

TANGGUH INDEPENDENT ADVISORY PANEL

September 30, 2002

Lord John Browne
Group Chief Executive
BP plc
1 St. James Square
London, SW1Y 4PD

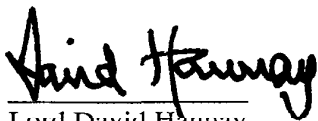
Dear Lord Browne:

The Tangguh Independent Advisory Panel submits to you its first report on the Tangguh LNG Project. Since you established this Panel in February, it has met several times and made an extensive fact finding trip to Indonesia where it met with Indonesian, U.S. and U.K. government officials, elected leaders in Jakarta, Jayapura, Manokwari and in the Bintuni Bay area, villagers in Tanah Merah and Taroy, NGOs in London, Jakarta and Papua, and many other affected Papuans.

Our inquiry suggests that the Tangguh LNG project has the potential to provide a stable supply of clean fuel to its customers while helping meet the needs of the local population and protecting the environment. The Report addresses issues related to possible delay of the Project, which may have added significance in light of the recent decision by China regarding LNG imports for the Guangdong and Fujian terminals.

We will be pleased to respond to any questions you may have and to share with you the insights that we have gained from this inquiry. We hope that these recommendations will help to make Tangguh a success in every way.

Sincerely,



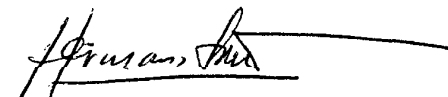
Lord David Hannay



Senator George Mitchell



Ambassador Sabam P. Siagian



Reverend Herman Saud

The Tangguh Independent Advisory Panel's First Report on the Tangguh LNG project was commissioned for the sole purpose of consulting credible third-party international expertise for use in assisting the project and its stakeholders to meet high standards and manage impacts appropriately. BP emphasises that the views, opinions and conclusions expressed in the report are solely those of the authors, and should not be regarded as those of the Project.

TANGGUH INDEPENDENT ADVISORY PANEL

**FIRST REPORT
ON
TANGGUH LNG PROJECT**

OCTOBER 2002

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I. Summary and Principal Recommendations

The Tangguh Independent Advisory Panel was established by BP to provide external advice to senior decisionmakers regarding non-commercial aspects of the Tangguh LNG Project. This Project is of enormous significance to BP, Indonesia and the people of Papua. The Panel was given complete access to information about the Project and independence in its inquiries, deliberations and findings. The Panel had extensive consultations with a wide variety of governmental and non-governmental stakeholders and a thorough site visit to Papua. It reviewed BP's planned activities in relation to current and recognized global norms that establish best practices for projects in developing countries.

This Report, which the Panel views as the first annual review of the Project, evaluates BP's current phase in advance of any construction. It recognizes that circumstances may change once construction or operation commences, which could modify any of the recommendations suggested herein.

The Panel makes the following principal recommendations, each of which is described in more detail below.

Overview

- Continue and intensify the dialogue BP has begun with the central government, regional government leaders in Papua, NGOs and religious leaders.
- Make sure that any commitments made by the company make a clear distinction between matters under consideration and actual decisions, and that all specific promised benefits are set out in writing.

Substantial and Tangible Benefits in the Near Term

- Provide early, tangible and visible support to the Bird's Head region and the province in education, health care, capacity building and job training. This early support from BP will help to diminish any opposition to the Project resulting from any delay of revenues under Special Autonomy.
- Work closely with and support efforts of the U.S. Agency for International Development ("USAID"), the U.K. Department for International Development ("DFID") and the United Nations Development Programme ("UNDP") to set up programs for governmental capacity building in Papua, so that revenues are usefully spent.
- Enter into discussions with the government of Indonesia and the authorities in Papua regarding the viability of an externally financed line of credit to bring forward and smooth out the flow of revenues to Papua from the Project.

Community Development

- Provide direct support for improved educational facilities and teaching in the Bird's Head region and for technical training and higher education programs in Manokwari and Jayapura.
- Provide direct support for increased health care in the Bintuni Bay region, including malaria control in the Directly Affected Villages and towns and funding for medical supplies, facilities and personnel, particularly during the construction phase of the Project.
- Because of its critical importance to health and development, provide improved drinking water infrastructure where needed in the Directly Affected Villages and towns.

Security

- Pursue the concept for community based security flexibly, recognizing the need to reconcile this approach with the TNI's obligation to protect vital national assets.
- Engage in high level consultations with senior political, military and police officials about the implementation of this concept, and aim, if possible, to establish a sound basis for cooperation with senior political and military officials before a final decision is made by BP to go forward with the Project.
- Support programs that provide training to the military and police, such as that run by the International Committee of the Red Cross.
- Resist demands by the TNI or the police for direct funding.

Training and Employment of Papuans

- Continue to train local villagers in useful trade skills, such as carpentry.
- Implement a job recruitment and training program for Papuans in the region to help actualize the promise of a job for every family in the Directly Affected Villages.
- Support the modernization of the local fishing fleet by providing assistance for better boats and other equipment.

Relationships with Pertamina and New Implementing Body ("BPMIGAS")

- Strengthen and expand relationships with senior officials at Pertamina in order to provide stability to this evolving relationship.
- Monitor closely and develop relationships with the officials of BPMIGAS that will oversee Tangguh activities.

Mitigation of Construction Impacts

- Pursue strictly its programs to limit construction worker off-duty activities in and around the Bintuni Bay area.
- Engage closely with its contractors to emphasize the importance of this policy and ensure that the contractors strictly adhere to the company's Code of Conduct.
- Provide educational programs for all affected villages and towns to inform the villagers of the dangers of disease, alcohol and drug use.

Environment

- Safeguard biodiversity in the region and support the flagship biodiversity action program at Cagar Alam.
- Support measures to ensure proper environmental management of the facilities and protect Bintuni Bay from any degradation of water quality or other impacts that could affect the marine environment and the livelihoods of the local population.
- Implement all requirements of the AMDAL fully and in the appropriate timeframe.
- Commit to removal of all BP facilities and equipment on decommissioning and to the mitigation of any damage to land utilized.

Public Information

- Produce and disseminate materials about the Project and BP's programs to provide accurate and current information and to avoid misconceptions and untruths.

II. Establishment of Panel and Scope of Report

In early 2002, BP established an independent advisory panel to provide external challenge, advice and assurance to BP in connection with the Tangguh LNG Project in Papua, Indonesia. The Panel is chaired by U.S. Senator George Mitchell and includes Lord David Hannay of Chiswick from the U.K., Ambassador Sabam Siagian from Jakarta, and the Reverend Herman Saud from Jayapura. The Panel is charged with advising BP as to how Tangguh can achieve its potential as a world-class model for development, taking into account specifically: the Project's effects on local communities; its effects on the environment and biodiversity; its impact on political, economic and social conditions in Indonesia generally and in Papua in particular; and its evaluation of Indonesia and Papua "country risk."

The Panel was requested to submit its initial report to the BP Group Chief Executive, following detailed background briefings by the BP Indonesia and Tangguh team and an extensive visit to Indonesia, including Jakarta, Jayapura, the Bintuni Bay region and the Freeport McMoRan mine and related facilities. The Panel met with a wide variety of Indonesian, U.S. and U.K. government officials, elected leaders in Jakarta, Jayapura, Manokwari and Aranday, village leaders in Tanah Merah and Taroy, NGOs in London, Jakarta and Papua and many directly affected Papuans.¹ The Panel utilized independent legal counsel, and was given complete access to all information it requested and total independence in its inquiries and its findings. The conclusions and recommendations in this report are those of the Panel alone.

The Tangguh Project is of enormous significance to Indonesia and to Papua, because of both its magnitude and its timing. Over the next 30 years, it is expected that the central government could

¹ A list of all individuals and entities consulted by the Panel is included at Appendix 1.

receive more than US \$8.7 billion from Tangguh, and the Papuan government could receive \$3.6 billion.² During its period of highest impact, estimated at 2011 to 2022 under the current operations timetable, around \$225 million annually could flow from Tangguh to the Papuan provincial government; currently, Papua's total annual budget is approximately \$190 million.³ Indonesia is already the largest LNG exporter in the world, having exported 27 million metric tons of LNG with a total value of \$6.8 billion in 2000,⁴ but production is declining at the large Arun field operated by Exxon Mobil. Tangguh, therefore, provides the opportunity for Indonesia to remain one of, if not the largest LNG exporter in the world. In addition, Tangguh would be the largest foreign investment in Indonesia since the economic crisis and the resignation of President Suharto in 1998. Further, Tangguh would be the most substantial new project affected by the new Special Autonomy law for Papua,⁵ under which revenues will be divided, after taxes and first tranche petroleum are provided to the central government, between the central government and the Papuan regional government by a new formula that allocates seventy percent of the revenues to the region and thirty percent to the central government.

The Project is particularly significant to the Bintuni Bay region in the Bird's Head area of Papua. This region has only three substantial towns, each of which is well over 100 kilometers from the Tangguh site. The more immediate area of the Project is a large, pristine bay, with perhaps the world's largest mangrove forest and it is considered one of the world's most diverse marine ecosystems. Bintuni

² See APCO Macroeconomic Impact Study, April 2002 at 4. These revenue estimates assume a four train LNG project and a crude oil reference price of \$16 Brent. See Appendix 4 for an annual estimate of Papua and Indonesia revenues.

³ *Id.*

⁴ *Id.* at 9.

⁵ Law No. 21/2001. The impact of this law is explained more fully below.

Bay is surrounded by a huge expanse of untouched jungle, pockmarked with logging operations (legal and illegal) and several oil palm plantations and sago tree nurseries. The communities around the bay consist of small, isolated villages with thirty to 100 families, who live in primitive wooden houses with thatched or corrugated metal roofs and outdoor cooking and toilet facilities. The villages have electricity and, anachronistically, several satellite dishes; at least one village even has a DVD rental shop as one of its few commercial enterprises. The overwhelming majority of the men are involved in shrimp fishing using dugout canoes, most without outboard motors. There are many children, and those of school age attend elementary school each morning in the village. Most villages have a mosque, and both a Catholic and a Protestant church.

The Bintuni Bay region has several small towns; of those, Babo (on the south shore) and Aranday (on the north shore) are closest to the Project site. These communities are somewhat larger and more commercial than the villages and include the local government office, run by the Camat, or mayor. The towns also have junior high schools as well as small health clinics. There are no roads leading into any of the towns or villages; all transportation is by boat or helicopter. Babo will be the site of BP's construction base camp, with substantial construction of facilities, including expanded harbor facilities and a new air strip.

Without question, Tangguh is the most significant project in Papua since the Freeport McMoRan gold and copper mine complex, which began operations at its Ertsberg mine in 1973⁶, expanded significantly in the late 1980s with the discovery of the Grasberg mine and now employs more

⁶ About Freeport, Operations and History, <http://www.fcx.com/fmcg/index.htm>, viewed July 3, 2002.

than 14,000 people⁷, Tangguh is the largest project ever in the “Bird’s Head” region of northwest Papua. Because of the controversies related to security, human rights and environmental impact of the Freeport project, Tangguh is both welcomed as a new model for international corporate conduct and feared because of Papua’s past experience.

The Panel reviewed BP’s proposals in relation to the most respected current global norms that establish best practices for projects in developing countries. Standards were consulted governing human rights, labor, security and environment, including specifically, the Universal Declaration of Human Rights, the International Labour Organisation Convention Concerning Indigenous and Tribal Peoples in Independent Countries, the World Bank Operational Directive with respect to Indigenous Peoples, World Bank and IFC policies and guidelines regarding environmental operations and protection of natural habitats, and the International Organization for Standardization “ISO 14001” (environmental management systems).⁸

BP’s compliance with Indonesian law was outside the scope of the Panel’s inquiry, but it was assured that all national and local legal standards would be met.

III. Political Background

Indonesia has gone through a massive political shift since the fall of President Suharto in 1998. It is in the early stages of democracy. It is tied to a past in which the military is both independent and paramount and where the two most significant forces are nationalism and Islam.

⁷ More than 7,000 workers are directly employed by PT Freeport Indonesia, and more than 7,000 additional workers are employed through contractor and partner companies. *See* Fast Facts: Economic Impact in Indonesia, <http://www.fcx.com/mr/fast-facts/ff-econimpact.htm>, viewed July 3, 2002. *See also Working Toward Sustainable Development*, 2001 Economic, Social and Environmental Report of Freeport-McMoRan Copper & Gold, Inc., at 2.

⁸ Appendix 2 summarizes the key components of these and other global standards consulted by the Panel.

Most significant to BP is Jakarta's relationship with Papua, but also instructive are its policies in Aceh. The central government has enacted Special Autonomy laws for the two provinces which are at its geographic extremities. These laws provide a measure of federalism and substantial revenue sharing for natural resource development. In Aceh, however, Special Autonomy comes too late to avoid separatist violence and disruption. More than 20,000 troops are stationed near the Exxon Mobil Arun gas operations, with many fatalities weekly; radical Islamic and separatist forces are active and a major threat to Indonesian unity.

In Papua, on the other hand, Special Autonomy is Jakarta's more timely response to separatist pressures and to a less organized separatist movement, the Free Papua Movement, *Organisasi Papua Merdeka* ("OPM"). The promise of Special Autonomy for Papua is to provide a measure of local control through an elected Governor and elected legislature, a recognition of the local cultural tradition known as *adat*, as well as considerable independence in such matters as revenue allocation, borrowing, education and health. Hopefully, this will avoid the separatist violence now raging in Aceh and afflicting the Exxon Mobil operation. But Special Autonomy is a "constitutional" document, establishing the structure of the Papuan government and its various interrelationships with Jakarta. To implement it fully, both governments will need to enact additional legislation. At best, this will take time; at worst, it may not be fully implemented and could fail in its political objective.

Special Autonomy is currently endorsed by most of the political establishment in Papua, but with a significant caveat. It is viewed as a test, to be evaluated over time and to be judged by whether it is implemented in a way that supports its promise of genuinely sharing political and economic power. At this point, it is by no means certain that Special Autonomy will be implemented in a way that satisfies the political demands of Papuans. Thus far, many Papuans believe the pace has been slow. Further, the

attention of Jakarta may be diverted. For these reasons, while Special Autonomy should be a positive factor if fully and timely implemented, it would be unwise for BP to rely too heavily on its delivery for all the needs of the Papuan people.

One measure of Papuans' concern about the viability of Special Autonomy relates to the investigation of the murder last fall of Theys Eluay, the charismatic leader of the Papuan Presidium Council, a peaceful but pro-independence Congress. Almost every Papuan with whom we met raised this issue. Following widespread concern in Papua about the identity of the killers, the new TNI leadership recently announced that a total of ten of its officers will be tried in connection with the killing.⁹ Jakarta's handling of this case is viewed by most political elements in Papua as the first test of the new relationship. And Papuans are withholding judgment until it is resolved. This episode serves to underscore the fragility of the Indonesia/Papua political relationship and the critical role that the TNI can play in enhancing or destabilizing that relationship.

Most recently, concern regarding escalation of violence in Papua has been increased by the August 31, 2002 ambush near Freeport of a convoy carrying teachers from an international school attended by the children of Freeport employees. Two Americans and one Indonesian teacher were killed.¹⁰ This is the first time since the fall of President Suharto that foreigners have been targeted in the conflicts in Papua. The Indonesian military has blamed OPM rebels for the ambush,¹¹ but Papuan

⁹ See "Indonesian military announces murder suspect in Eluay's murder," Deutsche Presse-Agentur (July 30, 2002); "Trials of 10 Kopassus officers slated this month," The Jakarta Post (Aug. 2, 2002).

¹⁰ "Villagers Eyed in Indonesian Attack," Associated Press (Sept. 3, 2002).

¹¹ "Papua police question 17 soldiers in the murder of two American teachers," Associated Press (Sept. 15, 2002).

Police Chief Pastika has said that “[t]here is no strong indication that the perpetrators were the OPM.”¹² If this attack proves not to be specific to the ongoing controversies at Freeport but signals the beginning of a broader cycle of violence, there would certainly be adverse implications for BP’s plans for security at Tangguh and for Papua’s political stability generally.

To complicate matters further, an entirely separate threat to stability and security in Papua is presented by the recent arrival in the Bird’s Head region of radical outside groups which carry their own specific agendas.¹³ Although not directly related to the Project, this creates a destabilizing factor with potential for violence and increased military operations in the area.

Decisions regarding Tangguh must be made in the context of this new, yet dynamic and unpredictable political and cultural milieu. The novelty of the Special Autonomy relationship provides a great opportunity because the failed military responses of the past, such as that used for Exxon Mobil in Aceh, may be less likely to be repeated. But its dynamism also presents a challenge, in which BP can play only a limited role, to harmonize these conflicting forces, or at least to avoid open conflict, by bettering people’s lives and hopes for their children’s futures, building provincial and regional government capacity, and encouraging democratic and peaceful solutions for resolving conflicts. The Panel believes that BP can and should contribute to the achievement of these goals.

IV. Overview

In general, the Panel found that reactions to the Project were positive in Jakarta, Jayapura and the Bintuni Bay region. With few exceptions, government officials, NGOs, and local citizens welcomed

¹² “Papua whodunnit a political volcano,” *The Australian* (Sept. 17, 2002).

¹³ The Indonesian government has arrested and charged Ja’far Umar Thalib, the leader of one group, in connection with religious violence in the Maluku. See “Ja’far trial adjourned till Aug. 15,” *The Jakarta Post* (Aug. 2, 2002).

the Project as a major benefit to Papua and welcomed BP's consultative processes to date and its assurances of responsiveness to their needs. These groups, particularly at the Papua provincial level, told us that this contrasts sharply with their previous experience with Freeport.

However, this process already has produced "a momentum of expectation" at all levels and considerable impatience for tangible benefits. As a result, confusion regarding promised benefits of the Project or delays in delivering them may be viewed as broken promises and could sacrifice the gains in good will obtained thus far from such painstaking preparation. The most serious immediate risk could occur from any postponement of the Project based on commercial factors. It is essential that BP make clear what it is proposing, in writing wherever possible, and deliver in a timely way on all promises made.

BP's presence already has led to a series of escalating requests, bordering on demands, by those affected by the Project. For example, the decision to provide new housing to the villagers from Tanah Merah, which must be physically moved, has led to parallel demands by villagers from the north shore.¹⁴

In addition, there is a clear tension with respect to the anticipated allocation of revenues from the Project among the province of Papua, the Bird's Head region, and the villages on the north versus the south coast of Bintuni Bay, all of whom expect to benefit substantially. Although BP cannot control the allocation of these revenues, it has a vital interest in insuring that, first, the 70/30 split provided by Special Autonomy is implemented quickly, accurately and transparently; second, the allocation of

¹⁴ After meeting with a group of villagers from the north shore, the Panel received a formal petition of demands of the Taroy villagers (attached at Appendix 3), which includes demands for new housing, a clean water supply and new health and educational facilities.

revenues among the Directly Affected Villages, and to the Bird's Head region and the province of Papua is fair and reasonable so as to avoid severe imbalances and resulting disputes; and third, revenues begin to flow and development begin to take place in a timeframe that is consistent with BP's schedule for the Project.

It would be imprudent and not helpful for the Panel to speculate about the long-term political and economic stability of Indonesia or Papua for the multi-decade lifetime of the Project. It is clear, however, that the relationship between Papua and Indonesia is not entirely predictable over the long-term and that forces exist that could affect Papua's political status, potentially as early as after the next elections in Indonesia in 2004, or by the expiration of the first phase of Special Autonomy in 2005.¹⁵ Accordingly, it is critical that BP establish a structure that is sustainable through political change that benefits all of the major political elements and thereby reduces incentives for any group to interfere with the Project. The Panel believes that the timely implementation of Special Autonomy would make it possible to accomplish a structure that materially reduces "country risk" from instability in Papua.

One highly sensitive issue is the active presence and involvement of the Indonesian military in the security of all substantial projects and the fear and disaffection of the Papuan people with respect to this military activity. The structure for security at Tangguh may evolve over time, but the Panel believes it is important at the outset that BP seek to implement, to the extent possible, its concept of community based security. The Panel concludes that with flexibility and high level engagement with the TNI and the police, particularly in the immediate period before BP finally commits to proceed, security arrangements can be agreed to that satisfy the needs of all parties.

¹⁵ The Special Autonomy law provides that the law's application shall be evaluated at the end of the third year after the law takes effect and annually thereafter. Law No. 21/2001, Art. 78.

The Project will be by far the largest construction project undertaken in the Bintuni Bay region. Despite its magnitude, the Panel believes that with proper development Tangguh can have modest adverse environmental impacts on this important ecosystem. In light of this determination, together with the enormous environmental benefits that the Project would attain by displacing coal use in China and other South Asia economies, Tangguh provides the opportunity to be a world-class model for development. However, there are significant local environmental issues that must be addressed, the most important of which is the preservation and enhancement of the shrimp and fishing industry of Bintuni Bay, on which most of the villagers depend for their livelihoods.

Should market developments lead to a decision to delay the construction phase of the Project, it will be important that BP explain the background of this decision and its prospects to all affected by it—to the Government of Indonesia, to the Papuan regional authorities and to the people directly affected in the Bintuni Bay area. There will initially be an adverse reaction, with some criticism that a project which had come so far already, should not yet be moving ahead. The key to managing this reaction will be for BP to continue its programs in the education and health sectors and its efforts at capacity building in Papua so that the basic structures for absorbing an increased flow of funds at a later date are steadily strengthened. Any delay in the Project operation date will also make more important the Panel's recommendation for bringing forward some of the already delayed revenue flow. This recommendation could take on added significance in light of the recent decision by China regarding LNG imports for the Guangdong and Fujian terminals.

In sum, the Panel concludes that BP has laid the groundwork for policies that respect the interests of and provide tangible benefits to all parties in interest, including the Indonesian government, the Papuan government, the several regencies of the Bird's Head region, and the villages of Bintuni Bay.

Among the significant challenges for BP will be to retain sufficient flexibility to implement these policies effectively as circumstances change. In practice, it is also critical that BP make sure its policies are properly carried out by its contractors, which should be required to sign and adhere to a strict Code of Conduct. These challenges are always more difficult than planning.

Recommendations :

- **Continue and intensify the dialogue BP has begun with the central government, regional government leaders in Papua, NGOs and religious leaders.**
- **Make sure that any commitments by the company make a clear distinction between matters under consideration and actual decisions, and that all specific promised benefits are set out in writing.**

V. The Need for Substantial and Tangible Benefits in the Near Term

BP Indonesia has brought most of the political constituencies into a dialogue and a consultative process. Consultation is an essential first step in creating consensus and understanding. However, this extensive dialogue has created a momentum of expectations that will have negative consequences if they are not fulfilled. Although some of these expectations are unrealistic, they have the potential to interfere with the Project if they are not sensitively addressed.

A key problem regarding benefits to the region is created by the timing of revenue flows to Papua under the Special Autonomy law. Because of the revenue splits in the production sharing contract (the “PSC”), including the need to provide cost recovery and first tranche petroleum off the top and the requirement to repay debt service, there will be no substantial revenues flowing to Papua until

2011 at the earliest, at which time a sharp increase should take place.¹⁶ This contrasts sharply with the timing of the Project's anticipated construction phase and potential commencement of operations and first LNG exports in 2006. Accordingly, unless affirmative steps are taken, about a decade could elapse between commencement of construction and initiation of substantial revenue flows to Papua. Moreover, when revenues begin, the sudden increase may be overwhelming and create problems in appropriate use. Given the history of Freeport's operations in Papua and the deep suspicions of Papuans regarding the reality of Special Autonomy, this lengthy delay is likely to provoke much dissatisfaction. Dissatisfaction is likely at the provincial level even if BP provides its planned community development support for the villages in the region.¹⁷

The Panel believes there are at least two ways in which BP can mitigate any negative consequences of the delay in revenue flows to Papua. First, BP could provide benefits throughout the Bird's Head region by developing its programs in education, health care, capacity building, job training and sustainable development. The object of this early support is to provide tangible and visible benefits from BP in Papua. Second, BP can work with the Papua government and the central government to establish an external line of credit, fund or other mechanism that borrows against future Project revenues.¹⁸ Such advance funding not only would bring forward the flow of revenues, it also would

¹⁶ Appendix 4 provides a graphic illustration of the revenue flow to Papua. The level of revenue varies substantially with world oil prices. The timing of revenue assumes, of course, no delays in the anticipated commencement of operations.

¹⁷ BP's community development includes the promotion of a strengthened regional healthcare program and educational system in the Bird's Head region, as well as aid for micro- and small-enterprise development. *See* ANDAL Executive Summary at ES-21.

¹⁸ Special Autonomy provides for loans to Papua from offshore resources with approval from the Papua House of People's Representatives and the Indonesian government. Law No. 21/2001, Art. 35(4). Under Article 35(5), the total
(continued)

permit the ramping up of the revenues smoothly over time, making more likely the effective utilization of funds. It should be possible for such lending to be supervised in order to provide some assurance that the funds are being spent on needed facilities and are not being wasted, or worse, diverted, through ineffective or corrupt local governments.¹⁹ If these funds are dispensed with some supervisory control by the lending institution in a timeframe consistent with the development objectives of regional and local governments, there is likely to be sufficient governmental capacity at the local and provincial levels to utilize these additional revenues effectively and transparently.

BP has initiated discussions with USAID, DFID, and UNDP with regard to support for governmental capacity building in Papua, and has proposed an impending partnership with USAID to provide support for civil governance in Papua. The Panel recommends that BP implement its support for these programs. As one additional option, BP could seek to become a flagship project under UN Secretary-General Kofi Annan's "Global Compact," which challenges corporations to adhere to principles drawn from the Universal Declaration of Human Rights, the International Labour Organisation's Fundamental Principles on Rights at Work and the Rio Principles on Environment and Development.

It is critical that effective and transparent government structures exist in Papua so that the benefits of the Tangguh Project will be useful and directly visible. If these benefits are not demonstrable,

(continued)

loans to Papua from domestic and offshore resources "may not exceed a certain percentage of the total revenues of the Regional Budget according to the provisions of statutory regulations."

¹⁹ Appendix 5 summarizes the powers of the key multilateral lending institutions, including the World Bank and the Asian Development Bank, that could be available for such loans.

BP may attract some of the blame for the government's failure and antagonism toward the Project could result.

Recommendations :

- **Provide early, tangible and visible support to the Bird's Head region and the province in education, health care, capacity building and job training. This early support from BP will help to diminish any opposition to the Project resulting from any delay of revenues under Special Autonomy.**
- **Work closely with and support efforts of the U.S. Agency for International Development ("USAID"), the U.K. Department for International Development ("DFID") and the United Nations Development Programme ("UNDP") to set up programs for governmental capacity building in Papua, so that revenues are usefully spent.**
- **Enter into discussions with the government of Indonesia and the authorities in Papua regarding the viability of an externally financed line of credit to bring forward and smooth out the flow of revenues to Papua from the Project.**

VI. Community Development

BP will be of most value to the people of Papua and the residents of the Bird's Head region if it continues to focus its community development efforts in education, health and sustainable employment.²⁰

Throughout Papua, from Tanah Merah to Jayapura, the need for better education is paramount, at both the elementary and secondary levels as well as for technical training and higher education.

The options are many, and include better facilities and equipment for elementary schools in the Directly Affected Villages; improved facilities at the intermediate school levels in the affected towns of Bintuni Bay; support for construction of a secondary school in the Bintuni Bay region (where none exists today); scholarships or other incentives for teacher education at Manokwari and Jayapura for teachers

²⁰ See The Tangguh LNG Project Integrated Social Strategy.

who return to the Bird's Head region; bonuses or stipends to teachers who serve in the region; support for the departments and faculties for education and healthcare at the university level at Manokwari and Jayapura; support for study abroad programs and English language training for faculty at Manokwari and Jayapura Universities; and BP endowed chairs or scholarships in areas of particular interest, such as engineering or marine environment or forestry. The Panel recommends that these options be given consideration, as each could provide meaningful support for educational opportunities.

BP also should support increased health care in the Bintuni Bay region. Health care generally in the villages is minimal; in the towns, it is inadequate. The most single significant health problem is malaria, which particularly affects the children. Although child mortality levels from malaria are modest, many children still die at an early age and a very substantial number contract malaria and suffer its effects. Freeport has funded a malaria control program in Timika and the surrounding communities, which has reduced malaria prevalence dramatically.²¹ BP should consider malaria eradication in the Directly Affected Villages and towns. In addition, these communities have inadequate supplies, facilities and trained medical personnel, and the medical "infrastructure" will likely become even more strained during the construction phase of the Project when migrant workers could bring new contagious diseases to the area, including HIV/AIDS. The Panel recommends that BP consider direct support for health care in these communities, at least until sufficient revenues begin to flow from Tangguh to enable local governments to fund these activities adequately.

²¹ See Fast Facts: Public Health & Medical Programs, <http://www.fcx.com/mr/fast-facts/ff-health.html>, viewed on July 11, 2002. Under this program, some Papuan communities have seen a reduction in malaria prevalence from eighty percent in the early 1990s to less than ten percent today. *Id.*

Essential to health is clean drinking water. Local leaders in Aranday and Taroy specifically requested that BP assist the villages on the north shore of Bintuni Bay with improved drinking water as a critical area in need of improvement. Because of its critical importance, the Panel recommends that BP provide assistance for the Directly Affected Villages in this sector.

To the extent possible, BP's support for education, health care and job training should be coordinated with and administered by local officials. BP must take care not to assume the roles of a local government, or to be perceived as such, as Freeport has done in Timika.

The Panel believes that BP can strike the proper balance by (1) implementing the recommendations set forth above; and (2) carefully coordinating all support with parallel efforts to improve the capacity of local and regional governments.

Recommendations :

- **Provide direct support for improved educational facilities and teaching in the Bird's Head region and for technical training and higher education programs in Manokwari and Jayapura.**
- **Provide direct support for increased health care in the Bintuni Bay region, including malaria control in the Directly Affected Villages and towns and funding for medical supplies, facilities and personnel, particularly during the construction phase of the Project.**
- **Because of its critical importance to health and development, provide improved drinking water infrastructure where needed in the Directly Affected Villages and towns.**

VII. Security

Security, and the anxiety of many Papuans regarding the role of the military in managing that security, may be the most difficult and sensitive issue for BP. This anxiety is based on a history of controversies involving the activities of the TNI in some parts of Indonesia and more locally at the

Freeport facility in Timika. The Panel was informed that up to eighty percent of the TNI's revenues have been derived from businesses and facilities it protects. However, last year a central government reorganization moved the police outside of the TNI, and left the military with the job of defending against outside threats and protecting vital national assets. It is unclear, and untested, how this new arrangement will work. Thus, two serious issues arise: first, the role of the TNI and police in providing security for Tangguh; and second, the financial demands that the TNI may place on BP and Pertamina.

BP Indonesia has developed a concept for community based security that would enlist local Papuans for basic perimeter security, utilize the police for major internal disturbances, and reserve the TNI for the most serious threats. Because of past experiences with the TNI, many believe this concept is unrealistic and that the TNI will insist on protecting this vital national asset at close range.

The Panel recommends that BP go forward with its community based security program, while retaining flexibility in its implementation. At the same time, BP should consult promptly at the highest levels with the police and TNI, and respect their appropriate roles in the security of the Project.

BP must avoid the extremes of becoming too closely associated with the TNI or being used as a weapon by political forces against the TNI. The Panel believes that reaching an early understanding with senior security, military and police officials is the best way that BP can implement some form of its community based security and avoid surprises or unwelcome demands.

In that regard, the Panel believes that high level consultations including the Coordinating Minister for Security and Political Affairs, the new Commander of the Armed Forces and other appropriate officials at the national and regional level should be undertaken. The Panel was encouraged in discussions with the commander of the Papuan police, who explained the recent reorganization of the police force outside of the TNI and offered his view that a central government decision is needed to

implement a new “paradigm,” which will include community based security, the police as the primary back-up, and the TNI only for the most serious threats. Others urged similar high level and early contacts. BP must convey its strong interest in this structure and its importance to the Project to the TNI leadership and other senior government security officials, and must reconcile its proposal with the TNI’s obligation to protect vital national assets.

To the extent possible, BP should seek a sound basis for cooperation, endorsed by senior political and military leadership, that outlines the community based security concept and delineates the role of the TNI. BP should work to accomplish this, if possible, before a final commitment to proceed is undertaken.

BP should be supportive of police training and infrastructure in several ways. It can encourage the central government or provincial Papuan government to allocate a portion of Tangguh revenues to police infrastructure and training. It can also support programs such as one run by the International Committee of the Red Cross, which provides training in humanitarian law, procedures to contain the use of force and alternatives to the use of force for Indonesian military officers in Papua and the police.

However, BP’s response to any TNI requests for funds to support security at Tangguh is clear. The Panel believes BP should resist any requests for direct financial support.

Recommendations :

- **Pursue the concept for community based security flexibly, recognizing the need to reconcile this approach with the TNI’s obligation to protect vital national assets.**
- **Engage in high level consultations with senior political, military and police officials about the implementation of this concept, and aim, if possible, to establish a sound basis for cooperation with senior political and military officials before a final decision is made by BP to go forward with the Project.**

- **Support programs that provide training to the military and police, such as that run by the International Committee of the Red Cross.**
- **Resist demands by the TNI or the police for direct funding.**

VIII. Training and Employment of Papuans

BP has promised a job offer in the Tangguh Project for one member of each family in the Directly Affected Villages. It is important for BP to fulfill this promise. Actual employment for many may be difficult given the current lack of training and job discipline. Therefore, to increase the success rate, BP should implement a job recruitment and training program for Project-related positions at all levels, including community security, for both construction and operation phases. The Panel also recommends that BP encourage its contractors to make a significant effort to train and recruit ethnic Papuans.

The hiring of Papuans for construction jobs may create independent problems when these jobs are eliminated at the end of the construction phase, possibly as early as 2005. The Panel endorses BP's goal of sustainability in its Integrated Social Strategy, which seeks to provide long-term private sector opportunities to the indigenous people, and emphasizes the importance of developing practical opportunities while construction is ongoing.

The Panel also believes there is a strong need to provide training or equipment to enable the people of Bintuni Bay—particularly the youth—to improve their livelihoods and expand their career opportunities, which are severely limited. Virtually the sole source of outside income to the directly affected area derives from shrimp fishing. Much, if not most, of this is conducted from dugout canoes. It is likely that construction of the LNG tanker pier and combination pier will disrupt fishing patterns on the south shore of Bintuni Bay, as may the LNG platforms and the tanker traffic. BP should consider

supporting the modernization of the local fishing fleet by providing assistance to local fishermen to compensate for any dislocations caused by the Project. BP should also continue to train local villagers in useful trades, such as carpentry and electrical work, to provide skills for alternative sustainable careers.

Recommendations :

- **Continue to train local villagers in useful trade skills, such as carpentry.**
- **Implement a job recruitment and training program for Papuans in the region to help actualize the promise of a job for every family in the Directly Affected Villages.**
- **Support the modernization of the local fishing fleet by providing assistance for better boats and other equipment.**

IX. Relationship with Pertamina and New Implementing Body (“BPMIGAS”)

BP and Pertamina have a complex and evolving relationship. They are partners under the PSC and Pertamina has management control over all BP expenditures. Indonesia’s new oil and gas law²² will essentially privatize Pertamina by November 2003. A new governmental entity has been established that will accede to Pertamina’s regulatory functions, including awarding all oil and gas contracts; exercising management control over BP’s Tangguh activities; and acting as the government’s agent for selling its share of production gas. The new implementing body, known as “BPMIGAS,” is accountable directly to the President. All employees of Pertamina involved in production sharing management will be transferred to BPMIGAS. Its first chairman is Rachmat Sudibjo, the current Director General of Oil and Gas at the Ministry of Energy and Mineral Resources. The Panel was informed by Mr. Sudibjo

²² Law No. 22/2001.

that the new entity will exercise somewhat looser management control over BP, conducting post-audit scrutiny of the operator's costs and not requiring any pre-approval of expenditures.

BP Indonesia's primary relationship with Pertamina is through the project manager Pak Yoga Suprpto. The current arrangements are fragile, and could be altered by the departure of Pak Yoga or the transfer of functions to the new BPMIGAS. The Panel recommends that BP develop a working relationship at the highest levels of Pertamina and BPMIGAS, and that BP Indonesia monitor closely the policies of BPMIGAS and develop close working relationships with Mr. Sudibjo and other senior officials.

Recommendations :

- **Strengthen and expand relationships with senior officials at Pertamina in order to provide stability to this evolving relationship.**
- **Monitor closely and develop relationships with the members of BPMIGAS that will oversee Tangguh activities.**

X. Mitigation of Construction Activities

The most sensitive period in the life of the Project will be the initial construction phase, when up to 5,000 workers will be employed in the Bintuni Bay area. The Panel endorses the objectives minimizing the adverse effects of this migration into the Bintuni Bay region, particularly the proposals to locate workers at Manokwari, Fak-Fak and Sorong while not on shift, to isolate them to the extent possible while at the site, and to refrain from constructing any roads leading to the site area. Even with these restrictions, the Panel expects that considerable tension, including inter-ethnic and inter-denominational problems, will arise during this period, in part because of the practical difficulty in enforcement of these restrictions. In addition, cultural and health concerns are likely, such as alcohol or

drug use and the introduction of HIV/AIDS into the area. The Panel emphasizes the importance of early educational programs, for all affected villages and towns, to inform people of the area of these dangers.

It is also critical that BP contractors, who will have management control over many of these workers, take seriously the policies BP has propounded. BP should engage with each of its contractors to emphasize the full meaning and importance of a Contractor Code of Conduct that requires each contractor in writing to abide by the policies BP has established to limit the impacts of migrant workers. BP should ensure that all contractors adhere strictly to the Code of Conduct and should impose real sanctions for serious violations.

Recommendations :

- **Pursue strictly its programs to limit construction worker off-duty activities in and around the Bintuni Bay area.**
- **Engage closely with its contractors to emphasize the importance of this policy and ensure that the contractors strictly adhere to the company's Code of Conduct.**
- **Provide educational programs for all affected villages and towns to inform the villagers of the dangers of disease, alcohol and drug use.**

XI. Environment

The environment and ecosystem of Bintuni Bay must be protected. In addition to minimizing the environmental impacts in or around the Project site, the Panel recommends that BP enhance conservation efforts in the surrounding areas. Southeast Asia's most extensive intact mangrove area, located 80 kilometers east of the Project in the Cagar Alam nature reserve, will become the focus of the Project's Flagship Biodiversity Action Program. The Panel endorses

this effort as a significant measure that will benefit biodiversity and the environment.²³

As of this date, the AMDAL is not completed or adopted by the Government of Indonesia. BP, government officials and NGOs are engaged in discussions regarding several specific aspects of the AMDAL. The Panel understands that the commitments included in the AMDAL are binding. It recommends that BP implement each of the requirements in the AMDAL fully and in the appropriate time frame.

The Panel also was informed that the Governor of Papua has committed to the local villages that the land on which the Project is located will be returned to them when the facility is closed and decommissioned. However, while the AMDAL discusses the post-operation phase, there may be no specific agreement concerning the condition of the land at that time. The Panel recommends that BP clarify this issue at this time with a commitment to remove all facilities and equipment upon decommissioning and to mitigate any damage to the land utilized so that its obligations are environmentally sound and unambiguous. By this action, this issue will not likely become contentious at a later date.

Recommendations :

- **Safeguard biodiversity in the region and support the flagship biodiversity action program at Cagar Alam.**
- **Support measures to ensure proper environmental management of the facilities and protect Bintuni Bay from any degradation of water quality or other impacts that could affect the marine environment and the livelihoods of the local population.**
- **Implement all requirements of the AMDAL fully and in the appropriate timeframe.**

²³ BP description of the environmental, social & economic aspects of the Tangguh Project, http://www.bp.com/location_rep/indonesia/tangguh_project/enviro.inc?bpcomprintversion=true; viewed July 3, 2002.

- **Commit to removal of all BP facilities and equipment on decommissioning and to the mitigation of any damage to land utilized.**

XII. Public Information

The scope and nature of the Project are unique to Papua. The government and the people are unfamiliar with BP and its policies and intentions. What little precedent exists has the potential to lead to misconceptions and erroneous views of BP. Accordingly, it is particularly important for BP to articulate its positions publicly, clearly and promptly.

First, the Panel recommends that BP continually produce and disseminate information and materials that are descriptive of various aspects of the Project and BP's programs in Indonesia and Papua. This information should be in a form that is understandable and useful to the local communities and their representatives, both governmental and NGOs. To the extent possible, this information should inform the public of the various aspects of the Project and also provide some insight regarding upcoming activities and other firm commitments. Parallel materials should also be developed and prepared for the press, both local and international. The Panel believes this is BP's best insurance against damaging misconceptions and outright untruths.

Second, Tangguh should be prepared at all times to explain promptly and accurately any events that are unplanned and unexpected, including emergencies, mishaps or delays. These developments must not be allowed to be interpreted by others, often inaccurately, leaving BP to respond defensively and possibly after initial perceptions have formed.

Recommendation:

- **Produce and disseminate materials about the Project and BP's programs to provide accurate and current information and avoid misconceptions and untruths.**