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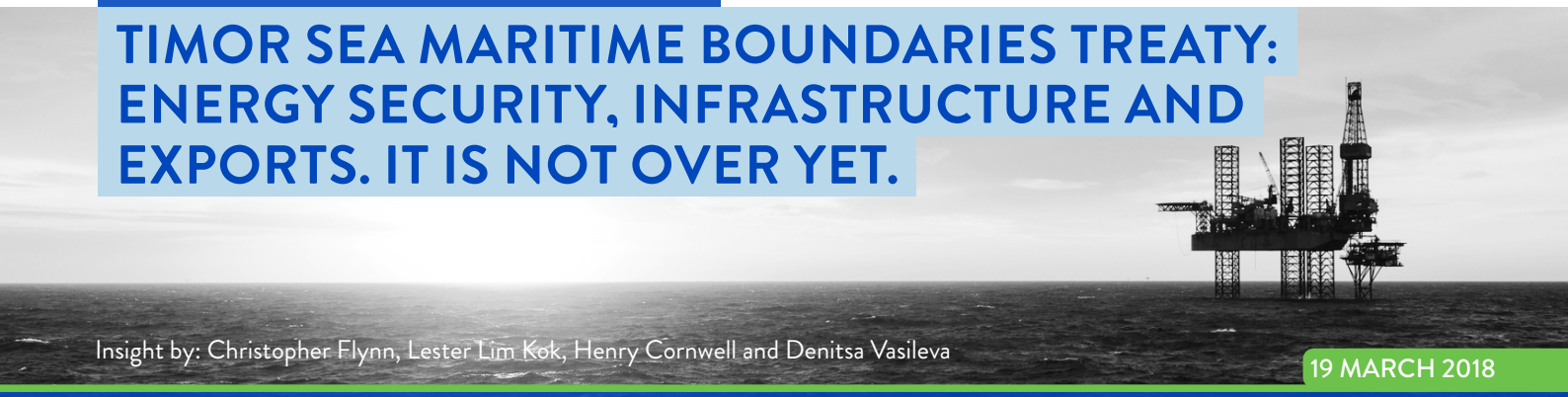
CLIENT UPDATE

TIMOR SEA MARITIME BOUNDARIES TREATY: ENERGY SECURITY, INFRASTRUCTURE AND EXPORTS. IT IS NOT OVER YET.



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19 MARCH 2018

*After a long and difficult history, on 6 March 2018, the Democratic Republic of Timor-Leste (**Timor-Leste**) and the Commonwealth of Australia (**Australia**) (together, the **States**) signed their new Treaty Establishing Maritime Boundaries in the Timor Sea (the **Treaty**).*

Signing of the Treaty marks the culmination of the conciliation proceedings between Timor-Leste and Australia. A Conciliation Commission (the **Commission**) established pursuant to the *United Nations Convention on the Law of the Sea* (**UNCLOS**)[1] under Permanent Court of Arbitration (**PCA**) administration facilitated the proceedings. It was the first conciliation process to occur under UNCLOS.

At the time of writing this article, the parliaments of each State are yet to ratify the Treaty.[2] Once in force, the Treaty will replace the 2002 Timor Sea Treaty[3] and the 2003 International Unitisation Agreement for Greater Sunrise.[4] The 2006 Treaty on Certain Maritime Arrangements in the Timor Sea (**CMATS**)[5] was terminated on 10 January 2017 as part of the conciliation process.

KEY IMPLICATIONS OF THE TREATY

+ In essence, Australia has abandoned its historically expansive claims in the Timor Sea and settled those claims with Timor-Leste on more generally accepted bases of public international law. This is consistent with Australia's strong foreign policy emphasis on maintaining the international rules-based order in the Asia Pacific in light of the potential for significant changes to that order with the re-emergence of China as the region's dominant state actor.[6]
+ The focus now turns to the trilateral negotiations between the States and the Woodside-led Greater Sunrise Joint Venture (the **Joint Venture**)[7] on the development of the Sunrise and Troubadour gas fields (**Greater Sunrise**) under the special regime established by the Treaty (the **Special Regime**). Striking a balance between commercially efficient development of Greater Sunrise, and the broader economic, political and strategic interests of Timor-Leste's economic development, will be an important challenge going forward, with potential ramifications for the Australia-Timor-Leste relationship, energy security and the broader foreign policy posture of both States.
+ Timor-Leste will associate a significant strategic premium with any liquefied natural gas (**LNG**) project that it believes carries the potential to improve its economic independence. That is a strategic premium that is very likely not factored into more traditional 'rational' economic models (such as those traditionally favoured by Western project sponsors, investors and financiers). That premium also carries with it the potential to reduce or re-direct its reliance on foreign aid, particularly from Australia (along with the implicit political conditionality of foreign direct aid).[8]
+ The Government of Timor-Leste is likely to remain committed to Timor-LNG and its efforts to stimulate much needed economic development on its south coast. Projects like Timor-LNG often require ancillary infrastructure like roads, power stations, water and sewage systems. Economics permitting, this infrastructure may also be able to be deployed, at least to some extent, for the benefit of the immediate local area. Timor-Leste will be aware of these benefits. The risk for Australia is the extent to which those benefits may be able to be provided by non-Western state-backed rivals with a lower

economic cost of capital or a higher strategic appetite for such investments. That is, if Australia insistently requires Greater Sunrise's gas be processed at Darwin, it could sacrifice some of its broader strategic imperatives in East Timor.

+ More broadly still, Australia has long held the position that it is in Australia's national security interests to remain part of the energy security equation in the Asia Pacific region.[9] It is natural that Timor-Leste will adopt the same position for itself with respect to its own hydrocarbon resources. Tactically, as our region changes, Australia should be motivated to combine these two objectives as practicably and best it can.

BACKGROUND TO THE TREATY

The Treaty ends more than 45 years of dispute and negotiation between Australia and Portugal, Indonesia and finally Timor-Leste, over their respective boundaries in the Timor Sea, and rights to its potential wealth. From the 1960s, negotiations with Portugal (Timor-Leste's former colonial ruler) were characterised by a game of diplomatic cat-and-mouse, as both parties responded to the evolving doctrines of the law of the sea. In late 1975, one week after Timor-Leste's unilateral declaration of independence from Portugal, Indonesia invaded Timor-Leste.

Australia and Indonesia signed 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* in 1989, which entered into force in 1991. Under that treaty, Australia and Indonesia agreed to delimit their permanent maritime boundaries at a later date, but declared a 'Zone of Cooperation' over a section of the Timor Sea, from which oil revenues were to be shared 50:50.

In 2002, following Timor-Leste's independence from Indonesia in 1999, the States agreed the Timor Sea Treaty. Under that treaty, the Joint Petroleum Development Area (**JPDA**) was declared, from which petroleum produced was to be shared 90:10 in Timor-Leste's favour. Again, however, no permanent boundary was decided.

In 2006, the States entered into CMATS, which provided for equal distribution of revenue from Greater Sunrise and placed a 50-year moratorium on negotiating a maritime boundary between Australia and Timor-Leste. In 2013, Timor-Leste commenced proceedings at the PCA seeking to invalidate CMATS, on the basis that Australia's alleged spying on Timor-Leste's negotiators in 2004 contravened the requirement under the *Vienna Convention on the Law of Treaties*[10] that treaties be negotiated in good faith.

Timor-Leste initiated conciliation proceedings on 11 April 2016 by way of a 'Notification Instituting Conciliation under Section 2 of Annex V of UNCLOS'. A Conciliation Commission was subsequently constituted on 25 June 2016. The Commission's role was to meet openly with the States to hear their views and propose a recommended non-binding settlement for their dispute.[11] The Commission was empowered to provide documents to the States and make proposals with a view to reaching an amicable settlement.[12]

On 9 January 2017, six months after the PCA's award in *The Republic of Philippines v The People's Republic of China* (the **South China Sea Arbitration**)[13] (see our Insight on that significant ruling), Australia agreed to abandon CMATS as part of a 'good faith' breakthrough in the proceedings, in particular in return for Timor-Leste abandoning its espionage claims. This cleared the way for a final and permanent agreement on maritime boundaries and the regime for developing Greater Sunrise achieved in the Treaty.

DELIMITATION OF MARITIME BOUNDARIES

Notably, the Treaty's recitals expressly reference Articles 74(1) and 83(1) of UNCLOS. Those Articles provide that exclusive economic zones (**EEZs**) and continental shelves are to be delimited 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.

The Treaty delimits, for the first time, the permanent maritime boundaries in the Timor Sea between the States, including the continental shelf boundaries (which entails the right to exploit seabed resources, such as petroleum) and the EEZ boundaries (which entails the right to exploit resources in the water column, such as fisheries) between the States. These boundaries depart from the limits of the existing JPDA (which will cease to have effect once the Treaty comes into force), and confirm Timor-Leste's sovereignty over the area encompassing the JPDA as well as the areas in which the majority of Greater Sunrise is located. The Treaty establishes a boundary between the States the southern aspect of which is broadly consistent with the median line between the States' adjacent coasts. This follows the equidistance principle under UNCLOS and customary international law.[14]

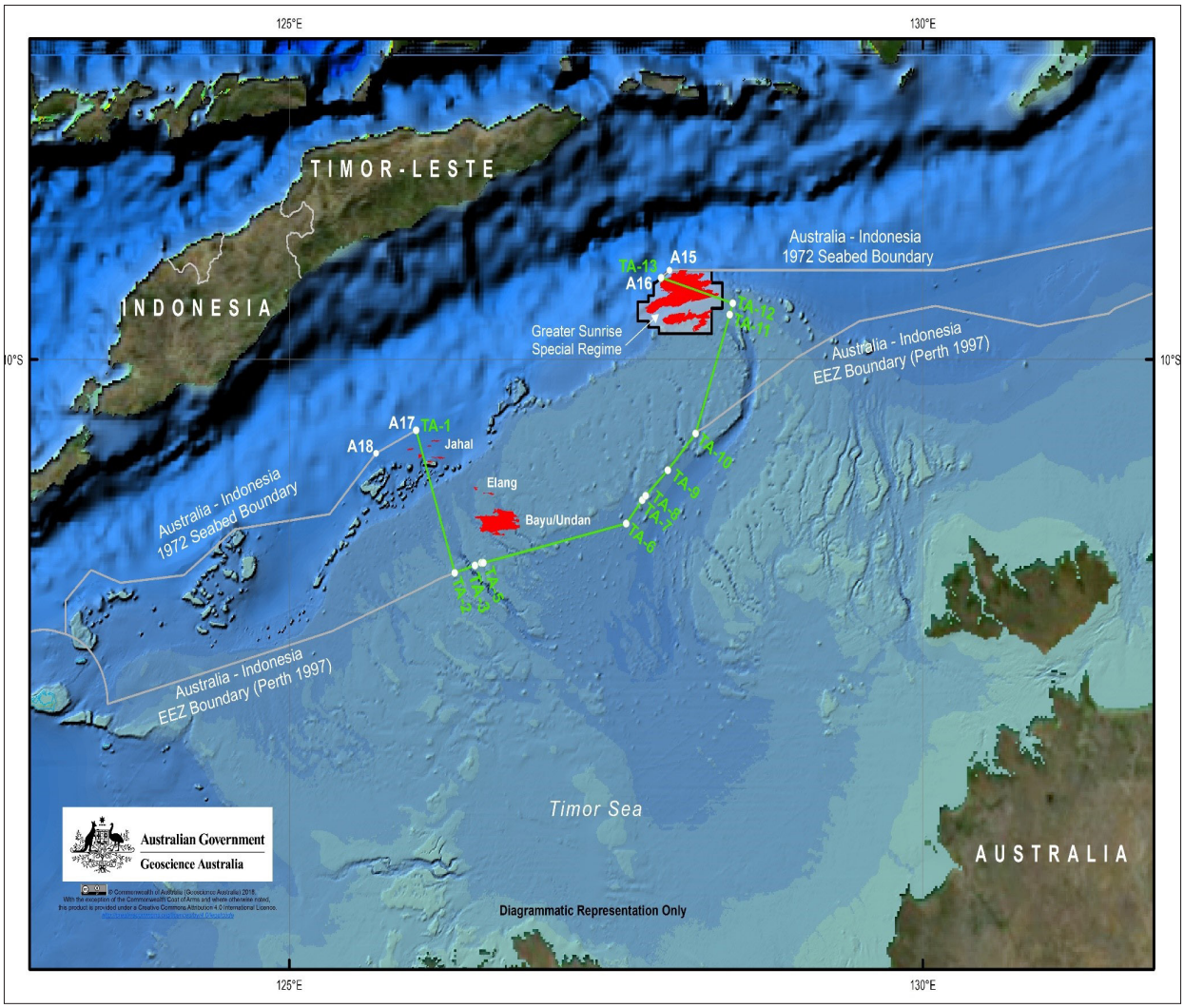
Importantly, the western and eastern lateral boundaries under the Treaty connect with the pre-existing continental shelf boundary between Australia and Indonesia agreed in 1972.[15] This means that the Australia-Indonesia seabed boundary is not prejudiced, nor does the Treaty prejudice any rights Indonesia has under existing arrangements with Australia.[16]

Australia's Foreign Minister Julie Bishop has announced that the Australian Government will look at resulting 'technical' changes to the EEZ between Australia and Indonesia.[17] It remains to be seen how Indonesia will react to the Treaty, and the extent to which it will seek to reopen discussions with Australia regarding the international maritime boundaries between those two countries.

The Treaty also contains an innovative mechanism for adjusting the agreed continental shelf boundary at such time as Timor-Leste and Indonesia agree a permanent boundary between them. This is unusual for delimitation treaties of this kind and is an important feature aimed at ensuring the Treaty's permanence.

Under this mechanism, the western border would swing to the west, and the eastern border would straighten to meet the border ultimately agreed between Timor-Leste and Indonesia. This could result in 'widening Timor-Leste's "window" on the Timor Sea', which would itself redefine the Timor Gap.[18] Any readjustment can only take place once the Greater Sunrise fields have been commercially depleted. The States may also agree to extend the EEZ boundary agreed under the Treaty.[19]

The green line in the following map depicts the boundaries established under the Treaty:



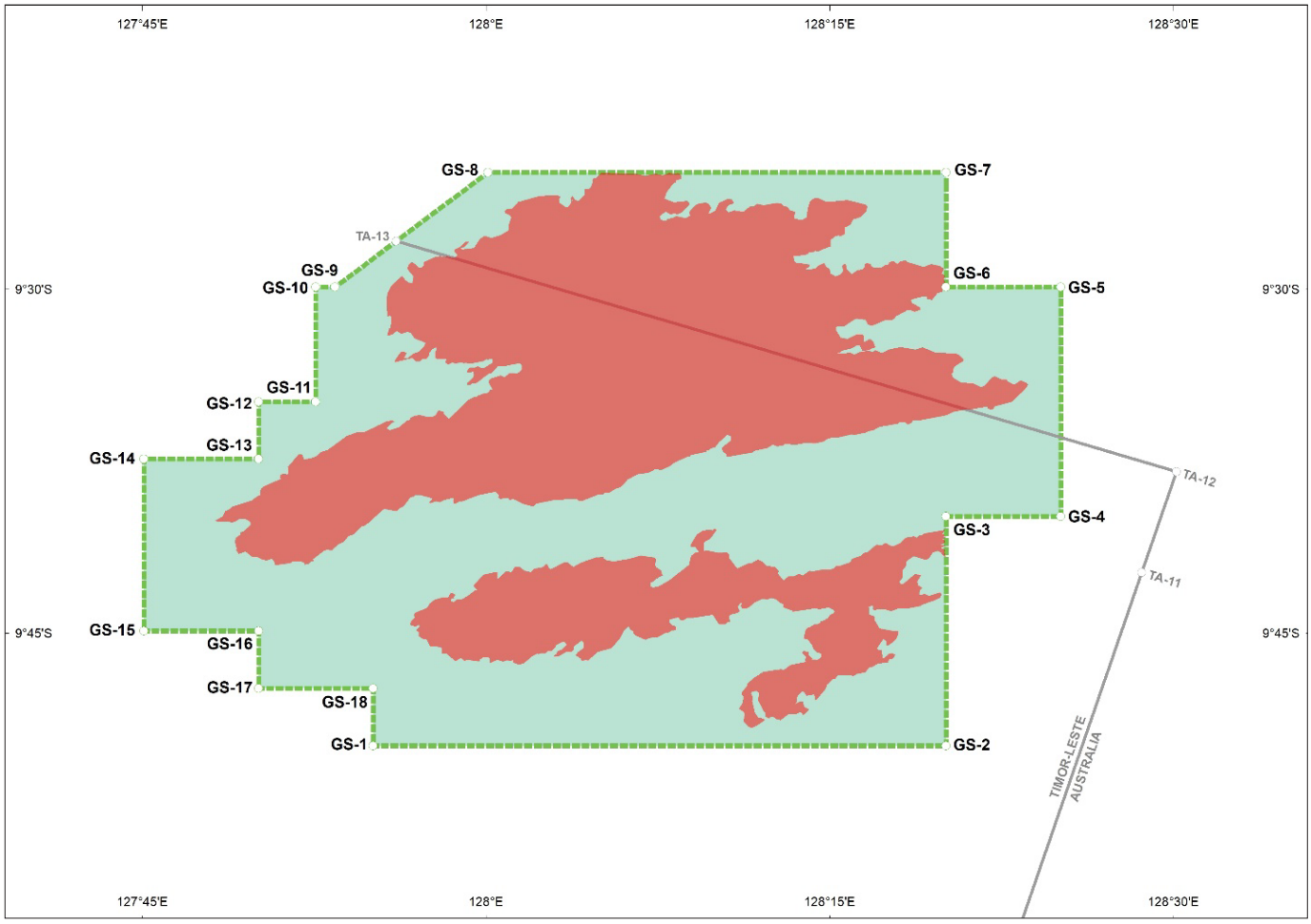
Source: Geoscience Australia; Department of Foreign Affairs and Trade

Together with the Special Regime, the new boundaries promise significant material benefits for Timor-Leste. In light of the country's long struggle against first Portuguese and then Indonesian occupation, formalising its southern boundary also represents an important symbolic milestone in its continued path to sovereignty. As former Timor-Leste Prime Minister Rui Maria de Arujo has articulated it, *'establishing permanent boundaries is a matter of national priority for Timor-Leste as the final step in realising our sovereignty as an independent state.'*[20]

DEVELOPMENT OF GREATER SUNRISE

The Special Regime replaces the existing arrangements governing the development and exploitation of hydrocarbons produced from Greater Sunrise. The Special Regime will govern the joint development and management of Greater Sunrise hydrocarbon resources for the benefit of both States. It contemplates different 'development concepts' and revenue sharing arrangements between the States, and so provides a framework for resolving the important question of whether gas produced from the Greater Sunrise fields will be piped to Beaco, on the south coast of Timor-Leste, or Darwin for processing. While the framework requires this question to be resolved according to commercial principles, the answer to that question will have significant downstream impacts for both States and the Joint Venture.

The Special Regime covers the area of the continental shelf depicted in the following map:



Source: Treaty, Annex C (Special Regime Area).

Title to hydrocarbons

The Treaty recognises both States' respective rights over Greater Sunrise hydrocarbon resources,[21] with the majority of Greater Sunrise falling within the sovereign territory of Timor-Leste, as illustrated in the map above.

Revenue sharing

The States have agreed to share revenue derived directly from upstream exploitation of hydrocarbons produced from Greater Sunrise. Upstream revenue is limited to first tranche petroleum, profit petroleum and taxation.

The actual proportion of revenue received by each State depends on the location for processing any hydrocarbons extracted from Greater Sunrise.

If Greater Sunrise is developed with a pipeline to a new LNG processing plant to be constructed onshore Timor-Leste (**Timor-LNG**), Timor-Leste will receive 70% of government revenue derived from Greater Sunrise, and Australia 30%. This roughly reflects the territorial division of the Greater Sunrise fields under the Treaty. Alternatively, if a pipeline is connected to the existing Darwin LNG processing plant (**Darwin-LNG**), Timor-Leste would receive 80% of revenues, with 20% for Australia.[22]

The Commission has estimated that the incremental 10% to Timor-Leste would amount to between USD 3.134 billion and USD 3.539 billion in additional revenue to Timor-Leste over the life of the Greater Sunrise project.[23] According to the Commission, that amount effectively matches the total capital investment that Timor-Leste has estimated for all south coast infrastructure projects, other than installation of the LNG plant itself. The additional revenue available to Timor-Leste could therefore be allocated to infrastructure and industrial development initiatives on Timor-Leste's south coast.[24] While either model will be a significant improvement for Timor-Leste on the 50/50 split under CMATS, Timor-Leste remains committed to developing appropriate infrastructure to process and export Greater Sunrise's gas onshore Timor-Leste.

Regulatory structure

The Special Regime establishes a two-tiered regulatory structure, comprising a Designated Authority and a Governance Board.[25] The Designated Authority (Timor Leste's Autoridade Nacional do Petróleo e Minerais) will regulate and manage hydrocarbon activities in the Special Regime Area, among other functions.[26] It will report to the Governance Board, comprising one representative appointed by Australia and two appointed by Timor-Leste.

The Governance Board will provide strategic oversight over the Special Regime and make decisions on 'strategic issues', including assessing and approving a development plan for Greater Sunrise and the construction and operation of a pipeline for transporting its hydrocarbons.[27] Its decisions are to be made by consensus.[28] Disputes among or between the States and the Governance Board and any failure to reach consensus within the Governance Board are to be resolved by a dispute resolution committee comprising either a representative of each State and an independent appointee of either those representatives in agreement, or in the case of disagreement, an appointee of the Secretary-General of the PCA.[29]

Development of Greater Sunrise

The States have not agreed on the development concept for Greater Sunrise, including whether gas from Greater Sunrise will be processed in Timor-Leste or Australia (see our discussion on this point below). Instead, the Treaty includes a mechanism for the States to engage with the Joint Venture participants on development proposals. Specifically, the Treaty requires that:

+ the Designated Authority will enter into a production sharing contract with the Joint Venture participants for the development of and production from Greater Sunrise, as soon as practicable;[30] and
+ the States, through the Designated Authority, will engage with the Joint Venture participants to agree a plan to develop Greater Sunrise, in accordance with the criteria and process set out in the Treaty.[31] Importantly, that development plan must, among other things:
  - support the development objectives and needs of each of Timor-Leste and Australia while at the same time providing a fair return to the Joint Venture participants;
  - demonstrate that it can deliver significant contributions to the sustainable economic development of Timor-Leste, including through measurable and enforceable local content commitments;
  - demonstrate that the project is commercially and technically feasible, and that the Joint Venture participants are financially and technically competent to carry out the development; and
  - indicate whether the Joint Venture participants have entered into binding, arms-length arrangements for sales and/or processing of gas produced from Greater Sunrise.[32]

The Special Regime also addresses issues relating to jurisdiction, customs and migration, quarantine, environmental protection and management, vessels and decommissioning obligations relating to Greater Sunrise. The Special Regime remains in force until the Greater Sunrise fields are commercially depleted.

Existing activities

The Treaty provides that the existing arrangements relating to the Buffalo oil field, which previously fell within Australian jurisdiction will now be within the continental shelf of Timor-Leste, and so will transition to Timor-Leste's exclusive jurisdiction.[33] Once the Treaty enters into force, Timor-Leste will receive all future upstream revenue derived from petroleum activities from the Bayu-Undan gas field and Kitan oil field.[34] The Treaty also provides for certain transitional arrangements for those fields.[35]

The Treaty also bars the States from making claims against each other relating to the cessation of the JPDA and the establishment of the continental shelf boundary under the Treaty.[36]

LNG processing

The Treaty does not resolve a critical question of the dispute: whether gas from Greater Sunrise will be developed at Beaco or Darwin. The Timor-LNG project would involve constructing an LNG plant and associated facilities at Beaco, as well as various ancillary infrastructure projects along the south coast of Timor-Leste. Using Darwin-LNG facilities would involve tying-in Greater Sunrise to the existing Bayu-Undan pipeline that currently transports gas produced from the ageing Bayu-Undan gas field to the Darwin-LNG processing facility at Wickham Point, where the gas produced from Greater Sunrise would be processed for export as LNG.

The Australian Government's commitment to Darwin-LNG

If the plan to process Greater Sunrise gas at Darwin-LNG goes ahead, the Australian Government has committed to contribute USD 100 million toward a domestic gas pipeline to Timor-Leste, as well as various other commitments to support the development of the Timorese petroleum sector and the use of the south coast of Timor-Leste as a petroleum hub for the Timor Sea and surrounding areas. This includes a dedicated visa and labour scheme to provide Timor-Leste citizens access to employment in the onshore petroleum sector in the Northern Territory.[37] Further, under the Darwin-LNG model, the Joint Venture participants have committed to:[38]

+ locating various operations for the Greater Sunrise project in Timor-Leste;
+ funding for a domestic gas pipeline to Timor-Leste; and
+ various other matters relating to equity participation by Timor-Leste in the project, employment, supply sourcing, local content commitments and support for the development of the petroleum sector in Timor-Leste.

For Australia, piping gas from Greater Sunrise to Darwin-LNG would ensure the continued productive utilisation of that plant following the depletion of the Bayu-Undan gas field,[39] with its associated economic efficiencies as well as preserving existing jobs in the Northern Territory.

Joint Venture participants' preference for Darwin-LNG

No doubt, the preference of the Joint Venture participants for Darwin-LNG involves the greater economic certainty and efficiency involved in using existing infrastructure compared to the possible additional costs and timeframes to undertake a greenfield project in Timor-Leste.

These conditions may be compounded by the current state of LNG markets. In recent years, low LNG prices have discouraged investment in new production. As a result, the global market for LNG is expected to hit a shortfall in 2023. Developing a new field typically takes four to five years. Achieving a 2023 deadline for bringing Greater Sunrise online is important as new projects in Papua New Guinea and Qatar are also anticipated to come online within a similar timeframe. This means time is of the essence for Timor LNG. Work would need to start as soon as possible.

This time pressure is compounded by the technical difficulty that Australia and the Joint Venture say would be involved in constructing a pipeline through the Timor Trough,[40] if Timor-LNG were to proceed.[41] However, it would not be the first time an LNG project has been undertaken in a developing country. It has been done before and many have been successful. The market-leading PNG LNG facility is a case in point. There are also other notable examples in Africa.

The Bayu-Undan field is expected to be exhausted some time between 2022 and 2023. ConocoPhillips, the operator of the Bayu-Undan project, will likely look for new supplies to feed its export plant from 2023. Of course, considering the Bayu-Undan field is Timor-Leste's only existing source of oil and gas, achieving the 2023 deadline should also be a priority for the Government of Timor-Leste.

The Commission's assessment

Prior to the signing of the Treaty, the Commission prepared a 'Condensed Comparative Analysis of Alternative Development Concepts' and a 'Commission Paper on the Comparative Development Benefits of Timor-LNG and Darwin-LNG'. These were made public along with the terms of the Treaty on 6 March 2018. These documents do not make recommendations regarding Greater Sunrise's development. Nevertheless, its comparison of the two concepts firmly favours Darwin-LNG. This is partly because the Commission assessed that Timor-LNG would require a direct subsidy of approximately USD 5.6 billion, which would otherwise be available for other development investment. More importantly, based on independent advice, it concluded that if Australia and Timor-Leste decide to proceed with Timor-LNG, the development of Greater Sunrise may not go ahead at all.[42] Timor-Leste strongly disagrees with that conclusion.

Two models have been considered for Timor-LNG: an 'integrated project' revenue model, in which upstream and downstream returns are combined; or a 'tolling project' revenue model, in which a fee would be paid to the downstream plant for LNG processing.

Critically, the Commission concluded that as an integrated project, Timor-LNG would generate a return in the order of 7% on a capital investment of USD 15.621 billion. According to the Commission, *'[t]his would not be sufficient to meet the industry standard for investment by an international oil company.'* A tolling fee higher than USD 2.50 per MMBtu would involve a return on

the upstream project that would not be investable for the Joint Venture participants or other private sector actors.[43]

As a tolling project, the Commission estimates that Timor-LNG would, with a toll of USD 2.00 per MMBtu (which would fall within industry standard levels), *'have a negative return of minus 4% on a capital investment of USD 7.142 billion.'*[44] Alternatively, if the Timor-Leste Petroleum Fund (Timor Leste's sovereign petroleum wealth fund) were to invest in the project with its target rate of return of 4%, the Commission estimates that Timor-LNG would need to charge a tolling fee of at least USD 3.50 per MMBtu (USD 1 per MMBtu higher than commercial investors would tolerate). The Commission also concluded that:

> *'In order to achieve a return of 7% to permit [commercial] debt financing or the equity participation of an experienced operator, the Commission anticipates that the Timor-LNG would need to charge a tolling fee of at least USD 4.50.'*

This would be USD 2 per MMBtu higher than commercial investors would tolerate.

Timor-Leste's reaction to the Commission's assessment

> *'The Commission opted for the easiest way out, which is a shame as in my perception it reveals a lack of impartiality on your behalf!'* – *Xanana Gusmão*

A letter from former Timor-Leste President, former Prime Minister and Chief Negotiator for Timor-Leste, Xanana Gusmão, leaked just a few days before the Treaty was to be signed, was scathing in its accusations that Australia had colluded with the Joint Venture participants, that the Commission lacked impartiality, and that the Commission had made conclusions on behalf of the people of Timor-Leste based on superficial assessments rather than through careful consideration of Timor-Leste's stated position.[45]

Xanana Gusmão's allegations suggest that, at least for Timor-Leste, not all of the matters in dispute are quite settled yet.

Implications for Australia and Timor-Leste

UNCLOS and the international rules-based order

Australia is a vocal advocate of the 'international rules-based order' as the framework for trade and dispute resolution in international politics. It also supported the PCA's decision in the South China Sea Arbitration. In addition to public pronouncements on various matters, the centrality of this principle to Australian foreign policy going forward is also evidenced in the Australian Government's 2017 Foreign Policy White Paper (the **White Paper**).[46]

The South China Sea Arbitration ruling iterated the central role and comprehensive scope of UNCLOS as the basis on which states may delimit their maritime boundaries together with the principles to be applied in doing so. Since that ruling, Australia has encouraged China and other states to act consistently with international law in disputes over maritime boundaries in the South China Sea, specifically in accordance with the PCA's ruling on the principles that govern the determination of states' maritime boundaries under UNCLOS.[47]

Consequently, the South China Sea Arbitration and, in particular, the PCA's position on reservations to UNCLOS, carried with it significant implications for Australia's position in its long-running dispute with Timor-Leste on the delimitation of the maritime boundaries between the States, and which culminates in the signing of the Treaty. It would have been very difficult for Australia to maintain its position with respect to its claims in the Timor Sea while also encouraging China to comply with the PCA's decision.

Australia's strategic and foreign policy interests

Australia has a strong interest in a prosperous and stable Timor-Leste. In a geopolitical environment where the key economies and powers in Asia (particularly China and India) are taking a 'strategically oriented' approach to energy security, rather than the 'market oriented' approach traditionally favoured by the West,[48] the Treaty comes at an important time for Australia as a regional energy power. Timor-Leste has a strong interest in the secondary economic benefits Timor-LNG would bring to it. From Timor-Leste's perspective it is not difficult to see how those benefits, including in-country training, skills and secondary infrastructure may outweigh the value of the additional 10% in revenue and other incentives offered to it to support Darwin-LNG.

Importantly, abandonment of the licence to Greater Sunrise, as the Commission predicts may happen if Timor-Leste were to block Darwin-LNG, would not necessarily prevent Timor-LNG from surviving in another form. A Greater Sunrise/Timor-LNG project may be economic for competitors to Western oil companies (particularly state-owned entities from non-Western countries), with lower costs of capital and lower operating costs. Likewise, the states from which those companies typically come take a more strategic approach to energy security (rather than the more market oriented approach favoured in the West). Consequently, they may be prepared to wear and support certain additional direct economic costs to secure an additional reliable supply of LNG (or to deprive their rivals of that supply), particularly given the anticipated global LNG shortfall in 2023. Access to port infrastructure and other assets may also place a strategic premium on an otherwise uneconomic investment. In this context, it bears repeating that Timor-Leste's south coast is less than 400 nautical miles from Australia and sits on the Indonesian archipelago. The Timor Sea is one of many potential strategic chokepoints scattered throughout Southeast Asia.

Naturally, the Government of Timor-Leste is determined to see Timor-LNG go ahead. The project would create employment opportunities for many people and facilitate market-driven economic development of the area with improvements in infrastructure, education and knowledge transfer being some of the side benefits. Timor-Leste has invested considerable financial and political capital in the development of its south coast. This includes the development of costly infrastructure premised on the development of an LNG liquefaction facility. The country's 2015 budget allocated USD 433 million for spending on related projects between 2015 and 2019, accounting for about 14% of the country's total capital spending in that period.[49] To date, many of the indirect economic benefits of those projects have landed offshore, as contracts have been won by overseas rather than domestic companies, including Chinese state owned enterprises.[50]

Timor-LNG would bring broad structural, political and economic benefits that would be difficult to quantify. In particular, installing an LNG facility would necessitate the installation of major infrastructure including power stations, sewage treatment systems, running water and other works. All of these facilities can provide ancillary benefits to local communities. Given Timor-Leste's relatively high costs of capital and minimal existing economic activity, these projects would be significantly more expensive on a standalone basis in the absence of a primary project such as Timor-LNG, and not be worth undertaking in the absence of an existing economic rationale.

It is highly likely that the Government of Timor-Leste has determined that the windfall generated by receiving 80% of proceeds from Darwin-LNG would be insufficient to purchase those ancillary benefits. This would lead to the conclusion that the additional costs of undertaking Timor-LNG would ultimately be outweighed by its long-term secondary economic benefits.[51] Timor-Leste will associate a significant premium with any project that carries the potential to improve its economic independence. That is a strategic premium that is very likely not factored into any purely 'rational' economic models (such as those traditionally favoured by Western project sponsors, investors and financiers). That premium also carries with it the potential to reduce or re-direct its reliance on foreign aid, particularly from Australia (along with the implicit conditionality of direct aid).[52]

The Government of Timor-Leste is likely to remain committed to Timor-LNG and its efforts to stimulate much needed economic development on its south coast. Australia has long held the position that it is in Australia's national security interests to remain part of the energy security equation in the Asia Pacific region.[53] It is natural that Timor-Leste will adopt the same position for itself with respect to its hydrocarbon resources.

China is already a very significant investor in Timor-Leste. Its interests include investments in key and strategic infrastructure.[54] It has also long been a supporter of East Timorese sovereignty and interests. This dates to the international community's tacit support of Indonesia's invasion of East Timor, at a time when China – economically weak, geopolitically isolated and conscious of recent western incursions in Korea and Vietnam – was particularly eager to assert the international legal principle of non-aggression. Since independence, Timor-Leste has managed competing Australian and Chinese interests adroitly.

Although the Treaty currently enjoys bipartisan support, Timor-Leste will be returning to the polls on 12 May 2018. This presents a potential ratification risk, particularly if the issue is politicised in the lead-up to the election. Xanana Gusmão is deeply respected in Timorese politics, even by his opponents. Since the Treaty was signed, he has promised to 'continue to struggle to draw the pipeline to East Timor.'[55]

Akin to a founding father of Timor-Leste for his role in leading the nation's resistance movement against Indonesian occupation, it is very likely that ratification of the Treaty will depend on his approval, regardless of his party's success at this year's elections. If another regional power can offer Timor-LNG, the Parliament of Timor-Leste may use ratification as a bargaining chip. Australia will not be the only regional power who has been watching developments closely. Though remote, ratification risk adds to Australia's imperative to continue to work with Mr Gusmão's delegation to achieve broader economic outcomes for Timor-Leste.

Sovereign risk

Now that third parties – the Joint Venture participants – have been brought into the decision-making process for developing Greater Sunrise, Australia and Timor-Leste will need to work hard to achieve an outcome that is consistent with each of their respective economic and energy policy settings. If the Greater Sunrise fields are to be developed, the Joint Venture participants must be satisfied that the project would be profitable, and involve an acceptable level of risk. With a known sovereign risk in Timor-Leste and a perceived sovereign risk in Australia through, for example, the recent introduction of the Australian Domestic Gas Security Mechanism,[56] the commercial viability of either country hosting the processing facilities might be harder to calculate.

ENDNOTES

[1] *United Nations Convention on the Law of the Sea*, opened for signature 10 December 1982, 1833 UNTS 3 (entered into force 16 November 1994).

[2] Elections are due to be held in Timor-Leste on 12 May 2018, that may delay the ratification of the Treaty by Timor-Leste's parliament.

[3] Timor Sea Treaty between the Government of East Timor and the Government of Australia, signed 20 May 2002, 2258 UNTS 3 (entered into force 2 April 2003).

[4] Agreement between the Government of Australia and the Government of the Democratic Republic of Timor-Leste relating to the Unitisation of the Sunrise Troubadour Fields, signed 6 March 2003, 2483 UNTS 317 (entered into force 23 February 2007).

[5] Treaty between Australia and the Democratic Republic of Timor-Leste on Certain Maritime Arrangements in the Timor Sea, signed 12 January 2006, 2483 UNTS 359 (entered into force 27 June 2006).

[6] The position has been particularly pronounced since the Permanent Court of Arbitration's ruling in the *South China Sea Arbitration (Philippines v China)* (Award) (Permanent Court of Arbitration, Case No 2013-19, 12 July 2016). See our Insight on the South China Sea Arbitration available at our website. It has been brought to the fore by the Australian Government's 2017 Foreign Policy White Paper.

[7] At the time of writing this article, the Sunrise Joint Venture participants are Woodside (operator) 33.44%, ConocoPhillips 30%, Shell 26.56% and Osaka Gas 10%.

[8] See, generally, Department of Foreign Affairs and Trade, *Overview of Australia's Aid Program to Timor-Leste* (2018) <https://dfat.gov.au/geo/timor-leste/development-assistance/Pages/development-assistance-in-timor-leste.aspx>.

[9] John Mitchell, Koji Morita, Norman Selley and Jonathan Stern, *The New Economy of Oil: Impacts on Business, Geopolitics and Society* (Royal Institute of International Affairs and Earthscan: London, 2001).

[10] *Vienna Convention on the Law of Treaties*, opened for signature 23 May 1969, 1155 UNTS 331 (entered into force 27 January 1980).

[11] UNCLOS, Annex V, Article 6.

[12] UNCLOS, Annex V, Rules of Procedure.

[13] *South China Sea Arbitration (Philippines v China) (Award)* (Permanent Court of Arbitration, Case No 2013-19, 12 July 2016).

[14] Article 15 of UNCLOS provides that failing agreement to the contrary, the territorial seas of neighbouring states are to be delimited by a 'median line every point of which is equidistant from the nearest points on the baselines from which the breadth of the territorial seas of each of the two States is measured'. In contrast, the provisions relating to the delimitation of EEZs and continental shelves are more broadly espoused. Articles 74 and 83 of UNCLOS provide that the delimitation 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. See also *Maritime Delimitation in the Black Sea (Romania v Ukraine) (Judgement)* [2009] ICJ Rep 61, 101 [115]-[116]; *Dispute Concerning the Delimitation of the Maritime Boundary between Bangladesh and Myanmar in the Bay of Bengal (Bangladesh/Myanmar)* ITLOS Judgement of 14 March 2012, 72-6 [225]-[240]; *Case Concerning Maritime Dispute (Peru v Chile)* [2014] ICJ Rep 4, 64-71; *In the Matter of the Bay of Bengal Maritime Boundary Arbitration (Bangladesh v India) Award of United Nations Convention on the Law of the Sea* Annex VII Tribunal, 7 July 2014 [341,345]-[341,346].

[15] Agreement between the Government of the Commonwealth of Australia and the Government of the Republic of Indonesia establishing Certain Seabed Boundaries in the Area of the Timor and Arafura Seas, Supplementary to the Agreement of 18 May 1971, signed 9 October 1972, 974 UNTS 319 (entered into force 8 November 1973).

[16] Treaty, Article 6(1).

[17] Primrose Riordan, 'Indonesia border deal may be tweaked, Julie Bishop says', *The Australian* (online), 19 March 2018 <https://www.theaustralian.com.au/national-affairs/foreign-affairs/indonesia-border-deal-may-be-tweaked-julie-bishop-says/news-story/f92ee0a38335bbb45cf3fea86e092508>.

[18] Treaty, Article 3. See also Clive Schofield and Rebecca Strating, *Timor Gap: a boundary, yet disputes linger* (The Interpreter, Lowy Institute, 7 March 2018) <https://www.lowyinstitute.org/the-interpreter/timor-gap-boundary-yet-disputes-linger>. Bilateral boundary negotiations between Timor-Leste and Indonesia commenced in late 2015, however are yet to be concluded.

[19] Treaty, Article 4(2).

[20] Rebecca Strating, Law of the Sea: *Settling the Australia and Timor-Leste Dispute* (Australian Institute of International Affairs, 13 September 2017) <https://www.internationalaffairs.org.au/australianoutlook/law-sea-settling-aus-timor-dispute>; Clive Schofield and Rebecca Strating, *Timor Gap: a boundary, yet disputes linger* (The Interpreter, Lowy Institute, 7 March 2018) <https://www.lowyinstitute.org/the-interpreter/timor-gap-boundary-yet-disputes-linger>.

[21] Treaty, Annex B, Article 2(1).

[22] Treaty, Annex B, Article 2(2).

[23] Conciliation Commission, *Commission Paper on the Comparative Development Benefits of Timor-LNG and Darwin-LNG* (22 February 2018) <https://pcacases.com/web/sendAttach/2303>, 2.

[24] Conciliation Commission, *Commission Paper on the Comparative Development Benefits of Timor-LNG and Darwin-LNG* (22 February 2018) <https://pcacases.com/web/sendAttach/2303>, 2.

[25] Treaty, Annex B, Article 5.

[26] Treaty, Annex B, Article 6.

[27] Treaty, Annex B, Article 7.

[28] Treaty, Annex B, Article 7(6).

[29] Treaty, Annex B, Articles 7, 8.

[30] Treaty, Annex B, Article 4. The conditions of the production sharing contract must be equivalent to those in Production Sharing Contracts JPDA 03-19 and JPDA 03-20, and to the rights under retention leases NT/RL2 and NT/RL4 in accordance with Article 22 of the Timor Sea Treaty and Article 27 of the International Unitisation Agreement.

[31] Treaty, Annex B, Article 9.

[32] Treaty, Annex B, Article 9.

[33] Treaty, Annex D, Article 4.

[34] Treaty, Annex D, Article 1.

[35] Treaty, Annex D, Article 2.

[36] Treaty, Article 10.

[37] Conciliation Commission, *Commission Paper on the Comparative Development Benefits of Timor-LNG and Darwin-LNG* (22 February 2018) <https://pcacases.com/web/sendAttach/2303>, 3-4.

[38] Conciliation Commission, *Commission Paper on the Comparative Development Benefits of Timor-LNG and Darwin-LNG* (22 February 2018) <https://pcacases.com/web/sendAttach/2303>, 2-3.

[39] This is assuming replacement gas is procured until actual processing of hydrocarbons from Greater Sunrise takes place. See Angela Macdonald-Smith, 'ConocoPhillips, Santos push ahead with $500m plan to develop Barossa gas field', *The Australian Financial Review* (online), 8 March 2018 <http://www.afr.com/business/energy/gas/conocophillips-santos-push-ahead-with-500m-plan-to-develop-barossa-gas-field-20180308-h0x6yw>.

[40] The Timor Trough is a 3,500-metre trench 40 nautical miles from the coastline of Timor-Leste. It divides the Timor Plate to its north from the Australian Plate to its south.

[41] See Clive Schofield and Rebecca Strating, *Timor Gap: a boundary, yet disputes linger* (The Interpreter, Lowy Institute, 7 March 2018) <https://www.lowyinstitute.org/the-interpreter/timor-gap-boundary-yet-disputes-linger>.

[42] Conciliation Commission, *Commission Paper on the Comparative Development Benefits of Timor-LNG and Darwin-LNG* (22 February 2018) <https://pcacases.com/web/sendAttach/2303>, 4.

[43] Conciliation Commission, *Commission Paper on the Comparative Development Benefits of Timor-LNG and Darwin-LNG* (22 February 2018) <https://pcacases.com/web/sendAttach/2303>, 5.

[44] Conciliation Commission, *Commission Paper on the Comparative Development Benefits of Timor-LNG and Darwin-LNG* (22 February 2018) <https://pcacases.com/web/sendAttach/2303>, 5.

[45] Peter Lloyd, 'East Timor accuses Australia of colluding with companies over Greater Sunrise oil and gas deal', *ABC News* (online), 7 March 2018 <http://www.abc.net.au/news/2018-03-06/east-timor-acuses-australia-of-collusion/9519530>.

[46] Commonwealth of Australia, 2017 *Foreign Policy White Paper* (Canberra, November 2017).

[47] See, for example, Minister for Foreign Affairs, 'Australia supports peaceful dispute resolution in the South China Sea' (Media Release, 12 July 2016).

[48] John Mitchell, Koji Morita, Norman Selley and Jonathan Stern, *The New Economy of Oil: Impacts on Business, Geopolitics and Society* (Royal Institute of International Affairs and Earthscan: London, 2001).

[49] Asian Development Bank, 'Growing the Non-Oil Economy: A Private Sector Assessment for Timor-Leste' (2015) <https://www.adb.org/sites/default/files/institutional-document/161516/tim-growing-non-oil-economy.pdf>, 13.

[50] La'o Hamutuk, 'South Coast Petroleum Infrastructure Project' (19 September 2011, updated 19 June 2016) <https://www.laohamutuk.org/Oil/TasiMane/11TasiMane.htm#hwytender>.

[51] According to a 2015 report by the Asian Development Bank, a comprehensive cost-benefit analysis of the project has not been prepared: see Asian Development Bank, 'Growing the Non-Oil Economy: A Private Sector Assessment for Timor-Leste' (2015) <https://www.adb.org/sites/default/files/institutional-document/161516/tim-growing-non-oil-economy.pdf>, 13. According to the Commission, 'a number of consultant reports have endeavoured to quantify the broader economic benefits to Timor-Leste of Timor-LNG or the benefits to Australia of LNG operations in Darwin. The Commission recalls that earlier in these proceedings both governments agreed that such economic effects are difficult to quantify with precision. This continues to be the case': see Conciliation Commission, *Commission Paper on the Comparative Development Benefits of Timor-LNG and Darwin-LNG* (22 February 2018) <https://pcacases.com/web/sendAttach/2303>, 2.

[52] See, generally, *Department of Foreign Affairs and Trade, Overview of Australia's Aid Program to Timor-Leste* (2018) <https://dfat.gov.au/geo/timor-leste/development-assistance/Pages/development-assistance-in-timor-leste.aspx>.

[53] John Mitchell, Koji Morita, Norman Selley and Jonathan Stern, *The New Economy of Oil: Impacts on Business, Geopolitics and Society* (Royal Institute of International Affairs and Earthscan: London, 2001).

[54] La'o Hamutuk, 'South Coast Petroleum Infrastructure Project' (19 September 2011, updated 19 June 2016) <https://www.laohamutuk.org/Oil/TasiMane.htm#hwytender>.

[55] Oki Raimundos, 'Hero's welcome for East Timor border negotiator Xanana Gusmao', *The Sydney Morning Herald* (online), 12 March 2018 <https://www.smh.com.au/world/oceania/hero-s-welcome-for-east-timor-border-negotiator-xanana-gusmao-20180312-p4z3vy.html>.

[56] The Australian Domestic Gas Security Mechanism (**ADGSM**) is an initiative of the Australian Government that provides the federal Minister for Resources the power to restrict exports of LNG in the event of a forecast shortfall for the domestic market in any given year ('shortfall year'). If a shortfall year is declared, LNG exporters would be required to either limit their exports or to find new sources of gas to offset the impact on the domestic market. While the ADGSM was implemented as a temporary measure, there is a possibility that the ADGSM is still in place when production commences from the Greater Sunrise fields.

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