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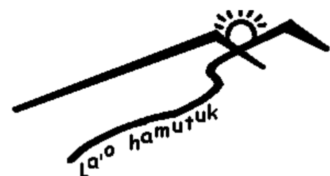

Submission to the National Petroleum Authority Democratic Republic of Timor-Leste

from

La'o Hamutuk

regarding the

Draft Regulation for Petroleum Operations Relating to Subsea Petroleum Resources in the Timor-Leste Exclusive Area

and the

Draft Model Timor Leste Onshore and Offshore Production Sharing Contracts

30 June 2014

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Main points

1. The drafts include confusing language, ambiguous clauses, missing definitions, omitted legal references, wrong numbering and many other errors which should be corrected.
2. The role of the ANP should be made clearer, rather than frequent references to the "Ministry."
3. Many provisions on environment, health and safety should be improved, including those discussing management of discarded materials, legal frameworks, minimizing risks, banning flaring, defining "best practice" and "reasonably practical," health and safety committees and audits, sanctions, and protecting against companies' negligence or malfeasance.
4. Timor-Leste's interests are broader than simply maximizing production of oil and gas, but encompass state revenues, environment, sustainable development, and minimizing risks of injury, damage or corruption.
5. Before onshore exploration begins, local communities need more consultation and protection.
6. Transparency is generally ignored and sometimes prohibited by these draft regulations and contracts, and needs more attention, requirement and protection.
7. Even though local content is unlikely to be a significant element in building Timor-Leste's non-oil economy, it needs better definition and clearer requirements.
8. Timor-Leste should receive more revenues from extracting our oil and gas, and not be so generous to the companies.
9. Obligatory monetary "contributions" from companies are inappropriate, as they violate budgetary and democratic processes.
10. All revenues – taxes, royalties, fees, penalties – must be deposited into the Petroleum Fund as required by the Petroleum Fund Law.

Introduction

La'o Hamutuk appreciates the opportunity to comment on the draft Regulation for Petroleum Operations Relating to Subsea Petroleum Resources in the Timor-Leste Exclusive Area and the Model Timor-Leste Onshore and Offshore Production Sharing Contracts.

As we wrote in our blog,[1] we are disappointed that the public (including civil society groups like ours) were only given a few weeks to comment on regulations which have been in process for three years. In the short time available, we have not been able to consult extensively with legal or technical experts who could have helped us be more effective in supporting ANP to ensure that these regulations protect and serve Timor-Leste's interests.

We urge ANP and others involved in this process to take more time putting them into force. Our brief review found many errors in drafting and concept which make Timor-Leste more vulnerable to greedy foreign oil companies, or which create legal uncertainty that could give rise to misunderstanding, disputes or lawsuits. Timor-Leste is already spending tens of millions of dollars for legal fees relating to conflicts over revenue-sharing agreements and petroleum taxes, and new regulations like these should, as far as is reasonably achievable, prevent such disputes in the future.

This submission is based on the English versions of the documents posted at http://www.anp-tl.org/webs/anptlweb.nsf/vwAll/PUBLIC%20CONSULTATION. Although Portuguese is the legal language in Timor-Leste, the petroleum industry worldwide functions in English, and we expect that companies who will sign these contracts and must obey these regulations will use the English

[1] http://laohamutuk.blogspot.com/2014/05/private-public-consultations.html

versions, which is perhaps why the Portuguese draft regulations say "Tradução" on every page. Therefore, it is important that they be accurate and clear, using correct and consistent terminology.

The draft regulations have numerous errors in section numbers and cross-references, such as starting articles 8, 9, 11 and 12 with paragraph "8.7", for example, rather than "8.1," and the English differs from the Portuguese translation. In this submission, we have tried to figure out the intended references when the printed ones are obviously wrong, although we usually use the (sometimes erroneous) section numbers in the draft English documents in our commentary which follows.

Definitions and specificity

Several omissions in definitions will make it difficult to understand these documents, which must be unambiguous for effective implementation and regulation. For example, the documents repeatedly refer to the "Petroleum Act" which is not defined. We believe that it refers to Law No. 13/2005 of 2 September on Petroleum Activities.

More generally, there are several references to "all licenses, permits, approvals or consents" or to "applicable law" in the draft regulations and PSCs. It would be good to be specific about what is required, as international oil companies cannot be expected to be experts on Timor-Leste's legal code. More concretely, companies should be informed that civil and penal codes, labor laws, tax laws, environmental laws, international treaties Timor-Leste has ratified and other such statutes apply.

The definition of "TLEA" refers to "any onshore area" but the boundaries of "onshore" are not defined, which is important in a country influenced by tides and monsoonal rivers.

Throughout the regulations, the word "Ministry" is used, which should be defined as the Ministry of Petroleum and Mineral Resources or the "Ministry with responsibility for the Petroleum Sector." However, the designation of the "Ministry" as the primary regulator may contradict Article 26.1 of Decree-Law no. 20/2008 on the National Petroleum Authority which states that *"Powers and functions of a regulatory nature, and rights and obligations related to petroleum and gas and related products industry, which were originally granted by law or contract, directly or in representation, to the Ministry in charge of the petroleum sector as the public contracting party, shall be vested in the National Petroleum Authority."*[2] However, the only reference to "ANP" is the draft regulations is in paragraph 3.1(3) as owner of technical data (which should actually be the State of Timor-Leste), and its initials are not spelled out.

In that regard, the only mentions of the ANP in the draft Production Sharing Contracts after the title page are in Article 16.5 on attending meetings and Article 20.3(b) on insurance, when in reality it has much broader powers and responsibilities.

However, the petroleum resources belong to the State of Timor-Leste, and the Ministry of Petroleum and Mineral Resources represents Timor-Leste in making petroleum contracts for the benefit of our people. Therefore, we suggest that the phrase "Ministry Share" in PSC Articles 9 and 10 should be changed to "Timor-Leste share," which is more consistent with Article 139 of the RDTL Constitution.

In the PSCs, "petroleum" needs to be defined, in light of Bayu-Undan helium dispute and because PSC article 2.6(a) depends on its precise meaning.

Environment, health and safety

The definition of "Environmental Impact Assessment" following Regulation Article 1 should refer to Decree-Law No. 26/2012 of 4 July, the **Basic Law on Environment,** in addition to Decree-Law No. 5/2011 on **Environmental Licensing**. On the other hand, it seems superfluous to reference Decree-

[2] *"Os poderes e funções de carácter regulador, bem como todos os direitos e obrigações assumidas na qualidade de contratante público, relativos à indústria do petróleo, do gás natural e dos seus derivados, que por lei ou contrato, directamente ou em representação, estavam atribuidos ao Ministério responsável pelo sector do petróleo passam à titularidade da ANP…"*

Law No. 41/2012 of 7 September, the Organic Law of the Fifth Constitutional Government, in this definition. This section should also define what an "Environmental License" is.

The first paragraph of Article 17.1 (17.7 in the English version) refers to "applicable law…," but it should refer to these two specifically, as well as others. This paragraph should inform Authorized Persons that they need to do more than "submit" EIA, EMP and other documents, but that they need to hold the required consultations, perform the revisions, and obtain environmental licenses from the National Environment Directorate for each relevant project activity, as described in DL 5/2011.

The definition of **"Waste Material"** as "useless material" without "economic value" discourages recycling, as many "waste" materials do indeed have economic value, including natural gas and helium. The definition refers to materials "acquired, used or generated" during Petroleum Operations, although some materials (packaging, surplus and used items, etc.) are not "generated" during Petroleum Operations but will be discarded by them. Similarly, Article 17.2 (numbered 17.8 in the English draft) regarding handling and management of materials should apply more broadly than narrowly defined "waste" but should include all material discarded, leaked, spilled or disposed of by an Authorised Person or his subcontractors or workers.

The definition of **"Safety Case"** refers to keeping risks "as low as reasonably <u>possible</u>" while other parts of the draft regulations refer to "as low as reasonably <u>practical</u>." We suggest that the former, stricter standard should apply in all areas of health, safety and environmental protection. The Portuguese version uses "ALARP" in all such articles, but this English-language acronym is not defined. In areas of public safety, the stricter standard ALARA (As Low as Reasonably Achievable) Should Be Applied.

We appreciate the requirement in Article 6.2(o) that a proposed development plan must include methods to achieve **zero flaring**, but this is contradicted by Articles 6.1(3), 17.8(3)(a) and others which describe how flaring will be allowed. It would be better to prohibit all flaring and venting of natural gas except in the event of an emergency.

We are concerned by the many references to "**industry best practice**" in the draft PSCs and **"Good Oil Field Practice"** in Article 16.10(2) and other parts of the regulations. These two clichés are undefined, unmeasurable, unenforceable goals. In reality, the global oil and gas industry has repeatedly shown that is cannot be relied on to behave responsibly, as accidents and negligence from Montara to Deepwater Horizon have shown. Timor-Leste deserves better than normal industry practice, and our laws must require it.

In Article 16.9(1), a project should ensure protection of "health, safety, hygiene and welfare" of everyone, not only those "directly involved with or otherwise impacted by Petroleum Operations and Facilities." Everyone should be protected from such impacts, whether or not they are "directly" involved or impacted, and this phrase should be removed.

In Article 16.13, the **Health and Safety Committee** should include representatives selected by the workers, perhaps through their labor unions, as well as from major subcontractors. This Health and Safety Committee should be responsible to approve the reports described in Article 16.15, and these reports should be made public.

The **Health and Safety audit** described in Article 16.17 should be conducted and/or verified by ANP and/or a third party, and not left for the contractor alone to do, as the contractor will understate risks and error so as to minimize their costs.

Under Article 17.9, in addition to paying compensation, the authorized person may be subject to **civil and criminal sanctions under environmental laws** in force (including Articles 34-35 of D-L 5/2011 and Articles 59-62 of D-L 26/2012), just like anybody else. ANP's regulations must not supersede or contradict Laws and Decree-Laws, which are higher in the legislative hierarchy.

Article 17.10 implicitly contradicts the requirement for **insurance** in Article 28.1(b) of the Petroleum Act. Insurance premiums are allowed as a recoverable cost by proposed Article 19.8(1)(b), which means that Timor-Leste is partly paying for them, and implicitly owns a portion of money paid by the

insurance company to cover a third party claim. It also is inconsistent with PSC article 20.3(d) which allows cost recovery for claims which exceed the insurance coverage.

We do not agree with allowing the contractor to recover costs due to their own negligence or legal violations, as this reduces the incentive for the contractor to avoid such behavior. Cost-recoverable insurance policies (PSC Article 20.3) should explicitly exclude coverage for fines, penalties or other consequences of negligent or criminal behavior, thereby lowering the premiums and the cost to Timor-Leste. The company alone should bear the responsibility for such behavior and resulting sanctions and compensation, and if they choose to insure themselves against the costs of such malfeasance they should pay for it themselves.

This intention is embodied by paragraphs 2.8(r and t) and 3.7(c) in Annex D of the draft PSCs, which appropriately make the contractor liable for costs of non-compliance, wilful misconduct and negligence, but that principle should be extended to insurance premiums. Similarly, paragraph 3.12 in PSC Annex D should not allow cost recovery for claims resulting from negligence or malfeasance.

Regulations Article 19.8(1)(b) requires insurance to "be commensurate with those customary for the industry," which is not a well-defined standard, given past industry practice.

We are also concerned about the ***Force Majeure*** definitions in article 21 of the model PSC, which allow the contractor to escape responsibility for many normal events. Specifically, paragraph 21.1(a)(iii) should not allow "any occurrence due to natural causes" to be a *force majeure* exception. Contractors should anticipate and safeguard against normal events like storms, high tides, heavy winds, small earthquakes and lightning, and should not be exempted from liability in such cases, leaving Timor-Leste and its citizens to bear the consequences alone.

Looking out for Timor-Leste's interests

As Timor-Leste's current experience with the Greater Sunrise project shows, Timor-Leste authorities must be allowed to reject a proposed Development Plan which they believe is not in the **nation's best interest**. However, Article 6.3(2) of the draft regulations only mentions requirements of applicable law and Good Oil Field Practice as conditions that Timor-Leste can stipulate. We believe that the "Ministry" should be able to require other modifications to the Development Plan to make it better serve the country's overall national and economic interests. We also suggest that the "within reasonable time of receipt" requirement for "Ministry" response in Article 6.3(3) either be deleted or be made more specific, as it is currently meaningless.

The regulations contains numerous references to "**independent third party consultant**," including articles 5.5, 5.6, 5.7(6), 7.7, 8.10(2), 13.12(2), 16.16(3), 21.9(3) and the definition (without "independent") following Article 1, as well as PSC paragraph 10.2(b). These should be clearer that the "Ministry" has the right to accept or reject such a consultant in advance, or perhaps to nominate them. A consultant selected and paid by a company cannot be truly "independent," as a company who can award future contracts to a "third party" will implicitly or explicitly influence that "third party" not to report things the company would prefer were not known.

Article 10.5 and others describe a "**Decommissioning Fund**," but apparently the amount which that Fund should contain is not calculated until near the end of production or the contract, in the Decommissioning Plan. A preliminary estimate should be part of the Development Plan, subject to "Ministry" approval, which can later be modified by the Decommissioning Plan. We agree with PSC Article 6.1(b) that establishment of and payments into this Fund begin when production starts, and should not be deferred until a Decommissioning Plan is made 2-5 years before it ends, and therefore its amount needs to be established sooner.

Article 11.12(4), describing the factors the "Ministry" may consider in evaluating a prospective Assignee, should include the **ethical, environmental, governance, corruption, legal and human rights records** of any prospective Assignee, not only its "financial and technical capabilities." A similar evaluation process should be conducted of the companies initially signing a new Production-Sharing Contract, but we did not find this in the regulations, and it should be added. Article 21.7(4),

listing factors the "Ministry" can consider, should also include these areas, and should recognize that every citizen is a "potentially affected person" due to Timor-Leste's overwhelming reliance on petroleum revenues to finance state activities.

In the same way, the information specified in PSC Schedule E for transferring operatorship should also apply to the initial selection of the operator when the PSC is first signed. It should include data on the company's financial and environmental record going back much more than three or five years. It should also require specific information about any criminal or civil claims against the operator in relation to petroleum activities anywhere, any time, and about any settlements or rulings which found them negligent or in violation of legal requirements.

"State-owned contractor" in Article 12 should be clarified to mean companies owned by the State of Timor-Leste, as it could refer to Statoil or Petronas. Although Article 2 of Law No. 13/2005 (Petroleum Act) defines "State-owned contractor" as one "controlled, directly or indirectly by Timor-Leste," the draft regulations and PSCs do not define it. The regulations should refer to Decree-Law 31/2011 or otherwise make it clear that this is a contractor primarily owned by the State of Timor-Leste.

We are concerned that the draft onshore PSC has no provisions which explain how the company should relate to **local communities** they will be operating in. It should cover good communications with local residents, access to land, employment for local people, compensation for rights of way, environmental impacts and land use, rights of transit and ongoing community use of areas under contract, among others. More fundamentally, we have seen during the last decade that projects with large commercial or government backing (so-called "national interest"), such as the Suai Supply Base and Timor Plaza, often violate Timor-Leste people's rights to free, prior and informed consent and fair compensation, and we urge much more caution before any on-shore oil and gas contracts are issued and exploration begins.

Transparency and accountability

Timor-Leste is justifiably proud of its record of transparency in the petroleum sector, including EITI, contract transparency, and revenue management. However, these draft regulations and PSCs take the country backwards, and are grossly deficient in **making information available to the public**. Transparency is an essential tool to allow citizens to hold companies and officials accountable for the wise use of state resources, as well as to protect the public interest.

In the nine years since the Petroleum Act was enacted, Timor-Leste has increased its commitment to transparency, which we appreciate. These new regulations should require public availability for the following:

- Approved Development Plans (Article 6.3)
- Annual exploration reports (Article 4.6)
- Annual production reports (Article 6.11), including the reports on Health & Safety (Article 16.5) and environment (Article 16.11(u)). (The reference to Article 6.2 in article 6.11(1)(v) appears incorrect.)
- Pipeline annual reports (Article 8.13)
- Local content proposals, overall and annual plans and reports (Article 18.2, 18.8, 18.12)
- Summaries of annual work programmes (Articles 4.1, 6.4)
- Reserves estimates (Article 6.12), which are also needed to Estimate the Sustainable Income each year. Projected production and revenue estimates should also be public.

The regulations should require companies to comply with all Extractive Industry Transparency Initiative **(EITI)** requirements, not only "reporting of payments" as specified in article 11.10, and should inform the companies of other requirements for transparency, such as publishing PSCs as mandated by Article 30 the Petroleum Act.

Article 20.9(3) of the regulations and Paragraph 16.6 of the PSC **limit information** that companies can share with the public, including with their investors (such as in annual reports), and they should be removed. Companies should be encouraged, not prohibited, to provide more information than the minimum required by law. For example, compliance with EITI would be banned under these clauses unless it was legally compulsory. La'o Hamutuk and others supports the global Publish What You Pay campaign, which encourages voluntary transparency beyond legal requirements, and Timor-Leste should not tell companies not to participate.

In addition to stating that information in general "shall not be confidential" except in specified cases, Regulation Article 20.9 should explicitly say that such information shall be published or otherwise made publicly available.

The proposed PSCs also need to **support transparency more effectively**. For example, Paragraph 16.1(b) could mention the ANP website, *Jornál da República* and EITI reports as ways to disseminate information.

We are concerned that "project data" is not clearly delineated, which is important because PSC Paragraph 16.3(e, f, and g) requires that the Ministry hide it from the public when it is most relevant. More generally, PSC Paragraph 16.3 (as well as the appropriate regulation) should require the Ministry to make information available to the public, not merely allow it to choose to do so, except for a few narrowly defined exceptions.

Regulations Article 21.1(3) [incorrectly numbered as 21.7(3)] allows the Ministry to "give appropriate opportunity to Persons or representative institutions of groups of Persons likely to be affected to make representations" regarding a proposed PSC or Development or Decommissioning Plan. This is an overly-restrictive reference to **public consultations**. Timor-Leste is one of the most petroleum-dependent countries on earth, and every citizen is affected by petroleum activities. Inclusive public consultation should be encouraged, and the relevant authorities should listen and respond to public views.

Paragraph 19.4 of the PSC needs to be made consistent with the laws and Constitution of Timor-Leste. In addition to the Ministry's right to audit the Contractor's books, accounts and records, such materials must also be made available to, among others, the Ministry of Finance, the Anti-Corruption Commission, the High Administrative Tax and Audit Court, and the Prosecutor-General of the Republic. Although the first of these is a "representative of the government" as specified in 19.4(b), the others are independent state agencies.

Local content

Around the world, the oil and gas industry provides fewer jobs per dollar invested or revenue received than virtually any other economic sector. Therefore, we do not believe that **local content** will be a major factor in helping Timor-Leste develop an equitable, sustainable economy. Nevertheless, we encourage provisions in these regulations and PSC which seek to maximize the benefits to Timorese workers and suppliers from the oil industry. This should be focused on effectively utilizing resources the companies have, such as internships and entry-level jobs for Timorese workers, so that they can learn skills and gain experience which could be applied in a range of sectors.

The definition of a **"Timor-Leste Supplier"** is too broad to accomplish meaningful benefits to the domestic economy, which is its purpose. It should require more than 5% ownership – and the red alternative wording in the draft has no minimum percentage. Given the shortage of genuine local suppliers, it could be better to have a two-level system, with a preferred category of *Genuine Timor-Leste suppliers* comprising companies which are majority-owned by Timorese nationals and which supply "Timor-Leste Goods," and a second choice of *Timor-participating suppliers* -- companies which have some Timorese ownership. Otherwise, a few rich Timorese business owners will front for foreign companies and importers to create "Timor-Leste Suppliers" who don't employ any Timorese workers and buy nothing from the local economy.

Similarly, "Timor-Leste Goods" should be defined more clearly – is part B intended to mean that half of the costs were incurred in Timor-Leste and half the materials were produced here? Also, the standard in A for an item to be "100% designed and engineered" in Timor-Leste is unachievable (designs always build on earlier designs from other places), so that local manufacture of a foreign-designed item should be acceptable.

In article 11.3 (incorrectly numbered as 11.9), the decision to **limit exports** of oil and gas should not simply be "declared by the Prime Minister" but should require an official Resolution of the Council of Ministers, so that companies don't worry that an arbitrary whim could force them to break contracts with their customers. Such a decision, including the notice from the "Ministry", should be more specific as to what kind of petroleum, where, at what price, etc. Is the intention of this article that Timor-Leste will take some or all of its share of production in kind, or can it cover the entire production of a project?

In Article 18.3.1(2)(d), one preference is for "**suppliers who potential partner with Timor-Leste**." What does that mean? A joint venture with the State of RDTL, or an E.P. owned by the State, or a supplier to the State, or a company which includes public officials on its board?

Article 18.3.2(2) refers to the "Ministry website" but the Ministry of Petroleum and Minerals Resources doesn't have a website. Is this intended to refer to ANP's website? More generally, this section could be stronger if it referred to procurement regulations already in force in Timor-Leste.

Article 18.3.3 and other relevant articles apply to "any process for the procurement of goods and services." We suggest that there should be a threshold, perhaps $500, and that complex procedures should not be required every time someone goes to a store to buy a few pens and notebooks.

Article 18.3 (misnumbered as 18.10) should specify that the RDTL Labor Code applies, and that any workers who are not Timor-Leste nationals must have the appropriate visas.

The article numbered 18.13 should specify who carries out the third-party Local Content Audit, and who chooses and approves the selection of the auditor.

Paragraph 7.5 in the PSC, requiring companies to make monetary "contributions" for education and other petroleum-related state activities, should be deleted, as discussed in the next section.

Collect as much revenue as is reasonably acceptable

The only valid reason for TL to allow extraction of the oil and gas deposits under our land and sea is to provide revenues to the state, which will then enable the government to provide services and improve the lives of our citizens. For marginal fields, we should not make tax and other concessions which will allow companies to profit but will not benefit our people. Developing any field brings administrative, environmental and social risks and costs, and Timor-Leste should only encourage oil and gas projects which are lucrative enough to justify these negative impacts.

Timor-Leste's petroleum officials are confident that we have significant undiscovered oil and gas reserves, and we hope that they are right, and that La'o Hamutuk's analysis that such fields are unlikely is wrong. However, we should not subsidize company projects which are primarily speculative or have other motives (such as development of new technology) by giving away their potential benefits.

We agree that the "government take" should be based on the price of oil and gas, as in Offshore PSC Article 9.1(b)(iii and iv). We appreciate learning from experience with the old PSCs where Timor-Leste and Australia's "Profit Oil" was shared 50-50 with the contractor, but we think that the percentage of **"Government Take" should be higher** than 55% when the price of oil goes above $80/barrel (at the moment, the Brent Crude price is $114; it has been above $80 since late 2010), perhaps by defining another price class above $100, as the draft Onshore PSC does.

In many countries, "profit oil" is shared 30% to the contractor and 70% to the state. Timor-Leste should design a contract where the "Government take" is higher when the price of oil goes up, to 65%

when the oil price is above $80, and to 70% when the price goes above $100. With this higher share combined with high taxes on company revenues (more than the 10% in the current tax law), Timor-Leste can maximize revenues when the price of oil rises and production continues for a long time.

The 80% Cost Recovery Ceiling in offshore PSC Article 8.1(d) is higher than in many other countries, For example, Cameroon has a ceiling of 60%, Sudan and Vietnam have 45%, and Angola has 50%. We suggest that Timor-Leste should limit cost recovery to 45-60% of the value of the oil and gas produced. The draft onshore PSC has no ceiling (i.e., 100%) for cost recovery, and we suggest that it should also be between 45% and 60%.

The table in paragraph 9.1(a) of the Onshore PSC is ambiguous. Does the company pay 6% royalty on the first 10,000 barrels, and then 8% on the next 15,000 – e.g. 7% of the total if production is 20,000 bpd? Or do they pay 8% on everything if production is between 10,000 and 25,000 bpd? The gas table has a similar problem.

Paragraph 9.1(c) in both PSCs reduces the government take when the sales price is lower. Is it possible that a company could negotiate a lower price with a customer (with perhaps a *quid pro quo* somewhere else) so that they can pay less to Timor-Leste? Our interests could be better protected if the price classes were based on a global indicator, such as Brent Crude Oil, rather than sales from the individual project.

Although Timor-Leste is a small nation with deep seas, we believe that companies are still interested to explore and exploit our petroleum reserves. Therefore, we must ensure that this development benefits Timor-Leste as well as the companies, by increasing our people's share of the profits to the highest amount the companies can accept.

Other financial issues

We suggest **removing Paragraph 7.5 in the PSC**, which obliges companies to "contribute" money for scholarships and other petroleum-related State activities. Decisions about allocating money for education and other State functions should be done through the democratic budget process conducted by Government and Parliament. All money the companies pay to Timor-Leste should be deposited into the Petroleum Fund, as required by the Petroleum Fund Act, and then be appropriated through the General State Budget.

It is inappropriate to "shake down" the companies to fund specific activities beyond the scope of developing their petroleum projects. Tax and royalty rates in the PSC should be set to the maximum level which does not deter companies from developing our resources. If the extra charges described by this paragraph do not make us too expensive for companies to be interested, equivalent amounts should be assessed by raising the tax or royalty rates, not by creating a revenue stream which circumvents fiscal mechanisms.

We hope that companies will be generous and public-relations minded enough to engage in **Corporate Social Responsibility** as a non-recoverable cost, although we realize that it is often meant to increase their image with the public and political leaders. However, CSR is the companies' decision and responsibility, not something dictated by contract. Moreover, most people in Timor-Leste realize that we need to reduce our dependency on oil and gas and strengthen the non-oil economy, while Paragraph 7.5 undercuts our ability to do that.

Companies have expertise and openings for interns, trainees and apprentices in the energy sector, and Timor-Leste should encourage them to provide such opportunities for Timor-Leste students and workers. But that is not the same as telling them to pay for someone else to do it.

Although PSC Paragraph 7.5(a) says that these obligatory "contributions" are not recoverable costs, PSC Annex D Paragraph 3.2(d) could be understood to mean that such contributions are indeed recoverable, and needs to be clarified.

Paragraph 6.1 of the draft regulations discusses **"prudent production"** as *maximizing the amount of petroleum* extracted from a given deposit. We suggest that this is the wrong goal – the objective should be to *maximize the benefits* to Timor-Leste from petroleum production. There is no reason to produce if the cost is higher than the return, or if collateral costs to environment, health, safety or local communities outweigh the benefits. Prudence does not only come in barrels.

We appreciate that Timor-Leste has learned from our experience with ConocoPhillips, and that PSC Paragraph 19.2 requires contractor to keep financial records in Timor-Leste. This should also be included in regulations paragraph 21.9.

Regulation paragraph 22.7 should be specific that penalties and other liabilities cannot be charged against the project as recoverable costs, as specified in PSC paragraph 2.8(g).

The administrative and other fees in regulation paragraphs 23.7 and 23.8 violate Article 6 of Law No. 9/2005 on the Petroleum Fund, which requires that "any amount received by Timor-Leste relating directly to petroleum resources" must be **deposited into the Petroleum Fund**. Paying such fees directly to the "Ministry" (or ANP) to spend as they see fit also violates principles of budget allocation and transparency. Timor-Leste inherited a system of direct payment of fees to the TSDA for the bi-national JPDA, but there is no reason for this convoluted, illegal system to be used for TLEA or onshore activities.

In the same light, Offshore PSC Paragraph 12.1 (12.2 in the onshore PSC), requiring contractors to pay "all fees and other payments" to the "Ministry" (of Petroleum) is illegal – such payments must be made into the Petroleum Fund, in coordination with the Ministry of Finance Petroleum Revenue Directorate.

PSC paragraph 10.2(b) is confusing, as exploration in a contract area may continue even after development has begun. Is the State-Owned Contractor liable for a share of costs of such exploration after the SOC becomes a participant? The important terms "carried interest" and "working interest" are not defined in definitions or in paragraph 10.1, but should be.

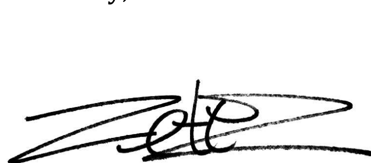
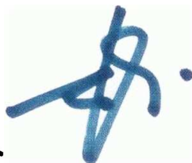
Paragraph 11.2(a)(1) of both draft PSCs refers to paragraph 11.1(a) which does not exist. More generally, Article 11 is missing many specifics and needs to be more carefully drafted. For example, what price is Timor-Leste obligated to pay for oil and gas purchased under this Article? Paragraph 11.2(c) mentions "Regulation Chapter 14," which is about Title to Assets, not about pricing.

PSC Annex D paragraph 3.2(b) disallows personal income taxes as recoverable costs. It should also disallow wage income tax and withholding taxes, as those are the terms used in Timor-Leste, even if they are paid by the employer.

Conclusion

This ends our submission. Thank you very much for your attention, and we continue to be ready to provide information or clarification.

Sincerely,

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