CHINESE LESSONS: AMBOW SETBACK TEACHES BARING ABOUT CHINA

ASIAN LEGAL BUSINESS

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ASIA ENERGY REPORT 2013

VIETNAM

REFINERY DREAMS

VIETNAM IS GOING THROUGH AN OIL REFINERY BOOM RIGHT NOW, WITH A NUMBER OF MASSIVE PROJECTS EITHER PLANNED OR ALREADY IN CONSTRUCTION. BUT HOW FEASIBLE ARE THESE PROJECTS, AND WHAT SHOULD FOREIGN INVESTORS LOOK OUT FOR? **RANAJIT DAM** INVESTIGATES

Vietnam's first oil refinery, the Dung Quat refinery in Quang Ngai Province, was inaugurated in 2009 after some two decades of planning, disagreements, pullouts by investors, delays and much frustration. But once it was launched, it brought serious economic benefits to both the province and the country; industrial gross output in Quang Ngai Province increased by 144.7 percent in 2009, and the share of the oil industry in the province's GDP surged from 36.2 percent in the previous year to 46.3 percent. Today, 90 percent of the province's income comes from the Dung Quat Economic Zone, where the refinery is located.

It is no surprise that Vietnam now wants more of them, and fast. State-owned oil and gas group PetroVietnam, the owner of Dung Quat, is now planning two more refineries – the $9-billion Nghi Son plant in the central province of Thanh Hoa and a petrochemical complex in southern Vietnam. Petrolimex, the country's largest fuel distributor, said it is looking for investors to build the Nam Van Phong Refinery in the central province of Khanh Hoa. Also being planned are the $3.2-billion Vung Ro refinery in central Vietnam, a joint project by the UK's Technostar Management Ltd and Russia's Telloil, and another $350-million project in the Mekong Delta city of Can Tho, which received an investment licence in 2008.

"NO OIL AND GAS PROJECT IN VIETNAM CAN PROCEED WITHOUT A CONSIDERABLE DEGREE OF INTERACTION WITH VIETNAMESE GOVERNMENTAL AUTHORITIES."

ANGUS MITCHELL, DFDL

And Thailand's state oil company PTT has proposed building the mammoth $28.7-billion Nhon Hoi refinery and petrochemical complex in central Binh Dinh Province, which if completed, will become one of the largest refineries in the world. Aside from all of this, the Dung Quat plant aims to raise its capacity from 135,000 barrels per day, which is currently meeting a third of the country's oil demand, to as much as 240,000 barrels per day.

However, much like Dung Quat before them, the planned refineries face far from a smooth road going forward. Construction of the 200,000-barrels-per-day Nghi Son refinery was originally scheduled to start in the first quarter of 2011, but has been delayed due to difficulties with preparation procedures and its four investors – PetroVietnam, Kuwait Petroleum International, Japan's Idemitsu Kosan Co, and Mitsui Chemicals – announced only last month that they would proceed with the project in Vietnam after reaching a final investment decision. Construction plans for the Vung Ro refinery were revised in October after a two-year delay, and the investment was raised to twice the original plan. The project in Can Tho has not made any progress since it received an investment licence in 2008, with no commencement date being announced. And in April, PetroVietnam expressed "great concerns" about the Nhon Hoi project, stating that PTT had not properly

A general view of Dung Quat oil refinery plant in Vietnam's central Quang Ngai province. REUTERS/Kham

evaluated availability of stable, long-term crude oil, details of the partners to be involved in this project, and capital arrangements.

Angus Mitchell, partner at DFDL and head of the firm's oil and gas division, says that while the premise behind establishing refineries is sound, the projects can be extremely challenging. "Though it remains a net exporter of crude oil, Vietnam is a net importer of refined petroleum products," he says. "This leads to balance of payments issues among others, so Vietnam has joined many nations in putting an expansion of internal refining capacity at the forefront of its development plans. Every government wants to add value to exports and to replace expensive imports." He adds that on the face of it, the economics should be attractive for investors as well, "but massive capital costs, long project lives, difficult siting and challenging feedstock and output pricing are among the issues that make refineries some of the most demanding projects to push through to financial close."

FEASIBILITY IN QUESTION

According to Vietnam's Ministry of Planning and Investment, the month of May saw $3.4 billion in fresh capital injected into projects currently being implemented, a 14 percent rise compared to the same month last year. The bulk of this came from Idemitsu pouring $2.8 billion into Nghi Son, but it is clear investors want to introduce more capital in order to increase capacity. For example, the Vung Ro refinery was initially planned with an initial capacity of four million tonnes per year, a figure that local officials claim would make the project "inefficient and unprofitable," and so capacity was doubled, as was the investment to $3.2 billion.

However, the worry is that once all these projects become operational, Vietnam may face a shortage of crude oil. Media have quoted Tran Viet Ngai, chairman of the Vietnam Energy Association, as saying that if the country does not find new oil reserves, current resources, which can provide 14 to 15 million tonnes of crude oil per year, would not be enough for the new refineries. Dung Quat, for example, needs about 6.5 million tonnes of crude oil per year. Similarly, one of the biggest questions is where the crude oil will come from for the Nhon Hoi refinery. Bill Magennis, a Hanoi-based partner at Allens, notes that currently Vietnam imports petroleum products, "and it is always possible to import crude oil to make those petroleum products in Vietnam by way of import replacement. It is simply a matter of getting the right quantity to meet domestic demand, and/or to have a plan for export of product."

Mitchell at DFDL notes, however, that estimates related to this can be wrong, as

evidenced by refineries operating at below capacity in some jurisdictions and at peak capacity in others. "The sponsors and the lenders on the Nghi Son project will have had the greatest incentive to get that refinery's economics right," he says, "and (albeit after many hurdles and false starts) their positive FID should be taken as a positive and educated endorsement of refinery economics in Vietnam." He adds that from the Vietnamese government's perspective, it makes sense to encourage the development of a number of these projects right now, "in the knowledge that only the 'fittest will survive' the natural winnowing process and make it to financial close," he says. "Presumably, Vietnam would prefer to have an excess of refining capacity that a deficit and will tailor its policies accordingly."

REFINING THE RISKS

Lawyers agree that the most important requirement for investors in these projects is that they be financially capable enough to ensure the smooth arrangement of capital and borrow capital from credit institutions. They especially need to have the right to take initiative in distributing products. "Oil and gas projects are the same as any other projects that require massive capital," says Magennis. "Such projects require investors to have a sufficiently positive view as to long-term demand for the products, and require providers of large-scale loan finance to have risk abatement measures agreed with the government." Adds Mitchell of DFDL: "Obtaining financing is the most challenging issue for investors."

Another issue is currency risk, given that the Vietnamese dong is a highly volatile currency. "Though the dong-U.S. dollar exchange rate has remained relatively stable recently, refinery projects – and their project debt – are long-term prospects, so appropriate derivatives contracts can be a useful tool to mitigate exchange rate fluctuations," says Mitchell. Having offtake priced and paid for in a foreign currency may also allay some concerns. The availability of foreign exchange and non-convertibility of the dong is a related issue that should be addressed through a Vietnamese government guarantee if possible." Magennis says that the best hedge is to provide for earning foreign currency by way of exports. "In so far as a project is for import substitution, then one needs agreement on availability of dollars," he says.

Finally, Mitchell adds that getting the government's buy-in is paramount. "No oil and gas project in Vietnam can proceed without a considerable degree of interaction with Vietnamese governmental authorities; be it PetroVietnam as a contract counterparty in a PSC or as a refinery consortium member, or other governmental authorities granting the countless required project approvals," he says. "This can lead to delays, costs and associated frustrations, as well as a ceding of more control over a project than might be the case in other jurisdictions."

FUELING THE PROMISE

Despite the risks, however, Mitchell says that Vietnam's oil and gas industry has much going for it. "[The country] remains home to some relatively unexplored and potentially resource-rich acreage," he says. "It is located in the heart of a region whose thirst for petroleum will continue relatively unabated for the foreseeable future, despite periodic market downturns. Those fundamentals merit a look from all oil and gas investors, be they juniors or majors or something in between. However, good local advice – legal, commercial, practical and political – will be more important than in some other jurisdictions."

An appetite for risk, however, is vital. "Perhaps the biggest concern relating to Vietnam's most prospective oil and gas areas is the Chinese government's expansive claims in the South China Sea," adds Mitchell. "Only oil majors that can play the long game and take losses, or juniors whose investor base has an enormous appetite for risk – and commensurate reward – should wade into those waters." ALB

MYANMAR

POWERING UP

THE LONG-CLOSED COUNTRY FINALLY TAKES A SEAT AT ITS OWN OIL AND GAS FEAST, SAYS **WAYNE ARNOLD** OF REUTERS

In a few months, impoverished Myanmar plans to start pumping roughly $45 million worth of oil and gas a day from the Bay of Bengal to China by pipeline. The vital fuel for China's growing economy will bypass the Malacca Straits and U.S. ally Singapore.

It will mostly also bypass Myanmar.

Though rich in natural resources, Myanmar has little capacity to use them for its own development. For decades, its leaders valued gas for the hard currency it could earn rather than the economic development it could fuel. Today, only one in four of Myanmar's citizens have electricity.

Now, two years after sweeping aside six decades of self-imposed isolation in favour of democratic reforms, Myanmar's leaders face pressure to deliver tangible results, to appease voters ahead of the 2015 elections, and to quell sectarian unrest.

"We're now entering the third year of the reforms," said opposition leader and Nobel peace laureate Aung San Suu Kyi, who used her appearance at the World Economic

Forum's East Asia summit in Myanmar last week to underline her ambition to run for president. "What we really want to see now are results in the form of a real change in the lives of our people."

That, experts say, means giving Myanmar energy.

"Electricity is definitely no. 1," says Hans Vriens, a Singapore-based consultant who advises companies on investing in Myanmar. "No electricity. No factories."

Making the switch from seller to consumer, however, could change Myanmar's attitude toward its resources in a way that may smack of "resource nationalism."

Multinationals vying to drill for gas and oil off Myanmar will have to negotiate with the nation as a customer instead of as a partner. And Myanmar's own customers, China and Thailand, already find themselves redrawing old purchase agreements.

"We're renegotiating already," says Pailin Chuchottaworn, CEO of Thai oil company PTT, which imports $2 billion of gas a year from Myanmar. Last year, Myanmar approached PTT with a proposal to retain a fifth of the gas its sells Thailand.

"The problem is not the gas, it's the overall capacity."

Myanmar produces gas equivalent to 10.2 million tonnes of oil a year, according to a report prepared for the forum by Accenture and the Asian Development Bank (ADB). All but about 15 percent of it is sold to Thailand.

"Myanmar has a supply deficit," says Stephen Groff, ADB vice-president for East Asia, Southeast Asia and the Pacific. "You've already set aside a fairly substantial amount of your resources for export."

IN THE DARK

As a result, Myanmar only counts on gas for about 12 percent of the power it generates. Most power comes instead from hydroelectric plants whose water supply varies so widely between the monsoon and dry season that they run at roughly 60 percent of generating capacity. Even in the commercial capital, Yangon, residents can only count on power for roughly a third of any given day, according to the report prepared for the forum.

A new offshore gas field near Myanmar's maritime border with Bangladesh will boost output by 75 percent. The gas is bound for China, earning state-owned Myanmar Oil and Gas Enterprise (MOGE) another $1.8 billion annually, the report estimates. Though at least a portion of the gas has been reserved for domestic use, Myanmar lacks the onshore infrastructure to make much use of it.

A view of oil wells in Myanmar's village of Chauk, home to one of the longest producing oil fields in the world. REUTERS/Staff

> "FOR DECADES, ITS LEADERS VALUED GAS FOR THE HARD CURRENCY IT COULD EARN RATHER THAN THE ECONOMIC DEVELOPMENT IT COULD FUEL. TODAY, ONLY ONE IN FOUR OF MYANMAR'S CITIZENS HAVE ELECTRICITY."

Where MOGE has been putting its money is a mystery, experts say. Myanmar's government budget accounting remains murky, the result of antiquated record keeping and widespread corruption.

As part of its plan to streamline national energy policy, Myanmar in January put MOGE along with the Ministry of Energy and the 10 other government institutions involved in energy development under a single National Energy Management Committee.

Myanmar has also vowed to join the Extractive Industries Transparency Initiative (EITI), set up in 2002 by then UK Prime Minister Tony Blair, to help reduce the potential for payments to developing nations to feed graft and conflict.

Following President Thein Sein's visit to the United States last month, Washington is working with the government to help it meet EITI's membership criteria. Myanmar and the United States are drafting a letter of intent to publish at the June 15 launch of the Group of Eight's new transparency initiative, according to Julia Nesheiwat, Deputy Assistant Secretary at the U.S. State Department's Office of the Bureau of Energy Resources.

"They could be in the EITI by December," Nesheiwat says.

That would coincide with the deadline for companies submitting bids to Myanmar's government to explore for oil and gas in 30 offshore blocks. Bids are due on June 14, with contracts due to be awarded by year-end.

ANOTHER NIGERIA?

Whatever they find and whenever they find it, they will end up negotiating with a government more determined to lavish most of these new resources on its citizenry, which already pays less for the electricity they receive than it costs to produce.

"If we have any new discovery, we will use that for our domestic utilisation first. And then if we have excess hydrocarbon, it will be considered value-added for selling to other buyers," Myanmar's Minister of Energy, U Than Htay, said in an interview last month.

Energy companies say returns will need to be commensurate with growing risks, particularly as violence between Buddhists and Muslims grows in western Rakhine state.

Rakhine stretches along roughly one-third of Myanmar's coastline, and China's pipelines already traverse the state. Foreign industry and government officials worry that adding more oil and gas to this landscape could increase the likelihood that it becomes a new battle grounQd for religious extremism.

Drilling for oil and gas produces few local jobs. So keeping Myanmar from becoming a new Nigeria, Sudan or Iraq will require making sure that local populations benefit from the investment.

"It's critical that the government makes investments in health, in education and in agricultural productivity," says Groff at the ADB.

But the new gas is still years away. For Myanmar to deliver power quickly to its rural masses, industry executives say, it must look to Laos and Cambodia where small generators produce power by burning farm byproducts such as rice husks or pig manure.

An even simpler step would be to fix Myanmar's existing infrastructure. Aging turbines and transmission losses have cut the nation's power output to just 44 percent of capacity.

"There are a lot of GE gas turbines running at half their efficiency," says Stuart Dean, head of General Electric Co's Southeast Asian operations. "By refurbishing them, you could double capacity overnight." ALB

CHINA

SWITCHING TO SHALE?

AS SHOWN BY THE RECENT SUNTECH SAGA, RENEWABLE ENERGY COMPANIES BASED IN THE GREATER CHINA REGION ARE STRUGGLING AGAINST ONEROUS DEBT BURDENS AMID INCREASING CONCERNS ABOUT THE INDUSTRY. WHILE IT WILL MEET ITS ENERGY NEEDS THROUGH COAL IN THE SHORT TERM, CHINA IS LOOKING TO EMULATE THE U.S. AND HAS LAUNCHED ITS OWN FORAY INTO ITS SHALE GAS SECTOR. HOWEVER, SEVERAL TECHNOLOGICAL, ENVIRONMENTAL AND REGULATORY CHALLENGES STAND IN CHINA'S PATH. **KANISHK VERGHESE** REPORTS

Encouraged by a shale boom in the U.S., China has launched its own shale gas initiatives since 2009. It aims to produce 6.5 billion cubic metres of the gas by the end of 2015, and a whopping 60 to 100 billion cubic metres by 2020. As part of this push, Beijing has held two auction rounds for the gas, and a potential third round is on the cards. Government departments are also working to implement beneficial policies, such as tax and financial incentives, to encourage shale gas development. But a lack of experience in exploiting the gas among the 16 firms awarded exploration rights in the latest auction is likely to hinder development.

China is believed to be sitting on the world's largest deposits of shale gas, with an estimated 1,275 trillion cubic feet (36 trillion cubic metres) of technically recoverable shale gas reserves. Seeking to kick-start a shale boom of its own, the government introduced its first shale auction in July 2011, which was quickly followed by a second round in September 2012. Bidding in the first auction was dominated by large Chinese state-owned energy companies, including CNOOC and PetroChina, while the second auction lured more than 100 companies. In an effort to open up the shale gas industry to a wider range of players, Beijing encouraged both private Chinese companies and Sino-foreign joint ventures to place bids in the second auction. Energy experts comment that the eclectic mix of bidders in the second auction reflects the mounting interest in China's shale gas sector. The 16 winning firms of the second auction consist of six state-run utility and coal firms (including Huadian Group, Shenhua Coal Group and China Coal Group), eight energy investment firms freshly formed under the auspice of local governments, and two little-known private firms, including Huaying Shanxi Energy Investment Co, owned by Shanghai-listed coal miner Wintime Energy.

A LACK OF EXPERIENCE

Despite growing demand for China's shale gas, industry experts have serious concerns over the lack of technological experience among interested firms. Out of the 16 companies awarded exploration rights in the second auction, not one has drilled a gas well before. As a result, the auction winners will have to buy in the expertise they lack.

"I do not think the companies have much experience or ability to drill," says Xiao Yong, the head of Vinson & Elkins' China practice. "It is more of a commercial incentive for them - they are hoping that in the future there will be increased demand for shale gas in China. So, if they can get involved in the industry and win a bid, they can then look to join together with foreign parties."

A worker performs a routine check on the valves at a natural gas appraisal well of Sinopec in Langzhong county, Sichuan province. REUTERS/Stringer

On the other hand, the technological roadblock presents the prospect of lucrative contracts for specialist foreign firms such as Schlumberger or Halliburton for the "fracking" (hydraulic fracturing) technology to extract the gas. The lure of multibillion dollar drilling contracts has already enticed U.S. companies to invest in Chinese counterparts. Schlumberger bought a 20.1 percent stake in Hong Kong-listed Anton Oilfield Services Group for about $80 million in 2012, while Halliburton formed a strategic alliance with China's SPT Energy Group Inc to provide drilling operations.

Other challenges remain in the form of more complex geology and a scarcity of water. Energy analysts in China have questioned the quality of the shale gas blocks offered in the second auction, stating that they are located in areas with a very complicated geology. Indeed, China's shale gas deposits are mostly found deeper underground than in the U.S. and reserves are more dispersed. In addition, water shortages for fracking in gas basins in China where the shale is located is another serious obstacle.

CUSHIONING THE BLOW

Both challenges create greater risk and higher exploration and drilling costs for the auction winners, especially given their limited expertise in the shale industry. The cost of drilling a single shale gas well in China ranges from $5 million to $12 million, compared to the average cost per well of $2.7 million to $3.7 million in the United States, according to a report by Norton Rose.

Furthermore, progress among the big Chinese state-owned oil firms has also been slow. PetroChina and Sinopec Corp had drilled more than 60 shale wells by May 2012, but PetroChina had produced just a little over 11 million cubic metres in its most promising area by November last year. Meanwhile, U.S. shale production in 2011 rose to 240 billion cubic metres, according to Reuters.

To encourage investment and cushion the impact of high shale exploration and drilling costs, Beijing is considering putting in place several tax incentives and financial subsidies. "The government is trying to open the door for private companies and SMEs to get involved in shale gas," says Xiao Yong. One suggested policy is for the government to make initial investments alongside companies during the exploration stage, which will then be repaid to the government once the companies become profitable.

ROUND THREE?

Nonetheless, China is racing ahead to open up its shale gas sector to a broader investor base. including more SMEs and foreign firms. It is

speculated that Beijing is planning to hold a third shale gas auction by as early as the end of this year. For the first two auctions, only Chinese companies and Sino-foreign joint ventures were allowed to place a bid. If the third round does take place, it will be interesting to see whether the government will allow foreign companies to directly participate in the bidding, says Xiao Yong. He also urges the government not to rush into the third auction, suggesting that it should first put in place clearer incentive policies as well as legal regulation. "Right now a lot of policies are still waiting to be clarified, and the industry does not know what the legal regime will be like in the future. We hope things will be clearer this year, or even during the third round, so

"I DO NOT THINK THE COMPANIES HAVE MUCH EXPERIENCE OR ABILITY TO DRILL. IT IS MORE OF A COMMERCIAL INCENTIVE FOR THEM - THEY ARE HOPING THAT IN THE FUTURE THERE WILL BE INCREASED DEMAND FOR SHALE GAS IN CHINA."

XIAO YONG, Vinson & Elkins

our clients can feel more comfortable about investing," says Xiao Yong.

Indeed, there is no doubt that the legal and regulatory shroud that surrounds China's shale gas sector is a cause for concern among both domestic and international players. Shale gas is fast emerging as a lucrative sector in China's developing energy market, but the government will have to provide clear regulation and incentives to help overcome the technological, environmental and regulatory roadblocks that investors face. "Shale gas will become increasingly important over the next few years," says Xiao Yong. "If Beijing can develop a clear policy and regulatory regime, it will really benefit the development of China's shale gas sector."

WILL SHALE GAS DECIMATE CHINA'S TOY MAKERS?

By **Clyde Russell** at Reuters

Such is the impact of the shale gas revolution in the United States that it's quite possible that babies born today will no longer play with plastic dolls and cars made in China.

It's almost become a fait accompli that China is the world's factory, but the early warning signs that this may be changing are starting to show. The advent of cheap natural gas in the U.S. is threatening to displace expensive naphtha in the production of petrochemicals, the key building blocks for plastics, synthetic fibres and solvents and cleaners.

While the shale gas boom is certainly no longer a secret, up to now its main impact has been in displacing coal in power generation in the U.S., and making inroads as both a heating and transport fuel. While the U.S. is planning to export some of its shale bounty as liquefied natural gas, in effect it is already exporting more energy in the form of coal, which has helped keep Asian prices soft even in the face of record Chinese and Indian imports.

The same sort of dynamic is likely to start hitting the Asian petrochemical sector in the next few years, as U.S. output ramps up on the back of cheap natural gas and producers from India to China struggle to compete given their reliance on oil-derived naphtha. Sinopec Corp, Asia's largest refiner, admitted that it has been caught off guard by the advent of U.S. competitors using cheaper feedstock. "This is something we did not expect before," Wang Tianpu, Sinopec's vice-chairman and president, said on Mar. 25 at a briefing to announce the company's results, which saw a 12.8 percent slump in profits in 2012 from the year earlier.

Sinopec will strive to lower its petrochemical costs by using less naphtha and optimising the product mix, Wang said. The problem for Sinopec, and other Asian producers, is that while this may help at the margins, it's not going to be enough to meet the threat of cheaper U.S. petrochemicals.

While shale gas may become available in China, wide-scale production is still several years away and is unlikely to be as cheap as U.S. supplies anyway.

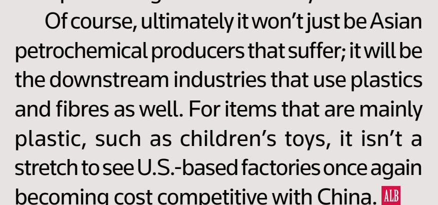
There is the possibility of cheaper LNG, but even this is unlikely as the market for the super-chilled gas is expected to remain tight for the next few years, even allowing for relatively small amounts of U.S. exports. This means the existing major producers supplying Asia, namely Qatar, Australia, Malaysia and Indonesia, are still going to be able to charge oil-linked prices for LNG, meaning it will be no cheaper than naphtha as a feedstock for chemicals.

There is also the option of using gas liquids such as propane and butane as a feedstock, but these are also derived from crude production and are priced accordingly.

The prospect of coal gasification also holds promise, but even if this were to prove economically viable, which is by no means certain, it will take at least a decade to build any plants of sufficient scale to displace naphtha. Which means Asian petrochemical producers are stuck with naphtha for the foreseeable future. Benchmark Tokyo naphtha closed at $938 a tonne on Mar. 27, and although the price has eased in recent weeks, it is 284 percent higher than the low reached in November 2008 during the global recession.

In contrast, natural gas futures on the New York Mercantile Exchange closed on Mar. 27 this year at $4.068 per million British thermal units, down about 43 percent from November 2008. Naphtha has also managed to maintain its premium to Brent crude in a fairly narrow range since the 2008 financial crisis, and is currently around the mid-point at $120.65 a tonne.

What this shows is the enormous advantage natural gas users in the U.S. are getting compared to Asian petrochemical producers. It's little wonder that Dow Chemical, the largest U.S. chemical maker, announced Mar. 18 it intends to build several plants on the Gulf of Mexico using shale gas as a feedstock. It joins Exxon Mobil, Royal Dutch Shell and others in expanding capacity in the U.S. as they bet cheap natural gas is here to stay.



Of course, ultimately it won't just be Asian petrochemical producers that suffer; it will be the downstream industries that use plastics and fibres as well. For items that are mainly plastic, such as children's toys, it isn't a stretch to see U.S.-based factories once again becoming cost competitive with China.

INDONESIA

THE STANDOFF CONTINUES

INDONESIA IS STRUGGLING TO REVERSE DECLINING OIL AND GAS OUTPUT TO MEET EXPANDING ENERGY NEEDS, BUT INVESTORS ARE GROWING INCREASINGLY FRUSTRATED OVER REGULATORY AND OTHER ISSUES, FINDS **RANAJIT DAM**

ADDITIONAL REPORTING BY REUTERS

Investor confidence in Indonesia's oil and gas sector remains increasingly shaky, and one needs to only pick a single example among a number of recent ones to see why. At the end of May, PetroChina had access to 14 of its oil and gas wells in Sumatra, producing 433 barrels of oil and around 11 million standard cubic feet of gas daily, blocked by a local government hoping to secure energy supply. The Chinese oil giant said that the East Tanjung Jabung administration had requested five million standard cubic feet of gas per day last year, and had withheld PetroChina's land permit when the request wasn't complied with quickly.

As Indonesia today struggles to attract investment to reverse declining oil output amid ballooning domestic energy demand, it also facing international criticism for unstable regulations, its nationalist stance on resources and the occasionally unusual

A villager works near the gas pipelines of the Cimalaya Onshore Receiving Facility owned by Indonesia state oil and gas company Pertamina near Subang, Indonesia's West Java Province. REUTERS/Beawiharta

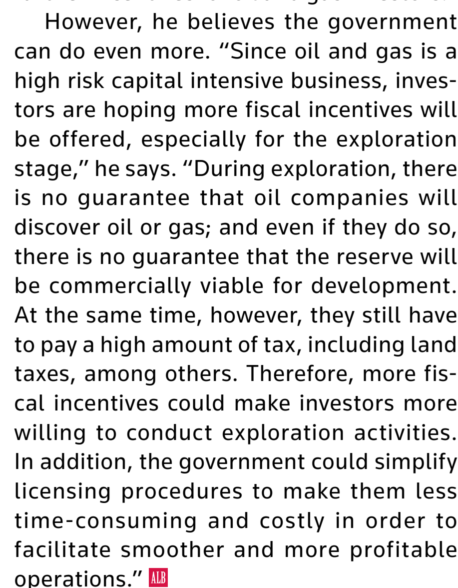
obstacles investors have to overcome, be it lockouts like the above, or as Exxon Mobil faced in January, when a senior Indonesian official asked for the U.S. energy group to replace its country manager after delays at one of its major oilfields, fuelling concerns about the state meddling in the sector.

However, there is no doubt it needs foreign investors urgently, as it seeks to raise oil and gas production. In May, Indonesia opened a rights tender for 21 oil and gas exploration blocks, including 17 offshore blocks, most of which will require overseas investors to carry out exploration, given the prohibitive costs for domestic companies. "Investors have voiced concerns that the government is unable to provide sufficient and reliable oil and gas data, which has created reluctance on the part of investors to participate in oil and gas tenders," says Emir Kusumaatmadja, partner at Mochtar Karuwin Komar. "Another obstacle is the oil and gas regulatory framework, which consists of overlapping regulations among technical departments and between central and local governments. Complicated and excessive licensing procedures are a result. Also, in 2010, the government issued a regulation limiting recoverable costs, somewhat to the detriment of the cost-recovery scheme."

It is hard to imagine that Southeast Asia's largest economy was once a significant producer of oil. In 1995, the annual oil production target peaked at 1.6 million barrels per day (bpd), but for 2014, the Indonesian government first set an oil production target of between 900,000 and 930,000 bpd, which it subsequently reduced to 860,000 bpd. In March 2013, the output was 840,000 bpd, compared to the target of one million bpd. At the same time, domestic demand for oil and gas has been ballooning. It is no surprise that much like their Southeast Asian counterparts such as PTT and Petronas, Indonesian oil and gas giants Pertamina and Medco are also pursuing overseas oil and gas opportunities in the Middle East, Southeast Asia and Australia.

> "SINCE OIL AND GAS IS A HIGH RISK CAPITAL INTENSIVE BUSINESS, INVESTORS ARE HOPING MORE FISCAL INCENTIVES WILL BE OFFERED, ESPECIALLY FOR THE EXPLORATION STAGE."
>
> **EMIR KUSUMAATMADJA**, Mochtar Karuwin Komar

Kusumaatmadja says that the Indonesian government has put forward certain fiscal incentives to draw the investors in. "For instance, goods and equipment for upstream oil and gas activities are now exempted from customs duties and value-added tax," he says. "In addition, it has been reported that the government is currently looking for further incentives for oil and gas investors."



However, he believes the government can do even more. "Since oil and gas is a high risk capital intensive business, investors are hoping more fiscal incentives will be offered, especially for the exploration stage," he says. "During exploration, there is no guarantee that oil companies will discover oil or gas; and even if they do so, there is no guarantee that the reserve will be commercially viable for development. At the same time, however, they still have to pay a high amount of tax, including land taxes, among others. Therefore, more fiscal incentives could make investors more willing to conduct exploration activities. In addition, the government could simplify licensing procedures to make them less time-consuming and costly in order to facilitate smoother and more profitable operations." ALB

INDONESIA MPS SEAL FUEL PRICE HIKE AFTER BACKING HELP FOR POOR

By **Kanupriya Kapoor** and **Adriana Nina Kusuma** at Reuters

Indonesia's parliament paved the way last month for a jump in gasoline and diesel prices after months of delay that have undermined confidence in the government and the ability of Southeast Asia's biggest economy to continue growing rapidly.

The average 33 percent price rise will cut the government's costly fuel subsidies and could give support to the struggling rupiah after the central bank scrambled last month to prop up the currency as it was caught in an emerging market selloff.

The surge in fuel prices, which will boost inflation and in turn could spark labor union wage demands, is testing President Susilo Bambang Yudhoyono's already uneasy ruling coalition of political parties, which are increasingly focused on next year's general and presidential elections.

The president has yet to formally sign off on the measures. He had agonized for months over whether to lift the price of fuel and risk a public outcry. In the end, he thrust the problem on parliament's shoulders by making MPs first agree to come up with help for the poor.

The revised budget sets aside about 9 trillion rupiah ($910 million) in cash compensation for more than 15 million families, which will be paid over four months.

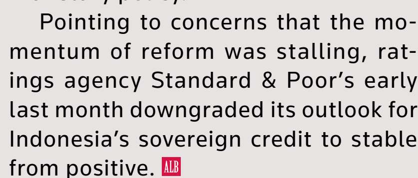
Under the government's proposal, ordinary gasoline would rise 44 percent and diesel by 22 percent.

REFORM TEST

Raising fuel prices has been seen as a key test of Yudhoyono's commitment to economic reform in the final 1-1/2 years of his term as prospects for rapid economic growth soften.

Fuel subsidies last year cost the former OPEC member some $20 billion and is putting pressure on the current account deficit. The finance ministry has said the price rises could save the state about $4 billion if they are implemented this month.

Rumors late last week that Jakarta was about to raise fuel prices helped lift the rupiah off its lowest level against the dollar in almost four years as the currency came under fire from investors cutting their emerging market exposure over uncertainty in the future of U.S. monetary policy.



Pointing to concerns that the momentum of reform was stalling, ratings agency Standard & Poor's early last month downgraded its outlook for Indonesia's sovereign credit to stable from positive. ALB

LOO & PARTNERS

Loo Choon Chiaw

"WE HAVE BEEN TRULY FLYING THE SINGAPORE FLAG"

SINGAPORE: Your Gateway to Asia, Q&A with Loo Choon Chiaw, Managing Partner of LOO & PARTNERS

ALB1: To what extent is Singapore handicapped by its size and the lack of natural resource in its economic development?

LCC1: God in His wisdom has decided that Singapore, a small city state (it was once called the "little red dot" by a politician from a neighboring country, when the bilateral relationship between Singapore and that country was slightly strained), with a land area of approximately 700 square km and without a hinterland should also go without any natural resources. These are givens, which Singapore cannot run away from. As a born optimist looking at the half-filled glass of water, I always focus on the long-term opportunity available to Singapore, rather than agonising over the short-term challenge of the limit of its size or its lack of inherited wealth. Looking from a positive angle, Singapore should thank God in freeing it from the negative impact of natural wealth, be it, what the economists call the 'Dutch Disease-dynamics' or environmental damage associated with the exploitation and production of natural resources. From Day One, Singapore has been forced to survive from crisis to crisis, and attain its wealth creation and accumulation by the determination and sheer hard work of its Government and people working together as a team despite its inherent limitations.

ALB2: Can Singapore, with all its limitations, really play a role in the era of globalisation, where the global economy is constantly changing?

LCC2: There has not been any suggestion from any expert renowned in the subject that the changes in the global economy currently under way will seriously undermine Singapore's competitive position. In the present context, small may indeed be beautiful in that Singapore will be able to react speedily to any major and unexpected change in the global market, which is becoming more frequent these days. Indeed, where there is any fundamental change in the global market, Singapore cannot just sit idly, but must be prepared to adjust to that change decisively and swiftly.

ALB3: Has Singapore been successful in its drive to become a knowledge-based, innovation-driven economy?

LCC3: *The Global Competitiveness Report 2012/2013* published by the World Economic Forum ranked Singapore as the second-most competitive economy in the world and classified it as an innovative-driven economy and placed it in the same league as the United States, Finland, Sweden and Switzerland. Singapore has achieved a steady transition towards a knowledge-based and an innovation-driven economy, an aspiration outlined in the *Report of the Economic Review Committee 2003*. The requisite infrastructure has been firmly in place. It has been successful in attracting foreign scientific talents, however, it will take a while for the results of the scientific research to be translated into new products or services of any significant scale. In this connection, we must be reminded of an ancient Chinese saying <好的开始是成功的一半>, a good beginning is half way to success.

ALB4: Is Singapore an attractive Foreign Direct Investment (FDI) location?

LCC4: As a FDI location, Singapore remains highly attractive to foreign companies who invest in high-tech and capital intensive industries. However, Singapore, as observed in the *Singapore Competitiveness Report 2009* produced by the Asia Competitiveness Institute and published by the Lee Kuan Yew School of Public Policy has been increasingly moving beyond just being a host of FDIs, and is becoming an important source of FDIs, especially for other parts of Asia. In this context, Singapore has increasingly been recognised as a jurisdiction of choice to foreign investors who intend to effect a FDI via an investment holding vehicle incorporated in Singapore.

ALB5: Why Singapore?

LCC5: Any foreign investor who is considering effecting a FDI into Singapore or into the Asian region through Singapore will ask the following questions: (1) will the FDI be protected in or through Singapore, (2) is Singapore business friendly, (3) does Singapore have a favourable tax regime, (4) will the FDI enjoy the benefits of any avoidance of double taxation agreement (DTA) entered into between Singapore and the host jurisdiction of the foreign investor or the jurisdiction where the FDI is to be located or both, and (5) will the FDI enjoy the benefits of any free trade agreement (FTA) entered into between Singapore and the host jurisdiction of the foreign investor or the jurisdiction where the FDI is to be located or both.

ALB6: What investment protection can a foreign investor expect as regards its FDI in Singapore?

LCC6: As long as the host jurisdiction of the foreign investor has entered into an International Investment Agreement (IIA) with Singapore, the FDI in Singapore will be subject to investment protection. The benefit does not just stop there. Should the foreign investor decide to effect the FDI via a Singapore subsidiary into a jurisdiction with which Singapore has entered into an IIA, the FDI will also be protected thereby according to the terms of the IIA. Basically, as regards the

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FDI, there will not be any unlawful expropriation and that adequate and effective compensation must be paid in a prompt fashion. Thus, should a PRC investor effect a FDI in Myanmar via its Singapore subsidiary, the PRC investor's investment in its Singapore subsidiary will be protected from any unlawful expropriation in Singapore by virtue of the IIA entered into between the PRC and Singapore. Furthermore, the PRC investor's FDI in Myanmar, via its Singapore subsidiary, will be similarly protected in view of the ASEAN Comprehensive Investment Agreement entered into by all the ASEAN States in 2012, under which both Singapore and Myanmar are member states.

ALB7: Can you elaborate on Singapore's business friendliness and how favourable its tax regime is?
LCC7: Singapore has consistently been ranked as one of the world's most business friendly countries in international surveys. It has strong international trading linkages, very low level of corruption and excellent and advanced infrastructure. All sectors of industry and commerce are encouraged. It allows 100% foreign ownership in most sectors of the economy. A local subsidiary of any foreign investor is entitled to most of the tax concessions and privileges that are available to a company wholly owned by Singapore citizens. Singapore offers relatively low corporate taxes, currently stands at 17%. It has no capital gains tax. Specific tax incentives and exemptions are available to targeted companies, eg, to any company that performs the function of a regional or business headquarters.

ALB8: How extensive is Singapore's DTA network and how will the foreign investor benefit from it?
LCC8: Singapore has an extensive network of DTAs with more than 70 countries across the globe. The key benefits of a DTA are the avoidance of double taxes and lower withholding taxes on certain payments made by the Singapore subsidiary to the foreign investor (assuming that it is located in a jurisdiction which has entered into a DTA with Singapore), for instance, interest or dividend, which will minimise the overall tax burden of the foreign investor.

ALB9: How extensive is Singapore's FTA network and how will the foreign investor benefit from it?
LCC9: As an integral part of its trade architecture, Singapore has been working toward a comprehensive network of FTAs. The FTA network aims to position Singapore as an integrated manufacturing centre in the region; promote research and development in its knowledge-based economy and boost its services hub. A FTA is basically a legally binding agreement between two or more countries to reduce or eliminate barriers to trade, and facilitate the cross border movement of goods and services between the territories of the parties. Since the signing of its first FTA under the ASEAN Free Trade Area (AFTA) in 1993, Singapore's network of FTAs has expanded to cover 18 regional and bilateral FTAs with 24 trading partners. Singapore's FTAs have been instrumental in helping Singapore-based businesses strengthen cross-border trade by eliminating or reducing import tariff rates, providing preferential access to services sectors, easing investment rules, improving intellectual property regulations, and opening government procurement opportunities. The addition of the European Union, the world's largest trading bloc of 500 million consumers, which is expected to be become effective in 2014, would significantly enhance Singapore's current network of FTAs covering 18 regional and bilateral agreements with 24 trading partners, including ASEAN, China, India, Japan, South Korea and the United States. The Singapore subsidiary of a foreign investor will clearly derive benefits under the provisions of the applicable FTA.

ALB10: As a specialist boutique practice in the corporate field, what has been keeping your firm busy these days?
LCC10: Our banking practice colleagues have been very busy with the increase in instructions on aircraft and vessel financing. Our private wealth practice colleagues are acting for more family offices from Europe. Our corporate practice colleagues have been kept busy with an increase in instructions from funds , including compliance. In view of the uncertainties in the global financial market, some IPO projects which we were working on have been put on hold. We are focusing more on cross-border M&As at the moment. As I have highlighted earlier, Singapore does have much to offer as a host of high-tech and capital intensive FDIs and a source of FDIs into Asia. We have been busy advising our clients, both local and foreign, who are undertaking FDIs into Asia, in particular into ASEAN, to take full advantage of the comprehensive framework which is available in Singapore, and assisting each of them to establish the most appropriate deal structure in the light of all the relevant circumstances. In this regard, we have been truly flying the Singapore flag in promoting Singapore: the Gateway to Asia.

WE ARE OUR CLIENTS' PARTNER

We regard ourselves as our clients' strategic partner when tackling their daily challenges. No stone shall be left unturned in our daily search for the most effective legal solution to meet the special needs of each of our clients.

OUR MEMBERS ARE OUR ASSETS

In Loo & Partners, every individual (no matter what position he or she occupies) is a member of our team and an asset to the firm. We are constantly searching for persons with the requisite qualities to join our team.

WE ARE A LOCAL FIRM WITH REGIONAL CAPABILITIES

We strive as follows:

- To be the best amongst our peers
- To attract and retain committed team members
- To enable each member to attain his or her full potential
- To be our clients' strategic partner in tackling their daily challenges
- To implement changes necessary to serve our clients better, increase efficiency and reduce costs
- To maintain a level of profitability that sustains growth, funds further investments to enhance our overall capabilities and provides fair rewards to members