

Timor Sea Treaty between the Government of Australia and the Government of East Timor, done at Dili on 20 May 2002.

AMENDED NATIONAL INTEREST ANALYSIS

Proposed binding treaty action

1. It is proposed to bring into force the Timor Sea Treaty between the Government of Australia and the Government of East Timor (the Treaty).

Date of proposed binding treaty action

2. The proposed treaty action will enter into force on the day that both Parties have notified each other in writing that their respective requirements for entry into force have been complied with (Article 25). Upon entry into force the treaty will be taken to have effect and all of its provisions will apply and be taken to have applied on and from the date of signature, 20 May 2002.

3. The treaty was signed in Dili on 20 May 2002.

4. Upon entry into force of the Treaty, the Exchange of Notes constituting an Agreement between the Government of the Democratic Republic of East Timor and the Government of Australia concerning Arrangements for Exploration and Exploitation of Petroleum in an Area of the Timor Sea Between East Timor and Australia, done at Dili on 20 May 2002, will cease to have effect.

Date of tabling of the proposed treaty action

5. 25 June 2002.

Summary of the purpose of the proposed treaty action and why it is in the national interest

6. The Timor Sea between northern Australia and East Timor contains proven petroleum resources in the seabed. Australia and East Timor have competing claims to the resources of this seabed. The treaty enables Australia and East Timor to jointly develop the petroleum resources of a major part of the seabed of the Timor Sea, defined in Article 3 of the Treaty as the Joint Petroleum Development Area (JPDA), pending agreement to a seabed boundary with East Timor.

7. The Treaty benefits Australia and provides certainty for investors by providing an international legal basis for continued development of major oil and gas deposits in the Timor Sea.

8. Both Australia and East Timor will receive the benefits of revenue from petroleum activities in the JPDA. The main projects include the Bayu-Undan and Greater Sunrise developments that are estimated to collectively contain recoverable reserves of around 11 trillion cubic feet of gas and 700 million barrels of petroleum liquids. Bayu-Undan, which lies wholly within the JPDA, is estimated to contain around \$A15 billion worth of petroleum. Australia will also receive substantial benefits from the development and processing of natural gas, including construction and operation of an LNG plant in Darwin.

Reasons for Australia to take the proposed treaty action

9. The resource potential of the Timor Sea was initially recognised in the 1989 Timor Gap Treaty between Australia and Indonesia. With the separation of East Timor from Indonesia on 25 October 1999 Australia entered into an Agreement with the United Nations Transitional Administration in East Timor (UNTAET) (the February 2000 Exchange of Notes) to allow Australia and East Timor to benefit from the continuation of exploration and exploitation activities in the Timor Sea.

10. Recognising that the February 2000 Agreement would terminate upon East Timor's independence, Australia and UNTAET/East Timor commenced negotiations to develop a framework for the joint development of resources in the Timor Sea. On 5 July 2001 Australia and East Timor endorsed a less than treaty status document, the Timor Sea Arrangement, which outlined the framework for a Treaty to cover the joint development of resources in the Timor Sea. In Dili, on 20 May 2002, the date of East Timor's independence, the Timor Sea Treaty was signed.

11. Upon entry into force of the treaty, the Exchange of Notes constituting an Agreement between the Government of the Democratic Republic of East Timor and the Government of Australia concerning Arrangements for Exploration and Exploitation of Petroleum in an Area of the Timor Sea Between East Timor and Australia, done at Dili on 20 May 2002, (the Exchange of Notes) will cease to have effect. The Exchange of Notes provided legal certainty to allow petroleum projects to continue in the Timor Sea by maintaining, in essence, arrangements that existed on 19 May 2002. Under the Exchange of Notes, East Timor's share of petroleum and income tax on petroleum production revenue that it would have received had the Timor Sea Treaty entered into force upon signature, will be placed into an interest-bearing escrow account. The February 2000 Exchange of Notes also allows East Timor to receive 90% of revenue from certain income taxes before entry into force of the Timor Sea Treaty. Upon entry into force of the Timor Sea Treaty, the Treaty will have effect and be taken to have had effect from 20 May 2002.

12. Recognising that Australia and East Timor have competing claims to the resources of the seabed of the Timor Sea, the treaty, pending a delimitation of the seabed, in accordance with Article 83 of the United Nations Convention on the Law of the Sea (UNCLOS), enables Australia and East Timor to jointly develop major oil and gas deposits in the Timor Sea. Article 3 of the Treaty defines this area of the seabed between Australia and East Timor, as the Joint Petroleum Development Area (JPDA).

13. The JPDA contains substantial condensate and gas reserves. The treaty will enable continued investment in two major petroleum projects in the JPDA – the Bayu-Undan and Greater Sunrise developments. These developments are estimated to collectively contain recoverable reserves of around 11 trillion cubic feet of gas and 700 million barrels of petroleum liquids. When the treaty enters into force, the revenue to Government from oil and gas production in the JPDA will be shared in the proportions of 90:10 East Timor to Australia.

14. Phillips Petroleum as contract operator, representing joint-venture partners is currently developing the oil phase of the Bayu-Undan field and plans to invest in a second phase of the project to exploit gas. Phillips plans to establish a liquefied natural gas (LNG) processing facility near Darwin to utilise most of Bayu-Undan's 3.4 trillion cubic feet gas production. The resulting LNG will be exported. The overall development will consist of

offshore oil and gas production facility, a gas pipeline to Darwin, and an onshore LNG facility, involving total capital expenditure of the order of \$A6 billion. East Timor can expect to receive up to \$A6 billion over the life of the project with operations commencing in 2003/04.

15. Greater Sunrise, with petroleum resources valued at around \$A30 billion, has 20.1 percent of its reserves located within the JPDA and 79.9 percent located within Australian waters. The Greater Sunrise gas field is larger than Bayu-Undan, containing around 9.2 trillion cubic feet of natural gas and 335 million barrels of condensate. The joint venturers, Woodside, Shell, Phillips and Osaka Gas, are currently assessing options for development of Sunrise petroleum. The two main alternatives are a floating LNG facility (FLNG) to process Sunrise gas for export or a proposal that the Sunrise gas be brought onshore to supply industrial projects and the general domestic market.

16. The treaty 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 application of taxation and criminal law. The treaty also provides for the creation of a petroleum mining code. A taxation code has been developed and forms Annex G of the Timor Sea Treaty. The treaty also provides for the development of an international unitisation agreement between Australia and East Timor, which is required for the expansion of the Greater Sunrise field projects.

Obligations

17. Article 2 of the Treaty recognises that the treaty is without prejudice to both Australia's and East Timor's legal claims to the seabed in the Timor Sea.

18. Article 3 of the Treaty establishes the JPDA, the exact location of which is described in detail in Annex A, and recognises that Australia and East Timor shall jointly control, manage and facilitate the exploration, development and exploitation of the petroleum resources of the JPDA. It also requires contractual arrangements be made between the designated authority and any persons intending to undertake any petroleum activities in the JPDA.

19. Article 4 of the Treaty recognises Australia's and East Timor's title to all petroleum produced in the JPDA, as well as any costs involved in the Treaty, will be 10 % for Australia and 90% for East Timor.

20. Article 5 of the Treaty establishes how the fiscal arrangement and taxes will be dealt with. For existing projects (Elang Kakatua, Bayu-Undan, and Greater Sunrise) the existing production sharing contracts will continue to apply (Annex F). For any future projects in the JPDA, Australia and East Timor are to seek to agree on a joint fiscal regime. If agreement cannot be reached, Australia and East Timor may apply their own fiscal schemes to their respective share of the petroleum (as per Article 4). In addition to revenue collected by way of production sharing contracts, Australia and East Timor will apply their own tax laws to their respective shares of the petroleum produced.

21. Article 6 of the Treaty establishes a three-tiered joint administrative structure. Article 6(b) establishes the Designated Authority, that, for the first three years after the treaty enters into force, or longer if agreed by the parties, the Joint Commission will designate.

After the three year period, or longer if agreed, the East Timorese Ministry responsible for petroleum or an East Timor statutory authority will be the Designated Authority. The Designated Authority will be responsible to the Joint Commission and will carry out the day-to-day regulation and management of petroleum activities. A listing of more detailed powers and functions of the Designated Authority is set out in Annex C to the Treaty. The Designated Authority will be financed from fees collected under the Petroleum Mining Code.

22. The Joint Commission shall consist of commissioners appointed by Australia and East Timor. The commission will have one more commissioner appointed by East Timor than by Australia (Article 6(c)(i)). The Joint Commission will establish policies and regulations for petroleum activities in the JPDA and oversee the work of the Designated Authority, a listing of more detailed powers and functions of the Joint Commission is set out in Annex D to the Treaty. The Joint Commission can meet annually or as required, and will be chaired alternatively by Australia and East Timor (Article 6(c)(iv)). The commissioners of the Joint Commission may at any time refer a matter to the Ministerial Council for Resolution.

23. Article 6(d) established the Ministerial Council that consists of an equal number of Ministers from Australia and East Timor. It shall consider any matter relating to the operation of the Treaty referred to it by either Australia, East Timor or the Joint Commission. In the event the Ministerial Council is unable to resolve the matter, either Australia or East Timor may invoke the dispute resolution mechanism as set out in Annex B to the Treaty (binding international arbitration).

24. Article 7 of the Treaty requires Australia and East Timor to negotiate a Petroleum Mining Code to govern petroleum projects in the JPDA, as well as the export of petroleum from the JPDA. If no such Code is agreed by the time the treaty enters into force, the Joint Commission is to adopt an interim Code.

25. Article 8 of the Treaty recognises that Australia will have jurisdiction over the planned pipeline from Bayu-Undan to Darwin. However, Australia is not to object to a pipeline to East Timor or floating processing facilities where these are proposed on a commercial basis.

26. Article 9 of the Treaty recognises that any reservoir of petroleum that extends across the boundary of the JPDA shall be treated as a single entity for management and development purposes and Australia and East Timor will work expeditiously to reach agreement on the manner in which the deposit will be exploited and the sharing of such a deposit. The Greater Sunrise field is one such reservoir of petroleum. The treaty therefore provides, *inter alia*, for the negotiation of an “international unitisation agreement” covering the Greater Sunrise field. A unitisation agreement is necessary because the Greater Sunrise deposit straddles the eastern border of the JPDA. The treaty provides in Annex E that the Greater Sunrise field be unitised on the basis that 20.1 percent of it lies in the JPDA and 79.9 percent is attributed to Australia. A Memorandum of Understanding on an international unitisation agreement between Australia and East Timor was also signed on 20 May 2002. Both Australia and East Timor undertook to conclude a unitisation agreement for the Greater Sunrise fields by 31 December 2002.

27. Article 10 of the Treaty requires Australia and East Timor to co-operate to protect the marine environment of the JPDA and to prevent and minimise pollution and other harm from

petroleum activities and requires the development of contingency planning for combating pollution.

28. Article 11 of the Treaty provides, with due regard to occupational health and safety requirements, for preference in employment to be given to East Timorese nationals and permanent residents. Australia is to facilitate training and employment opportunities for East Timorese nationals and permanent residents.

29. Article 13 of the Treaty establishes the Taxation Code, Annex G, which provides a comprehensive regulatory and fiscal framework applicable to the JPDA. The Treaty also specifies provisions on criminal jurisdiction, customs, quarantine and migration, surveillance, security, search and rescue and air traffic services governing the JPDA (Articles 14-21).

30. Article 22 of the Treaty specifies that the duration of the Treaty will be 30 years or until there is a permanent seabed delimitation, whichever is sooner. When the Treaty enters into force it will be taken to have effect and all of its provisions will apply and be taken to have applied on and from the date of signature, 20 May 2002. This will mean for example, that revenue sharing arrangements of 90:10 will apply and be taken to have applied from 20 May 2002.

31. Article 23 of the Treaty specifies that disputes under the Treaty are to be settled by consultation or negotiation. Failing resolution by these means a dispute may be referred by either country to binding international arbitration in accordance with the procedure set out in Annex B.

Implementation

32. Once the Timor Sea Treaty enters into force it will apply and be taken to have applied as from the date of signature, 20 May 2002 (Article 25). This provision will require a transitional arrangements provision in the Timor Sea (Joint Petroleum Development Area) Bill 2002. This means that the 90:10 revenue split will be taken to have applied on and from 20 May 2002 including revenue from resource and company taxation. The decisions of the Joint Authority made during the period between 20 May 2002 and entry into force of the Timor Sea Treaty will be taken to have been the decisions of the Designated Authority.

33. The object of the Timor Sea (Joint Petroleum Development Area) Bill 2002 is to provide for petroleum activities in the JPDA. The Bill will describe the administrative regime which will administer the JPDA and the applicable law. There will also be minor consequential amendments to other legislation including the *Crimes at Sea Act 1979*, the *Customs Act 1901*, the *Income Tax Assessment Acts 1936 and 1997*, the *Petroleum (Submerged Lands) Act 1967*.

Costs

34. Australia will incur no additional costs through the treaty action.

Consultation

35. The Exchange of Notes provides an international legal basis for petroleum activities to continue in the area until entry into force of the Treaty. The Commonwealth Government

has consistently been urged by State and Territory Governments, as well as by interested companies to assist in ensuring a smooth continuation of activities in the area. Consultation on Timor Sea arrangements were held with State and Territory representatives, industry representatives, including Phillips Petroleum and the Sunrise Joint Venture Partners. Timor Sea negotiations were listed on the schedule of treaties circulated by the Commonwealth-States-Territories Standing Committee on Treaties.

Regulation Impact Statement

36. No Regulation Impact Statement is required.

Future treaty action: amendments, protocols, annexes or other legally binding instruments

37. The Treaty may be amended at any time by written agreement between Australia and East Timor (Article 24).

38. Article 9 of the Treaty requires Australia and East Timor to work expeditiously and in good faith to reach an international unitisation agreement in relation to any deposit that straddles the boundary, being an agreement on the manner in which the deposit will be most effectively exploited and on the equitable sharing of the benefits arising from such exploitation. Annex E of the Treaty provides that the Greater Sunrise field be unitised on the basis that 20.1 percent of it lies in the JPDA and 79.9 percent is attributed to Australia. A Memorandum of Understanding on an international unitisation agreement between Australia and East Timor was also signed on 20 May 2002. Both Australia and East Timor undertook to conclude a unitisation agreement for the Greater Sunrise fields by 31 December 2002.

39. Further work on the annexes to the Treaty is continuing including the Production Sharing Contracts for Bayu-Undan, Elang-Kakatua and Greater Sunrise, a new Petroleum Mining Code and a new model Production Sharing Contract.

Withdrawal or denunciation

40. The Treaty states that it shall be in force until there is a permanent seabed delimitation between Australia and East Timor or for thirty years from the date of its entry into force, whichever is sooner. The Treaty also provides for renewal by agreement between Australia and East Timor (Article 22).

41. The Treaty does not contain express provisions dealing with withdrawal or denunciation. In these circumstances it is possible to withdraw from the Treaty at any time by consent of both the parties to the treaty action (by virtue of Article 54 of the Vienna Convention on the Law of Treaties).

Contact details

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