THE LEGAL STRUCTURE AND ATTENDANT PROBLEMS OF THE NATIONAL PETROLEUM CORPORATION OF MALAYSIA

I. *INTRODUCTION*

The national petroleum corporation of Malaysia, Petroliam Nasional Berhad (Petronas), was incorporated under the Companies Act, 1965 (Revised 1973)[1] on 17th August, 1974 as a public company limited by shares. The Petroleum Development Act, 1974,[2] which sanctioned the incorporation of Petronas, received the Royal Assent on 30th July, 1974. Of all the public corporations established recently, it is this one that is potentially the most significant from the nation's economic point of view, and the one which gives rise to many difficult problems relating to its legal form, its powers, its objects and its duties. It is the first, and to date the only, public corporation set up under the Companies Act as a company, whilst at the same time conferred with special powers, privileges, and rights under an Act of Parliament. This article will endeavour to bring to light some of the legal problems that can arise out of the legal structure of Petronas, and also the consequent difficulties and problems that might arise in the corporation carrying out its duties and using the powers conferred upon it. A proper understanding of the nature and extent of the legal implications of the powers and scope of activity of Petronas would help to dispel or affirm many fears surrounding the Petroleum Development Act, 1974, especially among foreign businessmen, and in particular the oil companies operating in Malaysia.

II. *REASONS FOR INCORPORATION OF PETRONAS*

In order to see in perspective the role and powers of Petronas, it is first necessary to appreciate the phenomenal increase in the importance of petroleum in the Malaysian economy over the past two years. Malaysia's domestic needs for petroleum and petroleum products have so far been satisfied by imports, chiefly from the Middle East. Only small quantities of low sulphur crude oil are being extracted in East Malaysia, and this is exported. There are only two modern oil refineries in Malaysia which refine imported crude for local needs. For a developing country like Malaysia cheap energy is crucial. Much of the tremendous development success of the European countries and Japan after the Second World War can be attributed to cheap energy. The recent sky-rocketing prices of oil have brought to an end the era of cheap energy throughout the world. This gave a great impetus to the exploration of new sources of oil throughout the world, including Malaysia. Between 1973 and 1974 a number of oil strikes and natural gas strikes were made off the east coast of Peninsular

[1] Act 125.
[2] Act 144.

Malaysia and East Malaysia. These discoveries made petroleum an important natural resource of the country, its importance being all the greater in view of the high prices of oil and world-wide shortages caused by Arab oil embargoes and cutbacks in production. Hence, whereas previously the Government was quite contented to see the various States in the Federation granting licences for the exploitation of oil to the oil companies, the change in circumstances brought about a radical reassessment of the manner in which the exploitation of oil was to be carried out. At the same time oil-producing countries all over the world were taking a tighter grip over the exploitation of oil, either by nationalisation, or by acquiring substantial interests in the oil companies operating in their respective countries, or by entering into production-sharing agreements. Certainly the previous practice of merely collecting royalties for the amount of oil extracted had completely lost favour. Prior to the setting up of Petronas a number of States in Malaysia, e.g., Pahang and Sarawak, had already entered into some form of production-sharing agreements with the oil companies.

Even though the various States of the Federation were already changing over from collecting royalties to production-sharing, yet the Federal Government still felt that there was a need to set up a central authority to administer the petroleum resources of the country. There are a number of reasons for this. Firstly, there was no harmony and consistency in the various agreements entered into by the States with the oil companies. These differences existed not only as regards the agreements entered into by the different States with the oil companies, but also as between the agreements with different oil companies within one State. Furthermore, it was felt that the States individually did not possess sufficient resources and bargaining strength to obtain the most favourable terms from the oil companies. The Federal Government's feeling on the matter is that production-sharing in itself is not sufficient: the ultimate control of the resources themselves, their exploitation, marketing, distribution, pricing etc. must be under the control of the country. The nation ought also to obtain the maximum benefits of the spin-offs of oil prosperity in terms of employment, downstream[3] industries, transportation and the servicing of the oil industry. It is not enough merely to share in the profits of oil production when a great deal more can be earned as an ancillary to the exploitation of oil. A crucial factor behind the setting up of Petronas is the New Economic Policy as stated by the Prime Minister in his Foreword to the Second Malaysia Plan, especially the redistribution of wealth in the country in order to give Bumiputras (the Malays and other indigenous races) a 30% share in all spheres of commercial and industrial activity in the country by 1990.[4] The Government quickly recognised that control of the petroleum resources would render considerable assistance in achieving the stated targets. Hence control and checks could be maintained on the racial composition of persons employed by the oil companies so as to reflect the national racial composition. But this is a relatively minor matter because there is a total lack of petroleum technology and experienced personnel in the country at the present time, and furthermore the oil industry

[3] The terms "upstream" and "downstream" are used in petroleum jargon as meaning activities relating to the extraction of crude oil, and all other activities dealing with the processing of crude and petro-based products, respectively.
[4] Second Malaysia Plan, 1970-1975 at p. V. and para. 2.

is very capital-intensive, requiring relatively few workers. However, the oil industry would nevertheless be significant in the implementation of the New Economic Policy through spin-off industries that will be created. For example, the supply of food and equipment to the oil rigs could be channelled through local firms with Bumiputra participation; and the Malaysian International Shipping Corporation has already got on order oil tankers and ships to carry natural gas which is expected to be produced from Malaysian oil fields and natural gas fields. The oil companies can be required to use Malaysian tankers and ships for the petroleum extracted from Malaysia. Such advantages can only be obtained if there is uniformity in the approach to the oil companies and if the bargaining strength of the parties is equal.

In order to reap the full harvests of petroleum prosperity it was recognised that it is also very important to obtain control of the downstream industries. These include the refining, marketing and distribution of oil so as to provide energy as cheaply as possible, and in order to be self-reliant in fertilisers, raw materials for plastics and other petroleum products. Again, merely collecting royalties, or obtaining a share of profits through production-sharing, is not enough to secure these benefits. There has to be some form of direct control over at least a proportion of the oil extracted to obtain these advantages as well.

The Government thinking behind the setting up of Petronas and its expected role is reflected in an extract of the speech delivered by the Yang di-Pertuan Agong on the opening of the new Parliament:[5]

> My Government has established the Perbadanan Petroliam Nasional i.e., Petronas, which has been given ownership and control of all matters relating to oil and which will take an active part at all levels of the industry from production to marketing. In this way, my Government will be able to ensure that the people will get the fullest benefit from our rich natural resources. This is in line with our objective to be self-reliant in fields such as fertilizers, raw materials for plastics and other commodities relating to the petroleum industry. Many of our people will have the opportunity to get. employment and to acquire new skills.

III. THE LEGAL FORM OFPETRONAS

The Petroleum Development Act, 1974[6] provides in s. 2(1) that a corporation is "to be incorporated under the Companies Act, 1965, or under the law relating to incorporation of companies". S. 3(1) goes on to provide that "the Corporation shall be styled as the Petroleum[7] Nasional Berhad or in short form Petronas" notwithstanding the provisions of s. 22 of the Companies Act, 1965.[8] As has been pointed out the legal form of Petronas is a peculiar hybrid of a Government company and a statutory corporation. It obtains its legal identity by virtue of incorporation under the Companies Act, and hence is also subject to all the provisions applicable to companies generally, whereas at the same time the Act confers special powers and privileges upon it which would not otherwise be available to a

[5] 5th November 1974.

[6] Act 144, hereinafter referred to as "the Act".

[7] The spelling of this word in the certificate of incorporation of the Corporation is "Petroliam".

[8] S. 22 of the Companies Act deals with the name that may be given to a company.

company. In this section it is hoped to indicate some of the special features of Petronas under its memorandum and articles of association, and how the general law on companies will affect Petronas, especially in its fulfilling of its special role.

(a) *Share Capital*

Petronas is a public company with liability limited by shares. Its authorised share capital is M$500 million divided into 500,000 shares of M$ 1,000 each. At the time of writing[9] the company had issued 10,000 fully paid-up shares. The M$10 million hence obtained by the company is to be used for the initial expenses of setting up the company and its organisation and for its recurrent expenses e.g., salaries, rentals etc. The company is not yet fully operational and it is envisaged that when it does become fully operational it will have to issue further share capital. Under Malaysian law the amount of capital with which a company is registered is only significant in determining the amount of fees to be paid in order to obtain registration. The nominal share capital of a company can be increased at any time by the company passing an appropriate resolution in general meeting, provided that this is authorised by the articles and the resolution complies with the articles.[10] If the articles do not contain a provision authorising an increase in capital, then the company must first pass a special resolution altering its articles [11] to give itself power to do so. Notice of the resolution authorising the increase in capital must be lodged with the Registrar within one month.[12] The company will then have to pay the additional registration fees.[13] Cl. 29 of the articles of association of Petronas provides that the company can increase its share capital by ordinary resolution at any time. Hence, if Petronas at any time finds that it needs to issue shares in excess of its authorised share capital, it merely has to pass a resolution with a simple majority in general meeting sanctioning the increase.

(b) *Shareholders*

Coupled with the share capital structure of the company is the persons who may be permitted to own shares in the company. Cl. 1(2) of the Articles of Association of Petronas provides that "no person or corporation other than the Government of Malaysia shall become or remain a member of the Company." In order to obtain registration of a company the Companies Act requires two individuals to subscribe to the memorandum.[14] This was duly done by Petronas, but these shares have since been transferred to the Government of Malaysia. The Companies Act, s. 36 provides that where the membership of a company falls below two, and the company carries on business for more than six months while the membership is so reduced, then the person who was a member during these six months is personally liable for all debts incurred by the company during that period, and both the company and that person are guilty of an offence under the Act if the company continues to carry on business beyond the

9 July 1975.
10 Companies Act, 1965, s. 62(1).
11 *Ibid.,* s. 31(1).
12 *Ibid.,* s. 62(5).
13 *Ibid.,* Second Schedule, cl. 3.
14 *Ibid.,* s. 14(1).

six months. This provision, therefore, raises the question whether Petronas at the present time is committing an offence and has lost the benefit of limited liability, and also whether cl. 1(2) of its Articles of Association, being contrary to the Companies Act, is invalid. The issue turns on whether the Government of Malaysia is one person or multiple persons. Neither the Companies Act nor the Federal Constitution provides an answer here. However, it is considered that since the Government is a separate legal entity which can sue and be sued [15] in its own capacity it must be regarded as a single unit of separate legal entity. The Companies Act regards all bodies corporate, corporations and companies as single separate entities, so much so that s. 36 of the Companies Act confers an immunity on wholly-owned subsidiaries of holding companies. The Government certainly cannot be classified as a holding company. It would appear, therefore, that cl. 1(2), being contrary to the Companies Act, is invalid.

Another question that arises is why Petronas has been incorporated as a *public* company if its shareholding is to be restricted to the Government of Malaysia only. The advantage of being a public company is the ability to have more than fifty shareholders, and the permitting of free dealings in its shares.[16] Since the articles themselves do not allow the company to have more than one shareholder, the company could just as well have been incorporated as a private company. This would have dispensed with the need to publish a prospectus, or a statement in lieu of prospectus which every public company must do.[17] However, incorporation as a public company does confer certain advantages in borrowing by way of issue of debentures to the public.[18] However, in view of its nature and the reasons for its incorporation, it is unlikely that Petronas will ever issue debentures to the public.

Apart from these special features, the legal form of Petronas under company law is in all other respects just like that of any other company. Its articles make the necessary provisions for compliance with formalities under the Companies Act, e.g., calling of meetings, preparation and submission of accounts, declaration of dividends, appointment and removal of directors, and the taking of minutes. The problems that surround Petronas arise from the co-relationship between company law and the Petroleum Development Act, 1974.

IV. *OBJECTS AND POWERS*

The preamble to the 1974 Act states that it is an Act:

> to provide for exploration and exploitation of petroleum whether on-shore or offshore by a Corporation in which will be vested the entire ownership in and the exclusive rights, powers, liberties and privileges in respect of the said petroleum, and to control the carrying on of downstream activities and development relating to petroleum and its products.

It will be seen from the preamble that Petronas is intended to be the body through which the petroleum resources of the country will be exploited, and that it is to oversee the entire development of the

[15] See, for example, *Stephen Kalong Ningkan* v. *Government of Malaysia* [1968] 2 M.L.J. 238.
[16] Companies Act, 1965, s. 15.
[17] *Ibid.,* s. 50.
[18] *Ibid.,* s. 15(1)(c).

petroleum industry, both upstream and downstream. In order to carry out this role Petronas is to be vested with full and total control of the petroleum resources of the country.

The objects of Petronas under its memorandum of association cover both upstream and downstream matters. Cl. 3 of the memorandum of association provides:

> 3. The objects for which the Company is established are:
>
> (1) To acquire, hold, maintain and keep the ownership, rights, liberties and privileges in respect of petroleum lying offshore and onshore.
>
> (2) To prospect, explore for, produce, exploit, refine, compound, treat, process, manufacture products and by-products from, pipe, store, transport, buy, sell, transfer, distribute, supply and otherwise deal in: petroleum, crude oil, natural gas, and their products and by-products of any kind whatsoever.

It will be observed that although cl. 3(1) is termed an object clause, yet in reality it is a power — the clause gives the company the power to take over the control of the petroleum resources of the country conferred upon it by the 1974 Act. Sub-clause (2) is a genuine objects clause, conferring on the company the object of carrying out upstream and downstream petroleum activities. The objects clause in the memorandum of association contains thirty-three sub-clauses, conferring upon the company the objects and powers to do everything it will ever likely need to do in achieving the purposes for which it was set up, including areas which are not directly related to petroleum. These provisions, taken in conjunction with s. 20 of the Companies Act (which is identical to s. 20 of the Australian Uniform Companies Act), effectively abrogate the spectre of *ultra vires.*

V. *VESTING AND CONTROL OF OIL INDUSTRY*

(a) *Petronas and the States*

The 1974 Act, s. 2(1), vests in Petronas "the exclusive rights, powers, liberties and privileges of exploring, exploiting, winning and obtaining petroleum whether onshore or offshore of Malaysia". Subsection (3) goes on to provide that "the exclusive rights, powers, liberties and privileges so vested shall be irrevocable and shall enure for the benefit of the Corporation and its successor." It is seen, therefore, that this provision vests in Petronas all upstream rights, in effect amounting to the nationalisation of petroleum resources of the country. However, the Act in itself is not sufficient to bring within the exclusive ownership of Petronas the oil resources of the country. Under the Federal Constitution, cl. 2(c) of the State List provides that "permits and licences for prospecting for mines; mining leases and certificates" is within the province of each State. Even though cl. 8(j) of the Federal List gives the Federation power to deal with development of mineral resources, this power is subject to cl. 2(c) of the State List. Hence, before Petronas can have exclusive claim to the petroleum resources of the country, it must first get the various States individually to transfer their jurisdiction over their petroleum resources to it. Each individual State's rights extend to mineral rights within the State's territorial jurisdiction i.e. onshore land. Beyond

that, off-shore mineral rights belong to the Federal Government.[19] Even the Federal Government must first transfer its rights to Petronas before Petronas can claim exclusive control. The form of the agreement whereby the States and the Federal Government are to vest their rights in petroleum to Petronas is provided for in the Schedule to the 1974 Act. In accordance with s. 2(1) of the Act, the vesting is made in perpetuity and enures for the benefit of Petronas and its successors.

In exchange for vesting Petronas with exclusive control over its petroleum resources, each State and the Federal Government are entitled to such cash payment as may be agreed between the parties.[20] Petronas has indicated that the compensation that will be agreed to between itself and the States will give the States a sum equal to what they are in receipt of or would have received from the oil companies under their royalty agreements. It appears from the agreements already made with some of the States[21] that the compensation to be paid is to be calculated by reference to the gross total production of oil and gas from that State. The amount fixed in most cases is five per cent of gross total production. It is doubtful whether this figure represents a true compensation of loss of revenue to the State. No doubt where the States have granted mining rights to oil companies in exchange for royalties, the present figure is fair. But it must be borne in mind that prior to the incorporation of Petronas, after the discovery of large oilfields in Sarawak and Pahang, these States in fact entered into production-sharing agreements with the oil companies, which no doubt would have brought more revenue to the State than five per cent of gross production.

It may also be observed that since mineral rights are a State matter neither the 1974 Act nor any other statute can compel any State to transfer its rights over petroleum to Petronas. Such compulsion can only be effected by an amendment of the Constitution itself. However, should any particular State refuse to fall in line, it will no doubt lose favour with the Federal Government, which could give rise to financial difficulties to the State.

(b) *Petronas and the Oil Companies*

Apart from the relationship between Petronas and the various States, more difficult issues arise in gauging the relationship between Petronas and the oil companies with which the States or Federal Government have already entered into agreements granting them some concession as regards on-shore or off-shore land, respectively. Under the Petroleum Mining Act, 1966 (Revised 1972), a Petroleum Authority[22] can enter into two types of agreements, i.e. grant exploration

[19] S. 1 of the Petroleum Mining Act, 1966 (Revised — 1972), (Act 95), defines "on-shore land" as including the foreshores and submarine areas beneath the territorial waters of the States; and "off-shore land" as meaning the area of the continental shelf.

[20] Petroleum Development Act, 1974, s. 4.

[21] At the time of writing (July 1975) seven States had entered into agreements with Petronas, namely Trengganu, Sarawak, Penang, Kelantan, Perlis, Negeri Sembilan and Perak.

[22] S. 4(3) constitutes the Ruler or the Governor of the State as the Petroleum Authority for on-shore land of the State in which the area in question is situated, and the Yang di-Pertuan Agong as the Petroleum Authority for all off-shore land.

licences or petroleum agreements.[23] Since the agreements were entered into between the oil companies and the individual States or the Federal Government, as the case may be, the question arises as to what extent these agreements affect Petronas, where a particular State has vested Petronas with exclusive rights over its petroleum resources by contract.

Prima facie it would appear that these agreements would continue to operate as between the oil companies and the individual States or Federal Government, as the case may be. At the time these agreements were entered into, Petronas was not even in existence, and it cannot acquire any rights under the agreements due to the doctrine of privity of contract. Hence, if the individual States or Federal Government refused to do so, Petronas cannot compel the oil companies to comply with the terms of their rights under the agreements and enter into fresh contracts with Petronas, until such time as the agreements have run their course. This problem assumes major importance when it is borne in mind that it is the declared policy of Petronas to renegotiate the contracts entered into previously with the oil companies so as to secure a larger slice of the benefits of petroleum exploitation for the country.

The device used to bring to heel quickly recalcitrant oil companies is contained in s. 9 of the 1974 Act. The section provides that the exploration agreements or petroleum agreements entered into under the Petroleum Mining Act, 1966 are to continue for a period of six months from the date of coming into force of the 1974 Act, or for such extended period as the Prime Minister may allow. Most agreements entered into under the Petroleum Mining Act, 1966 are for a period of two years or more. This provision hence prevents the agreements from running their course where the agreement would otherwise have continued for more than six months beyond the coming into force of the 1974 Act. This provision is obviously designed to ensure that the oil companies enter into serious negotiations with Petronas quickly. The problem is whether this provision can effect a frustration of the contracts between the States and the oil companies. This in turn depends on whether the provision is *intra vires* the Federal Constitution. Mineral rights are vested in the individual States under the Federal Constitution. The agreements made between the oil companies and the States are within the scope of the powers of each individual State and comply with the provisions of the Petroleum Mining Act, 1966. Hence, it appears that s. 9 *prima facie* is encroaching into the jurisdiction of the States. If anybody has the power to terminate the agreements, it is the State concerned, either under the express terms of the contract or by passing a State Enactment. *Prima facie* s. 9 cannot be relied upon to prevent the oil companies from continuing operations under contracts which have not expired after the six months are over.

However, the problem must be viewed in the light of the agreements between Petronas and the individual States. If these agreements effect an assignment of the contracts entered into between the States and oil companies by the State concerned to Petronas, then Petronas steps into the shoes of the State. The Schedule to the 1974 Act,

[23] See s. 7 of the Petroleum Mining Act, 1966, for the meaning and nature of "exploration licence", and ss. 8 and 9 for the meaning of "petroleum agreements".

which contains the form that the contract between Petronas and the State must take, provides that the Government of the State concerned "hereby grant in perpetuity and convey to and vest in Petronas the ownership in and the exclusive rights, powers, liberties and privileges of exploring, exploiting, winning and obtaining petroleum whether lying onshore or offshore of Malaysia." The phraseology of the Schedule must be seen in the light of s. 2(1) of the 1974 Act, which vests "the entire ownership in and the exclusive rights, powers, liberties and privileges of exploring, exploiting, winning and obtaining petroleum..." in Petronas. Although neither the Schedule nor s. 2(1) expressly refers to the contracts that already exist as between the States and the oil companies, yet, it is submitted, these contracts have been assigned to Petronas by operation of law, if not by contract. The words of s. 2(1) are wide enough to cover not just the vesting of the actual petroleum resources in Petronas but also the contracts for the exploitation of those resources. Petronas would not have the "exclusive rights" if the contracts between the States and the oil companies continued to subsist as between those parties. The transfer by a State of the exclusive ownership and rights over the petroleum resources of that State must equally operate as an assignment of contracts entered into for the exploration or exploitation of those resources to Petronas. Since Petronas has now stepped into the shoes of the States concerned, it can compel compliance with the terms of the contracts, failing which the contract may be terminated if any of its conditions are broken. At the same time, Petronas can rightfully seek renegotiation of the terms of the contract even before it expires, but cannot compel an oil company to enter into a new contract.

As regards the position of s. 9, since the States have relinquished by express contract their constitutional rights over their petroleum resources and have vested them in a corporation set up by Federal Government, an Act of Parliament can regulate the corporation and the resource. Equally, since by operation of law there was an assignment to Petronas of the contracts entered into by the States with the oil companies, s. 9 will be effective in regulating the duration of those contracts. Hence in the case of contracts which had more than six months to run at the time the 1974 Act came into force, if the Prime Minister does not allow extension of the six months, those contracts will be frustrated. Technically, it is not a breach of contract because it is not Petronas that is terminating the contract, but an outside authority acting under powers given by an Act of Parliament. If it were Petronas that could refuse to extend the period, then there would be a breach of contract for which Petronas would be liable in damages, if the oil company concerned had complied with the terms of the contract.

(c) *Control of Downstream Industries*

The device used to bring the downstream industries within the purview of Petronas also consists of vesting Petronas with the sole right to carry on such business. S. 6(1) of the 1974 Act provides that[24]

> ... no business of processing or refining of petroleum or manufacturing of petro-chemical products from petroleum may be carried out by any

[24] As amended by the Petroleum Development (Amendment) Act, 1975, (Act A290).

person other than Petronas unless there is in respect of any such business a permission given by the Prime Minister.

The Petroleum Development (Amendment) Act, 1975 has added to s. 6(1) of the 1974 Act, "any business of marketing or distributing of petroleum or petro-chemical products.".[25] Hence the entire downstream petroleum sector is now within the exclusive control of Petronas. All future downstream petroleum activities will now be carried out by Petronas, except where the Prime Minister gives his permission for some other person to carry out a particular business. The Prime Minister's permission will no doubt be based on recommendations made by Petronas. Needless to say, Petronas will ensure that ample safeguards are provided for the carrying out of national development objectives, the priority of local demands and proper local participation. In fact permission has recently been granted for the setting up of a joint-venture between the Negeri Sembilan State Economic Development Corporation and middle-eastern interests for the processing of petro-chemicals and gas, under the title "Petrogas". Petronas has also announced recently that all petrol dealers will be required to obtain licences from Petronas. This will enable Petronas to ensure that there is no abuse of the distribution network and also enable it to monitor the extent of bumiputra participation in the distribution of petroleum spirit. However, it must be re-stated that s. 6(1) of the 1974 Act (as amended) applies only to downstream activities intended to be commenced after the passing of the legislation.

As regards those businesses which were already carrying on such activities as are referred to in s. 6(1) before the passing of the 1974 Act, s. 6(2) provides that they may continue to do so but must apply to the Prime Minister for permission to carry on within six months of the passing of the legislation. It is to be noted that the requirement is to apply for permission within six months — not that permission must be *obtained* within six months. Therefore, so long as there is no express refusal, the activity in question may be carried on. The 1975 Amendment Act has now further provided that in granting permission the Prime Minister may impose such terms and conditions as he may deem fit.[26] It is envisaged that this provision will only be exercised to require the business concerned to comply with the New Economic Policy, especially as regards the use of local skills and materials where possible, bumiputra equity participation and the workforce reflecting the nation's racial composition.

The 1975 Amendment Act has also added a further provision, s. 6(5), which creates an offence for failure to comply with the provisions of s. 6 or the terms and conditions imposed by the Prime Minister. The maximum penalty is a fine of one million dollars or imprisonment of up to five years. Where the offence is a continuing one a further fine of up to one hundred thousand dollars per day or part thereof may be imposed. Furthermore, the plant, machinery, tools and other property of the offender, including any petroleum by-products thereof are liable to forfeiture. The 1975 Amendment Act has also included a s. 7B, sub-section (1) of which provides that where an offence has been committed by a company any person who was a director, manager or other similar officer of the company, shall be

[25] *Ibid.,* s.2(c).
[26] *Ibid.,* s. 2(c), forming s. 6(4) of the 1974 Act.

deemed to be guilty of that offence. The penalty of imprisonment, therefore assumes a major deterrent effect, as the decision-makers of the company can be personally punished for the commission of the offence. Furthermore, the officers cannot hide behind the corporate curtain, as the offence is deemed to have been committed by them. The severity of the penalties reflects the seriousness with which Government regards failure to observe its policies on the exploitation of the nation's petroleum resources. It provides a direct challenge to the large and powerful foreign oil companies to comply with government policy or to face the consequences. The need for such extreme penalties may have been felt in view of the fact that many of the large international oil conglomerates have financial resources exceeding those of the Malaysian Government.

It is of interest to note that although it is Petronas that has been vested the right to carry out the downstream activities, yet any new ventures not set up by Petronas, and existing businesses, have to apply to the Prime Minister for permission. This is an important reservation on the power of Petronas, even though the Prime Minister may act on the advice of Petronas; and indeed the applications for permission are channelled through and first vetted by Petronas. Should Petronas ever grow so powerful that it could turn its back to Government policies, provisions of this nature could be used to pull Petronas back into line. It was perhaps with an eye on the relationship between the Indonesian Government and Pertamina that the Malaysian legislation has reserved for the Prime Minister these powers.

One other interesting matter arising from the 1975 Amendment Act is the deletion of the words "or body of persons or company" appearing in s. 6(1) and (2) of the principal Act.[27] As amended, s. 6 applies only to "any person" carrying on the activities in question. The legislation does not contain any definition of the word "person" but it is probable that the word is intended to cover all legal *personae,* natural or artificial. In conjunction with "body of persons or company" the word "persons" could be interpreted to relate to natural persons only, but on its own it is submitted that it has a wider meaning.[28] The amendment is no doubt designed to ensure that no entity involved in any petroleum activity can avoid the terms of s. 6 by virtue of the fact that it is carried on by an entity not falling within those specified in the section.

VI. *CONTROL AND MANAGEMENT OF PETRONAS*

(a) *Appointment of Chairman and Board of Directors*

In accordance with its articles, the sole shareholder of Petronas is the Government of Malaysia. Hence shareholder control over the company will be exercised only by one person, the Government, through its proper representative, presumably the Prime Minister. Under company law, shareholder control can be exercised only through the general meeting. The articles of Petronas do not reserve any special functions or powers to the general meeting, except such powers as are to be exercised in general meeting by law, e.g., the passing of special or ordinary resolutions, the approval of annual

[27] *Ibid.,* s. 2(a) and (b).

[28] But s. 3 of the Interpretation Act, 1967 (Act 23 of 1967) defines "person" as including "a body of persons, corporate or unincorporate".

accounts and annual reports, the fixing of directors' remuneration, appointment and removal of directors and other such formal acts. The fact that Petronas has only one shareholder certainly makes it easier to obtain shareholder approval where necessary, while at the same time making it easier for shareholder control to be maintained. However, the extent of the control of a company's affairs reserved to the company in general meeting under the law is very limited. The general meeting may only lay down general policy, whereas the management and administration of the company must be left to the Board of Directors.[29] This is especially so because the articles of Petronas do not reserve any special powers to the general meeting, except that the Board of Directors may not dispose of the whole or substantially the whole of the undertaking of the company without the consent of the company in general meeting.[30]

One effective means of control over a company is the possession of powers of appointment and dismissal of the board of directors of the company. In the case of Petronas, the most important officer of the company is the Chairman. The power of appointment of the Chairman is not reserved to a meeting of the Board of Directors, as is the usual case, but is vested in the Prime Minister.[31] In making the appointment the Prime Minister may vest the person so appointed with such powers, authorities and discretions as the Prime Minister shall direct, and these powers etc. shall constitute and form part of the articles. The terms and conditions may be agreed between the appointee and the directors, unless fixed by the Prime Minister. If the Prime Minister fails to appoint a Chairman, then the directors may do so. The other service directors, e.g., the Deputy Chairman and Managing Director, are to be appointed by the Chairman, on such terms as the Chairman sees fit.

These provisions are peculiar in a number of respects. Normally, the appointment of the Chairman is reserved to the Board of Directors, or more rarely, to the company in general meeting. Here the power is reserved to the Prime Minister. Although the Prime Minister no doubt represents the Government as the sole shareholder of Petronas, yet the reservation of the power in him is not *vis-a-vis* the Government as shareholder. Furthermore, the Chairman is generally required to be appointed from among the Board of Directors. In the case of Petronas, it appears that anyone may be appointed as Chairman, whether or not at the time of appointment he is already a member of the Board of Directors. This applies not only to an appointment made by the Prime Minister, but also where the appointment is made by the Board of Directors, in the event of the Prime Minister not making the appointment.

As regards the power of the Chairman to make all the executive appointments from amongst the members of the Board, this power is normally vested in the Board itself, the appointments of individual service directors being done collectively by the Board. Even the terms of the appointment are left to the Chairman, and the Chairman

[29] *Automatic Self-Cleansing Filter Syndicate Co.* v. *Cunninghame* [1960] 2 Ch. 34.
[30] Petronas Articles of Association, cl. 85.
[31] *Ibid.,* cl. 65. The first Chairman was Tengku Tan Sri Razaleigh Hamzah.

may delegate such powers as he deems fit to the service directors appointed.[32] The Chairman, when he has been appointed by the Prime Minister, has been given a further power to appoint any other person to be a director either to fill a vacancy or as an addition to the Board.[33]

Although these provisions are somewhat unconventional, they do not contravene the Companies Act. However, they are effective in ensuring tight control of the Company. The Chairman is directly answerable to the Prime Minister and not to the Board (in fact the Prime Minister stated, when he appointed Tengku Tan Sri Razaleigh as Chairman, that the appointment carried Cabinet ranking, although the appointee was not made a Minister as such). Equally, the Prime Minister has to shoulder the responsibility for Petronas in Parliament. At the same time, the answerability of the other service directors directly to the Chairman will ensure that the appointments are carefully made. It will be in the interest of the Chairman to ensure that these appointees carry out their duties properly, failing which he will have to answer to the Prime Minister directly. The possibility of shifting responsibility from one person to another and perhaps even covering up for one another, as can happen where the shareholder control lies only over the Board of Directors collectively, is taken away. In view of the potential importance of the petroleum industry, both economically and politically, it is clear that the Government has thought it best to keep a close watch on Petronas right from the outset.

(b) *Prime Ministerial Control*

The seriousness with which the Government views the importance of the proper control of Petronas is further amplified by s. 3(2) of the 1974 Act, which provides that "The Corporation shall be subject to the control and direction of the Prime Minister who may from time to time issue such direction as he may deem fit." Sub-section (3) further provides that "the direction so issued shall be binding on the Corporation." Hence, the Government has been given legal backing for ensuring that Petronas follows government policy, and the Prime Minister himself has been charged with the task of overseeing the corporation. It is submitted that the statutory power to give directions extends beyond the control exercisable by the company in general meeting, and even applies to management decisions.

Although it is not difficult to appreciate the need for close control of the corporation and the vesting of the power of control in the Prime Minister, yet the manner in which this control has been so vested gives rise to certain problems due to the fact that Petronas is a company registered under the Companies Act. The definition of "director" in s. 4 of the Companies Act provides *inter alia* that a "director" includes "a person in accordance with whose directions or instructions the directors of a corporation are accustomed to act." Hence, the Prime Minister will be regarded as a director of Petronas for purposes of the Act. At common law any person intermeddling with the affairs of a company will have the duties of a constructive

[32] *Ibid.,* cl. 66.
[33] *Ibid.,* cl. 67.

trustee imposed upon him.[34] It is submitted that the possession of the power to give binding directions to the board of directors will make the Prime Minister a constructive trustee in relation to Petronas, especially if the power is exercised. The office of director attracts a number of responsibilities under company law, with which the Prime Minister will have to comply. More precisely, the Prime Minister is placed in a fiduciary relationship towards the company. Apart from questions of liability arising by virtue of making a personal gain out of his position as a director,[35] a director of a company must act in the best interests of the company, i.e., *bona fide* in the interests of the company as a whole. So long as the interests of the nation and Petronas are common there will be no difficulty in the Prime Minister following this principle. But it is possible that at some future time the Prime Minister may make such directions which may affect the profitability of the corporation, but are in the best interests of the nation. In such a case the Prime Minister may be liable for breach of fiduciary duty. However, it is extremely unlikely that the Prime Minister will ever be faced with legal proceedings for breach of this duty. The saving feature lies in the fact that "interests of the company" has been interpreted to mean the interests of shareholders, present and future.[36] In the case of Petronas, the articles provide that there can be only one shareholder, the Government. The interests of the nation, as seen in the light of national policy, will therefore also be in the interests of the shareholders, so that there is in fact no conflict between the two interests. The other feature that will prevent a legal action being brought against the Prime Minister is that a breach of fiduciary duty of this nature can only be remedied by action brought by a shareholder. Since the shareholder is the Government there is no likelihood of an action being brought against the Prime Minister.

However, the Companies Act also makes it an offence to disregard fiduciary duties. S. 132(1) provides that "A director shall at all times act honestly and use reasonable diligence in the discharge of his office". Breach of the provision results in the commission of an offence against the Act, the penalty for which is imprisonment for one year or a fine of two thousand five hundred dollars.[37] Proceedings for any offence under the Companies Act may be brought by the Registrar of Companies, or by any person with the consent of the Minister.[38] Hence the safeguard that the person bringing proceedings must be a shareholder in the case of a civil action is taken away where proceedings are brought for commission of an offence. Accordingly, it is submitted that the present legislation does not provide the Prime Minister with complete legal immunity. The 1974 Act should be amended so as to place the Prime Minister outside the scope of a fiduciary *vis-a-vis* Petronas.

(c) *The National Petroleum Advisory Council*

Whilst on the question of control and supervision of Petronas by persons other than its appointed management, mention may also be

[34] See *Selangor United Rubber Estates Ltd.* v. *Craddock* [1968] 2 All E.R. 1073: *Boardman* v. *Phipps* [1967] 2 A.C. 46.
[35] See Companies Act, 1965, s. 132.
[36] *Savoy Hotel* case (H.M.S.O. 1954).
[37] S. 132(3) (b).
[38] *Ibid.,* s.371(1).

made of the National Petroleum Advisory Council, which is set up by s. 5 of the 1974 Act. Its composition is left to the Prime Minister, with representation from the relevant States. The States represented at the present time are only those with known petroleum resources. The duty of the Council is to advise the Prime Minister "on national policy, interests and matters pertaining to petroleum, petroleum industries, energy resources and their utilisation."[39] The Council is purely advisory, and its advice may be accepted or rejected by the Prime Minister. Since the advice is to be given to the Prime Minister only, there is no liability on the Council under company law. The present membership of the Council consists of the leading financial and economic experts of the country, including representatives from Sabah, Sarawak. Pahang and Trengganu.[40] However, it is significant to note that none of its members have any special expertise in petroleum matters as such. Hence, it is envisaged that the Council will only advise from a general economic and financial point of view.

(d) *Management Powers*

The effective management of Petronas lies in the hands of the Chairman and the executive directors of the company. The articles do not spell out the precise scope of the powers of the Chairman, but as has already been stated above the Prime Minister, when appointing the Chairman, may invest him with such powers, authorities and discretions as he sees fit, and these powers, authorities and discretions are then deemed to form part of the articles.[41] Hence it is up to the Prime Minister to decide what powers he wishes to confer on the Chairman. Obviously, it is intended that the Chairman is to be the most important officer of the company. Accordingly, it is likely that he has been conferred the widest powers, especially when it is borne in mind that the Chairman of Petronas has Cabinet ranking. The other executive directors of Petronas are, in turn, to be appointed by the Chairman, and they may be vested with such powers as the Chairman sees fit.[42]

The provision that such powers that are conferred upon the Chairman are to constitute part of the articles of Petronas raises some problems. Under s. 33(1) of the Companies Act, 1965, the articles of a company form a contract as between the company and its members. The terms of the contract are the various clauses of the articles. Anything outside the articles cannot form part of the contract. It would appear that the powers that are conferred upon the Chairman by the Prime Minister cannot form part of the statutory contract, as they are not contained in the contract at the time it is made. However, since the articles themselves provide that such powers are to constitute part of the articles, then it is possible that these powers may be incorporated by reference in the articles.[43] The better method of achieving the same result would be for the articles to provide that the Chairman shall have all such powers and discretions in running

[39] Petroleum Development Act, 1974, s. 5(2).
[40] See Federal *Government Gazette,* Jil 19 No. 7, 1975.
[41] See *supra,* p. 136.
[42] See *supra,* p. 137.
[43] In *Re New British Iron Co., ex. p. Beckwith* [1898] 1 Ch. 324, the terms of the articles of the company were incorporated by reference in the contract between the company and its directors.

the company, so as to achieve its objects, except insofar as any powers or discretions are reserved to the Prime Minister. This device would also overcome the problem of public notice of the articles. Since the articles are a public document everybody is deemed to have constructive notice of them. In view of the manner in which the articles of Petronas are drafted at present, an outsider dealing with the Chairman or other executive directors of Petronas cannot be said to have constructive notice of the officer's powers, as these do not appear on the face of the articles. Hence, an outsider would be able to rely on the *Turquand Rule*[44] should the transaction between him and the Chairman or an officer appointed by the Chairman be in excess of his actual authority.

It appears that the powers the Prime Minister may vest the Chairman with are additional to the powers that may be exercised by the Board of Directors under the memorandum and articles of the company. Cl. 84 of the articles of association of Petronas provides that the business of the company shall be managed by the Directors who may exercise "all such powers and do all such things as the Company is, by its Memorandum and Articles of Association or otherwise authorised to exercise...". There is clear public notice, therefore, that the Directors have all managerial powers for conducting the business of Petronas. However, there is no public notice of those additional powers and discretions that may be vested in the Chairman, and delegated by the Chairman to the executive directors, in order to enable the company to carry out its other, and more significant role of overseeing the petroleum industry of the country and ensuring that the exploitation of petroleum resources helps in fulfilling national development objectives. It is accordingly submitted that the appointment of the Chairman, and the vesting of powers and discretions in him should at least take the form of a "special resolution",[45] which must be registered with the Registrar of Companies and hence will constitute public notice to all.

(e) *Management Immunity*

Before leaving the subject of management and control of the company, attention may be drawn to cl. 57 of the articles of association of Petronas. Cl. 57 provides:

> Subject to the provisions of the Act, no Director shall be disqualified from contracting with the Company whether as vendor, purchaser or otherwise, nor shall any such contract or arrangement entered into by or on behalf of the Company with any company or partnership of or in which any Director shall be a member or otherwise interested be avoided nor shall any Director so contracting or being such member or so interested be liable to account to the Company for any profit realised by any such contract or arrangement by reason of such Director holding that office or of the fiduciary relation thereby established but the nature of his interest must be disclosed by him at the meeting of the Directors at which the contract or arrangement is determined on, if the interest then exists, or in any other case, at the first meeting of the Directors after the acquisition of the interest. A director shall not vote as a Director in respect of any contract or arrangement or proposed contract or arrangement in which he may be interested as a Director, officer or shareholder of another company or in which he has directly or indirectly any material interest.

[44] *Royal British Bank* v. *Turquand* (1856) 6 E. & B. 327. See Gower, *The Principles of Modern Company Law,* (1969) Stevens, chap. 8, pp. 150-169 for a fuller discussion of the *Turquand Rule* and its implications.

[45] See Companies Act, 1965, s. 152.

This clause seeks to exempt directors from liability where they enter into contracts with the company and thereby make a profit, even though they stand in a fiduciary relationship to the company. The directors may keep whatever profits they make, the only conditions being that they must first disclose their interest in the contract and must not vote. It is somewhat surprising to find such a provision in the articles of Petronas, especially because Petronas is a Government company and is expected to help achieve national objectives. If anything, a higher standard of integrity ought to be required of officers of this company, all the more so because public resources and funds are at stake. In any event, it is of interest to examine the extent to which the clause is successful in protecting the directors from liability.

Firstly, as regards the requirement that the director must disclose the nature of his interest, the disclosure must comply with s. 131 of the Companies Act. The section lays down minimum requirements for disclosure which must be complied with, failure to do so resulting in criminal liability, although the contract itself may be validated by the articles.

Secondly, cl. 57 also seeks to protect directors from liability to account for breach of fiduciary duties. Stringent fiduciary duties are imposed on directors both at common law and under the Companies Act, 1965.[46] If fiduciary duties could be excluded by the articles, it would make a mockery of the entire concept of duties of directors, especially the duty to act in good faith. The whole concept of fiduciary duties hinges around the duty to act in good faith. Furthermore, any effort to exempt directors from their duties are nullified by s. 140(1) of the Companies Act, 1965, which provides

> Any provision, whether contained in the articles or in any contract with a company or otherwise, for exempting any officer or auditor of the company from, or indemnifying him against, any liability which by law would otherwise attach to him in respect of any negligence, default, breach of duty or breach of trust of which he may be guilty in relation to the company, shall be void.

VII. *MANAGEMENT SHARES— SECTION 6A*

The Petroleum Development (Amendment) Act has added an important new provision to the 1974 Act, i.e., s. 6A. Briefly, every company carrying on any downstream petroleum business is required to issue to Petronas at least one per cent of its share capital, in the form of management shares.[47] Where the company is quoted on the Stock Exchange, the price for the issue is to be the prevailing market price of the ordinary shares on the day of the issue, and in the case of an unquoted company, the price for the issue is to be a fair and reasonable price, as determined by the Prime Minister.[48] The management shares allotted to Petronas are to rank *pari passu* with the ordinary shares of the company in relation to dividends, bonuses and rights issues, return of capital, and participation in the surplus assets of the company upon liquidation.[49] The significant advantage attached to the management shares is that each management share is to have

[46] S. 132.
[47] S. 6A(1) and (2).
[48] *ibid.,* sub-sections (2) and (3).
[49] *Ibid.,* sub-section (5).

five hundred votes for every share on a resolution for the appointment or dismissal of a director, or any member of the staff of the company. In all other respects the shares carry the same voting rights as ordinary shares.[50] Failure to comply with the section makes the relevant company guilty of an offence punishable upon conviction by a fine of up to one million dollars or to imprisonment of up to five years, or both, and in the case of a continuing offence, a fine of one hundred thousand dollars for each day that the offence continues.[51]

(a) *Take-Over Jitters*

It is the first time that legislation has ever been passed in Malaysia under which a business can be required to transfer shares to a person compulsorily. The implications of the provision are far-reaching, from both the economic and legal points of view.

From the economic point of view, the first impression that is formed is that the provision is designed to enable the possible complete take-over of the relevant company. It is to be noted that the *minimum* number of shares required to be allotted to Petronas is one per cent: Petronas can rely on the legislation to have any number of shares allotted to it. However, the shares allotted to Petronas will come from the fund of shares not yet issued, so that the shares already issued will not be affected. But, Petronas can require the relevant company to issue to it management shares equal to its existing issued shares, in which case Petronas would obtain effectual control of the company. Furthermore, should the relevant company increase its issued capital by issuing further shares, one per cent of every such issue must be designated for Petronas as management shares. Where the relevant company has already issued shares up to its authorised capital, in order to comply with the requirement to issue shares to Petronas, the company will simply have to increase its authorised share capital.[52] It is evident, therefore, that there is the potential for the provisions to be used so as to bring the relevant company under the control of Petronas. Although this does not amount to nationalisation in the true sense of the word, yet ability to control the utilisation and disposition of the assets of a company by a government-owned company is not a feature of free enterprise. This is especially true in the case of foreign enterprises, in the light of recent statements by government officials and Ministers, calling for greater control of foreign enterprises to ensure compliance with the aspirations of development objectives under the New Economic Policy.

The legal scope of the provision must be balanced with its actual use by Petronas, in the light of the aims behind it and the position of the economy of the country as a whole. It must be remembered that the Malaysian economy is dominated by foreign businesses, especially in the rubber, tin, commercial and industrial sectors. Furthermore, the rapid rate of growth of the country can be attributed to the attractive investment climate in the country, which has brought in many foreign businesses. The Government frequently embarks on promotions of the country overseas to bring in more foreign invest-

[50] *Ibid.,* sub-section (6).
[51] *Ibid.,* sub-section (11).
[52] Companies Act, 1965, s. 62, provides for the manner in which authorised share capital may be increased.

ment. Under the New Economic Policy, however, joint ventures between foreign and local partners are given greater incentives, and to this end many public enterprises have been set up by the Government, both at State and Federal level. Foreign investors provide a very important stop-gap in those areas of management and technical skills lacking in Malaysia at the present time. One of the main attractions to foreign investors in this country has been the relative political stability and the non-interference by Government in the disposition of the control of the business and its assets. Should Petronas rely on the legislation to assume control of any company it would considerably undermine foreign business confidence in the country, and this would result in a draining of capital out of the country. There will also be a substantial loss of much needed foreign managerial and technical skills. Such an incident would set the growth of the country back many years. Furthermore, the professed intentions behind the legislation do not pertain to the assuming of control of downstream petroleum businesses. Both the Prime Minister and the Chairman of Petronas have made frequent public statements to the effect that there is no intention to nationalise any business. The reasons underlying the provision have been said to be to ensure national control over resources, to extend bumiputra participation in the petroleum industry, to provide for planned growth of downstream activities, to enforce co-operation between Petronas and the more recalcitrant oil companies, and generally to enable Petronas to have an ear to the ground of the trend of thinking and activity of downstream oil companies.[52A]

The question that inevitably arises is whether it was necessary to pass s. 6A, i.e., whether the above purposes could not have been achieved by other means. As regards national control over resources, the 1974 Act itself vests in Petronas the sole ownership over petroleum resources. Furthermore, s. 6A is restricted to those companies engaged in the downstream sector only. The most important resource used here is capital. Capital requirements of these companies here in the past have been met either from overseas or by competition with other industries in the financial market locally. Government does not exercise much control over the granting of loans to businesses by commercial banks, other than the normal controls exercised by Bank Negara (the Central Bank). However, should the company wish to make a public issue of shares, or wish to borrow through a government agency or enter into a joint venture with a State or Federal agency, or wish to obtain tax benefits, then Government does exercise a considerable degree of control. Conditions are frequently imposed as regards the proportion of output that may be exported and that which must be allotted for local consumption, the employment of bumiputra workers, the use of local raw materials and local equity participation. The Petroleum Development Act, 1974 (as amended) itself requires all downstream businesses to obtain the Prime Minister's consent within six months of the passing of the legislation. The permission granted by the Prime Minister may be coupled with conditions

[52A] *Editor:* In the wake of a storm of protests from oil companies and disturbed foreign investors, the chairman of Petronas recently announced that there would no longer be any question of foreign oil companies having to issue management shares to Petronas. Although this announcement appeared to herald the demise of the management share concept, there was no indication that s. 6A would be removed from the statute book. See "Malaysia: the Yamani touch", *Far Eastern Economic Review,* 18th June, 1976, p. 56.

that will ensure that the company complies with Government policy. The Government can also rely on the Industrial Co-Ordination Act, 1975,[53] which requires every person engaged in a manufacturing activity to obtain a licence, and in issuing the licence the Minister may impose such conditions as he sees fit.[54] It would appear, therefore, that the Government has more than sufficient ammunition to ensure proper compliance with Government policy. To make for better co-ordination in the oil industry the various powers of Government could be delegated to Petronas for petroleum matters. The one thing that the existing legislation does not enable Petronas to do is to obtain an insight into the operations of oil companies at management level, and hence the need for the appointment of a director to the board of the company concerned. This result can, however, be achieved without the requirement for the issue of management shares, either by passing legislation requiring oil companies to accept as a member of their board a Petronas representative, or by imposing a condition to that effect in the permission granted by the Prime Minister to continue operations, or in the licence granted under the Industrial Co-Ordination Act, 1975. It must be remembered that requiring oil companies to issue management shares cannot be used to force them to enter into production-sharing agreements: s. 6A only applies to companies carrying on downstream activities.

(b) *Legal Ramifications*

As regards the legal implications of s. 6A itself, the first point to note is that the provision only applies to companies, be it public or private, with a share capital. Hence if any downstream activity is carried on by a business unit such as a partnership or sole proprietorship, or even a company without a share capital, e.g., a guarantee company, then s. 6A is ineffective. However, it is probable that if any business is carried on by a unit other than a company with a share capital, in granting permission under s. 6 the Prime Minister will impose the condition that it is to form a company.[55]

Once issued, the management shares rank *pari passu* with the ordinary shares of the company, except that on a resolution for the appointment or dismissal of any member of the staff of the company, each management share carries 500 votes. This extra voting right does not in itself secure the appointment of a Petronas representative to the board of any company, if Petronas holds merely the minimum one per cent shares in the company, as Petronas could still be outvoted in spite of the loading in its favour. In order to ensure the appointment of its representative to the board of such a company, Petronas will have to acquire more than the one per cent, so as to have a majority vote on a resolution for the appointment or dismissal of a director. Such a move could be self-defeating. It could bring to the fore the fears of the foreign investor (which have already been mentioned).

However, a person appointed by Petronas as its representative to the board of an oil company is put in a precarious position. As director of the company, he must disregard the special interests he

[53] Act 156.
[54] *ibid.,* s. 3(1) and s. 4(4).
[55] See s. 6A(8) of the 1974 Act (as amended).

represents and have regard only to the benefit of the company as a whole, i.e., the general body of shareholders. The interests of the general body of shareholders may not necessarily be in common with the interests of Petronas. If the director acts in the interests of Petronas only and disregards the interests of the shareholders as a whole, he exposes himself to an action for breach of fiduciary duty. Indeed, any agreement between the nominee director and Petronas that the nominee is to act in accordance with the instructions of Petronas will be illegal.[56]

The price at which the shares are to be allotted to Petronas is stated to be the market price of the ordinary shares prevailing at the date of the issue in the case of a quoted company, and a fair and reasonable price as determined by the Prime Minister in the case of any other company. Objections may be raised as to the manner in which the price of the shares has been fixed in the 1974 Act. In the case of an unquoted company the matter is left to the discretion of the Prime Minister. The Prime Minister is certainly not a neutral by-stander in the matter, and protests may be raised against his valuation. It would have been best to have provided for the valuation to be done by an independent valuer. As regards the quoted companies, the prevailing quoted price may not reflect the true value of the shares, due to market conditions. Furthermore, the quoted price does not take into account the value of the very significant advantage attached to the management shares, especially when that advantage can be used to secure control of the management of the company.

This in turn raises the question whether the provision is *ultra vires* the Federal Constitution, Article 13. Article 13 provides that no person may be deprived of property save in accordance with law, and no law may provide for the acquisition of property without adequate compensation. Hence, the question is whether the price stipulated for the issue in s. 6A is adequate compensation. Although there are no Malaysian authorities on the matter, in India "compensation" has been equated with market price.[57] Failure to take into account the special privilege attached to the management shares in determining the price will not reflect a true market price of those shares. However, closer examination shows that Article 13 does not apply to the present situation at all. This is in view of the word "property". S. 98 of the Companies Act, 1965, provides that "shares … *of any member* in a company shall be movable property." Although shares are, therefore, classified as property, they must be in the hands of a member to qualify as such. In the case of s. 6A of the 1974 Act (as amended), the shares are required to be *issued* by the relevant company. Until such time as they are issued and are held by a person they cannot be classified as property under s. 98 of the Companies Act, 1965. Accordingly, no question of adequate compensation, or indeed any compensation under Article 13 of the Federal Constitution, can arise.

[56] See *Boulting* v. *Association of Cinematograph, Television and Applied Technicians Union* [1963] 2 Q.B. 606; *Selangor United Rubber Estates* v. *Craddock* [1968] 2 All E.R. 1073; *Scottish Co-operative Wholesale Society Ltd.* v. *Meyer* [1959] A.C. 324.

[57] See *State of West Bengal* v. *Bella Banerji* A.I.R. 1974 S.C. 170; *State of West Bengal* v. *Subodh Gopal Bose* A.I.R. 1954 S.C. 92.

It may also be argued that the special voting rights attached to the management shares are "property", and Article 13 will therefore apply to these. However, there is in fact no *deprivation* of any voting rights, even if these can be considered as property.[58] Until the shares have been allotted, there are no voting rights in existence, and once the shares have been allotted with the prescribed voting rights there is no taking away of the rights then attached to those shares. It must also be remembered that a company, as a legal entity, cannot itself possess voting rights in itself. Furthermore, the special voting rights attached to the management shares allotted to Petronas apply only in one limited circumstance. The only deprivation that can arise is when Petronas uses its special voting power to secure management of the company. In such a situation it is arguable that since the company concerned has been ousted from managing the company, there has been deprivation of property, i.e., management rights. However, it has been held in India that management rights are not property rights.[59] Accordingly, there is nothing in s. 6A of the 1974 Act to which Article 13 of the Federal Constitution can apply.

VIII. *SUITABILITY OF LEGAL FORM OF PETRONAS*

It is apparent from the foregoing that the peculiar legal form bestowed upon Petronas, i.e., incorporation under the Companies Act, 1965, does raise many problems. These problems are further aggravated where Petronas has to carry out executive and administrative duties that are best handled by a Government department. For example, although it is the Prime Minister who is charged with the function of granting the various permissions and licences under the 1974 Act, no doubt the processing of the applications will be done by Petronas, and the Prime Minister will act on the advice of Petronas. Furthermore, there is also the role of policing the various conditions and terms (if any) laid down in the licences. The company form is most unsuited for the carrying out of such activities effectively. The entire law governing companies is designed to ensure the maximum commercial viability of the enterprise whilst maintaining a careful balance for the protection of creditors, members and generally the public. Even if Petronas can carry out the policing function, it will need special powers to give it the right to do so and to carry out enforcement proceedings should any person fail to comply. Primarily, such power lies in the Prime Minister, but by virtue of the 1975 Amendment Act he may delegate his powers to any person, which in this case will no doubt be Petronas or its officers.

No doubt there are some advantages to be gained from using this particular form. Petronas is intended to carry on commercial activities in the petroleum industry, both upstream and downstream, either by means of joint-ventures or on its own. The company form provides the maximum flexibility required for carrying out commercial

[58] It has been held that the right to have a vote recorded is a right of property: *Pender* v. *Lushington* (1877) 6 Ch. D. 70 at p. 80. Voting rights attached to shares have been said to be proprietary rights: *North-Western Transportation Co.* v. *Beatty* (1887) 12 App. Cas. 589; and *Burland* v. *Earle* [1902] A.C. 83. But in all these cases the voting right had arisen by virtue of the ownership of shares which had already been allotted, and did not exist independently of the shares.

[59] See *Charanjit Lal Chowduri* v. *Union of India* A.I.R. 1951 S.C. 41; *Dwarkadas Shirinvass* v. *Union of India* A.I.R. 1954 S.C. 170.

activities in terms of organisation, management, recruitment of employees, establishing business policies, and raising finance from outside sources. It also minimises interference and control from the Government, but this is not strictly true in the case of Petronas, as the Prime Minister may give directions which Petronas must observe. As the Prime Minister is in a position to give binding directions, Petronas is subject to full Parliamentary control through the Prime Minister in Parliament. As regards finance, any appropriations made to Petronas by the Government by way of subscription for share capital must first be approved by Parliament. The only real advantage in using the company form as regards finance is that Petronas can make a direct approach to the Prime Minister, instead of going through the bureaucratic procedures of the Treasury.[60] One other advantage of using the company form is that the management staff can be recruited on a commercial basis from the commercial sector, and hence break away from the conservative thinking of civil servants. Petronas can implement its own terms of service and remuneration in competition with the private sector to attract the best brains.

These advantages must be viewed in the light of the problems raised by the legal form, and more importantly the suitability of the legal form in fulfilling its objects. Basically, Petronas is expected to do two things: firstly, to assume full control of the petroleum industry in the country and oversee the functioning of individual petroleum ventures to ensure compliance with and implementation of national development objectives; and secondly, to participate directly in the petroleum industry so as to earn profits that will go into the national coffers rather than be salted away abroad. It is submitted that the present legal form is too clumsy to enable Petronas to carry out this dual role effectively and efficiently whilst remaining within the bounds of the law. The role of controlling and overseeing the petroleum industry of the country can only be achieved with legislative backing. Although the legislative backing is provided in the form of the 1974 Act, it must be exercised in the light of the constraints of the other body of law affecting Petronas, i.e., company law. The better means of achieving the same result, but more effectively and tidily, would have been to incorporate Petronas as a statutory corporation, under a separate statute. This statute could be so drafted as to confer upon Petronas such powers and privileges as are needed to carry out its overseeing role, including the conferring of such powers as are necessary in administering and policing these controls. Also, Petronas would then come under greater public and Parliamentary control.[61] The disadvantages and bureaucracy associated with the obtaining of finance by statutory corporations could be overcome by special provision in the legislation, providing for direct access through the Prime Minister. Indeed, the Prime Minister could continue to have his control over the corporation without opening himself to liability under company law. As regards the recruiting of staff, the statute could also expressly permit it to make its own provisions as to remuneration and terms of service.

[60] For a fuller discussion on the pros and cons of using the registered company form for carrying on a public enterprise, see Jaginder Singh, *The Legal Structure of Public Enterprises in Malaysia* [1975] Journal of Malaysian and Comparative Law (JMCL) Vol. 2 Part 1.

[61] For a discussion on the legal implications of statutory corporations in Malaysia, see *loc. cit.*

At the same time, the direct commercial participation and operational aspect of Petronas's role could be carried out through separate companies incorporated by Petronas under the Companies Act, 1965. This would give these subsidiaries the full advantage of the company form for commercial purposes, and indeed allow for joint-ventures to be set up more conveniently. In carrying on commercial activities there is no need for any special powers or privileges, and in so far as these would be needed by the subsidiary, the parent statutory corporation could make the requisite delegations. The use of subsidiaries for separate ventures would also make it possible to assess the commercial viability and success of the venture more effectively. After all, commercial ventures ought to be assessed on a commercial basis. This would also mean that the parent statutory corporation could function without worrying about being judged on a commercial basis, as its immediate role would manifestly be that of controlling and overseeing the petroleum industry, and planning commercial exploitation.

In conclusion, it is hoped that Petronas in its fervour to fulfil its economic objectives will not forget the legal problems it is confronted with, and will take these into account in working out its "master-plan". Only too often are legal problems ignored and left unsolved until the last moment, when legislation is rushed through Parliament. Legal tidiness provides for security in operations and immunity from unnecessary embarrassment.

JAGINDER SINGH *

* Lecturer, Faculty of Law, University of Melbourne.