

**RESEARCH MANAGEMENT CENTRE**

**INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA**

**CHECKLIST FOR COMPLETION OF RESEARCH PROJECT**

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| **NO.** | **ITEMS** | **✓** |
| 1. | End of Project Report Form |  / |
| 2. | Evidence of Research Report * Printed version of uploaded document in IREP
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| 3. | A copy of seminar paper, conference, proceedings, publications  |  |
| 4. | Attach Original Receipts*(Kindly sort the receipts according to votes / budgets and properly pasted on separate sheets)* |  |

*Note:*

*The research project is considered completed once all the above have been submitted and all disbursed funds have been fully reconciled.*

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**INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA**

**END OF PROJECT REPORT FORM**

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| 1. **RESEARCH DETAILS**
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TITLE OF RESEARCH: The Legal Regulatory Framework for Unfair Risk Allocation in Oilfield Service Contracts in Malaysia

TYPE OF GRANT: RIGS

PROJECT ID: [RIGS16-007-0171](https://rmsv2.iium.edu.my/hor/research/RIGS16-007-0171/detail)

PROJECT START DATE: 1/11/2016

PROJECT END DATE: 30/11/2017

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| 1. **RESEARCHER DETAILS**
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PRINCIPAL RESEARCHER: WAN MOHD ZULHAFIZ BIN WAN ZAHARI

DEPARTMENT/KULLIYYAH/CENTRE: AIKOL

PROJECT MEMBERS:

DEPARTMENT/KULLIYYAH/CENTRE: CIVIL LAW DEPARTMENT

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| 1. **RESEARCH ALLOCATION**
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| **Vote** | **Total Approved budget****(RM)** | **Supplementary Budget Approved (***if any***)****(RM)** | **Total Cumulative Expenditure****(RM)** | **Balance****(RM)** |
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| 1. **EQUIPMENT/ASSET PURCHASED**
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| **No.** | **Item**  | **Placement****(*please state specific location)*** |
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(*Machinery, books, software, IT equipments e.g. laptop, desktop, printer, scanner, digital camera, and others)*

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| 1. **PROJECT ACHIEVEMENT**
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1. **Publications**

1. **Perception of Contractual Risk Allocation in the Oil and Gas Contracts in Malaysia, *International Journal of Trade & Global - IJTGM (Scopus Indexed),* 2017**
2. **Alternative Dispute Resolution (ADR) in Oil and Gas Industry in Malaysia – A New Legal Framework, *Advanced Science Letter (Scopus Indexed),* 2017**
3. **A comparative analysis on the enforceability of knock-for- knock indemnities in Thailand and the United Kingdom, Journal of Malaysian and Comparative Law, 44 (1). pp. 33-42. ISSN 0126-6322 – (Era Indexed)**
4. **Intellectual Property Rights** *(Patent, Industrial Design, Trademark, Copyright, etc.***)**

**-**

1. **Human Capital Development** *(PhD, Masters, Research staff with specialty, etc.***)**

**-**

1. **Commercialization** *(Licensing royalty, spin-off, direct sale, etc.***)**

**-**

Signature of Principal Researcher: …………………………………………

Name : WAN MOHD ZULHAFIZ WAN ZAHARI

Date : 17/11/2017

1. **RESEARCH MANAGEMENT CENTRE**

**COMMENT:**

**VERIFICATION ON RESEARCH OUTPUT:**

1. Book
2. Journal
3. Prototype
4. Patent
5. Commercialization
6. Other (Please specify)

Signature:

Name:

Date:

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| **FULL RESEARCH REPORT****Research Initiative Grant Scheme (RIGS)** |

**Project ID/Title:** [RIGS16-007-0171](https://rmsv2.iium.edu.my/hor/research/RIGS16-007-0171/detail)

**Project Sponsor: International Islamic University Malaysia**

**Author Name(s): Wan Mohd Zulhafiz bin Wan Zahari**

**Department/Kulliyyah/Institute/Centre: AIKOL**

**Abstract:**

Many oilfield service contracts in Malaysia contain an imbalanced allocation of liability and unfair indemnity and hold harmless clauses. Therefore, the legality of oilfield service contracts, and in particular the risk allocation provisions, will be explored and analysed in this study. It is also expected that the findings from this research will shed light on the problem concerning imbalanced risk allocation provisions and unfair indemnity and hold harmless clauses. Combining empirical evidence with legal doctrinal study, this research will propose a regulatory framework and practical measures to the Malaysian legislative body. Thus, a suitable legal mechanism will be proposed in order to solve this problem. The regulations are designed to address the issue of imbalanced risk allocation and unfair indemnity and hold harmless clauses between the operator and contractor in the oilfield service contracts in Malaysia. This study suggests a specific statutory law designed to regulate unfair risk allocation provisions and imbalanced indemnity and hold harmless clauses. The proposed law would seek to protect the interest of contractors in Malaysia and would be called: the Malaysian Oilfield Anti-Indemnity Act.

**Key words:** Oil and gas law, oilfield service contracts, risk allocation, indemnity clauses.

**Introduction:**

This research aims to address the problems and legal issues arising from indemnity and hold harmless clauses in the oil and gas industry in Malaysia. It specifically focuses on risk allocation between the operators and contractors. It also proposes a regulatory framework to protect the respective interests of both parties by drawing inspiration from the indemnity laws in the United Kingdom and the United States of America. Usually contractors argue that the allocation of the risk favours operators, who have greater bargaining power over the contractors. They also claim that the conditions of contract put forward by the operators contain imbalanced risk allocation provisions. These conditions and other Invitation to Bid documents are given to the contractors during the bidding process for negotiation. However, contractors claim that they are not in the position to qualify or change such conditions since they fear not being awarded a contract. In this regard, it is argued that there is unequal bargaining power between the operators and the contractors in allocating the contractual risk under the oilfield service contracts in Malaysia.

**Background:**

Oil and gas projects are risky undertakings. Players in the oil and gas industry have to contend with a wide range of risks[[1]](#footnote-1) such as the risk of destroying the entire facility and the risk of injuring or killing the people on it.[[2]](#footnote-2) For example, in Malaysia on the 26th of January 2012, a Malaysia International Shipping Corporation (MISC) tanker, MT Bunga Alpinia, caught fire in Labuan during methanol loading. [[3]](#footnote-3) This unfortunate accident not only resulted in the loss of life and damage to property but also indirectly caused economic losses since the fire led to disruption at Patau-Patau Power Station.[[4]](#footnote-4) The oil tanker had caught fire and exploded at the jetty of Petronas Methanol Labuan.[[5]](#footnote-5) The facility is part of the Rancha-Rancha industrial zone, which is located on the island of Pulau Enoe, near Labuan. The 38,000 deadweight-tonne MISC tanker was loading six tonnes of methanol when a small fire broke out during a thunderstorm.[[6]](#footnote-6) The fire reportedly spread rapidly, sparking off at least three major explosions that some reported could be felt throughout the island.[[7]](#footnote-7) MISC, a subsidiary of Petronas, confirmed that the accident had claimed five lives.[[8]](#footnote-8) Following the incident, operations at the Patau-Patau Power Station located next to the terminal and the only power station in Labuan were halted for safety reasons.[[9]](#footnote-9) On another occasion, it was reported that five offshore workers were injured (two employees employed by Petronas and three workers employed by the contractors)[[10]](#footnote-10) in an explosion on the 11th of July 2012 at Petronas Tukau B drilling platform located offshore in Sarawak, Malaysia.[[11]](#footnote-11) A similar incident happened on the 10th of May 2012, where one worker was killed and twenty three injured in a gas plant blast at a Petronas gas processing plant in the GPP Complex A, which is located in Kerteh, Teregganu, Malaysia.[[12]](#footnote-12) Some of the victims were working for the contractor servicing the GPP, Hyundai-PFCE Consortium.[[13]](#footnote-13)

It is important to note that injuries to personnel and severe damage to property may result in very large losses for the project participants. Redressing the financial consequences of such risks can be very costly[[14]](#footnote-14) and may cause significant financial setbacks to a business.[[15]](#footnote-15) Industry players usually undertake various measures and practices to manage the risks in order to reduce the exposure. Risk allocation in the industry may be achieved by setting out contractual clauses which declare which party will be liable for (or exempted from) a given risk and to what extent, and enables the risk to be allocated between the parties in advance.[[16]](#footnote-16) The allocation of their respective shares of liability in such events is typically carried out under standard industry contracts, which have been established over many years.[[17]](#footnote-17) Until the Macondo oil spill in the Gulf of Mexico in 2010, these standard models of liability allocation have been largely non-contested, and where reviewed before the courts, have been held to be enforceable.[[18]](#footnote-18) Nonetheless, after Macondo, ‘operators in a wide variety of settings have begun to challenge the traditional allocation of liability or imposed changes to the risk allocation and attempt to negotiate contracts which apportion more liability to contractors in the event of a catastrophic incident.’[[19]](#footnote-19) Making a different assessment, the insurance industry does not anticipate that contractors will take what is regarded as an operators’ risk, nor does it believe the post-Macondo risk allocation accommodates for the eventualities pertaining to contractor liability.[[20]](#footnote-20) Therefore, the insurance industry does not support this change in risk allocation. Moreover, such uneven risk allocation may cause significant financial setbacks to the contractors.

Aside from that, the dominant position of the operator, as well as the existence of a national oil company (Petronas) and its Production Sharing Contractors, has implications for allocation of liability under the oilfield contracts.[[21]](#footnote-21) The reason for this is that the greater bargaining power of these operators compared to contractors in a weaker position in the oil and gas industry allows them to assume that they can impose whatever conditions they wish.[[22]](#footnote-22) In addition, most standard forms of oilfield service contracts used in Malaysia are developed and maintained by operators. Therefore, they tend to be less balanced where risk allocation and fairness of the contractual terms and conditions are concerned.

It could be argued that the lack of national legislation in this field or in an international convention is the principal source of the above-mentioned problem.[[23]](#footnote-23) Without any regulation, contractors could find themselves in a situation where they have no ability to fully mitigate the risk and in which they have no full operational control and decision-making powers.[[24]](#footnote-24) Therefore, this research recommends the enactment of certain legal mechanisms that would guide or even require operators to adhere to the established industry practice. In other words, the Malaysian authorities should pass an appropriate piece of legislation to govern the loss and liability of the project participants in relation to the risk allocation for oil and gas projects. The significance of this study is to achieve fairness with regard to contractual risk allocation between the operator and contractor.

**Objectives:**

1. To identify the actual phenomenon which leads to the problem of imbalanced risk allocation and unfair indemnity and hold harmless clauses in oilfield service contracts in Malaysia.
2. To examine the legal and regulatory framework with regards to risk allocation and indemnity and hold harmless clauses in oilfield service contracts in Malaysia.
3. To recommend a legal and regulatory framework, which provides solutions and alternatives to the issue of imbalanced risk allocation and unfair indemnity and hold harmless clauses in oilfield service contracts in Malaysia.

**Methodology:**

A qualitative research methodology will be used in this research. The qualitative method adopted combines two research designs. Since the research contains a case study, it engages in “empirical legal scholarship”. The purpose of the empirical study is to investigate the prevalence of inequality of bargaining power in the relationship between operators and contractors. The empirical study also explores how risk is allocated between the parties. The empirical evidence illustrates the reality of commercial practice in contractual negotiations in the oil and gas industry in Malaysia. In conducting the empirical study, semi-structured interviews were conducted with the key players in the Malaysian oil and gas industry. This research organised the interviewees into two categories. The first category included oil operating companies. The second category of interviewees included service contractors from different companies. This research in addition adopts a traditional approach to doctrinal legal study. This approach is adopted because it allows for an analysis of judicial interpretation of the law as well as the statutory legislation itself. Such an analysis leads to a more comprehensive and systematic methodology of exploring the instrumental and normative flaws of the laws.

In order to determine the benchmark by which to judge whether a clause is fair or unfair in the Malaysian legal system, it is necessary to engage in a comparative analysis of the UK and the US jurisdictions. Such comparative analysis would allow this research to determine which approach would be the most appropriate for the Malaysian oil and gas industry. Special reference will be made to the practice in the UK and the US. Regarding the judicial interpretation and statutory legislation relevant to risk allocation and indemnity and hold harmless clauses in the oilfield service contracts under both jurisdictions.These jurisdictions are chosen because of their frequent use as the ‘applicable law’ governing international oil and gas contracts. Furthermore, acomparison of the practice in these two legal regimes with the Malaysian system presents an opportunity to make an original contribution to legal scholarship. This is because such comparative analysis produces original research dealing with the subject of imbalanced risk allocation and unfair indemnity and hold harmless clauses in oilfield service contracts in Malaysia, the UK and USA. To the author’s knowledge, this has not been studied previously.

The doctrinal analysis is based on a mix of primary and secondary data, which is taken from several sources.Primary sources of data will be the case laws of the respective jurisdictions, as well as, the statutory laws, which include but are not limited to the Malaysian Contracts Act 1950, the UK Contract (Rights of Third Parties) Act 1999, the Texas Oilfield Anti-Indemnity Act and the Louisiana Oilfield Anti-Indemnity Act. Secondary sources of data are textbooks, journals, newspaper articles and online databases such as Lexis-Nexis, HeinOnline, Westlaw and others.

**Findings:**

It is argued that a special regulation should be implemented in Malaysia to combat unfair risk allocation in the oilfield service contracts between the operators and the contractors.

**Conclusion:**

A special regulation, such as, Oilfield Anti-Indemnity Act should be passed by the Parliament to resolve the issue of unbalanced indemnity and unfair risk allocation in oilfield service contracts in Malaysia.

**Output:**

* **Publications**
1. **Perception of Contractual Risk Allocation in the Oil and Gas Contracts in Malaysia, *International Journal of Trade & Global - IJTGM (Scopus Indexed),* 2017**
2. **Alternative Dispute Resolution (ADR) in Oil and Gas Industry in Malaysia – A New Legal Framework, *Advanced Science Letter (Scopus Indexed),* 2017**
3. **A comparative analysis on the enforceability of knock-for- knock indemnities in Thailand and the United Kingdom, Journal of Malaysian and Comparative Law, 44 (1). pp. 33-42. ISSN 0126-6322 – (Era Indexed)**

**Future Plan of the research:**

There are several areas for future research in relation to unfair risk allocation and imbalanced indemnity and hold harmless clauses in oilfield service contracts in Malaysia.

Firstly, it is necessary to conduct a study on the aspects of Malaysian law which are currently insufficient to support the existing legal framework on risk allocation in oilfield service contracts. For instance, it is essential to research the need to establish a legal framework on mandatory insurance requirements for indemnity and hold harmless clauses in the Malaysian oil and gas legal regime. The research would highlight insurance as an efficient risk management tool in allocating the risk. Secondly, in respect of comparative analysis for future research, it is suggested the scope of discussion could be expanded to other jurisdictions. For example, it will be interesting to explore Norwegian law because that country adopts the knock-for-knock indemnity approach to governing oilfield service contracts. Finally, in view of the importance of environmental awareness, further research could be carried out on the impact of Macondo, such as a study on the reports of the Oil Spill Prevention and Response Advisory Group (OSPRAG). The research would analyse the OSPRAG report in the light of the environmental regulation regime in Malaysia.

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12. Farik Zolkepli, ‘Worker Killed and 23 Hurt in Gas Plant Blast’ *The Star* (11 May 2012) <http://www.thestar.com.my/News/Nation/2012/05/11/Worker-killed-and-23-hurt-in-gas-plant-blast/> accessed on 25 October 2013. [↑](#footnote-ref-12)
13. Ibid. [↑](#footnote-ref-13)
14. Piper Alpha is said to have occasioned a total insured loss of US$3.304 billion; See Hewitt (n2) 178 [↑](#footnote-ref-14)
15. According to the Guardian the Deepwater Horizon incident has led to the dip of BP’s profits by 35%. See Dan Milmo, ‘BP's Deepwater Horizon costs rise $847m’ (TheGuardian 2012) <http://www.theguardian.com/business/2012/jul/31/bp-deepwater-horizon-costs> accessed 28 October 2013. [↑](#footnote-ref-15)
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22. Chris Thorpe, *Fundamentals of Upstream Petroleum Agreements* (C P Thorpe Ltd 2008) 282; Cameron (n17) 213. [↑](#footnote-ref-22)
23. Cameron (n17) 212. [↑](#footnote-ref-23)
24. Ibid. [↑](#footnote-ref-24)