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Marginal fields – Investment opportunities in oil & gas

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Prior to 1974, the Malaysian oil and gas industry was based on the concession system under the Petroleum Mining Act 1966. Due to the energy crisis in the 1960s-1970s and the need for a greater centralised control of the industry, Petroliam Nasional Berhad (PETRONAS) was established under the Petroleum Development Act 1974 (the PDA) and Malaysia adopted the production sharing contract (PSC) regime.

Production sharing concept

By virtue of the PDA, PETRONAS has the exclusive right of exploring, winning and producing petroleum in Malaysia and any person who intends to carry out upstream operations (i.e. the exploration, development and production of oil and gas) must conclude a PSC with PETRONAS.

Under the PSC, all such expenditure incurred in developing the field shall only be recoverable upon commercial production in accordance with the PSC subject to the payment of royalties. The excess oil and/or gas available after cost recovery is treated as profit oil and/or profit gas to be shared accordingly between PETRONAS and the Contractors subject to petroleum income taxes and other payments due under the PSC. Various other obligations such as research cess and abandonment programmes are also imposed on the Contractors.

Risk service contracts regime

However, times have changed as Malaysia is now facing the risk of the depletion of its natural oil and gas resources. As exploration for more petroleum reserves continues due to the ever increasing energy demand for domestic consumption, Malaysia cannot afford to neglect and ignore the need for developing its existing marginal fields. Sources estimated that Malaysia has identified more than 100 marginal fields but most of them have not yet been fully developed. The cost required in developing these marginal fields are somewhat similar to those required for large fields. Thus, the PSC regime may not be attractive to investors as there may not be enough balance of oil/gas for profit sharing purposes.

As part of the efforts to be more dynamic, PETRONAS has recently come up with a new regime to attract international oil and gas companies to invest in the the country's oil and gas industry, i.e. the risk service contract (RSC) regime.

The RSC is a service contract whereby the Contractors provide services to PETRONAS in developing marginal oil fields in return for fees. Like the PSC, all development expenditures are advanced by the Contractors upfront in accordance with the agreed participating interests and most of these expenditures are monitored and approved by PETRONAS throughout the operations.

Under the RSC regime, PETRONAS retains ownership of the petroleum and the contractor is only entitled to remuneration fees for the services provided upon commercial production. Under this regime, such remuneration fees are not subject to petroleum tax but are only subject to tax applicable to corporations in Malaysia. Unlike the PSC regime, no research cess or abandonment commitment is imposed on the contractor.

Incentives for RSC

In 2011, provisions on tax exemption and special treatment for income were introduced in the Petroleum (Income Tax) Act 1967 and the Prime Minister also announced several incentives in the 2013 Budget which include:

(a) a 100 percent income tax exemption for a period of 10 years, exemption of withholding tax and stamp duty on Oil & Gas public private partnership;
(b) a 100 percent income tax exemption on statutory income for the first three years of operations for liquefied natural gas trading companies; and
(c) a reduction from 38 percent to 25 percent on the tax imposed on foreign companies investing in marginal fields.

The first RSC was awarded in 2011 to Kencana Petroleum Bhd, Sapura Crest Petroleum Bhd, and Petrofac Energy Developments Sdn Bhd for the development of the Berantai field, situated offshore Terengganu, Malaysia. Subsequently, the second RSC was awarded to Dialog Group Bhd, Roc Oil Malaysia (Holdings) Sdn Bhd and Petronas Carigali Sdn Bhd for Balai Cluster Fields, offshore Sarawak, and the most recent RSC was awarded to Coastal Energy Co for the Kapal, Banang and Meranti fields.

Exciting times for marginal field developers

The above three RSCs were part of the 27 marginal fields which PETRONAS intends to develop in the near future. This provides investment opportunities for marginal field developers plus other ancillary service providers.

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