



**Republic of Palau**  
**Aide Mémoire**  
**World Bank Petroleum Sector Mission**  
**Koror, June 19-24, 2007**

**I. Introduction:**

A World Bank Petroleum Sector Mission (Silvana Tordo - Senior Energy Economist, Oil and Gas Policy Division) visited Koror between June 19-24, 2007. Scope of the Mission was to gain a better understanding of: (a) the status of the discussions between the Government and the holder of the Palau North license;(b) the progress made on plans and institutional arrangements for oil sector development since the creation of the Oil and Gas Task Force; (c) the Government's and Civil Society's expectations and concerns regarding the development of the oil sector in Palau; and to discuss (d) the time table and extent of the preparatory activities that need to be undertaken by the Task Force prior to the start of the project; and (e) the time table for the implementation of project activities. Ms Gunvor Balle, Adviser, Office of the Prime Minister of the Faroe Islands, joined the mission to present her country's experience in the establishment of institutional, legal and contractual frameworks for the development of the petroleum sector.

The mission wishes to thank the Olbiil Era Kelulau (OEK), the Office of Environmental Response and Coordination (OERC), the Governor's Association, the Environmental Quality Protection Board (EQPB), the Oil and Gas Task Force, the Palau Chamber of Commerce, and all other government agencies, NGOs and trade associations visited for the cooperation and courtesies extended to it during its stay in Palau. A partial list of persons met is shown in Annex I.

The Mission's findings are summarized below.

**II. Background Information**

- An Oil and Gas Task Force was established by Executive Order no. 241, 16<sup>th</sup> February 2007 to: (i) assess the viability and the environmental and socioeconomic impact of the development of the petroleum sector; (ii) propose the necessary petroleum legislation, contract and fiscal policies, and associated regulatory framework; and (iii) propose institutional arrangements for the management and oversight of the sector at national and state level.



- The Oil and Gas Task Force includes two members appointed by the President (Ms Youlsau Bells, National Environmental Planner, and Mr. Terangue Gillham, consultant former head of the EPQB), one member appointed by the Senate (Mr. Santy Asanuma, Senator), one member appointed by the House of Delegate (Mr. Noah Idechong, delegate), one member appointed by the EQPB ( Ms. Portia Franz), two members appointed by the Chamber of Commerce ( Mr. Sam Scott, and Mr. Victorio Uherbelau), and two members appointed by the Governors' association (Governor Edwin Chiokai, and Governor Jackson Ngiraingas).
- Funding of the Oil and Gas Task Force will be ensured through special allocations from the national budget, and from grants provided by international donors. A Multi-Donor Trust Fund administered by the World Bank was established to support the design of the petroleum sector legislation and regulatory framework for the development of the petroleum sector in the Republic of Palau. The Grant Agreement, executed on the 11<sup>th</sup> day of April 2007, covers the following activities:
  - a. Development of a hydrocarbon code and model agreement;
  - b. Development of petroleum operations regulations;
  - c. Development of environmental regulations for petroleum operations;
  - d. Development of hydrocarbon tax regulations; and
  - e. Performance of Project financial audits

The OERC will be the implementing agency.

- The first meeting of the Oil and Gas Task Force was held on June 19, 2007.

Copies of Executive Order no. 241 and Senate Joint Resolution 7-S4, SD2, HD1 are shown in Annex II.

### **III. Progress since last petroleum sector mission in November 2004**

- In March 2006 Palau Pacific Energy Inc (PPE) and Tobi State entered into an exploration and production license. The license covers the marine area extending seaward from the shorelines of the islands of Hatohobei, Hotsarihei and Peraurou to twelve nautical miles from the traditional baselines off each of these islands.
- PPE also holds rights in an exploration and production license with Kayangel State covering an area known as the Velasco Reef. The company is planning to drill two exploratory wells but has so far failed to obtain the necessary permits and authorizations.
- Although seismic data and oil seeps analysis have been conducted in various parts of the Palauan offshore by PPE and other companies before it, the Government is not in possession of a copy of such data. Therefore, it is not in a position to conduct an independent evaluation of the potential of its offshore.
- In order to create a framework for petroleum operations in Palau, in 2004 the OEK had started the preparation of the Palau Petroleum Act. The Act underwent



several amendments and is now pending before the House of Delegate for further discussion and possible amendments to take in due consideration the conclusions of the report to be produced by the Oil and Gas Task

- The Constitution contains a number of key articles concerning intergovernmental fiscal and natural resources management in Palau. The National governments/legislative arm has significant responsibilities over natural resource and environmental regulations, as well as national tax and expenditure functions. The states have the right to regulate and derive revenue from natural resources located within the territory of the state (land and surrounding waters within 12 nautical miles of the watermark). There is an on-going discussion around the appropriate institutional and legal design for the effective management of the petroleum sector, including the design of revenue/benefit sharing from prospective oil revenue streams.
- The existing institutional capacity is not sufficient to regulate, and monitor petroleum operations and ensure the implementation of local and applicable international law.

#### **IV. Outcome of the discussions with the Oil and Gas Task Force**

- In order to consolidate public opinion over hydrocarbon resource exploitation and allocation of revenue between states and national government it was agreed that the Oil and Gas Task Force would oversee and direct the analysis and the preparation of a report which will be presented to the Executive and Legislative Branches and to civil society for comments. The report will inter alia cover the following areas:
  - a. Ownership of hydrocarbons, with particular emphasis on its implications in terms of granting of exploration and production rights, management and oversight of the sector, and revenue allocation between the states and the national Government;
  - b. Capacity constraints and implications for the creation of local business opportunity and employment;
  - c. Advantages and disadvantages of alternative institutional set up for the management of the petroleum sector;
  - d. Fiscal terms generally applicable to oil and gas exploration and production and their effects on investment decisions and government revenue;
  - e. Absorption capacity and inter-temporal distribution of revenue.

The outline of the report was discussed, and agreement was reached on topics in respect of which the Oil and Gas Task Force would benefit from the technical expertise of the World Bank and/or of the Faroese Government (see Annex III).

The policy recommendations contained in the report will inform the preparation of the petroleum legislation, regulations, and model contract to be funded by the Multi-Donor Trust Fund administered by the World Bank.



- Meetings were held with the Governors' Association, the OEK, the EQPB and the Chamber of Commerce to:(i) discuss their expectations and concerns with respect to the conduct of oil and gas exploration and production activities in Palau; (ii) present the objectives of the report; and (iii) obtain feed back on the areas and issues that the report should cover. The protection of the environment, the creation of an appropriate institutional, legal and contractual framework in line with other countries' best practice, the establishment of equitable principles for revenue sharing between States and national Government, and the need for promoting the Palauan economy through the creation of business and employment opportunities, were among the concerns raised by the stakeholders.
  
- Upon the request of a representative of the House of Delegates, the Oil and Gas Task Force provided a summary of generally accepted terms and conditions for petroleum exploration, development and production (see Annex IV).

## V. Next steps

- *Collection of information.*
  - a. *Hydrocarbon prospectivity.* It is important to collect as much information as possible on Palau's geological potential. The information will form the basis for defining the potential contribution of the oil sector to Palau's economy and devise suitable institutional, legal and contractual frameworks. To this end, the Oil and Gas Task Force will expeditiously contact PPE to request the delivery of the seismic data, oil seeps analysis and geophysical reports in their possession. The Oil and Gas Task Force will also contact the Mineral Management Service and the US Geological Service to enquire about the existence of geophysical and geological data covering any portion of the Palauan territory. The Faroese Geological Service will provide technical assistance with respect to data interpretation with the objective of improving the knowledge of the hydrocarbon potential of Palau, and to assess the need for and positioning of additional seismic surveys. Third parties' consultant services may also need to be considered.
  
  - b. *Existing legal and contractual framework.* The Oil and Gas Task Force will collect all relevant laws, regulations, and contracts (including international treaties to which Palau is a signatory), and will seek the legal opinion of Palau's General Counsel with respect to the interpretation certain provision of the Constitution that affect, inter alia, the granting of hydrocarbon exploration and production rights, the management and oversight of hydrocarbon exploration and production activities, and the authority for imposing and collecting taxes and fees related to such activities. The information will be analysed in the report.



- ***Preparation of the report.*** The following time line was agreed:
  - a. A preliminary version of the report will be distributed to the OEK, the Executive Branch, the Chamber of Commerce, and NGOs for review by July 27, 2007. Feed back will be collected during the first two-three weeks of August.
  - b. The final version of the report will be ready before the end of November 2007. The Oil and Gas Task Force will seek the endorsement of the policies recommended in the report by the OEK and to the Executive Branch. A national forum will be organised to present the findings and recommendations contained in the report to civil society.
  
- ***Preparation of the legal, contractual, and regulatory framework.*** The following time line was agreed:
  - a. Based on the formal feed back of the OEK and the Executive Branch, a tender process will be launched in January-February 2008 to recruit consultants for the preparation of the legal and contractual framework for oil exploration and production activities. The task is expected to be completed before the end of May 2008.

**Washington, the 29<sup>th</sup> day of June, 2007**