MALAYSIA - LAW & PRACTICE

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Malaysia

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General Structure of Petroleum Ownership and Regulation

System of Petroleum Ownership

Prior to 1974, the oil and gas resources in Malaysia were owned respectively by the 13 states forming part of the Federation of Malaysia. In 1974, the federal government enacted the Petroleum Development Act 1974 (PDA) and incorporated the national oil company, Petroliam Nasional Berhad (PETRONAS). PETRONAS is a public limited company wholly owned by the government of Malaysia. The entire ownership, and the exclusive rights, powers, liberties and privileges of exploring, winning and obtaining petroleum onshore and offshore Malaysia were vested in PETRONAS in perpetuity pursuant to the PDA. Each state irrevocably vested its ownership, rights, powers, liberties and privileges in the petroleum by executing the vesting instrument stipulated in the PDA.

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Regulatory Bodies

Upstream petroleum activities in Malaysia are primarily regulated by PETRONAS. It derives its powers from the PDA and the Petroleum Regulations 1974 (PR). All functions relating to the regulation and governance of upstream oil and gas activities in Malaysia is exercised by a division within PETRONAS known as the Malaysia Petroleum Management. PETRONAS awards licences to international oil companies (IOCs) to explore, develop and produce oil and gas onshore and offshore in Malaysia through production-sharing contracts (PSCs) with PETRONAS and PETRONAS Carigali Sdn. Bhd. (PCSB), its wholly-owned upstream exploration and production subsidiary. Pursuant to the terms of the PSCs, PETRONAS regulates the petroleum operations through its approval of well locations, area and field development plans, annual work programmes and budget and procurement of goods and services above a certain monetary threshold. Its approval is also required for the disclosure of any data from the PSC contract area, for any public announcement, or for the sale or assignment of any of the IOCs' interest in the PSC. All senior management for the IOCs' operations in Malaysia must also be approved by PETRONAS.

The PR stipulates that all goods and services for upstream petroleum operations in Malaysia can only be supplied by companies which are licensed by PETRONAS. The PSCs and PETRONAS Procedures and Guidelines for Upstream Activities (PPGUA) have strict provisions relating to procurement of goods and services. Non-compliance with the guidelines or procurement of goods and services from non-licensed companies would bar the contractors from recovering their costs from cost oil or cost gas under the PSCs. All PSC accounts are subject to annual audits by PETRONAS.

Downstream petroleum operations are primarily regulated by the Ministry of Domestic Trade, Cooperative and Consumerism (MDTCC) (www.kpdnkk.gov.my) and the Ministry of International Trade and Industry (MITI) (www.miti.gov.my) pursuant to the PDA and the Industrial Coordination Act 1975 (ICA). MITI issues licences for the refining of petroleum and the manufacturing of petroleum and petrochemical products. MDTCC issues licences for the marketing and distribution of petroleum and petrochemical products, including the operation of retail stations and transportation of such products.

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National Companies

Malaysia’s national oil company is PETRONAS (www.petronas.com.my). As discussed above, pursuant to the PDA, PETRONAS was vested with the entire ownership, and the exclusive rights, powers, liberties and privileges of exploring, winning and obtaining petroleum onshore and offshore in Malaysia. As the owner of the petroleum assets, PETRONAS awards the licence to IOCs to explore, develop and produce oil and gas in Malaysia through PSCs between it, the IOC and PCSB.

PETRONAS is the regulatory authority for upstream petroleum operations on Malaysia. It participates in petroleum operations through its governance, approval and audit processes and also in its participation in the management committee of each PSC.

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Laws and Regulations

The primary petroleum law and regulation in Malaysia is the PDA and the PR. The PDA vested in PETRONAS the entire ownership, and the exclusive rights, powers, liberties and privileges of exploring, winning and obtaining petroleum onshore and offshore in Malaysia. It stipulates that royalty in the form of cash payment shall be paid by PETRONAS to the federal government and to the relevant state governments in return for the ownership, rights, powers, liberties and privileges vested in PETRONAS by virtue of the PDA. It also provides that the marketing and distribution of petroleum and petrochemical products must be licensed by the MDTCC and the refining of petroleum and manufacturing of petrochemical by MITI.

The PR stipulates the types of upstream activities to be licensed by PETRONAS and the downstream activities to be licensed by the MDTCC and MITI. It also sets out the fees payable for the licences.

The Environmental Quality Act (EQA), Merchant Shipping Ordinance 1952 (MSO), Exclusive Economic Zone Act 1984 (EEZA), Merchant Shipping (Liability and Compensation for Oil and Bunker Oil Pollution) Act 1994 (MSOP) and the Continental Shelf Act 1966 (CSA) are the main regulations governing the protection of the environment and the prevention of oil spills and pollution onshore, in Malaysian waters and its exclusive economic zone (EEZ). The EEZA and the CSA also govern petroleum operations in Malaysia's EEZ and continental shelf.

Private Investment in Petroleum – Upstream

Allowed Private Investment in Upstream Interests

Prior to the PDA coming into force, oil companies were granted the right to explore, develop and produce petroleum through concession agreements between the oil companies and the individual state governments in Malaysia. After 1974, private investors were able to obtain the right to explore for, develop and produce petroleum in Malaysia through PSCs and risk service contracts (RSCs) with PETRONAS, and alliance agreements and services contracts with PCSB.

The PSCs and RSCs are awarded by PETRONAS to oil companies. The PSCs give the contractor the right to exploration, development and production of onshore and offshore fields, while the RSCs are for the development and production of small marginal fields. The RSC framework was introduced by PETRONAS in 2011 for the purposes of encouraging the development and production of small and marginal fields. In the early days of the RSCs, IOCs were awarded RSCs. However, in recent years the trend appears to be that RSCs were awarded to Vestigo Petroleum, which is a wholly-owned subsidiary of PCSB.

The alliance agreement and services contract models are typically for blocks where PCSB is the PSC contractor. PCSB enters into the alliance agreements or services contracts with oil services companies for the development and production of the oil fields. Examples of these models include the alliance agreement entered between Halliburton and PCSB for the development of the Bayan field; and the offshore services agreement between Schlumberger and PCSB for provision services related to the enhancement of recovery of reserves at the Semarang field.

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Upstream Licences

Private investors who are interested in obtaining an upstream licence in Malaysia have to formally express their interest to the Petroleum Resources Exploration Department of PETRONAS' Malaysia Petroleum Management (MPM). Apart from regulating and governing upstream oil and gas activities, MPM is also responsible for marketing and promoting Malaysian exploration activities.

In order to register their interest, a private investor must first submit its company profile together with its latest audited financial statement to PETRONAS. MPM will screen the investors based on their submissions and those who pass the screening process will be invited for a data review session. A technical summary of the focus blocks will be sent together with the invitation. Those invited must first sign a confidentiality agreement with PETRONAS prior to the data review session. During the review session only information on the offered blocks will be made available.

If a potential investor is interested in the block, it must then submit a technical evaluation report on its findings two months after it completes the data review of the block together with a written expression of interest (EOI) to participate in the bidding process for the block. After the submission of the EOI, if the potential investor is shortlisted by PETRONAS, it will be invited to participate in a closed tender. It will receive another confidentiality agreement template that it has to sign prior to receiving a bid package for the closed tender from PETRONAS. This confidentiality agreement is different from the one entered into prior to the data review. This second agreement governs the confidentiality of the data and information related to the bid activity. The bid package will consist of: an invitation to bid (ITB); the executed confidentiality agreement; a template for the bid; tender information including rules for submission of the proposal and instructions to bidders relating to conflicts of interest; a draft PSC; a location map; and a location map and coordinates of the block.

If the potential investor wishes to participate in the bidding process for the block, it has to respond to the ITB before a given deadline (usually one month after receiving the bid package from PETRONAS) and submit the following information:

(a) Its company profile;

(b) Geological and geophysical evaluation of the block;

(c) Proposed exploration strategy of the block;

(d) Proposed minimum exploration work for the block; and

(e) Proposed financial commitment for the proposed exploration activities for the block.

The bid submissions will be evaluated by PETRONAS' bid evaluation committee. Upon recommendation from the committee, PREX will conduct a clarification meeting with the shortlisted bidder, during which the bidder is required to explain its bid proposal focusing on the proposed minimum work, financial commitment and exploration strategy. The bidder may be asked to revise their proposal. PETRONAS will conditionally award the successful bidder with an upstream licence after the clarification meeting and submission of its revised proposal (if requested). The awarded investor will be subject to the finalisation and execution of the PSC with PETRONAS and a joint operating agreement (JOA) with PCSB.

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Typical Fiscal Licence Terms

Production Sharing Contracts

There are four types of PSCs all of which have different fiscal terms for the way profit oil and profit gas are shared between PETRONAS and the contractor. The types of PSCs are the 1976 PSC, 1985 PSC, Deepwater PSC and Revenue-over-Cost PSC (R/C PSC). The 1976 PSC was to convert the existing Concession Agreements between Exxon and Shell with the state governments into PSCs. The 1985 PSC was formulated to attract other oil companies besides Exxon and Shell to participate in exploration activities in Malaysia and the Deepwater PSC was targeted at oil companies with deepwater experience. The R/C PSC was introduced in 1996 in order to attract new foreign investment through a smart partnership concept with PETRONAS. Most of the PSCs awarded after 1996 are based on the Deepwater PSC and R/C PSC models.

The fiscal terms of the PSC under upstream licences are entirely contained in the PSC and are enforceable under Malaysian law. Under the terms of the PSCs, the oil companies (referred to in the PSCs as Contractor) are solely responsible for all the exploration, development and production costs of the contract area under the PSC. They bear all the risks associated with petroleum activities. PETRONAS owns all the PSC data and assets and uses the approval mechanism under the PSC and the Work Program and Budget (WPB) to monitor and control the expenditure incurred by the Contractors for the petroleum operations. The costs expended are recoverable from the Contractors' portion of the cost oil and cost gas. The percentage of cost oil/gas from the production volume differs between the PSC models, with the Deepwater and R/C PSCs having a larger percentage of cost oil/gas than the 1976 and 1985 PSCs. The cost oil/gas ceiling in the R/C PSC is on a sliding scale based on the Contractors' revenue-over-cost ratio.

The direct payments the government takes from the oil and gas produced in Malaysia are royalty payments, petroleum tax and export duty. The Contractors pay royalties from the available production volume to the state and federal governments. Ten percent of production volume is deducted by PETRONAS at source and paid to the federal government. The federal government then distributes half of the 10% royalty payment to the relevant state governments.

The production volume, less royalties and cost oil/gas, is shared between PETRONAS and the Contractors as profit oil in accordance with the percentage rate agreed in the PSC. The Contractors' share of the profit oil in the R/C PSC is on a sliding scale based on the Contractors' revenue-over-cost ratio. They are required to make supplemental cash payments to PETRONAS for such portion of the Contractors' profit oil or profit gas that exceeds a specified base price agreed in the PSC. Both PETRONAS and the Contractors are taxed for their share of the profit oil under the Petroleum Income Tax Act 1967 (PITA). Crude oil exported from Malaysia is subject to export duty. A very small percentage of the Contractors' profit oil is paid to PETRONAS as contribution to research and abandonment funds. Under the 1976 and 1985 PSCs, there were requirements for payments of signature and discovery bonuses. However, such payments are no longer required under the Deepwater and R/C PSCs.

Risk Service Contracts

Under the terms of the RSC, PETRONAS retains ownership of assets and hydrocarbon produced. The Contractors are responsible for the field development, production and petroleum operations. There is no concept of cost oil/gas or profit oil/gas in an RSC. The Contractors are entitled to reimbursement of all capital and operational expenditure up to an agreed cap and remuneration fee for the oil and gas produced based on certain key performance indicators stipulated in the RSC.

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Tax Regime

Petroleum (Income Tax) Act 1967

The Petroleum (Income Tax) Act 1967 (PITA) governs the taxation of petroleum income in Malaysia. PITA came into force in 1967 and was initially designed for concession agreements between the IOCs and the state governments. Over the years, it has been amended to accommodate the PSC regime.

Petroleum income tax is charged on the income of every “chargeable person” derived from “petroleum operations” in Malaysia at the rate of 38%. The “chargeable persons” under PITA are PETRONAS, the Malaysia-Thailand Joint Authority and PSC Contractors in respect of each PSC. PSC Contractors are taxed on a per PSC basis on the profit oil and profit gas (less allowable deductions and capital allowances) produced from its operations in Malaysia. PITA allows qualifying exploration expenditure and all outgoings and expenses wholly and exclusively incurred in the production of gross income to be deducted from the gross income. Each PSC is considered as a separate chargeable person. Where a PSC partnership (eg parties to a PSC through a JOA or a shareholding in a company) is party to more than one PSC partnership, its “cost pools” from one PSC partnership cannot be used against revenues from another PSC unless the PSC areas are geographically contiguous.

Malaysia is defined as the territories of the Federation of Malaysia, the territorial waters of Malaysia, its exclusive economic zones and the sea-bed and subsoil of such areas. PETRONAS is also taxed under PITA for the sale within Malaysia of any petroleum obtained outside Malaysia. Income derived from services provided to upstream operations is not taxed under PITA but under the Income Tax Act 1967 (ITA). Income derived from downstream operations is also taxed under ITA.

Tax Incentives

To encourage the development of marginal oil fields marginal fields, enhanced oil recovery, high carbon dioxide gas, high pressure high temperature and deepwater projects, the government introduced new tax incentives through subsidiary legislations. They are as follows:

(a) Petroleum (Income Tax)(Exemption) Order 2013 (Exemption Order);

(b) Petroleum (Income Tax)(Accelerated Capital Allowances)(Marginal Field) Rules 2013 (ACA Rules);

(c) Petroleum (Income Tax)(Marginal Field) Regulations 2013; and

(d) Petroleum (Income Tax)(Investment Allowance) Regulations 2013 (IA Regulations).

They are collectively known as the New Tax Incentives.

The New Tax Incentives took effect in November 2010. The ACA Rules allows for accelerated capital allowance (ACA) on qualifying plant expenditure incurred for petroleum operations in a marginal field. Applying the ACA rate, capital allowance on qualifying plant expenditure can be fully claimed within five years as opposed to ten years based on conventional capital allowance rates. Under the Exemption Order, the Minister exempts a portion of the statutory income derived from petroleum operations in a marginal field, which results in chargeable income derived from marginal fields being taxed at 24.966% instead of 38%.

The IA Regulations provide for an investment allowance equal to 60% of qualifying capital expenditure incurred in that basis period for a year of assessment within a period of ten years in respect of a qualifying project; or on an infrastructure asset as determined by the Minister. A “qualifying project” is a project either: in a field which carries out either enhanced oil recovery, high carbon dioxide gas, high pressure high temperature or any combination thereof; or in an area under a PSC in respect of a deepwater project. It results in a 60% investment allowance in addition to capital allowance and 70% statutory income from a qualifying project is tax exempted equal to the investment allowance available.

Goods and Services Tax

Goods and services purchased or supplied for upstream operations are subject to a goods and services tax (GST) under the Goods and Services Tax Act 2014 (GST Act), which came into force on 1 April 2015. Acquisition of materials, equipment and services for petroleum operations is considered as input to the upstream Contractor. Any GST incurred by the operator under a PSC in purchasing the input is claimable as input tax credit which can be offset against GST charged on the supply of a product. As a general rule, all types of taxable supply pertaining to upstream activities are subject to GST at the standard rate of 6% if they are supplied in Malaysia, except for the exportation of crude oil, condensate and gas which is subject to GST at a zero rate.

Export Duty and Withholding Tax

Export of crude oil, condensate and gas is subject to an export duty of 10% under the Customs Act 1967, and withholding taxes are applicable to payments made to non-residents, eg for technical services, rental of equipment or management services.

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Special Rights to National Companies

As stated above, PETRONAS awards upstream licences to IOCs through PSCs entered with PETRONAS. Under the PSC, the contractor is required to provide on-the-job training to PETRONAS’ personnel. The IOC must also pay a training and education commitments, the amount of which is negotiated between the parties and contractually agreed between them in the PSC.

As a matter of policy, the IOC must enter into the PSC with PCSB, which is PETRONAS's wholly-owned exploration and production arm. The contractual relationship between the IOC and PCSB under the PSC is governed by a JOA between them.

Pursuant to the PSC, PCSB is carried for all exploration costs until the completion of the minimum work commitment and minimum financial commitment (Carried Interest Period). It will not be liable for the costs, expenses and liabilities for exploration work during the Carried Interest Period and has the right to decide the extent of its participation in the PSC at the end of the Carried Interest Period or upon a declaration of commercial discovery. Where the IOC is the operator under the PSC, PCSB has the right to second its personnel to the operator to assist with the petroleum operations, and to request the operator provide on-the-job training for its employees in the operations. The programme and terms and conditions of the training must be mutually agreed on by PCSB and the operator.

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Local Content Requirements

There are no local content requirements for an IOC to enter into a PSC with PETRONAS. The entity of the IOC entering into the PSC can be wholly foreign owned. This is because PCSB is also a party to the PSC.

The Contractors have to undertake the development and training of its Malaysia personnel for all positions, including administrative, technical and executive management positions. They are required under the PSC to annually submit for PETRONAS' approval its plans and programmes for development and training.

With regards to the procurement of goods and services for the petroleum operations under the PSC, the contractors are required to give priority to locally manufactured goods and to purchase the goods and services from suppliers who are licensed by PETRONAS. It is an offence under Petroleum Regulations 1974 for a supplier to supply goods and services to the upstream oil and gas industry in Malaysia without a licence. In order to be licensed, the supplier must comply with the local content requirement stipulated by PETRONAS for the relevant category of supply.

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Development and Production Requirements

Once crude oil is discovered in a commercial quantity in any part of an exploration area under a PSC, the area automatically becomes a development area. No separate approval is required to convert the area from an exploration area to a development area. The Contractor has to then submit a field development plan and an area development plan prior to the expiry of the exploration period. The development area automatically converts to a production area upon first commercial production of crude oil.

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Other Key Terms of Upstream Licences

The exploration, development and production periods under a PSC are expressly stipulated in the PSC. The periods may be extended subject to PETRONAS' approval. The Contractor has to expressly apply for the extension from PETRONAS. There is no provision for automatic extension under the PSC. Any exploration area which has not been converted into a development area at the end of the exploration period is deemed to be relinquished. The minimum work commitment and minimum financial commitment to be completed during the exploration period is based on the Contractor's proposal in its tender for the block as agreed with PETRONAS.

PETRONAS owns all the assets in the contract area and all the data (including samples) acquired in relation to the contract area. The Contractors are prohibited from removing or transmitting the data from Malaysia without PETRONAS' prior written approval. Subject to the terms of the PSC, the Contractors may recover the costs of procuring the assets from its cost oil and cost gas.

The Contractors are entitled to market, lift and export its portion of the cost oil and profit oil. However, Contractors may only sell its share of the cost gas and profit gas together with PETRONAS on a joint-dedicated basis. They are not permitted to sell the natural gas on any other basis. Typically, the Contractors will sell their natural gas to PETRONAS who will then sell the gas to a third party purchaser, or the Contractors and PETRONAS will jointly enter into a gas sale agreement as sellers with a purchaser.

Contractors may terminate the PSC "without cause" by giving at least six months' notice to PETRONAS. They will remain liable for all their obligations under the PSC prior to the termination. PETRONAS may terminate the PSC by giving the Contractors' at least 90 days' notice on the occurrence of any of the events of defaults detailed in the PSC. Where the default is capable of remedy, the Contractors have the right to remedy their default under the PSC and PETRONAS' right to terminate only arises after it has given the Contractor notice of the default and the Contractor fails to remedy the default within the period specified in the notice.

Malaysia is a party to international conventions governing the decommissioning of offshore installations (eg the Geneva Convention on Continental Shelf 1958 and the United Nations Convention on the Law of the Sea 1982) and those which primarily regulate marine pollution but also affect decommissioning activities offshore in Malaysia (eg the International Convention for the Prevention of Pollution from Ships, 1973 and its 1978 Protocol, the International Convention on Oil Pollution Preparedness, Response and Co-operation 1990, the International Convention on Civil Liability for Oil Pollution Damage, 1992 and the International Convention on the Establishment of an International Fund for Compensation for Oil Pollution Damage 1992).

The Contractors are obliged during the term of the PSC to abandon all petroleum facilities that have been approved by PETRONAS as abandoned. They must also contribute to an abandonment cess, which is used to fund the abandonment operations under the PSC. The abandonment cess payments are cost recoverable and a deductible expense under the Petroleum (Income Tax) (Deduction of Abandonment Expenditure) Rules 1997. The Contractors have to conduct the abandonment in accordance with an abandonment work programme and budget that has been approved by PETRONAS, Malaysian law, the PSC and "good, modern and prudent international practice." They are not obliged to undertake the abandonment of any upstream facility after the expiry or termination of the PSC (except to complete any abandonment work which was commenced prior to the expiry/termination of the PSC). The PSC provides that the Contractors will be liable for any damages, claims, costs or expenses arising out of the abandonment operations which are caused by the wilful misconduct or negligence of the Contractors.

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Requirements for Transfers of Interest

Upstream licences can be transferred through the assignment of the licence holder's participating interests (or part of its participating interests) in a PSC. The PSC Contractor must submit to PETRONAS for its approval the names of the proposed bidders and the PSC documents, information and data to be disclosed pursuant to the sale process. All approved bidders must enter into a confidentiality agreement with PETRONAS and the Contractor based on PETRONAS' confidentiality agreement template before the Contractor is permitted to disclose the approved PSC information and data to the bidders.

Once the terms and conditions of the transfer have been agreed on with the proposed purchaser, the PSC Contractor must obtain PETRONAS' prior written approval for the assignment and transfer of its (or part of its) participating interests to the proposed purchaser. The other PSC Contractors (except where the proposed purchaser is a related company) have a first right of refusal in relation to the participating interests to be sold, based on the same price and terms and conditions of the proposed agreement between the farmor and the farmee. Where the proposed farmee is not a related company, the farmor must offer the participating interests to be sold to the other PSC Contractors for the same price and on the same terms and conditions to that agreed with the proposed farmee. The other Contractors have 30 days from the date of the notice to accept the offer. The farmee must also obtain the consent of the other Contractors prior to the sale and transfer of the participating interests to the farmee.

The instrument of transfer is an assignment agreement in the form of a deed of assignment to be entered into between the Contractor (who is the assignor) and the farmee/purchaser (who is the assignee). The terms of a deed of assignment must be approved by PETRONAS prior to signing by the parties. Under Malaysian law, for the assignment to be legally binding, the assignor must notify the other parties to the PSC pursuant to a written notice of assignment. The assignee must also enter into a novation agreement of the JOA with the assignor and the other PSC Contractors. The terms of the JOA novation agreement must be agreed with the other parties to the JOA and approved by PETRONAS prior to execution.

Notwithstanding the transfer and assignment of its (or part of its) participating interests to the assignee, the assignor remains liable for all liabilities and obligations in relation to the assigned interests that have vested, matured or accrued under the PSC and JOA prior to the assignment.

Private Investment in Petroleum – Downstream

Allowed Private Investment

Private investment is allowed in plants (including refineries), wholesale and retail marketing of petroleum and petrochemical products and oil transportation pipelines. Investment by private investors in refineries and petrochemical plants are subject to licence by MITI pursuant to the PDA and Industrial Co-ordination Act 1975 (ICA). Wholesale and retail marketing of petroleum and petrochemical products is licensed by the MDTCC. Under the current guidelines issued by the MDTCC, foreign equity party participation in wholesale and retail marketing of petroleum and petrochemical products is limited to 30%. Construction and operation of oil pipelines are subject to approval by MDTCC.

There is a 120km multi-product pipeline (MPP) on the west coast of Peninsular Malaysia that transports motor gasoline, automotive diesel and jet fuel from the PETRONAS refinery in Melaka, and the Shell and Petron refineries in Port Dickson to the Klang Valley Distribution Terminal and the Kuala Lumpur International Airport. The pipeline is jointly owned by PETRONAS, Shell and Petron (a subsidiary of the San Miguel Corporation of the Philippines). Exxon was a joint owner of the MPP until it withdrew from the downstream market in Malaysia by selling its shares in its Malaysian downstream subsidiaries to Petron.

However, private investments are currently not permitted in relation to the natural gas transmission and distribution networks including pipelines.

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Rights and Terms of Access to Downstream Operation Run by National Monopoly

Peninsular Malaysia has one of the most extensive natural gas pipeline networks in Asia. All the companies that own and operate the gas delivery system in Malaysia are subsidiaries of PETRONAS. The Peninsular Gas Utilisation (PGU) system is owned and operated by PETRONAS Gas Berhad. The regasification terminal in Melaka is owned and operated by Sungai Udang RGT Sdn. Bhd. and the distribution system is owned by Gas Malaysia Berhad.

Access to and supply of gas through the PGU system is regulated by the Energy Commission under the Gas Supply Act 1993 (GSA) and the Gas Supply Regulations 1997. Pursuant to the GSA, a person must be licensed by the Energy Commission in order to supply gas through pipelines.

Any person who wants to have access and use the PGU system has to enter into a gas transportation agreement with PETRONAS Gas Berhad. The agreement regulates the commercial and operational requirements of the gas transportation system as well as the roles and responsibilities of the shipper and the transporter.

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Downstream Licences

Applications for downstream licences are made to the respective ministries. Only companies which are incorporated in Malaysia and registered with the Companies Commission of Malaysia (CCM) may apply for downstream licences.

Applications for permission to market and distribute petroleum and petrochemical products in Malaysia are made to MDTCC. To apply for the permit, the applicant must submit a fully completed Form KPDN(DN)/5 together with the latest print-out from the CCM relating to the company, its latest audited financial statement and an original support letter from the supplier of the petroleum product. There is a minimal application fee of MYR25 per year. Applicants for bunkering, transportation and wholesale activities must pay an amount equivalent of three years' fees, while those for the operation of petroleum retails stations must pay an amount equivalent of five years' fees.

Applications for permission to refine crude oil, manufacture petroleum and petrochemical products and process natural gas are made to MIDA. The applicant is to submit three copies of the completed Form PDA2 to MIDA. Among the information required is the project costs, its equity structure and the percentage of local and foreign equity, authorised capital of the applicant and its shareholders’ funds, manpower for the project, manufacturing process and pollution control, sources of technical know-how, major raw materials and components, and estimated labour costs and earnings.

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Typical Fiscal Terms

Downstream licences do not contain any fiscal terms.

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Tax Regime

The income tax regime for downstream operations is the Income Tax Act 1967 as explained in section **2.4**.

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Special Rights for National Companies

PETRONAS may refine crude oil, manufacture petroleum and petrochemical products and process natural gas without any licence or permission from the government. Section 6(1) of the PDA expressly states that all persons other than PETRONAS requires permission from the prime minister of Malaysia to carry on the business of processing or refining oil and gas or manufacturing petrochemical products.

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Local Content Requirements

The local content requirement for wholesale and retail marketing and distribution of petroleum and petrochemical products is at 70% Malaysian. Foreign participation is restricted to 30%.

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Other Key Terms

The key terms of a downstream marketing and distribution permit are the products that the licensee is permitted to sell in Malaysia. For lubricants and petroleum retail stations, the permit will expressly state the brand name of the product. The permit will usually be granted for a period of three years and will state on the face of the permit the date of expiry. The licensee is required to apply for a renewal of the permit at least three months before its expiry.

Manufacturing licences are typically evergreen and are location specific. It will state the type of products to be refined or manufactured at the refinery or plant. It will also include a condition that any change in control in the license holder will require MITI's prior written approval.

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Condemnation/Eminent Domain Rights

A private investor constructing an infrastructure will obtain land rights either from purchasing or leasing the land from the owner of the land or from the government of the state in which the land is located.

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Third Party Access to Infrastructure

The downstream licences and applicable laws do not provide open access rights to third parties in privately constructed infrastructure.

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Restrictions on Product Sales into Local Markets

Only companies with a valid marketing and distribution permit issued by the MDTCC under the PDA may market and distribute the petroleum and petrochemical products listed below in Malaysia. The companies must be incorporated in Malaysia and registered with the CCM. The products are: petroleum, liquid petroleum gas (LPG), natural gas, motor gasoline, automotive, industrial and marine diesel oil, fuel oil, kerosene, aviation turbine fuel, dual-purpose kerosene and jet-fuel, bitumen and asphalt, lubricants, naphta-based solvents, benzene, ethylene, methanol, propylene, xylene, methane, toluene, propane, butane, acetylene, ammonia and urea from ammonia.

Petroleum and petrochemical products not listed above may be sold in Malaysia without a PDA permit.

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Requirements for Transfer of Interest

Downstream licences are not transferable. Typically the licence conditions would state that any change in the control of the licensee requires prior written approval from the licensing authority. The licensee is also required to notify the licensing authority of any change in its board of directors.

Foreign Investment

Foreign Investment Rules

Foreigners are permitted to invest in the upstream and downstream petroleum sectors in Malaysia. Such investments are regulated by specific guidelines, policies and licensing requirements issued by PETRONAS for the upstream industry; and those issued by the Malaysian Investment Development Authority (MIDA) (on behalf of MITI) and MDTCC for the downstream industry.

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Investment Protections

Investment protection for foreign investors and investments is granted at the national level in Malaysia. They are provided to investors from countries with which Malaysia has entered into bilateral or multilateral investment treaties.

Malaysia signed its first Bilateral Investment Treaty (BIT) with Germany in December 1960. It has since signed at least 68 BITs, of which at least 53 have come into effect. At least 39 of these BITs are publicly available at the time of writing. The publicly available BITs signed by Malaysia generally provide for a relatively broad definition of investment and contain a “fair and equitable treatment” provision as an obligation on the contracting state vis-à-vis qualifying investors and/or investments. Some of Malaysia’s BITs prohibit arbitrary and discriminatory treatment of qualifying investors and/or investments by contracting states. In general, all of the publicly available BITs provide for the “full protection and security” of investments of the other contracting state, and prohibit the expropriation, nationalisation and any other measure having an effect equivalent to the expropriation or nationalisation except if such a measure taken by the host state serves a public purpose, is taken under due process of law, is non-discriminatory in manner and is accompanied by the payment of prompt, adequate and effective compensation. They also contain a Most Favoured Nation (MFN) clause requiring that the treatment of the investments of investors from the other contracting state be no less favourable than that granted to nationals or companies of third states. However, in many of the BITs, certain areas are expressly excluded from the MFN provisions, eg customs unions, free trade areas, common markets and international agreements or domestic legislation relating mainly or wholly to taxation, and some BITs exempt the membership of ASEAN with respect to Malaysia and arrangements concerning frontier trade.

Malaysia is a party to a number of multilateral investment protection treaties. Among them is the the ASEAN Comprehensive Investment Agreement (the ACIA) which came into force on 29 March 2012. Malaysia is one of the founding members of the Association of Southeast Asian Nations (ASEAN) and is a party to the ACIA. The ACIA aims to create a free and open investment environment through the consolidation and expansion of existing agreements between ASEAN member states, and contains substantive investment protections commonly found in BITs, eg provisions on non-discrimination, MFN treatment, fair and equitable treatment, full protection and security, and expropriation. Malaysia has also been a member state of the Asia-Pacific Economic Co-operation

(APEC) since 7 November 1989, the Convention Establishing the Multilateral Investment Guarantee Agency (MIGA) since 6 December 1991 and the World Trade Organisation (WTO) since 1 January 1995.

Arbitration proceedings in Malaysia are governed by the Arbitration Act 2005 (AA), which is based on the UNCITRAL Model Law on International Commercial Arbitration of 1985. The AA applies to both domestic and international arbitrations, which are arbitrations also connected to any state other than Malaysia, eg where the parties have expressly agreed that the subject matter of the arbitration agreement relates to more than one state.

Malaysia is a party to the New York Convention 1958 and the Washington Convention of 1965, which established the International Centre for the Settlement of Investment Disputes (ICSID). ICSID awards and arbitral awards issued in New York Convention member states are enforceable in Malaysia.

Environmental, Health and Safety (EHS)

Principal Environmental Laws and Regulators

The principal environmental laws having jurisdiction over upstream operations, and downstream operations in Malaysia are the Environmental Quality Act (EQA), the Merchant Shipping Ordinance 1952 (MSO), the Continental Shelf Act 1966 (CSA), the Exclusive Economic Zone Act 1984 (EEZA) and the Merchant Shipping (Liability and Compensation for Oil and Bunker Oil Pollution) Act 1994 (MSOP).

The Department of Environment (DOE) (www.doe.gov.my) has jurisdiction over both upstream and downstream petroleum operations in Malaysia. Its primary function is to administer and enforce the EQA and the EEZA and to ensure “the preservation of the environment’s uniqueness, diversity and quality.” The EQA adopts a licensing mechanism as the main environmental permitting tool for control of pollution. The construction of petroleum facilities onshore and offshore requires an environmental impact assessment and must be approved by the director general of environment (DGE). The EEZA stipulates that the installation and operation of any structures, facilities or pipelines within the EEZ requires the approval of the JKZEE, which is a committee comprising representatives from multiple government ministries, led by the MDTCC.

Oil spills and pollution onshore and in Malaysian waters (eg 12 nautical miles from the baseline measured in accordance with the Geneva Convention on the Territorial Sea and Contiguous Zone) are governed by DOE pursuant to the EQA. Spills in Malaysia’s exclusive economic zone are governed by the DOE and the Department of Marine (www.marine.gov.my) pursuant to the MSO, CSA, EEZA and MSOP.

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Principal Health and Safety Laws and Regulators

The principal health and safety laws having jurisdiction over upstream and downstream operations in Malaysia is the Occupational Health and Safety Act 1970 (OSHA), the Factories and Machinery Act 1967 (FMA) and the Petroleum (Safety Measures) Act 1984 (PSMA). The principal health and safety regulator is the Department of Occupational Safety and Health (DOSH) (www.dosh.gov.my).

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EHS in Offshore Development

The PSC requires the contractors to conduct an initial assessment of the environment, health and safety (EHS) risks involved in the execution of petroleum operations in the contract area. They are also required to take appropriate measures to prevent any EHS incidents from occurring offshore and to minimise the consequences of such incidents in the event they do occur. The contractors have to ensure that all its personnel are competent, fully trained, experienced, skilled and certified to carry out the tasks of operating all machinery, equipment and tools offshore. They must also ensure that all personnel comply with PETRONAS's EHS requirements and all safety manual policies and procedures.

The contractors are required to establish an emergency response and preparedness plan and to report to PETRONAS on the occurrence of any EHS incident (including near misses) and to notify the relevant authorities, eg the DOE and the Department of Marine. The contractors have to maintain an accurate incident and injury report and monthly EHS performance statistics.

For offshore transportation and installation, the contractors must also ensure that all marine vessels and equipment used comply with Malaysian legal requirements and PETRONAS' Guidelines for Barges Operating Offshore Malaysia.

These EHS requirements are subject to an annual audit by PETRONAS and the contractors are required to ensure that all gaps found in the audit are addressed to PETRONAS' satisfaction.

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Environmental Obligations

Prior to commencing a major petroleum project, the private investor must conduct an environmental impact assessment (EIA) of the proposed project and obtain approval of the EIA report by the DOE. For upstream operations to be conducted offshore in the EEZ, the operator of the PSC must also obtain the JZKEE's approval to install and operate platforms, pipelines and submarine cables in the EEZ. Installation activities are prohibited in the EEZ without the official approval of JKZEE. The approval process takes approximately six months and must be done through PETRONAS.

Other approvals required include: for the importation of materials and equipment (including communication equipment) for the project; installation of subsea trunk pipelines and onshore pipelines; and approvals for cranes, pressure vessels and machineries on platforms. The contractor must also notify the Department of Fisheries of platform and pipeline installations for the purposes of compensation payments to the fishermen affected by the installation work.

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Requirements for Decommissioning

The legal framework governing the decommissioning of oil and gas structures in Malaysia is provided by several statutes. There is no separate law for onshore and offshore decommissioning. PETRONAS regulates decommissioning of oil and gas structures through the PSCs (and RSCs) and the Guidelines for Decommissioning of Upstream Installations as part of the PETRONAS Procedure and Guidelines for Upstream Activities (PPGUA).

During the term of the PSC, the contractors are responsible for carrying out the abandonment activities of all the petroleum facilities under the PSC. This obligation ceases if the field is relinquished on the expiry or termination of the PSC. The contractors to an RSC do not have any obligation or responsibility to conduct any abandonment works and/or decommissioning of the petroleum facilities and wells after the expiry of the RSC, or at the end of a field life. PETRONAS has the sole obligation to abandon and/or decommission any petroleum facility under an RSC.

The PSC contractors must obtain the approval of PETRONAS before commencing any abandonment or decommissioning operations. The operations must be conducted in accordance with the abandonment work programme and budget approved by PETRONAS. The work programme and budget has to describe in detail the abandonment plan specified in the field development plan of petroleum facilities of the specified field, the detailed plans for the abandonment of petroleum facilities and itemised cost estimates for the implementation of abandonment. Where the contractors are required to undertake decommissioning operations of petroleum facilities of a field during the term of a PSC, the contractors must request from

PETRONAS an amount equal to the cumulative abandonment cess paid by the contractors to PETRONAS or the actual cost of such abandonment operations, whichever is lower. Under the terms of the PSC, the contractors are liable for any damages, claims, costs or expenses arising out the abandonment operations which is caused by the wilful misconduct or negligence of the contractors.

There have been only two decommissioning projects in Malaysia to date. Both these projects were undertaken by Shell. One structure was completely removed from the site and the other, Baram-8, was toppled and converted into artificial reef offshore in Sarawak. The decommissioning of Baram-8 was the first ‘rig-to-reef’ programme in Malaysia. Shell had relinquished the Baram field long after its PSC with PETRONAS. After the relinquishment, Shell was not obliged under the terms of its PSC to decommission the Baram-8. Shell had publicly stated that the agreement to decommission the Baram-8 platform formed part of a separate agreement with PETRONAS. Prior to commencement of the decommissioning operations, Shell had to obtain the approval of PETRONAS and the DOE for the decommissioning plans and they had to engage in extensive consultation with external stakeholders, namely local fishermen associations, village headmen, parliamentary representatives, local councils, government departments and federal and state ministries.

Miscellaneous

Unconventional Upstream Interests

There is currently no special scheme relating to unconventional upstream interests in Malaysia.

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Liquefied Natural Gas (LNG) Projects

The LNG facilities in Malaysia are located in Bintulu, Sarawak. The MLNG facility in Bintulu comprises eight production trains and a total liquefaction capacity of 1.2 Tcf/y, and is operated by three companies: Malaysia LNG Sdn. Bhd. (MLNG), Malaysia LNG Dua Sdn. Bhd (MLNG 2) and Malaysia LNG Dua Sdn. Bhd (MLNG 3). PETRONAS owns a 90% interest in MLNG and a 60% interest each in MLNG 2 ad MLNG 3. The other shareholders of the companies are the Sarawak Government, Shell Gas B.V., Mitsubishi Corporation, Diamond Gas and JX Nippon.

PETRONAS is currently constructing two floating LNG facilities (PFLNG1 and PFLNG 2). Once completed, the floating LNG facilities will be moored offshore Sarawak and Sabah to help “unlock” the gas reserves located in the remote and stranded fields in Malaysia.

The development of LNG facilities in Malaysia requires permission from the prime minister. Section 6(1) of the PDA states that no business of processing oil and gas may be carried out by any person other than PETRONAS unless permission is given by the prime minister. Applications for permission under section 6(1) must be made to MIDA.

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