Gas, money and spies: Time running out for Timor-Woodside deal

Unless the project that's been in the pipeline for 20 years and is potentially worth $20 billion is producing LNG before the end of this decade, East Timor faces bankruptcy.

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The Australian government, energy giant Woodside Energy and the tiny island nation of East Timor are locked in a high-stakes, 20-year stand-off.

The tensions cut across the global energy price crunch, geopolitical power plays involving Canberra and China, a spying controversy, East Timorese nationalism, a big taxation opportunity and the economic viability of one of Australia's closest neighbours.

At the heart of the wrangle is: if, and where, a potential $20 billion liquefied natural gas project in the Timor Sea will pipe and process gas recovered from waters in the Greater Sunrise field, situated 150 kilometres off East Timor and 450km north-west of Darwin.

In a game of political-corporate brinkmanship, Woodside is adamant the only commercial option is to process the gas at the established energy hub of Darwin.

But powerful East Timorese political leaders, including returned President Jose Ramos-Horta and influential former president and independence fighter Xanana Gusmao, insist the LNG processing plant must be constructed at the island's south coast, to create jobs and economic prosperity for its impoverished citizens.

Tripartite negotiations between East Timor, Australian government officials and Woodside are at a sensitive stage, according to sources close to the discussions. East Timor's government has lobbied the new Foreign Affairs Minister, Penny Wong and Resources Minister Madeleine King.

There is speculation that East Timor may try to dump Woodside as the project's operator and joint venture partner. But close observers worry such a move could deprive East Timor of its only path to economic security and create problems for Australia.

The Greater Sunrise gas field is 56.56 per cent controlled by state-controlled company Timor Gap. The project's operator, Woodside, has a 33.44 per cent interest and the technical experience to get the project off the ground. Japan's Osaka Gas has a 10 per cent stake.

The value of gas and condensate resources in the Sunrise field has been estimated at more than $US50 billion ($70.2 billion).

A decision due before the end of this year will determine the flow of potentially tens of billions of dollars in revenue to Woodside shareholders and both governments via royalties. Yet, unless the project gets the go-ahead soon and is producing LNG before the end of this decade, East Timor faces bankruptcy.

Under financial pressure, Western foreign policy officials worry the fledging democracy could become unstable and be vulnerable to China's overtures.

The Albanese government wants Sunrise developed as quickly as possible, in a "commercially viable" and "technically feasible" manner, in line with a 2018 maritime treaty signed with East Timor.

Oil and gas dependence

Oil and gas accounts for 80 per cent to 90 per cent of East Timor government revenue to pay for public spending. The existing Bayu-Undan offshore gas field in the Timor Sea, 250km south of East Timor and 500km north-west of Darwin, is due to run out by late this year, depriving Dili of almost its entire annual revenue.

The country's $US18 billion petroleum fund is on track to be depleted by about 2030, leaving East Timor with no money to fund basic services for its 1.3 million citizens.

Parker Novak, who worked in Dili for 18 months until 2019 as the East Timor program director for the pro-democracy, Washington-based International Republican Institute, says getting Greater Sunrise producing gas is critical to the country's future.

"They've got to get Sunrise developed and producing meaningful revenue by the late 2020s," Novak says.

"Timor's political leaders have spoken for years about diversification and avoiding the 'resource curse', but they're about to run head straight into it ... if Sunrise doesn't work out, economically there is nothing else."

Under a maritime boundary and revenue sharing deal renegotiated in 2018, Australia is entitled to 20 per cent or 30 per cent of the royalties from Greater Sunrise and East Timor is eligible for 70 per cent or 80 per cent.

To fully understand the standoff, it is necessary to revisit the history of the Timor Sea revenue sharing arrangements. The East Timorese harbour mistrust towards Australia and Woodside over one of Canberra's most contentious acts in foreign affairs.

In 2004, the Howard government offered to better physically secure the office of East Timor's first democratically elected prime minister, Mari Alkatiri.

That offer followed the internationally acclaimed peace-keeping mission by Australian soldiers who protected the East Timorese after it secured independence between 1999 and 2002 from its Indonesian occupier.

But Australian Secret Intelligence Service officers, dressed as tradesmen, planted listening bugs in the prime minister's office in Dili.

The secret devices enabled Australian spies to eavesdrop on East Timor's political leaders during their private deliberations for negotiations with Australia for dividing the Timor Sea maritime boundary around Sunrise.

Australia, sitting across the negotiating table on maritime boundary negotiations, knew the private thoughts of its inexperienced and undersized interlocutor.

Acting under the guise of a friendly neighbour helping a poor emerging nation, Australia resorted to espionage partly for the corporate benefit of Australian-based oil and gas companies keen to develop Greater Sunrise. Woodside was a major joint venture partner at Sunrise, with Phillips Petroleum (a precursor to ConocoPhillips) and Shell.

A 2005 treaty secured Australia and East Timor a 50-50 split of the royalty revenue from Greater Sunrise. A maritime boundary favourable to Australia was locked in for 50 years. This was despite Greater Sunrise being about three times closer to East Timor.

The deal was promoted by the then-foreign affairs minister Alexander Downer as a big win for East Timor because it was an improvement on the previous 18 per cent it was entitled to and the 82 per cent Australia previously controlled. Downer (now a columnist for *The Australian Financial Review*) later joined Woodside as a consultant after exiting politics.

Former US diplomat and chief oil and gas negotiator for East Timor, Peter Galbraith, in 2019 told The Guardian that the spying was “shocking” “corporate greed” undertaken by the Australian government as “shills for the corporations”.

Spying on governments for political purposes is widely considered fair game. But governments spying and collecting intellectual property for corporate purposes is generally considered to be crossing a red line – acts for which the United States and Australia often condemn China.

Forced back to the negotiating table

The secret intelligence advantage that Australia held over East Timor may never have been exposed, except for an ASIS whistleblower, known as “Witness K”.

Initially, he reported his concerns to the intelligence watchdog, the Inspector General of Intelligence and Security, and later an approved lawyer, Bernard Collaery.

Collaery believed Australia had breached international law and the maritime boundary treaty was void. He reported the alleged breach to the United Nation’s International Court of Justice.

Collaery, in his book *Oil Under Troubled Water*, also alleged Australia secretly connived to hide billions of dollars worth of helium gas from the Bayu-Undan gas field, a move that former Victorian Labor premier Steve Bracks says was “our betrayal of the Timorese”.

“While our army was on the ground bravely bringing peace to a shattered land, in Canberra our Department of Foreign Affairs and Trade was scheming to deny Timor-Leste billions of dollars of desperately needed revenue,” Bracks wrote in a forward to Collaery’s book.

In a similar blistering assessment, former Financial Review journalist and former adviser to East Timor, Paul Cleary, says in his book, *Shakedown: Australia’s grab for Timor oil*, “Australia, the country which had delivered freedom to the Timorese by intervening against Indonesia’s bloody attacks in 1999, was now trying to deny it a fair share of the [oil and gas] profits”.

Nevertheless, Collaery and Witness K were charged in 2018 by Australian authorities for breaching intelligence laws. Witness K received a three-month suspended sentence. The new Labor federal Attorney General, Mark Dreyfus, in July this year dropped the charges against 77-year-old Collaery, who is a former attorney-general of the Australian Capital Territory.

(The influential Gusmao thanked the Albanese government for abandoning the charges and said the decision “allows our countries to move forward in a positive way to strengthen our friendship and cooperation”. The disclosures by Collaery and Witness K forced Australia back to the negotiating table on the maritime treaty and revenue sharing deal.)

A new deal with Australia

After a long and tortuous international arbitration, in 2018 a new deal was signed. Instead of the 50-50 split under the spy-tinged treaty, East Timor is now entitled to 70 per cent of the royalty revenue from Sunrise if the gas is processed in East Timor, or 80 per cent if the gas is processed in Australia. Australia will receive 20 per cent if the gas is piped to Darwin, or 30 per cent if East Timor processes the gas.

The revenue sharing agreement is designed to compensate the country that doesn’t secure the broader economic development benefits of onshore gas processing.

East Timor is proposing new greenfield developments at three sites along its Tasi Mane south coast at Beasso, Betano and Suai, including new ports, a refinery and connecting highways.

But Darwin has the advantage of existing LNG infrastructure including a port, processing plants, highways and a skilled workforce.

To accommodate new gas supply from Sunrise, Woodside probably needs to strike a deal to expand processing capacity by building new LNG trains at either Santos’ Wickam Point plant or the Inpex-operated Ichthys processing facilities at Bladon Point.

An independent report for the international conciliation commission process in 2018 estimated that East Timor would require a $US5.6 billion subsidy to build the project locally, to achieve an adequate rate of return that would attract equity and debt financing.

Woodside considers East Timor as too expensive and too risky. Observers also say Woodside would need to factor in sovereign risk, the potential for corruption, workforce challenges and the potential need to fly-in, fly-out workers if the processing plant was built in East Timor.

But East Timor’s political leaders and influencers are not backing down. A confidential report prepared for East Timor’s government and leaked to the *Financial Review* last month found that the stalled gas project could be built and run at a similar cost in East Timor, instead of Darwin.

The ERCE consultancy report, commissioned by state-owned Timor Gap, estimated that the total capital expenditure for the LNG project construction would be $US11.8 billion in Darwin and $US14.1 billion in East Timor, according to the report finalised in July 2021.

ERCE estimated that annual operating costs for upstream, midstream and downstream gas processing would be $US1.3 billion a year cheaper in East Timor at $US5 billion, versus $US6.3 billion in Darwin.

Engineering challenges

Underlining differing views between Woodside and East Timor, a footnote in the report says some of the operating costs are based on Timor Gap's "upstream and downstream cost estimates which differ from operator" Woodside.

Several energy industry experts, including East Timor sympathisers, are sceptical of the findings. While the 150km distance to East Timor is three times closer than Darwin, the massive pipeline would need to be laid along the bottom of the "Timor trench", which is up to 3000 metres below the water surface.

Oil and gas engineers say this is technically possible, but highly risky due to the geology of the seabed depression that would risk the pipeline being damaged from seismic activity.

In contrast, a pipeline stretching 450km to Darwin would be laid along the continental shelf, where pipelines already run from other oil and gas fields north of Australia.

Veteran oil and gas engineer Geoffrey McKee says he advised energy companies and East Timor political leaders including Ramos-Horta between the late 1990s to the mid-2010s on developing Sunrise, and originally pushed for the gas to be piped to East Timor.

"I feel very guilty about this pipeline idea because I promoted it in 1999," McKee says. "It's very expensive and very risky at 3000 metres down.

"But East Timor has still got this fixation on onshore and see it as a game of chess they have to win, but they've lost the whole bloody project at great cost to the people."

Speaking from Vietnam, McKee says technology advancements since his onshore processing idea mean that a floating LNG platform at Sunrise is a better option.

"It's more cost-effective than a greenfield site," McKee says. "But the floating LNG didn't give Gusmao the onshore economic benefits."

Diminishing appeal of floating LNG

Sydney-based Credit Suisse energy analyst Saul Kavonic says: "Developing Sunrise via existing LNG infrastructure in Darwin is more economically compelling than via a new site in East Timor.

"Unless a government is willing to provide a multibillion-dollar subsidy on geopolitical grounds, Sunrise is either going to be developed in Darwin, or not developed at all, in our view."

Kavonic says floating LNG is no longer a good option. "Floating LNG [FLNG] was considered years ago, but is no longer a viable option following Shell's exit from Sunrise, alongside less appetite for such large-scale FLNG projects in the region in the wake of the disappointing experience at Prelude."

Floating LNG produces natural gas on a platform offshore, with tankers then collecting the LNG. Shell's Prelude floating LNG project at the Browse Basin around the North West Shelf off Western Australia has had mixed success and the technology has proven more costly than hoped.

Moreover, Shell in November 2018 sold its 26.56 per cent interest in Sunrise, robbing Woodside of a potential joint venture Sunrise partner with floating LNG experience. East Timor spent $US650 million buying out Shell and ConocoPhillips four years ago to gain majority control of Sunrise.

ConocoPhillips executive Chris Wilson said at the time: “While we differ on the proposed economic development option, we recognise the importance of Sunrise to the nation of Timor-Leste and hope the sale of our interest to the government allows them to progress their vision for the development of Sunrise.”

Gusmao was the special representative overseeing East Timor’s buyout, giving it an almost 57 per cent share. Observers have questioned the poor East Timor spending finite taxpayer money on the project.

East Timor has also built a new $US135 million airport on the south coast, in the hope of attracting the gas processing plant and demonstrating the supporting infrastructure that it is capable of providing. But observers say the new Suai airport is largely empty and only has the occasional light plane arriving because most commuters fly to the Dili international airport.

Moreover, the $US18 billion sovereign wealth fund, which is usually well governed, had $US1 billion raided just before the April presidential election to pay for social assistance for resistance fighters.

A hot political issue

Nevertheless, Gusmao remains determined to secure onshore gas processing and is waging a battle to secure economic sovereignty and independence for East Timor.

The independence fighter Gusmao – president from 2002-2007 and prime minister from 2007-2015 – does not currently occupy an official position in the government but is viewed as a de facto leader wielding influence with senior politicians.

His dream of a local LNG processing plant has become a hot political issue around recent and upcoming elections. The largest party in the governing coalition, Fretilin, had been neutral on whether to build the project at home or in Darwin. But around elections, opposing local processing would not be a popular political message.

Approaching the April 2022 presidential election and next year’s parliamentary elections, the returned president and Nobel Peace Prize winner Ramos-Horta and the Minister for Petroleum, Víctor da Conceicao Soares, have openly barracked for the onshore project.

Parliamentary elections are due in the first half of next year and there is speculation that Gusmao could possibly return as PM, or at a minimum, remain a power player.

“There is a lot of politics around it,” Novak says. “This has been his baby for a long time ... He is absolutely convinced this is going to deliver the country’s economic future and be the legacy he is going to bequeath.”

Gusmao spent 17 years as a guerrilla resistance fighter in the jungles before being arrested in 1992 and jailed for seven years in Indonesia. His persistence has kept proving naysayers wrong, such as achieving independence and the 2018 renegotiation of the maritime boundary.

Novak says while he is sympathetic to East Timor's objectives, the better option for the people of East Timor is probably to build the project in Darwin. "There are a lot of viability questions and I tend to think Timor hosting the LNG processing plant is rosily optimistic," Novak says.

The countries and Woodside are trying to conclude a governance and legal framework this year, including a production-sharing agreement between the joint venture partners, a petroleum mining code, tax and royalties, custom rules and emergency management.

At the tripartite negotiating table are East Timor's National Petroleum and Minerals Authority, Australia's Department of Industry, Science and Resources and Department of Foreign Affairs and Trade, and the project's energy partners from Woodside, Timor Gap and Osaka Gas.

East Timor hopes that the new Labor government may be sympathetic to East Timor, given the new government's interest in greater economic and diplomatic engagement with island neighbours.

One argument that supporters of East Timor are making is that by helping East Timor to build a new port and wharf for the project, it could strategically block China and be a geopolitical win for Australia and its Western allies.

One external consultant even suggests the pipeline could be armed with Western intelligence apparatus to spy on Chinese navy ships and submarines.

China's presence in East Timor is growing through the construction of other infrastructure and aggressive diplomacy. One former adviser to East Timor says Australia's betrayal of East Timor during the spying scandal backfired and gave China an opening to move in.

Western officials worry that a financially desperate East Timor could become easy prey for a cashed-up China seeking to expand its influence in the Pacific and south-east Asia, as it has already done via a security agreement with the Solomon Islands.

In 2019, East Timor signed a memorandum of understanding with state-owned China Civil Engineering Construction Corporation to build a port at the proposed gas processing plant site at Beasso for an estimated $US943 million. However, the deal never completed, with third-party investors apparently balking.

Alan Dupont, an Australian former senior national security adviser and former adviser to East Timor says Australia must look at the situation strategically, beyond pure commercial terms.

Courting Chinese investment

"If we don't support East Timor's economic development, that opens up the opportunity for China to exploit it as they have in other places," he says. "The East Timor elites are fully committed to getting this processing facility in East Timor.

"If Woodside doesn't come to the party, I'm pretty certain East Timor will look elsewhere to build the processing plant and China would be the logical place to look."

Novak says East Timor has been trying to entice Western investment from Australia, the US, Japan and Europe for years. "But they have been courting Chinese investment for years for this project and other infrastructure too."

He recalls driving along a brand-new highway on the East Timor south coast in 2018 that was built by China under the Belt and Road Initiative. “It was a beautiful road,” he says. But within a month, there was a giant landslide that took out a very large section of the road and, for months and months, it wasn’t fixed.”

Drivers were detoured on to the opposite side of the road along a one-way stretch for 1 to 2 kilometres, he says.

And industry experts are unsure if China has the oil and gas expertise like Woodside to construct the undersea pipeline.

Oil and gas prices

Woodside wrote down its 33 per cent interest in Sunrise to a value of zero in July 2020, when oil price futures turned negative during the pandemic. Oil prices have since unexpectedly rebounded strongly to above $US100 a barrel this year, underpinned by sanctions on energy-rich Russia’s unprovoked invasion of Ukraine

The energy price spike and search for new sources of oil and gas outside Russia have led to calls from Woodside chief executive Meg O’Neill for “serious consideration” to be given to kick-starting stalled gas mega-projects, including Sunrise.

O’Neill said in April the energy crisis fuelled by Russia’s invasion of Ukraine “may help pick up the pace in progressing those discussions” on the Sunrise scheme’s production-sharing contract.

Woodside is adamant that East Timor’s stipulation that an LNG plant is built on its southern coast is not viable.

“The economics of taking gas to Timor Leste and building new plants just are prohibitive – so that’s something that needs to get cracked – but the PSC [production sharing contract] terms need to get sorted out first,” O’Neill said in April.

“The field is closer to existing LNG infrastructure. There’s potentially some interesting opportunities there to use existing facilities. So just from an economics perspective, taking the gas to Timor-Leste and building a brand-new plant just doesn’t make sense.”

A former Western adviser to East Timor and long-time supporter of the country sums up the situation: “What this country desperately needs is revenue before 2030.”

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