Bounty versus Boundaries:
The pursuit of equity and certainty over and down under the Timor Sea
CONTENTS
EXECUTIVE SUMMARY .................................................................................................................. 4

What conditions have impeded boundary settlement between East Timor and Australia? ......................... 5
What are the reasons for Australia’s apparent lack of enthusiasm for a boundary settlement? ..................... 5
How has Australia sought to protect its position? ..................................................................................... 5
The report therefore finds and recommends that Australia: ...................................................................... 6

INTRODUCTION
An Overview Of Current Circumstances ................................................................................................. 8

CURRENT STATUS BETWEEN EAST TIMOR AND AUSTRALIA .......................................................... 8
AN ORIENTATION TO THE OCEAN AND SEABED BOUNDARIES ISSUES THAT STILL DIVIDE .............. 9
A SNAPSHOT OF THE PETROLEUM RESOURCES INTERTWINED WITH THE BOUNDARY ISSUE .......... 10
THE CIRCUMSTANCES THAT UNDERLIE BOUNDARY NEGOTIATIONS .............................................. 11

PART ONE • TIMOR SEA UP TO THE 1999 BALLOT
The Historical Underpinnings Of The Current Impasse ......................................................................... 12

A GAP BELOW TIMOR IS CREATED BY AUSTRALIA AND INDONESIA
The 1971 And 1972 Seabed Agreements ................................................................................................. 12
PETROLEUM BEGINS TO FILL THE GAP
Exploration Sets The Stage For Commercial Development ...................................................................... 14
AN AREA WITHIN THE GAP IS DEFINED BY A DEVELOPMENT AGREEMENT
Australia And Indonesia Negotiate A 1989 Commercial Treaty To Exploit Petroleum ............................. 14
THE 1989 TIMOR GAP TREATY
A Treaty For Joint Development Without Seabed Boundaries Settled ................................................ 15
Anecdotal Description Of The Zones Of Development Cooperation ...................................................... 16
Legality of the 1989 timor gap treaty and boundaries challenged .......................................................... 16
BOUNDARIES CHANGE BUT THE SEABED REMAINS THE SAME
1997 Treaty With Indonesia Establishes Eez And Water Column Only ............................................... 17
WORKING THE GAP AS INDEPENDENCE BALLOT APPROACHES .................................................... 18

PART TWO • TIMOR SEA TRANSITION TO INDEPENDENCE
The Break With The Past But An Uncertain Future For Boundaries ....................................................... 20

INTERIM MEASURES ON THE WAY TO A FRAMEWORK ARRANGEMENT
Untaet Replaces Indonesia In The 1989 Treaty ...................................................................................... 21
NEGOTIATIONS BEGIN TOWARDS A NEW TREATY
‘Seabed And Commercial Development Treaty’ Or A ‘Provisional Agreement Of A Practical Nature’ ....... 21
Negotiations Advance While Boundaries Recede .................................................................................... 22
East Timor Establishes A Position Based On Boundaries ...................................................................... 22
Australia’s Approach And Strategy Leading To And Beyond July 2001 .............................................. 23
Oil Companies Provide A Constant Focus For East Timor And Australia Negotiations ...................... 25
AN ARRANGEMENT OF SORTS
July 2001 Framework For A New Treaty ................................................................................................. 26
Comparison: Key Changes Between 1989 Treaty And 2001 Arrangement ............................................ 27
Immediate Reactions ............................................................................................................................... 29
COMMERCIAL DEVELOPMENT IN THE TIMOR SEA IS SUSPENDED
The Arrangement Is Suitable For Governments But Not For Contractors ............................................. 29
The Machinations Of Government Negotiations ...................................................................................... 29
Oil Companies Reject The Arrangement As Unsuitable; Suspend Development .................................. 31
EXECUTIVE SUMMARY

As of July 2002, a proposed new and permanent Timor Sea Treaty (TST) is still awaiting ratification by the governments of East Timor and Australia. The new agreement is largely based upon the terms and conditions of a previous and long-standing 1989 Timor Gap Treaty for joint commercial development between Australia and Indonesia. While the most visible change to the terms and conditions is an increase from 50% to 90% of the net production sales royalties that East Timor will receive from the area as currently defined, other more subtle and complex modifications impact upon their shares to the far greater residual economic benefits that petroleum development creates.

Both the old and new agreements are ‘provisional arrangements of a practical nature’ as allowed by the United Nations Convention on the Law of the Sea (UNCLOS) in situations where two countries wish to pursue the commercial exploitation of seabed resources in contested areas where they have not yet reached final settlement on seabed boundaries.

The pending treaty documents signed on May 20, 2002 indicate that no progress has been made by the East Timorese to advance their enduring desire to delimit new maritime and seabed boundaries with Australia. The perimeters of the zone of joint cooperation described by both old and new treaties remain unchanged. East Timor has pursued finalisation of borders and boundaries with neighbour Australia with neighbouring nations to cement their status as a freestanding independent nation, and deems that any fair allocation of the petroleum resources taken from the seabed of the Timor Sea should be the logical consequence of such an agreement rather than an issue to be independently negotiated.

In discussions and formal negotiations with Australia spanning 2½ years, East Timor had therefore consistently sought a new and permanent Timor Sea agreement with Australia that would incorporate both objectives: final boundaries and a consequent protocol for joint commercial development. As the basis for determining their seabed boundaries, they have applied the widely accepted solution provided by the 1982 Law of the Sea convention, which strongly indicates that a notional median line of equidistance should divide the sea and seabed between East Timor and Australia. This solution has been regularly tested and validated over the years through arbitral tribunals and the International Court of Justice.

While ratification on the one hand will secure faster access to the primary source of available income that East Timor requires in order to become economically sustainable, the agreement appears likely to inhibit East Timor’s future efforts to settle boundaries. It will also leave the ownership of other large petroleum reserves in and around the area covered by the treaty unresolved and risks increasing contestation over any of the economic benefits that might result from their development.

The inability to fully resolve these differences between our two countries holds risks for both. The lack of a complete and confirmed national identity, the perception that a neighbour may be benefiting from some of the resources that the people of East Timor feel they own, and the inability to use those resources to move forward from the marginal existence the pending agreement will allow and advance human development and economic self-reliance could destabilise their tenuous foothold on democracy.

An unstable East Timor, as a close neighbour with whom our history is intertwined, could disrupt the already tenuous relationships in our region and threaten our own security, particularly if we are seen by our neighbours to be a precipitating cause. If East Timor is unstable or even becomes a failed state, Australia could face a flow and the associated costs of refugees and be expected by the Australian and international community to bear a greater responsibility for increased humanitarian aid and assistance and provide continued peacekeeping and civil security assistance.

Australians, already well endowed with natural, mineral and petroleum resource and wealth, may be seen as unnecessarily selfish and opportunistic by our regional neighbours and the international community as the reasonable nature and basis of East Timor’s position becomes more public. And the international recognition for the support that Australia has extended to East Timor since the end of 1999 could be eroded.

The converging commercial, economic, political, legal and circumstantial issues and interests between East Timor and Australia concerning the search for agreement on Timor Sea development and boundaries are by themselves complex. The confidential nature of bilateral negotiations between countries and the expectations of industry partners for commercial-in-confidence make access to information for East Timorese and Australians more difficult and are obstacles to understanding.

The author has nonetheless sought to identify, review and analyse the multi-faceted issues and dynamics of the Timor Sea, and the negotiations, underlying history and relationships that have so far impeded progress towards the settlement of boundaries between East Timor and Australia, as the basis for making recommendations towards resolution. The paper therefore follows a chronological format based upon time periods during which defining issues emerged that cumulatively explain the status of negotiations today.
What conditions have impeded boundary settlement between East Timor and Australia?

- **Commercial imperatives:** Petroleum production was finally starting following over ten years of exploration and commercial development in the area of joint development at the same time that East Timor began the transition to independence. This has meant that Australia and East Timor have spent most of the last two 2½ years responding to the pressing need to satisfy the requirements of oil companies holding Petroleum Sharing Contracts in the area and their need for legal, regulatory and fiscal certainty in order to protect billions of dollars worth of investment in development by their shareholders.

- **The competing demands of nation building:** East Timor has been slowly emerging from a period of extreme crisis following the ballot for independence in 1999, has only recently adopted a Constitution and the mechanisms of governance and still lacks a comprehensive legislative framework to provide a basis for dealing with the complex boundary and development issues at issue with Australia in the Timor Sea.

- **Problems with interim agreements:** The terms of the new agreement created additional commercial complications when first introduced in July 2001 and have the potential to reduce the benefits received by East Timor compared to Australia and as previously enjoyed by Indonesia. The attention required in response detracted significantly from consideration of boundary issues.

- **Most importantly, lack of a willing partner:** Australia has not yet demonstrated the same enthusiasm as East Timor for reaching a timely and final settlement of seabed and boundary issues. Without shared motivation and a common goal, the hallmark of any good faith negotiations, or a willingness to allow impartial arbitration in their absence, it will not be possible to find a resolution that both East Timorese and Australians can accept as durable.

What are the reasons for Australia’s apparent lack of enthusiasm for a boundary settlement?

- Australia is not subject to the same desire or need to establish its national identity.
- Australia is not beset by the same unstable circumstances as East Timor nor does it depend upon the petroleum from the Timor Sea as its only source of significant income. (See Appendix B)
- Australia has already secured and enjoys the benefits of the petroleum resources made available by the existing and proposed commercial treaty agreement. This includes not only those from within the area of joint development but also those that by definition fall immediately outside and into waters and seabed exclusively under the control of Australia, now contested by East Timor.
- Australia secured those rights and benefits under the circumstances of an earlier time, and under the UN conventions and laws that then existed but have now changed and evolved.
- Australia negotiated those rights and benefits with Indonesia in large part based upon the argument that their seabed extends to the edge of their continental shelf calculated to span almost 85% of the distance from its land mass to the coast of East and West Timor
- Australia’s continental shelf argument has never been objectively tested or validated outside of the constraints of closed bilateral negotiations where a range of other factors can influence outcomes.
- Objective testing of Australia’s continental shelf argument in a boundary settlement under current conventions and prevailing laws, whether by impartial international conciliation, arbitration or disputation, is more likely to favour East Timor’s median line of equidistance solution.
- Australia has argued that any change to a median seabed boundary with East Timor that differs from the compromise settlement they reached with Indonesia in 1972 based upon their continental shelf argument will provide Indonesia with a basis to re-open negotiation of their boundaries.
- Any change to the median boundary based upon and validated by current conventions and laws strengthens the legal basis and increases the likelihood that the lateral perimeters of the current development will change.
- Any change to the lateral boundaries is more likely to increase East Timor’s seabed area and decrease Australia’s in an area where far larger petroleum reserves and potential income exist.

How has Australia sought to protect its position?

- Australia has focused on forging a commercial development treaty that does not address any of the outstanding boundary issues.
- Although the commercial development treaty is ‘without prejudice’ as required under UNCLOS regarding the future delimitation of boundaries, the treaty extends for at least 30 years and provides no imperative, incentives, framework or mechanisms for advancing boundary settlement.
Australia has supported a requirement by the oil companies that East Timor and Australia must come to an agreement on terms to unify the conditions of the largest of the known petroleum fields in the area, Greater Sunrise. The field straddles the eastern and most contentious boundary of the development area and 80% currently falls within Australian waters. Agreement is sought by year’s end and likely after Treaty ratification despite that fact that project developers do not have markets established, are divided over production options and will not produce oil until at least 2006/7. Together with a ratified treaty, agreement on unitisation is a disincentive to boundary settlement and may diminish East Timor’s ability to recover revenues in the unlikely case that a settlement on delimited boundaries is reached with Australia in future.

The treaty fails to take into account the variance between East Timor's and Australia’s boundary claims by providing a trust or escrow mechanism into which funds derived from development in contested areas can be placed until boundaries are ultimately determined.

There is some precedent to indicate that international tribunals or the International Court of Justice will decline to rule on changes to boundaries that are already reached by agreement in commercial development treaties.

Australia has taken steps to foreclose certain options for compulsory dispute settlement by arbitral tribunals and the ICJ that would otherwise be afforded to East Timor under UNCLOS.

Australia continues to prepare a submission to the UN Commission on the Limits of the Continental Shelf by the end of 2004 that seeks to reinforce its continental shelf argument and claims to the resources held within the seabed, thereby extending its Maritime Jurisdiction from 11 to 16.5 million sq. kilometres. In an apparent trade-off for an increase in East Timor’s share of net royalties, Australia has negotiated modifications to the 1989 Treaty that diminish guarantees for East Timorese participation in the far more lucrative upstream and downstream economic benefits from petroleum development when compared to those enjoyed by Indonesia.

Under the same basis, Australia has negotiated new terms absent of previous guarantees that diminish East Timor’s entitlement to training and employment related to development.

Australia has also not assured the inclusion of any mechanism within the agreements themselves that would obligate a progressive building of East Timor’s capacity to participate and gain an increasing share of employment and development benefits. Under terms with Indonesia, these were equally shared relative to the 50:50 division of revenues.

When the taxation and fiscal terms of the July 2001 framework arrangement that forms the basis for the current Treaty were rejected by the operator of the Bayu Undan fields, ready to being production after spending well over A$ 2 billion on preparations, Australia and East Timor both participated in direct negotiations with them to resolve the problems. East Timor agreed to conditions in December that Australia has not yet accepted, linking it to all other JPDA projects.

The report therefore finds and recommends that Australia:

- Recognise first and foremost that for East Timor the settling of boundaries with Australia holds far greater significance than solely the allocation of petroleum resources and revenues or advancing a boundary claim simply to improve their negotiating position.
- Recognise the imbalance in the conditions and circumstances between East Timor and Australia that make it difficult for both countries to negotiate on equal footing.
- Recognise that East Timor must also negotiate boundaries with Indonesia that will inevitably involve or impact upon Australia and their current agreements with Indonesia, and therefore provide a basis for their possible re-negotiation. Accept therefore that boundary adjustment with Indonesia is not a justification to avoid settlement with East Timor.
- Recognise that the current tax and fiscal scheme agreement between East Timor and Phillips Petroleum remains a further obstacle to and distraction from negotiations to settle boundaries. If Australia is unwilling to endorse the agreement as it currently stands, the ratification and unitisation agreement process should be suspended until a new agreement can be negotiated that is acceptable to all parties.
- Recognise that withholding East Timor’s future funds in escrow at a time when desperately needed and while Australia continues to realise substantial income for contested areas around the JPDA, places undue pressure on East Timor during negotiations. Acknowledge this inequity by releasing escrow funds to East Timor. Likewise encourage Phillips Petroleum to release their upfront contribution to Bayu-Undan if they have not already done so.
Recognise that the Bayu-Undan agreement between Phillips and East Timor was reached under the terms of the July 5, 2001 MOU-TSA that enabled them to stand apart from all other projects. Break therefore the subsequent link that Australia established between Bayu-Undan and all other current Timor Sea developments and remove the requirement that all conditions must first be satisfied.

Recognise that the entry into force of the current agreement may inhibit future boundary settlement and does not provide East Timor with adequate guarantees for participation in all aspects of petroleum development. Suspend ratification until such time as the terms and conditions of the current Treaty or a supplemental agreement can be amended or drafted to provide:

- a clear framework with agreed guidelines for prioritising the final settlement of ocean and seabed boundaries using all available avenues as a shared goal for both countries
- a definitive timeframe not to exceed five years in which boundaries will either be settled by negotiation or referred to impartial international arbitration
- an escrow or trust into which revenues generated from areas where boundary claims overlap are withheld from each country until such time as there is final settlement
- guarantees for East Timorese levels of participation in all aspects of petroleum development beyond revenues earned from taxation and production royalties
- a progressive and benchmarked system for increasing the skill capacity of and employment opportunities for East Timorese over the life span of the agreement
- an accompanying method for granting financial compensation or compensation-in-kind to East Timor in lieu of the capacity to attain the guaranteed levels of participation and to be graduated in accordance with the reaching of established benchmarks.

Recognise that, while Australia engages in a national debate about access to Timor Gas for domestic markets and to advance Australia’s economic, social and industrial health, East Timor has similar or greater needs and the TST makes no provision to address them. Amend therefore the TST to incorporate terms that facilitate East Timor’s direct access to and use of their Timor Sea gas as they see fit, or otherwise provide compensation-in-kind.

Recognise that agreement on unitisation of the Greater Sunrise field directly impacts upon future boundary settlement and resource allocation and could prevent East Timor from recovering or enjoying their due and proportional entitlements and benefits. Incorporate therefore within the unitisation agreement amended terms reached by an amended treaty or supplemental agreement.

Recognise that the Greater Sunrise project is in the early design development stage, does not yet have an agreement on development plans between industry partners, has not yet secured any sales commitments or letters of intent from potential customers and that there is no indication that the project or the cost of the gas generated will be competitive and commercially viable. Suspend therefore the current December 31, 2002 deadline to reach agreement until all other obstacles have been sufficiently addressed to warrant consideration and after the treaty agreement is amended.

Recognise that Australia’s withdrawal in March from the compulsory dispute resolutions afforded under the provisions of UNCLOS have severely limited East Timor’s options to achieve a timely settlement of boundary issues and are increasingly seen as a provocative action that is not justified under the conditions of imbalance that exist between East Timor and Australia. Reinstate therefore adherence to all of the four choices of procedure available for resolution of disputes as afforded by UNCLOS.³

Recognise that acceptance of all of these recommendations does not necessarily guarantee a timely resolution of boundaries with East Timor. Offer East Timor therefore a commitment to submit within a year the boundary claims of both countries to Conciliation as provided under UNCLOS, Part XV, Article 284, for analysis and non-binding recommendations as to the appropriate solution under prevailing provisions of UNCLOS and relevant precedents established under common international law. Subsequently use the analysis and recommendations to further bilateral negotiations.

Recognise that Australia’s submission regarding its continental shelf claim to UNCLCS by the end of 2004 will further delay progress on boundary settlement with East Timor. Agreed, therefore, to excise the areas below East Timor and the adjoining areas of current boundaries with Indonesia if an agreement in principle on final boundaries has not yet been reached with East Timor, and

Recognise that Article 83 of the United Nations Law of the Sea calls on countries involved with negotiations not to act in a way that jeopardises or hampers final delimitation of seabed boundaries.⁴
INTRODUCTION
An Overview Of Current Circumstances

Current status between East Timor and Australia
At midnight on May 19 2002, East Timor became an internationally recognised independent nation, bringing centuries of colonial rule, decades of struggle under Indonesian occupation and almost three years of United Nations administration to a close.

East Timorese and UNTAET negotiators had been working with representatives of the Australian government to establish a new and permanent Timor Sea treaty throughout the period of transition beginning with the independence referendum held on August 30, 1999.

An interim agreement reached in early 2000 and a new arrangement signed in mid-2001 allowed the momentum of a decade of commercial development to exploit the petroleum resources held within the seabed of the Timor Gap area to proceed while negotiations towards forging a new and permanent treaty continued. At the same time, those transitional instruments also exposed new obstacles to final settlement and highlighted the existing and unresolved issues and concerns.

Former UN negotiator Peter Galbraith may have understated the circumstances when he described negotiations as a quirky mix of politics, geology and international law. Over the last three years of transition, clear distinctions in the motivations and priority of interests have progressively emerged between East Timor and Australia no less so than very divergent methods for conducting the business of negotiations over the Timor Sea have been demonstrated.

While resources are unquestionably important, the issue above all others that continues to stand between them is the permanent delimitation of their joint maritime boundaries. The most recent in the series of agreements signed in May, while new, offers neither permanency nor resolution for an East Timor still in search of a national footprint. The Australian government on the other hand, comfortable with decades of unresolved boundaries with their neighbours when a fair and equitable outcome might otherwise endanger or diminish their claims to the wealth down under the Timor Sea, are satisfied to settle agreements on matters of commercial development within the limits of an area defined at a different time, under different precedence of international law, in different circumstances.

East Timor remains the proverbial meat in the sandwich of other interests, a position with which they are all too familiar. Two years after stating their intention to secure maritime boundaries hand in hand with commercial development during negotiations with partner Australia, they’ve made no discernable progress on the former. At every turn, their efforts to re-focus attention on boundaries have been foiled by circumstance or distracted by the machinations and demands of others.

With the passage of maritime zones legislation on July 9, 2002, declaring their maritime boundary and continental shelf entitlement based upon commonly accepted principles of international law, East Timor has completed a 27 year uphill struggle to simply attain the same status and standing that Indonesia enjoyed in their less than successful seabed negotiations with Australia over two decades.

The issues that divide remain unchanged. A new East Timor seeks their share of access to resources as a consequence of a fair and equitable outcome on the basis of an accepted principle of international law. In their dealings to date, Australia has protected their control of the wealth of the seabed based upon a now outdated claim to an ocean territory twice the size of their dry land.

Whether or not East Timor will fare any better than their occupiers, in time to make a difference between economic dependency and self-reliance, will depend largely on whether the people of Australia will choose to advance principle and East Timor’s case above parochial self-interest.

On May 20, 2002 the new government of East Timor adopted the first and most pressing of many pending bilateral agreements, international instruments and memberships that will over time cumulatively define the country’s status and secure their future as a free-standing member amongst the community of nations.

Mari Alkatiri and John Howard, Prime Ministers of East Timor and Australia, signed a new draft Timor Sea Treaty (TST), and a related Exchange of Notes and Memorandum of Understanding (MOU) in Dili governing petroleum exploitation in the Timor Sea as a matter of immediate priority for both
countries. These instruments supersede the authority of a previous Exchange of Notes\textsuperscript{10} and largely incorporate the terms of the most recent of framework arrangements, a much-heralded Memorandum of Understanding of Timor Sea Arrangement (MOU-TSA)\textsuperscript{11} signed on July 5, 2001 between Australia and UNTAET on East Timor’s behalf. This previous Exchange of Notes, which gave legal basis to continued development in the absence of an agreement with treaty status, expired at midnight along with the United Nations authority to administer the affairs of the island country.

The new Exchange of Notes is in effect as of May 20, 2002 under largely the same terms that existed up to May 19 and continued from the 1989 Timor Gap Treaty between Australia and Indonesia. The Exchange of Notes is a legally binding bridging agreement that enables development to continue until the new Treaty and MOU are ratified. Together, the instruments affirm the July 2001 decision to reallocate 90% of the net royalties from production within the area of mutual cooperation to East Timor, with the remaining 10% for Australia. Under the terms of the 1989 Timor Gap Treaty, the Joint Authority representing the joint interests of Indonesia and Australia divided the proceeds equally between them.

Until such time as the new Treaty is ratified and fully in force, the previous 50:50 split of royalty proceeds from ongoing development prevails and is distributed to East Timor. The balance otherwise calculated on the basis of the difference in proceeds from the future 90:10 split is held in escrow for East Timor. Proceeds over the next three years will primarily be derived from the modest Elang-Kakatua fields until petroleum sales from phase one of the next projects come online in around 2005.\textsuperscript{12}

The May 20 signing thus avoided a legal vacuum that could have placed at risk billions of dollars of development costs already invested in the Timor Sea by petroleum companies and their backers over the last decade, and delayed or endangered East Timor’s share of revenue upon which their future national and human development largely depends.

Pressures of expediency and necessity therefore dictated the prompt signing of this latest instalment in a long series of Timor Sea agreements. However, while the partnership to the agreement has now officially changed, the fundamental issues that confronted the parties to previous negotiations and agreements still remain unresolved with little visible progress between East Timor and Australia.

Amongst the many East Timorese concerns expressed over the months of protracted Timor Sea negotiations with Australia, and reiterated in the immediate aftermath of the May 20, 2002 signing, was that the impact of the as yet unratified Timor Sea Treaty on East Timor’s right to pursue, declare and resolve their maritime boundaries was and remains of paramount and immediate importance.

**An orientation to the ocean and seabed boundaries issues that still divide.**

Maritime boundaries are not a new issue in the Timor Sea, for either the East Timorese or their predecessors in negotiation and treaty with Australia.

The terms and framework of the current Treaty, much like the two interim instruments forged between UNTAET and Australia in 2000 and 2001, still remain very much the legacy of the Timor Gap Treaty signed between Australia and Indonesia in 1989\textsuperscript{13}. Although Australia’s de jure recognition of Indonesia’s annexation of East Timor in 1978 allowed formal negotiations to mutually explore and exploit oil resources in the Timor Sea to proceed, conflicting maritime and seabed boundary claims prevented their agreement for eleven years. Even then, settlement of definitive boundaries could not be reached, resulting in the creation of an innovative and complex joint development area based upon their overlapping claims to the continental shelf and respective exclusive economic zones.

Independent East Timor now walks a well-worn path on maritime boundary negotiations with Australia. The JDPA defined by the 1989 Treaty falls within the so-called Timor Gap, created in 1972 when Portugal and Australia failed to resolve similarly conflicting boundary claims while Australia and Indonesia reached a compromise agreement which gained for Australia 100% control of 85% of the sea and seabed territory on each of the sides of the Gap. A subsequent 1997 Treaty\textsuperscript{14} would grant Indonesia rights to a greater area of the water column but the seabed agreement remained unchanged.

As did Portugal and Indonesia, East Timor cites a notional median line solution to overlapping entitlements to the 200 nautical mile continental shelf and exclusive economic zones as provided under the 1982 United Nations Convention on the Law of the Sea and reinforced by prevailing common international law.\textsuperscript{15}
Australia continues to adhere to its claim to the limits of its continental shelf as the determinant, which they locate on average about 50 kilometres from East Timor’s south coast. Australia established the basis of their claim on a United Nations Convention on the Limits of the Continental Shelf (CLCS)\textsuperscript{16} first established in 1958 during the inaugural series of meetings of UNCLOS I. While such claims are still recognised under UNCLCS 1982, a fair and ‘equitable’ outcome for all parties to boundary delimitations is the governing principle as set forth under Article 38 of the Statute of the International Court of Justice.\textsuperscript{17}

Throughout their last decade of struggle and during current negotiations, East Timorese spokespeople have made clear that their access to resources, however important a revenue issue, must be a consequence rather than the first determinant of the maritime boundary question.

Given that defined and accepted boundaries are the physical manifestation of sovereignty and the footprint that defines nationhood and independence, CNRM\textsuperscript{18} (National Council of the Maubere Resistance) and CNRT (National Council of Timorese Resistance), East Timor’s broad-based political umbrella organisations of resistance during the last decade of the independence struggle, identified their intention to delimit maritime boundaries as a first priority of nationhood.

The East Timorese have always clearly stated that they would not accept the role of successor to Indonesia in a 1989 Treaty with Australia that they considered to be illegal. In the absence of final delimitation of boundaries between Australia and Indonesia, the new Timor Sea Treaty establishes boundaries by default to facilitate commercial exploitation and maintains the skeletons of the past.

While acting with Australia throughout negotiations to assure that commercial development of petroleum would not be endangered, the East Timorese have continually sought to reach an agreement with Australia on either new definitive boundaries or an appropriate framework to expeditiously determine them rather than simply accept the existing JPDA default boundaries. Neither goal has so far been attained nor do current circumstances offer hope for resolution.

A snapshot of the petroleum resources intertwined with the boundary issue.

Exploration by oil company contractors working under the terms of the previous treaty agreement between Indonesia and Australia had identified three major field areas by 1999 that are either currently or close to producing. The discovered reserves are rich in oil, natural gas and liquid condensate. They are located within the previous 75,000 sq. km. overall Joint Petroleum Development Area (JPDA), inside of the smaller principal area of mutual development, Zone of Cooperation A, now also known as the JPDA. Other smaller prospective fields have been discovered throughout the zone and a number of fields are producing or have been discovered in the immediately surrounding area.\textsuperscript{19}

The smaller Elang-Kakatua fields have been producing oil and relatively modest revenues since 1999.\textsuperscript{20} Approximately US$1.8 billion has already been spent to develop the first liquids phase of the Bayu-Undan fields, slated to begin production in 2005/2006, to supply LNG (Liquefied Natural Gas) to Japan.\textsuperscript{21} Greater Sunrise, the largest of the known field areas,\textsuperscript{22} is currently in the design development stage and commercial partners have not yet determined the preferred method for extracting the gas. Eighty percent (80%) of Greater Sunrise sits within Australia waters as previously defined by seabed boundary agreements with Indonesia in 1971 and 1972 and the remaining twenty percent (20%) falls with the JPDA. Oil companies, working under Production Sharing Contracts (PSCs) administered by a Joint Authority now representing Australia and East Timor, anticipate that these proved and probable reserves and future explorations will yield at least 22 trillion cubic feet of oil and gas products with an estimated market value over US$100 billion, that could generate combined revenues for Australia and East Timor of over US$45 billion.\textsuperscript{23}
The circumstances that underlie boundary negotiations

While their differing respective positions on maritime boundaries have remained largely consistent, and East Timor can now negotiate with equal standing as a nation state, the circumstances between East Timor and Australia are very different and contrast sharply with past negotiating environments.

Legal opinions meanwhile vary widely, on both the validity of the competing maritime boundary claims of East Timor and Australia and the effect that the *Timor Sea Treaty* will have on resolution. There is little legal analysis that takes into account the subjective effect that internal, bilateral and geopolitical factors can have on influencing final outcomes. While the terms of the commercial development Treaty (TST) as required by UNCLOS 1982 are ‘without prejudice’ to a final delimitation of seabed boundaries, the impact of the prevailing conditions and circumstances on finding a negotiated, arbitrated or adjudicated settlement that is fair and equitable remains uncertain.

Viewed in total and without the luxury of time or freedom from pressures, East Timor and Australia have and continue to seek resolution of their differences and outstanding issues in a highly complex and unprecedented negotiating environment (See Appendix B for a comparison of circumstances).
PART ONE • TIMOR SEA UP TO THE 1999 BALLOT
The Historical Underpinnings Of The Current Impasse

The treaty actions now pending between East Timor and Australia are primarily limited to a specifically defined Joint Petroleum Development Area (JPDA) within the Timor Sea previously known as Zone of Cooperation A (ZOCA), in which both countries collaborate to mutually develop the exploration and exploitation of petroleum resources. They share in revenues from taxation, and net royalties once oil company contractors have been compensated for development costs, receive incentives and extract profits from sales. (See Appendix A)

The current Joint Petroleum Development Area (JPDA) falls within a larger area, previously known as the Zone of Cooperation (ZOC) created by a 1989 Timor Gap Treaty between Indonesia and Australia. Unable to reach agreement on final maritime boundaries, the overall ZOC defined three separate commercial zones created by the conflicting and overlapping claims of both countries.

The other two development areas straddled ZOCA to the north and south. Within Zone C to the north and closest to East Timor, exclusive development rights were held by Indonesia until October 25, 1999 when the United Nations Security Council passed a resolution authorising the United Nations transitional administration of East Timor. Zone B to the south was exclusively controlled by Australia.

When the May 20 2002 Timor Sea Treaty and Exchange of Notes replaced the 1989 Timor Gap Treaty and the successor Exchange of Notes between Australia and UNTAET that occurred in February 2000, Zones B and C ceased to exist. Those areas now fall solely within the Exclusive Economic Zones (EEZs) of each country as provided by the Law of the Sea (UNCLOS). East Timor’s new Parliament formally declared their EEZ in the Maritime Zones Act on July 9, 2002.

All of the current and previous joint development areas fall within a wide expanse of the Timor Sea south of East Timor and generally known since 1972 as the Timor Gap.

A GAP BELOW TIMOR IS CREATED BY AUSTRALIA AND INDONESIA
The 1971 And 1972 Seabed Agreements

Approximate distances between East Timor and Australia:

- Closest land masses:
  Approximately 515 kilometres = 320 miles = 278 nautical miles (nm).
- East Timor land mass to Australia’s Bathurst/Melville Islands:
  Approximately 430 kilometres = 267 miles = 232 nautical miles (nm)
- Approximate location of the Timor Trough from East Timor’s southern coast:
  40 nautical miles ~= 70 kilometres

The so-called Timor Gap was created in 1972 and identifies the area of the Timor Sea south of then Portuguese (East) Timor. The Timor Gap was established by default when Australia and Indonesia reached agreement on their joint seabed boundaries to the east and west of the area, but neither country could reach an accord with Portugal. The 250 km space below East Timor between the east and west termination points, established by the 1972 agreement, remains un-delimited.

While maritime boundary negotiations were taking place in the late 1960’s and early 1970’s, extensive petroleum explorations licensed by all three countries had been ongoing for years and were indicating the presence of significant hydrocarbon reserves throughout the Timor Sea.

In 1969 and 1971, the Petrol and Tern gas fields were discovered in the lower Bonaparte Basin of the Timor Sea 300 km from Darwin. In 1971, an Arco Exploration well located in the Kelp geological strata within the current joint development area, 11 miles from the currently producing Elang-Kakatua fields, indicated the strong presence of sizeable hydrocarbon reserves. Australia discovered large reserves in 1971 in the western Timor Sea in their North West Shelf area.

In their negotiations with Australia, Portugal would not compromise on their position that, under the emerging but yet to be formalised provisions of UNCLOS, a nominal median line solution should prevail in cases where the coastlines of opposing countries are less than 400 nautical miles apart and their EEZs therefore overlap. Since entering into force in 1994, the provisions of UNCLOS 1982
Article 57 entitle all nation states to an Exclusive Economic Zone (EEZ) and continental shelf to a distance of 200 nautical miles from their low water-mark baseline whether or not they have declared the EEZ or signed and ratified the Convention.\textsuperscript{26}

Australia would likewise not compromise their historic position that their ocean territory and seabed rights extend to the limits of their continental shelf. ‘In geomorphological terms, the continental shelf of Australia ends at the Timor Trough, about 70 kilometres from the coast of East Timor and significantly closer to East Timor than to any notional median line. The Timor Trough is 2,350 meters deep in the western part and 3,306 meters deep in the eastern part and forms a striking geological feature 45 nm from East Timor’s coast.’\textsuperscript{27}

Although the same opposing positions were held by Indonesia and Australia, they were able to reach a compromise agreement on their joint seabed boundaries in 1971 and 1972. Formal negotiations had started in 1969, a few years after General Soeharto established himself as President following a military coup in 1965. At the time, Indonesia was in danger of quickly becoming a net importer of petroleum but by the mid-1980s became and remains the world’s largest exporter of liquefied natural gas (LNG).\textsuperscript{28}

The compromise established an intermediate line between Australia’s continental shelf boundary position to the north and Indonesia’s EEZ claim to the south that gave Australia control over 85% of the seabed resources.

There were several reasons for Australia’s success in the negotiations. It had the stronger bargaining position due to its relative economic and trade strength. Australia had also accrued considerable goodwill diplomatically and through aid to Indonesia. When Indonesia agreed to a settlement favouring Australia, it allowed them to be less beholden to Australia. Also, by displaying its willingness to negotiate sensitive strategic issues, Indonesia hoped to allay suspicions held by some Australians that it was an expansionary power and a threat to Australian security. Finally, the oil companies active in the Timor Gap region since 1963 had, by the early 1970s, accumulated a great deal of knowledge about its potential oil and gas reserves. The Australian government was privy to this information, and the Indonesian government was not.\textsuperscript{29} Australia in effect had a better idea of the petroleum resources available to them under a claim to extended jurisdiction.

The Timor Gap was therefore established when two treaties delimiting maritime boundaries on either side and to the south of Portuguese (East Timor) entered into force in November 1973 following an exchange of ratification instruments.

The second of the two, an Agreement between the Government of the Commonwealth of Australia and the Government of the Republic of Indonesia establishing Certain Seabed Boundaries in the Area of the Timor and Arafura Seas, supplementary to the Agreement of 18 May 1971 also know as the International Seabed Agreement, was signed in Jakarta on 9 October 1972.\textsuperscript{30} This treaty focused on the western Timor Sea and updated the previous agreement establishing boundaries in the Arafura Sea area east of Portuguese (East) Timor similarly titled Agreement between the Government of the Commonwealth of Australia and the Government of the Republic of Indonesia establishing Certain Seabed Boundaries.\textsuperscript{31}

Although the treaties provided for the adjustment of A16 and A17, two boundary tri-points that defined the eastern and western limits of the Timor Gap should an agreement eventually be reached with Portugal\textsuperscript{32}, neither Indonesia nor Australia can unilaterally withdraw from the Treaty without the consent of the other.

The possibility of reaching agreement with Portugal diminished in December of 1972 when the Whitlam Labor Party government stated their determination that Portuguese colonisation of East Timor, long condoned by previous governments, should end while reasserting their view that an independent East Timor was economically and politically non-viable.\textsuperscript{33}

PETROLEUM BEGINS TO FILL THE GAP
Exploration Sets The Stage For Commercial Development

In the two years following the creation of the Timor Gap, petroleum exploration yielded dramatic results while Portugal and Australia continued boundary negotiations to close it. Australia’s Woodside-Burma Oil discovered the Greater Sunrise hydrocarbon reserves (Sunrise and Troubadour) in 1974, now the largest known fields within the Timor Gap area.\(^{34}\)

As the real possibility of East Timorese independence from Portuguese colonial administration grew closer in 1974 and 1975, petroleum exploration also became an increasing source of conflict between Australia and Portugal. In March 1974, Australian Prime Minister Whitlam told Parliament that the Australian government had protested to Portugal concerning their encroachment into the contended overlapping area claimed by Australia.\(^{35}\)

A government policy planning paper in May, while advising caution so as not to be seen as motivated by self-interest on the issue of East Timor’s independence or incorporation by Indonesia, states that Australia should ‘bear in mind that the Indonesians would probably be prepared to accept the same compromise as they did in the negotiations already completed on the seabed boundary between our two countries. Such a compromise would be more acceptable to us than the present Portuguese position.’\(^{36}\)

Anxious about the success of Australian exploration in the Timor Sea in the absence of a definitive boundary agreement, Lisbon issued an exploration concession in late 1974 covering 23,000 sq. mi. of the disputed area to Petrotimor, the Portuguese subsidiary of a US defence contractor.\(^{37}\) Pro-independence forces in East Timor reportedly were not consulted.\(^{38}\)

Around the same time, Indonesia’s state-owned oil company Pertamina could not pay US$10 billion in loans and faced bankruptcy, heightening their interest in new sources of petroleum wealth.\(^{39}\)

Richard Woolcott, then Australia’s Ambassador to Indonesia, cabled the Department of Minerals and Energy on April 17, 1975 stating that the closure of the Timor Gap could be ‘much more readily negotiated with Indonesia by closing the present gap than with Portugal or an independent Portuguese Timor.’ He noted, ‘I know I am recommending a pragmatic rather than a principled stand but that is what national interest and foreign policy is all about.’\(^{40}\) In later years, Woolcott became head of the Department of Foreign Affairs and a consultant for BHP on seabed matters.\(^{41}\)

Events soon overran the independence aspirations of the people of East Timor and petroleum development in the Timor Sea. The Portuguese colonial administration withdrew from the mainland starting in August 1975\(^{42}\) following the outbreak of conflict between independence supporters and forces favouring autonomy or incorporation by Indonesia. The independence of East Timor had only been declared for a week when Indonesia invaded Dili, East Timor on December 7,1975.\(^{43}\)

At a press briefing held in Jakarta following the invasion, the Australia embassy told the media that an independent East Timor ‘could well have become a source of instability to Indonesia. If Australia had helped its formation, it could have become a constant source of reproach to Canberra. Conceivably, it could have affected the defence of northern Australia. It would probably have held out for a less generous seabed agreement than Indonesia had given off West Timor’.\(^{44}\)

Another sixteen years would pass before the development of the petroleum resources in the Timor Sea regained momentum.

AN AREA WITHIN THE GAP IS DEFINED BY A DEVELOPMENT AGREEMENT
Australia And Indonesia Negotiate A 1989 Commercial Treaty To Exploit Petroleum

The negotiations
The Indonesian Parliament promulgated legislation on July 17, 1976 incorporating East Timor as its 27\(^{th}\) province.\(^{45}\)
In October, Australia and Indonesian began informal negotiations over maritime boundaries to close the Timor Gap but the legal status of East Timor was the main impediment to progress. During a visit to the Indonesian parliament in the company of a senior oil company representative, Australian Prime Minister Malcolm Fraser signalled the possibility of de jure recognition of Indonesia’s annexation of East Timor for the first time when he acknowledged the merger based on humanitarian grounds.  

While Australia expected a generous deal from Jakarta as a result and thought they could in effect draw a line across the existing gap to connect the 1972 boundaries, Indonesia’s Foreign Minister made clear that the outcome would not be based upon the compromise of boundary positions previously reached in 1972, stating that Indonesia had been ‘taken to the cleaners’.  

“The Indonesian position is based squarely on the law existing at present. The Australian position is that we should just draw a line connecting the old lines. In effect it is saying ‘Negotiate in 1984 on the basis of the 1958 convention, which has already been revised.’ It is an untenable position”.

As Indonesian newspaper Kompas later made known, Mochtar Kusumaatmadja, Indonesia’s Foreign Minister at the time, instructed his Australian counterpart that negotiations on the continental shelf boundary could not begin without Australia first recognizing Indonesian sovereignty over the whole island, especially as the south coast of Timor formed one of the survey base lines. The Australian government in September 2000 released government files and information describing the role of the Timor Gap in relations between Australia and Indonesia during this period.

Formal negotiations between them to delimit joint boundaries and close the Timor Gap began in February 1979 following Australia’s de jure recognition of Indonesia’s annexation of East Timor on December 15, 1978, the only nation to do so during the entirety of the occupation.

In the same year, Australia laid claim to a 200 nautical mile Exclusive Economic Zone, effectively transforming Australia from an island in an international sea to a country with borders touching on the doorsteps of Timor and Papua New Guinea. The creation of the 200 nautical mile Australian Fishing Zone brought within its jurisdiction the islands and reefs that had been integral to the survival and culture of the fishing communities of the islands in the Timor, as well as the Arafura Seas. Australia’s occupation of the Timor Sea was justified on similar grounds to the colonial occupation of the Australian mainland.

Indonesia similarly declared their EEZ in March of 1980 and promulgated legislation in October 1983 and subsequently subscribed to UNCLOS in 1986. Archipelagic or island nations must apply a different and more complex formula to determine their baselines under UNCLOS Part VI.

Australia meanwhile continued to issue licenses for petroleum exploration within the Timor Sea and generate revenues for the government. On September 10, 1985 for example, the Australian government received A$ 230 million in license fees, and oil company bids brought another A$ 31.5 million dollars in March 1986.

Negotiations would continue for another eleven years before agreement was reached on December 11, 1989.

The 1989 Timor Gap Treaty
A Treaty For Joint Development Without Seabed Boundaries Settled

Unable to resolve their competing claims after more than a decade of negotiations to delimit final seabed boundaries, Indonesia and Australia in 1989 nonetheless concluded a complex and innovative arrangement to jointly explore and exploit petroleum resources in an area within the Timor Gap. UNCLOS (1982) Article 83 allows states to enter into ‘provisional arrangements of a practical nature’ and, during this transitional period, not to jeopardize or hamper the reaching of the final agreement. Such arrangements shall be without prejudice to the final delimitation.

East Timor’s resistance leaders quickly condemned the agreement. In a letter to Australian Prime Minister Bob Hawke on the same day that it entered into force, resistance leader Xanana Gusmao called the *Timor Gap Treaty* a total betrayal by Australia of the East Timorese people.\textsuperscript{57}

The Treaty defined a large Zone of Cooperation area for the joint development of petroleum covering almost 75,000 sq. kilometres of the Timor Gap and sets up joint regime and institutional structures to administer exploration, exploitation and distribute proceeds to Australia and Indonesia.

The overall zone was comprised of three separate zones defined by lateral lines of equidistance and the longitudinal boundaries of Australia and Indonesia’s overlapping maritime boundary claims.

### Anecdotal description of the zones of development cooperation

The eastern and western lateral boundaries, relatively perpendicular to the respective and opposite coasts of Australia and East Timor, used tri-points A16 and A17 that define the Timor Gap as determined by the 1972 treaty between Indonesia and Australia and applies their interpretation of the principles of equidistance outlined by *UNCLOS 1982 Articles 14 and 15*\textsuperscript{58}.  

**Zone C**, the northernmost of the development areas, was approximately defined by Australia’s claims to the outer edge of its continental margin under UNCLOS guidelines. The northern border represented the bathymetric axis or average depth at 2500 metres at the deepest part of the Timor Trough, the absolute limit to entitlement under UNCLOS. The southern border was set by the line of the 1500 metres isobath roughly defining the southern edge of the Trough. The inward turning lateral boundaries that form the coffin shape of the zone were a concession to Indonesian concerns that the development area not take too much of their continental shelf.\textsuperscript{59} Indonesia administered this zone and agreed to pay Australia 10\% of the revenues generated from their Contractor’s Income Tax. Little exploration was undertaken or successful, given that the zone was essentially comprised of the deepest cleft in the continental shelf and the geology was unstable.\textsuperscript{60}

**Zone B**, the southernmost of the development area, was defined to the north by a notional median line boundary representing a compromise between East Timor and Australia’s overlapping 200 nautical mile EEZs as granted under the provisions of UNCLOS 1982. The southern limit of Zone C and of the overall zone of cooperation represents the maximum extent of East Timor’s EEZ. Australia administered this zone and agreed to pay Indonesia 10\% of the gross Petroleum Resource Rent tax they generated.

**Zone A**, also known as the principal Zone of Cooperation and the largest of the three zones, sat between them and covered an area of 34,970 sq. kilometres. Indonesia and Australia held equal rights and authority over the zone and agreed to share the proceeds yielded by petroleum development on a 50:50 basis. A Joint Authority, established by the Treaty to administer Zone A on behalf of both countries, created 14 areas of up to 3,000 sq. kilometres each and issued Production Sharing Contracts (PSCs) to exploration and development contractors.

*If Indonesia had agreed to continue the seabed along the boundary established in the 1972 agreement, virtually all of the currently known petroleum resources would belong to Australia.*

*If Australia had agreed to accept the notional median line solution favoured under UNCLOS and common international law at the time, they would have belonged to Indonesia and now to East Timor.*

### Legality of the 1989 Timor Gap Treaty and Boundaries Challenged

While the East Timorese struggle against Indonesian occupation continued, exploration for petroleum resumed in earnest in 1991, within the Zone of Cooperation and the surrounding Timor Sea.

Australia and Indonesia penned an agreement on December 11, 1991 to award production sharing contracts to exploration and petroleum companies operating in the area\textsuperscript{61} one month after Indonesian troops killed up to 400 East Timorese mourners at Santa Cruz cemetery in Dili. By year’s end, Pertamina had signed 11 PSCs representing an investment of US$362 million dollars.\textsuperscript{62}
In the background, the Timor Gap Treaty was the source of continuing political conflict between Australia, Portugal and Indonesia. Portugal initiated proceedings against Australia before the International Court of Justice (ICJ) in The Hague on February 22, 1991 over the legality of the treaty and claimed it was invalid under the provisions of UNCLOS. The Portuguese government contended that Australia had violated East Timor's right to self-determination and Portugal's right as the administering power still recognised by the United Nations.

The case did not conclude until June 30, 1995, when the ICJ ruled that it could not make a decision on the legality of Indonesia’s annexation, as Indonesia did not recognise its authority. In so far as the dispute challenged the legitimacy of the default maritime boundaries defining the Zone of Cooperation, the ICJ determined that any affected third party interests must be represented in decisions under UNCLOS. While Australia claimed that real dispute was between Portugal and Indonesia, the Court found that there was in fact a legal dispute between Australia and Portugal. While the Court decided that it did not have the jurisdiction to make a determination, it emphasized that, for the two parties (Australia and Portugal), the Territory of East Timor remains a non-self-governing territory and its people have the right to self-determination.

East Timorese representatives of CNRT also waged an unsuccessful challenge to the Treaty in Australia’s domestic courts on similar grounds.

During the intervening years, the first of the Elang-Kakatua and the Bayu-Undan fields within the zone of cooperation were discovered as was first of the Laminaria-Corallina fields, located immediately west of the area within Australian waters as defined in the 1973 Seabed Agreements with Indonesia.

BOUNDARIES CHANGE BUT THE SEABED REMAINS THE SAME
1997 Treaty with Indonesia Establishes EEZ and Water Column Only

Commencing in April 1993, Australian and Indonesian officials held eight rounds of consultations on the three outstanding areas of maritime boundaries left unresolved in the previous three treaties and a number of non-treaty status agreements relating to fisheries enforcement matters within the water column between the countries:

- the seabed and water column boundary between the Indonesian island of Java and the Australian Territory of Christmas Island;
- the complete water column boundary between the Australian mainland and Indonesia; and
- the extension of the seabed boundary between the Australian mainland and Indonesia west of the point reached in the 1972 treaty.

Following signature of an agreement between Indonesia and Australia in Perth on March 14 1997, the Treaty between the Government of Australia and the Government of the Republic of Indonesia establishing an Exclusive Economic Zone Boundary and Certain Seabed Boundaries was tabled for consideration by the Australian Parliament’s Joint Standing Committee on Treaties in August.

Australia’s claims to the seabed under their continental shelf argument were not tested. According to the National Interest Analysis issued by the Department of Foreign Affairs to the Committee, it was important to note that the treaties negotiated to date have treated the seabed differently from the water column. Primarily, this is because recognition of continental shelf jurisdiction in international law predated the recognition of EEZ jurisdiction. Recognition of the latter form of jurisdiction only occurred in the late 1970s. That is, international law at the time of the negotiation of the 1971 and 1972 seabed treaties did not know the concept of the EEZ. Except in relation to the area between Christmas Island and Java, this Treaty continues to treat seabed jurisdiction separately from water column jurisdiction.

Hence the agreement did not cover the area of the seabed that is defined within the default boundaries of the 1989 Timor Gap Treaty and the JPDA. It did however define a notional median boundary line under the guidelines of UNCLOS 1982 that in effect averages Australia’s and East Timor’s 200 nautical mile exclusive economic zones and overlays the southern boundary of the current zone of cooperation, previously known as ZOCA.

Above or north of this line, East Timor now controls, as did Indonesia until October 25, 1999, sovereignty rights to the water column under the provisions of UNCLOS 1982.
The seabed above the line remains governed by the past and current terms of the Timor Gap treaties and agreements. Australia enjoys exclusive control of the water column and seabed south of the median line.

The 1997 Treaty is yet to be ratified by the Australian Parliament, due in part to unresolved issues concerning Christmas Island and jurisdictional issues for fishing. The current refugee debate may also feature and the terms may also require amendment to reflect any impact that results from a final delimitation of boundaries between East Timor and Australia.

The Portuguese Embassy in Canberra lodged a protest note following Australia’s signature of the 1997 EEZ Treaty in so far as ‘it establishes an exclusive economic zone boundary in the Timor Gap’, arguing that Indonesia has no rights to make treaties in respect of East Timor because Portugal remains the administering power.

WORKING THE GAP AS INDEPENDENCE BALLOT APPROACHES

All of the current significant gas and condensate fields located within and surrounding the Zone of Cooperation had been discovered by the end of 1995, and commercial efforts focussed on defining and mapping the reserves and advancing preparations for development.

By mid-1997, within a few months of the signing of the EEZ boundary and seabed agreement, the East Asian economic crisis erupted, the Indonesian presidency of Soeharto was destabilised, Habibe replaced him, and the chain of events unfolded that inexorably led to the August 30 1999 referendum and the last stage of the transition to independence for East Timor.

Australia had not yet accepted independence as a real possibility. In a letter to Indonesian President Habibe, former member of the Board of Commissioners of Pertamina, on December 23, 1998, Prime Minister John Howard proposed that Indonesia provide autonomy for East Timor noting the long-standing position of Australia is that the interests of all three countries had been ‘best served by East Timor remaining part of Indonesia…the successful implementing of the autonomy package with a built-in review mechanism will allow time to convince the East Timorese of the benefits of autonomy within the Indonesian Republic.

East Timorese leaders were already considering the impact that independence would have on future Timor Gap issues. In response to the start of production from Elang-Kakatua in mid-1998, CNRT issued a statement reasserting their claims that the Treaty was illegal and resources were illicitly appropriated. They called for revenues to be placed in trust for the people of East Timor while taking pains to reassure Australia and Timor Gap contractors that their interests ‘will not be adversely affected by East Timorese self-determination.

There was little indication to this point that events onshore in any way inhibited or slowed offshore development within the Timor Sea Zone of Cooperation. By 1999, oil companies are estimated to have spent US$485 million on exploration and US$196 million on development of projects in the area over the ten years of the 1989 Timor Gap Treaty’s existence.

Violence accelerated in East Timor, by militia groups with Indonesian army backing who opposed independence as the referendum on self-determination grew more likely, and began to change the dynamics of petroleum development in the Gap.

While a concern for some Timor Gap contractors, others saw opportunity. The proposed $US1.3 billion (A$2.1 billion) Bayu-Undan liquids project in the Timor Sea has fallen behind its development schedule, with the partners blaming low oil prices and political uncertainty. In combination with their diminishing bottom line, this may have contributed to BHP’s long expected decision to sell their interest in the Bayu Undan project, purchased by Phillips Petroleum for A$ 300 million in April. BHP and Phillips had long been at loggerheads over how best to develop the project.

Following the announcement by President Habibe that he would accept the results of the referendum and relinquish claims to the Timor Gap if East Timor chose independence, the Australian government signalled their acceptance of a successor state model in a submission by the Attorney General in April 1999 to an ongoing Senate Inquiry into East Timor. The final decision to hold a referendum followed in May and a UN mission arrived in June to facilitate the ballot process.
As centuries of colonial rule and occupation drew to a close in East Timor, a submission in May to a Senate Inquiry into East Timor by the Department of Industry, Science and Resources revealed figures that disclosed the sheer scale of income that the Timor Gap had already generated for Australia despite the fact that only the modest Elang-Kakatua oil fields were beginning to generate any production income.

Under the terms of the 1989 Timor Gap Treaty, not carried forward within the current TST with East Timor, both Indonesia and Australia were obligated to equally share not only production revenues but in the totality of all economic benefits that development generated.

Service contracts alone had generated over US$ 700 million of income for the two countries, although Indonesia was receiving only about 5% of the benefit. ‘From the commencement of activities in 1991 and up to the end of December 1998, there were 475 service contracts awarded: of these 429 went to Australian subcontractors (estimated value US$670 million), and 17 to Indonesian subcontractors (estimated value US$34 million). Contracts worth US$415 million, representing 37% of the total value of service contracts, have been awarded to companies from other countries.’
PART TWO • TIMOR SEA TRANSITION TO INDEPENDENCE
The Break With The Past But An Uncertain Future For Boundaries

While East Timor would embark on the final period of transition towards Independence in May 2002, the commercial imperatives of continuing development, the machinations of negotiations and contrasting motives of governments, and the starkly different environment and circumstances in which Timor Sea discussions took place would bring the East Timorese no closer to realising their entitlement to ocean and seabed boundaries that would affirm their sovereignty.

The people of East Timor voted overwhelmingly for independence (78.5%) in the referendum on August 30, 1999 and the Indonesian-Australian partnership governing the previous regime in the Timor Gap drew quickly towards a close.

Not without controversy, industry joint venture partners and the Joint Authority continued to progress and administer development work even as they anticipated the change of agreement partners and working relationships. Shortly after Australia agreed to lead a UN peacekeeping force to stem the continuing violence, Phillips Petroleum made a final and controversial Timor Gap royalty payment of US$ 2.9 million dollars to Indonesia in September, around the time that militia violence and the comprehensive destruction of the physical infrastructure of East Timor reached its peak.78

The Indonesia Parliament endorsed the referendum and renounced all claims to East Timor on October 20 and CNRT leaders issued a letter to reassure petroleum operators and joint venture partners of their good intentions to maintain a stable operating environment for development ‘without negative impact on Timor Gap operations’ the following day.80

The passage of the UN Security Council resolution on October 25, 1999, assigning the responsibility to administer East Timor to the UNTAET mission, provided the opportunity to secure commercial certainty and stability during the transitional period. New operator Phillips Petroleum announced their intention to invest over US$ 1.4 billion in the development of the Bayu Undan project the following day.81 Project operator Woodside commenced production at its A$1.37 million Laminaria/Corallina project immediately outside the western boundary of the Zone of Cooperation the following week.82

As had been the case throughout the past decade, the East Timorese leadership made clear that they would accept the commercial terms contained within the 1989 Timor Gap agreement as an interim measure to enable petroleum development to proceed, but would never accept a successor state role by supplanting Indonesia in a treaty they always considered to be illegal.

“It’s not a problem of oil and gas but maritime boundaries, which East Timor will define and negotiate following independence,” according to then CNRT Timor Gap spokesman Mari Alkatiri.83 This position was reiterated in a Timor Gap workshop in Dili in January 2000 involving CNRT leadership, Australian government, transitional administration and industry stakeholders.84

The circumstances in Dili as throughout East Timor remained at best chaotic. Many of the over 200,000 refugees in West Timor flowed back, the displaced returned from the mountains, transmigrates arrived from the districts and rural areas in search of families and security under the protection of the Australian-led INTERFET mission, and thousands of international emergency workers arrived to provide humanitarian aid and set up the UNTAET mission. All were competing for the skeletal supplies of, food, medicines, shelter, communications and transport.85

Undeterred by events, petroleum operators were already pursuing domestic sales of Timor Sea gas, which ‘could find its way into new markets in the Northern Territory, Queensland and south-eastern States through a new marketing alliance to bring gas from the Bayu-Undan field to Darwin formed between Phillips Petroleum and Epic Energy.’86

Amidst these obstacles and the immediacy and priority of human needs, CNRT leaders, UNTAET representatives and the Australian government moved quickly to maintain the stability and continuity of development and fill the legal void in governance of the Timor Gap created by the expiration of Indonesia’s role.
INTERIM MEASURES ON THE WAY TO A FRAMEWORK ARRANGEMENT

UNTAET Replaces Indonesia in the 1989 Treaty

An Exchange of Notes and Memorandum of Understanding were signed between Australia and UNTAET on February 10, 2000. Exercising the absolute powers granted by the Security Council and in recognition of East Timor’s historically consistent refusal to legitimise the 1989 Timor Gap Treaty by succession to the role of partner, UNTAET replaced Indonesia in an innovative transitional arrangement made in lieu of a new treaty accord. If the Agreement had not been entered into, the terms of the Timor Gap Treaty, under which exploration and exploitation activity in the Timor Gap Zone of Cooperation is initiated and carried out, would not have continued to operate.

The agreements, made retrospective to October 25, 1999, also avoided other potential legal complications by incorporating in the main the terms and substance of the 1989 treaty without adopting the instrument itself. UNTAET’s role and the agreement itself were slated to simultaneously expire at the moment of East Timorese independence and the end of the UN’s transitional authority, with the date for Independence still to be determined.

The Exchange of Notes gave legal basis to the Memorandum of Understanding, and to subsequent amendments to Australian domestic law, on practical arrangements for the transitional period. These arrangements will ensure a smooth transition for the Treaty, and provide the political confidence necessary for significant investments presently under consideration in the Timor Gap Zone of Cooperation.

Otherwise, the terms and conditions of the 1989 Treaty did not substantially change. The demarcation of three separate areas with the zone of cooperation, tax and fiscal regimes and the administration and distribution of royalties by the Joint Authority remained and existing Production Sharing Contracts were honoured, with UNTAET to receive proceeds on East Timor’s behalf. The accompanying Memorandum of Understanding also recognised that it was important to ‘facilitate, as a matter of priority, employment opportunities for the East Timorese.’

All parties therefore recognised the need for continuing negotiations to forge a future and permanent agreement. The Agreement does not provide for the negotiation of any future legally binding instruments. However, in order for the terms of the Timor Gap Treaty to continue to operate after the independence of East Timor, a successor agreement will be required between Australia and the Government of an independent East Timor.

In a clear signal that the interim commercial environment was secure for development to proceed amidst the continuing turmoil and efforts to build stability within East Timor, the Joint Authority awarded final formal approval for Phillip’s A$2.9 billion Bayu Undan project on February 28.

NEGOTIATIONS BEGIN TOWARDS A NEW TREATY

‘Seabed and commercial development treaty’ or a ‘provisional agreement of a practical nature’

Though still based upon the terms of the previous Timor Gap treaty, a new operating framework to govern the Timor Sea was now in place that broke with the past and gave sufficient security for commercial development to continue for at least the immediate future. All stakeholders accepted the interim agreement as the new starting point for their shared goal: to define and settle a new and permanent accord by Independence Day, expected to occur in mid-2001.

Starting in May and June, during the ensuing months leading towards the start of formal negotiations in October, and thereafter, it became increasingly evident that the joint East Timorese and UNTAET negotiating team and the Australian government held little else in common between them and the point of difference in their divergent tactics, approach and desired outcome to negotiations hinged around the issue of maritime boundaries then as it does now. One path moved towards a fair and equitable outcome; the other towards a result that would be ‘seen to be fair’.

Along the way, more and more time otherwise spent negotiating boundaries would be consumed by increasing demands on attentions to address and resolve the changing goalposts for taxation and fiscal arrangements in order to keep the engine of development running.
During the interim, little news concerning the Timor Sea would surface. The people of East Timor struggled to gain a solid foothold and set in place the foundations for their path towards independence. CNRT, a broad-based political and social umbrella forged to unify the resistance during the struggle for independence, worked to transform into a representative pre-election body, resolve differences and build consensus policies and positions. UNTAET established their mission and initiated a series of transitional and governmental structures that would change numerous times throughout the next two years of Timor Sea negotiations.  

**Negotiations advance while boundaries recede**

CNRT representatives first broke this period of relative silence on the issue in June and demonstrated an open and forthright approach to negotiations when they announced their policy position on the Timor Sea on the eve of preliminary talks with Australia. The declaration affirmed their historical stances and concluded more recent debate amongst the leadership as to the best way forward. Further statements and clarifications would follow in a series of point and counterpoint exchanges with Australia, first in answer to their response to CNRT’s policy announcement and subsequently as their tactical approach to negotiations with East Timor was revealed.

So began a protracted period of thrust and parry with still no apparent end in sight, an abrupt baptism to the arena of bilateral relations for a new nation and future government with many other pressing priorities and demands on its attention. Although punctuated with a much-heralded July 5 2001 framework agreement and the pending May 20 2002 draft treaty and related documents, two years later East Timor’s position and real progress towards boundaries remains largely unaltered.

**East Timor establishes a position based on boundaries:**

CNRT’s approach and key positions were based on pursuit of a new treaty that could accommodate their two goals of boundary and development certainty:

- **Boundaries are the determinant:** The CNRT, “effectively East Timor’s government-in-waiting, is insisting that a new seabed boundary, drawn an equal distance between East Timor and Australia, is the starting point for negotiations on a new Timor Gap oil and gas revenue sharing deal.”

- **Maritime boundaries, not revenues, are the starting point.** – CNRT, Mari Alkatiri

- **New treaty or interim agreement:** We seek a new treaty not renegotiation of the old, to be settled and signed by Independence. Otherwise a transitional agreement can govern the Timor Gap area until independence or until a final delimitation of boundaries can be reached. – CNRT Timor Gap policy

- **Current international law should prevail:** ‘...a major point in negotiations will be to set a boundary midway between the two nations rather than at its current position, which he said grossly favours Australia – Mari Alkatiri. "It is the application of international law. The law first all of all considers 200 miles for each country. There is no 200 miles so we have to go to the midpoint" – CNRT calculates the mid-point as the southern end of Zone A the then current Zone of Cooperation.

- **Revenues are the consequence:** ‘While we may be entitled to more revenues, it would not be a major issue for Australia, which would have the benefit of the downstream development.’

- **Nor will we be intimidated:** In response to a complete change in the Canberra team and tactics at the height of negotiations, Alkatiri said that Australia was attempting ‘blackmail’ because ‘they know time is short and we need this money desperately to develop the country. We will show the Australians that the principal resource of the Timorese is creative capacity and patience.’

**UNTAET, CNRT advisors and observers further defined the issues:**

- **Independent arbitration is an option for fair settlement:** “All of our research points to the fact that a settlement in accordance with international norms would be in East Timor’s favour. I think this will be settled by independent arbitration. If it goes to arbitration, East Timor can’t lose.” – Oil industry consultant Geoffrey McKee
■ **Compensation in kind:** “If there is a lower profit share then we would like to see more East Timorese being employed and trained on a wage parity with Australians. Regardless we want to see movement on the issue of training for Timorese”.104 – CNRT negotiator Alfredo Pires.

■ **Disputation remains an option:** UNTAET negotiator Peter Galbraith said they were so confident that East Timor was entitled to boundaries that included the disputed oil fields that it was prepared to take Australia to the International Court of Justice.105

■ **The difference in revenues for East Timor:** “These resources can make the difference between its being a small country dependent on foreign aid as far into the future as we can see, as opposed to its being self-sufficient in five years.”106 “It is more important to us than Australia – the terms of the new treaty. We would be prepared to accept less Australian aid in the event that it gained us a greater share of the revenue – it is preferable that we get it rather than having it go to Canberra and then comes to us as aid.”107 – Xanana Gusmao

■ **The difference in revenues for Australia:** Galbraith quotes figures stating that Northern Territory alone would gain 2800 jobs and a majority of the $4.8 billion dollar downstream capital expenditure. Each NT household would receive value greater than the average per capita income of the East Timorese.108

East Timor wants to be in a position to influence the tax regime and the pattern of developments at present gives all downstream benefits to northern Australia.109 - Galbraith

■ **We can wait for a fair and equitable outcome:** Without a treaty based on international law, the East Timorese are prepared to patiently for their rights.110 - Galbraith

**Australia’s approach and strategy leading to and beyond July 2001:**

In response to the CNRT and UNTAET position, the Australian government’s Timor Sea views and tactical approach became cumulatively understood, as they positioned for the start of formal negotiations in October and thereafter. Over time, they could alternately be seen to be magnanimous, altruistic, paternalistic, threatening and even duplicitous. All Australian statements sought to move the focus towards their priority on commercial interests and away from maritime boundaries, while steering the process towards negotiations in a confidential environment and away from independent arbitration or disputation. Australia in this way could protect past boundary and commercial agreements while delaying challenge to their continental shelf argument.

The Australian government’s approach can be seen as a calculation to minimise risk and protect exploitation of and benefits from a greater resource base. By avoiding boundary delimitation and limiting the scope of negotiations to the confines of the current development area, Australia could trade off a share of known net royalties against the potentially larger loss of possible revenues and up/downstream benefits from discovered and promising petroleum reserves within and immediately adjoining the zone of cooperation.

■ **Australia wants new Timor Gap Pact to benefit both sides:**

CANBERRA -(Dow Jones)- Australia wants any renegotiation of the terms of the Timor Gap treaty to benefit both sides, include underpinning a stable and independent East Timor, according to a spokesman for Foreign Minister Downer.111

■ **Focusing on revenues rather than borders is in East Timor’s own best interest:**

CANBERRA: (Dow Jones). The share of royalties from energy developments in the Timor Sea is more important than fixing a midway boundary between Australia and East Timor in future talks, a government spokesman said.112

■ **Australia knows what’s best for East Timor:**

Mr. Downer emphasises stability as East Timorese push for oil royalties: Australian Foreign Minister Alexander Downer said stability in Timor was the priority as East Timorese leaders began to push Thursday for a greater share of oil and gas royalties.113

■ **Confidential and proper negotiations, not arbitration or disputation, is the way:**

We wouldn't want to see any of the prospective investments jeopardised by an unsuccessful or poorly-handled negotiation. “As far as the International Court of Justice is concerned, I think from my reading that…it’s more of a throw-away line rather than something we would want to overshadow negotiations.”114 - Downer

International law had changed a lot since the Timor Gap Treaty, and Australia was liable to be seriously contested in any international tribunal.115 - Australian Defence Studies Centre

Australia rejects idea of taking Timor Gap rift to Intl Court - Australia has rejected the idea of taking its rift with East Timor over the Timor Gap Treaty to the International Court of Justice, an Australian daily reported on Monday.116 - The Indonesian National News Agency
“They are continuing the negotiating process and the details of the negotiations remain confidential,” a spokesman for Australian Foreign Affairs Minister Alexander Downer said.117

- **Australia chooses not to acknowledge East Timor’s ‘boundaries first’ argument**: Australia “understands that the discussion or debate is about the share of revenue; it’s not the actual delimitation of the seabed,” a spokesman for Foreign Minister Alexander Downer told Dow Jones Newswire at the time.118 He also said that the arrangements for sharing benefits covered by the MOU were “quite stable”. “We don’t start from the position where we think the thing is in any way lopsided to begin with.”119

- **Imply threats to Australian aid to East Timor**: Downer warned the East Timorese that any changes in the Timor Gap affecting the share of royalties ‘would play into the overall size of the government aid program in East Timor’. An Australian official (Department of Industry, Sciences and Resources) pointed out that A$150 million in aid has been earmarked for East Timor over the next four years. This figure could fall if East Timor’s revenue from oil royalties rises.120

- **Australia faces pressure from home**: The Democrat and Labor parties urge the Australian government to change its national boundaries with East Timor to help the struggling country gain financial independence. Labor backed an equidistance solution that constitutes a just outcome consistent with the law of the sea.123

- **UN’s Galbraith is the problem**: Australian government officials are concerned that East Timor’s negotiating stance has been captured by a man deeply hostile towards Australia’s policy. Many observers said his comments, that recognition of Indonesia was an essential precondition for the negotiation of the Timor Gap Treaty, were alarming and provocative. He reportedly told Darwin businessmen that ‘you f…king Australians will pay’.124 “I’m not convinced in my own mind…that he speaks for all the East Timorese leadership.”125 - Northern Territory Chief Minister Denis Burke

- **Australia has investments to protect**: Northern Territory alone has spent over A$1 billion to develop capital facilities that can provide logistical support to Timor Sea operations. A$200 million has been spent or committed to build the East Arm Port, which will link an oil tank farm, container yard and related facilities, and secure NT’s A$1.1 billion dollar investment in the Australasian Railway linking the toepend with Central Australia.127

- **US energy and oil services contractor Halliburton, vying to participate in the Sunrise project, is one of the principle joint venture partners in the railway.**128

- **It’s not us, it’s the oil companies**: Senator Minchin said that the Australian government understood the “needs of the new East Timor nation” but he added that certainty for investors was a vital prerequisite of the deal…we hope the East Timorese understand that there is a sense of urgency about this, given the substantial prospective investments and the billion-dollar decisions that need to be made very soon.130

- **It’s not us, it’s Indonesia**: Canberra is fearful that a new deal linked to redrawing the seabed boundary would trigger the need to deal with Indonesia on the seabed boundary off Indonesian-controlled West Timor.131

- **East Timor is risking its reputation**: But he had a warning for Dili. “East Timor’s reputation will not be well served if this project doesn’t go ahead, because East Timor is refusing to budge on this tax question,” Downer said.133

- **East Timor will be vulnerable to a change in our tactics:**
Australia changed their negotiating team in the final months prior to signing the July 2001 arrangement and signalled a tougher position that would roll back concessions already offered to East Timor.  

**Oil companies provide a constant focus for East Timor and Australia negotiations:**

By all initial indications, the business of development had resumed in the Timor Sea after legal stability was secured in February. In the midst of a variable market beset by fluctuating petroleum prices and stiff international competition for sales to domestic and export customers, shareholdings in the principal reserve areas changed hands or consolidated. Companies holding Petroleum Sharing Contracts granted by the Joint Authority progressed discussions to coordinate project plans for joint exploitation of the gas fields even as they sought sales opportunities as rivals. Australian company Woodside fought a takeover bid by Shell, both holding large stakes in the Zone of Cooperation, while Phillips awarded contracts to construct offshore equipment for Bayu Undan, the next major field scheduled to produce.

All of the companies closely monitored the ongoing negotiations between East Timor and Australia, but Phillips took a vocal interest. With comparatively little development progress and investment compared to Bayu Undan, largely spent in search of Australian domestic customers, Sunrise partners could only speak about possibilities lost if a satisfactory accord could not be reached. Operator Phillips, however, had already invested well over US$1 billion in the Bayu Undan project and had little choice but to proceed regardless of the outcome.

As long as they remain relatively cost neutral, the percentage split of net sales royalties between joint development countries are of little consequence to petroleum companies, who depend upon suitable pecuniary, legal, regulatory and tax structures to assure cost recovery and profits for their shareholders and investors. Phillips need for the convergence of a treaty agreement, offshore preparations, onshore forward planning and fiscal certainty brought concerted pressure to bear upon negotiations.

The oil companies would also provide, for the first of many times throughout the negotiating process, strong incentives to find quick agreement in a form that best suited their conditions. Deadlines were declared, with the threat of delay or danger to project development and, by definition, to access of production revenues if unmet. The extent to which these declarations have been real or feigned, justified by the direction of negotiations or consequences of the larger forces of competition in a changing marketplace, or due to positioning between joint venture partners remains to be seen. Lack of ratification and unitisation by end of 2002 has been declared as the latest threat to continued development.

- **The whole world is watching:**
  
  “East Timor’s economic future is being decided. The world’s view of Australia could be at stake.”¹³⁵ - Phillips

- **Certainty not royalties is our concern:**
  
  Oil companies have stressed that they are not concerned about the royalties split as long as the tax rate is not changed.¹³⁶ – Phillips, J. Mulva at SEAACOC 2000
  
  ‘Royalty is purely a matter for the two governments to sort out. The contractor’s share isn’t open to discussion, debate or change. Whatever comes out of this treaty negotiation must maintain our legal rights and fiscal and tax arrangement in exactly the same manner as they are today.’¹³⁷ – Phillips, J. Godlove

- **Everyone will benefit:**
  
  “The infrastructure we will build, both offshore and onshore...will be the catalyst for other companies to increase their investments in the region and develop additional markets for Timor Sea gas.”¹³⁸ - Phillips, J. Mulva

- **But delays could have consequences – the first line in the sand:**
  
  But he said that companies wanted the treatment of gas under a new treaty to be settled quickly or there could be project delays. Gas was never fully addressed under the Australia-Indonesia treaty.¹³⁹ – Phillips, J. Mulva
  
  “We need an answer and we need it now.”¹⁴⁰ – Phillips, J. Godlove
  
  “But everyone knows that rationally these projects will go ahead, because so much capital is already sunk into them and the engineering is all under way.”¹⁴¹ - Oil industry consultant

- **Provide some incentive to settlement:**
  
  Operators of the Bayu Undan and Greater Sunrise gas fields have warned the Australian government and UNTAET that July 31 is the deadline for the decision on construction of a 500-km pipeline to carry the gas to planned processing plants in Darwin. ‘We need resolution of fiscal and legal issues to secure markets to justify the pipeline.’¹⁴²
  
  “We have taken the Timor Sea gas to the threshold of development. For us to go across the line, we require governments to provide us with legal and fiscal certainty.”¹⁴³ - Phillips, J. Godlove

25
Outside of the inner workings of government and industry, a handful of legal commentators, petroleum analysts and solidarity support groups identified the threat to future settlement of boundaries and fair allocation of resources that any form of adoption of the former Timor Gap Treaty would have for East Timor. But they were little heard by the Australian press and not at all in East Timor outside the confines of the government negotiating team. Geoffrey McKee, an engineer whose small company had explored acreage within the Zone of Cooperation in 1991, succinctly summarised the views of a Canadian barrister who had spent twelve months analysing the consequences:

- ‘The legal irony of East Timor's ocean claims thus becomes apparent. The passage of time has entitled the new state to the full benefit of recent developments in international law, developments not available to Indonesia as it attempted to maximise continental shelf claims in the Timor Sea. Those developments strongly suggest that a median line will ultimately form the Exclusive Economic Zone (EEZ) boundary between East Timor and Australia.’

- The second lesson is that inflexible pragmatism has its inherent risks, since today's interests may be short-sighted tomorrow. Compliance with now well-defined international law principles may offer more long-term stability.\textsuperscript{144}

The recommendations of a Senate Inquiry into East Timor, originally convened in November 1998, addressed the issue of the Timor Gap directly when handing down its final report on December 7, 2001, and the issue of boundaries was prominently featured. Amongst its conclusions, the Committee acknowledged Australia’s less than savoury history in East Timor ‘characterised as one in which ‘pragmatism, expediency and short-term self-interest have prevailed at the expense of a more principled approach’ and further noted that, while not prescribed by UNCLOS, ‘the median point is now generally accepted as the basis for delimitation.’\textsuperscript{145}

While the report declined to advocate a specific solution, the Committee did recommend:

- that, in its negotiations with UNTAET on the future of the Timor Gap Treaty, the Australian Government should take into account current international law in relation to seabed boundaries, the history of our relations with the East Timorese people, the need to develop good bilateral relations with East Timor and the need for East Timor to have sources of income that might reduce dependency on foreign aid.

Foreign Affairs spokespeople Laurie Brereton (Australian Labor Party) and Vicki Bourne (Australian Democrats), also a Committee member, were more explicit in their recommendation for an equidistant median line solution and transferring the bulk of resources to East Timor. “Such a settlement would place major gas and petroleum reserves within East Timor's maritime boundaries and constitute a just outcome consistent with the law of the sea.”\textsuperscript{146} Neither the Committee nor political parties addressed the issue of the lateral boundaries of the joint development area.

\section*{AN ARRANGEMENT OF SORTS}

\subsection*{July 2001 Framework for a New Treaty}

With elections pending for the Constituent Assembly, the first day of the campaign replaced Independence Day as the new deadline for reaching agreement. On July 15, ‘our current Cabinet which represents the East Timorese leadership will be replaced by a technocratic cabinet that will obviously have no mandate to negotiate on such a critical matter as East Timor’s economic future.’\textsuperscript{147}

Attainment of full independence was delayed, but Australia, East Timor and UNTAET did manage to sign a Timor Sea document on July 5, 2001. The international media greeted the Memorandum of Understanding of Timor Sea Arrangement\textsuperscript{148} (MOU-TSA) with much fanfare, and perhaps accorded greater significance than it deserved at the time. It was generally described as the new hallmark Timor Sea treaty when it in essence demonstrated the state of progress to anxious oil companies and established framework terms and conditions for continued negotiations towards a new and permanent treaty pact.

It did however contain key new points of agreement and flagged changes to the terms and operating conditions of the previous Timor Gap Treaty. It held no status as a treaty, did not require parliamentary attention, nor did it directly impact upon the conditions in place since February 2000 to govern ongoing commercial development.
Estimates generally indicated that East Timor stood to gain up to A$7 billion in revenue over 20 years, despite the fact that production had not yet begun, no sales contracts were yet signed and international gas prices were flat.

At first appearance to public eyes, East Timor was still positioned to continue negotiations towards a combined ‘seabed delimitation and commercial development treaty’ or a transitional agreement in lieu. East Timorese diplomat Jose Ramos Horta had in fact intervened during the final weeks when negotiators were locked in a commercial terms impasse and faced the possibility of boundary litigation that threatened delay for years to the revenue base much-needed by East Timor. He brokered an agreement on terms that deferred ‘without prejudice’ the delimitation of permanent seabed boundaries until such time as final agreement on commercial and development terms could be reached.149

Australia’s position and approach on boundary settlement would in fact turn out to have been strengthened. Over a year of negotiations had passed but there were no real indications of either progress on or any change in Australia’s position on boundaries.

A joint media release from the Ministers of Foreign Affairs and of Industry, Science and Resources characterised the terms of the arrangement as largely finalised, expressive of generosity towards East Timor that ‘we believe is shared by all Australians’, provides a revenue split of 90% for East Timor from petroleum development activities, and defers delimitation of a permanent seabed boundary ‘without prejudice’ or ‘stating how or when it might occur.’ (italics added)150

The MOU-TSA focused only on changes to the existing commercial treaty and the new terms did not favour delimitation in the foreseeable future. It would, however, come to define the continuing impasse after Independence and the extent of progress or lack thereof would soon become apparent.

**Comparison: Key changes between 1989 Treaty and 2001 Arrangement:**
An anecdotal analysis of terms is warranted, given both the ensuing controversy that following the July 5 arrangement and the fact that the unratified May 20, 2002 *Timor Sea Treaty* and instruments largely incorporate its terms. The significant differences in May 2002 would be changes to reflect progress on taxation and fiscal matters and to the unitisation agreement as proposed in July 2001.

**Area of cooperation:**
Former Zones B and C, previously under the exclusive control of Indonesia and Australia disappeared. Former Zone A became the Joint Petroleum Development Area and the sole area of cooperation.

**Term:**
No reference to length of term was included. Under the 1989 Treaty, the initial period of 40 years extended indefinitely until either both parties agreed otherwise or seabed boundaries were delimited.

**Control and benefit sharing:**
1989: Joint control and the benefits of exploitation and exploration of resources shall be equally shared. Indonesia and Australia in effect held a 50:50 stake in all aspects, including participation in the up and downstream benefits, tax revenues on development, production and sales and net royalties.
2001: All such references were deleted and replaced with ‘Of the petroleum produced in the JPDA, 90% shall belong to East Timor and 10% shall belong to Australia.’ East Timor was in effect only explicitly guaranteed 90% ownership of petroleum once extracted and not of the reserves themselves. All other references regarding management, control and facilitation of exploration and development were only generally described as joint.

**Employment:**
1989: States the obligation to prefer employment of Australian and Indonesian nationals, and to their employment in equivalent numbers over the term of a production-sharing contract.
2001: Removed and replaced with ‘Facilitate, as a matter of priority, training and employment opportunities for East Timorese nationals and permanent residents.’ No similar obligation transferred to the new arrangement in order to assure any level of either East Timorese or Australian employment or training was provided in fact, nor was compensation in kind specified in the absence of the capability of East Timorese to participate. This in effect further reinforced the loss of guaranteed access to or benefit from any up or downstream activities created by development.
Fiscal arrangements and taxation:

1989: All explicit references to the specific tax regimes and income strands to which each country was previously entitled were removed, as were the explicit mechanisms for identifying the various forms of revenue gathering and distribution.

2001: Replaced with ‘East Timor and Australia shall make every possible effort to agree on a joint fiscal scheme for each petroleum project in the JPDA’ and cited mechanisms in the event that agreement on a joint scheme cannot be reached. All fiscal arrangements bar taxes would in effect be determined on a case-by-case basis. The countries were required to negotiate an agreed tax code to provide PSC contractors with relief from double taxation. If agreement is not reached by the entry into force, the Ministerial Council shall at its first meeting establish an interim code.

Deleted:
Model Production Sharing Contract

Restructure of administration and authority:

The Ministerial Council, having similar overarching responsibilities for fulfilling the terms of the agreement and authority for administrative and managerial matters, remains. The Joint Authority is to be replaced by an additional layer of bureaucracy and decision-making. Previous responsibilities are divided between a Joint Commission, with members appointed by the respective governments and answerable to the Ministerial Council, with East Timor to hold a majority of one, and a ‘Designated Authority’ responsible to the Joint Commission. In the absence of explicitly specified guarantees, the responsibility to decide levels of participation, control, and achieve access to up and downstream benefits is internalised. The power to define what is fair and equitable is left to the comparatively subjective bureaucratic powers of the new structure, and relies upon their ability to reach consensus in the absence of guarantees within the overriding terms of the agreement.

Pipelines

1989: Not defined as an explicit category.

2001: The TSA contains an explicit Article outlining terms and conditions for pipelines and attempts to foresee various development scenarios and responsibilities: A pipeline landing in either country shall be under their jurisdiction, thereby defining the basis for a stronger claim to control over and benefits from the downstream side of production. Neither country shall object to floating offshore production facilities and off take when it produces higher royalties than a pipeline to shore. Pipelines can carry petroleum from fields within, straddling or outside of the JPDA, thereby creating opportunities for amalgamation of reticulation (ie a pipeline to Australia) and a lessening of capital cost.

Unitisation Annex E:

1989: Parties shall seek to establish a unitisation agreement when fields overlap a lateral boundary.

2001: An agreement to unitise the Greater Sunrise field on the explicit basis that 20% lies within the new JPDA and 80% is attributed to Australia is required.

While unitisation is noted to be without prejudice to future delimitation of seabed boundaries, a requirement under the Law of the Sea, no explicit or secure method is specified to assure adjustment of production sharing in order to reflect future boundaries that may vary from those of the JPDA.

The agreement simply allows either party to request a review but places no obligation on the other party to accede or act to review let alone specify an obligation to adjust. Further, the terms state that the unitisation agreement may, rather than must or shall, be altered following the unlikelihood that a review takes place.

Finally, the unitisation terms do obligate both parties to reconsider the percentage terms of the current unitisation agreement in the event of seabed delimitation, but neither compels settlement nor sets forth any mechanism to reach a binding agreement on new terms. This provision, and the diminished likelihood of an adjustment to percentage terms, is further reinforced by an obligation on both parties to carry over the terms of all PSCs, licenses and permits issued under the previous agreement.

Much of the future debate and expressions of concern during the months immediately surrounding Independence Day would focus increasingly on the implications of Annex E on East Timor’s future rights. It provided neither incentive for Australia to negotiate seabed boundaries nor any guarantee of adjustment in the event of agreement of final delimitation.

But, in the immediate aftermath of July 5th, it is the last paragraph of the MOU-TSA that would monopolise attentions, progressively reveal far larger commercial implications particularly for Australia,
and dictate actions well into 2002. This clause specified that the conditions of contracts (PSCs) held by corporations prior to the entry in force of the new agreement would continue under the same terms and conditions, to be modified only to reflect the new administrative structure.

Immediate reactions

The public, politicians and Australian supporters of East Timor in the majority basked in the media glow of a deed well done by their elected representatives, a view that would largely hold until the weeks immediately surrounding Independence Day. The government did little to dissuade the prevailing view that a permanent agreement had been reached and that they had made the ultimate concession to East Timor’s needs and demands, sacrificing 90% of the benefits in the Timor Sea. With no doubt the best of intentions for East Timor, ‘Australian aid agencies today congratulated the Foreign Minister Alexander Downer for signing the new 30 year treaty giving East Timor 90% of royalties from the Timor Sea oil reserves’.151

UN negotiator Peter Galbraith was no less effusive in expressing his disappointment with the terms of the MOU-TSA, but he was little heard by the public and his role had been marginalised under attack by the Australian government, oil companies and their sympathetic media. Galbraith ‘rejected repeated assertions by Australia’s Foreign Minister Alexander Downer that Australia wanted to be and was generous in striking the agreement. The agreement isn’t about generosity’152

However accurate his critique, he also made no mention nor explained why no indication had been given of any progress on maritime boundary issues. The agreement is a “very good deal for Australia,” Galbraith said, as it will receive the benefits of the downstream activities that will take place in the Northern Territory. “Those activities probably will be worth between 5 and 10 times the amount of money...that will go to East Timor. Australia would get in the Northern Territory, perhaps A$50 billion in increased economic activity, which in turn would generate about A$15 billion in taxes,” he said.153

COMMERCIAL DEVELOPMENT IN THE TIMOR SEA IS SUSPENDED

The opportunity to pursue the issue of boundaries was swiftly overtaken by commercial and taxation issues and would not return to the public arena for almost eight months.

In a surprise move announced on July 31 following a letter of explanation to Kofi Annan, Phillips and Bayu-Undan partners announced that the A$ 500 million pipeline to Darwin was deferred indefinitely. Whether an arrangement or agreement, interim or permanent, the MOU-TSA had not delivered the certainty that the oil companies awaited.

"Participants in the Bayu Undan project have unanimously decided to defer indefinitely investment in the sub-sea pipeline proposed to transport gas from the Timor field to Darwin. The deferral reflects the need to resolve certain critical legal and fiscal issues arising from the Timor Sea arrangement."154

The Department of Foreign Affairs was quick to issue a press release that pushed the blame back on UNTAET and, by implication through comments by a Department spokeswoman, straight to Peter Galbraith. “The deferral arises from uncertainty about the legal and fiscal regime to apply in the Timor Gap as a result of tax proposals put forward by UNTAET/East Timor. Australia shares many of industries’ concerns. It is unfortunate that just hours after we agreed the Timor Sea Arrangement in Dili, UNTAET/East Timor announced that it would use its taxation powers to recover up to an additional US$ 500 million in tax from the companies.”155

The machinations of government negotiations

The circumstances were in fact quite different and provide some clear insight into the difference between the presentation of a public persona and the private machinations that East Timor has faced in Realpolitik negotiations with Australia. Examination of the issue no less demonstrates the intertwined complexities that have stood between meaningful and good faith progress in boundary discussions when pitted against the ever-present commercial imperatives and desire for acceptable fiscal certainty.

Australia already knew of the nature of the unresolved and conflicting tax status of East Timor when it signed the arrangement on July 5 in Dili. Under the terms of the UN mandate and Regulation 1/1999,
Indonesian law in the main prevailed in East Timor until superseded by new legislation. Under the previous Timor Gap tax regime, "Indonesian law set a higher company income tax rate than the Australian law (44% compared to 36%) and provided less generous write-offs for capital expenditure," according to Richard Krever, a Melbourne academic who had worked with UNTAET to establish new tax structures for East Timor.156

This anomaly already placed East Timor and UNTAET in a taxation conflict. They were on the one hand bound to abide by the higher tax rate terms of the Timor Gap Treaty under the February 2000 Exchange of Notes until a new ratified treaty was in force, while at the same time the new MOU-TSA eliminated explicit tax regime provisions and substituted the requirement that parties 'shall make every possible effort to agree on a joint fiscal scheme for each petroleum project in the JPDA'. Australia had willingly accepted the Indonesia tax rate under the terms of the previous treaty, even while they continued graduated reductions in their domestic corporate tax rate to improve the environment for investment.157

During recent negotiating sessions, East Timor and UNTAET had already expressed concern over any loss of potential taxation revenue that a new regime would bring that would diminish any of the benefits gained by receiving a greater share of net royalties, and equally about the loss of tax revenue to investment incentives previously given to industry, and Australia’s insistence that they carry over with the new arrangement.

The problem for Australia may not so much have been that Galbraith reminded them of these unresolved issues on July 5th, but that he did so publicly and risked dampening the public relations wave that the Australian government was riding.

Galbraith said that the Australian negotiators insistence on maintaining the field contracts for Bayu Undan and Greater Sunrise in spite of this revelation and given East Timor’s previous understanding that all aspects of previous agreements were open for renegotiation, had almost derailed talks in May.

"Both we and the Australian's were shocked at the negotiating round in May to learn that the contracts under the 1989 Timor Gap Treaty had investment credits worth 127 percent. This was not economic; it was a political incentive to get companies to come and invest in a place which the UN said did not belong to Indonesia.' He added that the East Timorese had estimated the incentives would cost the impoverished nation US$ 500 million.158

The Council of Ministers and Joint Authority may in fact only recently have granted the incentives to contractors, in response to concerns expressed by Indonesia in 1999 around the time that the independence referendum was approaching reality. While declining to talk about the future status of the Timor Gap Treaty should East Timor become independent, the Indonesian Mines and Energy Minister 'proposed tax and other incentives to encourage oil firms to explore and develop the Timor Gap' because projects 'have so far been found to be not economically feasible.'159

East Timor attempted to resist this provision as one way to resolve their concerns about lost tax revenues, according to Galbraith. We ‘agreed to Foreign Minister Downer’s request on June 28th that the new treaty should continue the terms of the company contracts from the old, illegal treaty. Even then, we made it clear, and not for the first time, that Timor would use its tax authority to recover part or all of the unfair investment incentives in those contracts.’160

Some steps inside of the closed negotiations had in fact been taken towards finding resolution despite the fact that the joint fiscal regime had not been finalised by July 5. Tax observers had already expected Australian authorities to ‘concede much of their taxations rights (royalty share) to provide revenue for the new nation.’ The downstream benefits from a decision earlier in the year to bring gas onshore was ‘expected to more than offset the small decrease in tax revenues’ if Australia agreed to vary the existing 50:50 split in favour of East Timor. In a bizarre twist, Australia gave up a greater share of net royalties than expected (90% compared to 85%) but UN negotiators ‘agreed to apply the split only to revenues from hydrocarbon extraction, exempting revenues from the pipeline carrying gas’ to Australia.161

In compensation, Australia had agreed to make an annual payment to East Timor of A$8 million dollars although the reasons were not cited in their July 5 media release. Tax observers calculate that the payment was far less than the tax revenue that East Timor would have gained had they accepted a lesser royalty split but applied it to 'both extraction and pipeline revenues, as well as applying VAT to
the pipeline operations. The annual payments were slated to begin in 2005 when Bayu Undan gas was scheduled to come ashore through the pipeline.

As further confirmation that negotiating teams were aware of the outstanding issues, UNTAET subsequently announced that talks would be held in Darwin on July 18 to “focus on East Timor’s new tax guidelines and prospective prices for natural gas.”

Regardless of the tale that each government has told, the objective terms of the MOU-TSA support East Timor’s rendering of events:

- Agreement on fiscal and taxation regimes was not required until a permanent treaty entered into force.
- Partners enjoy ownership only of produced not reserve petroleum held within JPDA fields and all provisions guaranteeing shared control and benefits to the related up/downstream activities had been deleted. These decisions would now be in the hands of another subjective negotiating process under the control of the Commission and Authority structure.
- Pipelines could carry petroleum from sources within and outside of the JPDA, significant given the recent decision by Bayu Undan to bring gas ashore to Darwin and the unresolved issue of options for development of Greater Sunrise.
- The terms recognised the possibility of a floating offshore production facility and did not exclude the ability of fields currently outside the JPDA in Australian waters to make use. Australian was better positioned to apply downstream taxes and benefit whether Sunrise gas came ashore or not.

Oil companies reject the arrangement as unsuitable; suspend development

There was no clear indication that the oil companies had yet been fully apprised of the intended changes to the previous treaty, forged during intense countdown negotiations starting in May, or even the extent to which they had been updated throughout the process when discord first became public.

Their first reaction was measured. The oil companies reserved judgement on the July 5 agreement while they considered the implications of the TSA, but they already flagged the possibility of their later decision to suspend the pipeline project. “Phillips is still absorbing the details of the new agreement before committing to the pipeline.”

From the perspective of seeking fiscal and legal certainty, their reading of the terms of the TSA would have offered cold comfort and intensive calculation of various scenarios. Amongst them:

- Resolution of joint fiscal schemes and taxation codes were unresolved and deferred to future negotiations and a subsequent agreement.
- An additional 40% of JPDA net production royalties under East Timorese jurisdiction would now be taxed at a higher rate despite the fact that Australia’s corporate tax rate had dropped a second time in July, from 36% to 30%. In the May budget, the Australian government also rejected tax office requests to spread the depreciation of the assets of capital-intensive industries such petroleum to 50 years, providing another avenue to potentially recover any increase in costs.
- While the locking in of previous PSCs under the new arrangement could deny East Timor avenues of compensation while protecting incentives, it also prevented the oil companies from seeking adjustment if their calculation of profits for shareholders and investors was lessened.
- For Phillips, who had only recently purchased a significant shareholding in Greater Sunrise in order to better negotiate an agreement with Woodside and Shell in February to seek cooperation and share offshore facilities between projects to lessen development costs, the TSA provided the project operators with alternative opportunities to Phillip’s Bayu Undan pipeline.
- The lack of guarantees to protect an East Timorese share in employment and participation in downstream activities could limit options to diminish the comparatively much higher cost of downstream Australian labour over the long term of the Bayu Undan project. A modest Australian contribution of A$700,000 made in early 2000 towards capacity building of East Timorese TSM Sea management skills might assist in the administration of petroleum development, but it was more so an indicator of the low priority given to East Timorese skills training and employment and the minimal weight that East Timor’s 90% gained in real downstream benefits under the MOU-TSA. By July 2002, the steering committee had produced few concrete results.
By the time that Phillips announced suspension on the pipeline, it was unclear as to whether the MOU and East Timor’s tax issues were the determinants that lead to the decision, or only one of many precipitating factors.

- Shell had already tipped the possibility of a Floating Liquefied Natural Gas (FLNG) facility at a recent conference in Hobart and would publicly announce their plan to use it within a week of Phillip’s August 1 announcement. Shell would claim that pipeline costs to the Northern Territory would make the project unviable, thereby foreclosing an opportunity for Phillips to reduce capital costs by shared use of facilities. If the FLNG were to be located in Australian rather than JPDA waters, it would further diminish the impact of a higher East Timor tax rate for operators.
- Despite a letter of intent to sell Bayu Undan production to US El Paso, the gas market was flat and showing little signs of recovery. Pre-production purchase and sales agreements, rather than letters of intent, lock in prices for gas products, which are generally sold to one customer at a fixed price over the term of production. Higher production costs would also diminish profits, making a regional customer in closer proximity more attractive.
- A decision to bring a gas pipeline from PNG to northern Australia was looming, with the possible effect of lowering prices and increasing competition for Timor Sea gas. None of the major PSC contractors working in the JPDA had yet found committed domestic customers in Australia for their gas products.

Whatever the reasons and calculations for announcing the pipeline suspension, oil companies also implied that UNTAET and East Timor were more so the culprits than Australia. They referred to the October 1999 letter signed by CNRT leaders the day after the UN Security Council resolution setting up the UNTAET mission in East Timor. The letter indicated that the conditions for investment in the Timor Sea would be no more onerous in a future agreement than under the existing regime and oil companies choose to blame UNTAET and by association Galbraith for failing to meet this commitment. The Australian government echoed these comments, which by implication assigned little responsibility and credit to East Timorese for their role in the negotiations. According to lead negotiator Mari Alkatiri, the UN was ‘playing the ball that we East Timorese want them to play.’

Observers and media commentators of the debacle failed to note the inherent contradiction in Phillip’s action to delay the Bayu Undan project. The media, oil companies and the Australian government had widely and loudly condemned Peter Galbraith at an April oil conference, when he indicated that an agreement might not be reached by July and that the East Timorese were prepared to wait for resources and revenues if sufficient progress was not made on maritime boundary issues.

**SEARCH FOR COMMERCIAL CERTAINTY PUSHES BOUNDARIES OVERBOARD**

A Commercial Agreement is Now Needed

**Taxation starts to dominate the stretch run to Independence Day**

Fiscal and legal issues would dominate the remaining negotiating period leading to Independence, leaving little time for any progress towards boundary delimitation between East Timor and Australia.

As Galbraith’s role as negotiator diminished, Phillips chose to pursue resolution of their fiscal and legal issues through direct bilateral negotiations, initially with both East Timor and Australia.

Along the way, East Timor would hold its first election, a new Constitution would be drafted, Woodside and Shell would consolidate holdings in Greater Sunrise and agree on using an FLNG to the detriment of Phillips Bayu Undan pipeline costs, the Australian federal and Northern Territory governments would hold elections, the Northern Territory government would initiate a campaign to bring Sunrise gas ashore in the national interest, Phillips would lose US El Paso as a customer for Bayu Undan, construction of offshore Bayu Undan equipment would near completion in Indonesia, Korea and Singapore rather than Australia, and a small subsidiary of a US defence giant would initiate a lawsuit in Australia seeking compensation for a 1974 Timor Sea exploration.

**2/3 of a commercial agreement creates more disagreement**

East Timor and Phillips would eventually reach a commercial agreement to govern the Bayu Undan project in late December 2001 but it did little to bring boundary discussions back to the foreground of
negotiations. Over the previous five months, issues of taxation had by all accounts consumed East Timor’s negotiating efforts and Timor Sea time in order to move Bayu Undan forward.

The terms of the agreement followed the tenor and intent of the MOU-TSA concerning pipelines, and gave East Timor some modest benefits related to development not otherwise guaranteed. East Timor agreed with Phillips to support a pipeline to Darwin for phase two processing of liquefied natural gas (LNG). “We avoided transferring some downstream benefits, and put them upstream,” according to Chief Minister of the transitional government Mari Alkatiri. “By doing this we recovered most of the revenues we were trying to recover through taxes.”

But the status of the boundary issue would not change. Any reference to agreement with Australia was visibly absent from the press statements issued by Phillips and the United Nations.

**Australia will not endorse the agreement between Phillips and East Timor**

Despite Australian’s ongoing role in negotiations, they did not and have not endorsed the understanding. Phillip’s was now faced with a commitment to a contractual understanding made with East Timor and a period of protracted negotiations with Australia armed with limited bargaining power.

With offshore shore equipment moving into place over the Bayu Undan reserves and production drilling starting in June, Phillips either had to convince Australia to accept the terms as they stood or face even less desirable options. If Phillips returned to East Timor for concessions, it would further delay and destabilise project development and risk the fiscal certainty and acceptable after-tax return for shareholders that Phillips thought they had attained. On the other hand, if they granted Australia greater benefits in exchange for their endorsement, East Timor would be entitled to an adjustment.

The outstanding reasons as to why Australia chose not to endorse an agreement that resulted from a process in which they largely participated continue to emerge, but any East Timorese illusions that maritime boundaries could be delimited by Independence were effectively overrun.

The specific terms of the commercial agreement were only generally described until Phillips Australian CEO Stephen Brand spoke at an offshore conference in June 2002 (SEAAOC)\(^{175}\). The lack of public disclosure may be in large part attributable to an agreement also being reached regarding requirements for commercial-in-confidence. Brand also noted that it was the view of Phillips that East Timor’s 90% share of petroleum produced meant that they should benefit from upstream development and the pipeline to Australia gave them the downstream benefits.

**Phillips CEO explains why the July 5 Arrangement is unworkable:**

- The July 5 MOU-TSA had made the Bayu Undan project uneconomic.
- Their previous negotiations with the transitional government had not been promising.
- There were complex three-way interests involved.
- Phillips was not prepared to accept less favourable terms and conditions than those on which their shareholders had made their original investment.
- Negotiations were conducted with no existing system of law or regulatory framework in place in East Timor and future development depended on the outcome.
- Bayu Undan is only one of many offshore projects for Australia and any agreement has implications beyond the JPDA. Australia’s approach was a determined one, over concerns about the precedent that an agreement might set.
- Phillips went back to the table in November with a proposal that linked development of Bayu Undan to East Timor's national development priorities.

**Brand reveals some of the terms of agreement with East Timor:**

- Phillips and East Timor had reached an agreement on commercial-in-confidence.
- Phillips pledged and East Timor accepted an initial direct investment of US$13 million towards associated project, community infrastructure and training.
- Phillips pledged an additional US$ 44 million for ongoing expenses over the project life.
- The investment would spur new business activity and multiplier benefits for East Timor.
Amongst the implications of the agreement:

- Australia has so far deemed the terms unsuitable for endorsement.
- East Timor has reached agreement on a fiscal, regulatory and taxation scheme through direct negotiations with a PSC contractor rather than through a negotiated decision reached with Australia under the terms set forth in the MOU-TSA.
- East Timor had found some guarantee of access to upstream benefits and participation despite their removal as explicit entitlements under the terms of the new MOU-TSA. On the other hand, US$ 57 million dollars is a minimal sum over the life span of a project that will generate billions of dollars of related commerce over and above production revenues.
- East Timor does not yet have comprehensive legislation in place governing a range of complex corporate, commercial, investment and regulatory and taxation needs. Agreement with Phillips means that, in effect, East Timor will need to draft and pass future legislation incorporating terms and conditions already set by commercial imperative, a risky proposition.

While Brand did not indicate when initial payment to East Timor would be made, if is safe to assume that ratification and unitisation must first be met. He concluded his remarks, in agreement with other JPDA contractors, by identifying completion of these two steps as the newest in the series of deadlines to avoid placing commercial development once again at risk of delay or suspension.\textsuperscript{176}

Community concern over the Timor Sea begins to surface in East Timor

For most East Timorese, outside of government circles, there was little to indicate that the bilateral efforts to resolve boundary issues before Independence Day were not continuing in the wake of the July MOU-TSA. The secretive nature of bilateral negotiations and recent agreement on commercial in confidence meant that little Timor Sea information of any kind found its way into the local press.

Historic bilateral and trilateral meetings between East Timor, Indonesia and Australia took place in Bali in late February and land sea boundary issues were placed on the agenda. The Indonesian Foreign Minister took pains to assure East Timor that Timor Gap petroleum resources were not sought. "What we can do now is only determine the sea boundary of the Timor Gap, on the east and west side, but not about the exploration of oil." Hassan said the meeting would "review the current temporary border between Indonesia and East Timor and find certain ocean lines to separate the two countries."\textsuperscript{177}

Some non-government organisations (NGOs), East Timor’s emerging labour unions and minor political parties however were becoming increasingly concerned over whether current and future agreements would benefit East Timorese through direct participation. In response, ACTU president Sharan Burrow flew to Dili for discussions and met with Chief Minister Alkatiri. "We hope that Australian companies and companies based in Australia would be proposing labour arrangements in East Timor that would be supportive of a sustainable labour base here. Australian unions "are not under any illusions that where a company is not held to some formal labour agreement, especially in this kind of international enterprise, they will try to get labour as cheap as possible. This country deserves a chance like any other."\textsuperscript{178}

A year earlier, Bishop Belo with the support of East Timor’s Inspector-General had already flagged the importance of monitoring all activities concerning Timor Sea development on the public’s behalf. He called for the establishment of a national and independent Timor Gap Watch and warned that the composition of the body must include credible people from the private sector, social organizations and the Church. “We will only be a rich country if the royalties (from oil and gas) are used to develop the country and not if they are spent by those who have been corrupted.”\textsuperscript{179}

COMMERCIAL IMPLICATIONS EXPAND FAR BEYOND BAYU-UNDAN

In concrete terms, negotiations to this point had produced no discernable progress on boundaries and netted little more than a generous reapportionment of shares that applied only to net revenues on sales and not to the more valuable wealth derived from development, and a tenuous commercial agreement unsecured with Australia that recovered a modest portion of upstream benefits for East Timor.
In real terms, the process had extinguished any illusions that achieving a new Timor Sea Treaty of any kind was as simple an act as reaching terms to define the general tenor of the commercial relationship between two bilateral country partners. While the July 5 Arrangement had so far proved effective in sideling the boundary issue, it was in effect an agreement to agree at some point in the unspecified future on pressing and uncertain commercial matters. The failure to incorporate and unify all of the conditions and requirements of the stakeholders in a form they would all accept instead incited a complex web of responses. The impact of the countermoves taken to progress the one Bayu-Undan project through a second level commercial agreement not endorsed by all quickly flowed to all other projects in the Timor Sea, spilled into a national debate in Australia and, ironically, has ultimately come back around again to the issue of unsettled seabed boundaries.

Should it come, a final and lasting deal will require completion and harmonisation of at least three sets of interwoven and compatible agreements that incorporate and resolve all issues and are forged and accepted between governments, between government and industry stakeholders and amongst industry and project partners.

**Australia cannot accept the precedent that commercial agreement will set**

East Timor had in effect increased their company-based tax revenues as a result of their agreement with Phillips, despite the pipeline tax deal with Australia. Phillips then sought to offset the higher tax they would ultimately pay to East Timor by negotiating a more favourable tax arrangement with Australia that would effectively grant them a fixed determination over the projected 17-year life of the project.

The Australian government, which had originally envisioned that all outstanding issues from the July MOU-TSA would be resolved by February and enable completion of parliamentary and legislative processes and approvals by the May date for Independence, had its hopes dashed by the Australian Tax Office (ATO).

“No other company in Australia has got that certainty” and for large infrastructure projects over long time periods, “that basically amounts to transferring the risk from them to us.” Although the July MOU-TSA required that East Timor and Australia make every possible effort ‘to agree on a joint fiscal scheme for each petroleum project in the JPDA’, the ATO was in fact concerned that ‘any concession granted to Phillips would be sought for other resources projects such as the Sunrise project operated by the Shell-Woodside consortium.’

Phillips like others had already been the beneficiary of a phased reduction in corporate tax rates in recent years following the implementation of the recommendations of the Ralph Review, and was part of a large petroleum industry and pipeline contractor lobby to block ATO efforts to extend the term of depreciation write-offs of major capital works to 50 years. The push was a trade-off for the earlier reductions in the corporate tax rate.

With no resolution in sight with Australia and the fiscal situation for Bayu-Undan no less certain than it had been when they suspended the pipeline in August 2001, Phillips contradicted their own previous arguments when they secured a sales agreement with Japan to purchase all of the LNG from Bayu-Undan. As had and continues to happen at various stages of the negotiating process whenever government decisions do not come as fast as PSC contractors desire, Phillips had in effect argued that without tax and fiscal certainty, they could not secure sales that would then justify investment by bankers in project capital works.

The agreement sold 3 million tons of LNG per year to Tokyo Electric and Tokyo Gas over the 17-year life of the project. “Development activities can begin immediately for both the LNG plant and pipeline projects. However, the project cannot proceed until we receive the endorsement of the Australian government.”

The fully-integrated development of the LNG plant and pipeline was good news for a Northern Territory government long in search of downstream benefits from the Timor Sea, but it would also crank the ongoing national and international debate over the Greater Sunrise project up another notch. The entirety of the Bayu-Undan gas would be sold on to Japan, leaving nothing to supply projected domestic needs and fuel industrial development in the Topend.
The failure of the July 5 Arrangement to provide Timor Sea production sharing contractors with sufficient fiscal and taxation certainty further fuelled a series of moves and counters between project partners who were otherwise competitors for sale of their percentages of oil and gas fields to domestic and export markets.

By the time that the dust had largely settled in February 2002, the Northern Territory had gone from the likelihood of having all downstream production from Timor Sea projects come ashore to production plants and customers via pipelines, to having one LNG plant and pipeline and no product available for sale and use in NT and Australia. NT Chief Minister Clare Martin would follow with a national campaign to lobby the Commonwealth government and all states to back efforts to bring Greater Sunrise gas ashore in the national interest. In the process, the bi-section of the Greater Sunrise fields by the development border between the JPDA and Australia waters would eventually thrust the issue of seabed boundaries back in the spotlight and the past focus on median would turn to the lateral.

**Chronological overview of petroleum manoeuvres behind the Northern Territory gas crisis:**

- **February 26, 2001:** Sunrise and Bayu Undan partners agree to pursue opportunities to share project infrastructure and reduce costs following Phillips 30% Sunrise buy-in.\(^{187}\)
- **April 23, 2001:** Woodside shares lose A$1 billion in value after Treasurer Peter Costello blocks Royal Dutch Shell’s takeover bid of the Australian company in the national interest.\(^{188}\)
- **April 30, 2001:** Woodside begins to rebuild relationship with 34% shareholder Shell, resolve competitive issues and pursue joint markets following failed takeover.\(^{189}\)
- **July 31, 2001:** Phillips suspends Bayu-Undan LNG pipeline and plant following July 5 MOU-TSA.
- **August 9, 2001:** Shell announces plans for Sunrise offshore LNG production (FLNG), saving 40% in pipeline and capital costs and causing a rift with Phillips.\(^{190}\)
- **August 31, 2001:** Shell offers partners take or pay gas stake in Sunrise FLNG.\(^{191}\)
- **September 27, 2001:** NT Resources Minister says main game is to get Bayu Undan and Sunrise gas ashore in significant volumes to build an industrial base and sell to eastern markets amid concerns that Methanex plans to build a US$1.5 billion Darwin plant will be lost.\(^{192}\)
- **November 1, 2001:** Methanex pulls out of Darwin and relocates to Western Australia in a move seen to help Shell’s FLNG proposal.\(^{193}\)
- **November 21, 2001:** Partners delay Sunrise for at least a year after rejecting the Shell plan after failing to obtain equity role. Shell wants all project gas for its US customers.\(^{194}\)
- **November 20, 2001:** Phillips and Conoco plan a merger to create US$67 billion oil company and compete for sale of Timor Sea LNG with Shell.\(^{195}\)
- **December 21, 2001:** Phillips and East Timor reach Bayu-Undan fiscal agreement.\(^{196}\)
- **January 23, 2001:** Woodside Petroleum’s largest shareholder, Royal Dutch/Shell, is thought to be working on a revised offer for the company after earlier bid was rejected.\(^{197}\)
- **January 21, 2002:** Woodside bids US$ 2 billion for international petroleum resources to reduce Shell’s 34% influence in company and efforts to restrict Woodside business to local markets.\(^{198}\)
- **January 31, 2002:** Woodside bid for international resources fails.\(^{199}\)
- **February 13, 2002:** Northern Territory representatives see that unless the massive untapped gas resources in Timor Sea come ashore, the national interest won’t be served.\(^{200}\)
- **February 20, 2002:** Woodside announces profit slide due to falling prices and lack of petroleum.\(^{201}\)
- **February 20, 2002:** Woodside agrees to support Shell’s FLNG plan.\(^{202}\)
- **February 27, 2002:** Shell lobbies Prime Minister to support Sunrise FLNG.\(^{203}\)
- **March 5, 2002:** NT Chief Minister makes national interest case in National Press Club speech.\(^{204}\)
- **March 7, 2002:** Australia faces an oil trade deficit of A$7.6 billion by 2010 if Australia doesn’t find more oil, but governments must create an investment environment competitive with overseas.\(^{205}\)
- **March 12, 2002:** Phillips commits sale of all Bayu-Undan gas to Japan.\(^{206}\)
- **March 15, 2002:** NT Resources Minister tables ACIL study claiming Sunrise pipeline is economically feasible, would bring over 10,000 jobs to Australia and increase NT GDP by 46%.\(^{207}\)
March 21, 2002: Federal government won’t force Sunrise partners to bring gas ashore.\textsuperscript{208}

March 27, 2002: The ATO declines to accept the terms of Phillip’s agreement with East Timor.\textsuperscript{209}

April 4, 2002: NT Chief Minister to ask Prime Minister to offer Shell up to A$200 million in assistance to assure that Sunrise gas comes ashore.\textsuperscript{210}

April 5, 2002: Osaka (10\%) joins Woodside and Shell in support of FLNG, totals 70\% of project.\textsuperscript{211}

April 17, 2002: Shell offers Sunrise partners a 49\% stake in FLNG proposal to win support.\textsuperscript{212}

April 18, 2002: Phillips rejects Shell’s US$ 2.7 billion FLNG plan despite backing from all other partners. Woodside believes that competition between Shell and Phillips in US markets is the reason.\textsuperscript{213}

May 8, 2002: Shell says FLNG is in the national interest. If the project doesn’t go ahead because it’s not viable, governments get nothing.\textsuperscript{214}

The Chief Minister’s efforts were rewarded by an announcement by Greater Sunrise partners on May 16 that they would suspend FLNG development, four days before East Timor’s independence and about the time that it became clear that a unitisation agreement would not be completed by East Timor and Australia to accompany the draft treaty. They agreed to revisit the domestic gas issue, seeking sales commitments from customers before issuing a report and recommendations in October.\textsuperscript{215}

At the time of the announcement, the ocean and seabed boundary issue had finally forced its way onto the public agenda if not the negotiating table in March following the first public Timor Sea seminar to take place in East Timor outside of the closed circles of government.

BOUNDARIES BECOME PUBLIC ISSUE IN THE FINAL RUN TO INDEPENDENCE

Billions At Stake In Ownership Claims Over Known And Future Oil Reserves

The full legal issues and resource consequences of ocean and seabed boundaries were placed before the East Timorese public and Members of Parliament for the first time throughout the entirety of the negotiating period by a small petroleum subsidiary of a US oil exploration company and its defence company parent pursuing its own share of the riches in the Timor Sea (see Petrotimor – Appendix C). The ramifications of the presentation by company executives and their industry and legal consultants would thrust not only median but lateral boundary issues into the international spotlight, and quantify the sheer scale of resources that East Timor stood to lose if a new Timor Sea Treaty was adopted without either final delimitation of boundaries or a mechanism for prompt settlement with guarantees for future adjustment of resource-sharing.

The company, still contesting A$2 billion in compensation before Australia’s courts for a 1974 oil concession granted by Portugal in the area of contested claims with Australia, had already sought to lay their boundary arguments before the East Timorese-UN negotiating team in 2001, prompting the UN administrator to issue a memo forbidding UN employees to have contact with Petrotimor staff.\textsuperscript{216}

The company also offered to provide East Timor with up to US$5 million to pursue litigation in the International Court of Justice of any disputed boundary claim with Australia.

Regardless of their motivations, the company raised legitimate maritime legal issues, prompting Chief Minister Alkatiri to fly to London to consult with UN and private legal advisors\textsuperscript{217}, Australia to take preventative and protective measures allowed under UNCLOS, compelling public interest in East Timor that has led to the creation of a broad-based non-government Timor Sea coalition and stimulating public legal analysis of the Timor Sea Treaty by a number of maritime experts.
Key seabed boundary and resource allocation assertions made in the March seminar:

- The 1971/1972 basis for continental shelf compromise in the International Seabed agreement with Indonesia is no longer valid. All countries since 1982 are entitled to claim a 200nm Exclusive Economic Zone (EEZ) and continental shelf.
- In cases where the EEZs of opposite countries overlap (less than 400nm apart), a notional median line of equidistance is the generally accepted solution.
- The median line boundary would capture all of Bayu Undan revenues, adding up to US$1 billion dollars over its project life for East Timor.
- An EEZ claim by East Timor to secure combined seabed and water rights would not only likely establish an equidistant median parallel boundary but also shift the east and west lateral boundaries in East Timor’s favour.
- The current east-west JPDA perimeters were based upon formulas for calculating perpendicular lines of equidistance that are no longer valid under international law.
- The tri-points (A16, A17) that established the limits of the Timor Gap in the 1972 International Seabed Agreement are not accurately established and provisions for adjusted were included.
- The lateral lines of equidistance utilised these points and are hence inaccurate.
- The starting points for both east and west lines are also inaccurate.
- If the western lateral boundary were to be adjusted according to current standards, the new line would divide or capture all of the currently producing Laminaria-Corallina oil fields.
- East Timor could therefore gain up to US$2 billion in potential additional revenues.
- The western lateral boundary that currently divides Greater Sunrise between the JPDA (20%) and Australian seabed (80%) uses an inaccurate starting point and gives Indonesia’s Leti Island full weight as a continental mass.
- Simply adjusting the starting point of the eastern lateral boundary to the outer perimeter of Jaco Island would by itself net East Timor over half of the Greater Sunrise fields.
- If the starting point was adjusted and Leti was given less weight as has occurred under current international law and ICJ decisions, the eastern lateral boundary would shift, giving East Timor more or all of the Greater Sunrise fields.
- If East Timor received its maximum eastern EEZ boundary entitlement, it would gain up to US$ 36 billion in additional revenues.
- A pipeline from Greater Sunrise is technically and economically feasible and would generate significant downstream and industrial development benefits.

The international maritime lawyers engaged by Petrotimor strongly recommended that East Timor not sign a new Timor Gap Treaty that was based upon the July 5 Arrangement. East Timor was entitled to claim full EEZ rights upon independence, admitting no Australian interest, and signing would ‘result in East Timor having significantly reduced rights over its legitimate seabed.’

They further argued that, regardless of ‘without prejudice’ provisions, acceptance of the terms of the Treaty and the default boundaries it contained could prejudice in-fact East Timor’s future boundary claims.

- International law requires an ‘equitable result’. Based upon recent precedents and assuming that the boundary arrangement was considered acceptable at the time of signing, ‘it is not probable that any tribunal adjudicating upon the Australia-East Timor boundary would regard the boundary as inequitable if the matter were submitted for delimitation at some time in the future.’

They finally brought the issue full circle and ultimately connected the boundary issue with the issues which had and continue to dominate negotiations post-July MOU-TSA: the outstanding taxation and commercial agreement with Australia and the unwelcome precedent it would set, the continuing domestic gas debate in the Northern Territory and beyond, and the unitisation of the Sunrise fields.

- ‘That agreement on unitisation of the resources under the proposed treaty would survive in the event that sea-bed boundaries were the subject of later delimitation. Although the Parties would be bound to “reconsider” the terms of the unitisation agreement in the event of a permanent delimitation, they would be under no obligation to modify them.’
AUSTRALIA QUICKLY TAKES PREVENTATIVE MEASURES
Limits East Timor’s access to future dispute resolution mechanisms in ICJ and under UNCLOS

Atop the increasing accumulation of unresolved and expanding commercial issues that had otherwise overwhelmed and distracted attention away from maritime boundaries for the majority of the negotiating period, it was likely as much their emergence from the dark halls of secrecy as the revelations themselves that prompted Australia to take immediate pre-emptive action.

The Australian government foreclosed a number of international options for third-party dispute resolution that would have otherwise been available to East Timor in the event that they either chose not to sign a new Treaty agreement on Independence Day or otherwise quickly tired of the pretence of negotiating permanent boundaries when all incentives for timely resolution had been removed from Agreements.

On March 21, the Australian government made and filed a declaration to the effect that it chose the International Tribunal for the Law of the Sea (ITLOS) and the ICJ as the bodies to settle disputes arising under UNCLOS and involving Australia, and further, specifically declined the jurisdiction of two other arbitral tribunals amongst the four options available under UNCLOS. Such declarations are within the rights of those countries that subscribe to UNCLOS although Australia had not previously chosen to do so since accepting all statutes and options in 1975 and despite decades of contentious maritime boundary negotiations.

In an action that would come to be seen as more provocative, Australia followed on March 25 with an announcement that it had also modified the terms of its adherence to the Statutes of the International Court of Justice so as to limit their acceptance of ICJ jurisdiction over all maritime boundary settlement disputes, and disputes concerning exploitation of resources within or adjoining a development area. It is generally understood that, to this point, Australia’s declaration to accept the jurisdiction of the International Court of Justice under Article 36 had been unconditional since its inception in 1946.

It appears that Australia had already anticipated the possibility of international maritime boundary arbitration or disputation with East Timor. The Government had initiated steps in Parliament starting on October 10, 2000, precisely during the first round of formal negotiations leading to the July 5 2001 Arrangement, to give support to international efforts to reinforce the power and privileges of ITLOS, one of the choices nominated by Australia in March. The Amendment was subsequently ratified by Parliament on May 11, 2001 and entered into force in Hamburg on December 31, 2001 when the required minimum number of nation states had subscribed.

Mari Alkatiri withheld his criticisms of Australia’s ICJ actions until mid-April, when frustration with the final stages of negotiations prior to Independence boiled over. To that point, he had expressed his willingness to sign a new Treaty on May 20 as long as it did not include finalisation of the Unitisation Agreement, which UN negotiators called highly complex instruments that could take up to three years to resolve. Agreement on unitisation was not required under the terms of the July 5 MOU-TSA until such time as the agreement entered into force following ratification, but Australia was now claiming that ‘until Annex E is elaborated in a full unitisation agreement covering Greater Sunrise, it will not agree to the full treaty coming into force.’

The Chief Minister had made clear that he would not compromise East Timor’s position and called Australia’s withdrawal from the International Court of Justice ‘an unfriendly act’ and one that is a ‘sign of a lack of confidence in us.’

According to a briefing paper by the Department of Foreign Affairs own researcher on ocean and sea policy, submitted to the Joint Standing Committee on Treaties examining the actions, Australia may in
fact have had too much confidence in the East Timorese government’s willingness to act in the best interests of its people.

- ‘East Timor is in a weak position to pursue its case further because recourse to the International Court of Justice has been cut off by Australia’s recent withdrawal of acceptance of the Court’s jurisdiction on maritime boundary issues. (3) East Timor’s only other avenue for internationalising the issue would be to make common cause with Indonesia and pressure Australia to recommence negotiations on a boundary based on equidistance. At present, there is no sign of such moves occurring, but since the issue potentially involves major economic assets, the success of future trilateral relations between East Timor, Indonesia and Australia may depend on a final resolution.’

East Timorese public awakens to Timor Sea issues and concerns

In the wake of the public disclosure of boundary and resource issues in March and amid increasing perceptions that Australia had elevated self-interest over principle following its withdrawal from UNCLOS, the Timor Sea became a public issue of national priority alongside justice and reconciliation for the people of East Timor. Regular meetings of a few NGOs, already active in the issue, quickly expanded to include most the key NGOs in East Timor, their peak representative body, the NGO Forum, Church representatives, labour unions and minor political parties.

In the month preceding Independence, East Timorese newspapers and radio stations covered the Timor Sea as an almost daily feature. Members from minor parties within the country’s Constituent Assembly, soon to become East Timor’s first Parliament and now confronted with the enormity of Timor Sea issues at stake, tested the new bounds of democracy within the unicameral house. With the signing of a new Timor Sea Treaty on Independence Day now appearing imminent, the Democratic Party (PD), Social Democratic Party (PSD) and others called on the Chief Minister to appear numerous times before the Assembly and provide a full briefing on developments since July 5, 2001 and pressed for a full six-month ‘parliamentary’ inquiry before any decision was made to endorse an new Agreement. Chief Minister Alkatiri declined to address them, despite virtually all Assembly members not in the majority party wanting to delay the signing, and told them he would not disclose the terms until after signature on May 20.

Member Eusebio Guterres, one of the opposition leaders in the Assembly, was no less forceful in his observations, representing the increasing consensus of non-government East Timorese concerned Australia’s role and actions. “Howard claimed by giving East Timor a 90:10 split of the oil and gas revenue in the JPDAs opposed to the 50:50 split with Indonesia under the 1989 Timor Gap Treaty, Australia has been fair and generous to East Timor. How can you give away something that does not belong to you?” According to Guterres if East Timor claimed its rightful maritime boundaries and EEZ-all the oil and gas fields of Bayu-Undan, Greater Sunrise and Laminaria/Corralina should belong to East Timor. Australia and East Timor can still agree to share the Timor Sea’s oil and gas resources—using a formula that would benefit both parties. “It should be East Timor, not Australia who should be dictating the terms of any agreement.”

Chief Minister Alkatiri did seek to respond to growing community concerns in a news conference a week before Independence Day. He signalled his intention to sign the treaty and acknowledged that the boundary issue had not been resolved. Once East Timor’s new Parliament adopted a law on boundaries, he intended to seek to negotiate border agreements with Indonesia and Australia, and he characterised the forthcoming treaty as a ‘very temporary arrangement.’

The now broad-based non-government coalition, known as the Timor Sea Working Group, issued a series of media releases and policy statements to the Australian press and solidarity organisations. For the first time, many in the Australian public were informed that many East Timorese were not content with the much proclaimed change in the split of net royalties if East Timor had to forfeit any of their hard won rights as the result of a commercial trade-off. A May 17 press release, issued three days before Independence, called upon the people of Australia, ‘through their representatives in government, to abide by the same international principles of respect for sovereignty, human and labour rights that guided our independence struggle and guarantee them in our mutual Timor Gap agreement’. They called on Australia to reinstate adherence to the coverage and determinations of UNCLOS.
The group’s concerns embrace issues beyond boundaries and revenues: employment, training, resource management, technology transfer, energy for East Timor’s needs, environmental protection, safeguards against the corrupting influence of oil that has beset other resource-rich developing countries, and independent oversight and monitoring of all aspects of development and production.237

Whatever expectations for acknowledgement of Australia’s generosity that Prime Minister John Howard brought with him to Dili for the independence celebrations, he was forced to defend accusations that Australia used unfair tactics in negotiating the Timor Sea Treaty and denied East Timor the right to pursue a greater share of resources in the joint zone and elsewhere in the Timor Sea.

About 150 East Timorese protesters, who had stood patiently outside the dedication of a new trade centre for over four hours, confronted him with banners saying “Australia stop stealing Timor’s oil”.238

A NEW TIMOR SEA TREATY IS SIGNED ON INDEPENDENCE
But Includes Few Changes To July 2001 Arrangement and all of the Big Issues Remain

In his maiden speech to the country’s new Parliament, just hours before meeting John Howard to sign a new treaty on May 20, now Prime Minister Mari Alkatiri reiterated his position that the agreement would be transitional until such time as East Timor could conclude an ocean and seabed agreement with Australia.

“[The treaty] does not represent, under no circumstances does it represent, a maritime border,” Dr Alkatiri told Parliament, which was attended by Mr Howard and other Australian politicians and officials in Dili for independence celebrations. The Government “will use all available instruments and international mechanisms to search for a solution”.239

Prime Ministers Mari Alkatiri and John Howard, together with their respective Foreign Ministers, penned three new agreements shortly thereafter, including a new Exchange of Notes to replace the now expired 2000 version, a Memorandum of Understanding relating to unitisation and a new Timor Sea Treaty.

In less than a week, the true meaning of the ‘without prejudice’ provision regarding future boundary settlement, that the East Timorese had accepted in the final days of negotiations before the previous July 5 2001 MOU-TSA, would be clear.

On May 24, speaking from Indonesia where he had flown immediately following East Timor’s Independence Day celebrations to attend the inaugural Australia-Indonesia Dialogue,240 Foreign Minister Alexander Downer signalled that Australia would ‘dismiss any proposals from newly independent East Timor to radically change seabed boundaries”, citing the implications on the thirty-year old arrangements with Indonesia which favour Australia’s continental boundary claims. I have explained to the [East Timorese], we are happy to hear what they have to say but we don’t want to start renegotiating all of our boundaries, not just with East Timor, but with Indonesia.”241

Although Mari Alkatiri would announce at an oil conference in June that he had received a cable from Canberra reiterating a willingness to talk with East Timor about boundaries242, the true tenor and demeanour of Australia’s negotiating position had been revealed, demonstrating again for the East Timorese the difference between negotiations in an environment that favours one party over another versus ‘negotiations in good faith’ where each party shares the goal of a timely, fair and equitable outcome.

A Mari Alkatiri clearly frustrated with the implications of Downer’s statement from Indonesia said, in an ABC radio interview, that contrary to Australian Foreign Minister Alexander Downer’s assertion, tax and boundaries had not been sorted out. “No no no no no. This is completely false. I made it clear in Canberra that all this is defined. This is nothing to do with boundaries and we would like to negotiate maritime boundaries in the lunch. Mr Downer responded to me that they are ready to do it.” In response to a question about Australia’s recent withdrawal from the jurisdiction of the International Court of Justice in March, the Prime Minister added “This was classified by me at the time as an unfriendly act from the Australian government. Now I’m realising that this act is linked to the maritime boundaries. I hope not. But I’m realising that this is really linked to the maritime boundaries - a way to tighten our hands.”243 Referring to his ability to pass ratification through Parliament whenever he
chose using his Fretilin Party majority, he made clear that he would “only do it if it really can help me serving in the best way my people”.

**Brief comparison between July 2001 MOU and May 2002 Timor Sea Treaty**

Three Timor Sea Treaty documents were signed by East Timor and Australia on May 20, 2002.

*Exchange of Notes*, entered into force upon signature:

- The current *Exchange of Notes* remains in force until the new *Timor Sea Treaty* enters into force, and replaces the previous *Exchange of Notes*, operating since February 2000 and which expired at the moment of East Timor’s Independence. The instrument avoids a vacuum by providing a new legal basis and provides for the continuation of the exploration and exploitation arrangements in force on 19 May 2002, including the joint development regime, that previously governed activities in the relevant area of the Timor Sea. To date, the mechanism of the joint development regime has functioned well in creating a workable legal framework for petroleum exploration and exploitation under the joint control of Australia and UNTAET/East Timor and for the joint benefit of Australia and UNTAET/East Timor. (For an explanation of Article 4 escrow provisions, return to page 8)

*Timor Sea Treaty*, enters into force upon exchange of instruments of ratification:

In comparison to the previous July 5, 2001 MOU-TSA, the new Treaty indicates no change in progress on the settlement of ocean or seabed boundaries. It extends for 30 years, renewable by agreement or until such time as permanent boundaries are delimited. In all substantial respects, the TST carries forward the terms already established in July, with some amendments to reflect progress on taxation and fiscal issues, and lacking significant change to unitisation:

- **Taxation:** Article 5 of the Treaty establishes how the fiscal arrangement and taxes will be dealt with. For existing projects (Elang Kakatua, Bayu-Undan, and Greater Sunrise) the existing production sharing contracts will continue to apply (Annex F). For any future projects in the JPDA, Australia and East Timor are to seek to agree on a joint fiscal regime. If agreement cannot be reached, Australia and East Timor may apply their own fiscal schemes to their respective share of the petroleum (as per Article 4). In addition to revenue collected by way of production sharing contracts, Australia and East Timor will apply their own tax laws to their respective shares of the petroleum produced.

- **Unitisation:** Article 9 and related Annex E has far greater implications. While it includes a minor adjustment of change to percentage of Sunrise within and outside of the JPDA (20:80 becomes 20.1:79.9), the terms remain unchanged from July 5 despite Mari Alkatiri’s pre-signing promise not to accept it. The terms, once ratified and in force, will recognise Australia as 80% owner of the Greater Sunrise fields in contract form.

- **Pipelines:** Although the terms of Article 8 from July 5 have neither changed nor are explicit in their mention of projects, the National Interest Analysis to Parliament reveals true intent: Article 8 of the Treaty recognises that Australia will have jurisdiction over the planned pipeline from Bayu-Undan to Darwin. However, Australia is not to object to a pipeline to East Timor or floating processing facilities where these are proposed on a commercial basis.

**Memorandum of Understanding** on Unitisation of Sunrise

The MOU simply states that both Parties shall work expeditiously and in good faith to conclude an agreement on the terms to govern unitisation of Sunrise by December 31, 2002, although it notes that the conclusion of the agreement is without prejudice to the early ratification of the Treaty.

Once the Treaty is ratified and the International Unitisation Agreement is completed and endorsed, it would appear that an additional contractual impediment to adjustment of revenues following any future boundary change is created. As the terms of the Treaty recognise Australia as owners of 79.1% of Greater Sunrise, and revenue sharing terms can only be changed in future by mutual consent without the inclusion of any obligatory mechanism, it would also appear that the favoured avenue for reaching accommodation with East Timor is for Australia as owner to grant East Timor a larger slice of Australia’s revenue share in a trade-off for maintaining boundaries as they now exist.
As a Phillips executive had predicted at the start of formal negotiations in October 2000, “the world’s view of Australia could be at stake.” What he may or may not have foreseen is the extent to which the motives and machinations of the oil companies holding production sharing contracts would also come to be seen as wielding a constant heavy hand of influence over the entirety of the negotiating process, pushing and pulling the government negotiators towards an outcome that would better assure fiscal certainty and profits for their shareholders over the multitude of needs of their ultimate employers and regardless of whether the quest for boundaries was sacrificed along the way.

The very confidential nature of the process as it has so far been approached has only served to crystallise for the public in East Timor and Australia the unavoidable link between maritime and seabed boundaries and the imperatives of petroleum development, even as those issues have grown in stature and remain unresolved, and even as parties to the process sought to keep them apart.

As Phillips had also forecast at the time, “East Timor’s economic future is begin decided” but its future is now known to be a calculation based upon how much of the billions of dollars of petroleum wealth now controlled by Australia in the Timor Sea they are willing to sacrifice to avoid permanent delimitation of boundaries with East Timor.

Although some significant benchmark agreements were reached along the transitional road to East Timor’s independence on May 20, 2002 in order to extend the continuity and security of conditions for commercial development within the area of joint development, there is no longer any visible sign of progress towards agreement on the fundamental issue that divides the respective governments: East Timor’s desire to define their national footprint by establishing accepted and definitive maritime boundaries with Australia.

The government and people of East Timor have made their case as best possible under their circumstances and there is little more direct action that they can now take in their dealings with Australia that will influence the outcome short of pursuing their claims through disputation before the World Court, a high threshold to chose for the world’s 190th nation wanting good long-term relations with their nearest neighbours.

The stage is now finally set either for the continuing predicament of treaties vs. boundaries vs. economic benefit, which Australia that has carried forward from the original negotiations with Indonesia in the past into East Timor’s post-independence future, or a new approach that can give certainty to all Parties in a form they can both live with long after the commercial imperatives have disappeared.

Following delay of the ratification process in East Timor pending the outcome of a Joint Committee Inquiry in Australia, a realistic appraisal and the possibility for East Timor to establish a sovereign footprint at any time in the future now largely rests with the Australian Parliament and people.
PART THREE • SUMMATION
Independence Comes And Where Will Boundaries Go

The heretofore endless walk towards finality of boundaries for East Timor continues even with their passage into independence, consigned to a bilateral environment that might best be characterised as a form of high-stakes negotiations poker where the contesting players bluff to gain advantage, are subject to variable hands and rules and the constant but ever-changing presence of external distractions, and pursue widely divergent strategies and motivations to achieve the best result for their stakeholders.

The new Timor Gap Treaty, signed as a matter of commercial expediency on East Timor's first day of independence and now awaiting ratification, does not by itself provide a solution and offers little motivation to find one for the Australian government. The terms, as did those of its antecedents, provide a framework to allow commercial development of petroleum to continue throughout its 30 year life or until such time as final maritime boundaries are delimited.

The government negotiators continue to hold their cards close to the chest, leaving particularly East Timorese stakeholders to interpret their actions for any signs of progress, and speculate as to how possible outcomes will impact upon their future, secure their society and national identity and circumscribe the relationships between East Timor, Australia and Indonesia.

The continuing pressure on East Timor to make quick decisions about the Timor Sea, which may ultimately set the terms and health of their future for decades, has somewhat and momentarily eased as the ratification process in Australia unfolds. But the window of opportunity once closed may not reopen until all of the known petroleum within and around the joint development area has been exhausted. It is worth considering whether or not the current pressures are real and justified.

EAST TIMOR'S REVENUE BASE IS SECURE FOR THE IMMEDIATE FUTURE.

Much like its February 2000 predecessor, the terms of the current Exchange of Notes provide a secure legal environment in which commercial development of petroleum resources can proceed until such time as a new and permanent treaty agreement is reached. It was sufficient over the period of the last two and one half years to justify the additional expenditure of hundreds of millions of additional dollars of new development costs and contracts atop the US$1.4 billion already spent to allow the next project to come off the ranks, Bayu Undan, to proceed and begin production.256 It also never impeded continuing production and flow of revenues from the Elang-Kakatua fields that Phillips also operates.257

Under the terms of the current Exchange of Notes, East Timor and Australia will continue to share royalties from the comparatively modest production from the Elang-Kakatua fields for a few more years and receive taxation income from the development phases of the other projects. Royalties from sales of Bayu Undan gas will not eventuate until at least 2005/6. While disproportionately small in East Timor's case due to lack of capacity and compensation in kind, both countries will benefit directly and indirectly from some of the substantial upstream (preparation, development and extraction) and downstream (pipelines, processing and distribution) activities, although much of the offshore equipment has already been constructed in Indonesia, Singapore and Korea.

East Timor's budget shortfalls are covered by international donations for the next three years,258 and the difference between the production royalties earned under the 50:50 scheme carried from the 1989 Timor Gap Treaty and the future 90:10 split under the pending Treaty is secured in escrow for East Timor by the Exchange of Notes. Value added and income taxes can be levied and collected on the costs of continuing upstream and project development costs.259

Therefore, despite the obvious need for real income to advance the long-term goals of East Timor's Human Development Report (NHDR), the country's identified short-term budgetary needs are covered and should not place undue pressure to ratify Timor Sea agreements prematurely. According to NHDR figures, East Timor's per capita income is about US$478. The average life expectancy is 57 years. Nearly half the population of about 800,000 survives on less than 55 cents a day. More than half of all adults in the country are illiterate, and more than half the country's infants are underweight.
East Timor has also announced that it will seek additional interim support by asking the United Nations to confer Least Developed Country (LDC) status.\textsuperscript{261} As an LDC, East Timor will be eligible for several economic benefits, including increased aid, concessionary loans and lower tariffs for its exports.

The additional revenues that can otherwise be accessed from petroleum escrow over the next three years are of modest consequence when compared to the overriding issues of sovereignty and boundaries and the real future income that a fair and equitable outcome can generate.

**HOW REAL ARE THE PRESSURES FROM OIL COMPANIES?**

The imperative to reach quick ratification of the current treaty and finalise a unitisation agreement to govern Greater Sunrise (Sunrise and Troubadour fields) and future projects, conditions regularly proclaimed in recent years by oil companies as their pre-requisite for investment in the next stages of development, continues to wield substantial influence and further pressurises the negotiating process.

Outcomes concerning maritime boundaries are secondary to their principle responsibility to shareholders and investors. The extent to which their financial risks are immediate or perceived is uncertain, as is the impact that an unratified agreement will have on development progress. Yet the new Exchange of Notes provides for the continuation of the exploration and exploitation arrangements in force on 19 May 2002, including the joint development regime, that previously governed activities in the relevant area of the Timor Sea\textsuperscript{262} and provided sufficient certainty for that purpose.

All external signs indicate that Phillips, the operator of next project ready to produce, must proceed. They have already spent billions of dollars to develop the first phase of Bayu Undan and have already started production,\textsuperscript{263} and have environmental approval and the full support of the Northern Territory government to build a pipeline and LNG plant in Darwin to process phase two gas\textsuperscript{264} despite some community concerns. All of the liquid condensate and gas is committed for sale to Japan.

They meanwhile continue to negotiate an acceptable tax and fiscal package with the Australian government that Australia has now chosen to tie into settlement of fiscal terms for all other Timor Sea projects in contradiction to the terms of the arrangement agreed to on July 5, 2001 (Part Two). Having already reached agreement with East Timor in December 2001, and given that Australia has already received substantial revenue from the previous stages of development (end, Part One), neither should Phillips hold to ransom their commitment to provide East Timor with US$13 million of upfront upstream benefits pending ratification of the treaty and completion of the unisation agreement.

There is no certainty that progress beyond the current design development phase of the far larger reserves of the Greater Sunrise fields will eventuate yet it remains a major complicating factor in current maritime boundary negotiations. The relatively recent discovery is surrounded by known reserves from east to west across the Timor and Arafura Seas, the North West Shelf and throughout the world that have been identified for thirty years but lacked the markets to justify development.\textsuperscript{265}

While the proven and probable resources of Greater Sunrise are 8.3 trillion cubic feet (TCF) of LNG\textsuperscript{266}, with the potential to generate revenues of US$36 billion under adjusted market prices,\textsuperscript{267} project partners have so far spent a relatively modest US$200 million dollars when compared to the momentum of the Bayu Undan project. Almost half of that amount has been expended over the last three years for marketing in search of markets and customers for the gas, with the balance spent on exploration, mapping, design development and related preparatory costs.\textsuperscript{268}

The partners in the Greater Sunrise project continue to debate on or offshore development options. Even in a best-case scenario, production will not generate revenues until at least 2006/7. They have not yet identified either domestic Australian or export customers for their gas in a highly competitive and flat international market where potential supply outstrips current users by a factor of two to one.\textsuperscript{269}

Operator Woodside and principal shareholder Phillips and Santos require that a International Unitisation Agreement for Greater Sunrise be finalised between East Timor and Australia by the end of 2002 before they are willing to invest in the next step towards even finding out whether the gas will be affordable and marketable at some point in the future.\textsuperscript{270}

Given the combination of long lead times involved, the uncertainty of future development and production under even the most optimal of conditions, and the fact that the current failure to settle outstanding commercial issues subject to the larger export versus export market gas debate and concerns for precedence is of Australia’s
making, East Timor should not be unduly penalised by pressures from production contract sharing oil companies to ratify and unitise quickly.

UNITISATION AND BOUNDARIES ARE INSEPARABLE

‘Unitisation’ in petroleum terms means that common conditions governing commercial relationships, administration, development and revenue-sharing are pre-determined and unified in cases where hydrocarbon fields overlap the border separating joint development areas from adjoining seabed under the sovereign control of one nation.

Unitisation, by its very nature, significantly raises the stakes and adds further complications to negotiations. At the same time that it offers a point of convergence for East Timor and Australia’s shared interest in providing certainty and incentives for further development, it is no less a point of departure on the consequence that any change in boundaries would have on the future allocation of revenues generated by Greater Sunrise project.

The dynamics of the maritime boundary debate have shifted significantly since the public became more generally aware of the relationship between unitisation and Greater Sunrise following the previously noted public seminar sponsored in Dili in March 2002. Presenters at the seminar made strong legal cases under their interpretation of UNCLOS and common international law for expanding all of East Timor’s maritime boundaries beyond the default boundaries of the joint development area. (See Part Two, Boundaries become a public issue)

If the eastern boundary were to shift as a consequence of lessening the effect of Indonesia’s small Leti Island, which was essentially treated as a continental mass in previous agreements, then a far greater proportion of Greater Sunrise reserves would fall into the current area of commercial cooperation. Successive Tribunal and ICJ decisions since the introduction of UNCLOS 1982 provide for the likelihood of giving islands a lesser weight than continental masses when determining lines of equidistance between countries, although this ambiguously defined provision is more complicated in the case of an archipelagic nation such as Indonesia. Dean Bialek, lecturer in the Faculty of Law, University of Melbourne, will examine the issue in detail in an article soon to be published in Melbourne Journal of International Law tentatively titled ‘East Timor’s EEZ and Continental Shelf Entitlements’. He argues that a strong legal basis in precedents exists for a change in the eastern boundary perimeter of the JPDA, as the possible consequence of negotiation between East Timor and Indonesia.

A number of legal concerns have been already been raised and addressed herein, by Ward et al, regarding the possible obstacle that acceptance of the pending TST and unitisation agreement as currently presented could have on East Timor’s future likelihood of both delimiting boundaries and realising the consequential economic benefit. This was further reinforced in an opinion issued by C. Ward post-independence. Bialek reiterated these concerns in an opinion issued on May 22, 2002.

An even more complex scenario would result if the demarcations of the zone of cooperation remained the same while new maritime boundaries outside of the zone were delimited partially towards the east or outside of the JPDA, creating an intervening area with the potential that Greater Sunrise would have three sets of conditions of governance requiring ‘unitisation.’

THE SIGNIFICANCE OF MEDIAN VERSUS LATERAL BOUNDARIES

The change in focus in the public debate towards the issue of the lateral boundaries of the joint development area is in many respects justified, but the continuing impact of the median boundaries should not be minimised.

From a resource and revenue perspective, Australia has already substantially conceded on their historic and consistent claims to the continental shelf, through the 1997 EEZ agreement with Indonesia and in the recent July 5, 2001 MOU-TSA that detailed the framework conditions for the current TST and granted East Timor 90% of the net royalties. It should be noted that all of the Bayu Undan area appears to fall well above the current notional median line.

In the complex field of international maritime law, particularly as it relates in this situation to the provisions of UNCLOS, the ambiguities in written law are progressively defined by the legal arguments and outcomes of disputation. Together with precedents set by previous maritime and seabed boundary claims settled by the ICJ, Australia may on the one hand have eroded some of their legal arguments relating to the continental shelf, while at the same time providing evidence specific to UNCLOS requirements for negotiated settlement of
disputes such that provisional arrangements provide a fair and equitable outcome reached by mutual agreement.\textsuperscript{276}

By avoiding a permanent notional median line settlement, likely to follow the southern border of the joint development area and already overwritten by the 1997 EEZ line, the royalty sharing compromise at least delays a bigger political and resource danger for Australia that will inevitably involve both median and lateral boundaries.

**AUSTRALIA AND THEIR BOUNDARIES WITH INDONESIA**

Ever since their original settlement of seabed boundaries in 1971 and 1972, a compromise set between Indonesia’s notional EEZ median line solution and the line of Australia’s continental shelf argument, and throughout the decade of negotiations to forge the 1989 Timor Gap Treaty, Indonesia has made it clear that Australia was the main beneficiary.

As noted, East Timor has already initiated maritime and seabed discussions with Indonesia. On July 9, 2002 East Timor passed the *Maritime Zones Act*\textsuperscript{279} declaring an exclusive economic zone and continental shelf 200 nautical miles from its baseline as is their right under the provisions of UNCLOS.\textsuperscript{280} The area is generally described rather than geographically specific. This officially defines and extends the area of contestation south of the current southern border of the JPDA defined in the pending TST, and extends their EEZ to what had been the previous southern border of Zone C under the 1989 Timor Gap Treaty, now within Australian waters. Although the legislation does not specifically define the EEZ in geographic terms, East Timor’s maximum EEZ zone can now extend beyond the eastern and western lateral boundaries. Under the terms of UNCLOS, all affected parties are now formally obligated to negotiate their contested claims.\textsuperscript{281}

Although the issue is not so explicitly defined as is the case with Australia, both Indonesia and East Timor have recognised that they do not as yet have common ocean and seabed boundaries. Each however has a declared EEZ and continental shelf and the same obligation to negotiate now applies.

If at any point Australia settles on a new notional median line governing the seabed as the accepted compromise solution favoured by common international law and UNCLOS, it would result in a Timor Bulge in place of the former Timor Gap, creating a situation that Indonesia is unlikely to find acceptable.

While neither party to the 1973 Seabed Agreements can unilaterally withdraw from the treaties,\textsuperscript{282} except under certain provisions of the Vienna Convention on Treaties,\textsuperscript{283} Australia would find it difficult to justify a refusal to accede to a request from Indonesia to renegotiate in search of a no less fair and equitable outcome than was reached with East Timor. In 2002, it is more difficult to imagine what compensating political factors Australia could bring to bear on the negotiations to influence the outcome. Unlike the situation in 1972, when the new Soeharto government was struggling and needed Australia’s support, Australia is now working hard to rebuild a bilateral relationship that was damaged in 1999 over the issue of East Timor.

An adjusted median line seabound boundary with Indonesia that follows both their own EEZ (water rights only) and a median line concluded with East Timor could have considerable consequences for the governance over petroleum resources and revenues in the Timor Sea. A number of known and prospective reserves have been discovered in recent decades that fall above, all along or in close proximity to the potential median line, including the large Evans Shoal fields also approaching development. (See Appendix A)

Of more immediate relevance, the currently operating Laminaria-Corallina fields to the immediate west of the zone of cooperation and the far larger reserves of the potential Greater Sunrise project to the east would all fall well above Australia’s newly delimited ocean territory if adjusted to a median line, and into either East Timorese and/or Indonesian areas of control. Some or all of the fields could fall primarily onto East Timor’s side if a renegotiated boundary fell west of the current demarcation of the joint development zone (JPDA). (See oil fields map, Appendix A)

This may in part explain why Australia continues to invest millions of dollars mapping their continental shelf claim in preparation to make a submission to UNCLOS by November 16, 2004.\textsuperscript{284} While the provisions of UNCLOS and the precedence set by successive boundary cases increasingly favours a 200 nautical mile combined continental shelf and exclusive economic zone, they are not prescriptive. Countries are entitled to make claims to a larger continental shelf as long as the outcomes are fair and equitable for all parties affected.

Countries that ratify UNCLOS are given ten years to make a submission arguing their claims before the *Commission on the Limits of the Continental Shelf* (CLCS) established by UNCLOS in 1982. Australia had
already ratified UNCLOS when it came into effect on November 16, 1994 following adoption by the required 60 countries. While the outcome to any claim by Australia is uncertain and recent boundary cases would not seem to favour Australia’s argument, it nonetheless underlies current negotiations with East Timor and could impact upon any future negotiations with Indonesia. Australia in fact has a representative appointed to CLCS Commission who was formerly in charge of mapping the continental shelf and preparing technical aspects of the submission at Geosciences Australia. In 1989, when the original Timor Gap Treaty was signed, he authored a paper entitled “Australia’s Petroleum Potential in Areas Beyond an Exclusive Economic Zone.”

He would presumably have to recuse himself from consideration of the claim when it reaches the Commission.

East Timor on the other hand has indicated a willingness to open maritime negotiations with Indonesia in search of mutual delimitation. They must do so as a matter of course, particularly given that no lateral boundaries have previously existed between them. The subject was featured in recent trilateral meeting also involving Australia held in Bali. East Timor and Indonesia have also agreed to establish a joint commission to discuss a number of bilateral issues, include common boundaries.

Representatives of the Indonesia government, while making no claim on the petroleum resources within the joint development area, have recognised the need to investigate the issue. The provincial government of West Timor started the NTT Timor Gap Investigation Working Group for that purpose. "We can't yet say the Indonesian people don't have rights to the Timor Gap because this must be investigated first. This is why the Working Group needs to immediately carry out its task. Investigations into whether or not Indonesia has rights to the Timor Gap need to involve a number of experts who understand the Timor Gap issue."

Maritime boundary negotiations between East Timor and Indonesia may ultimately and in all probability draw in Australia whether it welcomes the prospect or not.

The impact of resources held within the Greater Sunrise field is inevitably intertwined with both the eastern lateral and median boundary issues. While East Timor and Indonesia may find strategic advantage in their dealings with Australia by finding some resolution of their mutual lateral boundaries first, it could also limit the options for East Timor if the median boundary issue is not simultaneously considered:

Possible East Timor – Indonesia – Australia seabed boundary scenarios and consequences

To the east of the current JPDA:

- If the lateral boundary shifted closer towards Indonesian territory in the east by giving the island of Leti marginally less effect as a continental mass (ie ¾ or 2/3 instead of full weight as is current) so as to divide the field, but Indonesia's 1972 median boundary with Australia remained, only East Timor would gain the basis for a greater claim to the Greater Sunrise fields if the median line also did not shift south. It is difficult to imagine a scenario where Indonesian President Megawati Soekarnoputri could sell an argument to cede to East Timor ocean and seabed territory without compensating benefits, to an Indonesian Parliament still divided over the issue of East Timor.

- If the effect of the island of Leti was substantially diminished (ie half or 1/3 instead of full weight) and the boundary shifted significantly to the east and beyond the fields, Indonesia would gain no claim to benefits from Greater Sunrise regardless of whether the median line shifted farther south.

- If the lateral boundary were to remain the same as the current joint development demarcation or shifted closer towards the east so as to still divide the Sunrise fields, and the median seabed boundary line were to shift south to the 1997 EEZ line, Australia could lose the basis to claim control of Greater Sunrise and Indonesia and East Timor might then need to negotiate their own unitisation agreement.

- If the lateral boundary of equidistance established to demark the eastern boundary of the joint development area were to remain the same but the 1971/72 median boundary between Indonesia and Australia were to shift further south to a notional median line of compromise between overlapping EEZs, East Timor would not gain the basis to claim a greater proportion of Greater Sunrise and control of the remaining 80% would shift from Australia to Indonesia.

To the west of the current JPDA:

While similar scenarios apply to the currently operating Laminaria-Corallina fields immediately to the west of the joint development area, there are subtle but not insignificant changes. The potential compensating benefits for Indonesia are not as great on this side of the area if the western boundary were negotiated in isolation, but could influence arguments in the east if considered together. For instance, Indonesia might consider ceding greater territory and consequent benefits to East Timor in the west (ie giving basis for
claims to some or all of the Laminaria-Corallina fields) if a negotiated settlement were to give Indonesia the basis for claims to a portion of Greater Sunrise and petroleum territory in the east:

- If the lateral boundary shifted marginally towards the west and therefore divided the fields but the 1971/72 median seabed boundary remained the same, Indonesia would gain no basis for claim and a unitisation agreement could be required between East Timor and Australia.
- If the lateral boundary shifted marginally towards the west and divided the fields and the 1971/72 median seabed boundary shifted south to the notional median line, Indonesia would gain the grounds to claim a portion of the fields and a unitisation agreement between Indonesia and East Timor might be required. The fields would no longer fall in Australia ocean territory.
- If the lateral boundary line shifted significantly to the west and beyond the fields, East Timor would gain the basis to claim all of the fields, Indonesia would gain no basis for claim in either longitudinal boundary scenario and Australian would lose the basis for their claim.

None of these scenarios can stand-alone from other unpredictable factors and unknowns:

- While UNCLOS provides guidelines for determining points and lines of equidistance, they are largely the consequence of subjective negotiations and compromise between parties.
- While opinions differ, much of the legal analysis of the western boundary of the joint development finds it a suitable basis for a delimited boundary.
- While there is some precedent for using other methods to determine lateral boundaries, it has generally been in cases where the line of equidistance does not produce a fair and equitable outcome due to particular geographic or coastal characteristics.
- That said, the current lateral boundaries are determined on the basis of lines of equidistance spanning between coastal Timor and Australia. If a new notional median seabed boundary was delimited along the current 1997 EEZ line, effectively dividing the Timor Sea, the coastal and continental effect of Australia could be diminished and the basis for determining the lateral boundary lines could change.
- The 1997 EEZ treaty between Australia and Indonesia is not yet in force.
- Indonesia has not accepted the full jurisdiction of the International Court of Justice so any durable resolution with them must come through negotiation.
- East Timor and Indonesia are simultaneously engaged in discussions over a range of sensitive issues, including land borders between East and West Timor, the return of East Timorese and former militia from refugee camps in West Timor, Indonesian claims seeking compensation for certain assets left behind in East Timor, and whether the Ad Hoc Human Rights Court in Jakarta can deliver adequate justice for the victims of the 1999 violence in East Timor.
- These scenarios do not account for the effect that undisclosed discoveries or future explorations can have. A large portion of the joint development area remains unexplored while Australia continues to issue licenses to explore areas that fall directly outside of the default boundaries of the area. East Timor has presumably been notified.

As previously noted, two fundamental questions, whether answered through arbitration or disputation, may override all of the possible scenarios. One is the extent to which the agreed default boundaries of joint development areas would take precedence over a fair and equitable solution arbitrated under the mechanisms made available by UNCLOS in cases where they differ from contested permanent maritime boundaries. Analysis by some legal commentators argues that the ICJ and other arbitral bodies have in some cases accepted the joint development boundaries as fair and equitable because they were reached by mutual agreement through negotiations. This would also avoid the possibility of a situation where two separate sets of boundaries existed, one determined through negotiation and one through arbitration.

The second unanswered question involves the extent to which parties to a joint development are bound by their commitment to the commercial agreements and contracts of joint development in the absence of provisions for adjustment. In this circumstance, East Timor might succeed through negotiation or arbitration in delimiting boundaries, which differ from the demarcations of the joint development area, but be unable to access any increased benefits due to contractual or similar obligations. For these reasons, some commentators forewarned East Timor that they might be limiting their future options if they signed the May 20 agreement.

None of these or preceding scenarios suggest that East Timor should necessarily need to rush towards ratification and unitisation of the pending set of agreements.
EFFECTS ON EXPLORATION WITHIN AND OUTSIDE OF THE JPDA

According to Robert Mollah, director of the Timor Gap Joint Authority, new exploration for petroleum within the joint development area has slowed over the period of negotiations towards reaching a new and permanent Timor Sea Treaty.291 A number of other gas fields have already been discovered throughout the JPDA, but they have not progressed towards development, either because they are too small and located too far away from the development infrastructure of current fields to justify the economics of extraction or simply because too little is yet known about the extent of the reserves.292

This, however, is not the case in areas immediately outside and adjoining the perimeters of the existing JPDA, and particularly in proximity to existing development areas.

Despite the fact that the eastern boundary of the JPDA was known to be and is now officially an area of contestation with East Timor over boundaries, Australia in early 2002 released a petroleum exploration area known as NT02-1 for tender. The area is bounded on the west by the JPDA and wraps around the Greater Sunrise project area. Bids are due in October, after which permits will be issued and license fees collected.

The materials issued by the Department of Industry to accompany the request for exploration tenders describes the Sahul geological platform as potentially rich in petroleum, extending from well east of Greater Sunrise and to the west across almost all of the current JPDA to the Elang-Kakatua fields. USGS modelling predicts that another 10 trillion cubic foot field is awaiting discovery in the surrounding basin.

The original Greater Sunrise retention lease held by Shell for area NT/RL2 was slated to expire in December 2001 and has presumably been renewed. One of the permits held for two other exploration areas in between Greater Sunrise and the Evans Shoal project to the southeast, NT/P47 also held by Shell, expired in June 2002 and presumably has either been renewed or re-released for tender.

Australia has travelled the road of continued exploration in a contested area before, dating back to the early 1970’s with Portugal (see Part One), and now faces litigation in the federal courts as a consequence.

Given the current status and the increasing visibility and sensitivity of the Timor Sea relationship between East Timor and Australia, observers would be well justified in believing that continued exploration and issuance of licences by Australia within areas now officially contested is inappropriate unless coordinated with and also to the benefit of East Timor. If not already agreed and arranged, and given the accumulated income that Australia has already received from such licenses throughout the many years of Timor Sea exploration within or immediately adjoining the JPDA, a decision by Australia to reimburse East Timor for at least half of the fees collected during the course of post-ballot exploration would be warmly received and duly acknowledged.

AUSTRALIAN DOMGAS DEBATE AND EAST TIMOR’S ENERGY NEEDS

The arguments behind the current national debate in Australia about the efficacy and importance of bringing Sunrise and Timor gas and gas products ashore apply at least in same measure to East Timor and its energy needs.

The ongoing domestic Timor Gas campaign by the Northern Territory295, with the support of virtually all of the states, challenges local, state, territory and commonwealth governments to enact the range of energy and sustainable growth strategies currently adopted in Australia.296 Together they set forth long-term strategic plans to convert current fossil fuel sources to cleaner alternatives, to better reticulate national pipeline distribution of gas as an option to fossil fuels and coal throughout the country, and to utilise natural resources to spur industrial development and employment. Northern Territory is in essence arguing for a logical strategy to make Australia stronger, healthier and more sustainable as a nation.

East Timor has minimal industry and manufacturing, about 3.5% of its 2000 GDP, and over 94% of the sucos or villages depend upon subsistence agriculture to survive.297 As Bishop Belo recently pointed out, the success of East Timor’s future development will not result from simply expending the income received from Timor Sea petroleum in the form of economic and social support, but by using the opportunity to develop the human and economic capacity of the people of East Timor.

Most of East Timor does not have the capacity to generate electricity outside of Dili and a few district centres. All areas that have access to electricity were subject to periodic blackouts throughout the transitional period, and the blackouts are becoming more extensive since the start of the United Nations withdrawal. In an effort by
the government to generate sustainable tax revenue sources, those who do have electricity are now receiving electricity bills that in many cases approach the already inflated costs of housing rental in a population where estimates of unemployment exceed 80%. 299

During the transitional period in 2000/2001, the United Nations was spending US$180,000 per week to generate power and electricity in Dili and the districts 300, or about 14% of East Timor’s 2001/2002 budget of US$65 million. In much the same way that Australia is now debating the benefits of Timor Sea gas for lower energy costs, less greenhouse gases and more industrial development that would accrue should the gas come ashore, East Timor should likewise be entitled to benefit through access to their own gas.

The conversion of the current Dili and district diesel plants to gas could lower fuel import costs and direct much-needed resources to other priorities. The construction of gas and LNG storage depots around the country could spur the growth of small industry and business, provide a foundation for tourism development and stop the rapid degradation of East Timor’s forest and timber supply. Since kerosene imports largely ended following the referendum in 1999, people have had to cut down trees at an alarming rate in order to provide fuel for cooking and sterilise water. 301

The terms of the pending Timor Sea Treaty and related instruments do not in any way address these issues nor guarantee East Timor inexpensive access to gas produced from the current JPDA, which Australia and East Timor both agree they largely own.

Given the loss of guarantees within the new TST that previously existed under 1989 Timor Gap Treaty to assure that participation in and benefits from development are protected, and given that no formula for some level of compensation-in-kind is granted until such time as East Timor has the full capacity to participate, the current review of the TST in the Australian parliament provides a perfect opportunity to redress this imbalance. Any amendments for the inclusion of such corrections must necessarily be the consequence of a consultative process with the people of East Timor, who may in fact wish to use any adjustment or compensation-in-kind to develop sustainable forms of development and energy sources that may not be dependent upon fossil fuels.
THE WAY FORWARD

Given the extreme complexity and history of Timor Sea boundaries, petroleum development and bilateral relationships, and in light of the difficulty in accessing information from within the narrow confines of the negotiating environment, the author on behalf of interested parties and stakeholders has sought to provide an unusually comprehensive review and analysis of most if by no means all of the relevant factors and events that currently face the parliaments and peoples of both East Timor and Australia.

While detailed observations and conclusions can be found within the Executive Summary that heads this paper, the views can be simply summarised as follows.

- That the people of East Timor, more so in consideration of their long and successful struggle to achieve independence and the particular relationship that the people of East Timor and Australia wish to have, are deserving of their desire to delimit sovereign boundaries and secure their physical place in the world as a first priority;

- That the convergence of other factors and influences, prior to, during and subsequent to achieving their independence, have served to thwart their realisation of this goal;

- That the circumstances under which negotiations have occurred to date have not favoured a balanced environment in which both parties share equal footing and can negotiate in good faith towards a common goal; and

- That there is little more that the East Timorese people can do on their own to advance and achieve no more than the fair and equitable realisation of their goals unless and until the government of Australia, and particularly the majority of Australian people who have long supported East Timor's aspirations\textsuperscript{302}, act to insure that those goals are realised.
APPENDIX A
Boundary Maps, Oil and Gas Fields and Oil Companies

Boundary maps:
The maps on pages 54-55 show:
- the lateral lines of equidistance that were used as the basis for determining the east and west perimeters of the overall Zone of Cooperation in the 1989 Timor Gap Treaty, which are also still used as the basis for defining the Joint Petroleum Development Area in the currently pending 2002 Timor Sea Treaty;
- the median lines that were used as the basis for determining the north and south boundaries of the three Zones of Cooperation in the 1989 Timor Gap Treaty, which are also still used as the basis for defining the Joint Petroleum Development Area in the currently pending 2002 Timor Sea Treaty;
- the major oil and gas fields located within the Zone of Cooperation as of 1998, including prospective pipelines to Australia, just prior to the termination of the 1989 Timor Gap Treaty following East Timor’s referendum ballot for independence in 1999; and
- the petroleum exploration area known as NT02-1, in the area of contested boundary claims between East Timor and Australia, and within which Australia is currently soliciting tenders for explorations permits.

Gas and Oil Fields:
The maps and charts on pages 56-58 show:
- the oil and gas fields in the Timor Sea, located relative to both the currently defined perimeters of the Joint Petroleum Development Area and to East Timor’s Exclusive Economic Zone and continental shelf entitlement as defined by the provisions of UNCLOS and declared on July 9, 2002. The southern border of the JPDA represents the likely median compromise rather than East Timor’s full 200 nautical mile claim.
- some of the major oil and gas fields that Australia currently controls in addition to those that are located within the current Joint Petroleum Development Area;
- the proportion that each major petroleum company, or Petroleum Sharing Contractor, controls for each of the major oil and gas fields within the Timor Sea; and
- a relative comparison of the annual revenues earned by those petroleum companies and the governments that have had a recent role in the Timor Sea.

The maps and charts on pages 56-62 are included with the permission of La’o Hamutuk, the East Timor Institute for Reconstruction, Monitoring and Analysis located in Dili, East Timor. To read the full article, La’o Hamutuk Bulletin Vol. 3, No. 5, visit www.etan.org/lh.

Timor Sea Oil and Gas Companies at a Glance:
A snapshot of the oil and gas companies operating within and adjoining the Joint Petroleum Development Area can be found on pages 59-62, also provided courtesy of La’o Hamutuk.

Petroleum revenues and royalties:
The following resources provide explanations as to how Australia generally applies taxes and generates revenue from petroleum development, production and sales:

History and role of petroleum in East Timor and the Timor Sea:
A comprehensive analysis of the exploration for oil and gas in East Timor and the Timor Sea beginning in the 1800’s, and the role of governments and petroleum companies, is detailed in a book by George Aditjondro:

Map 1: The lateral lines of equidistance and tri-points A16 and A17, established through negotiation between Indonesia and Australia, as the basis for determining the eastern and western perimeters of the Zone of Cooperation as defined by the 1989 Timor Gap Treaty and maintained within the currently pending 2002 Timor Sea Treaty.

Map 2: The median and lateral perimeters of the three Zones of Cooperation established in the 1989 Timor Gap Treaty. Area A is now known as the Joint Petroleum Development Area in the currently pending 2002 Timor Sea Treaty. The perimeters remain unchanged from the 1989 Treaty.
**Map 3:** The principle oil and gas fields within and surrounding the previous Zone of Cooperation in the *1989 Timor Gap Treaty* and current Joint Petroleum Development Area (then known as Area A), also indicating prospective pipelines to Australia. Based upon a 1998 map published in the Petroleum Gazette, Vol. 33(4), 1998, Melbourne Australia.

![Map 3](image)


**Map 4:** NT02-1, current Australian 2002 release of petroleum areas and invitation to tender for award of exploration permits, in the area of maritime boundary contestation with East Timor immediately adjoining the JPDA. Permits for the areas in between NT02-1 and Evans Shoal expired in 2000/2001 and were either renewed or issued to new permit holders.

![Map 4](image)

Oil and Gas Fields in the Timor Sea

On 20 May, Australia and East Timor signed a treaty to share the Timor Sea oil and gas. It is not yet in effect, awaiting ratification by both parliaments. This treaty gives Australia revenues which would probably go to East Timor under the Law of the Sea (UNCLOS), which became international law in 1982. (See Lit Bulletin Vol. 3 No. 4.)

The map below shows the main oil and gas fields in the Timor Sea belonging to East Timor, Australia and Indonesia.

Maritime economic zones are shown in dashed boxes:

- **JPDA** (Joint Petroleum Development Area) is derived from the illegal 1989 Timor Gap Treaty between Indonesia and Australia. Under the Timor Sea Treaty (TST), the JPDA is shared 60% East Timor and 40% Australia. Under current international law principles, it would be 100% East Timor.

- **EEZ** (Exclusive Economic Zone) would be East Timor's under current law. The TST gives it to Australia.

*Australian* Zones which belong to a particular country without question are labelled as such.

Producing and future oil and gas fields are shown as circles, next to the underlined field name or connected by an arrow. Larger circles have more resources.

The **heavy solid line** is the Australia-Indonesia seabed boundary, negotiated in 1972. Although this line is based on outdated principles and closer to Indonesia than to Australia, it is still in effect.

The **lighter dashed line** is the median line, halfway between the shorelines of Australia and Indonesia or East Timor. If current Law of the Sea principles applied, this would be the seabed boundary.

There are many oil and gas fields in the Browse Basin south of West Timor. Because of the 1972 treaty, these belong to Australia, although some are closer to Indonesia. Since 1931, Australia has controlled four tiny uninhabited islands called Ashmore Reef. As a result, Australia's economic zone extends close to Rotti and West Timor, including many oil and gas fields.
Four-Fifths of Australia's Gas is Outside the Timor Sea

The oil and gas in the Timor Sea are the only significant petroleum resources available to East Timor, and East Timor's future depends on these revenues.

Australia, on the other hand, has four times as much gas in other parts of its territory, as shown on the map below. Circles show the location of Australia's "Proven and Probable" (2P) reserves of natural gas, where gas underground or undersea could be extracted and sold. The size of each circle represents the amount of gas in Trillions of Cubic Feet (Tcf). Oil reserves are not shown.

Australia has about 110 Trillion cubic feet (Tcf) of natural gas, with a value of approximately U.S. $850 billion ($850,000,000,000). This could produce about $406 billion in government revenues. Australia has much more gas than it can consume domestically, so most Timor Sea gas will be exported to Japan.

One-fifth of Australia's gas, 22 Tcf, lies under the Timor Sea. Some is in Australian territory and some in the "Joint Petroleum Development Area" shared between East Timor (90%) and Australia (10%) under the Timor Sea Treaty. The Treaty gives revenue from 4.7 Tcf of Timor Sea Gas to East Timor and 17.5 Tcf to Australia. If East Timor's full maritime boundaries were applied instead, 7.9 Tcf of this 17.5 could belong to East Timor.

If East Timor's legal maritime boundaries were applied, East Timor could gain 7.9 Tcf (10% of Bayu-Undan and 82% of Sunrise) given to Australia under the Timor Sea Treaty.

Under the Treaty, East Timor receives 4.7 Tcf: 90% of Bayu-Undan and 18% of Sunrise.

Australia owns 9.6 Tcf in the uncontested Petrel-Tern, Evans Shoal and Blacktip fields.

Source: Australian Department of Industry, Science and Resources
Company Shares of Timor Sea Oil and Gas Fields

Each bar represents the amount of oil and gas resources in each field under the Timor Sea (22 Tcf circle on Australia map, previous page). Because it includes both gas and oil, the chart shows energy content in "Barrels of Oil Equivalent" (BOE). One trillion cubic feet (Tcf) of gas is equivalent to about 175 million BOE.

Within each bar, each rectangle colored with a different pattern shows how much of the oil and gas from that field has been purchased by each company, as indicated on the right. Most of the oil in the Elang-Kakatua and Laminaria fields has already been extracted, and the bars show only the amount remaining.

Amount of Oil and Gas Remaining (millions of BOE)

- Elang-Kakatua
- Beaufort
- Undan
- Chuditch
- Greater Sunrise
- Lamina
- area
- Gannet
- Shoal
- Blacktip
- Petrel
- Tenn
- Other
- Eni (Agip)
- Kari- McGee
- Inpex
- Osaka Gas
- Santos
- Woodside
- Shell
- Phillips

Who gets the revenues

- Joint Petroleum Development Area (90% East Timor, 10% Australia)
- 80% or more Australian under treaty but East Timorese under international law
- Uncontested Australian territory

The money to be made from Timor Sea oil and gas has attracted many international petroleum companies to East Timor’s neighborhood. The graph above shows which ones have purchased rights to sell the oil and gas. Phillips Petroleum (USA), Royal Dutch Shell (Great Britain and the Netherlands) and Woodside Australian Energy have the largest shares, and they are operating the oil industry here. Below and on the next few pages, we give some basic information about these and other companies which own gas and oil resources in the Timor Sea.

Annual Revenues of Governments and Oil Companies

Multinational oil companies are huge and powerful institutions, larger than many governments. One way to evaluate their power is to look at the amount of money involved in their operations. The graph below shows how much money selected governments and oil companies received (revenues, sales and taxes) during 2001. For East Timor and the United Nations, the figures are from their proposed budgets for 2002. The United Nations number includes operations, administration, and peacekeeping everywhere in the world.

Billions of US Dollars per year

- Government of Australia: 94
- Government of Portugal: 49
- Government of Indonesia: 26
- Government of East Timor: 0.005
- United Nations Office and Programmes worldwide: 4.4
- Phillips Petroleum: 27
- Royal Dutch Shell: 135
- Woodside Australian Energy: 1.4
- Santos: 0.89
- Osaka Gas: 7.7
- Inpex: 1.3
- Kari- McGee: 3.6
- Eni (Agip): 44
- Conoco-Phillips (Petroleum): 0.003
Timor Sea Oil Companies at a Glance

The following brief summaries of basic information and history describe the international oil companies with the largest involvement in oil and gas developments in the Timor Sea. We have tried to make the information accurate, but inconsistencies in reporting and availability of data have required some estimates and approximations.

- Money is given in millions of U.S. dollars, according to each company’s Annual Report for 2001. “Assets” is the amount invested in the company, “revenues” is how much they received in 2001, and “profits” is how much was paid to the shareholders (owners) of the company during 2001.
- Reserves are oil and gas still in the ground, estimated in millions of Barrels of Oil Equivalent (mBOE), from annual reports and other sources. Unless marked as proved (P), figures are Proved and Probable (2P), indicating a 50% likelihood of containing this amount of energy. One BOE will sell for approximately U.S. $20.
- “Reserves in Timor Sea” shows the amount each company owns of both East Timorese and Australian parts of the Timor Sea oil and gas deposits.
- The “Timor Sea part of reserves” percentage is an estimate of what part of each company’s worldwide total gas and oil reserves is in the Timor Sea. It indicates approximately how important the Timor Sea is to the company’s future.

Phillips Petroleum operates and owns 38% of the Bayu-Undan project and some smaller fields in the JPLDA, and is also a 30% owner of Sunrise. In March 2002, Phillips announced plans to sell 10% of Bayu-Undan to Tokyo Electric Power Company and Tokyo Gas, two Japanese companies who will buy most of the gas from the field beginning in 2006.

Phillips began dealing with the Suharto regime in 1988 and, in 1991, was in the first group of companies to sign contracts for Timor Gap oil exploration during the Indonesian occupation. The company continued to pay millions of dollars in royalties to Indonesia even after the August 1999 referendum in East Timor. During the UNTAET period, Phillips fought hard (with support from the U.S. government) to limit East Timor’s efforts to tax its operations. The company has invested approximately U.S. $1.6 billion in Bayu-Undan. Phillips is pushing for a pipeline from Bayu-Undan to Darwin, and hopes to include gas from Sunrise in this pipeline. Initially, they are selling the liquid fuels from the Bayu-Undan field, and pumping the “dry gas” back underground for later use.

Phillips will merge with Conoco later this year to become the world’s seventh-largest oil company. Phillips works in all aspects of the oil and gas industry, from exploration and exploitation to refining and retail sales. For the past few years, Phillips has been shifting away from high-risk explorations (risk can come from doubt about oil resources as well as political uncertainty).

At the same time, the company has been buying up smaller oil companies. Phillips’ Board of Directors includes two people who directly supported Indonesia’s occupation of East Timor: J. Stapleton Roy was U.S. Ambassador to Indonesia from 1995 to 2000 and did little to support East Timor’s struggle for independence. During the destruction of September 1999, he explained U.S. inaction by saying “The dilemma is that Indonesia matters and East Timor doesn’t.” Roy, who now manages Henry Kissinger’s consulting firm, joined Phillips’ board in 2001. He is also on the Board of Freeport-McMorin Copper and Gold, a U.S. mining company deeply implicated in human rights violations in West Papua.

Lawrence Eagleburger was on Phillips’ Board from 1993 to 2001 and remains their special advisor on international affairs. In 1975, as U.S. Deputy Secretary of State (under Henry Kissinger), Eagleburger helped conceal Indonesia’s use of U.S. weapons to invade East Timor. As Secretary of State in 1992, Eagleburger supported increasing U.S. military aid to Indonesia just after the Santa Cruz massacre. He’s also on the Board of Directors of Halliburton, an oil technology company headed until 2000 by U.S. Vice President Dick Cheney.

The La'o Hamunak Bulletin

July 2002

Page 7
Royal Dutch Shell

Where based  Britain/Netherlands
Year founded  1890
Number of employees  91,000
Assets  $183,000
Revenues  $135,000
Profits  $12,000

Where do they get oil and gas?
41 countries, including Nigeria, Brunei, Colombia, Malaysia, Gabon, Philippines

Reserves worldwide (P)  19,100
Reserves in Timor Sea (2P)  1,350
Timor Sea part of reserves  3%

Royal Dutch Shell owns 27% and operates the Greater Sunrise field, and has shares in several other Timor Sea oil and gas fields, including Laminaria. It also owns 50% of the large Piviana/Shah gas field and 35% of Blockto, in the Australian part of the Timor Sea, as well as operating elsewhere in Australia. Shell has purchased more Timor Sea oil and gas than any other company. It plans to liquidate the Sunrise gas at a floating platform in the middle of the sea, since it wants to send the gas north and east, rather than to Australia. This would be the first such facility anywhere.

Shell is the second largest oil company in the world, with exploration and production on every continent. Shell signed contracts for the occupied Timor Sea in 1991, exactly 100 years after it first became involved in Indonesia (Dutch East Indies). The company has a long history of support for colonialism and repressive regimes, including the German Nazi until 1936.

During the 1980s, Shell was the target of worldwide protests over its support for the racist apartheid regime in South Africa. More recently, the company has come under fire for collaborating with a dictatorship and human rights violations in Nigeria, Africa's most populous country. Shell is accused of complicity in the 1993 execution of Nigerian playwright Ken Saro-Wiwa, an environmental activist who was hanged along with eight others for protesting oil exploration. In Europe, environmental NGOs have campaigned against Shell's environmental practices, including dumping toxic waste from its platforms in the North Sea.

Woodside Australian Energy operates the Laminaria-Coallina oil field in the disputed area just outside the JPDAs, and owns 45% of that field. In 2000 and 2001, Woodside's revenues from that field totaled U.$1.1 billion, 38% of the company's income. Woodside now owns 334% of Greater Sunrise, after selling off 6.5% last year.

Woodside was one of the first purchasers of Timor Sea contracts, in 1991. The company originally supported Phillips' proposal to build a pipeline to Darwin, but now supports Shell's preference for a floating facility, with Japan as the principal customer.

Woodside is an Australian company, with a minority of its operations in Asia and Africa. Most of the company's holdings are off the Northwest coast of Australia, although most of its gas is sold to Asia, with some to the Australian market.

Shell attempted to purchase Woodside in 2001, but was prevented by the Australian government which felt that too much foreign ownership of Australia's energy sources could endanger their security. Nevertheless, Shell owns 34% of Woodside, and three Shell executives sit on Woodside's Board of Directors.
Santos

<table>
<thead>
<tr>
<th>Where based</th>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year founded</td>
<td>1964</td>
</tr>
<tr>
<td>Number of employees</td>
<td>1,713</td>
</tr>
<tr>
<td>Assets</td>
<td>$3,100</td>
</tr>
<tr>
<td>Revenues</td>
<td>$690</td>
</tr>
<tr>
<td>Profits</td>
<td>$272</td>
</tr>
<tr>
<td>Where do they get oil and gas?</td>
<td>Australia, Papua New Guinea, Indonesia</td>
</tr>
<tr>
<td>Reserves worldwide (2P)</td>
<td>724*</td>
</tr>
<tr>
<td>Reserves in Timor Sea (2P)</td>
<td>770</td>
</tr>
<tr>
<td>Timor Sea part of reserves</td>
<td>50%*</td>
</tr>
</tbody>
</table>

Santos, Australia's largest gas producer, has been shifting its priorities from on-shore production to the larger reserves offshore. Santos is heavily invested in the sea off Australia's northwest coast, mostly in Australian waters. The company owns and operates the Petrel-Tern fields near Darwin, and also has a 12% share of Sunrise and pieces of small fields in the JFDI. It entered the Timor Sea in 1991, during the Indonesian occupation of East Timor. In July 2002, Santos took over from Shell as operator of the large Evans Shoal gas fields in the Australian part of the Timor Sea, of which it owns 40%.

* Santos' Annual Report gives a number for the company's total reserves worldwide which is less than the amount we believe they own in the Timor Sea. Since this is impossible, our figure for how much the Timor Sea represents of their total is a guess.

### Osaka Gas

<table>
<thead>
<tr>
<th>Where based</th>
<th>Japan</th>
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</thead>
<tbody>
<tr>
<td>Year founded</td>
<td>1897</td>
</tr>
<tr>
<td>Number of employees</td>
<td>9,264</td>
</tr>
<tr>
<td>Assets</td>
<td>$10,600</td>
</tr>
<tr>
<td>Revenues</td>
<td>$7,683</td>
</tr>
<tr>
<td>Profits</td>
<td>$291</td>
</tr>
<tr>
<td>Where do they get oil and gas?</td>
<td>Indonesia, Brunei, Australia, Malaysia</td>
</tr>
<tr>
<td>Reserves in Timor Sea (2P)</td>
<td>310</td>
</tr>
<tr>
<td>Timor Sea part of reserves</td>
<td>11%</td>
</tr>
</tbody>
</table>

Osaka Gas supplies gas to customers in the second-largest metropolitan area in Japan, representing about 32% of Japan's total gas consumption. In an effort to diversify its sources of gas, Osaka purchased 10% of the Greater Sunrise and Evans Shoal fields in 2000. However, Osaka remains primarily a distribution and sales company, and is not directly involved in exploration and exploitation operations.

### Inpex

<table>
<thead>
<tr>
<th>Where based</th>
<th>Japan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year founded</td>
<td>1966</td>
</tr>
<tr>
<td>Number of employees</td>
<td>227</td>
</tr>
<tr>
<td>Assets</td>
<td>$238</td>
</tr>
<tr>
<td>Revenues</td>
<td>$1,256</td>
</tr>
<tr>
<td>Where do they get oil and gas?</td>
<td>Mostly Indonesia, also Australia and 13 other countries</td>
</tr>
<tr>
<td>Reserves in Timor Sea (2P)</td>
<td>130</td>
</tr>
<tr>
<td>Timor Sea part of reserves</td>
<td>4%</td>
</tr>
</tbody>
</table>

Inpex was formed by Japanese energy companies to buy oil and gas from overseas, initially from Indonesia but recently expanding worldwide. They are responsible for more than one-quarter of all gas exported from Indonesia to Japan. The company first entered the Timor Gap in 1992, and now owns 11.7% of Bayu-Undan, as well as shares in some smaller fields.

Inpex also owns and operates the Abadi (Masela) field in the Indonesian part of the Timor Sea, east of East Timor. Abadi is not included in the graphs in this LHB Bulletin.

Half of Inpex is owned by the Japan National Oil Company, with the remainder divided among twenty other industrial and energy companies and banks, with the largest shares held by Japan Petroleum Exploration, Mitsubishi, and Mitsubishi Oil Exploration. Until last year, Inpex was known as Indonesia Petroleum Ltd.
**Kerr-McGee Corporation** bought the Dallas-based oil exploration company **Onyx Energy** in 1999. Onyx had been in the Timor Gap since 1991, and Kerr-McGee owns 11% of **Bayu-Undan**.

Kerr-McGee nuclear weapons plant in Oklahoma, USA, was implicated in the 1974 killing of employee Karen Silkwood as she was about to speak to the media. The company was charged with numerous instances of radioactive pollution, but has since left the nuclear weapons business.

Kerr-McGee recently signed agreements with Morocco to explore for oil off the coast of **Western Sahara**. This African territory is illegally occupied by Morocco in defiance of the United Nations, similar to Indonesia’s occupation of East Timor. Last January, the UN Legal Office declared that “exploration and exploitation activities would be in violation of international law principles.” It remains to be seen if Morocco and Kerr-McGee will respect that declaration, or if Morocco will permit the long-delayed referendum on independence to take place.

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**Eni**

- **Where based**: Italy
- **Year founded**: 1926
- **Number of employees**: 71,000
- **Assets**: $60,000
- **Revenues**: $44,000
- **Profits**: $6,900

Eni, the world’s sixth-largest oil company, owns Agip, which bought **British Borneo** in 2000. In 1991, British Borneo purchased 6.7% of **Bayu-Undan**; they later bought 30% of Blacktip. Eni is purchasing more of Bayu-Undan, and will soon own 12.2%.

The company has oil and gas developments all over the world, and their investment in the Timor Sea is a small part of their total operations.

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**Oceanic Exploration**

- **Where based**: United States
- **Year founded**: 1969
- **Number of employees**: 18
- **Assets**: $3
- **Revenues**: $3
- **Profits (loss)**: -$2.9

Oceanic Exploration claims rights to oil and gas in virtually the entire JGDA based on a 1974 contract with Portugal. Today, its claims are not recognised by any government. (See La’o Hamutuk Bulletin Vol. 3, No. 4).

Oceanic Exploration is a part of **Oceanic Exploration**, a tiny company which owns a few small businesses in different fields. Oceanic is owned by General Atomics, a U.S. nuclear technology company owned by the Blue family. One-fifth of PetroTimor belongs to East Timor.

In addition to advocating a pipeline to East Timor and providing legal advice for East Timor to claim its full maritime boundaries, PetroTimor is suing Phillips in Australian court for its expropriated property in the JGDA. With fewer than 20 employees in several businesses, Oceanic Exploration has no capacity to develop East Timor’s oil resources. Rather, the company is hoping to extract money from companies currently working on Timor Sea oil.
APPENDIX B

A overview of the difference in circumstances underlying the negotiating environment

Good faith negotiations that achieve an acceptable outcome that is fair, equitable and durable for both parties depend not only upon a commonality of purpose and commitment towards a common goal, but also require an environment that either reflects balance in circumstance or adjusts in order to account for the disparity of conditions that would otherwise create imbalance. Over and above the particular differences between East Timor and Australia in the positions, motivations, tactics and strategies with which they have approached Timor Sea negotiations, there are significant disparities in their national circumstances.

For most Australians, the Timor Sea appears to attract comparatively little interest. For the people of East Timor, the Timor Sea issue and the desire for an acceptable resolution has joined reconciliation and economic sustainability as priorities in the national psyche. The maritime and seabed boundary issue is in some respects an external extension of the prevailing need to find certainty and security in ownership of land and property within the country.

While the Timor Sea is inextricably tied to the shared history held between both countries, there are greater distinctions that underlie the negotiating environment:

**Social and economic indicators.**

*Australia currently enjoys the most vibrant economy and economic growth amongst OECD nations. East Timor currently depends upon international donor grants until significant Timor Sea production income begins.*

- Australia's real GDP grew by 4.1% in 2001, is enjoying a similar rate in 2002, and has averaged 3.4% over the last decade. Australia’s 2002/2003 Commonwealth Budget is about A$170 billion.\(^{303}\)

- East Timor experienced 15% GDP during the final year of the UN transitional government, and forecasts negative GDPs from 2002-2004 of up to ~2%. In July, the President approved a US$85 million dollar budget, of which US$42 million is generated by domestic revenue sources. The balance is made up by donor commitments of an additional US$360 million over three years, with the balance allocated to development costs and capital improvements.\(^{304}\)

- Australia’s budget divided by a population of 19.5 million: A$8,717 per person. East Timor’s budget divided by a population of 800,000: US$106 or A$193 per person.

- Australia’s per capita GDP in 2001 was US$24,574.\(^{305}\) East Timor’s per capita GDP in 2002 was US$478.\(^{306}\)

*Amongst 162 countries on UNDP’s Human Development Index (HDI), Australia ranked 2\(^{nd}\) in 2001. East Timor was comparably ranked with Rwanda at 152 in the UNDP’s East Timor Human Development Report 2002.\(^{307}\)*

- Australia’s adult literacy rate approaches 99%. Almost 60% of the East Timorese population is illiterate.

- Australians live on average for 78.8 years. East Timorese live on average until 57.

- The Australian infant mortality rate is 5 per 1000 live births, 5 per 1000 for infants under 5 years of age and the maternal mortality rate is negligible. The infant mortality rate for East Timor is 80 per 1000, 144 infants out of 1000 die before reaching five years of age, and 420 mothers die for every 100000 births.

- Australia spends almost US$2,000 per person each year on health or about 4X the average total per capita GDP in East Timor.

- Only 14% of Australians earn less than the median national income. Over 40% of East Timorese live below the country’s poverty line of US 55 cents per day.

*The vast majority of Australia’s are employed, many in the petroleum and mining sector. Few East Timorese are in employment that generates income and only a handful are currently employed in the petroleum industry.*

- Current unemployment in Australia is 6.7%.\(^{308}\) East Timor does not yet have the means to gather unemployment statistics or provide a measuring system that accounts for the 94% of villages who depend upon subsistence agriculture to survive. Anecdotal and media reports throughout the transitional period vary, describing unemployment as anywhere from 70 to 90%.\(^{309}\)

- Prior to the start of any substantial petroleum production, Australians received 124,000 man-days of employment in the JPDA between 1991 and 1999.\(^{310}\)
In 1999/2000, over 6000 Australians were directly employed in the oil and gas extraction industry only, exclusive of any related downstream production, manufacturing and distribution business and commerce. Around six East Timorese work for the Joint Authority, less than a handful are employed offshore in the Timor Sea and around thirty are currently under recruitment for training in skills required to participate in Timor Sea JPDA projects.

Security and stability.
Unlike Australia, East Timor is subject to a range of internal pressures that could undermine its fragile equilibrium as long as it lacks sufficient income to move beyond its current skeletal operating budget and make significant advances in human, social and economic development.

East Timor is currently experiencing a swift though anticipated economic downturn as the UN mission ends with the exodus of international aid, development and business workers and the flow-on benefits from their international salaries. A contraction of East Timorese jobs with the UN, government and related agencies has followed.

There are increasing reports of growing disenchantment amongst ex-Falintil guerrillas, unemployed adults, rural workers and youth who cannot yet access employment or education opportunities, which have necessitated public efforts by the President and Prime Minister to quell discord.

Minor political parties and some NGOs have expressed frustration with East Timor's new unicameral parliamentary system, with the majority party able to control decisions, and the limits this can place on the value of democratic representation and national debate.

The Timor Sea issue has joined truth and justice and land and property issues as the paramount social concerns and priorities in East Timor. Some NGOs, academics and church leaders have expressed concern about the increasing perception amongst the community that East Timor may not be receiving a fair and equitable result from their negotiations with Australia.

A recent report by the Australian Strategic Policy Institute has mirrored these concerns and warned that Australia's current aid program is doing little to help pressing internal security and law and order problems in East Timor. The report warns that Timor Sea revenues will not be sufficient to solve the country's immediate problems. Even with oil and gas income that will increase per capita GDP by US$500, East Timor will still be one of the poorest countries in Asia.

Governance.
Australia has enjoyed a stable system of government for a century and the current coalition has held government since 1996.

Since the Independence ballot of 1999 and throughout Timor Sea negotiations, East Timor has been successively administered or governed by: the INTERFET mission, the sole jurisdiction of UNTAET, then, in various combinations with UNTAET, a National Consultative Council, a National Council and Council of Ministers, a Constituent Assembly and Council of Ministers and now a Parliament and Council of Ministers. East Timor is just beginning to test the workings of a new Constitution, government and parliament, is at the early stages of developing a comprehensive legislative framework, will join the United Nations by September at the earliest and is just beginning to adopt international conventions and forge formal bilateral and multilateral relationships.

Humanitarian aid and assistance.
Since 1999, Australia has made a significant financial contribution to East Timor: by providing peacekeeping and granting humanitarian aid and assistance. It is difficult to accurately value net peacekeeping costs, or to distinguish between Australia's UN assessment and its additional bilateral contributions. Australia would likely have supported the UN's peacekeeping mission to some degree even had East Timor not been a near neighbour with whom it has closely interwoven history and ties.

The Australian Defence Force spent an estimated A$607 million for 1999/2000, largely for INTERFET, and had received US$10.9 million in reimbursements from the INTERFET Trust Fund by November 2001. ADF spent an estimated A$798 million as its contribution to UNTAET peacekeeping in 2000/2001, and is entitled to a maximum reimbursement from the UN of A$122 million dollars.

For 1999/2000, Australia contributed A$81 million in emergency and development assistance, including A$42 million for UN and World Bank related contributions and A$37 million in direct humanitarian assistance.

In the 2000/2001 budget, Australia committed A$150 million over four years in assistance to East Timor, including contributions to UN and World Bank multilateral programs as well as direct bilateral assistance.
Sovereign territory and national footprint

Australia has a continental ‘above water’ mass of approximately 7.7 million square kilometres with no shared land boundaries. In part because of some 12,000 islands within its territory, Australia’s EEZ adds another 11 million square kilometres of uncontested seabed and waters. If Australia’s submission to the Commission on the Limits of the Continental Shelf in 2004 were to be successful, its ocean territory would expand to 16.5 million sq. kilometres, resulting in a combined land and ocean area of 24.2 million square kilometres or 1.25 square kilometres per Australian.

East Timor has a land area of about 14,600 sq. kilometres and, for the first time in their history, the East Timorese have been able to declare their 200 nautical miles EEZ and continental shelf. Not only must East Timor settle ocean and seabed boundaries, but it has also started discussions with Indonesia to settle the land border between East and West Timor. There would be .05 square kilometres per East Timorese if the addition of their EEZ were triple the current land area.

Resource and wealth.

Australia is a petroleum and resource rich nation. East Timor awaits the future petroleum wealth of the Timor Sea as their foreseeable source of income needed to advance national and human development.

- Australia is the world’s leading coal exporter, the fourth leading producer and coal accounts for 44% of its energy needs.
- Australia’s current estimated proven natural gas reserves of 90 trillion cubic feet have more than doubled since 2001, but play a small role as a domestic fuel source. It is estimated that natural gas will provide 24% of total energy consumption by 2019-2020.
- Australia is the 3rd largest LNG producer and exporter in the Asia-Pacific region. The NW Shelf Project has created an estimated US$10 billion in business for Australian suppliers since 1980 and an estimated 80,000 flow-on jobs each year of its existence.
- For 1999/2000, Australia earned A$12.9 billion from excise taxes on petroleum products and crude oil and A$1.2 billion from Petroleum Resource Rent Tax (PRRT) applied against development costs. East Timor received its first national income from petroleum in November 2000, A$6 million from Elang-Kakatua production royalties. Revenues should climb in excess of A$25 million per annum over the next 2 years due to their agreement with Phillips in December 2001 to apply taxes on Bayu-Undan development costs.
- For 2000/2001, Australian governments were estimated to receive in excess of A$5 billion in secondary and income taxes from the upstream oil and gas industry, not including taxes paid by other indirect beneficiaries of industry activities.
- Centuries of ‘mining’ of natural resources such as sandalwood, the napalming of vast areas in the east during the occupation, the transmigration of farmers and the continued use of timber as a fuel source have all contributed towards the stripping of much of East Timor’s original environmental and ecological assets.

The Timor Sea petroleum related income.

No summary figures are published that provide the total cumulative cost of income that Australia or East Timor have received from exploration in the Timor Gap area prior to 1991, when jointly managed production sharing contracts were first awarded, or over the last eleven years from petroleum concession licenses, various taxes applied to development costs and production sales or the upstream and downstream benefits from within and directly adjoining the JPDA in areas where borders with East Timor are now subject to contested claims.

Solely within the JPDA:

- From late 1991 to end of 1998, Australian subcontractors received US$670 million (A$1.2 billion at current exchange rate) for 429 service contracts, almost all attributed to drilling wells and development of the Elang-Kakatua production facility.
- Petroleum production from Elang-Kakatua was valued at US$50 million by end of 1998, which is expected to generate about US$12 million per annum in combined taxes and royalties for each country only until production ceases in 2002/2003.
- As an example of benefits from past exploration, Australia received A$230 million in petroleum license fees in December 1985, and oil company bids brought another A$31.5 million dollars in March 1986, prior to the establishment of the Zone of Cooperation in 1989.
- A recent study commissioned by the Northern Territory government is a good indicator of the value of participation in up and downstream development benefits. If the Bayu-Undan and Greater Sunrise developments were to share onshore
pipelines and production facilities, the report estimates that NT would experience a 46% increase in GSP (Gross State Product), Australia would realise a A$4 billion GDP benefit, NT would realise a A$82 million real investment benefit, the Commonwealth government would receive A$210 million in additional revenues, and over 5000 permanent jobs would be created for NT and almost 10000 for Australia as a whole.  

- East Timor’s 2002/2003 Budget projects combined revenues from the Elang-Kakatua and Bayu Undan fields will reach US$101 million dollars in 2004/2005, essentially replacing the donor grants which expire that year and assuming no adjustment for a median line of equidistance EEZ and continental shelf boundary. Operator Phillips estimates that East Timor will receive at least US$147 million per annum over the 17-year life span on the Bayu Undan project when production begins in 2005/2006.

Immediately outside or overlapping the JPDA within the area of contested boundaries:

- In the absence of delimited boundaries, Laminaria-Corallina to the west of the JPDA will generate over its life an estimated US$1 billion in PRRT and US$.06 billion in excise taxes for the Australian government in as-spent dollars of the day.

- Greater Sunrise, which overlaps the contested eastern border of the JPDA, is estimated to generate up to US$36 billion dollars in revenues over its life. Under the current JPDA arrangements, Australia would receive up to US$28 billion dollars and East Timor would get the remaining 18% (90% of the one-fifth of the field that sits within the JPDA perimeter) or up to US$8 billion dollars given differing tax rates and structures. At the other extreme, East Timor would receive all of the revenues if its maximum EEZ area claims were upheld. This can make the difference between poverty and real development according to one East Timorese economist.

- Australia is engaged in exploration of a number of areas that immediately adjoin the JPDA. The large Evans Shoal field, to the southeast and at the outer limits of East Timor’s maximum EEZ claim, is approaching development. Plans include siting on an offshore methanol production plant nearing the field.
APPENDIX C • UNCLOS:
The United Nations Convention on the Law of the Sea

Extract from the United Nation’s Oceans and Law of the Sea website:338

The UN Convention on the Law of the Sea lays down a comprehensive regime of law and order in the world’s oceans and seas establishing rules governing all uses of the oceans and their resources. It enshrines the notion that all problems of ocean space are closely interrelated and need to be addressed as a whole.

The Convention was opened for signature on 10 December 1982 in Montego Bay, Jamaica. This marked the culmination of more than 14 years of work involving participation by more than 150 countries representing all regions of the world, all legal and political systems and the spectrum of socio/economic development. At the time of its adoption, the Convention embodied in one instrument traditional rules for the uses of the oceans and at the same time introduced new legal concepts and regimes and addressed new concerns. The Convention also provided the framework for further development of specific areas of the law of the sea.

The Convention entered into force in accordance with its article 308 on 16 November 1994, 12 months after the date of deposit of the sixtieth instrument of ratification or accession. Today, it is the globally recognized regime dealing with all matters relating to the law of the sea.

Navigational rights, territorial sea limits, economic jurisdiction, legal status of resources on the seabed beyond the limits of national jurisdiction, passage of ships through narrow straits, conservation and management of living marine resources, protection of the marine environment, a marine research regime and, a more unique feature, a binding procedure for settlement of disputes between States - these are among the important features of the treaty. In short, the Convention is an unprecedented attempt by the international community to regulate all aspects of the resources of the sea and uses of the ocean, and thus bring a stable order to mankind's very source of life.

Nations that are a Party to UNCLOS agree to abide by its provisions. In cases where further interpretation of the terms of UNCLOS is required, or disputes arise between nations in areas such as adherence to the terms of treaties or an inability to settle ocean and seabed boundaries between adjoining countries, UNCLOS provides for the use of independent tribunal mechanisms or the International Court of Justice as mechanisms to resolve disagreements through conciliation, arbitration or disputation. Through the rulings of these international institutions, precedents are then established that successively define common international law.

Prior to UNCLOS 1982:339

In 1945, the United States, responding in part to pressure from domestic oil interests, unilaterally extended jurisdiction over all natural resources on and within its continental shelf. Other nations followed with similar declarations. Until then, a freedom of the seas doctrine had prevailed, proclaiming the oceans to be free to all and belonging to none outside of a narrow band of waters surrounding national coastlines.

Difficulties immediately arose. Nations possessing a wide shelf had a more obvious basis for their claims, but states that were not naturally endowed were unwilling to accept geological discrimination. Conflicting legislative interpretations of ocean and seabed territory and rights made by individual countries led to efforts by the International Law Commission and United Nations, starting in the late 1940s, to establish an international framework to govern oceans policy and law. In 1957, the United Nations General Assembly established an international conference of nations to examine the law of the sea. The first UNCLOS conference in 1958 produced a series of Geneva Conventions on the Law of the Sea, including Conventions on the Territorial Sea and Contiguous Zone, the High Seas, Fishing and Conservation of Living Resources, and on the Continental Shelf.

The limits of the continental shelf were then defined by use as much as by geography and included "the seabed and subsoil of the submarine areas adjacent to the coast but outside the area of the territorial sea, to a depth of 200 metres, or, beyond that limit, to where the depth of the superjacent waters admits of the exploitation of the natural resources of the said areas".

During the 1960s, coastal states increasingly claimed a 12-mile territorial sea while major naval powers adhered to a 3-mile limit. Most feared that an extended limit would place important international navigation straits and channels under the exclusive control of individual nation states.

Coastal states such as Iceland, Peru, Chile and Equator240, which depended upon traditional fishing grounds as their primary source of national income, progressively claimed territorial sea farther from their shores in order to
prevent the increasing encroachment of large bottom dragging trawlers from European countries and the United States. Other countries and the European Community quickly followed suit.

In the face of increasing conflict, Malta’s Ambassador to the United Nations in 1967 called for "an effective international regime over the seabed and the ocean floor beyond a clearly defined national jurisdiction. It is the only alternative by which we can hope to avoid the escalating tension that will be inevitable if the present situation is allowed to continue". Before the Third United Nations Conference on the Law of the Sea convened in 1973, an interim series of meetings and measures had expanded the debate beyond seabed issues to include all aspects of ocean policy.

 Numerous countries had already declared that their offshore sovereignty extended to 200 miles from shore, primarily to protect valuable fishing grounds. At the time, only 2% of the continental shelf had been explored in search of petroleum, but the potential was already evident. Then, only a few months prior to the conference, skyrocketing global oil prices following the 1973 Arab-Israeli War and oil embargo heightened international concern over the control of offshore petroleum resources and the seabeds in which they were held.

By 1998, figures on known offshore oil reserves ranged from 240 to 300 billion tons. Production from these reserves amounted to a little more than 25 per cent of total world production in 1996. Experts estimated then that of the 150 countries with offshore jurisdiction, over 100, many of them developing countries, have medium to excellent prospects of finding and developing new oil and natural gas fields.

The UN Convention on the Law of the Sea, signed in 1982 following nine years of discussion amongst 160 countries, includes over 300 Articles and Annexes that cover all aspects of ocean policy. An ongoing series of UNCLOS-related decisions by Tribunals and the International Court of Justice has more firmly established a secure body of international case law that now underpins the efforts of the East Timorese to delimit maritime and seabed boundaries with Australia.

**KEY PROVISIONS OF UNCLOS RELATING TO DELIMITATION:**

**Exclusive Economic Zone**

*Part V* of UNCLOS contains provisions relating to the rights and duties of coastal states to claim and enjoy an exclusive economic zone and also sets forth the rights and duties of all other states in relation.

- **Article 56** (Rights, jurisdiction and duties of the coastal state in the exclusive economic zone): 1. In the exclusive economic zone, the coastal State has: (a) sovereign rights for the purpose of exploring and exploiting, conserving and managing the natural resources, whether living or non-living, of the waters superjacent to the seabed and of the seabed and its subsoil, and with regard to other activities for the economic exploitation and exploration of the zone, such as the production of energy from the water, currents and winds. *Note that ‘sovereign rights’ does not necessarily grant absolute national sovereignty.*

- **Article 57** (Breadth of the exclusive economic zone): The exclusive economic zone shall not extend beyond 200 nautical miles from the baselines from which the breadth of the territorial sea is measured. *In general, baselines follow the low water mark or a series of straight basepaths established along key low water mark points.*

- **Article 59** (Basis for the resolution of conflicts regarding the attribution of rights and jurisdiction in the exclusive economic zone): In cases where this Convention does not attribute rights or jurisdiction to the coastal State or to other States within the exclusive economic zone, and a conflict arises between the interests of the coastal State and any other State or States, the conflict should be resolved on the basis of equity and in the light of all the relevant circumstances, taking into account the respective importance of the interests involved to the parties as well as to the international community as a whole.

- **Article 74** (Delimitation of the exclusive economic zone between States with opposite or adjacent coasts): 1. The delimitation of the exclusive economic zone between States with opposite or adjacent coasts shall be effected by agreement on the basis of international law, as referred to in Article 38 of the Statute of the International Court of Justice, in order to achieve an equitable solution. 2. If no agreement can be reached within a reasonable period of time, the States concerned shall resort to the procedures provided for in Part XV. 3. Pending agreement as provided for in paragraph 1, the States concerned, in a spirit of understanding and cooperation, shall make every effort to enter into provisional arrangements of a practical nature and, during this transitional period, not to jeopardize or hamper the reaching of the final agreement. Such arrangements shall be without prejudice to the final delimitation. 4. Where there is an agreement in force between the States concerned, questions relating to the delimitation of the exclusive economic zone shall be determined in accordance with the provisions of that agreement.
Continental Shelf

Part VI of UNCLOS grants coastal states a continental shelf to at least the 200 nautical mile limit of their exclusive economic zone, and the rights to explore and exploit its natural resources.

- **Article 76** (Definition of the continental shelf): 1. The continental shelf of a coastal State comprises the seabed and subsoil of the submarine areas that extend beyond its territorial sea throughout the natural prolongation of its land territory to the outer edge of the continental margin, or to a distance of 200 nautical miles from the baselines from which the breadth of the territorial sea is measured where the outer edge of the continental margin does not extend up to that distance.

  Paragraphs 2-10 of Article 76 define the outer limits of any continental shelf claim beyond the 200 nm EEZ, the methods for measuring such a claim and the role of the Commission on the Limits of the Continental Shelf (CLCS) in ruling on the validity of such a claim.

  The continental shelf of coastal states shall not extend beyond either 350 nm from the baseline of the territorial sea, or 100 nm beyond the 2500m isobath, a line connecting depth measured to 2500 metres.

  Claims to a continental shelf beyond 200nm must be submitted for consideration to the CLCS as established under Annex II. The recommendations of the CLCS shall be final and binding.

- **Article 77** (Rights of the coastal State over the continental shelf): 1. The coastal State exercises over the continental shelf sovereign rights for the purpose of exploring it and exploiting its natural resources. These rights are exclusive and exist whether or not the coastal state proclaims or exercises them. This also applies to drilling in the seabed of the shelf as per Article 81.

- **Article 82** (Payments and contributions with respect to the exploitation of the continental shelf beyond 200 nautical miles): 1. The coastal State shall make payments or contributions in kind in respect of the exploitation of the non-living resources of the continental shelf beyond 200 nautical miles from the baselines from which the breadth of the territorial sea is measured. Paragraphs 2-4 set forth a payment regime exclude payments by states that are net importers of the mineral resources found within the shelf.

- **Article 83** (Delimitation of the continental shelf between States with opposite or adjacent coasts): 1. The delimitation of the continental shelf between States with opposite or adjacent coasts shall be effected by agreement on the basis of international law, as referred to in Article 38 of the Statute of the International Court of Justice, in order to achieve an equitable solution. 2. If no agreement can be reached within a reasonable period of time, the States concerned shall resort to the procedures provided for in Part XV. 3. Pending agreement as provided for in paragraph 1, the States concerned, in a spirit of understanding and cooperation, shall make every effort to enter into provisional arrangements of a practical nature and, during this transitional period, not to jeopardize or hamper the reaching of the final agreement. Such arrangements shall be without prejudice to the final delimitation. 4. Where there is an agreement in force between the States concerned, questions relating to the delimitation of the continental shelf shall be determined in accordance with the provisions of that agreement.

The Articles of Part II also include guidelines to be used for establishing baselines and delimiting boundaries by and between coastal states in order to define territorial waters and areas beyond.

- **Article 15** (Delimitation of the territorial sea between States with opposite or adjacent coasts): Where the coasts of two States are opposite or adjacent to each other, neither of the two States is entitled, failing agreement between them to the contrary, to extend its territorial sea beyond the median line every point of which is equidistant from the nearest points on the baselines from which the breadth of the territorial seas of each of the two States is measured. The above provision does not apply, however, where it is necessary by reason of historic title or other special circumstances to delimit the territorial seas of the two States in a way which is at variance therewith.

Annex II establishes the Commission on the Limits of the Continental Shelf (CLCS) and sets forth a specific method to be used in establishing the outer edge of the continental shelf margin.

Settlement of Boundary Delimitation Disputes

Part XV of UNCLOS sets forth a range of options available to states that are parties to a dispute over boundaries, which cannot otherwise settle them through negotiation or peaceful means.

Conciliation

Part XV, Article 284 allows parties to a dispute to seek the guidance of independent third parties and experts who can assist them by compiling a report and making non-binding recommending solutions for settlement. Countries can use either the procedure set forth in Annex V or establish procedures by mutual agreement.
**Compulsory Procedures**

If parties to a boundary delimitation dispute are unable to reach agreement by negotiation, and decline to submit themselves to conciliation, UNCLOS sets forth four available options for compulsory procedures entailing binding decisions in order to reach a final settlement. Any party to the dispute can request settlement by any of these tribunal or court options, provided that the other party has not limited their choice of nominated procedures as allowed under *Articles 287 and 298*. The four available choices provide for settlement using either various forms of arbitration utilising existing or ad hoc tribunals or through disputation under *Article 38 of the Statute of the International Court of Justice*.

- **Article 287** (Choice of procedure): 1. When signing, ratifying or acceding to this Convention or at any time thereafter, a State shall be free to choose, by means of a written declaration, one or more of the following means for the settlement of disputes concerning the interpretation or application of this Convention: (a) the International Tribunal for the Law of the Sea established in accordance with Annex VI; (b) the International Court of Justice; (c) an arbitral tribunal constituted in accordance with Annex VII; (d) a special arbitral tribunal constituted in accordance with Annex VIII for one or more of the categories of disputes specified therein. **If parties to a dispute have accepted the same procedure for settlement of dispute, it can only be submitted to that procedure.** If parties to a dispute have not accepted the same procedure, the dispute can only be submitted to arbitration in accordance with the terms of Annex VII, Arbitration.

- **Article 298** (Optional exceptions to applicability of section 2): 1. When signing, ratifying or acceding to this Convention or at any time thereafter, a State may, without prejudice to the obligations arising under section 1, declare in writing that it does not accept any one or more of the procedures provided for in section 2 with respect to one or more of the following categories of disputes:

  (a) (i) disputes concerning the interpretation or application of articles 15, 74 and 83 relating to sea boundary delimitations, or those involving historic bays or titles, provided that a State having made such a declaration shall, when such a dispute arises subsequent to the entry into force of this Convention and where no agreement within a reasonable period of time is reached in negotiations between the parties, at the request of any party to the dispute, accept submission of the matter to conciliation under Annex V, section 2; and provided further that any dispute that necessarily involves the concurrent consideration of any unsettled dispute concerning sovereignty or other rights over continental or insular land territory shall be excluded from such submission; (ii) after the conciliation commission has presented its report, which shall state the reasons on which it is based, the parties shall negotiate an agreement on the basis of that report; if these negotiations do not result in an agreement, the parties shall, by mutual consent, submit the question to one of the procedures provided for in section 2, unless the parties otherwise agree; (iii) this subparagraph does not apply to any sea boundary dispute finally settled by an arrangement between the parties, or to any such dispute which is to be settled in accordance with a bilateral or multilateral agreement binding upon those parties;

**Annex VI, Statute of the International Tribunal for the Law of the Sea (ITLOS),** establishes the Tribunal and sets forth its role, function, powers and responsibilities.

**Annex VII, Arbitration,** describes the procedure for establishing an ‘ad hoc’ arbitral tribunal other than ITLOS as one of the four options available under *Article 287, (1)c*.

As of March 2002, Australia has nominated the International Tribunal for the Law of the Sea (ITLOS) and the International Court of Justice as its two nominated procedures for settling delimitation disputes as afforded under *Article 287*.

UNCLOS (*Article 298(1)) also allows States to exclude certain specified categories of disputes from compulsory dispute settlement. Australia, also in March 2002, has excluded one of those categories – disputes concerning sea boundary delimitation and historic bays or titles - from compulsory dispute settlement. As a result, any sea boundary disputes between Australia and another State cannot be subject to compulsory dispute settlement under UNCLOS.
A number of boundary delimitation disputes that have been resolved using the procedures provided under Article 287 of UNCLOS may bear on any final settlement of boundaries between East Timor and Australia:

**The North Sea Case of 1969.**

The International Court of Justice was asked to determine the relevant principles of law but not to delimit boundaries. The ICJ decided under customary international law:

- That the continental shelf constituted the ‘natural promulgation’ of the land under the sea;
- That there was no legal limit to the factors relating to geology, geography or the unity of deposits which could be taken into account;
- That after consideration of these factors, proportionality (of coasts) could be taken into account and that a failure to achieve a reasonable degree of proportionality indicated that equitable principles had not been adequately applied; and
- That islands can generate maritime zones but they do not generate full zones when they are competing against continental land areas.

**The Anglo-French Channel Delimitation of 1978.**

An arbitral tribunal was asked to determine boundaries under international law at a time when the provisions of UNCLOS 1982, although considered, were still under negotiation. The Tribunal found:

- That the underlying principle of all delimitations was that they be equitable;
- That natural promulgation as determined in the North Sea case formed the basis for customary law and that the general geographical situation is of primary importance as a method of delimitation;
- That the Hurd Deep was ‘simply a fact of nature’ and was discarded from consideration;
- That proportionality was a mitigating factor rather than a principle in delimitation; and
- That an island might present a special circumstance.

**The Libya/Tunisia Continental Shelf Case of 1982.**

Under ICJ jurisdiction, the case was governed by customary law, sought to determine which principles of law to apply to the delimitation, and considered equitable principles and relevant circumstances including current trends in UNCLOS 1982 negotiations. The ICJ determined:

- That Libya’s extensive geographical arguments on natural promulgation should be dismissed;
- That equidistance was a method to be used rather than the principle basis for an equitable outcome;
- That the presence of natural resources and physical characteristics were also discounted in value to the status of factors rather than determining principles;
- That economic factors were rejected; and
- That Tunisia’s Kerkennah Island be given ‘half-effect’ despite a population of over 15,000.

**The Gulf of Maine Case of 1984.**

In the first significant case since the adoption of UNCLOS 1982, the ICJ was asked to determine a single boundary inclusive of both the continental shelf and EEZ. The ICJ determined:

- That the solution lay primarily with geography and rejected the methods proposed by the parties;
- That economic factors were of little importance, ecological and environmental factors were dismissed as too variable and not neutral as are geographical factors;
- That Canada’s Seal Island should be given half-effect despite its permanent year round population; and
- That the relevant provisions of UNCLOS 1982 complied with customary international law in requiring conformity to equitable principles and with regards to relevant circumstances to achieve an equitable outcome.
The Malta/Libya Case of 1985:347
The ICJ was asked to set forth the applicable principles and indicate the mean to apply them in determining the continental shelf between Libya and Malta. The ICJ found:

- That coasts outside of the delimitation area could have an influence, thus widening the ICJ’s approach;
- That each state was entitled to a 200 mile legal continental shelf whether or not it was continuous or extended that far;
- That the continental shelf concept defined within UNCLOS 1982 was a part of customary international law;
- That land mass and comparative economic position were deemed irrelevant but that security issues, political status of independent states and third state claims were given weight;
- That the narrowing of relevant categories was widening in contrast to the Gulf of Maine case; and
- That the main island of Malta should only be given partial effect when compared to the coastline of Libya, despite the fact that it had a population of over 350,000.

The Guinea/Guinea-Bissau Case of 1988:348
An arbitral tribunal was asked to boundary of the territorial sea, EEZ and continental shelf by a single line. The Tribunal took a regional view, taking into consideration coastline directions to ensure that the delimitation would fit with actual and future delimitations in the West African region. The Tribunal additionally determined:

- That economic factors, while not permanent circumstances, had relevance regards a developing nation-state, unlike the decision reached in Malta/Libya; and
- That the use of macrogeography justified consideration of the positions of third party states and rendered use of equidistance as inappropriate.

The St. Pierre/Miquelon Case of 1992:349
An arbitral tribunal was asked to rule on efforts of a small group of French islands off the coast of Newfoundland to claim a 200 nm EEZ, which Canada viewed as unrealistic. The Tribunal rejected Canada’s efforts to reduce the effect of islands based on political status and size and length of coastline, as well as the French position based upon equidistance. The boundary dispute was settled but the resource dispute was not.

The Jan Mayen Case of 1993:350
Denmark asked the ICJ to decide where a single line of delimitation should be drawn between Denmark’s and Norway’s fishing zones and continental shelf areas between Greenland and Jan Mayen. The ICJ found:

- That the overriding provision of UNCLOS 1982 to find an equitable solution reflecting the requirements of customary law regarding a joint delimitation of both the EEZ and continental shelf were upheld;
- That the starting point for delimitation was to first determine a median line and then examine any special circumstances to see if they should justify and adjustment;
- That the limited population and socio-economic factors of Jan Mayen were not factors to be considered;
- That the marked disparity in coastlines constituted a special circumstance; and
- That the vital security interests of each state must be protected.

In most cases of significance, rulings have been made and precedents established by the International Court of Justice, an option no longer available in the dispute between East Timor and Australia as a result of Australia’s declaration under Article 298 of UNCLOS.

For a more detailed analysis of the ‘effect of islands’ as it relates to the boundary delimitation dispute between Australia and East Timor, and particularly as regards precedence established by Indonesia in past boundary negotiations, see the forthcoming paper by Dean Bialek, lecturer in the Faculty of Law, University of Melbourne. Bialek will examine the issue in detail in an article soon to be published in Melbourne Journal of International Law tentatively titled ‘East Timor’s EEZ and Continental Shelf Entitlements’.351
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12 Ibid, note 9, Paragraph 4(a-d).
13 Treaty between Australia and the Republic of Indonesia on the Zone of Cooperation in an Area between the Indonesian Province of East Timor and Northern Australia [Timor Gap Treaty].
17 Statutes of the International Court of Justice, Article 38, 1. The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply: a. international conventions, whether general or particular, establishing rules expressly recognized by the contesting states; b. international custom, as evidence of a general practice accepted as law; c. the general principles of law recognized by civilized nations; d. subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law. 2. This provision shall not prejudice the power of the Court to decide a case ex aequo et bono, if the parties agree thereto.
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22 Ibid, note 19.
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33 Former Prime Minister Gough Whitlam, Committee Hansard, December 6, 1999. Submission to the Senate Inquiry into East Timor.
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