission no. 65, p. 3.

3 Attorney-General’s Department, submission no. 65, p. 2.

4 Opinion of the International Court of Justice, *Case Concerning East Timor (Portugal v. Australia)*, 30 June 1995. General List No. 84, 30 June 1995.

the drilling of 42 wells, resulted in the discovery of hydrocarbons in 36 of the wells and the identification in Area A of about 400 million barrels of condensate (a light oil) and LPG (liquid petroleum gas) and three trillion cubic feet of gas. These resources have been discovered in some medium to small oilfields, including at Elang-Kakatua and Jahal, and some large gas fields at Bayu-Undan and Sunrise Troubadour.<sup>5</sup>

4.6 At each Ministerial Council, Ministers from Indonesia and Australia gave reports on activities in Area C and Area B respectively. To date, there has been no exploration carried out in Area C and it is not seen as particularly prospective, both because of its depth and the geology of the area.<sup>6</sup>

4.7 In Area B, the Australian area of jurisdiction, there has been some exploration, both seismic and drilling of wells, but to date no hydrocarbons have been found.<sup>7</sup>

4.8 In Area A, the Elang-Kakatua field began commercial production in mid-1998 with production to November 1999 valued around \$A250 million, returning to each contracting state around \$5 million in revenues from the production sharing arrangements. East Timor received its first royalty payment from the Timor Gap, worth over US\$3 million, on 18 October 2000.<sup>8</sup> The revenue came from oil lifted from the Elang-Kakatua field, the only active oil field in the Timor Sea. The figure represented half of the revenues collected from production sharing between 25 October 1999 and 25 September 2000.

4.9 The cumulative employment figure for Area A of the Zone from the commencement of operations in 1991 to November 1999 was around 124,000 man-days for Australians and 80,000 man-days for Indonesians.<sup>9</sup>

4.10 The Treaty and associated arrangements attracted exploration and development to the Zone of Co-operation with significant industry investment. The Committee was told the Treaty provisions had withstood the test of time over the period 1991 to November 1999, and there had been no need to amend the Treaty, the petroleum mining code or the model production sharing contract. From time to time, various issues arose and were successfully resolved through the Joint Authority and Ministerial Council.<sup>10</sup>

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5 Mr Payne, *Committee Hansard*, 11 November 1999, p. 873.

6 Mr Kjar, *Committee Hansard*, 11 November 1999, p. 878.

7 Mr Kjar, *Committee Hansard*, 11 November 1999, p. 879.

8 UNTAET daily briefing, 24 October 2000. Due to the one-time nature of this windfall, this revenue was not expected to change the East Timorese budget in any significant way.

9 Mr Payne, *Committee Hansard*, 11 November 1999, p. 873.

10 Mr Payne, *Committee Hansard*, 11 November 1999, p. 873. At the eighth Ministerial Council meeting in Cairns in November 1997, Minister for Resources and Energy Senator Warwick Parer and his Indonesian counterpart, General Sudjana, struck an agreement on mutually acceptable principles for sharing production benefits of oil and gas deposits in the Zone of Co-operation. The Treaty signed in 1989 had not addressed what would occur if processing occurred outside the Zone of Co-operation, whether in

4.11 During the interim phase before independence, the United Nations transitional administration (UNTAET), has overall authority for the administration of East Timor and consequently, an important role to play in respect of continuity of the Timor Gap Treaty regime.<sup>11</sup>

### Indonesia's interest

4.12 The Zone of Co-operation established by the Timor Gap Treaty was intended to be referable only to the coast of East Timor and the opposite coastline of Australia. There is a question whether Indonesia has any remaining legal interest in the location of the boundaries of the Zone following the movement of East Timor out of Indonesian sovereignty. In this respect, the focus would be on points A16 and A17, identified in the 1972 seabed boundary agreement.<sup>12</sup> These are at the eastern and western extremities of the Timor Gap Zone of Co-operation (see map of the Zone of Co-operation).<sup>13</sup> Points A16 and A17 (at 9°28'S and 127°56'E, and 10°28'S and 126°E) are the points at which the Australia-Indonesia seabed boundary joins the Zone of Co-operation, on each side. It is those two points, termed *tripoints*, where the interests of Australia, independent East Timor and Indonesia would meet, and it is in the location of those points where Indonesia might have a continuing interest.<sup>14</sup> The 1972 seabed treaty noted in Article 3 that the lines connecting points 15 and 16, and points 17 and 18, indicated the direction of the boundary and that negotiations with other governments that claimed sovereign rights to the seabed (then Portugal, now East Timor) might require adjustments to points 16 and 17.<sup>15</sup>

4.13 Since the 1972 seabed boundary agreement was established, Indonesia has twice accepted those points as being reasonable, and in the proper location: first, in the negotiation of the Timor Gap Treaty itself; and, second, in the 1997 agreement between Australia and Indonesia establishing an exclusive economic zone boundary and certain seabed boundaries.<sup>16</sup>

4.14 The agreement of the Indonesian Government is not required for any changes to the Treaty. There are details which required attention in terms of Indonesian disengagement but, Indonesia, as representatives of Indonesia have said publicly, has no role in its future.<sup>17</sup>

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Indonesian waters or in Australian waters. These basic principles of fiscal benefit sharing paved the way for the development of the Bayu-Undan gas discovery (*Senate Hansard*, 25 November 1997, p. 9347).

11 Mr Campbell, *Committee Hansard*, 11 November 1999, p. 869

12 Mr Campbell, *Committee Hansard*, 11 November 1999, p. 869.

13 Mr Campbell, *Committee Hansard*, 11 November 1999, p. 870.

14 Mr Campbell, *Committee Hansard*, 11 November 1999, p. 870.

15 Department of Foreign Affairs, *Agreement between... Australia and... Indonesia Establishing Certain Seabed Boundaries*, Treaty Series 1973, No. 31.

16 Mr Campbell, *Committee Hansard*, 11 November 1999, p. 870.

17 Mr French, *Committee Hansard*, 11 November 1999, p. 883.

4.15 The two tripoints A16 and A17 are closer to the island of Timor than the mid-points between the island and Australia. In 1972, Indonesia accepted the Australian contention that the seabed boundary between the two countries should lie between the mid-line and the deepest part of the seabed, the Timor Trough.<sup>18</sup> Negotiations on a seabed treaty with Portugal failed at that time because Portugal argued for a boundary along the mid-line between Australia and Portuguese Timor.<sup>19</sup> If, in a new treaty, Australia were to concede to East Timor a seabed boundary along the mid-line, Indonesia might be prompted to seek re-negotiation of its seabed boundary with Australia.<sup>20</sup> Dr Gillian Triggs, Associate Dean of the University of Melbourne's Law Faculty, has commented: 'There is no doubt Indonesia will feel quite aggrieved if we have unequal boundaries in certain areas with Indonesia and we suddenly blow the boundary out and make a more equidistant one in relation to East Timor'.<sup>21</sup> The border alongside the Zone of Co-operation is a sensitive issue as several major gas and oil deposits lie just outside Indonesian territory in Australian waters including the 140,000 barrels-per-day Laminaria field.

4.16 However, it should also be noted that: (a) the seabed boundary treaty stands in perpetuity; (b) that amendment to the 1972 treaty can only be made by agreement of both parties; and (c) a party can only withdraw from the treaty with the agreement of the other party. As a consequence, it would be extremely difficult, if not impossible, for Indonesia to reopen the question of the seabed boundaries outside the Timor Gap (aside from the possibility of adjustment of tripoints A16 and A17). Any unilateral denunciation by Indonesia would be rejected by the International Court of Justice.

4.17 In August 1999, Australia defined the south-western maritime boundary for the Interfet operational area in East Timor by drawing a line perpendicular to the general direction of the coastline starting from the mouth of the Massin River, which separates West and East Timor. A similar projection of East Timor's maritime claims, if adopted as part of settlement of Timor Gap maritime boundaries, would bring the

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18 Indonesian Foreign Minister Mochtar Kusumaatmadja, who in 1971-72 was a principal member of the Indonesian negotiating team on the seabed boundary, complained in December 1978 that Australia had 'taken Indonesia to the cleaners' in 1972 ('Boundary threat to seabed leases', *The Sydney Morning Herald*, 21 December 1978). He did not specify how Australia had taken unfair advantage.

19 J.R.V. Prescott, 'The Australian-Indonesian Continental Shelf Agreements', *Australia's Neighbours*, vol. 82, September-October 1972, pp. 1-2. Brian Toohey, 'Oil: Portuguese tail-twisting could backfire', *The Australian Financial Review*, 26 March 1974; 'Canberra, Lisbon head for row', *The Age*, 26 March 1974; 'Australia calls for report on oil leases', *The Sydney Morning Herald*, 14 December 1974. Portuguese Ambassador Carlos Empis Wemans to Lisbon, 25 March 1974, Cour internationale de justice, *Affaire relative au Timor oriental (Portugal c. Australie): mémoire du gouvernement de la république Portugaise*, La Haye, 1991, Annexe IV.9, pp. 321-3.

20 Michael Richardson, 'Oil Reserves are Sensitive Independence Issue', *International Herald Tribune*, 15 December 1999.

21 Wendy Pugh, 'Australia seeks to avoid East Timor border dispute', *Reuters*, 6 October 2000.

Laminaria/Corallina fields, which are just outside the current western boundary of the Zone of Co-operation, within the sovereignty of East Timor.<sup>22</sup>

4.18 According to some experts, the line on the eastern side of the Gap seems to have been drawn from the eastern tip of the East Timor mainland, not the small outlying island of Jaco. If the eastern boundary were rectified to take this into account, the adjustment would put more of the Sunrise-Troubadour gas fields, found by Woodside Petroleum and partners, into the Timor Gap (north of the median line) rather than the Australian exclusive zone. Under the Treaty, this group of gas reservoirs extends about 20 per cent under the shared zone.<sup>23</sup>

### **1997 Delimitation Treaty**

4.19 The March 1997 Delimitation Treaty between Indonesia and Australia was a treaty which completed the negotiation of maritime boundaries between Australia and Indonesia. It has not yet been ratified, or entered into force. The Treaty delimited the exclusive economic zone boundary between East Timor and Australia. The Australian view is that the 1997 treaty remains in a satisfactory form between Indonesia and Australia, but it will have to be amended to reflect the fact that East Timor is no longer under Indonesian sovereignty.<sup>24</sup> On 2 September 1997, Portugal lodged a challenge to the Treaty, which was circulated at the United Nations. The protest document disputed the right of the Treaty to set a water-column line running through the Timor Gap, on the same grounds as Portugal's earlier challenge to the Timor Gap Treaty.<sup>25</sup>

### **Administrative arrangements in the transitional period**

4.20 Following the 30 August 1999 popular consultation, the Australian Government developed and implemented a strategy aimed at ensuring the smooth transition of the Treaty. Officers from the Department of Foreign Affairs and Trade, the Attorney-General's department, and the Department of Industry, Science and Resources liaised with officials from the United Nations and East Timorese representatives and consulted the petroleum industry to enable a smooth transition of operations under the Treaty. Transition arrangements needed to cover issues such as:

- the location of the headquarters of the Joint Authority, originally in Jakarta;
- appointment by the United Nations of appropriate representatives on the Ministerial Council and of people to participate on the Joint Authority; and

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22 Cmdr. Robin Warner, RAN, 'Law of the Sea Issues for the Timor Sea: A Defence perspective', *East Timor and its Maritime Dimensions: Law and Policy Implications for Australia*, Canberra, Australian Institute of International Affairs, 14 June 2000.

23 Hamish McDonald, 'Sounding the gap', *The Sydney Morning Herald*, 21 October 2000.

24 Mr Campbell, *Committee Hansard*, 11 November 1999, p. 871.

25 'Australia's sea boundary challenged', *ABC News*, 2 September 1997.

- the status of the existing production sharing contracts as well as the existing regulations, directions and other matters resolved to date by the Ministerial Council and the Joint Authority.<sup>26</sup>

4.21 In discussions with the Australian Government, East Timorese representatives, particularly Mr Gusmão, Dr Ramos-Horta, and the East Timorese spokesman on Timor Gap matters, Dr Alkatiri, confirmed their willingness to see the Treaty continue in its current form. The United Nations indicated a similar view.<sup>27</sup>

### **Bayu-Undan liquids recovery and gas recycle project**

4.22 The Darwin Area Manager of Phillips Oil Company Australia, Mr James Godlove, told the Committee on 8 September 1999:

Phillips, through various subsidiary companies, have major economic interests relating to petroleum development within area A of the Zone of Co-operation. We have already made very significant investments. With our co-venturers we are nearing a decision to approve a \$US1.4 billion budget for the construction and operation of the Bayu-Undan Liquids Recovery and Gas Recycle Project ... To provide a secure environment for these investments and to realise the full potential of petroleum resources in this area, it is vital that the treaty be sustained and that key transitional issues accompanying any change in the sovereign status of East Timor be managed smoothly.<sup>28</sup>

Mr Godlove also said:

... the present commercial and fiscal terms of the treaty must be maintained. These include provisions relating to production sharing and cost recovery of capital and operating expenses. Furthermore, any tax regime established in East Timor should be no more onerous than the Indonesian regime being replaced. These provisions establish the basis for petroleum development in the zone of cooperation and any adverse change in these provisions could have a profound effect on our project economics.<sup>29</sup>

Speaking at a seminar in Canberra on 14 June 2000, Mr Godlove said:

The major unresolved matter that does need to be addressed expeditiously is the lack of a defined fiscal regime in the terms of the Treaty regarding gas exported from the Zone of Co-operation. An agreement on that matter

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26 Mr Payne, *Committee Hansard*, 11 November 1999, p. 874.

27 Mr Michael Potts, *Committee Hansard*, 11 November 1999, pp. 871-2.

28 *Committee Hansard*, 8 September 1999, p. 417.

29 Mr J. Godlove, *Committee Hansard*, 8 September 1999, p. 418.

would have significant economic benefits to both East Timor and Australia.<sup>30</sup>

4.23 Mr Keith Spence, Woodside Energy Limited, told the Committee on 20 July 1999 that his company was concerned to preserve the stability and elimination of sovereign risk that the current Treaty regime provided.<sup>31</sup> Woodside expected to be among the suppliers to major new customers in the region, based on substantial reserves in the Sunrise-Troubadour field that extends into the Zone of Co-operation. Sunrise-Troubadour could probably produce ten trillion cubic feet of gas, as opposed to three to four trillion cubic feet from Bayu-Undan.<sup>32</sup>

4.24 A consortium led by Phillips Petroleum announced on 26 October 1999 that it would proceed with the first stage of the development of the Bayu-Undan field, in Area A of the Zone of Co-operation. This would involve the extraction of gas, stripping of the condensate and LPG liquids from the gas, and re-injection of the dry gas. The consortium would invest capital expenditure of about \$US1.4 billion. The project would provide significant employment opportunities to Australians and East Timorese. Phillips indicated that revenues of ‘many tens of millions of US dollars’ a year were likely to flow to Australia and East Timor.<sup>33</sup> In the press release announcing its decision to proceed with Bayu-Undan, Phillips referred to substantive and encouraging discussions with all relevant parties involved in East Timor’s transition to independence.<sup>34</sup> They had received a letter signed by Mr Gusmão, Dr Ramos Horta and Mr Alkatiri saying they would honour Timor Gap petroleum zone arrangements.<sup>35</sup>

4.25 Santos Ltd, which holds 11.8 per cent of the Bayu-Undan gas project, confirmed on 18 November 1999 that it had opted to participate in the project.<sup>36</sup> Santos was the last of the six partners in the project to publicly confirm its continuing participation, opening the way for the development plan to be submitted to the Joint Authority for final approval.<sup>37</sup> The project was expected to produce 110,000 barrels of

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30 Australian Institute of International Affairs, Centre for Maritime Policy at the University of Wollongong, and the International Law Association, *East Timor and its Maritime Dimensions: Legal and Policy Implications for Australia*, Canberra, 14 June 2000. Cf. Trevor Sykes, ‘The looming oil war with Indonesia’, *The Australian Financial Review*, 15 October 1997: ‘The various compromises reached by the diplomats have produced a rat’s nest of ownership and royalty regimes’. Sykes pointed out that the Treaty when signed in 1989 did not anticipate that an unfinished product might be exported across one of the boundaries. Phillips wished to pipe gas from Bayu-Undan to Darwin for conversion to LNG, which raised the question of whether the royalty to be paid to Indonesia would be on the value of the gas or the LNG.

31 *Committee Hansard*, 20 July 1999, p. 112.

32 Mr John Akehurst, Managing Director, Woodside Petroleum Ltd, quoted in ‘Australia’s Woodside Sees No Threat from Timor Gas Rivalry’, *Asia Pulse*, 6 December 1999.

33 Mr Godlove, *Committee Hansard*, 8 September 1999, p. 421; Mr Payne, *Committee Hansard*, 11 November 1999, p. 873.

34 Mr Payne, *Committee Hansard*, 11 November 1999, p. 885.

35 Paul Tait, ‘East Timor backs gas project but warns on treaty’, *Reuters*, 10 November 1999.

36 Mr Ross Adler, Managing Director, Santos Ltd, *Asia Pulse*, 18 November 1999.

37 The partners are: Phillips Petroleum Company, 50.29%, Santos Ltd, 11.83%, Inpex, 11.71%, Kerr McGee Corporation, 11.2%, Petroz NL, 8.26%, British Borneo, 6.72%.

condensate and LPG from 2004. The second stage of the project proposed construction of a gas pipeline to a LNG production facility in Darwin, which would then sell the product to overseas customers.<sup>38</sup>

4.26 On 28 February 2000, the United Nations Transitional Administrator in East Timor, Mr Vieira de Mello, and the Australian Minister for Industry, Science and Resources, Senator Nick Minchin, announced that approval had been given by the Joint Authority for the first phase of the Bayu-Undan petroleum project in Area A of the Timor Gap Zone of Co-operation.<sup>39</sup>

4.27 It is not possible to predict with certainty the likely revenues to flow to East Timor and Australia from the Bayu-Undan project. The actual revenues received will depend on highly variable oil and gas prices received from the project. Production rates tend to peak in the first few years of a liquids project and then decline, while gas projects have a relatively flat production profile related to the requirements of their gas customers and the timing with which the various phases of the project come on stream.<sup>40</sup>

4.28 Given uncertainties associated with price and different start-up dates for the phases of the project, the prospective income stream is in the order of several tens of millions of dollars annually, for over a decade from 2003. That would represent a significant proportion of East Timorese GDP.<sup>41</sup> In addition, Treaty-related activities would provide important employment and training opportunities for East Timorese across a range of disciplines from engineering to administration.<sup>42</sup>

4.29 In an interview on the ABC radio program *Asia Pacific* broadcast on 10 October 2000, Mr Peter Galbraith, Member for Political Affairs of the East Timor Transitional Cabinet, said:

These resources are enormously important to East Timor. By the end of the decade it could mean between \$US100 million and \$US200 million for East Timor, depending on how these negotiations turn out, and for a country whose annual budget is just \$US45 million that makes all the difference ... The resources of the Timor Sea could make the difference between having to choose between children's health and children's education to being able to do both.

### **The transition from Indonesia to East Timor**

4.30 Concerning the treaty obligations of new states, the Attorney-General's Department quoted an authoritative statement by Lord McNair:

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38 *Asia Pulse*, 18 November 1999.

39 Senator Nick Minchin, 'World Scale Petroleum Project for Timor Sea', Media Release 00/49.

40 Mr Payne, *Committee Hansard*, 11 November 1999, pp. 873-4.

41 Mr Michael Potts, *Committee Hansard*, 11 November 1999, p. 871.

42 Mr Michael Potts, *Committee Hansard*, 11 November 1999, pp. 871-2.

Newly established States which do not result from a political dismemberment and cannot fairly be said to involve political continuity with any predecessor, start with a clean slate in the matter of treaty obligations...<sup>43</sup>

4.31 When one state or one part of a state separates from an existing state there arises the question of whether that new state takes on the treaty obligations of the previous state or whether there is what is called a 'clean slate'. In other words, can they start again and choose those treaty obligations of the former state which they will take on later? In these circumstances, there are two relevant conventions,<sup>44</sup> but as Australia is not a party to them, customary international law becomes the basis. In terms of customary international law, if East Timor had become immediately independent from Indonesia without an interim period of United Nations administration, it would have been subject to the clean slate doctrine; it would not have been forced to take on the treaty obligations of Indonesia but, nevertheless, could have chosen those obligations which it did want to take on.<sup>45</sup>

4.32 However, East Timor was not the usual scenario. Indonesia no longer exercised sovereignty. The view was that Portugal should not re-assert its sovereignty, even in the most technical sense, a view shared by Portugal. But, as no new independent East Timorese state had emerged, Australia faced the situation of there being no state with which to treat. In the absence of such a state, with whom could Australia enter into agreement to secure the continued operation of the Treaty?<sup>46</sup>

4.33 The answer involved a new precedent in international law. Under Security Council resolution 1272, which set up the United Nations Transitional Administration in East Timor, UNTAET, a transitional period of some two to three years was established for East Timorese transition to independence. Under paragraph 35 of the United Nations Secretary-General's report, which was incorporated by specific reference into the Security Council resolution, the United Nations would 'conclude such international agreements with states and international organisations as may be necessary for the carrying out of the functions of UNTAET in East Timor'. Resolution 1272 stressed the need for UNTAET to consult and co-operate closely with the East Timorese people in order to carry out its mandate, including the question of keeping the Treaty on foot.<sup>47</sup> This gave UNTAET a wide treaty making power, providing more than sufficient basis for the United Nations to enter into an agreement with Australia to confirm the continued operation of the Treaty. In effect, the United

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43 McNair, Arnold Duncan, Baron *The Law of Treaties*, 1961 edition, p. 601; quoted in Attorney-General's Department, submission no. 65, p. 4.

44 The 1978 *Vienna Convention on Succession of States in Respect of Treaties*, and the 1983 *Vienna Convention on Succession of States in Respect of State Property, Archives and Debts*; quoted in Attorney-General's Department, submission no. 65, p. 4.

45 Mr Campbell, *Committee Hansard*, 11 November 1999, p. 879.

46 Mr Michael Potts, *Committee Hansard*, 11 November 1999, p. 872.

47 Mr Campbell, *Committee Hansard*, 11 November 1999, p. 881.

Nations, through UNTAET, would be Australia's treaty party until the independent state of East Timor emerged.<sup>48</sup>

4.34 A workshop on the Treaty of interested parties was held in Dili, 17–19 January 2000, attended by about 50 geologists, lawyers, engineers, economists and other experts from Australia, the United Nations, East Timor, Portugal and Mozambique. Woodside Petroleum and Phillips Petroleum were represented at the workshop. Dr José Ramos-Horta and other members of the East Timor National Consultative Council attended. Mr James Godlove, of Phillips Petroleum, said following the workshop, 'There was strong expressions of support for continuation of the Treaty and any continuation of the terms of the Treaty'.<sup>49</sup>

4.35 When the Committee took evidence in November 1999, the Government was involved in discussions with the United Nations on the detail of the arrangements for the transition of the Treaty. Some adjustments had to be made to the Treaty, primarily to the arrangements for the Joint Authority which managed the rights and responsibilities under the Treaty on a day to day basis.<sup>50</sup> While working to ensure the Treaty's future, there was the need to deal in an orderly way with the Treaty's past. Australian officials had discussions at a technical level within the Joint Authority concerning the process of Indonesian disengagement from the Treaty. Indonesian representatives, including the Ambassador at Large for the Law of the Sea and Maritime Affairs, Hasjim Djalal, expressed the view that Indonesia would no longer have a role to play in the Treaty. This view was shared by the Australian Government, and after the separation of East Timor from Indonesia was completed, detailed discussions commenced with Indonesia on the mechanics of Indonesian disengagement.<sup>51</sup>

4.36 On 10 February 2000, diplomatic notes were exchanged in Dili by the United Nations Transitional Administrator, Mr Vieira de Mello, and Australia's Representative in East Timor, Mr James Batley, to give effect to a new agreement, whereby UNTAET replaced Indonesia as Australia's partner in the Treaty. Under the agreement, which was negotiated in close consultation with East Timorese representatives, the terms of the Treaty would continue to apply. In talks in Jakarta preceding the agreement, Indonesian representatives had agreed that following the separation of East Timor from Indonesia, the area covered by the Treaty was now outside Indonesia's jurisdiction and that the Treaty ceased to be in force as between Australia and Indonesia when Indonesian authority over East Timor transferred to the

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48 Mr Michael Potts, *Committee Hansard*, 11 November 1999, p. 872.

49 'Support for Timor Gap Treaty at Dili workshop', *Australian Associated Press*, 20 January 2000.

50 Mr Michael Potts, *Committee Hansard*, 11 November 1999, p. 872.

51 Mr Michael Potts, *Committee Hansard*, 11 November 1999, p. 872.

United Nations.<sup>52</sup> The Australian *Timor Gap Treaty (Transitional Arrangements) Act 2000* formalised this position.<sup>53</sup>

4.37 Under the Treaty, the industry already had provided significant employment opportunities: of the number of man days, 124,000 were Australian and 80,000 were Indonesian. Those figures covered all activities related to exploration as well as production in the Zone, to October 1999. The employment included labouring jobs; technical jobs such as in engineering; and vocational jobs such as welders, electricians, engineers and geophysicists.<sup>54</sup> For the Indonesian share of employment to be transferred to the East Timorese, there was need to assist them in obtaining the skills and the skill levels needed to take up the available employment opportunities. Australia undertook to attempt to make those same opportunities available to East Timorese workers. A World Bank survey was undertaken of the training needs of the East Timorese population, to help them participate in an independent state. Part of that was to identify the kinds of skills that they would need if they were to take advantage of the opportunities presented under the Treaty.<sup>55</sup>

4.38 Responsibility under the Treaty for determining employment shares primarily rested with the production sharing contractors, with encouragement through the Joint Authority and the Ministerial Council. Under the terms of their contract, the production sharing contractors had the objective of giving preference to employing Australian and Indonesian (now East Timorese) nationals in equal numbers, subject to the requirement of good oilfield practice. The imbalance had been in Australia's favour but was gradually moving towards Indonesia's favour with employment on the Modec venture to develop Elang-Kakatua.<sup>56</sup> Both contractors and sub-contractors were bound by these employment requirements. Contractors required competent employees with requisite skills who could observe good oil field practice and safety at all times. As few East Timorese had such skills, training was required to enable them to attain the necessary skills to participate in the oil industry.<sup>57</sup> The Committee was told:

We have also been holding discussions with the production sharing contractors in terms of whether there are opportunities for them to provide training and work experience for East Timorese. As we work our way through the Joint Authority and the workshop which we will be having in December, and as we continue with those sorts of discussions through the Ministerial Council and through the Joint Authority, we would be hoping to get an indication from the East Timorese of where their priorities lie and

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52 Minister for Foreign Affairs and Minister for Industry, Science and Resources Joint Media Release, 10 February 2000.

53 *Senate Hansard*, 13 March 2000.

54 Mr Payne, *Committee Hansard*, 11 November 1999, p. 877.

55 Mr Payne, *Committee Hansard*, 11 November 1999, p. 877.

56 Mr Kjar, *Committee Hansard*, 11 November 1999, p. 878.

57 Mr Kjar, *Committee Hansard*, 11 November 1999, p. 878.

where the industry can fit in with aid agencies - whether they be AusAID, World Bank, Asian Development Bank or the other aid and service providers.<sup>58</sup>

4.39 On 4 October 2000, Minister for Resources Senator Nick Minchin announced two initiatives under the auspices of the Timor Gap Zone of Cooperation Ministerial Council. Funding of \$US700,000 per annum would be provided out of Joint Authority revenues for the following two years to train East Timorese in administration and policy development in relation to the Timor Gap Treaty and the resources covered by it. Also, a steering committee would be formed to look at petroleum related training and employment for East Timorese in the Timor Gap petroleum fields and associated areas.<sup>59</sup>

### **Attitude of the East Timorese**

4.40 A *CNRT Statement on Timor Gap Oil* dated 22 July 1998, signed by Dr Ramos-Horta, Dr Mari Alkatiri and Mr João Carrascalão said:

The National Council of Timorese Resistance will endeavour to show the Australian Government and the Timor Gap contractors that their commercial interests will not be adversely affected by East Timorese self-determination. The CNRT supports the rights of the existing Timor Gap contractors and those of the Australian Government to jointly develop East Timor's offshore oil reserves in cooperation with the people of East Timor.

4.41 The Committee was assured that there was a spirit of goodwill by all the parties for projects under the Treaty regime to proceed successfully. According to Mr Stephen Payne, General Manager, Petroleum Exploration and Development Branch, Department of Industry, Science and Resources:

We certainly recognise the importance of that stability and predictability for a project like Bayu-Undan, which is a massive project. With the first phase of it, you are looking at \$US1.4 billion and you are looking at long-lived projects so companies, understandably, need stability so they can make their decisions on investments. We have had indications from the East Timorese leadership ... that they are conscious of the need for the Treaty to continue to operate in a way that companies understand and which is predictable.<sup>60</sup>

4.42 With respect to future developments, Mr Payne told the Committee that Australia's approach had always been that there ought to be one set of rules for all projects under the Treaty, as had been the case with Indonesia. He said that Phillips had received an assurance from the East Timorese leadership, which had been taken into account before the companies made their decision to commit to the first stage of

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58 Mr Kjar, *Committee Hansard*, 11 November 1999, p. 878.

59 *Senate Hansard*, 4 October 2000, p. 17785.

60 Mr Michael Potts and Mr Payne, *Committee Hansard*, 11 November 1999, p. 876.

the Bayu-Undan project. The terms of that assurance talked about future projects as well as existing ones.<sup>61</sup>

4.43 At the hearing on 18 November 1999, Mr Abel Guterres, Chairman of the East Timor Relief Association, told the Committee:

Touching a little bit on the Timor Gap Treaty, I am sure the leadership has expressed that the bulk of the agreement will remain. But a time will come when people in the leadership will express their views on the subject. At this stage not a lot has been discussed because everyone is concentrating very much on the emergency needs of that population, that is, shelter and food. Hopefully, by some time next year, once UNTAET takes over, we can get that planning and those processes in train ... I do not think we would touch on the core aspect of the agreement because it is a waste of time ... I think there could be concerns in terms of taxation and royalties that may go to East Timor in terms of increase.<sup>62</sup>

4.44 The Committee was assured by the Attorney-General's Department that there were no legal barriers to East Timor and Australia signing off on a future agreement on the Zone of Co-operation.<sup>63</sup>

4.45 The East Timorese spokesman on Timor Gap matters, Dr Mari Alkatiri, stated on 10 November 1999 in reference to the letter to Phillips Petroleum signed by Mr Gusmão, Dr Ramos-Horta and himself giving an assurance that they would honour the Treaty arrangements:

Yes, it was sent ... but that doesn't mean we have already accepted the Treaty as it is. It's not a problem of oil and gas, it's a problem of maritime borders ... I think we have to redefine, renegotiate the border later on when East Timor becomes independent.<sup>64</sup>

In a further statement in Jakarta on 29 November 1999, Dr Alkatiri said:

We still consider the Timor Gap Treaty an illegal treaty. This is a point of principle. We are not going to be a successor to an illegal treaty.

Dr Alkatiri said the East Timorese were willing to make transitional arrangements so that existing operators could continue their projects. Negotiations between the United Nations, Portugal and Australia were under way to sort out intermediate arrangements, he said.<sup>65</sup>

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61 Mr Payne, *Committee Hansard*, 11 November 1999, pp. 876-7.

62 Mr Guterres, *Committee Hansard*, 18 November 1999, pp. 927, 937.

63 Mr Campbell, *Committee Hansard*, 11 November 1999, p. 883.

64 Paul Tait, 'East Timor backs gas project but warns on treaty', *Reuters*, 10 November 1999.

65 Karen Polglaze, 'Future of Timor Gap Treaty thrown into doubt', *Australian Associated Press*, 29 November, *The Sydney Morning Herald*, 30 November 1999.

4.46 The Treaty was designed to expire after 40 years, in 2029. At that time, if not before, the contracting parties would have the options of renewing it for a further twenty years, re-negotiating the Treaty as an interim arrangement, or attempting to negotiate a seabed treaty. It is important to note that the boundaries of Zone A, the shared area, were drawn with reference to the seabed boundary between Indonesia and Australia agreed to in 1972, which is closer to Indonesia than the mid-point between the two countries. If the Treaty were re-negotiated so that Zone A was shifted to sit closer to Australia astride the mid-line with East Timor, or if the Treaty were replaced by a seabed treaty which took the mid-line as the boundary, East Timor would come into possession of the bulk of the prospective hydrocarbons deposits.<sup>66</sup> Alternatively, there could be re-negotiation of the respective shares of revenue from the Zone going to both parties: Dr Ramos-Horta declared on 7 May 2000 that East Timor was entitled to up to 90 per cent of the revenues.<sup>67</sup> It should be noted that the Treaty covered revenue sharing arrangements only for petroleum; natural gas revenues were not explicitly included in the Treaty, although the Committee was told at the hearing on 11 November 1999 that ‘the approach had always been that there ought to be one set of rules for all projects under the Treaty ... That helps companies when they are making the major investment decisions that they do when you are talking about oil and gas developments’.<sup>68</sup>

4.47 On 15 June 2000, Dr Alkatiri announced CNRT policy on the Treaty. The CNRT would be seeking, prior to UNTAET relinquishing its mandate, a new seabed boundary drawn an equal distance between East Timor and Australia as the starting point for negotiations on a new oil and gas revenue-sharing agreement. He said: ‘We are not thinking of renegotiation but a new treaty. Of course, some of the terms will be the same but the starting point needs to be the drawing of a maritime boundary between our countries and that means the Treaty would not have any effect any more’.<sup>69</sup>

4.48 Dr Alkatiri was visiting Canberra as part of an UNTAET team to negotiate with Australia on a new treaty. Another member of the team, UNTAET’s Director of Political Affairs Peter Galbraith, made a statement following the talks, saying:

What UNTAET seeks is what the East Timorese seek. The East Timorese leadership has made it clear that the critical issue for them is to maximise the revenues of the Timor Gap. The legal situation is this: UNTAET has to continue the terms, but only the terms of the old Timor Gap Treaty and only

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66 Andrew McNaughtan, ‘New nation has opportunity for gains in the Gap’, *The Sydney Morning Herald*, 13 April 2000.

67 ‘Ramos-Horta calls on Australia to renounce Timor Gap oil treaty’, *Agence-France Presse*, 8 May 2000.

68 Mr Payne, *Committee Hansard*, 11 November 1999, pp. 876-7; ‘Bayu-Undan Project Good for East Timor—Phillips Petroleum CEO’, *Dow Jones*, 27 June 2000.

69 Peter Alford and Robert Garran, ‘East Timor wants new gap treaty’, *The Australian*, 15 June 2000; Rod McGuirk, ‘Downer stresses need for stability in Timor Gap’, *AAP*, 15 June 2000.

until independence. Therefore a new regime will have to be in place on the date of independence.<sup>70</sup>

4.49 The Australian Government's position was stated by a spokesman for Foreign Minister Alexander Downer on 11 July 2000, who said that Australia 'understands the discussion or debate is about the share of revenue; it's not delimitation of the seabed'.<sup>71</sup>

4.50 Speaking at a CNRT congress in Dili on 26 August 2000, Dr Alkatiri said East Timor wanted its maritime boundary with Australia to be equidistant between the two countries, which would put all the current oil and gas activity in the Timor Gap on East Timor's side. He stressed the need for a new legal instrument so as not to retroactively legitimise the 1989 Treaty: 'We refuse to accept that East Timor be the successor to Indonesia to the Treaty'.<sup>72</sup> Mr Galbraith said in a radio interview on 10 October 2000:

UNTAET's position, acting on behalf of the East Timorese people, is that the royalties and the tax revenue from the area north of the mid-point should come to East Timor, and if there is not going to be a maritime delimitation East Timor, however should have the same benefit as if there were a maritime delimitation. That, after all is what East Timor is entitled to under international law.<sup>73</sup>

4.51 In the same interview, Mr Galbraith said that any state, including the independent country of East Timor, had the option of going to the International Court of Justice to seek a maritime delimitation. 'Hopefully', he said, 'it won't come to that because an agreement acceptable to the East Timorese will be negotiated and in place by independence'.

4.52 On 18 September 2000, Foreign Minister Alexander Downer, Resources Minister Nick Minchin and Attorney General Daryl Williams announced that Australian officials would travel to Dili for a preliminary round of negotiations over three days from 9 October with UNTAET and East Timorese representatives on rights for future exploration and exploitation for petroleum in the Timor Gap. The Ministers said the aim of the talks was to reach agreement on a replacement for the Timor Gap Treaty to enter into force on East Timor's independence. 'It is expected there will be several rounds of talks', they said. 'Australia currently has an agreement with UNTAET which provides for the continued operation of the terms of the Timor Gap Treaty originally negotiated with Indonesia. It will expire on the date East Timor

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70 Mark Dodd, 'Timor Gap deal set to deliver windfall for Dili', *The Sydney Morning Herald*, 21 June 2000.

71 Ray Brindal, 'Australia says revenue, not border, focus of Timor talks', *Dow Jones Newswires*, 14 July 2000.

72 'Dili & Canberra to begin sea boundary talks in October', *Kyodo*, 28 August 2000; 'East Timor: Oil Negotiations with Australia to begin in October', *Lusa*, 28 August 2000.

73 *Asia Pacific*, 10 October 2000.

becomes independent.’ The Ministers said it was necessary to avoid a legal vacuum and to provide commercial certainty for the petroleum industry operating in the gap: ‘The eventual export of petroleum by pipeline from the Timor Gap to Darwin would bring considerable benefits in terms of Australian regional development. It is very important that there is a seamless transition or arrangements governing petroleum exploitation in the Timor Gap. These negotiations are a first step in that direction.’<sup>74</sup>

4.53 As already mentioned, there are two ways of providing East Timor with a better deal than the present 50:50 split as set out in the Timor Gap Treaty:

- by opting for a mid-point delimitation in a seabed boundary treaty rather than the joint co-operation zone on which the Timor Gap Treaty was based; or
- by providing East Timor with a generous share of the royalties derived from Area A in the joint zone of co-operation in a renewal of the present treaty - in effect, abolishing the distinction between ZOC A and ZOC C.

4.54 The Law of the Sea Convention, which entered into force in 1994, is not prescriptive about the basis for delimitation. Article 83 (1) reads:

The delimitation of the continental shelf between States with opposite or adjacent coasts shall be effected by agreement on the basis of international law, as referred to in Article 38 of the Statute of the International Court of Justice, in order to achieve an equitable solution.<sup>75</sup>

4.55 Article 38 of the Statute of the International Court of Justice reads:

The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:

- a. international conventions, whether general or particular, establishing rules expressly recognized by the contesting states;
- b. international custom, as evidence of a general practice accepted as law;
- c. the general principles of law recognized by civilized nations;
- d. subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.

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74 Minister for Foreign Affairs, ‘Timor Gap Treaty Negotiations to Begin’, media release, 18 September 2000; ‘Renegotiation of Timor Gap treaty to begin’, *AAP*, 18 September 2000.

75 Article 83 (1) in the Informal composite negotiating text, Document A/CONF.62/WP.10 of 15 July 1977 of the Law of the Sea Conference read: ‘The delimitation of the continental shelf between adjacent or opposite States, shall be effected by agreement in accordance with equitable principles, employing where appropriate, the median or equidistant line, and taking account all the relevant circumstances’. The reference to the ‘median or equidistant line’ was omitted in the final version of the Convention. The 1977 draft was included as Appendix II in the report of the Joint Committee on Foreign Affairs and Defence, *Australia, Antarctica and the Law of the Sea, Interim Report*, 1978.

2. This provision shall not prejudice the power of the Court to decide a case *ex aequo et bono*, if the parties agree thereto.

4.56 Although the Law of the Sea Convention does not prescribe the median point for delimitation purposes, the median point is now generally accepted as the basis for delimitation. It should be noted that Australia adopted the median line in 1981 as the fisheries boundary.

4.57 If the midpoint were adopted as the basis for delimitation purposes in a seabed boundary between Australia and East Timor, the current ZOC A would be located in East Timorese territory. It could also have implications for the boundary between Australia and Indonesia as the new Australia-East Timor boundary would be south of the two tripoints marking the Timor Gap in the Australia-Indonesia boundary. This could lead to Indonesian claims for a revision of its boundary with Australia. There could also be other ramifications.

4.58 In view of current international law, if the boundary between Australia and East Timor were confirmed as being a more or less straight line between the two tripoints marking the Timor Gap in the Australia-Indonesia boundary, Australia would be under at least a moral obligation to direct most of the revenue flowing from oil and gas production in Area A to East Timor. The ratio of 90:10, as claimed by East Timor, would not be unreasonable.

4.59 The Committee believes that it is in Australia's interest for East Timor to become a viable nation; one that does not remain a mendicant state and one that can play a constructive role in regional affairs. In one way or another, Australia has had an association with East Timor for almost 60 years and, for about half of that time, not one which has been particularly creditable to Australia. Although Australia did much to regain its reputation through its role in the establishment and deployment of Interfet, it has an opportunity in current negotiations on the Timor Gap Treaty to cement its future relations with East Timor.

4.60 Australian policy towards East Timor has often been characterised as one in which pragmatism, expediency and short-term self-interest have prevailed at the expense of a more principled approach. As is now evident, such foreign policy characteristics have not always been in Australia's long-term interests. By acting honourably and taking account of current international law, the Australian Government might not only earn the good will of East Timor but also of other interested parties, as well as providing East Timor with an economic basis on which it might be able to reduce its dependency on foreign aid. Any such reduction would, of course, also benefit Australia. However, the Committee does not believe that foreign aid should be used as a lever in the current negotiations.

4.61 The commercial operators have expressed concern relating to the outcome of the negotiations. In the event of unduly protracted negotiations, commercial operators could defer further decisions on investment in the Timor Sea. Any such decision would undoubtedly have adverse effects for both East Timor and Australia. In addition, as indicated by Mr Peter Galbraith, East Timor could also take the matter to

the International Court of Justice should it regard Australia as being unduly intransigent. Such a course of action, which could result in lengthy proceedings, would be inimical to Australia's interests and international standing.

4.62 In the Committee's view, it is incumbent on Australia at this time to act generously towards East Timor to provide it with the means by which it can develop a society and economy in keeping with the region. The revenues from oil and gas royalties would inevitably become the cornerstone of its future economic and social development.

### **Recommendation**

**The Committee RECOMMENDS that, in its negotiations with UNTAET on the future of the Timor Gap Treaty, the Australian Government should take into account current international law in relation to seabed boundaries, the history of our relations with the East Timorese people, the need to develop good bilateral relations with East Timor and the need for East Timor to have sources of income that might reduce dependency on foreign aid.**

Cartography by Chandra Jayasuriya originally prepared for: Victor Prescott, 'East Timor's Potential Maritime Boundaries', presented at *East Timor and its Maritime Dimensions: Legal and Policy Implications for Australia*, Australian Institute of International Affairs, Canberra, 14 June 2000.