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Submission to the President of the Republic Democratic Republic of Timor-Leste

**From
La'o Hamutuk**

**Regarding the
Decree-Law and Bylaws to establish TimorGAP, E.P.**

14 June 2011

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This submission to the President of the Republic is a revised version of La'ó Hamutuk's November 2010 submission to the Secretary of State for Natural Resources, and discusses the version of the Decree-Law passed by the Council of Ministers on 25 May 2011.¹

Introduction

La'ó Hamutuk has long supported the creation of a strong, well-managed, state-owned national oil company for Timor-Leste. Such an institution can help develop our human and nonrenewable resources and our capacity to manage them, as well as maximizing financial and other benefits to the people of Timor-Leste. It can give Timor-Leste a seat at the table (although not a controlling vote) in discussions among joint venture partners developing our petroleum reserves. In addition, a transparent, accountable, democratically-controlled national oil company is more likely to respond to the needs and wishes of our people. It could prioritize Timor-Leste's long-term interests, rather than daily share prices or quarterly dividends to foreign investors.

Unfortunately, for reasons explained below, we believe that the current version of the TimorGAP is inadequate to achieve these goals, and we encourage the President of the Republic to exercise his responsibility under Article 88.4 of the Constitution of the Democratic Republic of Timor-Leste to veto this legislation. By taking this action, the President can serious threats to our patrimony and democracy, and provide the opportunity to improve the foundation, the functioning and the form of Timor-Leste's publicly owned petroleum company so that it can advance public interests.

In other countries, national petroleum companies are often a pathway to disaster. Such companies can be used to evade responsibility for remediation for environmental damage caused by foreign companies (as in Ecuador). They can flout laws about safety or community relations, or become insolvent (as in Nigeria). They can take over state functions (as in Angola), or cause environmental disasters (as Thailand's company did in the Timor Sea). If not carefully regulated, a national oil company will become corrupt and unaccountable, increasing the severity of the "resource curse" and undermining the national economy. In reality, national companies are often more dangerous than investor-owned ones, which are accountable to stock exchange or government regulators in countries where their stock is traded.

- **When Texaco sold its projects in the Amazon jungle to Petroecuador**, the Ecuadorian national oil company took ownership of polluted land and contaminated oil equipment which continues destroying the environment, polluting lakes and rivers, bringing illness to many communities and taking away local livelihoods. Although Texaco made huge profits from Ecuador's oil resources, the people of Ecuador have inherited the responsibility to clean up their mess.²
- **Some national oil companies don't have good control over petroleum industry activities, such as PTT from Thailand.** Because they have limited experience and small budgets, these companies have difficulty implementing effective technology to prevent and mitigate environmental disasters, like the one at the Montara field in 2009.

¹ The November draft decree-laws are available in English and Tetum on the SERN website under "seminars" and also from <http://www.laohamutuk.org/Oil/PetRegime/NOC/10PETRONATIL.htm>, which also links to the Portuguese text and an unofficial English translation of the version approved by the Council of Ministers

² Four months ago, an Ecuadorian court ordered Texaco's successor Chevron to pay nearly \$20 billion in compensation for the environmental destruction the company caused, although they are appealing.

- **The Nigerian National Petroleum Company is nearly bankrupt because it has heavy loan repayments, corruption and mismanagement**, and its expenses overwhelmed its revenues.³ The Nigerian state, as the owner of the company, may have to pay its debts. In the Niger Delta, NNPC has been even worse than Shell, Texaco and Chevron in violating local community and environmental rights.

Timor-Leste officials assert that a national oil company is vital for Timor-Leste to optimize the economic benefits from our national resources, bring in new technology and develop the quality of our human resources. They have learned from national oil companies in Norway, Malaysia and elsewhere. According to these officials, these companies have performed well, both commercially and industrially. However, we should also consider negative experiences of other countries to avoid repeating their failures. Someone learning to become a doctor doesn't only study healthy people, but needs to know about diseases and their symptoms, so that he or she will be able to practice preventive and curative medicine.

During the public consultation, a SERN official said that almost every oil-producing country has a national oil company, but in reality many such countries – such as Australia, Britain and the United States – have never had them. In addition, many state-owned oil companies are being privatized, including Statoil (Norway), Eni (Italy) and Pertamina (Indonesia).

TimorGAP should be established by Parliamentary law, not decree-law.

In 2010, SERN was in a rush to establish TimorGAP so that it could participate in joint ventures to develop possible commercial discoveries in contract areas where Eni and Reliance would soon be conducting exploratory drilling. Unfortunately, those and other explorations during the past two years did not find commercial amounts of petroleum, and none are likely to be discovered before to the next bidding round in 2012 or 2013. Since there is no time urgency to create TimorGAP, there is no excuse for not following Constitutional, legal, transparent, deliberative and participative processes to enact this complex legislation with potential serious consequences.

As our July 2007⁴ submission suggested, Timor-Leste's national oil company should be established by Parliamentary Law in a public process with all political parties participating, rather than by Decree-Law approved in closed meetings of the Council of Ministers which only includes parties which are part of Government.

Although in this law, the government claims that it has the Constitutional mandate to create this national oil company, Parliament also has this competency, and the nation would be better served by a Parliamentary law for the following reasons:

- **International experience shows that the petroleum sector, especially in countries which depend on it for most of their revenues, is particularly vulnerable to mismanagement, corruption and abuse of power.** TimorGAP has long-term consequences for the State's non-renewable resources, being empowered to contract with international companies, take on debt, and undertake projects which will last for generations. It is therefore important to use

³ See, for example, "Corruption driving Nigeria's state NNPC into bankruptcy", Platts, 22 Jul 2010 at <http://www.platts.com/RSSFeedDetailedNews/RSSFeed/HeadlineNews/Oil/8932867>

⁴ La'o Hamutuk submission to the Ministry of Natural Resources, Minerals and Energy Policy regarding the Legislative Package on Reorganizing Petroleum Industry Activities in Timor-Leste on 27 July 2007, <http://www.laohamutuk.org/Oil/PetRegime/Restruc/07RestructLHSub2Jul07.htm>

the strongest, most transparent, most democratic, most inclusive and most deliberative process to establish the foundation for TimorGAP.

- **Article 92 of the RDTL Constitution defines “The National Parliament is the organ of sovereignty of the Democratic Republic of East Timor that represents all Timorese citizens and is vested with legislative supervisory and political decision making powers.” Article 103, on the other hand, states that the Government “is the organ of sovereignty responsible for conducting and executing the general policy of the country and is the supreme organ of Public Administration.”** The creation of a national petroleum company is a political decision, not the implementation of general policy already legislated by Parliament. As such, it falls within the Parliament’s mandate, rather than that of the Government.
- **Timor-Leste’s leaders overcame party differences to achieve a unanimous parliamentary vote for the Petroleum Fund Act in 2005.** This consensus model should be emulated, not circumvented. Involvement of elected representatives from both the governing parties and the political opposition is essential to provide stability for the future.
- **Constitution Article 115.3, cited in the preamble to this decree-law, reserves exclusive competence to the Government on “matters concerning its own organization and functioning, as well as on the direct and indirect management of the State.”** However, a national oil company is not merely an organizational mechanism, but a fundamental policy initiative. It more properly falls under Article 95.1, as a “basic issue of the country’s domestic and foreign policy” assigned to Parliament. In fact, this law may fall within the *exclusive* competence of Parliament as enumerated in Article 95.2 of the Constitution, as it has major implications for (p) tax policy and (q) the budget system.
- **Creating TimorGAP under Article 115.3 is a dangerously overbroad interpretation of this concept,** opening the way to cronyism and corruption in many areas. The decree-law contains several provisions which are not part of the normal functioning of a government agency: establishing reserves; issuing bonds; involvement in overseas activities; and exemption from procurement and personnel procedures. If such practices are implemented without Parliamentary authorization, it would be a precedent for Government to authorize other people to appropriate State property for personal gain.
- **Under Constitution Article 115.2(a), the Government is authorized “to submit bills and draft resolutions to the National Parliament.”** This would be the best path for enacting the proposed law on TimorGAP. The President of the Republic should veto this law and send it back to the Government, which should continue consulting with experts, the public and others. It should then submit a revised draft to Parliament for hearings, debate, amendment and approval, prior to promulgation by the President. This is the democratic and Constitutional approach, and is the only way to get the broad public and political support necessary for the stability of this new legal regime.

TimorGAP should serve the people of Timor-Leste.

Paragraph 3 of the preamble to the decree-law explains the creation of TimorGAP as a state-owned autonomous agency in order to achieve “higher managerial efficiency” to serve “the interest of the State.” We believe that its goal should be to serve the interests of the people of Timor-Leste, both present and future generations, in maximizing the benefits (including state revenues and secondary economic benefits like jobs and industrial development) and minimizing

the risks (including waste of non-renewable resources, environmental destruction and misallocation of public resources) to our population.

However, the principal reason for creating a National Oil Company is to be able to participate in discussions and decisions by corporate joint ventures exploring for and exploiting petroleum resources in Timor-Leste's sea and land territory, including the JPDA. This was the rationale for Article 22 of the Petroleum Act.⁵

In 2004, while the Petroleum Act was being debated,⁶ the Palacio das Cinzas (on behalf of then-President Xanana Gusmão) made a submission suggesting a larger role for the national oil company, as the signing party representing Timor-Leste in contracts signed with other oil companies to develop Timor-Leste's oil resources. However, this view was not accepted by Parliament or Government, and that role has been assigned to the National Petroleum Authority (ANP). The authors of that submission currently hold leadership positions in SERN, and we wonder if the current confusion about the purpose and powers of TimorGAP, discussed below, arise from the discussion five years ago.

At present, Timor-Leste is by far the most petroleum-export-dependent nation in the world, although our oil and gas reserves are limited. There is consensus among political leaders and advisors that we need to move beyond petroleum, to develop our non-oil economy for the not-too-distant day when our oil reserves will be exhausted. We are concerned that the dominant current role of petroleum in our economy directs disproportionate attention and power to the Government agencies in this sector. For example, the 2011 budgetary allocation for feasibility studies for the "Tasi Mane" project are more than double the appropriation for the Ministry of Agriculture, which relates to the vast majority of Timorese people. An unfettered national oil company could further distort these priorities, diverting resources from sectors such as education and health which develop all our human resources to spend them on an industry which will benefit only a few.

The Preamble to the TimorGAP decree-law cites Article 3 of Decree-Law 14/2003 (on public companies) as part of its legal authorization. Sub-article 3.3 states that "Proposals for the establishment of a company shall be accompanied by appropriate technical, economic and financial studies, as well as a draft organic structure of the company, including the opinion of Ministry of Planning and Finance." If these studies have been done, they should be provided to the President of the Republic and be made public prior to promulgation of this decree-law.

TimorGAP should follow the rules for state agencies.

During the Dili public consultation last November, it became clear that TimorGAP is expected to follow some Timor-Leste laws but is free to ignore others. For example, it was stated that it will obey the Petroleum Act (Article 6.2), environmental regulations (although this is not mentioned in the articles of the decree-law), the future National Strategic Development Plan (bylaws Article 24), and processes to investigate and prosecute corruption (also not mentioned in the law). However, it seems to be exempt from laws on procurement, budgeting (not being included in the General State Budget), staff hiring, salaries and Parliamentary reporting.

⁵ Law No. 2005/9, available in English at <http://www.laohamutuk.org/Oil/PetRegime/PetrolActPassedJul05En.pdf>

⁶ Submissions from that consultation, including those from the Palacio das Cinzas and La'ó Hamutuk, are available at <http://www.laohamutuk.org/Oil/PetRegime/04submission.htm>

Article 9(i) of the proposed bylaws says the Board of Directors shall “Define the general policies, including the commercial, financial, investment, environment and human resources strategic management policies.” There should be an explicit legal requirement that these policies must conform to applicable laws regarding environment, investment, business, and human resources. An unenforceable sentence in the preamble is not enough. Timor-Leste does not need a “state-within-a-state” which is exempt from laws which apply to everyone else.

SERN representatives have told us that Government processes in these areas don't work very well, which will make it difficult for TimorGAP to function. We believe that the solution to imperfect bureaucratic mechanisms is to fix them, not to circumvent them and create redundant structures. If the Government of Timor-Leste has difficulty perfecting one tendering or recruitment mechanism, will it be able to implement separate ones for every agency which is impatient with current reality? The proliferation of procurement processes (Pakote Referendum, PDD, EDTL), budgets outside normal procedures (ANP, ADN, special funds), and salary scales (ANP, national advisers) is already a problem, and TimorGAP should not make it worse.

Large items, especially, should go through normal procurement and bidding processes conducted by the Ministry of Finance. A rumor is circulating around Dili that TimorGAP will rent expensive space for its offices in a particular newly-constructed, privately-owned building. Will an open tender be held for this lucrative contract?

In order to make TimorGAP more accountable to the people of Timor-Leste, we suggest that the Council of Ministers be empowered to approve or modify fundamental TimorGAP decisions. These decisions and the policies and documents they result in should be public, published in the *Jornal da Republica* and elsewhere. In addition to the oversight from TimorGAP's internal Audit Board (bylaws article 17.1(b)), RDTL Constitution articles 95(d and e) and 145.3 require that TimorGAP's budget be approved by Parliament and its execution be subject to Parliamentary oversight. TimorGAP's budget and expenditures should also be available for investigation by the Anti-Corruption Commission, the Provedor for Human Rights and Justice, the Prosecutor-General and the Inspector General if there is suspicion of maladministration or corruption.

TimorGAP will be owned by the people of Timor-Leste, both because it is being started with \$2.5 million of the people's money from the General State Budget for 2011 and because it will extract non-renewable petroleum resources which belong to the State, according to RDTL Constitution article 139. It needs to be accountable to the citizens of this country, through their elected Parliamentary representatives and other democratic mechanisms.

According to article 8.3 of the Model Production-Sharing Contract,⁷ TimorGAP is exempt from articles 5.3(b) (annual health, safety and environment compliance plans) and 5.4 (local content rules) of the PSC. We believe that these are important provisions of the PSC, and that TimorGAP should abide by them. Although signed PSCs cannot be changed retroactively, an article could be included in the TimorGAP Decree-Law to implement compliance, and this article could be revised in the upcoming review of the model PSC.

TimorGAP needs to be transparent and accountable.

We are concerned that the proposed decree-law and bylaws do not contain the words “transparent” (except in a transitional provision), “corruption,” or “accountable.” As the

⁷ Available at [http://www.laohamutuk.org/Oil/PetRegime/PSC model 270805.pdf](http://www.laohamutuk.org/Oil/PetRegime/PSC%20model%20270805.pdf)

Government of Timor-Leste has clearly committed itself to these goals, they should be fundamental parts of TimorGAP.⁸

TimorGAP should be consistent with “the Gusmão Government’s policies and national agenda; implementing major reforms to strengthen the institutions of the state, professionalize the civil service, increase transparency in Public Finance Management and ensure good governance.” It should continue the process of “Placing the nation at the forefront of best practice in the petroleum sector ... [as] the third country in the world to be granted full compliance status by the Extractive Industries Transparency Initiative (EITI), the international oversight mechanism to ensure transparency and accountability in resource rich nations.”⁹

We share the Government’s goal of transparency, and suggest the following changes and additions to the TimorGAP decree-law and bylaws:

- **Include a legally-binding commitment to implement the Extractive Industries Transparency Initiative (EITI) and Publish What You Pay**, which requires companies to disclose all payments made to Government. When TimorGAP participates in joint ventures with other companies, this policy should be legally binding on its partners.
- **The organization’s budget should be part of the General State Budget**, approved by Parliament and with quarterly, public budget execution reports.
- **TimorGAP’s Income and expenditures should be reported** to Parliament and the public every three months.
- **“Internal human resource regulations”** (bylaws article 13.2(i)), including salary scales, should be published, and all hiring should be done through an open, fair process.
- **Fundamental policies**, including the strategic direction (bylaws article 9(a)), multiannual plans (bylaws article 9(b)), annual budget (article 8.4, bylaws article 9(b)), basic organization plan (bylaws articles 9(m) and 23), and other documents should be published when they are adopted.
- **The published Annual Report** (bylaws article 27.2) should include the Budget and Programs (Article 8.4); descriptions of participation in petroleum operations; descriptions of any investments made or joint ventures entered into; strategic, annual and multiannual plans (Article 9(b)); opinion and report from the Audit Board (bylaws Article 17.1(c) and (d)); a breakdown of how proceeds and profits were allocated; pay scales and salaries of officials at or above director level; remuneration of each member of the Board of Directors and Executive Management; a list of all officers and officials of TimorGAP; and a narrative report on principal activities and development.

⁸ These topics were explored in more detail on La’o Hamutuk’s July 2007 submission on the draft PETROTIL statute, available at <http://www.laohamutuk.org/Oil/PetRegime/Restruct/07RestructLHSub2Jul07.htm>, and most of those recommendations remain relevant, although we do not repeat them here. We commented on an earlier version in April 2007, at <http://www.laohamutuk.org/Oil/PetRegime/Restruct/07RestructLH.htm>. The current version appears no less vulnerable to corruption, conflict of interest and abuse of power than either of the 2007 versions.

⁹ “Timor-Leste’s ranking in Transparency International’s Corruption Perception Index leaps 19 countries as newer data is utilized,” press release issued by the Secretary of State for the Council of Ministers, 5 November 2010.

TimorGAP should be designed to prevent corruption.

Corruption is a problem in state-owned petroleum companies all over the world. TimorGAP will not have to comply with transparency and anti-corruption provisions of the Australian or U.S. Stock Exchanges, as Santos, Woodside and ConocoPhillips do. It will not have to obey well-established European or national regulators, such as those who try to keep Royal Dutch Shell, Eni and Statoil in line. Timor-Leste's state institutions will have the entire responsibility to keep it honest, responsible and transparent, and this is a critical and difficult task.

A reasonable reporting and transparency guideline for TimorGAP would be that required for a publicly traded, investor-owned company in a rich democracy. For example, the quarterly reports filed by Woodside and Santos with the Australian Stock Exchange provide information on sales and production from every project, as well as all exploration activities and significant financial developments. Every director's remuneration, share holdings, participation, and past and present employment are published annually. The company must report every well it drills, and the resulting discovery or production. Unfortunately, the TimorGAP statute contains none of these requirements, and it therefore endangers Timor-Leste.

Preventing corruption is more effective than punishing corruptors after the fact, and the TimorGAP statute should incorporate the following principles, especially since it is unclear which of Timor-Leste's other laws and processes intended to prevent or expose KKN will be applicable.

- **Checks and balances.** Under article 8.2 of the bylaws, the Secretary of State for Natural Resources appoints the Board, except for one member appointed by the Minister of Finance (who happens to be his sister). Ultimate authority rests with the Prime Minister, who is also responsible (Petroleum Act article 22.1) for deciding when TimorGAP will participate in Petroleum Operations. This strictly hierarchical decision-making structure fails to provide adequate protection against maladministration or malfeasance, and we encourage diversification of lines of authority and oversight to strengthen the organization. As one small step, the mandate of the National Petroleum Authority (ANP) to oversee TimorGAP's activities should be explicit in the law.
- **Conflict of interest.** The bylaws should define conflict of interest, and what level of family or financial relationship should exclude someone from participating in decision-making, winning a tender award, signing a contract or receiving a job. There could also be a time limitation for moving between employment with TimorGAP and with a foreign oil company or regulatory agency. If TimorGAP is to serve the interests of the state and people of Timor-Leste, it must be protected against manipulation to serve private interests.
- **Asset declaration.** We appreciate the addition of a requirement for declaration of assets upon assuming office (bylaws articles 18-19, although we prefer a public declaration to one filed with the Court), and they should also be declared annually thereafter, and when leaving office. False declarations should be criminally prosecuted, as well as illicit enrichment (which would be a crime under the pending anti-corruption law).
- **External audit.** Although internal audits are worthwhile, external audits by truly independent auditors (not directed by SERN or the TimorGAP the Board of Directors, as specified in Article 2.3 and bylaws Article 9(n)) are necessary to ensure fiscal accountability, and their reports should be published. When the High Tax and Audit Court is established, it can fulfill this responsibility, but in the meantime a professional outside firm, perhaps chosen by the Ministry of Finance, should be involved. Parliament, the Provedor and the Anti-Corruption Commission should also be empowered to request an external audit of TimorGAP.

- **Publish what you pay the workers.** TimorGAP is not required to use civil service hiring and payment processes (bylaws articles 13.2(i), 20 and 28.2). Therefore, it is essential that salary and benefit scales and staffing levels be published, as they are for other state employees. If Directors or others (such as advisors) receive higher remuneration, this should also be public.

TimorGAP should not be given more power than it needs.

At the November public consultation, SERN representatives said that there is no intention for TimorGAP to conduct business outside Timor-Leste, although this is explicitly allowed by the decree-law (Article 3, bylaws article 9(d)). We are also concerned about other unrelated activities, such as issuing bonds and taking out loans (bylaws articles 9(h) and 13.2(b)), or investing in other projects (many places).

These should be removed from the legislation, as they could lead to unclear priorities, over-reaching ambitions, misuse of state resources and dilution of human resources. If a specific case comes up in the future, the decree-law and bylaws can be revised, but for now the law should limit TimorGAP to its fundamental mandate. The current version adds examples of projects TimorGAP can invest in (bylaws articles 26.1 and 26.2), but it does not restrict investments to these or to the company's own activities and core functions.

TimorGAP is established as a public company so that the state of Timor-Leste can participate directly in the extraction of Timor-Leste's non-renewable petroleum reserves, which under Constitution Article 139 are "owned by the state and shall be used fair and equitable manner in accordance with national interests." Upstream oil and gas operations constitute a unique situation which requires special contracting, tax and regulatory regimes. As we have suggested since 2004,¹⁰ a Timor-Leste national oil company is an important step in developing the administrative and human resources of this country, as well as providing a window into joint ventures operating in our territory.

However, we feel that TimorGAP should not be involved in sectors which do not involve the conversion of Timor-Leste's non-renewable petroleum wealth into dollar wealth. In particular, activities which directly compete with the private sector – such as gasoline and diesel sales, refining, or other "downstream" business activities – are best left to private companies. If they are profitable, investors will come – and if they are not, Timor-Leste's people should not subsidize them through a state-owned company.

If Timor-Leste's democratic processes decide that the state should develop or intervene in a particular economic sector, this should be done by the Government directly, through democratic decision-making processes which are integrated with the Government's development program and priorities. We agree with the Minister of Finance that managers of the Petroleum Fund should not make decisions about investing in Timor-Leste's domestic economy, but should leave those decisions to the elected Parliament and Government. For the same reason, we believe that the

¹⁰ In La'o Hamutuk's September 2004 submission on the Petroleum Act, available at <http://www.laohamutuk.org/Oil/PetRegime/LH%20sub1%20Eng.htm>, we wrote "We support the creation of a Timor-Leste National Oil Company (TLNOC) as soon as practical. The primary reason for an NOC here would be to participate in the industry, developing Timor-Leste's human resources and capacity to eventually conduct its own oil exploration. ... The TLNOC should also be a partner in all joint ventures involved in petroleum development in Timor-Leste."

managers of the national oil company should not be directing state-owned funds at their discretion for investment activities unrelated to their work.

This separation of upstream and downstream activities is clear in Article 2 of the 2005 Petroleum Act, referred to in Article 4.1 of the TimorGAP decree-law. The Petroleum Act defines “petroleum operations” as prospecting, exploration, development, exploitation, sale or export of petroleum, or construction of facilities for such activities. “Petroleum” is defined as “any naturally occurring hydrocarbon, whether in a gaseous, liquid or solid state; (or a mixture thereof).” This definition does not include the results of processing or chemical conversions – LNG, diesel fuel, and asphalt are not “naturally occurring” but result from industrial processing. They are therefore outside the scope of the Petroleum Act, and should be outside the scope of TimorGAP as well.

The Government is prioritizing the “Tasi Mane” petroleum corridor in the southwest part of Timor-Leste, which is allocated \$31.1 million in the 2011 General State Budget. Most of this is for surveys and designs; actual construction will absorb much more money in future years. The budget says that these projects will be managed by the Prime Minister and the new National Development Agency, and we agree that it is appropriate to keep them within the Government’s democratically accountable processes.

The law does not specify that TimorGAP will be involved in the Tasi Mane project, although the list in article 4.1(b) implies that it will be. We suggest that TimorGAP’s statute should be clear that it will not engage in such activities, which are better conducted by Government and private sector. If a project is not attractive to private companies even with a state subsidy for design and construction, it should not be undertaken, and public resources should be directed to more labor-intensive activities which directly benefit Timor-Leste’s people, such as education, health, rural infrastructure (roads, water systems, renewable energy), telecommunications and agriculture.

Using state resources to “drive” a national development model which relies on limited, non-renewable petroleum resources is dubious at best; doing it outside of normal democratic decision-making and oversight processes is unwise. This will become even more dangerous if TimorGAP uses its power to borrow money (i.e. issue bonds, bylaws article 9(h)), thereby making future Governments liable to lawsuit if TimorGAP is unable to repay loans.

TimorGAP’s profits must be paid into the Petroleum Fund, not reinvested in the company.

Article 8.1 of this decree law states that TimorGAP “shall receive from the State, as initial incorporation fund, all operational business assets in connection with the petroleum industry owned by the State.” The General State Budget for 2011 allocates \$2.5 million to get TimorGAP started. The state is providing the initial capital, and continuing subsidies may be necessary as it will be many years before TimorGAP receives revenue from projects it partners in.

Neither the public consultation nor the decree-law mention the large sums of money TimorGAP will be required to spend to participate in petroleum operations, although Article 8.2(a) of the model PSC¹¹ states that TimorGAP will have to pay its share (up to 20%) of expenditures under “an approved development work programme and budget” “from the date of the decision” to participate in a PSC. This could be hundreds of millions of dollars which will be spent years before any revenues are received from a given field. In addition, the reduced value of the other joint

¹¹ Available at [http://www.laohamutuk.org/Oil/PetRegime/PSC model 270805.pdf](http://www.laohamutuk.org/Oil/PetRegime/PSC%20model%20270805.pdf)

venture partners' shares resulting from TimorGAP opting into a project will likely reduce their tax obligations, causing a hidden transfer of money from the Petroleum Fund to TimorGAP.

Article 8.3 says that TimorGAP takes as its property any proceeds it may earn, as well as assets, rights and obligations it may acquire. We believe that this may violate Article 6.2 of Law No. 9/2005 (the Petroleum Fund Act),¹² which states that the Petroleum Fund must receive "any amount payable by the national oil company as tax, royalty or any other due in accordance with Timor-Leste law; and any amount paid by the national oil company as dividend." The TimorGAP decree-law and bylaws does not require that TimorGAP pay any dividend at all – it could reinvest all its profits, place them in reserve, or invest them in other projects (bylaws Article 26). The broad scope of these powers could allow TimorGAP to become a virtual state within a state, as SONANGOL has become in Angola.

We suggest that TimorGAP's entire net earnings should be deposited in the Petroleum Fund, and expenditures be allocated from the General State Budget for any new investments or reserves that TimorGAP wishes to undertake. TimorGAP's Management and Board should not have the authority to funnel TimorGAP's profits away from the state.

If reserve funds (bylaws Article 26) are created, they must not be secret (which would violate Constitution article 145.2), and they should not be diverted to benefit particular individuals or interest groups. We therefore suggest that reserve funds be explicitly limited to specific functions and that they be public, transparent and subject to Parliamentary oversight.

TimorGAP should not be empowered to borrow or issue bonds by itself.

TimorGAP, as a state-owned company, is established to maximize the economic benefits to Timor-Leste from its natural resources. Therefore, TimorGAP should not decide on its own to engage in economic activity which will create risks for the state or our people, such as borrowing (bylaws article 9(h)). Such activities should follow the policies and investment strategies of the state, and should be managed by the Government and Parliament. TimorGAP investments should be restricted to the petroleum sector within the territory of Timor Leste and the Joint Petroleum Development Area.

Under the 2009 Law on Budget and Financial Management,¹³ the Government must seek Parliamentary approval before it can take out loans. We do not agree that the TimorGAP Board of Directors should have more power than the Council of Ministers to incur debt which the state must repay.

In Timor-Leste, 95% of state expenditures depend on Petroleum revenues, through the Petroleum Fund. Article 20.2 of the Petroleum Fund Act¹⁴ does not allow the Fund to be used as security or guarantee for borrowing. Therefore, if TimorGAP is allowed to take on debt, its law must clearly define that repayments can never become the responsibility of the state (even though such a provision will probably be ineffective against a lawsuit). Timor-Leste, including TimorGAP, must not burden the Petroleum Fund and future generations with heavy debt repayments.

¹² Law No. 9/2005, available at <http://www.laohamutuk.org/Oil/PetFund/PFLaw9-2005En.pdf>.

¹³ Law No. 13/2009, available at http://www.laohamutuk.org/econ/debt/LeiOrsJesFin13_2009Pt.pdf

¹⁴ Petroleum Fund Act article 20.2: "Any contract, agreement or arrangement, to the extent that it purports to encumber the assets of the Petroleum Fund, whether by way of guarantee, security, mortgage or any other form of encumbrance, is null and void."

The public consultation process was inadequate.

Timor-Leste began to create our national oil company in early 2007, under the previous Government. The current Government took three years to approve this decree-law, on which the State Secretariat for Natural Resources (SERN) held public consultations last October and November. La'o Hamutuk received the draft laws two days before the Dili consultation, and had less than a week to write our submission. Nobody in civil society had enough time to draw on outside expertise to help ensure that TimorGAP incorporates the best aspects and avoids the most dangerous risks which can be learned from the experience of other countries, in order to maximize the quality of this legislation.

Outside of Dili, most of the discussion was about the hopes and goals for TimorGAP, rather than the actual content of the decree-law and bylaws, and the Dili process did not receive enough informed input from the community, civil society and academics.

La'o Hamutuk appreciates that several of our recommendations during the consultation were incorporated in the version passed by the Council of Ministers, which is significantly better than last year's draft. The improvements include:

- Removing authorization for TimorGAP to engage in activities that are not Petroleum Operations (article 4.2 of the Decree-Law and bylaws).
- Adding a nonbinding clause to the preamble regarding health, safety, the environment and social responsibility, although it would be better to make this an article with legal force.
- Removing the tax exemption from TimorGAP that would have caused confusion for joint ventures in which it participated (former article 9.3 of the Decree-Law).
- Reducing the likelihood of political interference in TimorGAP by having its President appointed by SERN with Council of Ministers approval, rather than by the Prime Minister (bylaws article 8.2).
- Removal of the fund for unrestricted "investment purposes" (former bylaws article 9(o)), although this is made partly ineffective by bylaws article 26, which permits reserves and funds for various investment purposes.
- Increasing the size of the Executive Management from three to six or more (bylaws article 12.1), and allowing it to include people who are not on the Board of Directors (bylaws article 12.2), which may improve accountability.
- Requiring Board of Directors' approval for basic structural decisions which only needed Executive Management approval in the earlier draft (bylaws articles 13.2(f) through 13.2(i)).
- More clearly defining the responsibilities of the Audit Board (bylaws article 15).
- Adding a requirement for TimorGAP decision-makers to submit a declaration of their personal assets to SERN and the Court of Appeals prior to taking office (bylaws articles 18-19)), although this should be strengthened as discussed above.
- Removing the power to distribute TimorGAP's profits among its employees (former bylaws articles 19.2 and 25.2) or retaining profits in reserve (former bylaws article 25.1).
- Clarifying the definition and role of SERN (as the Government body responsible for supervision of the petroleum sector), which was inconsistently defined in many articles of the draft.
- Adding that the Annual Report shall be published (bylaws article 27.2), although its contents are still not well-defined.

Conclusion

Unfortunately, most fundamental deficiencies were not fixed before the Council of Ministers approved this decree-law. We are concerned that this decree-law lacks essential safeguards and robust structures which can protect Timor-Leste's interests. The Constitutionally dubious process of enacting it without Parliament weakens its legitimacy and stability. But even if it is found to be Constitutional, its many substantive shortcomings must be addressed before it comes into force – not everything which is Constitutional is good for the Nation.

La'o Hamutuk concludes that on balance, this decree-law will damage Timor-Leste's economic development, political democracy and equitable use of its non-renewable resources. Therefore, we urge the President of the Republic to utilize his powers under Article 88.4 of the Constitution of RDTL to veto this legislation, and to ask the Government to repair its defects and submit it to Parliament for enactment.

Given the many pressing matters awaiting Parliament, the early beginning of the electoral campaign, and the lack of urgency to create TimorGAP this year, it is probably best to wait until a new Government is formed after the 2012 election.

Thank you very much for your attention and consideration, and we are more than willing to discuss relevant issues with anyone who is interested.



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