Timor Sea Treaty

Submission No: 51

SHELL DEVELOPMENT (AUSTRALIA) PTY LTD

Submission to the Joint Standing Committee on Treaties

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1. Summary

Shell has been a partner with Australia in the development of oil and gas reserves in this country for over 100 years. Our operations today cover the full range of oil and gas activities, from exploration and production to refining and retail. In addition to our refineries and other facilities around the country, Shell has corporate offices in Melbourne, Perth, and Darwin. Shell employs about 20,000 people in Australia (direct and indirect) and pays approximately $400 million in income taxes per year.

Shell is a joint venture participant in many of the major offshore oil and gas fields in Australia, including the NorthWest Shelf and Gorgon off the coast of West Australia, and Greater Sunrise, Evans Shoal and Laminaria/Corallina in the Timor Sea.

1. Greater Sunrise Development

The Greater Sunrise gas fields, comprising the Sunrise and Troubadour reservoirs, were discovered in 1974 approximately 450 km north west of Darwin and 150 km south of East Timor. The reserves extend over a large area, approximately 70 km long, 35 km wide, and up to 2 km deep. Because of its remote location, flat geological structure, relatively low level of condensate, and limited market opportunities, Sunrise is a difficult development prospect.

Shell and the joint venture participants worked for over 3 years and spent approximately $200 million to bring Sunrise gas to shore. Shell and Woodside embarked on extensive marketing efforts, involving over 30 potential customers in the Northern Territory and Southeast Australia. We found no credible combination of domestic gas sales to support development.

In mid-2001, Shell proposed a floating LNG development for Sunrise. FLNG is an innovative synergy of three well-established technologies: (i) the proven, safe and reliable floating production and storage vessels used for oil production around the world, (ii) LNG shipping, and (iii) LNG plant design, in which Shell has been a world leader since 1968. By integrating these technologies, Shell is developing a safe, cost-effective, and environmentally friendly solution for unlocking a large base of stranded gas. FLNG is expected to deliver over $30 billion in export revenues and approximately $8 billion in taxes to Australia and East Timor. However, the market opportunity for this production is limited.

Nevertheless, in an effort to achieve joint venture alignment and to ensure that we have done all that is possible to meet stakeholder interests, Shell and the Sunrise joint venture participants embarked on a full review of the potential for a domestic gas market for Sunrise. This review is expected to be completed no later than October.

Simultaneously, Shell is proceeding with technical and commercial work programs to finalize the FLNG concept for Sunrise. Shell and Woodside are investing approximately US$6 million (A$11 million) on the technical program alone for Sunrise FLNG. We expect this work to conclude in October. In parallel, discussions are ongoing with the Sunrise joint venture participants in an effort to reach a mutually acceptable proposal for the development of Sunrise.

2. Timor Sea Treaty and the IUA

2.1 Summary

With a 26.6% equity stake in the Sunrise/Troubadour fields (Greater Sunrise) and various holdings in other Timor Sea permits, Shell has a significant interest in ensuring a stable investment climate in the Timor Sea. It is Shell's view that ratification of the Timor Sea Treaty is critical, as it is the legal framework that will validate the existing production-sharing contracts (PSCs) and underpin the international unitisation[1] of the Greater Sunrise fields.

However, the Treaty itself does not provide the necessary certainty to Companies wishing to invest and develop the Greater Sunrise reserves because the Treaty is without prejudice to the future seabed delimitation. Therefore, it is essential that the Treaty, the International Unitisation Agreement (IUA), and PSCs together ensure fiscal and regulatory certainty and stability throughout the lifetime of the Project so that Investors may have the confidence to invest. In this regard, it is essential that Investors be indemnified against any future change in seabed delimitation. It is hoped that these three documents can achieve this objective and certainly they must all be signed before any investment can proceed.

2.2 The Treaty, IUA, and PSCs for Sunrise

The Timor Sea Treaty currently being considered by the Committee provides a starting point for the commercialisation of Sunrise. While the Treaty outlines some fiscal and regulatory issues, such as the taxation code and the need for an IUA, it does this only at a very high level. At the same time, the Treaty does not address the ongoing fiscal and regulatory regime to be applied to the development and operations throughout the life of the project. These issues must be addressed in the IUA, which is an extensive and detailed agreement on a wide range of significant fiscal, jurisdictional, regulatory, operational and commercial issues.

The Treaty provides in Annex E for the attribution of Greater Sunrise on a 20.1% JPDA / 79.9% Australia basis, but it is without prejudice to a permanent delimitation of the seabed between Australia and East Timor. The possibility of an open and undefined reconsideration of the terms of the IUA would eliminate the fiscal and regulatory certainty and stability necessary for the commercialisation of Greater Sunrise.

The IUA, therefore, must expand on Annex E of the Treaty to provide full clarity on the intent, purpose, and interpretation of the Annex E clauses. In addition, any PSC, licence, or permit must continue to apply and maintain the fiscal and regulatory

[1] In the Timor Sea, the Greater Sunrise fields straddle four permit areas. The petroleum reservoirs are situated within both the JPDA and Australia. Unitisation is the process by which Greater Sunrise can be developed as a single entity by the most efficient and effective means possible.

conditions in existence at the commencement of the Sunrise Project for the life of the Project. These three documents must be agreed in parallel to provide a complete investment regime for Sunrise.

2.3 Outside the JPDA

Shell wishes to highlight a concern regarding the potential risk for producing assets in the Timor Sea such as Laminaria/Corallina, which lie within the exclusive economic zone claimed by East Timor but outside the current JPDA. Because the Timor Sea Treaty deals only with the JPDA and is without prejudice to future seabed delimitations, these assets should remain outside the scope of the Treaty.

Similarly, for the Greater Sunrise fields, the IUA will identify a "point of sale" for Sunrise petroleum that will establish the point of taxation and of valuation for PRRT purposes. The sale point will also identify the extent of the IUA jurisdiction. Any development downstream of the point of sale will not be covered by the terms of the IUA or the Treaty. Therefore, the certainty required for this development could be at risk from future seabed delimitation.

3. Recommendations

The Sunrise joint venture participants need fiscal and regulatory certainty and stability throughout the life of the project to proceed with commercialisation of the Greater Sunrise fields. In order to provide this certainty, we request that the Committee:

- Consider how best to ensure that Investors' interests can be protected against any future changes in the delimitation of the seabed boundaries;
- Recommend the simultaneous ratification of the Timor Sea Treaty and the International Unitisation Agreement, and;
- Note the importance of concluding new Production-Sharing Contracts for that portion of Greater Sunrise attributed to the JPDA.