

From: Afranco@worldbank.org
To: mnrnep@bigpond.com
Date: 5 June 2007
Subject: WB comments on new Draft Legislation to Reorganize Petroleum sector

Dear Madam/Sir,

Please find attached World Bank preliminary comments on the draft Decree Laws, dated 21 November 2006, proposing reform of the petroleum regulatory industry and establishment of a National Oil Company.

The Bank welcomes the work done in regard to the proposed reorganization of the petroleum sector as well as the consultation process that is being undertaken. The Bank looks forward to further dialogue with the Government on this important legislation, and would provide more detailed technical inputs on the revised laws once new drafts become available for consultation.

We are grateful for this opportunity to comment, please accept assurances of our highest consideration.

Kind regards,

Antonio S. Franco
Country Manager, Timor-Leste
Tel: +670 723 0550/723 1960
Fax: +670 332 1178

WORLD BANK COMMENTS/OBSERVATIONS ON THE DRAFT LAWS FOR THE REORGANISATION OF TIMOR-LESTE'S PETROLEUM SECTOR

As part of the public consultation process, the World Bank has undertaken a review of the draft laws, dated 21 November 2006, for the reorganisation of Timor-Leste's petroleum sector, which have been proposed by the Oil and Gas Directorate of the Ministry of Natural Resources, Minerals and Energy Policy—i.e., the umbrella petroleum regulation, the decree on the national regulatory authority for petroleum, natural gas and biofuels, and the decree on the national oil company. The Bank submits the following preliminary comments/observations on the draft laws for the Government's consideration.

The Bank welcomes the work done in regard to the proposed reorganization of the petroleum sector as well as the consultation process that is being undertaken. The Bank looks forward to further dialogue with the Government on this important legislation, and would provide more detailed technical inputs on the revised laws once new drafts become available for consultation. In addition, given the salient, complex, and difficult issues under consideration, *the Bank would encourage the Government to engage leading petroleum sector legal experts (as was done for Timor-Leste's overall petroleum sector regime) to advise on the revision/redrafting of the laws*, to ensure that they are consistent with existing legislation and international best practice.

Comments/Observations on the Consultation and Approval Process:

- **Wider Public Consultation Process.** Given the impact that these laws will have on the petroleum sector, and thus the country, *a wider process of public consultation, with adequate time for discussion by all stakeholders (e.g., government, civil society, development partners, etc), is advisable.* We recognize that consultations are ongoing. The public consultation process undertaken in 2004-2005 on Timor-Leste's draft petroleum sector legislation was exemplary. It would be advisable that the current consultations on the new draft laws be equally wide-ranging, open, and transparent. To enhance inclusion and participation, the new draft laws should be made available in a language (or languages) widely understood by the majority of the population, and enough time should be given for stakeholders to understand and comment on the laws.
- **Adoption by Parliament.** Given the public interest involved, and in keeping with the process followed for Timor-Leste's overall petroleum sector legislation, *discussion and adoption of the new laws by the Parliament* would allow for greater public debate and would ensure public accountability and transparency, in line with the Government's stated commitment to this principle, which has been widely accepted under the overall petroleum sector legislation, particularly the Petroleum Fund Act.

Comments/Observations on the Content of the Draft Laws:

- **Transparency.** *As currently drafted, the laws appear inconsistent with the principle of transparency that the Government adopted as part of its petroleum sector legislation, and may run counter to the spirit of the Government's commitment to implement the Extractive Industries Transparency Initiative.* The public reporting and disclosure provisions proposed for both the regulatory authority and the national oil company are limited in strength and scope, and would benefit from considerable reinforcement to include explicit provisions for financial disclosure and annual reporting to Parliament. The laws should also call for the independence of appointed auditors and the publication of audits as part of annual reporting processes. Having adopted the principle of transparency in the Petroleum Fund Act, the same level of transparency and accountability would be expected in regard to the policy, decision-making, and supervision mechanisms for the agencies being created by the new laws.
- **Concentration of Power, Weak Checks and Balances.** *The draft laws concentrate considerable discretionary authority in the Minister of Natural Resources, with few checks and balances by the other branches of government and limited public scrutiny.* The Minister would be responsible for minerals and natural resources sector policy; chair the proposed National Energy Policy Council (and appoint its civil society, academic, and private sector representatives); oversee the national petroleum regulatory authority; appoint members of the Board of Directors and have significant influence on the appointment of members of the Supervisory and Executive Boards of the proposed national oil company; nominate Timor-Leste's representatives to the Joint Commission for the JPDA; and represent Timor-Leste on the Ministerial Council created by the Timor Sea Treaty. The reporting requirements and accountability mechanisms associated with many of these duties are not explained. For instance, the relationship/reporting modality between the national petroleum regulatory authority and the Minister of Natural Resources is not delineated. Given the multiple roles proposed for the Minister, the potential for conflict of interest could also be significant. The system of checks and balances adopted for the Petroleum Fund serves as good guidance for establishing similar checks and balances in regard to the new agencies.
- **Potential Inconsistency with Existing Petroleum Sector Legislation.** *Overall, the legal basis for the regulations is unclear and would benefit from further and more deliberate consideration by petroleum sector legal experts.* Article 31 of the Petroleum Act permits the making of regulations. However, *the scope of the Petroleum Act is understood to be limited to upstream activities, which means that proposals regarding the national petroleum regulatory authority's involvement in*

downstream activities (e.g., refining, transport, etc.) would be inconsistent with what the Petroleum Act permits. The provision in relation to the regulation of imports and exports may also be problematic.

- ***Unified Management of Petroleum Revenues.*** While it is important for an entity such as the national petroleum regulatory authority to have a well-identified source of funding, *the proposal for it to retain fees and income from petroleum activities is inconsistent with the Petroleum Fund Act, which states that all receipts from petroleum activities should flow into the Petroleum Fund, and through the Petroleum Fund to the State budget.* It is then through the State budget that funding for Government programs, agencies, etc., is determined. The Petroleum Fund Act would likely require amendment to allow financial autonomy for the national petroleum regulatory authority, which would go against the spirit of accountability and transparency codified in the Act. It is thus recommended that any such amendment be avoided. *Likewise, it is recommended that all of Petrotil's revenues flow into the Petroleum Fund.*
- ***Rationale for Statutory Regulatory Authority.*** While the establishment of an independent petroleum regulatory body would serve to ensure competitiveness in recruiting high calibre petroleum sector specialists, the rationale for the creation of the regulatory authority and its relationship to the Ministry of Natural Resources remain ambiguous. The law should clarify these points.
- ***Role of National Energy Policy Council.*** While such a Council can be a useful mechanism for coordinating the Government's energy sector policy and regulation, *a closer look at the Council's proposed duties in relation to the duties of existing entities (e.g., the Ministry of Natural Resources, the Council of Ministers, etc.) is warranted.* For instance, the draft law indicates that the proposed Council would provide guidance to Timor-Leste's representatives on the Joint Commission: does this mean that the Council of Ministers and Prime Minister would no longer do so?
- ***Governance of the National Oil Company.*** *The governance provisions set out in the draft law on the national oil company appear weak, and leave many unanswered questions in regard to Petrotil's establishment.* While we are not against the establishment of such a company per se, we suggest that additional consideration on the timing of its establishment is warranted. Possible weaknesses in the draft law for its creation should also be addressed. For instance, no provision is made for the dismissal of members of the Board of Directors, nor is it clear to whom either the Supervisory Board or Board of Directors report. As an Empresa Publica the national oil company should be open to parliamentary scrutiny, and thus clear provision should be made for Petrotil's accounts to be submitted to Parliament for review. Clear provision for annual audit, in accordance with International Accounting Standards, should also be made, and the law should contain detailed public information provisions similar to those of the Petroleum Fund Act (subject to considerations of corporate competitiveness and state confidentiality). The protections against conflict of interest are limited, and only preclude Directors from voting on decisions regarding companies in which they have personal holdings. The protections should be broader in application. Provision exists for distribution of profit to workers and the Board, but the profit percentage is unspecified. It is not clear what is intended by 'simplified supply and contracting procedures'; in line with the principle of open and transparent procurement, competitive tender is the norm. Who will staff Petrotil, and what implications will this have in regard to the staff of the Ministry, which currently houses most of the country's petroleum sector expertise? *Finally, further information on the means by which the initial capital outlay of US\$10 million is calculated would be useful;* typically, this should be based on the results of a feasibility study.