Malaysian Oil and Gas Legal Framework: The Effects of Royalties Demanded Towards Achieving Sustainable Energy

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DOI: https://dx.doi.org/10.47772/IJRISS.2025.910000638

Received: 27 October 2025; Accepted: 02 November 2025; Published: 20 November 2025

ABSTRACT

Malaysia is a world producer of oil and gas industry, making it a critical sector in Malaysia, having the world's 23rd largest crude oil reserves and also 14th largest natural gas reserves. Administration is governed mainly by the Petroleum Development Act (PDA), the overall legal framework vested in the Petroliam Nasional Berhad (Petronas), that have exclusive rights to explore, win, and obtain petroleum resources. Petronas, being owned wholly by the Malaysian government, operates under agreements concurrently with both the federal and state governments, at the current set royalty rates of 5%. This research paper analyse this legal frameworks that governs the oil and gas sector and examines the effects of royalties demanded on the industry's contributions to achieving sustainable energy goals. The paper focuses on understanding the royalty structures and rates, which, at its core, impact all investment decisions, innovation, and the transition to renewable energy sources within Malaysia's energy landscape. The methodology applied involves a comprehensive review of all relevant laws, regulations, and current policies pertaining to the oil and gas sector in Malaysia. Key findings indicate that current royalty structures in Malaysia's oil and gas sector indeed have significant implications for sustainable energy development. Impact of these royalties on both federal and state levels, highlighting further their potential in enhancing state revenue, while raising possible deterrence of energy production and affecting long-term sustainability. The study highlights the importance of aligning royalty policies with sustainable energy objectives. The paper also addresses the issue by recommending the best practices from other countries with successful oil and gas frameworks that Malaysia could adopt.

Keywords: royalty, sustainable energy, oil and gas, petroleum, legal framework

INTRODUCTION

The oil and gas industry in Malaysia is a significant sector that has been given priority by the Government of Malaysia, with the country holding the world's 23rd largest crude oil reserves and 14th largest natural gas reserves. The main legal instrument for the oil and gas industry is primarily governed by the PDA, which vested the entire ownership and exclusive rights, powers, liberties, and privileges of exploring, winning, and obtaining petroleum in Malaysia to *Petroliam Nasional Berhad* which more commonly known as Petronas, a company wholly owned by the government of Malaysia who holds exclusive rights over the development of related resources. The royalty rates are set out in agreements between Petronas and the federal government and each of the 13 state governments. These agreements currently provide for rate payment of 5%. Royalty interest in the oil and gas industry refers to ownership of a portion of a resource or the revenue it produces. High rates of royalties can boost the state government revenue however at the same time could also deter the production of energy which ultimately would affect sustainability in the long run.

Prior to 1974, the federal government subsequently through PDA and the Industrial Coordination Act 1975 (ICA) to regulate the regime for upstream operations which relates to the activities including exploration, exploitation, winning, and obtaining of petroleum through the granting of licences, typically in the form of a

ISSN No. 2454-6186 | DOI: 10.47772/IJRISS | Volume IX Issue X October 2025

Production Sharing Contract (PSC) or a Risk Service Contract (RSC). It is established under the PDA, s. 2(1) of the Petroleum Income Tax Act , and the Federal Constitution that cash payment should be paid to the resourcing state government. Hence, this research would go to the extent of analysing the relation of royalties demanded with the sustainability of energy production.

Analysis of oil and gas legal frameworks in Malaysia focusing on the effects of royalties demanded to achieve sustainable energy including the impact of royalty requirements on the oil and gas industry's sustainability efforts in Malaysia. How the imposition of royalties influences the industry's ability to transition towards sustainable energy practices, considering factors such as investment incentives, regulatory compliance, and environmental sustainability goals was investigated. By evaluating the legal framework surrounding royalties in the Malaysian oil and gas sector, this shows the implications of these financial obligations on the industry's long-term viability and its capacity to align with sustainable energy objectives and the overall sustainability of the oil and gas industry in Malaysia aligned with the principle of sustainable development. John Rawls' notion of justice emphasises the need to balance economic benefits with environmental protection and the well-being of future generations. This means that while high royalties can generate immediate revenue for state governments, they should not be set at levels that compromise the industry's ability to invest in sustainable energy practices. Such practices are essential for ensuring that the benefits of oil and gas resources are available to future generations, thus adhering to Rawls' idea of justice as fairness.

The principle of sustainable development emphasises responsible resource management and environmental preservation simultaneously including advocate for the environmental considerations for a sustainable supply of energy, particularly oil and gas with the social equity and economic prosperity in the terms of the royalty to be paid. Therefore, the recognition-based justice principle which is one of energy justice is closely related to this topic. It highlighted how royalties are demanded, managed, and distributed within the legal framework, the extent to which these practices align with principles of fairness, inclusivity and respect for the rights of all stakeholders, ultimately contributing to the achievement of sustainable energy objectives can be seen. Recognition-based justice is served when Petronas and the Federal government acknowledge and fulfil their duty to pay for the royalties demanded by the related states. There is no such group that is left behind when justice is there in ensuring every interest is fulfilled. Transparency, inclusivity and fair distribution of royalties and benefits from oil and gas resources is essential for sustainable development and ensuring equitable outcomes for all stakeholders.

In order to achieve sustainable development for continuance supply of the oil and gas energy, environmental protection constitutes an integral part of the development process and cannot be considered in isolation from it. During the exploration and production of oil and gas, it negatively impacts the environment due to the chemicals and oil spill released into the sea. Therefore during this current time of climate change the principle of a high level of environmental protection is important which emphasises the need for the protection of the environment and the prevention of oil spills and pollutants on land and in Malaysian waters.

The principle of a high level of environmental protection would require the implementation of effective environmental laws, policies, and regulations. It includes the implementation of impact assessments, the promotion of sustainable logging practices, the reduction of emissions of short and long-lived climate pollutants, and the minimization and management of risks and impacts associated with pesticide use. This principle is closely related to the concept of ecological integrity, which requires the maintenance of the health and resilience of ecosystems, including their biological diversity, ecological functions, and processes. It required the integration of ecological integrity into decision-making processes in order to ensure that development activities do not compromise the ability of ecosystems to provide essential services and support human well-being.

In the context of the analysis of oil and gas legal frameworks in Malaysia, the polluter pays principle was applied to ensure that oil and gas companies are responsible for the environmental costs associated with their operations, including the management of waste and emissions, and the restoration of affected ecosystems. This is achieved with the use of economic instruments such as taxes or fees that incentivize companies to minimise their environmental impact and internalise the costs of their pollution. The polluter pays principle is also relevant in the context of royalties demanded for oil and gas extraction, as these royalties could be used to fund environmental protection and restoration efforts as well as to compensate affected communities. By ensuring that the costs of environmental damage are borne by the polluters rather than the public or the government, the polluter pays principle can help in promoting sustainable energy development and protect the environment for future generations. When the royalty is high, it will decrease in environmental protection as companies will not care much which leads to an increase in pollutants.

This study delves into the legal structures governing royalties, the distribution of petroleum resources, and the role of state and federal governments in regulating the industry. By examining the historical evolution of the petroleum legal framework, how royalty demands influence investment incentives, environmental sustainability practices, and the industry's transition towards sustainable energy sources can be understood. Thus, this research seeks to understand how these financial obligations influenced the industry's long-term viability and its alignment with global sustainable energy initiatives.

Principles Of Energy Law

The principle of national resource sovereignty is applicable in this research as the subject matter of this research is on the royalty. This principle encompasses the state’s right to control and manage its own natural resources without having any external interference. In this study, the PDA has vested the totality of ownership and exclusive rights over Malaysia's petroleum resources in the national oil company, PETRONAS and similarly when the state demands those cash payments for using their state’s resources.

Secondly, this research deals with the issue of sustainability, hence, the principle of prudent, rational and sustainable use of natural resources is also applicable. This principle highlights the importance of the responsibilities of the sustainable usage of oil and gas so that the future generations can use it. High royalty might deter investment hence hinder the development in sustaining the oil and gas energy.

Additionally, the royalties paid would also enhance the adherence to the third principle, which is the principle of protection of the environment, human health & combating climate change. This is when royalties fund the initiatives that address environment, human health and climate change movements. States receiving such royalties adopt clean technologies and controlling emissions and hence promote the overall wellbeing of the environment, human health and thus combating climate change.

Lastly, the principle of energy security and reliability gives emphasis to both parts of the research subject matter, be it the royalties demanded and the second part of this paper, which is towards the sustainability of the energy production in order to guarantee the energy security in Malaysia. As the dynamics between the royalties paid and the effects it bears on the sustainability of energy is inversely proportional, it is important to balance the interest between these two in order to ensure that Malaysia has a secured energy reliability. That is why we established this paper which is important in giving the insights of these two subject matters.

Analysis Of Royalties on Oil And Gas Between Federal and States Royalty

Before 1975, petroleum concessions in Malaysia were granted by state governments, allowing oil companies exclusive rights to explore and produce oil in return for which they paid royalties and taxes to the state governments (Ong, 20202). However, in 1975, the Petroleum Development Act (PDA) was enacted, transferring ownership and control of petroleum resources to Petronas. According to the PDA, Petronas makes cash payments, known as royalties, to the federal government and the relevant state governments. Section 2 of Petroleum (Income Tax) Act 1967 clarifies that these “cash payments” are made in exchange for ownership rights vested in Petronas under section 4 of the PDA. The royalty rates, specified in agreements between Petronas and the federal and state governments, are set at 5% of the petroleum's value for both the state and federal governments. Malaysia's adoption of the Production Sharing Contract (PSC) model means that the government, via Petronas, retains ownership of oil and gas resources. The royalty percentage is determined within the PSC agreements, not the PDA. Besides, royalty for oil and gas resources has been at the core of tensions between the federal and state governments. Sarawak, Sabah, Terengganu and Kelantan have demanded a greater share of the oil and gas revenue their states provide. The 1974 Petroleum Agreement stipulated a share of 5% of revenue. As there has not been full transparency in how profits are measured, it is not fully clear exactly how the 5% is calculated (ISIS, 2020).

According to Article 4(2) of Emergency (Essential Powers) Ordinance No. 7, 1969, it stated that for the purposes of the Continental Shelf Act, 1966, the Petroleum Mining Act, 1966, the National Land Code and any written law relating to land in force in Sabah and Sarawak, any reference to territorial waters therein shall in relation to any territory be construed as a reference to such part of the sea adjacent to the coast thereof not exceeding three nautical miles measured from the low-water mark. This provision restricts the extent of territorial waters for the mentioned laws and regions to ensure clarity and consistency in legal interpretations regarding maritime boundaries and land-related regulations. However, this territorial measure is sometimes become a controversial issue.

In short, royalty payment which is also known as 'cash payment' is established under section 2 of the (1) of Petroleum (Income Tax) Act 1967 and section 4 of the PDA. Nonetheless, as most of the upstream works are not carried out over three nautical miles measured from the low-water mark of the state as per Article 4(2) of Emergency (Essential Powers) Ordinance No. 7, 1969, Petronas and the Federal Government are giving non-payment of those royalties to the state government. However, it is pertinent that Petronas had actually signed agreements to pay royalty to every resourcing states respectively.

Case Study

Although petroleum is often regarded as an indicator of a country's economic strength, this wealth also brings about conflicts, both internationally and domestically within petroleum-producing nations which undoubtedly includes Malaysia. However, in this article the scope is limited on petroleum related conflict within Malaysia which entails the conflicts between the Federal and State governments, particularly Kelantan, Terengganu and Sarawak.

Kelantan

Kelantan has been embroiled in a legal dispute with the federal government over non-payment of its oil royalties, which it claims are worth RM12 billion. The demand for higher royalties by states is driven by the desire to increase their revenue share from the oil and gas sector, which is a significant contributor to their economies (Lee, 2013).

The dispute over oil royalties between the Kelantan state government and the Federal government in Malaysia presents a complex interplay of legal, political, and economic factors. The contention arose in 2009 when Kelantan demanded a 5% oil royalty for offshore petroleum extracted from its territorial waters, that request repeatedly denied by Federal authorities. Central to this dispute is the interpretation of legal frameworks such as the Territorial Sea Act and the Continental Shelf Act 1966, which delineate jurisdictional boundaries and rights concerning oil exploration and extraction.

Kelantan's argument for the 5% royalty is grounded in its custodianship of territorial waters based on the Petroleum Development Act 1974 that states "In return for the ownership and the rights, powers, liberties and privileges vested in it by virtue of this Act, the Corporation shall make to the Government of the Federation and the Government of any relevant State such cash payment as may be agreed between the parties concerned" and the perceived unfair treatment due to political biases. On the other hand, the Federal government maintains that Kelantan does not qualify for the royalty due to Petronas extracting oil beyond the state's three-nautical-mile limit, as stipulated in the Territorial Sea Act (Zawawi, 2018). This legal interpretation is further supported by the Emergency Ordinance Act 1969, reinforcing Federal control over waters beyond the three-nautical-mile limit.

Complicating the matter are historical agreements between Petronas and all 13 states in 1975, promising a 5% royalty for oil extraction, but without specifying the distance from the shore at which this royalty applies. Kelantan's oil reserves, located approximately 80 nautical miles offshore, pose challenges in defining jurisdictional boundaries, particularly as they overlap with neighbouring waters.

Although, the Federal government denied the 5% royalty sought by Kelantan government due to the three-nautical-mile limit, the Federal government has been providing financial aid in the form of "wang ehsan" and direct payments based on petroleum revenue[5]. Last year in 2023, The Kelantan government received about

RM218 millions of "wang ehsan". However, these financial measures do not address the fundamental disagreement over the royalty rate and jurisdictional boundaries. It is understandable the persistence of Kelantan to claim their unpaid royalty as one of the oil producing states, Kelantan should have been one of the richest states. The royalty would help fund the development which could build better public facilities, cost effective houses and help the poor as it is right for them to receive for the exploitation of their resources.

Nonetheless, if the Kelantan government demanded for increase of royalty rates which similarly increase in "wang ehsan" as expressed by Menteri Besar Datuk Mohd Nassuruddin Daud (Abdullah, 2024), it would affect the sustainability and efficacy of the drilling company that is PETRONAS since as a corporation they would prioritise profit more than the transition of more sustainable energy.

Terengganu

Terengganu had received a sum of RM 7.13 billion in royalties in 1978 until 2000. The state did enjoy tremendous growth from federal government royalties and formation of petroleum townships benefitted their economy. For example, Rantau Petronas, Kerteh is one of the most advanced full-fledged petroleum centres housing a small economy of its own (Faizli, 2013). However, in 2000 royalty payments were stopped. Under the constitutional clause allowing for discretionary payments from federal to state, a fraction of the due royalties known as "Wang Ehsan" (goodwill token) was paid instead through government agencies. In 2009, royalty payments were only continued when Terengganu was back under the Barisan government, even when productions were from areas sitting beyond three nautical miles from the state. This makes the task in concluding whether or not Terengganu should receive royalties a confusing one and become an issue when considering the payment was not fulfilled the moment it was a different ruling state government. Why does it apply to Terengganu and now, Pahang who is without question promised the five percent oil royalty for the Bertam PM307 discovery 160km (86.3 nautical miles) offshore Kuantan? Terengganu and Pahang then should rightfully have no claim over portions of gross oil revenues from areas beyond state borders. Due to political tensions and allegations of mismanagement by the state government, the royalties payments stopped in 1999 to 2004. It leading to the state received only gratuity payments instead of full royalties at that time (Hock, 2013).

In addition, the situation worsened when the federal government and PETRONAS argued that cash payments were not due to Terengganu for oil produced outside its territorial waters which created a difficult scenario regarding royalty entitlements. In Sep 2000 during the PAS government's tenure at the helm of the state, the payment of oil royalty was stopped by the orders of then Prime Minister, Tun Dr Mahathir Mohammad because of the reason incapable of managing the funds of over half a billion ringgit annually. The state received only gratuity payments or "wang ehsan" at a fraction of the oil royalties due from government agencies until 2004. Only RM432 million Wang Ehsan received from the state government between the period of 1999 to 2004.

The government of Terengganu sued PETRONAS and the federal government in March 2001 for the loss of its oil royalties and said that the federal government's orders were illegal as the state's agreement was exclusively with PETRONAS. The federal government and PETRONAS's stand that cash payments were not due to Terengganu for oil produced outside its territorial waters, which is outside the distance of three nautical mile limit. In 2009, royalty payments resumed even when production was from areas located beyond three nautical miles from the state shoreline. Terengganu's civil suit by the past lead government, originally filed, was eventually withdrawn by the new lead of state government in March 2012, but the details of the out-of-court settlement between the federal government, the state government, and PETRONAS still not revealed despite public outcry. There were some who believed that the decision to stop oil royalty payments to Terengganu from 1999-2004 was illegal, politically motivated and designed to punish the state. The revenue is split under the PSC regime which when a barrel of oil is sold, the first 10% is skimmed off as royalty and paid to the government. Half of this 10% is given to the state government. Terengganu contested this sometime back and the government replaced the 5% with "*wang ehsan*". Instead of giving it directly to the state, a company of Terengganu Investment Authority was formed, which known as 1MDB.

Benefits to a national or state economy don't come through the royalty payments. It is the knock on effect to the economy through contracts awarded to local service providers as Terengganu benefits from having Kertih (Exxon) and Kemaman Port to service the platforms offshore. Instead of clamouring for higher royalty payment, the state ensures that the port delivers good service to attract higher output and more jobs. The low oil price impacted the marine and offshore construction industry in Malaysia with many people laid off. There must be continuous development offshore so that Malaysian companies benefit. If foreign oil companies are deterred because their profits are carved out and given to the state then they will stop investing. The one that lost in this situation will probably the state.

In the case of Petroliam Nasional Bhd v Kerajaan Negeri Terengganu, it revolved around the interpretation of 1975 agreement and a vesting instrument, which granted the first defendant the rights to explore and exploit petroleum in Terengganu in exchange for a 5% payment of the value of the petroleum won and saved. The payments were made up until 2000 when they were discontinued, leading to the plaintiff's lawsuit. The defendants sought to have certain questions of law determined under the Rules of the High Court 1980 (RHC), specifically Order 14A and Order 33 Rule 2, which pertained to the plaintiff's rights over petroleum in the continental shelf before the PDA, the transfer of rights to the first defendant, and the entitlement to payments under the agreement. The High Court dismissed the applications however The Court of Appeal allowed the appeal and emphasising that the primary issue of the plaintiff's sovereign rights over petroleum in the continental shelf was a question of law that could be decisive for the case and ruled that the first defendant's 22 years of payments could not be used to interpret the agreements but could be relevant for establishing a contract or estoppel.

Sarawak

As per established earlier in the discussion, the PDA was passed by Parliament in 1974 and under this Act, the mining, winning and extraction and sale of petroleum products in Malaysia was reserved to a company eventually to be incorporated and known as Petronas. This is also in relation to the Malaysia Agreement 1963 (‘MA ’63’). The PDA was followed by the Sarawak State signing an ‘agreement’ with Petronas on the 27 March 1975 which provided, among other things:

“NOW THEREFORE in return for the ownership and the rights, powers, liberties and privileges in respect of petroleum vested by the GOVERNMENT (of Sarawak) in Petronas, IT IS HEREBY AGREED as follows:

1(1) Petronas shall make to the GOVERNMENT cash payment in the form of yearly sum amounting to the equivalence of 5% of the value of the petroleum won and saved from areas in Sarawak and sold by Petronas or its agents …”

Given that the Federal Constitution ultimately allows rights over natural resources to be exclusively reserved to the Borneo States, the divesting by the State of any such resources can be affected not by a simple agreement but by an act of the State Legislative Assembly. From all these, the issue of whether Petronas has ownership of the State’s natural resources or whether Petronas (by the PDA and the above ‘agreement’ read against the supremacy of the Federal Constitution) only owned extraction or mining and marketing rights while the sovereign ownership of the resource remains with the Borneon States has provided rich fodder for politicians to canvas support from the proletariat (Bato Bagi & Ors v Kerajaan Negeri Sarawak and another appeal).

By way of constitution, Sarawak state still receives royalty monies even though Petronas and its contractors are operating and producing out of more than three nautical miles beyond the coasts. However, this has its own history through the case of Petroliam Nasional Bhd (Petronas) v Kerajaan Negeri Sarawak. In this case, the applicant (Petronas) sought leave of a Federal Court judge to petition the Federal Court to grant declaratory reliefs against the respondent under arts 4(3) and 128(1)(a) of the Federal Constitution, to say that Parliament had exclusive legislative competence to enact laws pertaining to the exploration, exploitation, winning and obtaining of petroleum throughout Malaysia, whether onshore or offshore and the Sarawak Oil Mining Ordinance 1958 was impliedly repealed by the PDA. However, there was no real significance established in the case as the applicant did not specifically ask for any declaration that a certain law was invalid on the ground the legislature which made that law had no legislative power to make it. Also, it was only the issue of procedural matters that the Federal Court cannot grant the declaratory relief as per requested as it was within the original jurisdiction of the High Court, not the Federal Court. Nonetheless, the above case has reflected the intention of Petronas to set aside the Sarawak Oil Mining Ordinance 1958 in order to ensure full exclusive rights are upon them.

Sarawak had also once filed civil litigation against Petronas for payment of sales tax on petroleum products for 2019 of 2 billion ringgit ($462 million), at 5% of the value of products. Petronas in reply had also filed a legal suit which was withdrawn later sometime in 2020 when they decided to mutually resolve negotiations via the lens of commercial solutions towards a more stable business and investment environment.

Interestingly, the issue of royalty in Sarawak has not only vouched for the subject matter of energy sustainability and the royalty itself but has also led to many other political and legal concerns. Pursuant to the non-payment of the royalty from the 2019 sales from Petronas, it had caused a legal suit for defamation. This is because the plaintiff (the government of Sarawak) alleged that the defendant had uttered defamatory statements pertaining to the royalty and the relationship between the state government and Petronas.

Sustainable Energy

Generally, sustainable energy is any source that can be used indefinitely without being depleted. It does not require replenishment or renewal, and it meets our energy demands without the risk of running out or becoming unusable. This makes sustainable energy the ideal solution for our energy needs (Routledge Taylor & Francis Group, March 2022). Aligned with The 1992 UN Conference on Environment and Development in Rio De Jeneiro, Malaysia has taken its own steps in regulating the same subject matter (ie: oil) under the The National Energy Policy Objectives 1979, National Depletion Policy 1980 and Four Fuel Strategy 1980. While in the context of this paper, sustainable energy for oil and gas would have the meaning of ensuring sufficiency, security, reliability, quality and cost-effectiveness of oil and gas supply (Norfadhilah, 2009).

Royalty And Sustainability Energy

Royalties from energy projects provide governments with revenue streams that can be used for various purposes, including funding sustainable energy initiatives, infrastructure development, and environmental conservation efforts. Allocating royalties to local funds rather than state funds can enhance community engagement and support for sustainable energy projects. In the meantime, royalties also have an impact on their financial performance and sustainability practices. Royalties can influence investment decisions, encouraging companies to focus on sustainable and renewable energy projects that reduce greenhouse gases and contribute to climate change mitigation.

The ongoing dispute over oil royalties between the Kelantan state government and the Federal government in Malaysia has implications for the sustainable development of the oil and gas industry and the broader energy sector. Other than the unresolved dispute would create uncertainty for investors in the oil and gas sector. If there are changes in the royalty rate especially if it has made the rate increase, it might impact companies to be hesitant to invest in exploration and production activities fearing potential disruptions or changes in royalty rates that could impact their profitability. Subsequently impact the sustainability of energy production.

Furthermore, the focus on oil royalties also underscores the importance of transitioning to renewable energy sources. As global efforts to combat climate change intensify, there is a growing emphasis on reducing reliance on fossil fuels and promoting renewable energy technologies. Supposedly, Kelantan state should receive their fair share of the royalty if it is within their water and in accordance with the Ordinance to help develop the state. However, any increase of the royalty rate would affect the oil and gas sector to facilitate a smoother transition to a more sustainable energy.

As for the state, Terengganu, for instance, needed to plan new strategies in order to not depend on the oil and gas royalties that had not been paid. From The New Strait Times dated 31st December 2023 ‘Terengganu to Adopt New Economic Plan to Reduce Dependency on Oil Royalty’, the state is planning to adopt a new economic plan dubbed '*Pelan Penjanaan Pendapatan Baharu Negeri Terengganu'* as the effort to optimise the state's income. The plan encompasses seven strategies which would reduce the state's dependence on petroleum and gas royalty income and address the crisis of oil reserve shortages. The overall energy landscape within a state by incentivizing the development of clean energy projects and promoting energy transition initiatives. By aligning royalties with sustainable energy goals, states can drive investments towards environmentally friendly projects and support the transition to a greener economy.

While for the case of Sarawak, the state through the case of Bato Bagi & Ors v Kerajaan Negeri Sarawak and another appeal, the payment of royalties are important matters to them as they are in the belief that the federal government should not has more control over the state's oil and gas industry. Had that matter been allowed, Sarawak believes that public interest is not served. That is said when the loss of revenue from oil and gas exports would not help social development.

The dynamics shared between the royalty paid and how it affects energy sustainability, have the conflicting interest that should be at the utmost considerations. The royalties need to be paid for the public interest and the importance of the state development as well as providing justice to the States. This is also a way of recognising their rights and sovereignty over their own resources. It will cause a greater matrix of harm when corporations cannot fulfil their duty contracted stipulated under their agreement. Nonetheless, this paper also has come to the understanding on the grounds of why the corporation/federal government has yet to serve the royalties demanded by the State. This is as per the reason that the resources obtained are not within the State’s jurisdictional territory. In addition, the higher the royalty rate, the lower the corporation's revenue and chances of survival during a low oil price period (Ogolo & Nzerem, 2021). This will affect the goal of achieving energy sustainability, especially when the supply cycle cannot be sustained.

RECOMMENDATIONS

Providing royalty relief or tax incentives for renewable energy and projects and carbon capture are essential. Malaysia can also establish a clear legal and regulatory framework for renewable energy and emissions reduction besides encouraging collaboration between national oil companies and renewable energy developers. State and federal royalty policies are aligned to support sustainable energy goals that must be ensured.

To further incentivize sustainable energy development, Malaysia should consider reviewing its royalty policies and legal regime to provide more favourable terms for renewable energy projects and technologies like carbon capture and storage. This includes providing royalty relief or tax incentives for renewable energy projects as countries like Canada and Brazil. Establishing clear legal and regulatory frameworks for renewable energy and emissions reduction while encouraging collaboration between PETRONAS and renewable energy developers can also be done.

Malaysia should ensure its state and federal royalty policies are aligned to support sustainable energy goals. Currently, royalties are paid to both the federal government and state governments where production occurs. Harmonising these policies can create a more consistent investment environment for sustainable energy. Malaysia's main oil and gas legislation, the Petroleum Development Act 1974, focuses on conventional hydrocarbon resources. To enable development of new technologies, the Act may need to be updated to allow PETRONAS to participate in renewable energy and carbon capture projects, provide a legal framework for carbon storage and emissions trading and clarify regulatory oversight for emerging energy technologies.

Malaysia also can refer to other countries to improve this issue like Norway, United Kingdom, Australia, Nigeria, Indonesia, Brazil and Mexico. Norway's Petroleum Act clarifies the roles of the central government and municipalities in regulating the oil and gas industry, which Malaysia could use as a model to provide clarity between federal and state authority. Norway has high standards of transparency in disclosing details on oil and gas royalty payments and how the funds are used. This includes full disclosure of contracts, revenue flows, and government expenditure. This would ensure fair distributions of resources relevant to the issue raised by the oil producing state in Malaysia due to unfair distribution. Meanwhile, the UK has best practices that Malaysia could follow in terms of ensuring fair royalty rates that support sustainable development of oil and gas resources while allowing companies to profitably operate. The UK also has high transparency standards for disclosing oil and gas royalty payments and use of funds. Australia's regulatory framework provides a model for Malaysia to ensure fair royalty rates that support sustainable development of oil and gas resources. Nigeria adjusts its royalty rates based on factors like oil prices, production costs, and the need for government revenue and reinvestment in the industry, which Malaysia could emulate. Nigeria requires public disclosure of oil and gas royalty payments and how the funds are allocated in government budgets. Indonesia also adjusts royalty rates based on factors like oil prices, production costs, and government revenue needs, which Malaysia could consider. Indonesia requires public disclosure of oil and gas royalty payments and use of funds. Lastly, Malaysia could compare its upstream oil and gas legal frameworks to those of Brazil and Mexico to identify areas for improvement.

Malaysia can take hints of those countries that have more liberal legal systems of sustainable energy like the ones that offer royalty reliefs on renewable projects and certain regulations on the reduction of emissions such as Brazil and Canada. By working closely with these countries, Malaysia would be in a position of coming up with best practices that are in line with its setting. With the help of the updated legal framework and the royalty system, the Malaysian government can use its current experience and infrastructure in oil and gas to speed up the energy transition and earn money out of the hydrocarbon resources. Malaysia should establish the federal-state regulatory jurisdiction, fair and transparent royalty terms, and fostering the sustainable energy in the oil and gas industry

CONCLUSION

Finally, the Malaysian existing legal system of oil and gas production and exploration, that revolves around the Petroleum Development Act of 1974, is largely dedicated to traditional production of oil and gas and the royalty system that it organises. Although the royalties help the government in generating a lot of revenue, the royalties can also be used against investment in sustainable energy projects in comparison to traditional oil and gas. As a solution to this, Malaysia should learn the lessons of other countries that have revised their royalty policies, legal frameworks to better incentivise renewable energy, carbon capture and other clean technologies. This may include relief on royalty of sustainable projects, harmonizing royalty policies at state and federal levels, and revising laws to allow national oil company PETRONAS to be part of energy transition. Malaysia can also use the current oil and gas experience and infrastructure to hasten the transition towards a more sustainable energy future by modernising the legal and fiscal atmosphere.

ACKNOWLEDGEMENT

This publication is the result of a group project by students under the subject of Energy Law in the Faculty of Law at University Teknologi MARA (UiTM). We acknowledge the collective efforts, research, and dedication of the entire group who contributed to this work.

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ISSN No. 2454-6186 | DOI: 10.47772/IJRISS | Volume IX Issue X October 2025

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