

Timor Sea Treaty
Submission No: 46

**SUBMISSION TO THE JOINT STANDING COMMITTEE
ON TREATIES INQUIRY INTO THE TIMOR SEA
TREATY AND RELATED EXCHANGES OF NOTES
BETWEEN THE GOVERNMENT OF AUSTRALIA AND
THE GOVERNMENT OF THE DEMOCRATIC REPUBLIC
OF EAST TIMOR.**

OXFAM COMMUNITY AID ABROAD

AUGUST 2002.

Executive Summary and Recommendations.

The commercial, economic, political, and legal issues surrounding the search for agreement on Timor Sea development and boundaries are extremely complex. The confidential nature of bilateral negotiations between the East Timorese and Australian governments and the expectations of industry partners for commercial-in-confidence have further restricted access to information by the East Timorese and Australian public.

Oxfam Community Aid Abroad has sought to identify, review and analyse the multi-faceted issues and dynamics of the Timor Sea negotiations that have led to the conclusion of the Timor Sea Treaty, but so far prevented the settlement of permanent maritime boundaries between East Timor and Australia. Based on this analysis, which includes information gained through work with a number of East Timorese NGOs, Oxfam has made some recommendations towards the fair and equitable resolution of these issues.

As of July 2002, a new Timor Sea Treaty ('TST') requires ratification by the governments of East Timor and Australia before entering into force. The treaty is loosely based on the terms and conditions of a previous and long-standing 1989 Timor Gap Treaty between Australia and Indonesia for the joint commercial development of the hydrocarbon resources of the Timor Sea. There are, however, some substantial changes to the terms and conditions of the previous treaty. The most visible of these is the change from a 50-50 split of production under the previous 1989 Timor Gap Treaty to a 90-10 split in favour of East Timor under the new arrangements for the Joint Petroleum Development Area (JPDA). In addition there are more subtle and complex modifications to the institutional and administrative structure that will impact upon East Timor's access to the residual economic benefits that petroleum development creates.

In discussions and formal negotiations with the Australian government spanning the last 2 ½ years, East Timor has consistently sought a new and permanent Timor Sea agreement with Australia that would incorporate two objectives: the delimitation of new maritime boundaries and an arrangement for joint commercial development. As the basis for determining their seabed boundaries, East Timor has argued for the application of a 'median' or 'equidistant' line between the two countries to divide the Timor Sea. Since the early 1980s, lines of equidistance have been the preferred method for states and the International Court of Justice in the delimitation of maritime zones between states less than 400 nautical miles apart. Australia, on the other hand, claims that it is entitled to a seabed that extends to the outer edge of its continental shelf at the Timor Trough.

During negotiations, the Australian government has been less than enthusiastic about the prospect of settling permanent seabed boundaries with East Timor. There are a number of reasons for this reluctance. Australia favours arrangements for the joint development of the resources of the Timor

Sea that provide a secure and pragmatic solution to an otherwise intractable legal dispute. However the most significant reason is that the Australian government is concerned that any objective testing of its continental shelf or 'natural prolongation' argument might undermine the legal validity of its boundaries with Indonesia either side of the Timor Gap. These boundaries were established in 1972, giving Australia up to 85% of the area in dispute, and reflected in part the prominence of the legal concept of 'natural prolongation' in the decisions of the International Court of Justice at the time.

The Treaty signed on May 20, 2002 indicates that little progress has been made by East Timor to advance their argument for the delimitation of new maritime and seabed boundaries with Australia. As a 'provisional arrangement of a practical nature', the new agreement is expressed to be 'without prejudice' to the final delimitation of a seabed boundary, as required by the United Nations Convention on the Law of the Sea (UNCLOS). The treaty does not, however, provide any framework or mechanism for the advancement of maritime boundary negotiations.

Other concerns include the failure to incorporate in the Treaty any guarantees for East Timorese participation in the lucrative upstream and downstream economic benefits from Timor Sea petroleum development. **While article 11 of the treaty places an obligation on East Timor and Australia to give preference to the employment and training of East Timorese people, these obligations are not referred to within production sharing contracts.** New terms that fail to specify East Timor's entitlement to development-related training and employment are also of concern. The new treaty contains no mechanism to ensure a building of East Timorese capacity to participate and gain an increasing share of employment and development benefits.

As an adjunct to the Treaty, Australia and East Timor have agreed to move towards the conclusion of an International Unitisation Agreement to govern the exploitation of Greater Sunrise, the largest of the known gas fields in the area. The agreement (Annex E of the Treaty) determines that 80% of Greater Sunrise, which straddles the eastern lateral boundary of the JPDA, falls under exclusive Australian seabed jurisdiction. East Timorese negotiators have argued that under current principles of international law, most or all of Greater Sunrise rightfully belongs to East Timor. Despite the enormous potential of these deposits, project developers are yet to secure markets for future production and remain divided over production options. It is unlikely that the field will enter production stage before 2006/7. Agreement on the Greater Sunrise petroleum field is likely to be another barrier to future seabed boundary settlement. Unitisation of Greater Sunrise should be the consequence of maritime boundary delimitation.

Prompt ratification of the new Timor Sea Treaty would expedite access to revenue streams crucial to East Timor's economic sustainability. There are, however, some risks associated with the adoption of the terms of the treaty as they currently stand. The treaty appears likely to inhibit East Timor's future efforts to delimit new maritime boundaries. It will also leave the ownership of

other large petroleum reserves in close proximity to the JPDA subject to overlapping maritime claims, thereby jeopardising the economic benefits that might result from their development.

Ratification of treaty as it currently stands is likely to lead to a negative perception of Australia from the East Timorese population. Many East Timorese organisations perceive Australia as attempting to access resources that are rightfully East Timor's. Indeed this perception is compounded by Australia's recent withdrawal from the dispute settlement procedures offered by the International Court of Justice and the International Tribunal on the Law of the Sea with respect to maritime boundary disputes. This tactical manoeuvre has effectively removed any opportunity East Timor might have had for the independent resolution of its maritime claims and has been viewed by the East Timorese government as an 'unfriendly act.'

For Australia, an economically unviable East Timor could threaten national security and that of the region. An unstable East Timor could lead to a flow of refugees to Australia with associated costs. The Australian and international community would expect the Australian government to bear much of the responsibility for increased humanitarian aid and assistance, and the provision of continued peacekeeping and security assistance to East Timor. Our regional neighbours and the international community may view Australia, already well endowed with natural, mineral and petroleum resources and wealth, as unreasonably rigid and opportunistic. It has been estimated that the Timor Sea Greater Sunrise fields and those within the JPDA represent less than 20% of Australia's known gas and oil resources.

The failure to unlock the resources of the Timor Sea for the benefit of East Timor may have significant consequences for longer-term human development, economic self-reliance and stability. At this time, East Timor is taking steps to rebuild despite limited resources. As one of the world's newest and poorest nations, revenues from oil and natural gas currently represent East Timor's greatest hope for meeting the East Timorese people's basic needs, including economic development, health and education. The alternative is to have an East Timorese neighbour that is dependent on Australian development assistance for many years into the future.

Australia's position on maritime boundaries should be softened and broadened to take into account the full extent of East Timor's maritime claims, with the concomitant adjustment of the JPDA boundaries and revenue flows. Furthermore, East Timor's development objectives should be prioritised in all Timor Sea decision making processes. An economically viable and self-sufficient East Timor is most certainly a better option for Australia and the Asia-Pacific region.

Recommendations

Oxfam Community Aid Abroad makes the following recommendations to the Australian government regarding its ratification of the Timor Sea Treaty:

1. Recognise the right of East Timor to settle its boundaries with its international neighbours as the basis for the allocation of petroleum resources and revenues. *Australia's ratification of the Treaty should be contingent on fulfilment of the following conditions:*

- Declare the centrality of the Treaty's "without prejudice" clauses and acknowledge that the Treaty's arrangements are of a provisional nature only.
- Declare that the Treaty in no way inhibits the extent of East Timor's maritime claims.
- Declare that Australia recognises its international legal obligation to engage with East Timor in "good faith" towards the achievement of permanent maritime boundaries.
- Establish a definitive time frame, not to exceed 5 years, in which boundaries will be settled, with or without a joint development agreement, or otherwise referred to an impartial independent arbitration.
- Declare that Australia will refrain from improper intervention in the inevitable boundary negotiations between East Timor and Indonesia.
- Declare that Australia will promptly engage with Indonesia, consistent with its international legal obligations, to adjust Points A16 and A17 of the 1972 seabed boundaries in the event that East Timor negotiates lines more favourable than those reflected in the co-ordinates of the JPDA.

2. Recognise that the current treaty fails to provide East Timor with adequate guarantees for participation in all aspects of petroleum development in the Timor Sea, both upstream and downstream. *Ensure that guarantees for East Timorese participation are put in place through the following measures:*

- Confirm that as a participant in the Treaty's administrative functions, and consistent with Article 11 of the Treaty, Australia will prioritise "training and employment opportunities for East Timorese nationals and residents".
- Undertake to ensure that Production Sharing Contracts include provisions that prioritise East Timorese interests, in particular with respect to capacity building.

- Ensure that all efforts are made to assess the viability of bringing Greater Sunrise gas onshore in East Timor.
 - Declare that Australia will not use the Treaty's Ministerial Council to override or unfairly impede decisions of the Joint Commission or the Designated Authority.
 - Undertake not to use the provision of development aid, nor funds held in trust or escrow, as a leverage for more favourable outcomes in Timor Sea negotiations.
- 3 Suspend the current 31 December 2002 deadline for the conclusion of an international unitisation agreement (IUA) for Greater Sunrise**
- Recognise that a negotiated boundary between East Timor and Indonesia is the only reliable indicator as to the accuracy of the eastern lateral boundary of the JPDA.
 - Undertake to adjust the unitisation formula in Annex E to reflect the proportion of Greater Sunrise either side of a new JPDA lateral boundary or permanent boundary line delimiting the East Timor-Australia continental shelf.
- 4 Immediately reinstate Australia's adherence to the dispute settlement mechanisms of the ICJ and ITLOS**
- Recognise that Australia's withdrawal in March from the compulsory jurisdiction of dispute settlement mechanisms under UNCLOS and the Statute of the ICJ has severely limited East Timor's options in seeking an objective, third party resolution of the maritime boundary dispute and also damages Australia's international reputation.
- 5 Excise the Timor Gap from Australia's submission to the United Nations Commission on the Continental Shelf (UNCCS)**
- Recognise that inclusion of a continental shelf claim extending to the Timor Trough in Australia's 2004 submission to the UNCCS will further complicate and delay progress towards a boundary settlement with East Timor.

Bounty versus Boundaries

The pursuit of Equity and Certainty in the Timor Sea

Introduction.

At midnight on May 19 2002, East Timor became an internationally recognised independent nation, bringing centuries of colonial rule, decades of struggle under Indonesian occupation and almost three years of United Nations administration to a close.

In the lead up to independence, East Timorese and UNTAET negotiators had been working with representatives of the Australian government to establish a new regime for the exploitation of the resources of the Timor Sea. This process began with the independence referendum held on August 30, 1999, and in February 2000, an interim agreement was reached to continue the terms of the 1989 Timor Gap Treaty, with UNTAET assuming Indonesia's rights and obligations. In mid-2001, Australia and East Timor signed a Memorandum of Understanding that proposed a new arrangement for commercial development in the Timor Gap. It was this 'proposed' arrangement that finally formed the basis for the Timor Sea Treaty, signed on 20 May 2002.

Former UN negotiator Peter Galbraith described the negotiations as a quirky mix of politics, geology and international law.¹ Throughout the period of transition, clear differences of interest have emerged between East Timor and Australia. While resources are unquestionably important, the main issue of contention between the two States is the permanent delimitation of their joint maritime boundaries. The most recent in the series of agreements signed offers neither permanency nor resolution on this issue. The Australian government, concerned that their claims to the continental shelf may be jeopardised, prefer to leave the boundary issue to one side, opting instead to pursue the joint development of the resources in the disputed area of the Timor Gap.

East Timor remains caught between the need to provide a secure environment for hydrocarbon project developers and the desire to pursue potentially destabilising negotiations towards the achievement of permanent maritime boundaries. With the passage through Parliament of the East Timorese *Maritime Zones Act* on 23 July², East Timor declared a 200 nautical mile Exclusive Economic Zone and continental shelf entitlement, based upon generally accepted principles of international law. With this legislation, East

¹ 'A Tonic for East Timor's Poverty', New York Times, October 19, 2000

² "Maritime boundary legislation passed by National Parliament of East Timor", Media release, REPÚBLICA DEMOCRÁTICA DE TIMOR-LESTE, July 9, 2002, setting out in general terms all coastal, territorial waters, Exclusive Economic Zone and Continental Shelf.

Timor has created overlapping claims with Australia with respect to the resources of the Timor Sea, with the result that both countries are now under an international legal obligation to continue to negotiate on permanent boundaries. Whether or not East Timor is able to achieve an outcome that improves upon the terms of the current Timor Sea Treaty is unclear, and depends largely on the flexibility and good faith with which Australia approaches future negotiations.

A Brief History of the Timor Gap

Independent East Timor now walks a well-worn path on maritime boundary negotiations with Australia over the "Timor Gap". The Gap refers to a 135 nautical mile stretch of seabed left undelimited by Australia and Indonesia in drawing their 1972 seabed boundaries. The boundaries, either side of the Timor Gap, gave Australia about 80% of the area then in dispute, due mainly to the prominence in international law at the time of the concept of 'natural prolongation'. This meant that a state had sovereign rights over the continental shelf as the underwater extension of its land territory. With negotiations on a new United Nations Convention on the Law of the Sea (UNCLOS) continuing, Portugal, as the then controlling authority in East Timor, refused to negotiate with Australia on filling the gap.

With Australia's 1978 *de jure* recognition of Indonesia's annexation of East Timor came the possibility of negotiating an agreement for the development of the resources of the Timor Gap. Australia proposed closing the Gap with a line joining the terminal points of the 1972 boundaries. Indonesia would not agree to this solution, arguing instead that international law and practice had evolved in favour of fixing a delimitation of the Timor Gap at the median line between the opposite coastal States. Conflicting seabed boundary claims and a testy relationship prevented resolution of the dispute. Negotiations reached an impasse, so that the creation of an innovative and complex joint development area became a necessity.

The Timor Gap Treaty, signed in December 1989, defined a large three-area Zone of Cooperation (ZOC) area for the joint development of petroleum covering almost 61,000 sq. kilometres of the Timor Gap. It was the most sophisticated and complex joint development regime known at that time. The Zone was delineated in the north by the Australian view of the correct boundary (the axis of the Timor Trough), and in the south by Indonesia's claim to a 200 n.m. continental shelf.

Area A of the ZOC is the true joint development area in the "classic sense". It was subject to the control of a Ministerial Council and Joint Authority and the benefits of the exploitation of petroleum resources were shared equally between the two Contracting States. In other words, Area A production royalties were to be split 50:50. On the other hand, Areas B and C, to the south and north of Area A, were administered by Australia and Indonesia respectively.

Australia and Indonesia penned an agreement on December 11, 1991 to award production sharing contracts to exploration and petroleum companies operating in the area, and by 1994, the first of the Elang-Kakatua and Bayu-Undan fields were discovered in Area A. Implementation and progress under the Treaty was fruitful, and by 1999, total expenditures by contractors for exploration, development and production activities had exceeded US\$ 700 million.

Despite the destabilising events in East Timor during 1999, joint venture partners and the Joint Authority continued to progress and administer development work even as they anticipated the change of agreement partners and working relationships. Shortly after Australia agreed to lead a UN peacekeeping force to stem the continuing violence, militia activity and the comprehensive destruction of the physical infrastructure of East Timor reached its peak.

As had been the case throughout the past decade, the East Timorese leadership made clear that they would accept the commercial terms contained within the 1989 Timor Gap Treaty as an interim measure to enable petroleum development to proceed, but would never accept a successor state role by supplanting Indonesia in a treaty they always considered to be illegal.

A United Nations Transitional Administration (UNTAET) assumed authority over East Timor on 25 October 1999, and agreed with Australia, through an Exchange of Notes, to continue the "terms" of the Timor Gap Treaty. As an interim arrangement, the agreement enabled the Joint Authority to continue to regulate petroleum activities in the area, thereby securing current investments and encouraging further exploration.

In late 2000, negotiations began towards reaching an agreement to replace the interim arrangement that was to expire upon East Timor's formal independence. The East Timorese Transitional Administration signed a Memorandum of Understanding (MOU) with Australia on 5 July 2001 that proposed an agreement "suitable for adoption" as a treaty between Australia and an independent East Timor (proposed Timor Sea Arrangement). It proposed a Joint Petroleum Development Area (JPDA) which mirrors geographically the previous Area A of the ZOC under the Timor Gap Treaty, but altered the split of revenues to 90:10 in favour of East Timor.

As independence drew closer, doubts emerged as to whether the proposed arrangement represented the best possible outcome for an independent East Timor. In particular, debate centred on the respective rights of East Timor and Australia over the Greater Sunrise reservoir, which straddles the eastern lateral boundary of the proposed JPDA. Greater Sunrise is estimated to contain recoverable gas reserves worth approximately A\$30 billion.

Under the proposed Timor Sea Arrangement, Greater Sunrise was to be unitised on the basis that 20% lies within the JPDA, with the remaining 80% falling under exclusive Australian seabed jurisdiction as defined by the 1972 Australia-Indonesia Seabed Agreement. As negotiations continued in the lead

up to 20 May, putative Prime Minister Mari Alkatiri rejected the 20/80 split. He argued that under current principles of international law, East Timor was entitled to the entire Greater Sunrise deposit. Statements were made indicating that East Timor might be prepared to pursue its full maritime entitlements by reference of the dispute to the International Court of Justice (ICJ).

In this climate, Australia announced on 21 March 2002 that henceforth, it would exclude from the compulsory jurisdiction of the ICJ and the International Tribunal on the Law of the Sea (ITLOS) all disputes relating to the delimitation of maritime zones. Mr Alkatiri described this move as "an unfriendly act".

It was somewhat surprising, therefore, that on independence day, East Timor agreed to sign the Timor Sea Treaty, a document that effectively adopted the proposed Timor Sea Arrangement in its entirety, including the 20/80 split of Greater Sunrise in Australia's favour. The Timor Sea Treaty does not enter into force until ratified by both Parties, and as a result, a further Exchange of Notes was necessary to fill the potential legal vacuum. The 2002 *Exchange of Notes*, effective as of 20 May, 2002 applies the regime that existed for the Timor Sea as at 19 May. It therefore continues the terms of the 1989 *Timor Gap Treaty* with Australia and East Timor as the implementing parties. The *Exchange of Notes* is therefore a legally binding bridging agreement that enables exploration and development to continue until the new Treaty is ratified by both parties.

The Current Status of the Timor Sea Treaty

The new Timor Sea Treaty does not, of itself, provide for a resolution of the competing maritime claims in the Timor Gap. Neither does it provide much incentive for Australia to engage meaningfully in negotiations on the issue. The terms of the new treaty are stated to be "without prejudice" to the parties' position on seabed delimitation and provide a framework for the continuation of commercial development of petroleum resources throughout its 30 year life or until such time as final maritime boundaries are achieved.

As noted above, the 20 May 2002 *Exchange of Notes* currently applies the terms of the previous Timor Gap Treaty prior to the ratification and entry into force of the Timor Sea Treaty, with East Timor and Australia as the implementing parties. The *Exchange of Notes* provides that if the Timor Sea Treaty comes into effect, all its provisions will apply as from the date of independence of East Timor. Together, the new instruments affirm the July 2001 proposal to allocate 90% of the net royalties from production within the JPDA to East Timor, with the remaining 10% to go to Australia. Until such time as the new Treaty is ratified and fully in force, the previous 50:50 split continues to apply. However, as an incentive to East Timor's ratification of the new Treaty, the *Exchange of Notes* provides that the additional 40% of revenues that would accrue to East Timor under the new arrangements will be held in escrow until the Treaty enters into force, if that is to occur.

The May 20 *Exchange of Notes* thus avoids a legal vacuum that could have placed at risk billions of dollars of development finance already invested in the Timor Sea by petroleum companies and their backers over the last decade. Pressures of expediency and necessity therefore dictated the prompt signing of this latest instalment in a long series of Timor Sea agreements. However, the fundamental issues that divided the parties during previous negotiations and agreements still remain unresolved.

East Timorese concerns

East Timorese civil society groups have continued to express their concerns over the months of protracted Timor Sea negotiations with Australia. In the immediate aftermath of the May 20, 2002 signing, the impact of the as yet unratified Timor Sea Treaty on East Timor's right to pursue and permanently resolve their maritime boundaries became the most important of these concerns.

A civil society group called the 'Independent Information Centre for the Timor Sea' (CIITT), composed of 13 non-government organizations, has been among the most vocal of East Timorese civil society groups. CIIT is an information centre that monitors and analyses the process of determining legal maritime boundaries and the process of oil and natural gas exploration and production in the Timor Sea. The group wrote to the East Timorese Parliament on 13 June 2002 appealing to parliament members and the government of East Timor not to ratify the Treaty in its current form.

Among the main concerns of CIITT are that the Treaty enacts temporary boundaries which unfairly and illegally advantage Australia and the Treaty was written too quickly and does not adequately protect the marine environment. CIIT argues that the Treaty should not be ratified in its current form until boundaries are agreed to in accordance with the principles of the UN Convention on the Law of the Sea (UNCLOS.) In the meantime revenues from oil and gas in the dispute territory should be held in trust until there is settlement of boundaries.

Current Prospects in the JPDA

Three major hydrocarbon reserves have been identified in the Timor Sea Treaty's JPDA. The reserves are rich in oil, natural gas and liquid condensate. Other smaller prospective fields have been discovered in the JPDA, and a number of fields are either producing or known to exist in areas proximate to the lateral boundaries of the zone.³

³ 'Timor Sea Oil and Gas Factsheets', Office of Territory Development website, Northern Territory government, <http://www.otd.nt.gov.au/dcm/otd/otd/Fact%20Sheets/timor.html>

The Elang-Kakatua fields, situated in the west of the JPDA, have been producing oil and relatively modest revenues since 1999.⁴ Approximately US\$1.8 billion has already been devoted to developing the first liquids phase of the nearby Bayu-Undan fields, slated to begin production in early 2005. An agreement to supply Bayu-Undan LNG (Liquefied Natural Gas) to Japan has already been concluded.⁵

Greater Sunrise, the largest of the known JPDA reserves,⁶ is currently in the design development stage and commercial partners have not yet determined the preferred method for gas extraction. As noted earlier, only 20% of the Greater Sunrise reserves lie within the JPDA, with the remaining eighty percent (80%) subject to exclusive Australian continental shelf jurisdiction as previously defined by the 1972 Australia-Indonesia seabed delimitation agreements. While the proven and probable resources of Greater Sunrise are 8.3 trillion cubic feet (TCF) of LNG⁷, with the potential to generate revenues of US\$36 billion under adjusted market prices,⁸ project partners have so far spent a relatively modest US\$200 million dollars in development costs. Almost half of that amount has been devoted to the search for potential markets and customers for the gas, with the balance spent on exploration, mapping, design development and related preparatory costs.⁹

Oil companies, working under Production Sharing Contracts (PSCs) administered by a Joint Authority now representing Australia and East Timor, anticipate that these proved reserves will yield at least 22 trillion cubic feet of oil and gas products with an estimated market value of over US\$100 billion. This translates into potential revenues for Australia and East Timor of approximately US\$45 billion.

It is expected that the interim arrangements, pending the entry into force of the *Timor Sea Treaty*, will provide the legal security necessary for the continuation of current production in Elang-Kakatua¹⁰ as well as the movement forward of plans to exploit the Bayu Undan reserves.¹¹ On the other hand, the Greater Sunrise project partners continue to debate development and processing options. Operator Woodside and principal shareholders Phillips and Santos now require the conclusion of an International Unitisation Agreement (IUA) for Greater Sunrise as a precondition to the commitment of further funds in the area.¹²

⁴ 'Elang-Kakatua Oil and Gas Factsheets', Office of Territory Development website, Northern Territory Government, <http://www.otd.nt.gov.au/dcm/otd/otd/Fact%20Sheets/elang.html>

⁵ 'Bayu-Undan – Partnership for Development', Stephen Brand, CEO Phillips Petroleum Australia, delivered to SEAAOC conference, Darwin NT, June 17, 2002.

⁶ Ibid, note 19

⁷ 'Woodside in Northern Australia and the Timor Sea', paper presented by David Maxwell, Woodside Energy Ltd., SEAAOC, June 17, 2002

⁸ Petrotimor website, slides of presentations on boundary, economic impact and pipelines, www.ga.com/Timor_Site/

⁹ Ibid.

¹⁰ 'Elang Kakatua fact sheet', Office of Territory Development website, Northern Territory, <http://www.otd.nt.gov.au/dcm/otd/otd/Fact%20Sheets/elang.html>

¹¹ 'Project Status', Phillips Petroleum Bayu-Undan gas recycle project website, <http://bayuundan.phillips66.com/content/prjup02.htm>

¹² Phillips, Woodside, Santos presentation et al at SEAAOC.

The current negotiating positions of East Timor and Australia

The 'agreement to disagree' that underpins the current Timor Sea Treaty is very much the legacy of the divergent positions adopted by Indonesia and Australia during negotiations that preceded the conclusion of the 1989 *Timor Gap Treaty*.

East Timor, like Indonesia before it, proposes an equidistant or median line solution to the overlapping maritime claims in the Timor Sea. Australia, on the other hand, continues to adhere to its claim to the outer limits of the natural prolongation of its continental shelf at the Timor Trough. The trough is located, on average, only 50 kilometres from East Timor's southern coastline.

Australia's claim is based upon the definition of the continental shelf as first established in the 1958 *Convention on the Continental Shelf (CCS)*.¹³ It claims that the extension of its land territory seaward continues uninterrupted until the axis of the Timor Trough. Article 76 of the current UNCLOS still recognises the validity of 'natural prolongation' as a basis for continental shelf claims. However, in situations where coastal states are less than 400 nautical miles apart, Article 83 UNCLOS requires parties to negotiate on boundaries with the aim of achieving an 'equitable solution'. Recent state practice and international jurisprudence supports the proposition that in circumstances where continental shelf claims overlap, a median line is becoming the presumptive manifestation of an 'equitable solution', subject to the possibility of adjustment where equity demands. As a result, East Timor sees no need to accept a line in the gap joining the 1972 boundaries, nor does it submit itself to the role of successor to Indonesia in a 1989 Treaty with Australia that they considered to be illegal. Australia, on the other hand, is unlikely to depart from its long maintained position on the Timor Sea continental shelf. Any flexibility on this issue may call into question the legal validity of its seabed boundaries with Indonesia, which, according to Foreign Minister Downer, would be a "deeply unsettling development".

In the absence of any likelihood of a final delimitation of boundaries between Australia and East Timor in the near future, the new *Timor Sea Treaty* establishes a legal framework that facilitates commercial exploitation whilst leaving questions of sovereignty for further negotiation.

In the interim period prior to the entry into force of the Treaty, East Timor and Australia will continue to divide revenues from the Elang-Kakatua fields under the 50-50 split that applied under the previous Timor Gap Treaty. Royalties from sales of Bayu-Undan gas will not eventuate until at least 2005/6. While both countries will benefit directly and indirectly from some of the substantial upstream (preparation, development and extraction) and downstream (pipelines, processing and distribution) activities, East Timor's share is likely to be disproportionately small due to a lack of capacity and the bringing onshore of Bayu-Undan gas to processing facilities near Darwin.

¹³ Convention on the Continental Shelf 1958, United Nations Treaty series, done at Geneva on April 29, 1958 and entered into force June 10, 1964, <http://www.un.org/law/ilc/texts/contsh.htm>

Despite the obvious need for real income to advance East Timor's long-term development goals, the country's identified short-term budgetary needs appear to be covered by international donations promised over the next three years.¹⁴ However, as one of Asia's poorest nations, East Timor will inevitably look towards funds being held in escrow under the current *Exchange of Notes*. It is this economic reality that underlies East Timor's decision to sign and move towards ratification of the Timor Sea Treaty, despite concerns regarding the implications it might have for future negotiations on permanent boundaries.

How real are the pressures from oil companies?

Oil companies with vested interests in the Timor Sea have placed further pressure on Australia and East Timor to achieve prompt ratification of the new treaty. This includes finalisation of an International Unitisation Agreement (IUA) between Australia and East Timor to govern Greater Sunrise as a necessary pre-condition to investment in the next stages of development.

Outcomes concerning maritime boundaries are secondary to their principal responsibility to shareholders and investors. The extent to which their financial risks are immediate or perceived is uncertain, as is the impact that an unratified Timor Sea Treaty will have on development progress. Legal security appears ensured by the currently applicable *Exchange of Notes* and Phillips appears committed to developing the first phase of Bayu Undan.¹⁵ An agreement on tax and fiscal arrangements for Bayu Undan was achieved with East Timor in December 2001, including a commitment to provide East Timor with US\$13 million of upfront upstream benefits pending ratification of the treaty.

Unitisation and Lateral Boundaries Are Inseparable

'Unitisation' refers to the settlement of conditions governing commercial relationships, administration, development and revenue-sharing for deposits which straddle seabed boundaries, including joint development areas. Unitisation provides for the development of such deposits as a 'unitary whole'. This has the benefit of a pooling of development funds, and avoids development on one side of the boundary that is detrimental to the other.

The Greater Sunrise deposit straddles the eastern lateral boundary of the proposed JPDA, and under Annex E to the new Timor Sea Treaty, is to be divided on the basis that 20.1% lies within the JPDA, with the remaining 79.9% subject to exclusive Australian seabed jurisdiction. Revenues are to be divided in the same proportions.

The dynamics of the Timor Sea maritime boundary debate have shifted significantly since the public release of legal opinions presented at a seminar sponsored by PetroTimor in Dili in March 2002. The assertion was made that if East Timor were to

¹⁴ 'A\$815 m in aid for East Timor: Birth of a Nation, The Australian, May 16, 2002.

¹⁵ 'Drilling commences on Bayu-Undan', Project status, Phillips Petroleum Bayu-Undan Gas Recycle Project website, May 12, 2002, <http://bayuundan.phillips66.com/content/pu170502.htm>

claim their full maritime entitlements under international law, at least half of the Greater Sunrise reservoir would lie within an East Timorese EEZ.

The current easterly boundary of the JPDA is an equidistant line as between East Timor and the Indonesian island of Leti (Pulau Leti). The line is drawn giving "full effect" to the island, as though it is a continental land mass. This approach is consistent with Article 121 UNCLOS, which accords islands the full extent of maritime entitlements applicable to other land territory. However, according to a recent opinion by Lowe *et al*, the course of the easterly lateral boundary of the JPDA should be calculated so as to give a 'less than full effect' to the small island of Leti. This would have the effect of swinging the boundary east, thereby taking in a larger proportion of the Greater Sunrise deposits.

Recent state practice and international jurisprudence suggests that in certain circumstances, giving islands a lesser weight than continental masses when determining lines of equidistance between countries may be necessary so as to arrive at an 'equitable solution' as mandated by Article 83 of UNCLOS.¹⁶ Although such considerations become more complicated in the case of an archipelagic state such as Indonesia, Triggs and Bialek of the University of Melbourne Faculty of Law will argue in a forthcoming issue of the *Melbourne Journal of International Law* that it may be possible for East Timor to negotiate a 'less than full effect' eastern maritime boundary with Indonesia.¹⁷ This would suggest that East Timor has maritime entitlements to the east of the current JPDA eastern lateral boundary, and may therefore have an interest in Greater Sunrise in excess of that suggested by the Timor Sea Treaty.

The Continuing Significance of the Horizontal Boundaries

The change in focus in the public debate towards the issue of the lateral boundaries of the joint development area is in many respects justified, but the continuing impact of the median boundaries should not be understated.

From a legal perspective, Australia has substantially conceded the diminishing strength of its continental shelf arguments by agreeing to a joint development regime that gives 90% of the production derived from the JPDA to its opposite coastal state. The UNCLOS definition of the EEZ gives coastal states sovereign rights over the resources of the seabed, as well as those in the superadjacent waters or 'water column' within 200 nautical miles. State practice increasingly supports the logic of drawing a single boundary for both seabed and water column maritime jurisdiction, however, there is nothing to prevent countries from negotiating and agreeing to separate lines. Due to its 1997 EEZ agreement with Indonesia, it will be impossible for Australia to argue for anything other than a median line in the inevitable

¹⁶ 'Opinion in the Matter of East Timor's Maritime Boundary Entitlements', Paragraphs 37, V. Lowe, C. Carlton, C. Ward et al, 11 April 2002.

¹⁷ East Timor on the other hand has indicated a willingness to open maritime negotiations with Indonesia in search of mutual delimitation. They must do so as a matter of course, particularly given that no lateral boundaries have previously existed between them. The subject was featured in recent trilateral meeting also involving Australia held in Bali.

negotiation of a water column boundary with East Timor. Therefore the negotiation of a single EEZ boundary for the Timor Sea seabed and water column boundary would strengthen East Timor's claim to a median line solution.

On 23 July 2002, the East Timorese parliament passed a *Maritime Zones Act* that declared an exclusive economic zone and continental shelf out to 200 nautical miles from its baselines, as is their right under international law.¹⁸ The area is generally described rather than geographically specific. This officially creates overlapping claims to areas of seabed, including areas to the south of the current southern extreme of the JPDA as defined in the Timor Sea Treaty. Under the terms of UNCLOS, both parties are now formally obligated to negotiate their contested claims.¹⁹

If at any point Australia were to settle on a new notional median line as delimiting the Timor Sea seabed, a "Timor Bulge" would replace the former Timor Gap, creating a situation that Indonesia is unlikely to find acceptable. While neither party to the 1972 Seabed Agreements can unilaterally withdraw from the treaty²⁰, there is no doubt that international law has evolved to place more emphasis on the role of a median line as the starting point in delimiting overlapping maritime claims. From a political perspective, Australia is working hard to rebuild a bilateral relationship that was damaged in 1999 over the issue of East Timor. On the other hand, Australia is under no obligation to reopen discussions on previously agreed boundaries. An adjusted median line seabed boundary with Indonesia that mirrors the 1997 EEZ boundaries would have considerable consequences for the governance over petroleum resources and revenues in the Timor Sea. A number of known and prospective reserves have been discovered in recent decades that fall above, along or in close proximity to a potential median line. These include the large Evans Shoal fields, the currently operating Laminaria-Corallina fields to the immediate west of the JPDA and the far larger reserves of the potential Greater Sunrise project to the east would all fall well to the north of a median line shelf boundary with Indonesia.

Conclusions on Boundaries

The impact of resources held within the Greater Sunrise field is inevitably intertwined with both the eastern lateral and horizontal boundary issues. Maritime boundary negotiations between East Timor and Indonesia will provide an indication as to the rightful course of the JPDA's eastern lateral boundary, and might ultimately draw Australia into a reconsideration of the boundaries of the joint zone. If this was the case, East Timor might attempt to negotiate with Australia a shift to the east of the eastern JPDA boundary so as to "reflect" or "continue", south of the 1972 line, a new delimitation between Indonesia and East Timor that accorded a less than full effect to the Indonesian island of Leti. This would have the effect of bringing a greater proportion, or all of, the Greater Sunrise deposits within the JPDA, and therefore

¹⁸ United Nations Convention on the Law of the Sea, Part V

¹⁹ Dean Bialek, email to report author, July 11, 2002.

²⁰ 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. Also known as the International Seabed Agreement.

subject to a 90:10 split in East Timor's favour. Indonesia would gain no advantage from such a move, unless Australia agreed to reopen discussions on shifting the 1972 boundary southwards.

It is important to note that these considerations remain purely hypothetical. UNCLOS provides guidelines for determining points and lines of equidistance, but boundary delimitations and joint development regimes are largely the outcome of subjective negotiations and compromise between parties. Furthermore, changes in the political landscape have the potential to significantly alter the direction of negotiations. For example, Mr Ramos-Horta has now put a proposal to the Australian government seeking to widen the JPDA as part of a plan to give Australia responsibility for East Timor's maritime security.²¹

In moving towards ratification of the Timor Sea Treaty, two fundamental questions remain. One is the extent to which the agreed JPDA boundaries would impact upon a fair and equitable solution arbitrated under the mechanisms made available by UNCLOS. Analysis by some legal commentators notes that the ICJ and other arbitral bodies have in some cases accepted the joint development boundaries as fair and equitable because they were reached by mutual agreement through negotiations.

The second question involves the extent to which parties to a joint development are bound by their commitment to the commercial agreements and contracts of joint development in the absence of provisions for adjustment. In this circumstance, East Timor might succeed through negotiation or arbitration in delimiting boundaries which differ from the demarcations of the JPDA but be unable to access any increased benefits due to contractual obligations with petroleum operators. For these reasons, some commentators have forewarned that East Timor might be limiting their future options by ratifying the Timor Sea Treaty.

The Effects of Legal Uncertainty on Exploration and Production in the JPDA

Despite the fact that the eastern boundary of the JPDA was known to be and is now officially an area of contestation, Australia has recently issued exploration licenses and received fees to continue exploration in an area known as NT02-1, which shares an edge with the JPDA area and surrounds the large known reserves of the Greater Sunrise development area.

The materials issued by the Department of Industry to accompany the request for exploration tenders describes the Sahul geological platform as potentially rich in petroleum, extending from well east of Greater Sunrise and west across almost all of the current JPDA to the Elang-Kakatua fields. USGS modelling predicts that another 10 trillion cubic foot field is awaiting discovery in the surrounding basin.

Australia has travelled the road of continued exploration in a contested area before, dating back to the early 1970's with Portugal and now faces litigation in the Federal Courts as a consequence.

²¹ See Tim Dodd, 'Timor offers gas-for-security deal', *Australian Financial Review*, 31 July 2002.

Given the current status and increasing visibility and sensitivity of the bilateral relationship between East Timor and Australia over the Timor Sea relationship, continued exploration and issuance of licences within areas now officially subject to overlapping maritime claims is inappropriate. A decision by Australia to postpone the unilateral licensing of such activities pending final agreement on joint development or permanent maritime boundaries would be warmly received.

Timor Sea Governance Structure

The terms of the pending Timor Sea Treaty will involve the creation of a Designated Authority to carry out the day-to-day regulation and management of petroleum activities²², a Joint Commission to establish policies and regulations and to oversee the work of the Designated Authority²³ and a Ministerial Council to consider any matter referred to it by Australia or East Timor.²⁴ The Ministerial Council will consist of equal numbers of Ministers from Australia and East Timor, the Joint Commission will comprise one more commissioner to be appointed by East Timor. The Designated Authority, to be nominated by the Joint Commission for at least the first three years of the life of the Timor Sea Treaty, is thereafter to be the East Timor Government Ministry responsible for petroleum activities. As petroleum activities are to be regulated through a contract between the Designated Authority and a private entity, the East Timor appointed members of the Joint Commission could have a controlling role in those activities. However, the new treaty provides that it is open to either Party to refer a matter to the Ministerial Council, including any decision of the Joint Commission. This runs the possibility that Australia might use the power of reference to override or unfairly impede decisions of the Joint Commission.

Who Needs The Gas ?

The arguments behind the current national debate in Australia about the efficacy and importance of bringing Sunrise and Timor gas and gas products ashore apply at least in some measure to East Timor and its energy needs. East Timor has minimal industry and commerce and over 80% of the population survive on subsistence agriculture and farming. As Bishop Belo recently pointed out, the success of East Timor's future development will not result from simply expending the income received from Timor Sea petroleum in the form of economic and social support, but by using the opportunity to develop the human and economic capacity of the people of East Timor.

Most of East Timor lacks the capacity to generate electricity outside of Dili and a few district centres. All areas that have access to electricity were subject to periodic blackouts throughout the transitional period, and the blackouts are becoming more extensive since the start of the United Nations withdrawal. In an effort by the government to generate sustainable tax revenue sources, those who do have

²² *Timor Sea Treaty*, article 6 (b)(iv)

²³ *Ibid*, article 6(c)(i)

²⁴ *Ibid*, article 6(d)(i)

electricity are now receiving electricity bills that in many cases approach the already inflated costs of housing rental in a population where unemployment exceeds 70%.

During the transitional period, it was estimated that the United Nations was spending as much as US\$60,000 a week to import fuel to maintain diesel power generation at plants in Dili and district centres. In much the same way that Australia is now debating the benefits of Timor Sea gas for lower energy costs, less greenhouse gases and the industrial development that would ensue should the gas come ashore, East Timor should likewise be entitled to benefit through access to their own gas.

The conversion of the current Dili and district diesel plants to gas could lower fuel import costs and direct much-needed resources to other priorities. The construction of gas and LNG storage depots around the country could spur the growth of small industry and business, provide a foundation for tourism development and stop the rapid degradation of East Timor's forest and timber supply. Since kerosene imports largely ended following the referendum in 1999, people have had to cut down trees at an alarming rate in order to provide fuel for cooking and sterilise water.

The terms of the pending Timor Sea Treaty and related instruments do not in any way address these issues nor guarantee East Timor inexpensive access to gas produced from the current JPDA. While there are doubts as to the commercial viability of a pipeline spanning the Timor Trough to East Timor, the Timor Sea Treaty does not address the apparent imbalance in economic benefits to derive from the onshore processing of Timor Sea gas.

Given the absence of guarantees within the new TST that previously existed under the 1989 Timor Gap Treaty to ensure that participation in and benefits from development are protected, and given that no formula for some level of compensation in kind is granted until such time as East Timor has the full capacity to participate, the current review of the TST in the Australian parliament provides a perfect opportunity to redress this imbalance. Any amendments to the current arrangements must necessarily be the consequence of a consultative process with the people of East Timor, who may in fact wish to use any adjustment or compensation-in-kind to develop sustainable forms of development and energy sources that minimise reliance on fossil fuels.

The Way Forward

Given the long history and extreme complexity of bilateral efforts aimed at securing boundaries and petroleum development in the Timor Sea boundaries, Oxfam Community Aid Abroad has sought to provide a comprehensive analysis of the relevant factors that currently face the parliaments and peoples of both East Timor and Australia.

Legal opinions on the validity of the competing maritime boundary claims of East Timor and Australia vary widely, as do perspectives on the effect that the *Timor Sea Treaty* is likely to have on the possibility and content of a final resolution. There is little legal analysis that takes into account the effect that internal, bilateral and

geopolitical factors can have in influencing final outcomes. While the terms of the Timor Sea Treaty are stated to be 'without prejudice' to a final delimitation of seabed boundaries, the impact of the prevailing conditions and circumstances on finding a negotiated, arbitrated or adjudicated settlement that is fair and equitable remains uncertain.

Considering their long and ultimately successful struggle to achieve independence, the people of East Timor deserve the opportunity to pursue their desire to delimit sovereign boundaries and secure their physical place in the world as a first priority. We believe that the convergence of other factors and influences, prior to, during and subsequent to achieving their independence, have served to thwart their realisation of this goal. Following delay of the ratification process in East Timor pending the outcome of a Joint Committee Inquiry in Australia a realistic appraisal and the possibility for East Timor to establish a sovereign footprint at any time in the future now rests with the Australian Government.

ENDS.