

Timor Sea Treaty  
Submission No: .....36.....

**Worthington, Glenn (REPS)**

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**From:** Stephen Brand  
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**Subject:** JSCOT Submission

July 30, 2002

Committee Secretary  
Joint Standing Committee on Treaties  
Department of House of Representatives  
Parliament House  
Canberra, ACT

Attached please find a submission from the Bayu-Undan joint venture participants, Phillips Petroleum Company (91-12) Pty Ltd, Phillips Petroleum ZOC, Phillips Petroleum Timor Sea Pty Ltd, Agip Australia 91-13 Limited, Inpex Sahul Ltd, Santos (JPDA 91-12) Pty. Ltd. and Petroz (Timor Sea) Pty. Ltd. with regard to the Timor Sea Treaty. Should you have any queries please contact me.

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**SUBMISSION BY THE BAYU-UNDAN JOINT VENTURE PARTICIPANTS  
TO THE  
JOINT STANDING COMMITTEE ON TREATIES**

**PERTH  
July 2002**

## 1. INTRODUCTION

As the Unit Operator of the Bayu-Undan field, Phillips Petroleum (91-12) Pty Ltd (Phillips) welcomes this opportunity to submit our comments as the Joint Standing Committee on Treaties (JSCOT) considers the Timor Sea Treaty. This submission is made on behalf of Phillips and its Bayu-Undan co-venturers, Santos, Inpex, Agip, Petroz, and potential new participants Tokyo Electric Power Company and Tokyo Gas.

The Timor Sea, where this group of companies is developing the Bayu-Undan field, contains hydrocarbon reserves of regional and global significance. Full development of the Bayu-Undan reserves will provide opportunity and value for all stakeholders.

For the new nation of East Timor, the Bayu-Undan reserves offer the prospect of a high degree of economic and fiscal self-reliance. Development of these reserves will stimulate new investments and employment and provide a secure revenue stream for Government. They offer the opportunity to rebuild and regenerate the country's economy and shattered infrastructure.

For Australia, Bayu-Undan and other Timor Sea gas reserves can pave the way for new export industries and a vigorous and a more competitive domestic gas market, as well as providing a significant source of government revenue.

For the private sector, the Timor Sea gas reserves – estimated at 22 trillion cubic feet – are a significant commercial opportunity, with the potential to supply growing markets in Asia, and North America as well as Australia.

The Timor Sea Treaty, now being considered for ratification by the JSCOT, provides the framework that will enable Australia and East Timor to develop these major oil and gas deposits.

### Our Focus: Timing

The background to this important Treaty has no doubt been covered in more detail in other submissions to you. This submission focuses particularly on the advantages of the Treaty and the importance that we attach to its prompt ratification.

The Bayu-Undan project has a history that goes back more than ten years, but it is only in the past nine months that we found solutions to a series of difficult issues that, at various stages, seriously threatened development of the resource.

Also during the past nine months, we have been able to complete negotiations for the sale of the Bayu-Undan gas. The Bayu-Undan field is now fully commercialised - we

are committed to the delivery of liquefied natural gas (LNG) by January 2006 to Japanese customers. To meet this deadline and avoid substantial delay from the onset of the wet season, we must begin construction on the LNG plant in November of this year. But prudence and internal co-venturer approval processes dictate that we cannot commence construction without adequate assurances of the legal and fiscal outcomes of our investment.

In this regard, we are concerned by any suggestion that progress on any other matter would influence your views on the process for completing legislation for ratification of the Treaty. This would seem to be contrary to the Memorandum of Understanding between the governments of Australia and East Timor Concerning an International Unitisation Agreement (IUA), signed in Dili on May 20th, 2002, by the Prime Ministers of both countries, where it is stated that: *"The conclusion of the Agreement is without prejudice to the early entry into force of the Treaty and that the parties will work expeditiously and in good faith to satisfy their respective requirements for the entry into force of the Treaty"*

This understanding is very important as it removes the possibility of unforeseen delays. Again, our submission strongly supports ratification of the Treaty as soon as possible with no impact on the timing of the IUA negotiations.

## **2. THE IMPORTANCE OF BAYU-UNDAN**

The Bayu-Undan field is located in the Joint Petroleum Development Area (JPDA) defined by Article 3 of the Treaty. It contains estimated reserves of 400 million barrels of condensate and liquefied petroleum gas and 3.4 trillion cubic feet of natural gas. The field is located in 80 metres of water about 500 kilometres northwest of Darwin and 250 kilometres south of Suai in East Timor.

Our vision is to develop Bayu-Undan in two phases. The first, which has already commenced, is a gas-recycle project. Gas recovered will be stripped of liquids and then reinjected into the reservoir. The liquids will be sold. Liquid production from this field is expected to commence in early 2004 and will peak at around 110,000 barrels per day of condensate and LPG.

The second and larger part of the vision is, instead of reinjecting the Bayu-Undan gas, to pipe that gas to an onshore LNG plant in Darwin for export to Japan. Bayu-Undan is contracted to supply 3 million tonnes of LNG a year to Tokyo Electric Power Company and Tokyo Gas for a period of 17 years commencing in January 2006. This contract is expected to use nearly 100 per cent of the Bayu-Undan reserves.

### Importance to East Timor

Bayu-Undan is vital to the economic well being of the people of East Timor, not only over its first years of its independence but for the longer term.

For a government needing to rebuild the country's entire economic and social infrastructure, taxation and royalty payments from Bayu-Undan will almost certainly represent its biggest source of revenue.

In addition to royalties and taxation revenue of \$US 2.5 - 3 billion flowing directly to the East Timor government over the 17-plus years life of the project, the Bayu-Undan participants pledged direct investment of around \$US13 million in associated project and community infrastructure and training, and \$US44 million in ongoing expenditure over the 20-year life of the project.

Our direct investment associated with this project is specifically designed to bring wider economic and social benefits to East Timor:

- First, it will provide infrastructure such as a port, airport and health facilities, which will be available to the community at large.
- Second, our training and infrastructure strategies are directly linked to East Timor's national development objectives.
- Last, there will also be multiplier benefits from local wages and service industry growth as it will employ East Timorese and expatriate labour, off-shore and onshore, during both development and operation.

We gave a high priority to reaching agreement with East Timor authorities on terms and conditions for the employment of East Timorese. We already have more than 30 employees from East Timor.

An underlying principle of our engagement in East Timor is facilitation of other new business activity, both by East Timorese and foreign investors. We want our engagement and actions to encourage others.

### Importance to Australia

Australia has a very significant financial and strategic interest in seeing Bayu-Undan developed as soon as possible. It will help underwrite a secure and independent East Timor, a matter that Australia acknowledges to be of great strategic significance.

Further, Bayu-Undan will bring substantial benefits to Australia in its own right. It will generate some \$A2 billion in taxation and royalty revenue for the Australian Government over the life of the project. It will create a large number of jobs with the

installation of a major LNG plant in Darwin. It also opens the possibility that natural gas from the Timor Sea region could be brought onshore for supply to identified gas customers in the Northern Territory and south and southeast Australia. The potential impact on the future economy of Darwin is enormous.

### 3. HISTORY OF THE TREATY

The need for a Treaty goes back to 1972 when Australia and Indonesia agreed on their mutual seabed boundaries.

That 1972 agreement "was based on the 1958 Convention on the Continental Shelf which said that states should control the sea to the limits of their continental shelf, the place where the sea floor drops away to the deep ocean. The arrangement creates a boundary much closer to Indonesia than Australia, giving Australia control over the major part of the Timor Sea. Portugal (the colonial power in East Timor) argued that the boundary between Australia and East Timor should be based on the principle of a median (mid-way) line. Thus there was a gap in the line drawn between Indonesia and Australia in 1972 – the so-called Timor Gap." (Dr Stephen Sherlock, Foreign Affairs, Defence and Trade Group, Research Note no. 45 2001-02)

Indonesia inherited the Timor Gap dispute after it invaded East Timor in December 1975. It was not until 1986 that Indonesia and Australia agreed that negotiations could proceed. They lasted until 1989, when a compromise agreement was finally achieved with the signing of the "Treaty between Australia and the Republic of Indonesia on the Zone of Cooperation in an area between the Indonesian province of East Timor and Northern Australia". This allowed for joint exploitation of oil and gas resources in the area of overlapping claims.

Exploration activity in the Production Sharing Contracts that contain Bayu-Undan began in 1991. The Bayu-Undan discovery was made in December 1995.

On October 25, 1999, following the overwhelming vote for independence and six days after the Indonesian People's Consultative Assembly endorsed the East Timorese ballot results, the UN Security Council adopted Resolution 1272 (1999) establishing the United Nations Transitional Administration in East Timor (UNTAET). UNTAET would be "endowed with overall responsibility for the administration of East Timor and will be empowered to exercise all legislative and executive authority including the administration of justice."

On 6 December 1999, Foreign Minister Downer informed Parliament that: "On 17 November the Indonesian Government confirmed ...that the Treaty is no longer between Indonesia and Australia. During the course of last week, I discussed the

Treaty arrangements with Sergio de Mello, the special representative of the Secretary General for East Timor. The UN is willing to act for East Timor as Australia's treaty partner during the transitional phase. Thereafter, the treaty will be a matter for an independent East Timor. The East Timorese have confirmed to us their acceptance of these transitional processes." (Hansard, 6 December 1999).

In that role, UNTAET assumed responsibility for East Timor's interests under the Timor Sea Treaty, including the Joint Petroleum Development Area (JPDA). Ministers of the first and second East Timor Transitional governments were closely involved and made all decisions affecting development of offshore oil and gas reserves.

Australia and the first Transitional Government agreed at an early stage that the terms of the Treaty would remain in place until a new Treaty was signed with the independent Government of East Timor. To allow planning to proceed, East Timor entered into negotiations in October 2000 over arrangements governing the JPDA. These negotiations culminated in a new Timor Sea Arrangement (signed on 5 July 2001), which outlined the framework for a treaty to cover the joint development of resources in the Timor Sea.

The Arrangement, however, changed the revenue share between East Timor and Australia from petroleum development activities in the JPDA from 50/50 to 90/10. This change had a significant impact on the Bayu-Undan participants, making the project uneconomic because of the much greater exposure to higher taxation rates in East Timor.

The resulting negotiations with the governments of East Timor and Australia have been very fluid and complex. In East Timor, negotiations were conducted by a transitional government, with no existing system of law or regulatory framework in place. Indeed the whole system of government, including the supporting administrative systems, had unfortunately been destroyed. The East Timor government and their advisers had the task of building a new nation from naught, and in a very short time.

Our interest in the negotiations was to achieve sufficient regulatory and fiscal certainty that we could confidently enter into commercial contracts and make the necessary investments that would enable us to honour those contracts.

An agreement between East Timor and the Bayu-Undan participants was possible only because ultimately each of the parties to the negotiations was prepared to take a broad view of the development and work towards an agreement that achieved a balanced outcome for all stakeholders. In this spirit of partnership and with a new degree of openness and trust, the East Timor and the Bayu-Undan participants finalised a mutually satisfactory Understandings Agreement in December 2001.

That arrangement requires, among other things, variations to the Production Sharing Contract and the East Timor tax regime. We expect that documentation of all these arrangements will be complete by the end of August.

#### **4. THE NEED FOR CERTAINTY**

Phillips and the other Bayu-Undan participants support the Timor Sea Treaty as signed on 20 May 2002.

It provides a comprehensive regulatory framework covering matters such as development and production, the marine environment, employment, health and safety of workers, surveillance, security, search and rescue and air traffic services as well as the avoidance of double taxation in the application of the taxation laws of East Timor and Australia. The treaty also provides for the creation of a petroleum mining code. A taxation code for the avoidance of double taxation has been developed and forms Annex G of the Timor Sea Treaty.

As noted, the Bayu-Undan gas reserves are now fully commercialised and, with proper assurances on legal and fiscal matters, is ready to proceed. Ratification of the Treaty is essential to give us the legal framework on which to proceed in time for us to meet our contractual obligations. There is no room for slippage if we are to have LNG in Darwin ready for export to Japan in January 2006.

Our contractual obligations require us to begin construction by November of this year to avoid substantial delay from the onset of the wet season. A delay in ratification would have serious financial consequences, not only for both Phillips and its participants but also East Timor for which the need for employment and revenue generation is pressing. A delay would also have a detrimental impact on the economy of the Northern Territory, particularly the Darwin area.

Complete regulatory certainty and full ratification of the Timor Sea Treaty is essential for the Board of Directors of Phillips and the boards of our Bayu-Undan participants to confidently approve the investments and financing that are necessary for a project of this magnitude to proceed.

Stephen R Brand  
President  
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