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GREEN SUKUK: LEGAL FOUNDATIONS FOR DIVERSE APPLICATIONS IN SUSTAINABLE DEVELOPMENT

by Hurriyyah Kamaruzzaman & Naveena Nagarajah

Green Sukuk, a Shariah-compliant financial instrument, has emerged as a transformative tool in sustainable finance. Initially associated with renewable energy, particularly solar farms, Green Sukuk now finances a wide array of environmentally beneficial projects, including biodiversity conservation, climate adaptation, sustainable agriculture, and water management.

This legal insight explores the evolving legal frameworks that support these diverse applications, the challenges and opportunities they present, and the implications for Islamic Finance and ESG-Investment efforts.

Conceptual and Legal Foundations of Green Sukuk

Green Sukuk are structured similarly to traditional Sukuk but are distinguished by their exclusive use of proceeds for environmentally sustainable projects. They must comply with both Islamic finance principles and green finance standards, such as:

(a) Shariah compliance: Avoidance of interest (*riba*), uncertainty (*gharar*), and speculation (*maysir*); and

(b) Green finance standards: Alignment with frameworks like the ICMA Green Bond Principles, Climate Bonds Standard, and ASEAN Green Bond Standards.

In jurisdictions like Indonesia and Malaysia, Green Sukuk are governed by national regulations[1] that integrate these dual compliance requirements.

Expanding The Scope: Beyond Renewable Energy

1. Biodiversity and Nature Conservation

Green Sukuk is increasingly used to finance ecosystem restoration and biodiversity conservation, reflecting a shift toward nature-based solutions. In 2023, the Government of Malaysia, through the 2024 budget, announced the establishment of a RM1 billion biodiversity Sukuk facility to replant degraded forests and generate carbon credits support conservation efforts[2]. Eligible[3] biodiversity projects include, among others:

1 For example:

(a) Malaysia's 2021 Government of Malaysia (GoM) SDG Sukuk Framework, together with Securities Commission Malaysia's SRI Sukuk and Bond Grant Scheme

(b) Indonesia's Financial Services Authority Regulation No. 60/POJK.04/2017 outlines requirements for environmentally friendly debt securities, including Sukuk

2 Government of Malaysia's 2024 Budget Speech, News & Media – Official Portal of the Ministry of Finance

3 National Policy on Biological Diversity 2022-2030

(a) Habitat and Biodiversity Conservation:
  (i) sustainable management of land use and forestry;
  (ii) protection of coastal and marine environments;
  (iii) biodiversity conservation, protection and patrol programs;
  (iv) monitoring, control and surveillance for:
    a. fisheries;
    b. mangroves;
    c. wetlands;
    d. forest cover; and
    e. national parks

(b) Forestry and Environmental Research; and
(c) Sustainable Agriculture.

These projects align with Islamic principles of stewardship (*khalifa*) and public good (*maslahah*), reinforcing the ethical foundation of Green Sukuk.

2. Climate Adaptation and Resilience

For climate adaptation, funding can be directed towards sustainable and environmentally friendly initiatives, such as renewable energy installations, water conservation systems, and infrastructural enhancements to withstand climatic changes.

In Malaysia, the 2024 Budget saw a total of RM11.8 billion was allocated to flood mitigation projects, RM563 million to the rehabilitation of over 200 high-risk slopes nationwide and RM300 million to flood preparedness measures managed by the National Disaster Management Agency.

These applications demonstrate the instrument's flexibility in addressing both mitigation and adaptation goals under the Paris Agreement[4] and national climate strategies. Further, these projects often lack traditional revenue streams but are tradable carbon markets which could become viable through carbon pricing mechanisms, making Green Sukuk a bridge between Islamic finance and emerging climate finance tools.

Legal Structures And Contractual Models

Green Sukuk can be structured using various Islamic finance contracts, each suited to different project types or combined as underlying to a complex project financing potential:

Underlying Islamic Finance Contracts	Project Types
Musharakah (partnership)	a partnership where investors collectively own a stake in a climate adaptation project, sharing the costs and profits
Ijarah (leasing)	used for hire purchase of assets contemplated in the infrastructure and renewable energy projects

4 Article 4 (2) and (7) of the 2015 Paris Agreement by the Parties to the United Nations Framework Convention on Climate Change

Underlying Islamic Finance Contracts	Project Types
Istisna' (manufacturing sale)	suitable for construction-based projects
Wakalah (agency)	investors appoint a manager to oversee investment in complex climate adaptation projects
Murabahah (cost-plus sale)	an asset or pool of assets becomes basis of sale and resale at a fixed profit margin to replace interest
Mudarabah (profit-sharing partnership)	a partnership where investors provide capital to a venture with returns dependent on the venture's profit, suitable for potentially profitable projects like green buildings or sustainable agriculture

These contracts enable flexibility in financing diverse green assets while maintaining Shariah compliance.

Case Studies: Diverse Applications Beyond Malaysia

1. Indonesia's Green Sukuk Portfolio

In 2021, Indonesia issued sovereign Green Sukuk to fund:

(a) Renewable energy.[5]
(b) Sustainable transport (e.g., 690 km of railway tracks).[6]
(c) Waste management and pollution control.[7]

These projects are audited and verified by third parties, ensuring transparency and accountability.

2. United Arab Emirates (UAE) and Saudi Arabia

In the UAE, corporations such as DP World[8] and Majid Al Futtaim[9] have issued Green Sukuk for:

(a) green buildings; [10]
(b) lean transport;
(c) renewable energy;
(d) energy efficiency; and
(e) sustainable water management.[11]

Meanwhile, Saudi Arabia's Islamic Development Bank issued a €1 billion Green Sukuk to finance:

(a) renewable energy;
(b) pollution prevention and control;
(c) clean transportation;
(d) environmentally sustainable management of natural living resources and land use; and
(e) sustainable water and wastewater management.[12]

These examples highlight the regional diversification of Green Sukuk applications.

5 The Sovereign Green Sukuk: An Analysis of Its Process and Barriers to Funding Renewable Energy Projects in Indonesia

6 Accelerating Southeast Asia's Innovative Finance for SDGs: Indonesia's Pioneering Role

7 Green Sukuk Allocation and Impact Report 2023

8 DP World raises $1.5 billion for decarbonization - Offshore Energy

9 was listed as the world's first benchmark corporate Green Sukuk and the first issued by a corporate in the Middle East.

10 DP World Green Sukuk Allocation and Impact Report

11 Majid Al Futtaim Green Sukuk Case Study

12 Islamic Development Bank Achieves New Milestone with Debut Green Sukuk Worth EUR 1 Billion for Green Financing in its Member Countries

Governance And Legal Accountability

Green Sukuk offers stronger governance mechanisms than traditional green bonds due to their Shariah structure, that are:

(a) asset-backed structure, where the funds are tied to specific, identifiable assets and adhere to the principles of risk-sharing, which can be strategically aligned with sustainable development goals (SDGs);

(b) oversight by the Shariah advisory boards in respective jurisdictions, ensuring ethical and theological compliance; and

(c) its ring-fencing mechanism by the creation of special purpose vehicles (SPVs), to isolate financial risks, raise capital and manage assets efficiently.

These features mitigate greenwashing risks and enhance investor trust.

Legal Recommendations For Expanding Green Sukuk

1. **Develop Biodiversity Guidelines**

   Though we have not seen the planned Biodiversity Sukuk issued by the Government of Malaysia in the year 2024, in the near term, the agencies under the Government of Malaysia are recommended to publish clear criteria and indicators for biodiversity projects to facilitate their inclusion in the Green Sukuk frameworks. Certainty of eligibility will give confidence to the corporate sectors to participate under the guise of Public-Private Partnerships.

2. **Enable Carbon Credit Integration**

   Governments should develop legal infrastructure to support carbon markets and allow Green Sukuk to finance carbon credit-generating projects such as sustainable forestry, carbon capture, utilisation and storage (CCUS) alongside energy-transition activity in the oil & gas sector. Carbon-credit projects often lack direct revenue streams, making them challenging to finance through Sukuk. However, the emergence of carbon markets and tradable carbon credits offers a potential solution. Green Sukuk could be structured to finance projects that generate carbon credits, creating new revenue models.

3. **Promote Capacity Building**

   Creation of awareness by way of insights, campaigns, roadshows targeting issuers, investors, and Islamic Financial Institutions is essential to expand the market for capital-raising in ESG-related activities.

Conclusion

Green Sukuk is evolving from a niche instrument for solar energy into a multifaceted tool for sustainable development. Its legal frameworks are adapting to support diverse applications, including biodiversity conservation, climate adaptation, and sustainable agriculture.

By aligning Islamic finance principles with global sustainability goals, Green Sukuk offers a unique pathway to ethical and impactful investment. However, realising its full potential requires legal innovation, regulatory harmonisation, and market development. With the right legal infrastructure, Green Sukuk can mobilise billions toward a greener, more resilient future, while staying true to its ethical and faith-based foundations.

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BANKING IN MALAYSIA: NAVIGATING THE NEW OVERNIGHT POLICY RATE (OPR) LANDSCAPE IN A CHANGING ECONOMY

by Teo Siang Ly

Malaysia's banking sector is a cornerstone of the nation's economy, playing a pivotal role in supporting economic activity, national financial stability, and national development agendas. Regulated by Bank Negara Malaysia (**BNM**), the sector encompasses a broad spectrum of institutions, including conventional and Islamic banks, non-banking financial institutions, and an emerging digital banking segment.

On 9 July 2025, BNM lowered the Overnight Policy Rate (**OPR**) by 25 basis points, bringing it down from 3.00% to 2.75%, marking the first rate cut since 2020. BNM described the decision as a pre-emptive measure to cushion against moderating domestic growth and subdued inflationary pressures. BNM reaffirmed its commitment to preserving monetary and financial stability while supporting Malaysia's medium-term economic prospects.

This shift in the interest rate landscape calls for recalibration across the financial ecosystem. This article explores the wider implications of the July 2025 OPR from legal and regulatory perspectives, examining its impact on financing structures, compliance obligations, and the evolving strategic priorities of banks, borrowers, and legal professionals in Malaysia's dynamic financial landscape.

Regulatory Framework And Recent Developments

Malaysia's banking industry operates within a comprehensive framework designed to ensure financial stability, promote responsible innovation, and safeguard consumer interests. Regulated by Bank Negara Malaysia (BNM), this framework is governed by a suite of legislation and reinforced by proactive supervisory policies that respond to both domestic challenges and global shifts. In this regard, primary legislation include:

- **Financial Services Act 2013 (FSA)** – Governs conventional financial institutions, providing BNM with powers to regulate and supervise licensed institutions, enforce prudential standards, and ensure consumer protection.

- **Islamic Financial Services Act 2013 (IFSA)** – Governs Islamic financial institutions, incorporating Shariah compliance requirements and empowering the Shariah Advisory Council as the apex authority.

- **Central Bank of Malaysia Act 2009** – Establishes BNM as the central bank, sets out its monetary policy objectives, and confers powers relating to currency issuance, foreign exchange policy, and financial system oversight.

- **Development Financial Institutions Act 2002 (DFIA)** – Regulates designated development financial institutions (DFIs) tasked with financing sectors of strategic importance such as agriculture, infrastructure, and SMEs.

These legislative pillars collectively empower BNM to operate a principles-based and risk-focused regulatory regime.

BNM's regulatory philosophy is rooted in principles-based regulation, risk-based supervision, and forward-looking surveillance. This regulatory philosophy is designed to be responsive and adaptive, particularly as the financial ecosystem undergoes digital transformation and grapples with emerging environmental and operational risks.

Recent regulatory developments include:

- **Climate Risk Management and ESG Guidance** – BNM's issuance of the "Climate Risk Management and Scenario Analysis" (CRMSA) guidance and "Principles-Based Taxonomy" (PBT) reflects its expectation for financial institutions to integrate climate-related risks into governance, strategy, risk management, and disclosures.

- **Transition to Risk-Based Capital and Liquidity Standards** – In line with Basel III reforms, BNM continues to refine its capital adequacy framework and liquidity risk management, including the implementation of the Capital Adequacy Framework for Islamic Banks (CAFIB) and the Liquidity Coverage Ratio (LCR) requirements. These measures were introduced in response to vulnerabilities exposed during the 2007–2008 global financial crisis.

- **Digital Banking Regulatory Framework** – BNM awarded five digital banking licenses in 2022, with rollouts commencing between 2024–2026. These licensees are subject to a foundational phase lasting three to five years, during which capital requirements, prudential standards, and governance frameworks are tightly monitored.

- **Policy Documents on Credit Risk, Outsourcing, and Operational Resilience** – The liquidity risk guidance issued by BNM is grounded in international standards, including the Principles for Sound Liquidity Risk Management and Supervision and the Guiding Principles for Islamic institutions. These policies collectively establish expectations for governance, internal controls, and oversight, particularly in managing outsourced functions, cyber threats, and funding stability.

- **Foreign Exchange Policy Notices (FEP Notices)** – Set out BNM's rules on transactions involving foreign currency, non-resident entities, and offshore borrowing. These impact cross-border financing structures, requiring legal advice on compliance, registration, and approval thresholds.

The July 2025 cut in OPR marks a strategic shift in BNM's monetary and regulatory stance. Apart from moderating inflation and weakening external demand, the central bank's decision reflects a careful recalibration designed to stimulate domestic consumption and investment while preserving financial stability.

This policy adjustment signals responsiveness to lagging credit growth and an evolving macroeconomic environment. It also underscores BNM's ongoing commitment to maintaining macroprudential vigilance, even as it eases monetary conditions to support economic activity. The move comes at a critical juncture as Malaysia grapples with geopolitical uncertainties, volatile global markets, and rapid digital disruption.

In tandem with its monetary measures, BNM is expanding its regulatory focus under the Financial Sector Blueprint 2022–2026. The supervisory agenda now extends beyond traditional financial buffers to embrace wider priorities such as digital inclusion, sustainable development, and financial integrity. This broader approach recognises the need to build resilience not only against economic shocks but also against structural inequalities, climate risks, and technological transformation.

To support this shift, BNM is investing in regulatory and supervisory technologies (RegTech and SupTech), signalling a move toward a more integrated, data-driven framework. In this new landscape, legal and compliance functions must evolve. No longer merely a defensive mechanism, compliance has become a strategic enabler—demanding greater regulatory engagement, continuous training, and agile policy monitoring.

Financial institutions that embed environmental, social, and governance (ESG) principles, digital agility, and inclusive practices into their operations will be best positioned to lead in the future financial ecosystem. As BNM continues to modernise Malaysia's financial sector, those who align early with its vision will be the ones to shape and benefit from the next phase of regulatory transformation.

Market Trends And Economic Implications

The recent OPR cut signals a strategic policy shift aimed at invigorating domestic demand, stimulating private sector activity, and supporting economic recovery amid a complex global environment. The implications for the banking sector include:

a. Credit Growth and Demand for Financing

Lower interest rates are expected to spur borrowing, particularly in the residential property, SME, and consumer financing segments. With lower cost of funds, corporates are likely to explore refinancing of existing debt, funding of capital expenditures, or working capital needs. Legal advisors must be prepared to advise on refinancing transactions, loan restructurings, and new security arrangements.

b. Repricing of Loan Portfolios

As base lending rates decline, banks face immediate margin compression,

1 Société des Produits Nestlé S.A. v Cadbury UK Ltd [2017] EWCA Civ 358

2 Case T-112/13 Nestlé v OHIM [2016]

3 Cadbury UK Ltd v Société des Produits Nestlé SA (Comptroller-General of Patents, Designs and Trade Marks intervening) [2022] EWHC 1671 (Ch)

especially on loans priced against the Standardised Base Rate (SBR) or OPR. This repricing effect puts pressure on net interest margins (NIM), prompting financial institutions to reassess their lending strategies, credit risk appetite, and focus on higher-margin products. Legal review of loan documentation to ensure appropriate interest rate floors and repricing clauses is essential.

c. Deposit Competition and Liquidity Management

Lower deposit rates may lead to deposit outflows or shifts in maturity profiles, requiring banks to optimise liquidity buffers and funding strategies. To remain competitive, banks may introduce new deposit products, revise existing terms, or adopt differentiated pricing strategies to retain and attract funds. These developments require careful alignment with BNM's guidelines on product transparency and fair dealing. From a legal and compliance standpoint, in-house legal and compliance teams will need to monitor any changes in product terms and disclosures to ensure alignment with BNM's product transparency and fair dealing guidelines.

d. Increased Focus on ESG-Linked and Thematic Financing

ESG-linked financing continues to gain traction, with banks introducing sustainability-linked loans (SLLs), green financing schemes, and Islamic sustainable instruments such as sukuk. These instruments often include key performance indicators (KPIs) or margin ratchets based on ESG outcomes. Legal advisors must ensure that these provisions are clearly drafted and enforceable. Clear documentation, robust KPIs, and enforceable ESG mechanics are essential not just to uphold contract sanctity, but to protect lenders from reputational, regulatory, and litigation risks in an increasingly scrutinised financial landscape.

e. Digitalisation and Fintech Collaboration

The rate environment, coupled with evolving customer expectations, is driving further digital transformation. In an effort to remain competitive, banks are collaborating with fintechs to offer embedded finance, digital wallets, and alternative credit assessment models. This requires careful navigation of outsourcing regulations, data protection laws, and cybersecurity standards. Legal departments play a central role in reviewing partnerships, APIs, and cross-border data transfer arrangements. Another key risk area that financial institutions would need to traverse would be the demands of ensuring ever robust cybersecurity in a time when the digital economy brings with it heightened risk of cyber-insecurity.

f. Sectoral Variations and Emerging Risks

Certain sectors such as construction, hospitality, and retail remain vulnerable despite improved liquidity conditions. Banks must tailor credit assessments to industry-specific risks, while borrowers may need assistance navigating covenants, debt servicing obligations, or moratorium exits. Legal support is vital in structuring sector-specific terms and identifying force majeure or material adverse change triggers in facility agreements. A proactive legal approach helps banks harness the benefits of digital innovation while managing the attendant risks in a compliant and commercially sound manner.

g. Regionalisation and Cross-Border Opportunities

Malaysia's banking sector continues to regionalise, with local institutions expanding into ASEAN markets and exploring syndicated deals with foreign lenders. Cross-border deals introduce complexities around foreign exchange regulations, governing law, enforceability of judgments, and tax structuring. Cross-jurisdictional legal collaboration becomes essential in such scenarios.

The OPR cut has not only unlocked short-term credit expansion but has also created a competitive imperative for banks to innovate, differentiate, and streamline operations. In-house counsel, external lawyers, and business teams must work hand in hand to ensure that market responses are legally sound, strategically aligned, and regulatory-compliant.

Legal And Transactional Considerations

The recent reduction in the OPR to 2.75% has a significant impact on the structure and negotiation of financing documentation. Legal advisors, whether in-house or external, must assess the implications on interest rate clauses, covenants, and refinancing strategies.

Many Malaysian loan agreements adopt floating interest rates pegged to benchmarks like the OPR, Standardised Base Rate (SBR), or Base Rate (BR). In a low-interest rate environment:

- Lenders may push for interest rate floors or margin adjustment mechanisms to protect against further rate cuts.
- Borrowers are incentivised to refinance, triggering early prepayment clauses and the need to assess break funding costs.
- Fixed-to-floating conversion clauses may be revisited, requiring careful interpretation and possible amendment.

The July 2025 OPR cut calls for a comprehensive review of standard loan documentation. For banks and Legal advisors, this is a timely reminder to reassess whether existing templates provide sufficient flexibility and protection in a shifting interest rate environment.

Key provisions such as prepayment clauses, step-up margins, repricing triggers, and prepayment penalties should be clearly drafted and aligned with the bank's commercial objectives. Legal advisors should also ensure that such clauses allow for responsive adjustments while safeguarding lenders against interest rate risks and early repayment losses.

Financial covenants, particularly those linked to EBITDA or interest coverage ratios, may be impacted by economic headwinds. Material Adverse Change (MAC) clauses, often boilerplate, may gain renewed importance and must be carefully reviewed. Legal advisors must consider whether these covenants remain appropriate, and whether they should be recalibrated to reflect current market realities.

In syndicated transactions, lenders should ensure that amendment and waiver

provisions allow for agile responses to borrower requests. Facility agreements should also contain clear provisions on review events, refinancing mechanics, and margin recalibration.

Islamic finance transactions face their own complexities. Financing structures such as Murabahah and Tawarruq must incorporate profit rate adjustment mechanisms while avoiding elements of gharar (uncertainty). Shariah compliance, coupled with flexibility to adapt to market rates, is essential.

For cross-border financing, close attention must be paid to BNM's Foreign Exchange Notices (FX Notices). Transactions involving loans from non-resident lenders or guarantees provided by offshore entities may trigger approval, reporting, or registration requirements with BNM. Legal advisors play a critical role in guiding clients on regulatory compliance, as well as advising on hedging strategies and managing foreign exchange exposure.

In distressed scenarios, legal considerations become more urgent and complex. Legal advisors must assess the enforceability of securities, the risk of insolvency, and creditor remedies. With the continued evolution of judicial management and restructuring regimes under the Companies Act 2016, strategic enforcement planning is vital.

Future Outlook And Strategic Opportunities

The Malaysian banking sector is at an inflection point. While the OPR cut supports short-term credit expansion, underlying structural reforms and digital transformation remain critical to long-term growth. The
opportunities are abound for stakeholders:

- Banks can expand lending portfolios, explore fintech collaboration, and lead in green finance initiatives.
- Legal advisors can play a proactive role in guiding product innovation, strengthening internal compliance frameworks, and facilitating constructive regulatory engagement.
- Borrowers can leverage the current environment to optimise financing structures, renegotiate terms, and pursue strategic investments.

ESG Compliance And Sustainable Finance

The push for ESG compliance and sustainable finance presents new areas for growth. Green loans, sustainability-linked financing, and transition finance products are gaining traction, and legal advisors must be prepared to structure such facilities in line with global standards. Financial institutions that develop internal ESG taxonomies and adopt robust due diligence frameworks will be better placed to attract regional and international investors.

Digital Transformation

Digitisation continues to reshape the industry. The licensing of five digital banks

by BNM represents a structural shift that could recalibrate operational activities, profitability, customer expectations, operational costs, and market segmentation. Traditional banks can no longer rely solely on brick-and-mortar presence or conventional banking products. To remain competitive, they must either develop proprietary digital offerings or collaborate with fintech companies.

Geopolitical Risks and Cross-Border Financing

Global political uncertainty, including trade realignments and rising protectionism, continues to influence capital flows and supply chain configurations. For Malaysian corporates with exposure to foreign markets, this may necessitate cross-border financing arrangements that account for regulatory, currency, and counterparty risks. Legal advisors will need to address issues such as currency risk, regulatory arbitrage, and enforceability of foreign judgments or arbitral awards.

Regional Integration and ASEAN Banking Ambitions

Malaysian banks are well-positioned to play a greater role in cross-border financing within ASEAN. The liberalisation of foreign equity caps in financial services, coupled with harmonisation efforts under the ASEAN Banking Integration Framework, open doors for expansion. Legal advisors assisting banks with regional ambitions must be familiar with multi-jurisdictional licensing requirements and supervisory coordination across ASEAN central banks.

With the possibility of further monetary easing and ongoing geopolitical uncertainty, stakeholders must remain agile. Banks and borrowers alike should revisit legal documentation, manage risks proactively, and position themselves to benefit from Malaysia's resilient and evolving financial landscape.

Conclusion

The July 2025 OPR cut marks a pivotal moment for Malaysia's financial sector, prompting a reassessment of financing strategies, regulatory priorities, and market positioning. As highlighted in this article, the rate reduction carries wide-ranging legal and economic implications. It necessitates recalibrations across loan documentation, deposit strategies, and ESG-linked financing, while reinforcing the need for strict compliance with BNM's evolving regulatory framework.

From the repricing of loan portfolios to the rise of digital banking, legal advisors play a central role in safeguarding contractual integrity, advising on cross-border complexities, and navigating ESG obligations. Looking ahead, the OPR cut serves as both a short-term stimulus and a strategic signal, underscoring the urgency for stakeholders to future-proof their strategies in the face of digitalisation, sustainability imperatives, and deeper regional integration.

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RESILIENCE BY DESIGN: HARNESSING INFRASTRUCTURE AND PUBLIC–PRIVATE PARTNERSHIPS FOR DISASTER RISK REDUCTION IN MALAYSIA

by Sharifah Sazita Syed Hamzah & Mike Chan

When disaster strikes, the strength of a nation is measured not only by its response, but by how well it has prepared to withstand the blow. In Malaysia - where monsoonal floods, landslides, and coastal erosion increasingly threaten lives and livelihoods - the role of infrastructure is no longer confined to powering growth. It is the backbone of national resilience. From Kuala Lumpur's SMART Tunnel, which doubles as a traffic artery and a flood bypass, to coastal embankments shielding fishing villages, Malaysia has proven that the right projects, properly maintained, save lives and money. According to the United Nations Office for Disaster Risk Reduction, every $1 invested in prevention measures can generate savings of up to $15 in post-disaster recovery expenditure.

Malaysia's experience shows that a well-planned infrastructure programme can significantly reduce disaster impacts. Yet the next leap will require not only better engineering, but also innovative financing and delivery models. This is where Public–Private Partnerships (PPPs) should play a central role: unlocking private capital, transferring know-how, and ensuring long-term maintenance discipline.

A shifting risk landscape demands resilient infrastructure

Malaysia now faces a heightened spectrum of disaster risks, amplified by climate change and rapid urbanisation. Urban expansion has encroached on floodplains. Heavier rainfall overwhelms older drains. Slope development amplifies landslide risks, while rising seas threaten coastal settlements. These are not abstract scenarios - every flood season disrupts commerce, damages homes, and erodes investor confidence.

Infrastructure is our first line of defence, but "more of the same" will not suffice. Building more drains, levees and walls is no longer sufficient. Resilient assets must be planned for exceedance (beyond average rainfall), absorbing shocks without catastrophic failure, and rapid restoration - while delivering co-benefits in normal times. PPPs add a crucial dimension: structuring projects so that resilience is contractually guaranteed over decades, rather than left to overstretched public budgets.

Malaysian successes: Infrastructure that saves lives – SMART Tunnel, Kuala Lumpur

This is the world's first dual-purpose road and stormwater tunnel, conceptualised on a PPP basis. This infrastructure blends mobility and flood defence. Though delivered conventionally, it demonstrates the "multi-functionality" principle that PPPs are well suited to capture in contracts. On normal days, it functions as a motorway, easing traffic congestion in the city of Kuala Lumpur. During heavy rain, it transforms into a flood bypass, diverting millions of cubic meters of stormwater away from the city centre. Since completion of construction and during operational period, SMART has prevented countless floods in the Klang Valley's most vulnerable areas, proving that innovative design can solve multiple urban challenges at once.

Flood mitigation in Kedah, Kelantan, Johor and Sarawak

River bunds, detention ponds, retention ponds, levees, floodwalls, river channel upgrades, and upgraded pumps have reduced flooding frequency. Yet long-term operation and maintenance ("O&M") remains a challenge. Embedding these works in PPP structures - with private operators accountable for pump availability, drainage capacity, and maintenance - would lock in resilience performance.

Slope management in Penang and Cameron Highlands

Retaining walls, soil nailing, and drainage upgrades have curbed landslides. A PPP model could deliver these as programmatic bundles, covering multiple slopes under a single contract with monitoring sensors, parametric insurance, and lifecycle maintenance obligations.

Coastal protection in Sabah and Terengganu

Sea walls and breakwaters shield villages from erosion. Here too, PPP models could mobilise private capital for hybrid coastal defences, where availability payments are tied to reduced overtopping incidents or maintained protective width.

In a PPP, availability payments are regular payments made by the government (or contracting authority) to the private partner, as long as the infrastructure is available and performing to agreed standards.

- They are not linked to demand or user fees (e.g. tolls or ticket sales).
- Instead, they are tied to service quality and performance indicators - like safety, reliability, or resilience.
- If the infrastructure fails to meet the agreed criteria, payments are deducted (penalty for non-performance).

The lesson is not only that infrastructure works, but that PPPs can institutionalise resilience standards and secure O&M funding, reducing the risk of assets failing prematurely.

Global models and PPP lessons for Malaysia

I. Netherlands – "Room for the River" (Design–Build–Finance–Maintain)

While much of the Dutch programme was publicly funded, certain works used long-term PPP contracts that tied payment to flood resilience performance. Malaysia could adopt similar approaches: floodable parks and diversion channels delivered as PPPs, with revenue-sharing from adjacent land redevelopment.

II. Japan – Seismic PPP schools and hospitals

Private partners design, finance, and maintain public buildings to seismic standards. Malaysia could replicate this approach for schools doubling as flood shelters, ensuring durability and continuous readiness.

III. Bangladesh – Cyclone shelters and embankments

While largely public, donors are now piloting PPP-style O&M contracts for embankments. Malaysia's coastal districts could embark on trial PPP models for multipurpose community shelters, backed by blended finance.

IV. Chile – Concessioned infrastructure with seismic standards

Roads, bridges, and airports under concession contracts must meet strict earthquake resilience codes, with private operators liable for rapid recovery. Malaysia can embed similar requirements in PPP contracts for toll roads and ports in flood-prone areas.

V. Singapore – Marina Barrage

This is a multi-functional dam and reservoir that serves as a key part of Singapore's water management and flood control system. It creates the Marina Reservoir, a freshwater source in the heart of the city, whilst acting as a barrier to prevent flooding from sea surges and heavy rain. The Barrage also provides recreational spaces and is a popular tourist destination. Though publicly funded, its operation could easily lend itself to a PPP framework: performance-based O&M contracts ensuring flood control reliability, water quality, and energy efficiency.

The global lesson is clear: PPPs are not just financing tools - they are governance mechanisms that lock in long-term resilience by aligning private incentives with public safety.

PPPs as a vehicle for resilience financing

Resilient infrastructure is capital-intensive, but it can be structured to attract investment if service outputs are predictable.

- **Performance-based PPPs**
  Instead of paying for inputs (a pump station or levee), government pays for outputs: e.g., "maximum water level not exceeded in basin", "drainage system operational 99% of the time". Private operators bear lifecycle responsibility, incentivising preventive maintenance.

- **Blended finance PPPs**
  Concessional loans or guarantees from development banks (ADB, AIIB, World Bank) can lower the risk premium for resilience PPPs, particularly where climate hazards are uncertain.

- **Green sukuk and resilience bonds**
  Malaysia's leadership in Islamic finance positions it to issue resilience-linked sukuk for PPPs bundling multiple mid-size flood and slope projects. Institutional investors, particularly pension funds, are natural long-term partners.

- **Insurance-linked PPPs**
  Contracts can embed parametric insurance to cover extraordinary rainfall or surge events, ensuring both operator and government are protected.

Policy And Legal Frameworks To Enable PPP Resilience

Malaysia already has a PPP framework, but embedding resilience standards requires adjustments:

- Mandating climate risk assessments at project preparation stage.
- Allowing availability-based PPP payments tied to resilience outcomes.
- Encouraging catchment-scale PPPs (bundling multiple flood assets into one contract).
- Requiring private operators to integrate nature-based solutions - mangroves, wetlands, green buffers - into designs.
- Enhancing cross-agency coordination so that PPPs integrate with NADMA and local authority planning.

From Concept To Bankable PPPs: Pipeline For Resilient Infrastructure

To translate disaster-resilient infrastructure from concept to implementation, Malaysia must prioritise a pipeline of PPP-ready projects that not only protect communities but also demonstrate commercial viability and attract long-term capital. Four potential models stand out:

I. Klang Valley Detention Parks PPP

Flooding remains the most frequent disaster risk in Malaysia, particularly in the Klang Valley. Instead of relying solely on concrete drains and culverts, the government could pursue PPP for a network of floodable parks, smart drains and detention ponds, designed as multifunctional green infrastructure.

- The parks would function as community recreational spaces in dry conditions, while doubling as temporary stormwater storage during heavy rains.
- Private partners could be engaged to design, finance, build, and maintain the system.
- Payments from government would be structured as availability payments, tied to measurable flood outcomes such as reductions in peak flows into critical waterways like Sungai Klang.

This model would showcase how infrastructure can be both people-friendly and climate-resilient, while embedding private-sector efficiency into long-term operations.

II. East Coast Hybrid Coastal Defence PPP

Malaysia's East Coast is increasingly exposed to storm surges and coastal erosion. A PPP could be structured to deliver hybrid defences that combine hard infrastructure (breakwaters, revetments) with nature-based solutions (mangrove restoration and beach nourishment).

- Financing could be mobilised through sukuk (Islamic bonds), widening the pool of institutional investors and aligning with Malaysia's leadership in Islamic finance.
- The private consortium would be responsible for both the engineering works and long-term ecosystem management, with performance guarantees tied to coastal protection metrics such as reduced overtopping or maintained mangrove width.

This would mark Malaysia as a regional leader in green-blue PPPs, setting an example of how financial innovation and ecological design can reinforce each other.

III. Slope Safety PPP for the Highlands

Highland regions like Cameron Highlands and Genting face increasing landslide risks due to deforestation, heavy rainfall, and rapid development. A programmatic PPP could be developed to address slope safety at scale:

- The private partner would undertake a portfolio of slope stabilisation measures - such as soil nailing, retaining walls, vegetation cover, and smart sensors for real-time monitoring.
- Government payments would be tied to slope stability performance indicators, with parametric insurance embedded in the PPP contract to ensure rapid payouts if rainfall or ground movement exceeds pre-defined thresholds.
- This approach would replace piecemeal, reactive repairs with a long-term, preventive system, giving both residents and investors greater confidence in Malaysia's highland safety.

IV. Urban Tidal Control PPP

Coastal cities like Johor Bahru and George Town (Penang) are already experiencing tidal flooding linked to sea-level rise and land subsidence. A PPP pilot could deliver

tidal gates, pumping stations, and sea walls, integrated with urban regeneration schemes along the waterfront:

- Financing could include land value capture mechanisms, where the uplift in land and property values from revitalised, flood-protected waterfronts is channelled back into the project.
- The private consortium would be incentivised to maintain the defences at peak performance, as payments would be conditional on minimised tidal flooding incidents.
- Beyond flood control, such projects would catalyse economic development and tourism, showing how resilience infrastructure can be both protective and catalytic.

Conclusion: PPPs As A Catalyst For Resilience

Malaysia has shown that infrastructure can protect lives and livelihoods. The next frontier is to scale resilience through delivery models that guarantee long-term performance. Public–Private Partnerships are not a panacea, but they are powerful enablers - mobilising private capital, embedding lifecycle accountability, and aligning innovation with public safety.

If resilience is embedded into PPP contracts through measurable outcomes, innovative and blended financing, and strong enforceable legal frameworks, Malaysia can shift decisively from reactive disaster response to proactive risk reduction and prevention. In doing so, it can not only safeguard communities but also demonstrate regional leadership in financing and delivering resilient infrastructure.

It is highly commendable that Malaysia has already formalised its Disaster Risk Reduction ("DRR") agenda through the National Disaster Risk Reduction Policy 2030, launched by NADMA in 2024. This policy aligns with the Sendai Framework and cements DRR as a cross-sector requirement, such that infrastructure, land-use, and development projects must systematically integrate hazard and climate resilience considerations from the outset. For the infrastructure sector, this is a clear signal: resilience is no longer a "value-add" but a compliance and investment driver, opening the door to large-scale, well-funded projects nationwide.

Resilience is not a luxury; it is the currency of sustainable growth. With PPPs as a catalyst, Malaysia can transform its infrastructure landscape into one that not only withstands shocks but powers sustainable growth. The choice is clear: by building resilience into every contract and every project, Malaysia can engineer a safer, stronger, and globally competitive future.

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PERFORMANCE BONDS OR BANK GUARANTEES: RISK ALLOCATION IN CONSTRUCTION CONTRACTS

by Austen Pereira & Chow Chen Yie

The construction industry is a high-stakes environment. Projects are capital-intensive, technically complex, and often involve multiple stakeholders across extended timelines. Against this backdrop, the risk of contractor default, project delays, or defective work is ever-present. To mitigate such risks, parties rely heavily on performance bonds or bank guarantees. Though sometimes perceived as ancillary to the main contract, these instruments are pivotal in shaping the allocation of risk between employer and contractor.

Performance bonds or bank guarantees provide employers with swift financial recourse, while contractors accept them as part of the price of admission to major projects. Yet, their invocation is frequently contentious. Employers may call upon them in circumstances where the employers believe that contractors' obligations have not been substantially performed or where remedial works are not satisfactory. Contractors may respond by seeking urgent judicial intervention to restrain what they view as fraudulent or unconscionable conduct. Courts are then faced with a delicate balancing act: upholding the commercial certainty of bonds or guarantees while preventing unconscionable or fraudulent use.

The Malaysian jurisprudence reflects this tension. Influenced by English law, which most of the time recognises fraud as the sole ground for restraining calls, and Singaporean jurisprudence, which has developed unconscionability more expansively, Malaysia has adopted a middle path. This article examines the nature and purpose of performance bonds or bank guarantees, their role in risk allocation, the distinction between conditional and unconditional bonds or guarantees, the principle of autonomy, the grounds upon which a call may be restrained, and the practical implications for employers, contractors, and banks.

The Nature Of Performance Bonds Or Bank Guarantees

A performance bond or bank guarantee is typically a tripartite arrangement. The contractor procures a bond or guarantee from a bank or financial institution in favour of the employer, who is the beneficiary. In consideration of collateral or fees, the bank undertakes to pay a specified sum (commonly between five and ten percent of the contract price) if the contractor defaults on its obligations, depending on the terms of the performance bond or bank guarantee.

Unlike retention sums, which are monies withheld by the employer from sums otherwise payable under the contract, performance bonds or bank guarantees involve an independent undertaking from a third-party guarantor. This independence is significant: the obligation to pay rests on the bank, not on the employer, thereby insulating the employer's cash flow. For contractors, however, it imposes a tangible cost, whether through financing charges or tied-up collateral.

Malaysian courts have consistently recognised that performance bonds or bank guarantees constitute contracts separate from the underlying construction agreement. Once the employer issues a demand that complies with the bond's or guarantee's terms, the bank is obliged to pay, regardless of disputes under the main contract. This principle has been repeatedly affirmed in case law, including the Federal Court case of *Karya Lagenda Sdn. Bhd. v Kejuruteraan Bintai Kindenko Sdn. Bhd. & Anor* [2008] 6 MLJ 636.

Purpose And Risk Allocation

The primary purpose of performance bonds or bank guarantees is twofold: to protect employers against the financial consequences of non-performance or delay, and to incentivise contractors to perform diligently to avoid forfeiture.

For employers, the bond or guarantee functions as an assurance of ready funds. In the event of default, an employer does not need to first prove breach in arbitration or litigation (subject to the terms of the bond or guarantee); the bond or guarantee ensures immediate liquidity to finance remedial works or hire replacement contractors. The bond or guarantee also provides security against the ever-present risk of contractor insolvency, which is not uncommon in the sector.

For contractors, however, providing a bond or guarantee is a voluntary assumption of risk. Contractors must price the risk into their tenders, carefully negotiate the bond's or guarantee's wording, and maintain liquidity to withstand a potential call. A call on the bond or guarantee can have significant financial and reputational consequences, often impacting the contractor's credit standing and ability to secure future projects.

From the bank's perspective, the role is limited. Its obligation is to ensure that the demand complies with the precise wording of the bond or guarantee. Banks often do not concern themselves with disputes under the construction contract. This principle, known as the autonomy of the bond or guarantee, underpins the reliability and commercial value of such instruments.

Conditional And On-Demand Bonds Or Guarantees

Two categories of performance bonds or bank guarantees are generally recognised: conditional (or default) bonds or guarantees and unconditional (or on-demand) bonds or guarantees. A conditional bond or guarantee requires the employer to prove the contractor's default before the bank is obliged to pay. By contrast, an on-demand bond or guarantee requires only that the employer make a written demand in the form prescribed by the instrument, regardless of whether default is established at the time.

The classification turns not only on labels but on wording. The Court of Appeal in *Teknik Cekap Sendirian Berhad v. Public Bank Berhad* [1995] 3 MLJ 449 (affirmed by the Federal Court in [1998] 3 MLJ XXV) held that the operative question is whether the bond expressly makes payment conditional on proof of breach. Where it does not, courts will construe the instrument as on-demand. This principle was reaffirmed in *Suharta Development Sdn Bhd v United Overseas Bank (M) Bhd* [2005] 2 MLJ 762.

In practice, this judicial tendency reflects commercial reality: employers prefer bonds or guarantees that are "as good as cash," while banks require clarity as to their obligations. For contractors, however, the consequences are severe. Accepting an on-demand bond or guarantee means that payment may be triggered regardless of whether there is an actual breach. Contractors who wish to mitigate this risk must negotiate for conditional wording or certification mechanisms.

The recent Malaysian Court of Appeal decision in *Oxley Rising Sdn. Bhd. v. Ssangyong Engineering & Construction Co. Ltd.* [2023] Appeal No. W-02(C)(A)-274-02/2022 serves as a stark, modern reminder of the severe consequences of agreeing to an unconditional on-demand instrument. The court emphatically reaffirmed that where a guarantee is accepted by all parties as being "on-demand," its operation is not contingent upon the terms of the underlying construction contract. The court held that it is *"quite odd"* for a contractor to subsequently argue that conditions from the main contract must be satisfied before a call can be made, stating that if this was the intent, the contractor should not have agreed to an on-demand guarantee in the first place. This shows the critical importance of the initial negotiation phase; once an on-demand bond is executed, its autonomy is virtually absolute.

The Autonomy Principle

Performance bonds or bank guarantees are autonomous instruments. They are independent of the underlying construction contract, and the bank's obligation is confined to the four corners of the bond or guarantee. Once an employer makes a demand that complies with the bond's or guarantee's terms, the bank must pay, without inquiring into disputes between employer and contractor.

This principle was affirmed in *LEC Contractors (M) Sdn Bhd (Formerly Known As Lotteworld Engineering & Construction Sdn Bhd) V Castle Inn Sdn Bhd & Anor* [2000] 3 MLJ 339, where the Court of Appeal made clear that a bank is not required to investigate allegations of breach before paying under a bond. Similarly, in Karya Lagenda, the Federal Court held that bonds are to be construed strictly by their terms and not qualified by reference to the underlying contract.

The rationale for this principle is commercial certainty. If banks were obliged to investigate underlying disputes and to act as adjudicator to those disputes, performance bonds or bank guarantees would lose their utility. Employers value them precisely because they provide immediate liquidity. Contractors may consider this harsh, but it reflects the deliberate risk allocation inherent in agreeing to an on-demand instrument.

This principle of autonomy was rigorously applied in the *Oxley Rising case.* The Court of Appeal, binding itself to the apex court precedent in Karya Lagenda, ruled that an on-demand guarantee is a *"separate document entitling the* [employer] *to rely on its terms independent of and aside from the formal contract."* Therefore, the bank's obligation to pay and the employer's right to call the bond are determined solely by the guarantee's own wording, not by whether a breach of the main contract has been proven.

Grounds For Restraining A Call

Although the autonomy principle is robust, courts recognise narrow exceptions. In Malaysia, there are two grounds upon which a call may be restrained: fraud and unconscionability.

Fraud is the traditional and universally accepted ground. If the employer acts fraudulently in making a demand and the bank has notice of such fraud, the court may restrain payment. The standard is high. Fraud must be clearly established and must go to the root of the demand. Mere allegations of breach, unfairness, or opportunism are insufficient. The English House of Lord case of United City Merchants (Investments) Ltd v Royal Bank of Canada [1983] 1 AC 168 and English Court of Appeal case of *Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.* [1978] Q.B. 159 remains the touchstone, and Malaysian courts have followed this approach, such as the Supreme Court case of *Esso Petroleum Malaysia Inc v Kago Petroleum Sdn Bhd* [1995] 1 MLJ 149.

Unconscionability, by contrast, is a more recent development in Malaysian law. Recognised in the Federal Court case of *Sumatec Engineering & Construction Sdn Bhd v Malaysian Refining Co Sdn Bhd* [2012] 4 MLJ 1, unconscionability permits the court to intervene where a call is oppressive, unfair, or in bad faith. The standard is equally high. The doctrine is applied sparingly.

The *Oxley Rising* case provides a clear example of the high bar for establishing unconscionability. The High Court had initially restrained the call, finding it unconscionable because the guarantee was "over-securitized" and the employer had not proven the estimated losses at the time of the call. The Court of Appeal unanimously overturned this decision. It held that for an on-demand guarantee, the concept of being "over-securitized" is irrelevant, and the employer is not required to prove losses or a breach at the point of making the demand. The court emphasised that injunctive relief is a very harsh remedy that restricts a beneficiary from enforcing a substantive right they had bargained for. The plaintiff's failure to meet this "high threshold" was fatal to its case.

In *Perspektif Masa Sdn Bhd v Sabah Development Bank Bhd* [2024] CLJU 2512, the Court of Appeal stressed that contracts asking for an injunction on grounds of unconscionability must make full and frank disclosure to the courts that the bond is unconditional and on-demand. Failure to do so would cause the application to be dismissed.

Contractors seeking to restrain a call also face significant procedural hurdles. Applications are often made on an ex parte basis, requiring strict compliance with

the duty of full and frank disclosure under *Order 29 Rule 1 of the Rules of Court 2012. In Kosma Palm Oil Mill Sdn Bhd v Koperasi Serbausaha Makmur Bhd* [2004] 1 MLJ 316, the Court of Appeal underscored that failure to disclose material facts can itself justify setting aside an injunction. In fact, that duty is a continuing one.

The high bar for establishing fraud or unconscionability, combined with the procedural demands of injunction applications, means that successful challenges to bond or guarantee calls remain relatively rare.

Mere contractual or construction disputes are also not enough to elevate to a level of unconscionability (see *Malaysian Resources Corporation Berhad v HSBC Bank Malaysia Berhad & Ors and another suit* [2019] MLJU 813).

Practical Considerations For Employers, Contractors And Banks

For employers, performance bonds or bank guarantees provide a valuable form of security. They ensure that funds are available to remedy contractor default and provide leverage in negotiations.

For contractors, bonds or guarantees represent a significant financial exposure. Contractors must weigh the risks carefully during contract negotiations. Where bargaining power permits, they should negotiate for conditional bonds or guarantees or reduced quantum. Contractors should also be prepared for the possibility of a call by maintaining liquidity or arranging back-to-back securities with subcontractors.

Banks occupy a more neutral role, but one no less important. Their obligation is limited to verifying compliance with the bond's or guarantee's terms. Banks must avoid becoming embroiled in underlying disputes and should adopt a strict compliance approach. While banks may occasionally face injunction proceedings, adherence to the autonomy principle provides the clearest protection.

Comparative Perspectives

The Malaysian position is best understood in comparative context. English law continues to confine judicial intervention to cases of fraud. The fraud exception is well established and strictly applied. The English courts' priority is to preserve the commercial certainty of performance bonds or bank guarantees, even at the expense of fairness in individual cases.

Singapore, by contrast, has embraced unconscionability more fully. In *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] SGCA 28, the Court of Appeal restrained a call where the employer's conduct was deemed oppressive. The Singaporean approach provides contractors with greater protection but does potentially undermine the reliability of on-demand instruments.

Malaysia has chosen a middle course. It recognises unconscionability but applies it sparingly, ensuring that the commercial value of bonds or guarantees is preserved

while retaining a narrow equitable safety valve. The result is a body of law that prioritises certainty but remains open to intervention in very exceptional cases.

Conclusion

Performance bonds or bank guarantees are integral to construction contracts in Malaysia. They operate as tools of risk allocation, providing employers with financial security, disciplining contractors, and offering banks a clear and autonomous obligation. Yet their invocation is inherently contentious, and the courts are often called upon to balance certainty with fairness.

Bonds or guarantees are autonomous and enforceable upon demand. The exceptions of fraud and unconscionability remain narrow, with the latter applied only in truly egregious circumstances. For employers, the key lesson is to exercise calls responsibly, avoiding conduct that could be characterised as abusive or even fraudulent. For contractors, the reality is that furnishing an on-demand bond or guarantee is a deliberate assumption of risk that must be managed strategically. For banks, strict adherence to the autonomy principle remains paramount.

Ultimately, performance bonds or bank guarantees represent the commercial bargain struck by the parties. They are instruments of both security and discipline, designed to keep projects on track. As the recent *Oxley Rising* decision confirms, the Malaysian judiciary remains steadfast in prioritising the commercial certainty of unconditional on-demand guarantees or performance bonds. The courts will not inquire into underlying disputes or allegations of breach to qualify the employer's right to call the bond or bank guarantee. The narrow exceptions of fraud and unconscionability are applied stringently, with the latter requiring a truly egregious case that meets a very high threshold. This jurisprudence reinforces the finality of the commercial bargain struck between the parties at the time of contracting and serves as a clear warning to contractors to manage this risk proactively before the bond or bank guarantee is issued.

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COURT OF APPEAL ALLOWS TRANSFER PRICING APPEAL AND RULES THAT THE REVENUE LACKED AUTHORITY TO REVIEW PRICING METHODOLOGY

by Tan Jia Hua & S. Saravana Kumar

Recently, the Court of Appeal in EOS v Ketua Pengarah Hasil Dalam Negeri held that the Revenue has no legal authority to review and replace the taxpayer's chosen transfer pricing method (TP method). The Court of Appeal also held that the Revenue has no basis in law to apply median adjustments in relation to the taxpayer's transfer pricing treatment in the years of assessment (YA) 2014 to 2016. The court highlighted that such authority was only vested with the Revenue under the Income Tax (Transfer Pricing) Rules 2023 (TP Rules 2023), which only come into effect from the YA 2023.

The taxpayer in this appeal was successfully represented by the firm's Tax, SST & Customs Partner, S. Saravana Kumar together with associate, Tan Jia Hua.

Background Facts

The taxpayer's principal activity involved the chartering of offshore support vessels. In the YA 2014 to 2016, the taxpayer made payments to a related party for charter hire of vessels and crew management services, which were priced using the cost-plus method (CPM) with a mark-up of 35%.

The Revenue rejected the taxpayer's CPM method and substituted it with the transactional net margin method (TNMM). The Revenue further adjusted the charter hire and crew management service fees by applying the median of five comparable companies that the Revenue had identified.

Dissatisfied with the transfer pricing adjustment, the taxpayer commenced judicial review proceedings at the High Court. Although leave for judicial review was granted, the substantive application was subsequently dismissed on the basis that the dispute between the parties in relation to the appropriate transfer pricing method was essentially a question of fact. The High Court held that the matter was best referred to the Special Commissioners of Income Tax (SCIT).

Aggrieved by the High Court's decision, the taxpayer appealed to the Court of Appeal.

The Taxpayer's Appeal

At the outset, the taxpayer submitted that the present dispute raised a question of law rather than a mere question of fact, as it concerned the Revenue's authority to review and replace the TP method selected by the taxpayer under Section 140A of the ITA and the applicable TP Rules.

During the YAs in dispute, the choice of TP methods was governed by Rule 5(1) of the TP Rules 2012:

> *"A person shall apply the traditional transactional method to determine the arm's length price of a controlled transaction."*

The traditional transactional method, as defined by Rule 5(4) of the TP Rules 2012 includes CPM, which was the method used by the taxpayer in this case.

On the other hand, Rule 5(2) of the TP Rules 2012 specifies that the transactional profit method should only be applied when the traditional transactional method cannot be reliably used or is entirely inapplicable:

> *"Where the traditional transactional method cannot be reliably applied or cannot be applied at all, the person shall then apply the transactional profit method."*

The traditional profit method was defined by Rule 5(4) of the same TP Rules to include TNMM, which is the method used by the Revenue in this case.

However, neither Rule 5(1) nor Rule 5(2) empowers the Revenue to review or replace the TP method selected by a taxpayer. Instead, the TP Rules make clear that the discretion to apply the exception under Rule 5(2) rests with the taxpayer, not the Revenue.

Meanwhile, Rule 5(3) of the TP Rules 2012 merely empowers the Revenue to permit the use of an alternative method, it does not confer the authority to unilaterally review, dictate, or replace the method selected by the taxpayer.

This legal position is further reinforced by the introduction of Rule 6(3) of the TP Rules 2023, which expressly grants the Revenue the power to review and replace a taxpayer's chosen method.

In this regard, the High Court failed to appreciate that neither Section 140A of the ITA nor the TP Rules 2012 authorise the Revenue to apply the median range in making adjustments. Such an authority only arose with the introduction of Rule 13(3) and Rule 13(5) of the TP Rules 2023.

It was submitted that Parliament does not legislate in vain and as such, the very reason Parliament amended the Transfer Pricing Rules in 2023 was to expressly broaden the scope of the Revenue to review and substitute transfer pricing methods and to impose median adjustments.

However, the Minister in making the TP Rules 2023, did not intend for the Rules to operate retrospectively. This is evident from Rule 1(2), which provides that the TP Rules 2023 were to apply prospectively from the YA 2023 onwards.

Accordingly, it was argued that the Revenue acted ultra vires in reviewing and replacing the transfer pricing method used by the taxpayer for the YAs 2014 to 2016, and in selecting comparables and imposing a median adjustment in determining the arm's length prices for those years.

The taxpayer distinguished the present appeal from *Ketua Pengarah Hasil Dalam Negeri* v *Ensco Gerudi (M) Sdn Bhd* [2023] 5 MLJ 159, which was relied upon by the Revenue, for two principal reasons. First, the dispute in *Ensco Gerudi* centred on the factual issue of pricing, which concerned the computation of pricing, the accounting methods adopted by the taxpayer and the adequacy of the transfer pricing documentation. Second, in *Ensco Gerudi*, there was also the issue of time barred assessment, which inevitably raises the factual question of negligence, wilful default or fraud, all of which are factual disputes, which was absent in the present matter.

The Revenue's Response

First, the Revenue argued that tax matter in relation to transfer pricing is a question of fact and ought to be determined by the judges of facts- SCIT. This position has been confirmed in the case of *Ensco Gerudi*.

Second, the Revenue was originally empowered under Section 140A of the ITA to review and replace the transfer pricing method adopted by the taxpayer. The amendments introduced in the Transfer Pricing Rules 2023 were not to confer a new power but rather to keep pace with evolving tax developments and to provide greater breadth and clarity to the existing framework.

Finally, the Revenue submitted that since the taxpayer had already commenced its appeal before the SCIT, it would be most appropriate to allow the SCIT to continue with the determination of the dispute pursuant to Section 99(1) of the ITA. In the Revenue's view, this approach is consistent with the statutory scheme and respects the proper role of the SCIT as the fact-finding body for tax disputes.

The Court of Appeal's Ruling

The Court of Appeal unanimously reversed the decision of the High Court and in its oral judgment made several important findings.

First, the court held that the dispute was not a mere question of fact, as contended by the Revenue but one of jurisdiction. The central issue concerned whether the Revenue had acted within the scope of its statutory powers, which was a question of law suitable for judicial determination via judicial review.

Second, the court found that Section 140A of the ITA and the TP Rules 2012, which was applicable in the YAs 2014 to 2016, did not empower the Revenue to review and

replace the transfer pricing method chosen by the taxpayer. Neither did Section 140A nor the TP Rules 2012 permit the making of a median adjustment. Such powers were only vested with the Revenue through the TP Rules 2023, which was only effective from 1.1.2023.

On the basis of these findings, the Court of Appeal allowed the taxpayer's application, granted an order of certiorari and set aside the impugned tax assessments for the YAs 2014 to 2016.

Conclusion

This case is significant as it marks the first transfer pricing matter successfully allowed by way of judicial review at the Court of Appeal. While transfer pricing disputes are often fact-intensive and courts have traditionally deferred to the SCIT as the judges of fact, this decision makes clear that not all transfer pricing issues are purely factual.

The availability of judicial review in tax matters must be assessed on a case-by-case basis, particularly where the dispute concerns the jurisdiction or legal authority of the Revenue. In such circumstances, judicial review remains an appropriate remedy.

In light of the Court of Appeal's ruling that Section 140A of the ITA and the TP Rules 2012 did not empower the Revenue to review and replace the transfer pricing method chosen by the taxpayer and also to impose median adjustment, it remains to be seen if taxpayers will challenge such transfer pricing adjustments made by the Revenue prior to the YA 2023.

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OWNING THE FUTURE: AI, COPYRIGHT AND THE GLOBAL STRUGGLE FOR INTELLECTUAL PROPERTY IN 2025

by Lim Zhi Jian & Evien See

On 24 June 2025, Judge William Alsup delivered a pivotal ruling in *Bartz et al. v. Anthropic PBC*. This case has since become the largest certified copyright class action involving artificial intelligence to date, with the court allowing millions of U.S. authors to proceed together. At the heart of the dispute was whether AI developers may train their systems with copyrighted works without obtaining any licences.

The plaintiffs alleged that Anthropic ingested thousands of books into its Claude training datasets. Some were legitimately acquired, others pirated. The court drew a clear line: where the books were lawfully acquired, training on them amounted to fair use. The judge described the process as "transformative", similar to how a student studies and synthesises different works and then creates something new without copying any one source verbatim. However, where pirated works were retained and indexed, the court refused to extend the protection of fair use.

Instead of proceeding to trial, Anthropic raised settlement with the plaintiffs on 26 August 2025. While the terms remain confidential, the court filing noted that preliminary approval must be sought in early September. This marked the first major resolution of an AI copyright class action, with authors' counsel calling it "historic." The settlement also underscored the scale of potential liability, as judges had previously warned Anthropic could face billions in statutory damages over an alleged ingestion of up to seven million pirated books.

This ruling is significant because it gave the AI industry some breathing space: training on lawfully acquired works could fall within fair use. At the same time, the combination of class certification and settlement sent a warning that "data hygiene" matters. Using or failing to filter out pirated materials not only leaves companies exposed to infringement claims but now carries the real prospect of costly settlements or damages awards.

The Anthropic decision is not an isolated case. It sits within a larger global debate on three key questions: Who owns AI-generated works? Can training on copyrighted content without permission ever be justified? And what role should intellectual property law play when machines are increasingly involved in creative expression?

Generative AI And Ownership

Generative AI systems differ from traditional software in that they produce new text, images, music, video, and even product designs based on patterns learned from vast datasets. In simple words, the user provides a prompt, and the system generates content in response.

This gives rise to an immediate ownership dilemma. Is the AI company, having built and trained the model, the true creator? Is it the user, whose prompts guide the output? Should the output be considered a collaboration? Or should the law accept that these works cannot be owned at all?

There is still no consistent answer. Courts, regulators and creators are taking different positions depending on their jurisdiction and perspective.

United States: Human Authorship Remains Non-Negotiable

The U.S. has consistently rejected the idea that machines themselves can be authors.

In *Thaler v. Perlmutter*, Dr. Stephen Thaler tried to register a work generated by his "Creativity Machine," naming the AI as the author. Both the Copyright Office and the D.C. Circuit refused. The court held that the Copyright Act requires human authorship, and that listing only the AI meant the application had to be denied.

Similarly, in *Allen v. Perlmutter*, Jason Allen sought to register "Théâtre d'opéra Spatial," a work produced using Midjourney and later refined with software editing. He argued that his hundreds of prompt refinements amounted to authorship. The Copyright Office disagreed. It maintained that prompts alone are insufficient, since the "traditional elements of authorship" are executed by the AI, not the human. As Allen refused to disclaim the AI-generated portions, his application was rejected.

The *Bartz v. Anthropic* case shifts the focus from outputs to inputs. In this case, Judge Alsup gave a measure of clarity: lawfully acquired data may be used to train AI under fair use, but pirated data remains outside that protection. This ruling has made clear to the industry — data provenance is as important as the use of the final output.

Other U.S. disputes add to this picture. In *Thomson Reuters v. ROSS Intelligence,* the Delaware court found that ROSS had infringed copyright by using Westlaw's headnotes to build a competing legal research tool. The use was not fair use because it substituted directly for Westlaw's market. The ongoing New York Times v. Microsoft/OpenAI litigation raises similar issues in the context of news archives, while *Disney v. Midjourney* goes to the heart of whether training on visual works like Disney characters can be justified without licences.

There is a perceivable trend in the U.S.. Courts have firmly rejected the notion of machine authorship, insisting that only works created by humans can qualify

for protection. At the same time, judges are willing to accept that training on copyrighted works may fall within the scope of fair use, but only where the material has been lawfully obtained and the use is genuinely transformative. What U.S. courts will not accept is the use of pirated datasets or outputs that operate as a direct substitute for the original work. Through class certification, that principle was weaponised: infringement was no longer a one-to-one dispute, but a potential multibillion-dollar class liability.

China: Recognising The Prompt Engineer

China has shown greater openness to treating AI as a tool and crediting the human who guides it.

In *Li v. Liu*, the court held that Mr. Li's detailed prompts and technical settings in Stable Diffusion amounted to sufficient intellectual input. The image he generated was therefore protected, and the defendant's use without permission was infringing.

This reasoning was reinforced in the "Half Heart" case, *Chen (Lin) v. Changshu Qin Hong Real Estate*. Mr. Lin tested multiple prompts in Midjourney, selected the best results, and refined them in Photoshop. The court held that this reflected original intellectual input, sufficient for copyright. However, the ruling was limited to his 2D image; a 3D installation inspired by the same work was held not to infringe, because copyright protects expressions, not ideas.

By contrast, in *Feng Runjuan v Kuashi Plastic,* the court dismissed the plaintiff's claim when she could not demonstrate sufficient creative input. Her use of Midjourney prompts was deemed too vague and unoriginal, and she admitted she could not reproduce the work due to AI randomness. The court found that the AI had done the substantive creative work, leaving her with no valid copyright claim.

These cases show that Chinese courts are drawing a clear distinction. Where the human input is meaningful, demonstrable, and creative, the courts have been prepared to recognise copyright protection and treat the AI as no more than a tool. By contrast, where the involvement is minimal, mechanical, or incapable of being evidenced, the claim will fail.

Training Data: The Real Battleground

While questions of authorship remain important, the bigger disputes are now about training data. Can AI companies ingest copyrighted works without permission?

The U.S. Copyright Office's ongoing reports have addressed this head-on. The report in May 2025 reaffirmed that purely AI-generated works are not protectable, and that creators must disclose any AI involvement when registering works. The Office concluded that while fair use remains the applicable framework, there is no blanket safe harbour. Wholesale ingestion of creative works is risky, particularly where the outputs substitute for originals or undermine existing licensing markets. It also encouraged AI developers to adopt safeguards such as licensing agreements, filtering systems, and provenance tracking.

These principles are now playing out in courtrooms and negotiations. The New York Times case is testing whether mass ingestion of articles without permission can be justified as fair use. The BBC's dispute with Perplexity AI, which it accused of reproducing its articles verbatim, illustrates how news organisations are beginning to push back. Perplexity's response was to roll out a "Publishers' Program", offering to share advertising revenue whenever publishers' content surfaces in AI answers. Disney's suit against Midjourney raises similar concerns in the entertainment industry, particularly over the scraping of visual characters.

At the same time, OpenAI's accusations against DeepSeek highlight the industry paradox. OpenAI argues that its own use of public works in training is protected as fair use, but also objects to DeepSeek training its rival model on ChatGPT outputs. If it pursues litigation, it risks undermining the very defence it relies upon elsewhere.

All of this is unfolding against a political backdrop that is shaping how the law develops. The removal of U.S. Register of Copyrights Shira Perlmutter in May 2025 was a sharp reminder that copyright policy does not evolve in isolation. Perlmutter had warned against assuming fair use for wholesale ingestion of expressive works such as music. Her dismissal prompted questions about whether industry pressure played a role and about the independence of the Copyright Office itself. At the same time, public figures like Jack Dorsey and Elon Musk have fanned the flames of debate by questioning the value of intellectual property altogether. Their calls to "delete all IP law" are unrealistic, but they reflect a growing dissatisfaction with a system many view as ill-suited to an AI-driven economy.

What emerges is a fragmented and unstable landscape: companies are litigating, regulators are warning, and politicians and industry voices are pulling the debate in different directions. In practice, wholesale abolition of IP is off the table, but reform is inevitable. More likely than not, this reform will take the form of incremental steps—collective licensing arrangements, clearer exceptions for AI training, and stricter transparency requirements.

Looking Forward

As the law continues to develop, a few trends are already taking shape. This divergence creates a patchwork of rules that companies operating globally must carefully navigate.

Second, data provenance has become critical. Judge Alsup's ruling in the *Anthropic* case makes clear that fair use may protect training on lawfully acquired works, but the use of pirated or unlawfully obtained materials falls outside any safe harbour. For AI developers, this means that recordkeeping, dataset auditing, and provenance tracking are no longer optional but essential compliance measures.

Third, licensing and revenue-sharing mechanisms are beginning to take root. The "Publishers' Program" introduced by Perplexity AI is one example of how the industry may move towards a collective licensing model, similar to the way the music sector addressed digital disruption through blanket licences. While not a

complete solution, these frameworks offer a practical compromise, compensating rights holders while giving AI firms continued access to the data they need.

Fourth, transparency obligations are expanding. The U.S. Copyright Office has already introduced requirements for applicants to disclose AI involvement when registering works. Broader adoption of provenance tracking, labelling, and disclosure mechanisms is likely. These measures serve two purposes: they provide clarity for users and rights holders, and they help AI companies defend themselves against claims of hidden infringement.

Finally, policy remains heavily shaped by politics. The dismissal of Register Shira Perlmutter highlighted the degree to which copyright guidance can be influenced by industry lobbying and shifting political priorities. This means that the trajectory of copyright law in AI will not be determined by courts alone but will also depend on how governments balance innovation with protection of creative industries.

Conclusion: 2025 As A Turning Point

The *Bartz v. Anthropic* decision reflects the tension at the heart of today's copyright debates. By affirming that fair use can apply to training on lawfully acquired works while excluding pirated data, the court provided both reassurance and caution to AI developers.

The ripple effects are being felt globally. In the United States, the decision will influence ongoing disputes such as the New York Times case. In China, courts continue to carve out space for prompt engineers as authors. Meanwhile, companies are experimenting with licensing and revenue-sharing to reduce risk.

2025 may well be remembered as the year copyright law faced its most serious test since the digital revolution. Whether the law adapts by extending existing doctrines, developing new licensing models, or embracing collective solutions will determine not only who owns AI-generated works, but who owns the creative future itself.

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