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Submission to the State Secretariat for Natural Resources Democratic Republic of Timor-Leste

From
La'o Hamutuk

Regarding the
Proposed Decree-Laws to establish PETRONATIL, E.P.

24 November 2010

Contents

Introduction	1
The public consultation process is inadequate.....	2
PETRONATIL should be established by Parliamentary law, not decree-law.....	2
PETRONATIL should serve the people of Timor-Leste.....	4
This Decree-Law must be written clearly.....	4
PETRONATIL should follow the rules for state agencies.....	5
PETRONATIL needs to be transparent and accountable.....	6
PETRONATIL should be designed to prevent corruption.....	7
PETRONATIL should not be given more power than it needs.....	8
PETRONATIL's profits must be paid into the Petroleum Fund, not reinvested in the company.....	10
PETRONATIL should not be empowered to borrow or issue bonds.....	11

*This submission is based on the English draft documents distributed by SERN on 16 November 2010.*¹

Introduction

La'o 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. In addition, a transparent, accountable, democratically-controlled national oil company will respond to the needs and wishes of our people. It will prioritize Timor-Leste's long-term interests, rather than daily share prices or quarterly dividends to foreign investors.

However, 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 can be corrupt and unaccountable, increasing the risk 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 lands and defective oil equipment which continue 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 and the state of Ecuador have inherited the responsibility to clean up their mess.
- **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.
- **The Nigerian National Petroleum Company is nearly bankrupt because it has heavy loan repayments, corruption and mismanagement**, and its expenses overwhelmed its revenues.² 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 much 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 the negative experiences of

¹ The 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>.

² 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>

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 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 formerly state-owned oil companies have been privatized, such as Statoil (Norway), Eni (Italy) and Pertamina (Indonesia).

The public consultation process is inadequate.

Timor-Leste began to create our national oil company in early 2007, under the previous government. The current government has taken more than three years to prepare this draft, on which the State Secretariat for Natural Resources (SERN) held a public consultation on 18 November in Dili, although district consultations began about a month earlier. La'ó Hamutuk received the draft laws only two days before the Dili consultation, and have had less than a week to write this submission. Nobody in civil society has had enough time to draw on outside expertise to help ensure that PETRONATIL 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.

We appreciate that SERN distributed the draft laws in Tetum and English. However, errors in translation make it hard to analyze the Tetum version, and the final official version will be translated once again, into Portuguese.

We also question why the draft documents to create PETRONATIL and the Institute for Petroleum and Geology (IPG) are being discussed in the same consultation, although they have no relation to each other. Although there is time pressure to create the PETRONATIL *Empresa Publica*, there is no urgency to set up the IPG *Instituto Publico*. It would be better to let IPG wait, so that the people, SERN and the Council of Ministers can focus on the establishment of PETRONATIL.

Therefore, we consider that this consultation process is not fully effective, and will not receive enough good input from the community, civil society, and academics. Outside of Dili, most of the discussion was about the hopes and goals for PETRONATIL, rather than the actual content of the draft decree-laws and bylaws.

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

We understand that SERN wants to establish PETRONATIL quickly, so that it can participate in joint ventures to develop possible imminent commercial discoveries in contract areas S06-03 and S06-06, where Eni and Reliance are currently conducting exploratory drilling. However, the establishment of PETRONATIL should follow legal, transparent and participative processes, and should not be rushed to make up for years of lost time.

As our July 2007³ 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

³ La'ó 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>

Decree-Law approved in closed meetings of the Council of Ministers which only includes parties which are part of Government.

Although in this draft 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.** PETRONATIL has long-term consequences for the State's non-renewable resources, being empowered to contract with international companies and to undertake projects which will last for generations. It is therefore important to use the strongest, most transparent, most democratic, most inclusive and most deliberative process to establish the foundation for PETRONATIL.
- **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 the PETRONATIL 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 PETRONATIL under Article 115.3 is a dangerously overbroad interpretation of this concept,** opening the way to cronyism and corruption in many areas. The proposed laws contain several provisions which are not part of the normal functioning of a government agency: establishing reserves; issuing bonds; involvement in overseas activities; exemption from tax, procurement and personnel procedures; and profit-sharing. 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 PETRONATIL. The Government should continue consulting with

experts, the public and others. It should then submit a revised draft to Parliament for hearings, deliberation, amendment and approval, prior to promulgation by the President. This is the most 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.

PETRONATIL should serve the people of Timor-Leste.

Paragraph 3 of the preamble to the draft decree-law explains the creation of PETRONATIL 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 (include waste of non-renewable resources, environmental destruction, misallocation of public resources) to our population.

However, the principal reason for creating a National Oil Company here 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.⁴

In 2004, while the Petroleum Act was being debated,⁵ the Palacio das Cinzas (on behalf of then-President Xanana Gusmão) suggested a more expansive scope for PETRONATIL, to be 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 the Parliament or Government at the time, and that role has been assigned to the National Petroleum Authority (ANP). As the authors of that submission currently hold leadership positions in SERN, we wonder if the current confusion about the purpose and powers of PETRONATIL, discussed below, arise from the discussion five years ago.

This Decree-Law must be written clearly.

This Decree-Law is poorly drafted in many areas, and circumlocutions and vague terminology will give rise to confusion in the future. We recommend that a Definitions article be added to ensure consistent interpretation

For example, there are several references to “the body of the State’s direct administration responsible for supervising the oil industry,” “the Government body responsibility for the oil industry,” and the “industry supervisory body.” It would be better to specifically refer to SERN or ANP as appropriate, and clarify the difference between SERN’s oversight of PETRONATIL and ANP’s regulatory responsibilities for all corporate and state-owned petroleum companies operating in Timor-Leste’s territory. The phrase “the Ministry responsible for the oil industry” is used twice in Article 9 of the draft PETRONATIL bylaws, but the current Government structure has no such Ministry. Responsibility for the “oil industry” is shared among SERN, ANP, the Ministry of Economy and Development (DNMA), the Ministry of Finance (financial oversight and revenue collection), the BPA and other state agencies.

⁴ Law No. 2005/9, available in English at <http://www.laohamutuk.org/Oil/PetRegime/PetrolActPassedJul05En.pdf>

⁵ Submissions from that consultation, including those from the Palacio das Cinzas and La’o Hamutuk, are available at <http://www.laohamutuk.org/Oil/PetRegime/04submission.htm>

The Preamble to the draft PETRONATIL decree-law cites Article 3 of Decree-Law 14/2003 as part of its legal authorization. Sub-article 3.3 reads "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." We have not seen these studies, which should be provided both to the public and the Council of Ministers prior to adoption of this decree-law.

PETRONATIL should follow the rules for state agencies.

During the Dili public consultation on 18 November 2010, it became clear that PETRONATIL 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 draft decree-law), the future National Strategic Development Plan (Bylaws Article 22), and processes to investigate and prosecute corruption (also not mentioned in the law). However, it seems to be exempt from laws on procurement, budgeting (being outside of the General State Budget), taxes, staff hiring, salaries, audit and Parliamentary reporting.

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 statement that these policies must conform to applicable laws regarding environment, investment, business, and human resources. Timor-Leste does not need a "state-within-a-state" which can ignore the laws which apply to everyone else.

SERN representatives explained informally that many of the state processes in these areas don't work very well, and that they would therefore make it more difficult for PETRONATIL to function.

We believe that the solution to imperfect bureaucratic processes is to fix them, not to circumvent them and create redundant structures. If the Government of Timor-Leste has difficulty perfecting one tenderization 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), budgets outside normal procedures (ANP, Special funds proposed in OGE 2011), and salary scales (ANP, national advisers paid more than civil servants) is already a problem, and PETRONATIL should not make it worse.

Large items, especially, should go through normal procurement and tender processes conducted by the Ministry of Finance. A rumor is circulating around Dili that PETRONATIL 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 PETRONATIL more accountable to the state and people of Timor-Leste, we suggest specific additions, such as empowering the Council of Ministers to approve or modify fundamental PETRONATIL 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 PETRONATIL's internal Audit Board (bylaws article 17(b)), PETRONATIL's budget is required by RDTL Constitution articles 95(d - e) and 145.3 to approved by Parliament and its execution is subject to Parliamentary audit. It should also be available for investigation by KAK, the Provedor, and the Inspector General if there is suspicion of maladministration or corruption.

PETRONATIL will be owned by the people of Timor-Leste, both because it will start with \$2 million of the people's money appropriated in 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.

PETRONATIL will be a partner in joint ventures with investor-owned petroleum companies, or which are owned by other states. We believe it creates complications if PETRONATIL is exempt from taxation (Article 9.3(c)) but their partners are not. In particular, we believe that PETRONATIL should have the same obligation as any other PSC-holder to pay FTP royalties, profit oil, income tax, additional profits tax, value added tax, wage tax, withholding tax and other taxes required under the PSC. If Article 9.3(c) does not mean to say that PETRONATIL is free from taxes which other companies participating in petroleum operations are obligated to pay, it should be clarified.

If not, PETRONATIL's power to decide not to pay dividends or to reinvest its entire profit (bylaws Articles 23-25) could result in the *Empresa Publica* not paying one cent to the state of Timor-Leste.

According to article 8.3 of the Model Production-Sharing Contract,⁶ PETRONATIL is exempted 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 PETRONATIL should abide by them. Although signed PSCs cannot be changed retroactively, an article could be added to the PETRONATIL Decree-Law to implement compliance.

PETRONATIL needs to be transparent and accountable.

We are concerned that the proposed decree-law and bylaws do not contain the words "transparent," "corruption," or "accountable." As these are the often-stated policies of the Government of Timor-Leste, we believe they should be fundamental parts of PETRONATIL.⁷

PETRONATIL 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."⁸

We share the Government's goal of transparency, and suggest the following changes and additions to the PETRONATIL 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 PETRONATIL participates in joint ventures with other companies, these policies should be binding on its partners.

⁶ Available at http://www.laohamutuk.org/Oil/PetRegime/PSC_model_270805.pdf

⁷ 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/Restruc/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/Restruc/07RestructLH.htm>. The current draft appears more vulnerable to corruption, conflict of interest and abuse of power than either of the 2007 versions.

⁸ "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.

- **The organization's budget should be part of the state budget**, approved by Parliament and with quarterly, public budget execution reports.
- **Report income and expenditures** to Parliament and the public every three months.
- **"Internal human resource regulations"** (article 13.3(h)), including salary scales, should be published, and all hiring should be done through an open, publicly announced 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 21), and other documents should be published when they are adopted.
- **A published Annual Report** 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)); management report (Bylaws Article 17.1(c)); opinion and report from the Audit Board (Bylaws Article 17.1(c) and (d)); Balance Sheet (Bylaws Article 25), including a breakdown of how proceeds and profits were allocated; pay scales and salaries of officials at or above department head level; remuneration of each member of the Board of Directors; a list of all officers and officials of PETRONATIL; and a narrative report on principal activities and development.

PETRONATIL should be designed to prevent corruption.

Corruption is a common problem in state-owned petroleum companies all over the world. PETRONATIL 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 Government alone will have the responsibility to keep it honest, responsible and transparent, and this is a critical and difficult task.

One reasonable standard would be for the reporting and transparency requirements for PETRONATIL to be at least as strict as those 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 find or production. Unfortunately, the draft PETRONATIL statute contains none of these requirements, and it therefore endangers Timor-Leste.

Preventing corruption is better than punishing corruptors after the fact, and the draft PETRONATIL 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 apply.

- **Checks and balances.** Under article 8.2 of the draft by-laws, the Prime Minister appoints the Chair of the Board, and the Secretary of State for Natural Resources (who was himself appointed by the Prime Minister) appoints the rest of the Board. Although supervisory lines are confusing (see discussion on page 4 above), it seems that all lines lead up to the Prime Minister, who is also responsible (Petroleum Act article 22.1) for deciding when PETRONATIL will participate in Petroleum Operations. A strictly hierarchical decision-

making structure fails to provide adequate protection against maladministration or malfeasance, and we encourage some diversification of lines of authority and oversight to strengthen the organization. As one small step, the mandate of the National Petroleum Authority to oversee PETRONATIL's activities should be explicit in the law.

- **Conflict of interest.** The bylaws should define what a conflict of interest is, 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. If PETRONATIL is to serve the interests of the state and people of Timor-Leste, it must be protected against manipulation to serve personal or private interests.
- **Asset declaration.** Members of PETRONATIL's Board of Directors should be required to declare their assets upon assuming office, annually thereafter, and when leaving office. False declarations should be criminally prosecuted.
- **External audit.** Although internal audits are worthwhile, external audits by truly independent auditors (not chosen by the Board of Directors, as specified in 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.
- **Publish what you pay the workers.** PETRONATIL will not use normal civil service hiring and payment processes (bylaws articles 13.3(h), 19.1). Therefore, it is essential that salary and benefit scales and staffing levels be published, as they are for normal state employees. If Directors or others (such as advisors) receive higher remuneration, this should also be public.
- **PETRONATIL's profits belong to Timor-Leste, not to its staff.** Earlier drafts of the PETRONATIL bylaws provided for profit-sharing among employees, and we were glad to see Article 25.2 deleted from the latest version. However, Article 19.2 of the PETRONATIL bylaws says that "The internal regulations referred to in Article 13.3(h) may provide that a share of the employees' remuneration be linked to the Company's productivity and results." In addition to violating the Petroleum Fund Act, this causes employees to prioritize short-term productivity rather than longer-term state interests, which could undermine the Constitutional (Articles 61.1 and 139.1) and legal (Petroleum Act articles 6.1, 23.1(i) and 23.2) requirements to conserve and manage petroleum resources for maximum public benefit. Profit sharing has no place among state employees -- are tax collectors to be paid a percentage of the revenues they collect? Purchasing agents to receive a percentage kickback for the contracts they award? Public servants should be paid salaries for their work – not awarded commissions on monies that pass through their agency.

PETRONATIL should not be given more power than it needs.

At the 18 November public consultation, SERN representatives said that there is no intention for PETRONATIL to conduct business outside Timor-Leste (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). We suggest that these 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 PETRONATIL to its core mandate.

PETRONATIL 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 2004,⁹ 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 PETRONATIL should not be involved in sectors which do not involve the conversion of Timor-Leste's non-renewable resources into cash. In particular, activities which directly compete with the private sector – such as gasoline and diesel sales, refining, or other normal 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. Rather, if Timor-Leste's democratic processes decide that the state should intervene in a particular economic sector, this should be done by the Government directly.

This separation of activities is clear in Article 2 of the 2005 Petroleum Act, referred to in Article 4.1 of the draft PETRONATIL law. It 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 PETRONATIL as well.

The Government is focusing on a "Tasi Mane" petroleum corridor in the southwest part of Timor-Leste, which is allocated \$36 million¹⁰ from the new Infrastructure Fund in the proposed 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 draft law and public consultation were not explicit about PETRONATIL's involvement in construction or operation of the Tasi Mani project, and we believe that PETRONATIL's statute should be clear that it will not be involved in such activities, which are better managed by the government and private sector. If this project is not attractive to private companies even with a state subsidy for design and construction, it should not be undertaken, and state resources should be directed to more labor-intensive activities which directly benefit Timor-Leste's people, such as

⁹ 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."

¹⁰ The "Expenditures" part of Budget Book 1 says \$36 million, although Annex 2-B to the proposed Budget Law says \$31.1 million, of which \$23.6 million is for "oil and gas infrastructure."

education, health, rural infrastructure (roads, water systems, renewable energy), telecommunications and agriculture.

Using state resources as a “driver” for 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.

We are concerned that PETRONATIL may interfere in market mechanisms for retail fuel sales, as the Executive Management is authorized to set “price policies and basic price structures” (bylaws article 13.3(c)). We hope we misunderstand this article, as the experience with subsidized retail sales of rice in Timor-Leste and fuel in Indonesia should not be repeated. If, at some point in the future, the State decides that market mechanisms for distributing petroleum products to our citizens require price controls or subsidies, this should be done by the Government itself, not by an Empresa Publica, and subsidies should come from the state budget.

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

Article 8.1 of this decree law states that PETRONATIL “shall receive from the State, as initial incorporation fund, all operational business assets in connection with the petroleum industry owned by the State.” The proposed General State Budget for 2011 allocates \$2 million to get PETRONATIL started. Although the state is providing the initial capital, it is unclear whether continuing subsidies are planned.

Nothing was said in the public consultation or draft documents about the money PETRONATIL will have to expend to participate in petroleum operations, although Article 8.2(a) of the model PSC¹¹ states that PETRONATIL will have to pay its share (which can be up to 20%, but could be less) of expenditures under “an approved development work programme and budget” “from the date of the decision” to participate in a PSC. This could be many millions of dollars which will have to be expended years before any revenues are received from a given field. In addition, the reduced value of the other joint venture partners’ shares resulting from PETRONATIL opting into a project will likely reduce their tax obligations, causing a hidden transfer of money from the Petroleum Fund to PETRONATIL.

Article 8.3 says that PETRONATIL 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 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 PETRONATIL decree-law and bylaws does not require that PETRONATIL pay any dividend at all – it could reinvest all its profits, place them in reserve, or invest them in other projects (bylaws Articles 24 and 25). The broad scope of these powers could allow PETRONATIL to become a virtual state within a state, as SONANGOL has become in Angola.

We suggest that PETRONATIL’s entire net earnings should be deposited in the Petroleum Fund, and expenditures be allocated in the State Budget for any new investments or reserves that

¹¹ Available at http://www.laohamutuk.org/Oil/PetRegime/PSC_model_270805.pdf

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

PETRONATIL wishes to undertake. PETRONATIL's Management and Board should not have the authority to redirect PETRONATIL's profits away from the state.

If reserve funds are to be created, it is important that they not be secret (which would violate Constitution article 145.2), and that they 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.

PETRONATIL should not be empowered to borrow or issue bonds.

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

In Timor-Leste, 95% of state expenditures depend on Petroleum revenues through the Petroleum Fund. Article 20.2 of the Petroleum Fund Act¹³ does not allow the Fund to be used as security or guarantee for borrowing. Therefore, if PETRONATIL is allowed to take on debt, its law must clearly define that repayments can never become the responsibility of the state. Timor-Leste, including PETRONATIL, must not burden the Petroleum Fund and future generations with heavy debt repayments.

Thank you very much for your attention and consideration, and we are happy to discuss these or other relevant concerns with anyone who is interested.



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¹³ 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."