

# Oil Regulation

*Contributing editor*  
**Bob Palmer**



**2016**

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# Oil Regulation 2016

*Contributing editor*

**Bob Palmer**

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# Malaysia

Christopher Lee and Loy Ee Lin

Christopher & Lee Ong

## General

### 1 Describe, in general terms, the key commercial aspects of the oil sector in your country.

Malaysia is the second-largest oil producer in Southeast Asia behind Indonesia and one of the world's largest exporters of liquefied natural gas. Malaysia is also strategically located on main routes for seaborne energy trade. Malaysia's oil and gas industry have been major contributors to the country's development. It still contributes almost 20 per cent of Malaysia's total gross domestic product.

According to the Oil & Gas Journal, Malaysia held proved oil reserves of 4 billion barrels as of January 2014, the fourth-largest reserves in Asia-Pacific after China, India and Vietnam. Almost all of Malaysia's oil comes from offshore fields, from three producing basins: the Malay basin, the Sarawak basin and the Sabah basin. Malaysia's oil production has been gradually decreasing mainly because of the declining production in the mature basins located in the shallow waters offshore Peninsular Malaysia and Sarawak that have contributed the most to its oil production.

The first producing oil well was sunk by Shell in Miri, Sarawak in 1910. Prior to 1975, petroleum concessions were granted by state governments. Under those concessions, oil companies had exclusive rights to explore and produce oil. The companies then paid royalties and taxes to the state governments. In 1975, the Petroleum Development Act 1975 (PDA) was enacted and the government of Malaysia formed Malaysia's national oil company, Petroleum Nasional Berhad (Petronas).

Petronas is incorporated under the Companies Act 1965. Pursuant to the PDA, Petronas is vested with the entire ownership of (as well as rights, privileges and benefits in relation to exploring and producing) oil and gas, offshore and onshore in Malaysia. In return for the ownership and rights in petroleum resources, the PDA states that Petronas is to make cash payments to the federal government and the relevant state governments.

Pursuant to the Petroleum Regulation 1974 (amended in 1975, 1981 and 1991) (the Petroleum Regulation), Petronas is also the responsible authority for licensing any third-party contractors wishing to participate in upstream petroleum activities, including exploration and exploitation. Petronas is also responsible for licensing goods and service providers operating in the upstream sector, including providers of rigs and drilling services and supply of general goods and services related to upstream operations.

Petronas' wholly owned subsidiary, Petronas Carigali Sdn Bhd (Carigali) is its exploration and production arm. Although not required by law, it is the policy of Petronas that Carigali is one of the contracting parties to each production sharing contract (PSC). Exploration rights are granted to oil and gas exploration companies through the PSC. The successful company explores for hydrocarbons on behalf of Petronas and if oil or gas is discovered during the duration of the PSC, it can subsequently proceed to develop and produce the hydrocarbons resources. The PSC system in Malaysia was introduced in 1976, two years after the incorporation of Petronas. In addition to PSCs, Petronas has also executed risk service contracts (RSC) since 2011 for the development and production of oil from marginal fields. Petronas retains ownership of the oil.

As of December 2013, a total of 151 PSCs had been awarded by Petronas to oil and gas upstream companies, and Petronas had 27 PSC contractors participating in the country's upstream industry on a variety of fiscal arrangements. There have been five RSCs awarded in recent years.

### 2 What percentage of your country's energy needs is covered, directly or indirectly, by oil as opposed to gas, electricity, nuclear or non-conventional sources? What percentage of the petroleum product needs of your country is supplied with domestic production? What are your country's energy demand and supply trends, especially as they affect crude oil usage?

According to Malaysia's Energy Commission Statistics Handbook 2015, Malaysia's primary energy fuel sources for the year 2013 were 35.8 per cent crude oil and petroleum products, 44.1 per cent natural gas, 16.6 per cent coal and coke products, 3 per cent hydropower, 0.2 per cent biodiesel and 0.3 per cent biomass.

According to the Energy Information Administration Statistics (2015), the breakdown of Malaysia's energy consumption in 2012 was oil, 51 per cent; electricity, 21 per cent; liquefied natural gas 21 per cent; biofuels, 4 per cent; and coal, 3 per cent. The Malaysian government has emphasised the need for fuel diversification through coal imports and by promoting investments in renewable energy. Malaysia has maintained its position of being a net exporter of crude oil despite the increase in consumption. However, the net export of crude oil in Malaysia has steadily decreased from 22,000 ktoe in 1990 to 1,000 ktoe in 2012.

### 3 Does your country have an overarching policy regarding oil-related activities or a general energy policy?

The first energy policy in Malaysia was the National Petroleum Policy (1975) with the objectives of bringing about efficient utilisation of petroleum resources for industrial development, as well ensuring that the country exercise majority control in the management and operation of the industry.

Thereafter, the National Energy Policy (1979) was introduced with broad guidelines on long-term energy objectives and strategies to ensure efficient, secure and environmentally sustainable supplies of energy. Three principal objectives were identified to develop the energy sector in Malaysia:

- supply: to ensure the provision of an adequate, secure and cost-effective supply of energy;
- utilisation: to promote efficient utilisation of energy and to discourage wasteful and non-productive patterns of energy consumption; and
- environmental: to minimise the negative impact of energy production, transportation, conversion, utilisation and consumption on the environment.

In 1980, the National Depletion Policy was introduced to prolong the lifespan of the nation's oil and gas reserves and to safeguard the exploitation of natural oil reserves because of the rapid increase in the production of crude oil. The Four-Fuel Diversification Policy (1981) was also introduced to complement the National Depletion Policy to prevent overdependence on oil as the main energy resource with the aim to ensure reliability and security of the energy supply by focusing on four primary energy resources: oil, gas, hydropower and coal.

In 2001, the Four-Fuel Diversification Policy was revised to the Fifth Fuel Policy (2001) where renewable energy was announced as the fifth fuel in the energy supply mix. This policy was put in place as part of the Energy Commission Act 2001 to achieve a safe, cost-effective, secure energy supply. Pursuant to the Energy Commission Act 2001, the Energy Commission became the regulator and enforcer for all matters relating to energy supply activities and laws in Malaysia. In 2006, Malaysia introduced the first National Biofuel Policy, which was under the purview of the Ministry of

Plantation Industries and Commodities Malaysia. In the Eleventh Malaysia Plan (2016–2020) the government continues to emphasise the utilisation of renewable sources of energy and energy efficiency.

Malaysia launched the Economic Transformation Programme (ETP) on 25 September 2010, as part of Malaysia's National Transformation Programme. The goal is to elevate the country to developed-nation status by 2020, targeting gross national income (GNI) per capita of US\$15,000. This will be achieved through the implementation of 12 national key economic areas (NKEAs), representing economic sectors that account for significant contributions to GNI. The largest investment for the ETP goes to oil and gas as more than 20 per cent of GNI comes from the sector. The oil and gas NKEA aims to raise the total GNI contribution to 241 billion ringgit by 2020 from 110 billion ringgit in 2009. This will require the NKEA to grow at a rate of 5 per cent. The NKEA will require an investment of 218 billion ringgit to achieve this goal.

According to the roadmap for the ETP, the government aims to achieve this by focusing on four goals: sustaining oil and gas production, increasing downstream growth, being a leader in Asia for oil field services and building a sustainable energy platform.

#### 4 Is there an official, publicly available register for licences and licensees?

The Petronas website at [www.petronas.com.my](http://www.petronas.com.my) sets out the list of licences for the supply of upstream goods and services. There is no publicly available register for licences and licensees. A contractor wishing to participate in oil exploration and production activities must apply for and receive a licence from Petronas, in the form of a PSC or RSC. The Petronas licensing guidelines set out the general requirements for application of Petronas licences and the equity requirements based on the standardised work and equipment categories (SWEC) applied by Petronas.

#### 5 Describe the general legal system in your country.

The Malaysian legal system has been largely influenced by the English common law. Basically there are two main sources of law in Malaysia, written laws and unwritten laws. Written laws are the laws that are enacted by Parliament or state assemblies that are contained in statutes known as Acts, Ordinances and Enactments, which also extends to subsidiary legislation. Unwritten laws are laws that are not enacted through statutes, and this category of law consists of case law that is the decision of the superior courts, which are binding on lower courts, otherwise known as the 'common law'.

Malaysia practices the concept of constitutional supremacy under which the Malaysian federal Constitution is the supreme law of the land. The federal Constitution sets out the roles, limitations and conferment of powers on various persons and bodies in order to facilitate the orderly and efficacious governance of the country:

- the sovereign of Malaysia (known as the Yang di-Pertuan Agong) and rulers of the states in Malaysia: The constitutional monarch holds the governing powers of the country, which are restricted by the terms of the federal Constitution. Rulers of each of the states in Malaysia are also primarily responsible for the preservation of Malay customary laws and the administration of matters pertaining to the religion of Islam in Malaysia;
- the legislature (Parliament of Malaysia): The Malaysian legislative body is empowered to enact laws and also confer power on Ministers in government ministries to enact subsidiary legislation;
- the executive (prime minister and the cabinet): The Malaysian executive is empowered to administer laws enacted by the legislature; and
- the judiciary (subordinate courts and superior courts of Malaysia): The judiciary is tasked with upholding justice and the interpretation of laws by the legislature. The Malaysian judicial system is structured to include superior courts (consisting of the Federal Court, the Court of Appeal and two High Courts) and subordinate courts (consisting of session courts and magistrate courts).

Certain foreign judgments are enforceable in Malaysia in accordance with the Reciprocal Enforcement of Judgments Act 1957 (REJA). Before a foreign judgment can be enforceable, it has to be registered in the High Court of Malaysia. The registration of foreign judgments is only possible if the judgment was given by a Superior Court from the countries specified in the First Schedule of REJA, which include India, Hong Kong, New Zealand, Singapore and the United Kingdom. If the judgment is not from a country specified under the REJA, the only method of enforcement is by securing a

Malaysian judgment that involves suing on the judgment in the local courts as an action in debt.

The main legislation governing corruption and anti-bribery in Malaysia is the Malaysian Anti-Corruption Commission Act 2009 (MACCA), and the Malaysian Anti-Corruption Commission (MACC) was established as the body responsible for the investigation and prosecution of corruption in the public and private sectors. Anti-money laundering is mainly governed by the Anti-Money Laundering and Anti-Terrorism Financing Act 2001 (AMLA). The AMLA not only criminalises money laundering and terrorism financing, but also imposes various obligations on reporting institutions. It includes measures for the investigation of money laundering and terrorism financing offences and the freezing, seizure and forfeiture of criminal proceeds.

#### Regulation overview

##### 6 Describe the key laws and regulations that make up the principal legal framework regulating oil activities.

The key laws and regulations in relation to oil and activities in Malaysia are:

- the Petroleum Development Act 1974, providing that Petronas is vested with the entire ownership of, as well as rights, privileges and benefits in relation to exploring and producing oil and gas, offshore and onshore Malaysia;
- in addition to having exclusive rights over petroleum onshore and within the territorial seas of Malaysia, the Exclusive Economic Zone Act 1984 and the Continental Shelf Act 1966 extend Petronas' exclusive rights to petroleum to include Malaysia's exclusive economic zone and its continental shelf respectively;
- the Petroleum Regulations 1974, setting out the licensing requirements for upstream and downstream activities of refining, marketing and distribution of oil products;
- the Petroleum (Safety Measures) Act 1984 and the associated regulations govern petroleum transportation, storage and handling;
- Petronas licensing guidelines, essentially setting out the general requirements for application of Petronas licences or registration and the local bumiputra participation requirement for equity, board of directors, management and employees based on the SWEC applied by Petronas.

Petronas has imposed local incorporation and equity requirements for certain activities in the petroleum sector, pursuant to its powers and responsibilities under the PDA and Petroleum Regulations, and accordingly corporations wishing to engage in such activities must comply with such requirements in order to obtain the necessary licences from Petronas for their business operations in Malaysia;

- the Companies Act 1965, setting out the legal basis on which companies are formed, operated and managed;
- the Environmental Quality Act 1974 is the primary legislation governing the protection of the environment and the prevention of oil spills and pollutants on land and in Malaysian waters; and
- the Merchant Shipping Ordinance 1952 is the primary legislation governing licensing of vessels in Malaysia. All vessels engaged in providing shipping services in the Malaysian domestic shipping sector must be licensed by the Domestic Shipping Licensing Board under the Ministry of Transport.

##### 7 Are there any legislative provisions that allow for expropriation of a licensee's interest and, if so, under what conditions?

There is no legislative provision that allows for expropriation of a licensee's interest. However, according to the Petronas licensing guidelines, Petronas has the power to cancel licences, but it is not stated under what conditions.

##### 8 Identify and describe the government regulatory and oversight bodies principally responsible for regulating oil exploration and production activities in your country.

Under the PDA, all upstream activities such as exploration, development and production of resources are regulated by Petronas through PSCs and RSCs that contractors are required to enter into with Petronas in order to acquire the right to explore and produce oil in Malaysia.

Goods and service providers operating in the upstream sector including providers of rigs and drilling services and supply of general goods and services related to upstream operations also require a licence from Petronas.

Under the Petroleum Regulations, the Ministry of International Trade and Industry (MITI) is responsible for regulating the processing or refining of petroleum or manufacture of petrochemical products from petroleum,

and the Ministry of Domestic Trade, Cooperative and Consumerism (MDTCC) is responsible for regulating the marketing and distribution of petroleum and petrochemical products in Malaysia.

#### **9 What government body maintains oil production, export and import statistics?**

The Energy Commission maintains the oil production, export and import statistics of Malaysia. These statistics can be accessed at <http://meih.st.gov.my/statistics>.

#### **Natural resources**

#### **10 Who holds title over oil reservoirs? To what extent are mineral rights on private and public lands involved? Is there a legal distinction between surface rights and subsurface mineral rights?**

Pursuant to the PDA, Petronas is vested with the entire ownership in, and the exclusive rights, powers, liberties and privileges of exploring, exploiting, winning and obtaining oil and gas whether onshore or offshore of Malaysia, which extends to include Malaysia's exclusive economic zone and its continental shelf. In relation to oil and gas, there is no legal distinction between surface rights and subsurface mineral rights.

#### **11 What is the general character of oil exploration and production activity conducted in your country? Are areas off-limits to exploration and production?**

All exploration and production is dependent upon approval by Petronas, and Petronas determines the exploration locations and blocks. Presently, all oil exploration and oil production activities in Malaysia are conducted offshore.

#### **12 How are rights to explore and produce granted? What is the procedure for applying to the government for such rights?**

A contractor wishing to participate in oil exploration and production activities must apply for and receive a licence from Petronas, in the form of a PSC or RSC. The successful contractor explores for hydrocarbons on behalf of Petronas, and if oil or gas is discovered during the duration of the PSC or RSC it can subsequently proceed to develop and produce the hydrocarbons resources. The rights to oil exploration and production can be secured through participating in the Petronas bidding rounds for a PSC or RSC. Alternatively, farm-ins into existing contracts can be undertaken with the prior approval of Petronas.

#### **13 Does the government have any right to participate in a licence? If so, is there a maximum participating interest it can obtain and are there any mandatory carry requirements for its interest? What cost-recovery mechanism is in place to recover such carry? Does the government have any right to participate in the operatorship of a licence?**

It is the policy of Petronas that Petronas' wholly owned subsidiary, Carigali, its exploration and production arm, is one of the contracting parties to each PSC. Carigali's participating interest in each PSC varies. Carigali may also be the operator, but this is not generally the case.

#### **14 If royalties are paid, what are the royalty rates? Are they fixed? Do they differ between onshore and offshore production? Aside from tax, are there any other payments due to the government? Are there any tax stabilisation measures in place?**

Under the PDA, royalties are payable by Petronas to the federal government and each of the thirteen state governments to the extent petroleum production is undertaken in or offshore from the relevant state's shore. The royalty rates to be paid on petroleum production are set in agreements between Petronas and the federal government and each of the 13 state governments. These currently provide for 5 per cent of the value of the petroleum obtained to be paid to the state in which the oil is found, and 5 per cent to be paid to the federal government.

PSC or RSC contractors do not have to pay such royalties. They do, however, have to pay export duty for the export of crude oil.

#### **15 What is the customary duration of oil leases, concessions or licences?**

The term of a PSC or RSC will vary. There will generally be periods for exploration, development and production. The period for production for

PSCs will be up to 20 years and thereafter may be extended from time to time upon an application for extension.

#### **16 For offshore production, how far seaward does the regulatory regime extend?**

According to the Exclusive Economic Zone Act 1984, Malaysia's Exclusive Economic Zone extends to 200 nautical miles from the baselines from which the breadth of its territorial seas is measured. Malaysia has sovereign rights for the purpose of exploring and exploiting natural resources in its exclusive economic zone.

#### **17 Is there a difference between the onshore and offshore regimes? Is there a difference between the regimes governing rights to explore for or produce different hydrocarbons?**

There is no difference between the onshore and offshore regimes as both are governed by the PDA. The PDA regulates the exploration and production of 'any mineral oil or relative hydrocarbon and natural gas existing in its natural condition and casinghead petroleum spirit including bituminous shales and other stratified deposits from which oil can be extracted'.

#### **18 Which entities may perform exploration and production activities? Describe any registration requirements? What criteria and procedures apply in selecting such entities?**

In Malaysia, persons who wish to carry on a business in Malaysia must register under the Companies Act 1965 or Limited Liability Partnerships Act 2012. The Companies Act prohibits a company from carrying on business with fewer than two members for more than six months (although this prohibition is not applicable in respect of a company where the entire issued shares are held by a holding company). However, under the new Companies Bill 2015, companies may be formed by a single person and the prohibition on carrying on business with less than two shareholders no longer applies.

Any Malaysian or foreign company intending to participate in exploration and production activities must apply for and receive a licence from Petronas. The PDA and Petroleum Regulations are silent on what form such licence should take. However, in practice the licence will normally take the form of a PSC or RSC.

The Petroleum Regulations provide that the chair and chief executive of Petronas will process applications for licences and forward such applications to the prime minister for approval. Other than this, neither the PDA nor the Petroleum Regulations stipulate the process for a contractor to apply for or execute a PSC with Petronas.

#### **19 What is the legal regime for joint ventures?**

In Malaysia, there is no separate legal regime for joint ventures in the oil sector. Contracting parties to a PSC can be one or more companies but there must always be at least one company that 'operates' on behalf of all contracting parties. The PSC requires the contractors to enter into a joint operating agreement (JOA) in instances whereby there is more than one contractor to the PSC. The contractual relationship, rights and liabilities are regulated through the JOA. Each party's participating interests and obligations in the joint venture are set out in the JOA.

#### **20 How does reservoir unitisation apply to domestic and cross-border reservoirs?**

If Petronas is satisfied that the strata in a PSC contract area forms a single geological structure or reservoir with another PSC contract area, Petronas may ask affected PSC contractors to unitise the reservoirs. This is a standard provision of PSCs.

For cross-border reservoirs, Petronas will represent PSC contract areas in the international unitisation agreements after consulting with contractors of PSC areas involved on the terms and conditions of the international unitisation. PSC contractors are bound by the terms agreed by Petronas in international unitisation agreements.

#### **21 Is there any limit on a party's liability under a licence, contract or concession?**

The parties' liabilities will be set out in the JOA, PSC or RSC. The PSC requires the contractor to provide all the financing and bear all the risk of exploration, development and production activities in exchange for a share of the total production. The PSC contractors are also required to, among others, submit the work programme and budget annually, seek authorisation prior to incurring any expenditure beyond a certain threshold, and seek

various approvals from Petronas throughout all stages of operations. Failure to comply with these requirements may result in automatic relinquishment back to Petronas of the rights to carry out the operations.

According to the PDA, any person who acts in contravention of any term of condition of any permission granted shall be guilty of an offence and may be liable to a fine not exceeding 1 million ringgit or to imprisonment for a term not exceeding five years or both. If a contravention under the PDA is proved, contraventions committed by any clerk, servant or agent when acting in the course of his or her employment, then the principal shall also be liable for such contravention.

## **22 Are parental guarantees or other forms of economic support common practice? Are security deposits required in respect of any work commitment or otherwise?**

Parental guarantees would be required where a subsidiary is a party to the PSC or RSC. Such parental guarantees need not necessarily be from an ultimate parent but would have to cover all commitments of the subsidiary. Bank guarantees and security deposits are not normally used to cover all commitments. They may be required for specific work commitments or to cover certain operations.

### **Local content requirements**

## **23 Must companies operating in your country prefer, or use a minimum amount of, locally sourced goods, services and capital?**

There are no specific requirements on the use of a minimum amount of locally sourced goods, services or capital. However, such use is encouraged and incentivised through import restrictions or import duties on imports.

There is, however, a clear policy to encourage local equity participation. Malaysia applies local equity participation requirements in various economic sectors. However, the approach taken by the Malaysian government towards local equity participation requirements for the past few years and of late has been a positive one, with the abrogation or liberalisation of local equity participation requirements for different sectors. The precursor to the imposition of local equity participation requirements was the New Economic Policy (NEP). The aim of the NEP was also to ensure that local indigenous people (known as 'bumiputra') became full partners in all aspects of the economic life of the nation. Later, the Malaysian government implemented new policies called the National Development Policy (NDP) and the National Vision Policy (NVP) with the aims of achieving a 'balanced development' within a framework of rapid growth with equity as its primary thrust. In particular, one of the main objectives of the NVP was to achieve at least 30 per cent bumiputra participation in all industries by 2010. The Foreign Investment Committee (FIC) and guidelines regulating foreign participation in acquisition of interest, mergers and takeovers, and acquisitions of properties (FIC Guidelines) was formed to implement the NDP and NVP.

The prime minister has acknowledged the urgent need for Malaysia to undergo a transformation in its pursuit to achieve the status of a developed nation. Hence in 2009, the prime minister announced the removal of the 30 per cent bumiputra equity requirement for 27 services subsectors. Shortly thereafter, on 30 June 2009, the Malaysian government announced further measures to liberalise a host of restrictions on foreign investments in Malaysia, including disbanding of the FIC and the repeal of the FIC Guidelines.

Notably, the Malaysian government has stated that sectoral regulation by the relevant government ministries and agencies continues to apply. As such, there continues to be requirements for local equity participation in foreign investments in certain sectors. The requirements for local equity participation in foreign investments are administered by two methods, namely, legal, via the enforcement under statutes or subsidiary legislations; and non-legal controls, via the Guidelines on Foreign Participation in the Distributive Trade Services published by the MDTCC.

## **24 Describe any local content requirements likely to apply to oil companies operating in your country.**

Companies that wish to supply any goods or services to operators for upstream activities require a licence from Petronas and compliance with the Petronas licensing requirements, including the minimum local equity and paid-up share capital requirements, and the technical and registration requirements as stipulated under the SWEC.

Consequently, foreign companies wishing to supply goods and services to the upstream oil industry in Malaysia must either do so through

an agency agreement with local companies licensed by Petronas, or set up a local subsidiary to be licensed by Petronas pursuant to the PDA and Petroleum Regulations.

### **Transfers to third parties**

## **25 Is government consent required for a company to transfer its interest in a licence, concession or production sharing agreement? Does a change of control require similar approval? What is the process for obtaining approval? Are there any pre-emptive rights reserved for the government?**

According to the MDTCC Guidelines on PDA, a PDA licence may not be transferred unless permission is granted by Petronas.

PSCs or RSCs will typically impose the requirement on a contractor to obtain Petronas' prior approval before any participating interests in the PSCs or RSCs of the contractor may be transferred or assigned to any related party and will also stipulate that the consent of other contractors is also required for an assignment or transfer of a participating interest to a third party (other than a related party), though such consent shall not be unreasonably withheld.

There is no law or regulation that expressly states processes for obtaining approval for change of control. However, the PSC or RSC will typically contain a change in control clause, which requires a contractor to obtain written consent of Petronas before affecting a change in control of the contractor.

The approximate timeline for obtaining approval from Petronas is six weeks to two months.

There are no legislative provisions or guidelines providing pre-emptive rights. Any such rights will be contractual.

## **26 Is government consent required for a change of operator?**

If the operator is a Petronas licence holder, a change of shareholding or control of the operator will require the consent of Petronas under the relevant PSC or RSC.

## **27 Are there any specific fees or taxes levied by the government on a transfer or change of control?**

There are no specific fees or taxes levied by the government on a transfer or change of control. However, stamp duty would be payable on the instrument effecting the transfer or change in control.

### **Decommissioning**

## **28 What laws or regulations govern abandonment and decommissioning of oil and gas facilities and pipelines? In summary, what is the obligation and liability regime for decommissioning? Are there any other relevant issues concerning decommissioning?**

The abandonment and decommissioning of oil and gas facilities and pipelines are regulated by a number of legislation, namely: the Environmental Quality Act 1974 (EQA), the Merchant Shipping (Oil Pollution) Act 1994, the Fisheries Act 1985, the Continental Shelf Act 1966, the Occupational Safety and Health Act 1994 (OSHA), the MSO, the EZZA and the Natural Resources and Environmental Ordinance and Environment Protection Enactment 2002 (Sabah). The legislation dictates that relevant operators in the oil and gas industry must ensure that the abandonment and decommissioning of oil and gas facilities and pipelines are carried out in a safe manner. Furthermore, the abandonment and decommissioning of the facilities must not cause any pollution or interfere with other offshore activities.

Malaysia is a party to various international conventions that regulate the decommissioning of offshore installations, such as the London Dumping Convention 1972/1996, the Geneva Convention on Continental Shelf 1958 and the United Nations Convention on the Law of the Sea 1982. Petronas also 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.

## **29 Are security deposits required in respect of future decommissioning liabilities? If so, how are such deposits calculated and when does their payment become due?**

The PSCs provide for an abandonment cess to be paid to Petronas. The operator is responsible for calculating the cess payments annually in respect of its abandonment work programme and budget and submitting such

calculations to Petronas. The calculation of the annual abandonment cess is by reference to the annual production in million barrels of oil equivalent and an estimated abandonment cost.

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## Transportation

### 30 How is transportation of crude oil and crude oil products regulated within the country and across national boundaries? Do different government bodies and authorities regulate pipeline, marine vessel and tanker truck transportation?

The principal law governing transportation, storage and handling is the PSMA and its associated regulations. The PSMA regulates all modes of transportation of petroleum, including transportation of petroleum by road and railway, by water, and by pipelines.

The PSMA and the Petroleum (Safety Measures) (Transportation of Petroleum by Pipelines) Regulations 1985 (PSMR-Pipelines) govern the transportation of petroleum in pipelines to places including production facilities, tank farms, natural gas processing plants and terminals (covered pipelines). Certain pipelines are excluded from the application of the PSMA, including pipelines within refineries, industrial plants and gas distribution networks.

Under the PSMR-Pipelines, separate authorisations are required for the installation and operation of covered pipelines. To obtain each licence, a contractor must submit an application to the Department of Occupational Safety and Health, which is entrusted by the MDTCC (the original ministry responsible for issuing the licence) to implement the PSMR-Pipelines.

The Petroleum (Safety Measures)(Transportation of Petroleum by Water) Regulations 1985 provides the requirements for vessels carrying petroleum. All vessels carrying petroleum are required to be licensed by the Surveyor of Ships.

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### 31 What are the requisites for obtaining a permit or licence for transporting crude oil and crude oil products?

According to the PDA Guidelines released by MDTCC, the following factors will be taken into consideration in deciding whether or not the licence should be granted:

- private limited companies must have a paid-up capital of no less than 100,000 ringgit;
- the following equity conditions are fulfilled: foreign equity or foreign shareholders must not exceed 30 per cent of the total shareholding of the company and 70 per cent of the shareholding in the company must be held by local citizens, of which 30 per cent are bumiputras; and
- priority will be given to individuals or companies that possess no less than 30 per cent of its equity shareholding held by bumiputras.

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## Health, safety and environment

### 32 What health, safety and environment requirements apply to oil-related facility operations? What government body is responsible for this regulation; what enforcement authority does it wield? Are permits or other approvals required? What kind of record-keeping is required? What are the penalties for non-compliance?

The EQA is the main legislation that governs environmental matters in Malaysia. The Department of Environment was established under the EQA in order to regulate all controls relating to industrial pollution and promote environmental protection.

In general, the EQA and its accompanying regulations require an environmental impact assessment (EIA), project siting evaluation, pollution control assessment, monitoring and self-enforcement to be conducted in relation to prescribed industrial projects. Prior to the implementation of prescribed industrial projects or activities, relevant companies must obtain the following approvals from the director general of Environment Quality:

- an EIA for prescribed activities;
- site suitability evaluation;
- written notification or permission to construct;
- written approval for installation of incinerator, fuel burning equipment and chimney; and
- a licence to occupy and operate prescribed premises and prescribed conveyances.

Under the Environmental Quality (Prescribed Activities) (Environment Impact Assessment) Order 2015, the development and construction of

petroleum related facilities are listed as prescribed activities. An EIA must be carried out and submitted to the director general of Environmental Quality for approval, if the project includes any of the following activities:

- the development of an oilfield, gas field or oil and gas field;
- construction of offshore or onshore pipelines in excess of 30 kilometres in length;
- construction of oil or gas separation, processing, handling and storage facilities; and
- construction of product depot for the storage of petrol, gas or diesel that has the combined storage capacity of 60,000 barrels or more (excluding service station) within three kilometres of any commercial, industrial or residential area.

Any person who carries out a prescribed activity without submitting an EIA report will be committing an offence and shall be liable to a fine not exceeding 100,000 ringgit or to imprisonment for a period not exceeding five years or to both and to a further fine of 1,000 ringgit for every day that the offence is continued after receiving a notice from the director general requiring him or her to comply with the act specified in the notice.

In addition, the EQA expressly prohibits any unlicensed person from discharging or spilling any oil or mixture containing oil into Malaysian waters in contravention of the acceptable conditions specified under the EQA for the emission, discharge or deposit of oil or any mixture containing oil. Any person who breaches the above sections will be guilty of an offence and shall be liable to a fine not exceeding 500,000 ringgit or to imprisonment not exceeding five years or both.

The PSMA also provides that no person shall store or handle any petroleum without obtaining a valid petroleum storage licence, or valid petroleum handling licence granted under PSMA, authorising the storage or handling of petroleum in accordance with such conditions, if any, as may be attached to the licence.

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### 33 What health, safety and environmental requirements apply to oil and oil product composition? What government body is responsible for this regulation; what enforcement authority does it wield? Is certification or other approval required? What kind of record-keeping is required? What are the penalties for non-compliance?

The bodies responsible for setting the standards for oil and oil product composition and regulating compliance with the standards are the Department of Standards Malaysia and the MDTCC, through its Petroleum Safety Unit respectively.

The PDA, PSMA, OSHA and the relevant subsidiary legislation regulate the safety and environmental requirements in relation to oil and oil product composition. Non-compliance with this legislation may attract a fine or imprisonment, or both, upon conviction.

The Environmental Quality (Control of Petrol and Diesel Properties) Regulations 2007 provides that a fuel supplier is responsible for the sampling and testing of each batch of fuel after distillation, blending or import for properties including but not limited to lead, sulphur, benzene, and cetane, as the case may be.

The sample and record collected must be kept for a period of six months from the date of sampling and such information must be provided to the Director General or any authorised officer as and when they request it. Any persons who fail to perform the obligations stated above will be committing an offence and shall be liable to a fine not exceeding 50,000 ringgit or to imprisonment not exceeding two years or both upon conviction.

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## Labour

### 34 What government standards apply to oil industry labour? How is foreign labour regulated and restricted? Must a minimum amount of local labour be employed? Are there anti-discrimination requirements? What are the penalties for non-compliance?

The Employment Act 1955 (EA) applies only to employees whose wages do not exceed 2,000 ringgit a month and certain categories of employees irrespective of their wages, such as manual labourers, supervisors of manual labourers, drivers, domestic servants, etc. For those who do not fall under this category, their rights are dependent on their contract of employment. According to the Employment (Exemption) (No. 2) Order 1997, certain provisions of the EA will not apply to Petronas and any of its contractors and subcontractors provided that they are engaged in the upstream oil industry.



Foreign workers may only be employed provided that they have been issued a valid employment permit as accordance to the Employment (Restrictions) Act 1968. Besides that, pursuant to the Immigration Act 1955, any person who employs a foreign worker who is not in possession of such permit will be committing an offence. Once convicted, the employer of the foreign worker without permit will be charged with a fine not less than 10,000 ringgit but not more than 50,000 ringgit, or to imprisonment for a term not exceeding 12 months, or both, for each employee without a permit.

There is a minimum requirement to be fulfilled in relation to minimum bumiputra participation percentage for companies applying for a Petronas licence based on the applicable SWEC, which can be found on the Petronas website.

As of 1 June 2015, the Construction Industry Development Board (CIDB) requires anyone working in any of a total of 59 skilled trades to be certified by them. In relation to the oil and gas industry, these include riggers, scaffolders and chargemen. Currently, cost of training and assessment for Malaysian citizens is subsidised by the CIDB. Contractors need not pay for any fees in relation to this. However, this is subject to change in the future. Further, Petronas requires forklift drivers, hydrojetters and inert entry technicians to be certified by the National Institute of Occupational Safety and Health.

## Taxation

### 35 What is the tax regime applicable to oil exploration, production, transportation, and marketing and distribution activities? What government body wields tax authority?

The government body responsible for the tax collection and enforcement of tax laws is the Inland Revenue Board of Malaysia (IRB).

The taxation regime that applies to the oil and gas industry arises largely out of the Petroleum (Income Tax) Act 1967 (PITA). Under the PITA, petroleum income tax is chargeable for income derived from upstream exploration and production operations.

As for corporate income derived from non-petroleum operations, it would fall under the general regime of the Income Tax Act 1967 (IT). The statutory term 'petroleum operations' means searching for and winning or obtaining petroleum in Malaysia and any sale or disposal of petroleum so won or obtained, including the transportation of the petroleum to any point of sale, delivery or export. But, it excludes the following:

- any transportation of petroleum outside Malaysia;
- any process of refining or liquefying petroleum;
- any dealings with products so refined or liquefied; and
- services involving the supply and use of rigs, derricks, ocean tankers and barges

Hence, midstream and downstream activities of refining, processing, transportation, marketing and distribution of petroleum and petroleum products will be taxable in accordance with the IT.

Under the PITA, petroleum income tax is levied at the rate of 38 per cent of the income of a chargeable person accruing from petroleum operations. However, reduced rates apply for income from approved marginal fields under the Petroleum (Income Tax) (Petronas Marginal Field) Regulations 2014. Under the marginal field regulations, a 'marginal field' is defined as a field that is specifically designated by the Minister of Finance and that is within the petroleum agreement area that has potential crude oil reserves not exceeding 30 million stock tank barrels or natural gas reserves not exceeding 500 billion standard cubic feet. In such a situation, the statutory income derived from petroleum operations will be taxed at 25 per cent. For petroleum operations derived from a joint development area, the chargeable tax shall be zero per cent for the first eight years; 10 per cent for the next seven years; and 20 per cent for the subsequent years of production.

As stated above, income accruing from non-petroleum operations would be subject to the normal income tax regime, which for the beginning of the year of assessment 2016, shall be 24 per cent.

The normal regime of withholding tax would apply to the oil and gas industry. Withholding tax represents the portion of income of a non-resident payee that is held by a payer in Malaysia as tax and paid directly to the IRB. It is not applicable to resident companies.

A rate of 10 per cent for export duty applies to petroleum crude oil exported from Malaysia. Exportation of certain classes of petroleum products may require an export licence.

Malaysia's Goods and Services Tax (GST) also applies to the oil and gas industry. The Royal Malaysian Customs has issued guidelines on the

## Update and trends

Given current low oil prices, some of the RSCs appear to be non-viable. At least one has been surrendered and there is talk of a renegotiation on others.

In the first quarter of 2016, Malaysia signed on as a member state of the Trans-Pacific Partnership Agreement (TPPA). The TPPA is a free trade agreement comprising 12 members aimed at slashing trade barriers and liberalising trade and foreign investment among member states. It has implications for the Malaysian oil and gas sector as it aims to lower tariffs for the import and export of petroleum products. However, PwC, in its cost-benefit analysis of the TPPA, has asserted that the effect will be small as 74 per cent of Malaysia's exports are to non-TPPA parties. As for foreign investment into the sector, the prime minister's regulatory powers under the PDA remain unchanged, but Malaysia has committed to liberalise 12 goods and services within the oil and gas sector.

application of GST on petroleum upstream and downstream activities. GST is levied and charged on the taxable supply of goods and services made in the course or furtherance of business in Malaysia by a taxable person. GST can only be levied and charged if the business is registered with the Customs Department. A business will only be required to register if its annual turnover of taxable supplies exceeds the prescribed threshold, which has been fixed at 500,000 ringgit per annum. Any business that is not registered may not charge and collect GST on the supply of goods and services made to their customers. GST has been implemented in Malaysia from 1 April 2015 at a standard rate of 6 per cent (replacing the existing sales tax and service tax systems).

## Commodity price controls

### 36 Is there a mandatory price-setting regime for crude oil or crude oil products? If so, what are the requirements and penalties for non-compliance?

The MDTCC, through its powers under the Price Control and Anti-Profitteering Act 2011, is able to make orders regulating the maximum, minimum or fixed price for the manufacturing, producing, wholesaling or retailing of any goods.

In Malaysia, the retail prices of petroleum products, that is petrol, diesel and liquefied petroleum gas, is set through the automatic pricing mechanism. Since December 2014, the MDTCC decided to set the prices of petrol and diesel on a managed monthly float. Prices of petrol and diesel will be reviewed monthly to determine the following month's prices.

The MDTCC also issued the Price Control and Anti-Profitteering (Determination of Maximum Price) (No. 4) Order 2015 to set the maximum price that liquefied petroleum gas can be transacted at by producers, wholesalers and retailers.

Under the Act, it is an offence to buy and sell liquefied petroleum gas above the price set by the Order. Upon conviction, the person shall be liable to a fine not exceeding 500,000 ringgit and 1 million ringgit for subsequent offences if committed by a body corporate. For non-body corporates, the penalty is a fine not exceeding 100,000 ringgit or imprisonment for a term not exceeding three years, or both, and for subsequent offences, a fine not exceeding 250,000 ringgit or imprisonment of five years, or both.

## Competition, trade and merger control

### 37 What government bodies have the authority to prevent or punish anticompetitive practices in connection with the extraction, transportation, refining or marketing of crude oil or crude oil products?

The Malaysian Competition Commission (MyCC) enforces the Competition Act 2010, which generally applies to commercial activities in Malaysia or if the commercial activity is conducted outside Malaysia, it has an impact on competition in any market in Malaysia. All activities regulated under the PDA that are directly in connection with upstream operations comprising the activities of exploring, exploiting, winning and obtaining petroleum whether onshore or offshore of Malaysia are, however, exempted from the Competition Act. Petronas is the regulator of all upstream activities. The MyCC is the regulator having the authority to both prevent and punish anticompetitive practices in connection with non-upstream activities such as the transportation and marketing of crude oil or crude oil products.

**38 What is the process for procuring a government determination that a proposed action does not violate any anticompetitive standards? How long does the process generally take?**

Enterprises are required to conduct self-assessment to determine whether a proposed action violates any anticompetitive standards. The Competition Act 2010, however, empowers the MyCC to grant either an individual exemption for an individual agreement or block exemptions for a particular category of agreements, relieving such agreements from the prohibition against anticompetitive agreements in the Competition Act. The relief is granted only if certain conditions are fulfilled as set out in section 5 of the Competition Act, essentially that there are net economic benefits accruing in permitting such agreements.

Both types of exemptions are granted by the MyCC by way of an order published in the Gazette. In respect of block exemptions, the MyCC is required to publish details of the proposed block exemption, allow at least 30 days for the public to make submissions on the proposed block exemptions and give due consideration to any submissions made.

The process for block exemption can take two years based on the sole block exemption, which has been granted to date by the MYCC. The MyCC's own guidelines make clear that the time taken for the MyCC to issue its decision for exemption varies from case to case as it would depend very much upon the nature and complexity of the application, as well as on the volume of applications that have been filed with the MyCC at that particular juncture.

There is no merger control regime under the Competition Act and no procedure is established for notifying the MyCC of a merger.

**International**

**39 To what extent is regulatory policy or activity affected by international treaties or other multinational agreements?**

International treaties and multinational agreements signed by Malaysia have to be tabled in Parliament and incorporated into Malaysian law before having any legislative force. This is done by either enacting new legislation or amending current legislation to be in line with the signed treaties.

Some of the treaties that Malaysia has signed are of particular relevance to the oil sector:

- the London Dumping Convention 1972/1996;
- the Geneva Convention on Continental Shelf 1958;
- the United Nations Convention on the Law of the Sea 1982;
- 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.

**40 Are there special requirements or limitations on the acquisition of oil-related interests by foreign companies or individuals? Must foreign investors have a local presence (eg, local subsidiary or branch)?**

**Upstream Operations**

There are no special requirements or limitations at law on the participation of foreign companies. Foreign companies must enter into a PSC or RSC with Petronas and comply with the requirements set by Petronas to participate in exploration and production activities.

Companies that wish to supply any goods or services to operators for upstream activities require a licence from Petronas and compliance with the Petronas licensing requirements, including the minimum local equity and paid-up share capital requirements, and the technical and registration requirements as stipulated under the SWEC.

Consequently, foreign companies wishing to supply goods and services to the upstream oil industry in Malaysia must either do so through an agency agreement with local companies licensed by Petronas, or set up a local subsidiary to be licensed by Petronas pursuant to the PDA and Petroleum Regulations.

**Downstream Operations**

Pursuant to the MDTCC PDA Guidelines, foreign companies may only participate in the marketing and distribution of oil products in Malaysia through a locally incorporated subsidiary licensed by the MDTCC, and there are minimum local equity participation and share capital requirements stipulated in the licence.

Similarly, for refining and manufacturing activities, a foreign company must set up a local subsidiary and comply with the conditions set by the MITI. There are no local equity requirements in manufacturing and refining. Foreign companies may set up a 100 per cent-owned subsidiary for this purpose.

**41 Do special rules apply to cross-border sales or deliveries of crude oil or crude oil products?**

The Customs Act 1976 and the Excise Act 1976 and its regulations and orders would apply to cross-border sales and deliveries of crude oil and crude oil products. Approval has to be sought from the Royal Malaysia Customs and Excise Department for such activities.

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