

MALACAÑANG
MANILA

By the President of the Philippines

PRESIDENTIAL DECREE NO. 87

*Amending Presidential Decree No. 8 Issued on October 2, 1972
and Promulgation of an Amended Act to Promote the
Discovery and Production of Indigenous Petroleum
and Appropriate Funds Therefor.*

WHEREAS, Presidential Decree No. 8 dated October 2, 1972 was issued to promote the discovery and development of the country's indigenous petroleum resources and adopting therefore as part of the law of the land the provisions of Senate Bill No. 631 (An Act to Promote the Discovery, Production of Indigenous Petroleum and Appropriate Funds Therefor);

WHEREAS, it was found necessary for the national interest to amend Senate Bill No. 531 among other things more meaningful incentives to prospective service contractors.

WHEREAS, THEREFORE, I, FERDINAND E. MARCOS, President of the Philippines, by virtue of the powers vested in me by the Constitution as Commander-in-Chief of all the Armed Forces of the Philippines, and pursuant to Proclamation No. 1081, dated September 21, 1972, and General Order No. 1 dated September 22, 1972 as amended, do hereby amend Presidential Decree No. 8 as follows:

**AN ACT
TO PROMOTE THE DISCOVERY AND PRODUCTION OF
INDIGENOUS PETROLEUM, AND APPROPRIATING
FUNDS THEREFOR**

SEC. 1. *Short title.* This Act shall be known and maybe cited as "THE OIL EXPLORATION AND DEVELOPMENT ACT OF 1972".

SEC. 2. *Declaration of policy.* It is hereby declared to be the policy of the State to hasten the discovery and production of indigenous petroleum through the utilization of government and/or private resources, local and foreign under the arrangements embodied in this Act which are calculated to yield the maximum benefit to the Filipino people and the revenues to the Philippine GOVERNMENT for use in furtherance of national economic development, and to assure just returns to participating private enterprises, particularly those that will provide the necessary services, financing and technology and fully assume all exploration risks.

SEC. 3. *Definition of terms.* As used in this Act, the following terms shall have the following respective meanings:

(a) "Petroleum" shall include any mineral oil, hydrocarbon gas, bitumen, asphalt, mineral gas and all other similar or naturally associated substances with the exception of coal, peat, bituminous shale and/or other stratified mineral fuel deposits.

(b) "Crude Oil" or "Crude" means oil in its natural state before the same has been refined or otherwise treated. It does not include oil produced through destructive distillation of coal, bituminous shales or other stratified deposits, either in its natural state or after the extraction of water, and sand or other foreign substances therefrom.

(c) "Natural Gas" means gas obtained from boreholes and wells and consisting primarily of hydrocarbons.

(d) "Petroleum Operations" means searching for and obtaining petroleum within the Philippines through drilling and pressure or suction or the like, and other operations incidental thereto. It includes the transportation, storage, handling and sale (whether for export or for domestic consumption) of petroleum so obtained but does not include any: (1) transportation of petroleum outside the Philippines; (2) processing or refining at a refinery; or (3) any transaction in the products so refined.

(e) "Petroleum in commercial quantity" means petroleum in such quantities which will permit its being economically developed as determined by the contractor after taking into consideration the location of the reserves, the depths and number of wells required to be drilled and the transport and terminal facilities needed to exploit the reserves which have been discovered.

(f) "Posted Price" refers to the FOB price established by the contractor in consultation with the Department of Energy for each grade, gravity and quality of crude oil offered for sale to buyers generally for export at the particular point of export, which price shall be based upon geographical location, and fair market export values for crude oil of comparable grade, gravity and quality.

(g) "Market Price" shall mean the price, which would be realized, for petroleum, produced under a contract as hereinafter defined if sold in a transaction between independent persons dealing at arm's length in a free market.

(h) "Barrel" means 42 U.S. gallons or 9702 cubic inches at a temperature of 60°Fahrenheit.

Any reference in this Act to the value of any crude oil at the posted price or market shall be construed as a reference to the amount obtained by multiplying the number of barrels of that crude oil by the posted price or market price per barrel applicable to that crude oil.

(i) "Crude Oil Exported" shall include not only crude oil exported as such but also indigenous crude oil refined in the Philippines.

(j) "Government" means the Government of the Republic of the Philippines.

(k) "Contractor" means the contractor in a service contract whether acting alone or in a consortium with others.

(l) "Contract" refers to a service contract.

(m) "Filipino Participation Incentive" means the allowance, which may be given the contractor with Filipino participation as provided in Section 28 hereof.

(n) "Philippine Corporation" means a corporation organized under Philippine Laws, at least sixty percent of the capital of which is owned and held by citizens of the Philippines.

(o) "Affiliate" means (1) a company in which a contractor holds directly or indirectly at least fifty percent of its outstanding shares entitled to vote; (2) a company which holds directly or indirectly at least fifty percent of the contractor's outstanding shares entitled to vote; or (c) a company in which at least fifty percent of its share outstanding and entitled to vote are owned by a company which owns directly at least fifty percent of the shares outstanding and entitled to vote of the contractor.

(p) "Gross Income" means the gross proceeds from the sale of crude, natural gas or casinghead petroleum spirit produced under the contract and sold during the taxable year at posted or market price, as the case maybe, and other income which are incidental to and arising from any one or more of the petroleum operations of the contractor.

(q) "Taxable Net Income" means the gross income less the deduction allowed in this act.

(r) "Taxable Year" means the calendar or fiscal year of the contractor.

(s) "Casinghead Petroleum Spirit" means any liquid hydrocarbon obtained from natural gas by separation or by any chemical or physical process.

(t) "Petroleum Board (now the DEPARTMENT)" refers to the Petroleum Board (now the Department of Energy) created in Section Seventeen of this Act.

(u) "Operating Expenses" means the total expenditures for petroleum operations made by the CONTRACTOR both within and without the Philippines as provided in a service contract.

SEC. 4. *Government may undertake petroleum and production.* Subject to the existing private rights, the GOVERNMENT may directly explore for and produce indigenous petroleum. It may also indirectly undertake the same under service contracts as hereafter provided. These contracts may cover free areas, national reserve areas and/or petroleum reservations, as provided for in the Petroleum Act of 1949, whether onshore or offshore. In every case, however, the contractor must be technically competent and financially capable as determined by the Board to undertake the operations required in the contract.

SEC. 5. *Execution of contract authorized in this Act.* Every contract here in authorized shall, subject to the approval of the President, be executed by the Petroleum Board created in this Act, after due public notice, pre-qualification and public bidding or concluded through negotiations. If cash bids are requested or if no bid is submitted or the bids submitted are rejected by the Petroleum Board for being disadvantageous to the GOVERNMENT, the contract may be concluded through negotiations.

In opening contract areas and in selecting the best offer for petroleum operations, any of the following alternative procedures may be resorted to by the Petroleum Board, subject to prior approval of the President: (a) The Petroleum Board may select an area or areas and offer it for bid, specifying the minimum requirements and conditions; or (b) The Petroleum Board may open for bidding a large area wherein bidders may select integral are not larger than the maximum provided in this Act. Only the best offer shall be accepted and the selection thereon shall be made by a weighted system of evaluating the different aspects of each bid; or (c) An area may be selected by an interested party who shall negotiate with the Petroleum Board for a contract under the terms and conditions provided in this Act.

SEC. 6. *Nature of service contract.* In a service contract, service and technology are furnished by the service contractor for which it shall be entitled to the stipulated service fee while financing is provided by the GOVERNMENT to which all petroleum produced shall belong.

SEC. 7. *Special stipulation in service contract.* Where the GOVERNMENT is unable to finance petroleum exploration operations in order to induce the contractor to exert the maximum efforts to discover and produce petroleum as soon as possible, the service contract shall stipulate that the contractor shall furnish services, technology and financing, the proceeds of sale of the petroleum produced under the contract shall be the source of funds for payments of the service fee and the operation expenses due the contractor.

SEC. 8. *Obligations of contractor in service contract.* The arrangement pursuant to the preceding section shall be such that the contractor, which may be a consortium, shall undertake, manage and execute petroleum operations. The contract may authorize the contractor to take and dispose of and market either domestically or for export all petroleum produced under the contract subject to supplying the domestic requirements of the Republic of the Philippines on a pro-rata basis. The GOVERNMENT shall oversee the management of the operations contemplated in the contract and in this connection shall require the contractor to

- (a) Provide all necessary services and technology;
- (b) Provide the requisite financing;
- (c) Perform the exploration work obligations and program prescribed in the agreement

between the GOVERNMENT and the CONTRACTOR, which may be more but shall not be less than the obligations prescribed in this Act;

(d) Once petroleum in commercial quantity is discovered, operate the field on behalf of the GOVERNMENT in accordance with accepted good oil field practices using modern and scientific methods to enable maximum economic production of petroleum; avoiding hazards to life, health and property; avoiding pollution of air, land and waters; and pursuant to an efficient and economic program of operation.

(e) Assume all exploration risks such that if no petroleum in commercial quantity is discovered and produced, it will not be entitled to reimbursement;

(f) Furnish the Petroleum Board promptly with geological and other information, data and reports which it may require;

(g) Maintain detailed technical records and accounts of its operations;

(h) Conform to regulations regarding, among others, safety, demarcation of agreement acreage and work areas, non-interference with the rights of other petroleum, mineral and natural resources operations;

(i) Maintain all meters and measuring equipment in good order and allow access to these as well as to the exploration and production sites and operations to inspectors authorized by the Petroleum Board;

(j) Allow examiners of the Bureau of Internal Revenue and other representatives authorized by the Petroleum Board full access to their accounts, books and records for tax and other fiscal purposes; and

(k) Be subject to Philippine income tax;

On the other hand, the Petroleum Board shall:

(1) On behalf of the GOVERNMENT, reimburse the CONTRACTOR for all operating expenses not exceeding seventy percent of the gross proceeds from production in any year. Provided, That in any year the operating expenses exceeds seventy percent of gross proceeds from production then the unrecovered expenses shall be recovered from the operations of succeeding years.

(2) Pay the contractor a service fee the net amount of which shall not exceed forty percent of the balance of the gross income after deducting the Filipino participation incentive, if any, and all operating expenses recovered pursuant to Section 8 (1) above.

(3) Reimbursement of operating expenses and payment of the service fee shall be in such form and manner as provided for in the contract.

SEC. 9. *Minimum terms and conditions.* In addition to those elsewhere provided in this Act, every contract executed in pursuance hereof, shall contain the following minimum terms and conditions:

(a) Every contractor shall be obliged to spend in direct prosecution of exploration work, delineation and development following the discovery of oil in commercial quantity not less than the amounts provided for in the contract between the GOVERNMENT and the contractor and these amounts shall not be less than the total obtained by multiplying the number of hectares covered by the contract by the following amounts per hectare:

PERIOD	ONSHORE	OFFSHORE
Year 1	P 3.00	P 3.00
Year 2	3.00	3.00

Year 3	3.00	3.00
Year 4	3.00	3.00
Year 5	3.00	3.00
Year 6	9.00	18.00
Year 7	9.00	18.00
Year 8	9.00	18.00
Year 9	9.00	18.00
Year 10	9.00	18.00

Provided, That if during any contract year the CONTRACTOR shall spend more than the amount of money required to be spent, the excess may be credited against the money required to be spent by the CONTRACTOR during succeeding years: *Provided, further*, That in case the same contractor holds two or more areas under different contracts of service, the total amount of work obligations for exploration required for in the initial term of all contracts may be spent within any one or more of them as if they are covered by a single contract of service; *Provided, further*, That should the CONTRACTOR fails to comply with the work obligations provided for in the contract, it shall pay to the GOVERNMENT the amount it should have spent but did not in direct prosecution of its work obligations; *Provided, further*, That the CONTRACTOR shall drill a minimum footage of test well before the end of periods of time as may be specified in the contract with the Petroleum Board in order to be entitled to the extension of the exploration period for 3 years as provided for in paragraph (e) herein.

(b) In case the contractor renounces or abandons wholly or partly the area covered by this contract within two years from the effective date, it should in respect of the abandoned area pay the government the amount it should have spent, but did not, for exploration work during said two years, for which payment, among other obligations, the performance guarantee posted by the contractor shall be answerable.

(c) Every contract shall provide for the compulsory relinquishment of at least twenty-five percent of the initial area at the end of five years from its effective date and in the event of an extension of the contract from seven to ten years, and additional relinquishment of at least twenty-five percent of the initial area at the end of seven years from its effective date. But the portion already delineated as production area pursuant to the succeeding paragraph shall not be taken into account in ascertaining the extent of relinquishment required. Any area renounced or abandoned under Sec. 9 (b) above shall be credited against the portion of the area subject to the contract, which is required to be surrendered hereunder.

(d) The CONTRACTOR shall, from the discovery of petroleum in commercial quantity, delineated the production area within the period agreed upon in the contract.

(e) The exploration period under every contract shall be seven years, extendible for three years if the contractor has not been in default in its exploration work obligations and other obligations after which the contract shall lapse unless petroleum has been discovered by the end of the tenth year and the contractor request a further extension of one year to determine whether it is in commercial quantity in which event, another extension of one year for exploration may be granted. If Petroleum in commercial quantity has been discovered, the contractor may retain after the exploration period and during the effectively of the contract twelve and one-half percent of the initial area in addition to the delineated production area: *Provided, further*, That the contractor shall pay annual rentals on such retained area which shall not be less than ten pesos per hectare or fraction thereof for onshore areas and not less than twenty pesos as determined by the Petroleum Board per hectare or fraction thereof for offshore areas: *Provided, further*, That such rentals can be offset against exploration expenditures actually spent on such area.

(f) Where petroleum of commercial quantity is discovered during the exploration period in

any area covered by the contract, the contract with respect to said area shall remain in force for production purposes during the balance of the ten-year exploration period and for an additional period of twenty-five years, thereafter renewable for a period not exceeding fifteen years under such terms and conditions as may be agreed upon by the parties at the time of renewal.

(g) All materials, equipment, plants and other installations erected or placed on the expiration and/or production area of a movable nature by the contractor shall remain properties of the contractor unless not removed therefrom within one year after the termination of the contract.

(h) The contractor shall be subject to the provisions of laws of general application relating to labor, health, safety, and ecology insofar as they are not in conflict with the provisions otherwise contained in this Act.

(i) Every contract executed in pursuance of this Act shall contain provisions regarding the discovery, production, sale, and disposal of natural gas and casinghead petroleum spirit that shall be in line with the rules herein prescribed for crude oil except that:

(1) The market price shall be the basis for tax and all other purposes;

(2) After meeting the requirements in secondary recovery operations priority shall be given to supplying prospective demand in the Philippines.

SEC. 10. *Contract Areas.* Subject to Section eighteen hereof, a contractor or its affiliate may enter into one or more contracts with the GOVERNMENT. Contracts for offshore areas may cover any portion beneath the Philippine territorial waters or its continental shelf, or portion of continental slope, terrace or areas which are or may be subject to Philippine jurisdiction: *Provided*, That for offshore areas beyond water depths of 200 meters, the Petroleum Board may provide for more liberal terms that provided for herein with respect to contract area, exploration period and relinquishment.

SEC.11. *Transfer and Assignment.* The rights and obligations under a contract executed under this Act shall not be assigned or transferred without the prior approval of the Petroleum Board: *Provided*, That with respect to the transfer or assignment of contractual right and obligations under this Act to an affiliate of the transferor, the approval thereof by the Petroleum Board shall be automatic, if the transferee is as qualified as the transferor to enter into such contract with the GOVERNMENT; *Provided, further*, That the affiliate relationship between the original transferor or a company which holds at least fifty percent of the contractor's outstanding shares entitled to vote and each transferee shall be maintained during the existence of the contract.

SEC. 12. *Privileges of contractor.* The provisions of any law to the contrary notwithstanding, a contract executed under this Act may provide that the contractor shall have the following privileges:

(a) Exemption from all taxes except income tax;

(b) Exemption from payment of tariff duties and compensating tax on the importation of

machinery and equipment, and spare parts and all materials required for petroleum operations subject to the conditions that said machinery, equipment, spare parts and materials of comparable price and quality are not manufactured domestically; are directly and actually needed and will be used exclusively by the contractor in its operations or in operations for it by a subcontractor; are covered by shipping documents in the name of the contractor to whom the shipment will be delivered directly by the customs authorities; and the prior approval of the Petroleum Board was obtained by the contractor before the importation of such machinery, equipment, spare parts and materials which approval shall not be unreasonably withheld; *Provided, however,* That the contractor or its subcontractor may not sell, transfer, or dispose of these machinery, equipment, spare parts or materials without the prior approval of the Petroleum Board and payment of taxes due to the GOVERNMENT: *Provided, further,* That should the contractor or its subcontractor sell, transfer, or dispose of these machinery, equipment, spare parts or materials without the prior consent of the Petroleum Board, it shall pay twice the amount of the tax exemption granted: *Provided, finally,* That the Petroleum Board shall allow and approve the sale, transfer, or disposition of the said items without tax if made (1) to another contractor; (2) for reasons of technical obsolescence; or (3) for purposes of replacement to improve and/or expand the operations of the contract;

(c) Exemption upon approval by the Petroleum Board from laws, regulations, and / or ordinances restricting the (1) construction, installation, and operation of power plant for the exclusive use of the contractor if no local enterprise can supply within a reasonable period and at reasonable cost the power needed by the contractor in its petroleum operations, (2) exportation of machinery and equipment which were imported solely for its petroleum operation when no longer needed thereof;

(d) Exemption from publication requirements under Republic Act Numbered Five Thousand Four Hundred Fifty-five; and the provisions of Republic Act Numbered Sixty-one Hundred and Seventy-three with respect to the exploration, exploration or sale or disposition of crude oil discovered and produced in the Philippines;

(e) Exportation of petroleum subject to the prior filing pro-rata of domestic needs as elsewhere provided in this Act;

(f) Entry, upon the sole approval of the Petroleum Board which shall not be unreasonably withheld, of alien technical and specialized personnel (including the immediate members of their families), who may exercise their professions solely for the operations of the contractor as prescribed in its contract with the GOVERNMENT under this Act *Provided,* That if the employment of connection or any such alien with contractor ceases, the applicable laws and regulations on immigration shall apply to him and his immediate family: *Provided, further,* That Filipinos shall be given preference to positions for which they have adequate training and *Provided, finally,* That the contractor shall adopt and implement a training program for Filipinos along technical or specialized lines, which program shall be reported to the Petroleum Board;

(g) Rights and obligations in any contract concluded pursuant to this Act shall be deemed as essential considerations for the Conclusions thereof and shall not be unilaterally changed or impaired; and

(h) The privileges and benefits granted to a contractor under the provisions of this Act together with any applicable obligations shall likewise be made available to concessionaires under the Petroleum Act of 1949 and their authorized contractors and/or service operators, whether local or foreign, if they so elect.

SEC. 13. *Repatriation of capital and retention of profits abroad.* The contractor shall be entitled

to (1) repatriate over a reasonable period the capital investment actually brought into the country in foreign exchange or other assets and registered with the Central Bank; (2) retain abroad all foreign exchange representing proceeds arising from exports accruing to the contractor over and above (a) the foreign exchange to be converted into pesos in an amount sufficient to cover, or equivalent to, the local costs for administration and operations of the exported crude and (b) revenues due the GOVERNMENT on such crude: *Provided, however,* That the GOVERNMENT and the contractor shall stipulate in the contract the currency in which the GOVERNMENT revenues arising under (b) above are to be paid; (3) convert into foreign exchange and remit abroad at prevailing rates no less favorable to contractor than those available to any other purchaser of foreign currencies, any excess balances of their peso earnings from petroleum production and sale over and above the current working balances they require, and (4) convert foreign exchange into Philippine Currency for all purposes in connection with its petroleum operations at prevailing rates no less favorable to contractor than those available to any other purchaser of such currency.

SEC. 14. *Full disclosure of interest in contractor.* Interest held in the contractor by domestic mining and petroleum companies and/or the latter's stockholders may be allowed to any extent after full disclosure thereof to, and approved by the Petroleum Board.

SEC. 15. *Arbitration.* The Petroleum Board may stipulate in a contract executed under this Act that disputes in the implementation thereof between the GOVERNMENT and the CONTRACTOR may be settled in accordance with generally accepted international arbitration practice.

SEC. 16. *Performance guarantee.* In order to guarantee compliance with the obligations of the contractor in contracts executed under this Act, the contractor shall post a bond or other guarantee of sufficient amount in favor of the GOVERNMENT and with surety or sureties satisfactory to the Petroleum Board, conditioned upon the faithful performance by the contractor of any or all the obligations under and pursuant to said contracts.

IMPLEMENTING AGENCY

SEC. 17. There is hereby created a Petroleum Board composed of the President of the Philippine National Oil Company as Chairman, and the Secretary of National Defense, the Executive Secretary of Natural Resources, the Secretary of Finance, the Secretary of Justice, the Secretary of Industry, the Governor of the Central Bank and the Director of Mines as members. The Board shall designate and appoint its Executive Director (as amended by P.D. No. 469 dated May 23, 1974).

SEC. 18. *Functions of the Petroleum Board.* In accordance with the provisions and objectives of this Act, the Petroleum Board shall:

- (a) Define and give public notice when applicable of the areas available for service contract;
- (b) Enter into contracts herein authorized with such terms and conditions as may be appropriate under the circumstances including the grant of special allowance: *Provided, however,* That no depletion allowance shall be granted: *Provided, further,* That except as provided in Sections twenty-six and twenty-seven hereof, no contract in favor of one contractor and its affiliates shall cover less than fifty thousand nor more than seven hundred and fifty thousand hectares for onshore areas, or less than eighty thousand nor more than one million five hundred thousand hectares for offshore areas: *Provided, finally,* That in no case shall the annual net revenue or share of the GOVERNMENT, including all taxes paid by or on behalf of the contractor, be less than sixty percent of the difference between the gross income and the sum of operating expenses and Filipino participation incentive;
- (c) Provide for the manner and form of the income tax payment, the reimbursement of operating expenses, the payment of service fee, and payment of Filipino participation incentive allowance, if any, in the service contract;
- (d) Make specific proposals to Congress for the grant of subsidy to contractors and petroleum

companies at least sixty percent of the capital of which is owned by Philippine citizens, to be derived from the revenue or share that will accrue to the GOVERNMENT in pursuance of this Act:

- (e) Undertake intensive studies and researches in oil field practices, procedures, and policies.
- (f) Promulgate such rules and regulations as may be necessary and assess charges for service rendered to implement the intent and provisions of this Act;
- (g) Appoint, discipline and remove, and determine the compensation of, its technical staff and other personnel: *Provided*, That positions which are highly technical or primarily confidential shall not be subject to the Civil Service Laws and Rules, and of the Wage and Position Classification Office:
- (h) Within four months after the close of every fiscal year, submit to the President and Legislature as annual report on its activities, with appropriate recommendation; and
- (i) Generally, exercise all powers necessary or incidental to attain the objective of this Act.

TAX PROVISIONS

SEC. 19. *Imposition of Tax.* The contractor shall be liable each taxable year for Philippine income tax on income derived from its petroleum operations under its contract of service, computed as provided in Section 20 through 25.

SEC. 20. Determination of gross *income*. The gross income shall consist of:

- (a) In respect of crude oil exported, the gross proceeds from the sale of crude oil at the posted price;
- (b) In respect of crude oil sold for consumption in the Philippines, the gross income shall consist of the gross proceeds from the sale thereof at market price per barrel;
- (c) In respect of natural gas and/or casinghead petroleum exported or sold for consumption in the Philippines the gross income shall consist of the total quantity sold at the prevailing market price thereof; and
- (d) Such other income which are incidental to and/or arising from any petroleum operations.

SEC. 21. *Deduction from gross income.* In computing the taxable net income, there shall be allowed as deductions: (1) Filipino participation incentive; and (2) Operating expenses reimbursed pursuant to Section 8 (1) which includes amortization and depreciation as provided in Section 22.

SEC. 22. *Amortization and depreciation.* Intangible exploration costs may be deductible in full; all tangible exploration costs such as capital expenditures and other recoverable capital assets are to be depreciated for a period of ten years.

SEC. 23. *Deduction not allowed.* In ascertaining the taxable net income, no deduction from gross income shall be allowed in respect of any interest or other consideration paid or suffered in respect of the financing of its petroleum operations.

SEC. 24. *Return and payment of tax.* Every party to a service contract shall render to the

Petroleum Board a return for each taxable year in duplicate in such form and manner as provided by law setting forth its gross income and the deductions herein allowed. The return shall be filed by the Petroleum Board with the Commissioner of Internal Revenue or his deputies or other persons authorized by him to receive such return within the period specified in the National Internal Revenue Code and the Rules and Regulations promulgated thereunder. Every party to a service contract shall be subject to tax separately on its share of taxable income arising from such contract.

SEC. 25. *Applicability of the provisions of the National Internal Revenue Code.* All provisions of the National Internal Revenue Code and rules and regulations promulgated in relation therewith which are not inconsistent with the provisions of this Act shall be applicable to the CONTRACTOR.

SPECIAL PROVISIONS

SEC. 26. *Option of exploration concessionaires.* A holder of a valid and subsisting petroleum, exploration concession under the Petroleum Act of 1949 may, at this option enter into a contract of service under the rules of the Petroleum Act of 1949, subject to constitutional restrictions, with any local or foreign oil company under such terms and conditions as may be agreed upon by the concessionaire and the service contractor. As an alternative the concessionaire may convert his concession into a service contract as provided in this Act through negotiations, with all the rights and privileges herein authorized: *Provided*, That the contract which may concluded after said negotiation shall contain at least the minimum terms and conditions provided in this Act and shall take into account terms and conditions more favorable to the GOVERNMENT contained in contracts involving exploration pursuant to this Act; *Provided, further*, That the exploration period shall commence to run from the effective date of the original concessions, except when the concession has been effective for a period of seven years or more, in which case the CONTRACTOR shall be required to commence exploration drilling operations within a period of not exceeding eighteen months from the date of effectivity of the service contract. If the CONTRACTOR is not default in the drilling operations as hereunder required, an extension of the exploration period may be granted as provided in Section nine, paragraph (e) of this Act.

SEC. 27. *Alternative option of exploration concessionaire.* The concessionaire referred to in the preceding section may form a consortium with another company or companies and jointly enter into a service contract with the GOVERNMENT under this Act, with the right to assign to the consortium, subject to the approval of the Petroleum Board, the area covered by his concession which shall thereupon be governed by the provisions of this Act: *Provided*, That the voluntary relinquishment of the concession and its assignment, as well as all technical data on the area resulting from the studies conducted by the concessionaire and subsisting improvement introduced by him thereon, shall be evaluated and given a fair value which may constitute his contribution, wholly or in part to the consortium: *Provided, however*, That the exploration period under the new contract shall commence to run from the date of effectivity of the contract if it covers areas in addition to the assigned areas; otherwise the provisions of the preceding section shall apply: *Provided, further*, That duly published applications for exploration concessions as bids thereof already awarded by the Secretary of Agriculture and National Resources under the provisions of the Petroleum Act of 1949 shall be recognized and the corresponding deeds of concessions issued accordingly: *Provided, finally*, That exploration concessions on which the holders thereof failed to perform for three consecutive years the exploration work required under the provisions of the Petroleum Act of 1949, as amended by Republic Act Numbered Five Thousand Eighty-Six shall be considered automatically cancelled.

SEC. 28. *Filipino Participation Incentive.* The contractor under a service contract in which Philippine citizens or corporations have a minimum participating interest of fifteen per cent in the contract area may, subject to reasonable conditions imposed by the Petroleum Board, be granted a government subsidy, commensurate with the scope of Filipino participation incentive not exceeding seven and one-half percent, which shall be computed by deducting the said allowance from the posted or market price, whichever is higher, of crude oil exports produced in the contract area, and from the market price of crude oil produced in the contract area, sold or disposed of for consumption in the Philippines.

SEC. 29. *Publicity.* Negotiations with the GOVERNMENT for the concluded hereunder shall be

given publicity consistent with the best interest of the GOVERNMENT.

SEC. 30. *Provisions of Petroleum Act Applicable.* The provisions of the Petroleum Act of 1949, as amended, shall not be applicable to the service contract provided in this Act, except the following articles.

- (a) Article 16, referring to public easements on lands covered by concessions;
- (b) Article 17, providing that petroleum operations are subject to existing mining rights, permits, leases and concessions in respect of substances other than petroleum, and to existing petroleum rights;
- (c) Article 18, referring to the right of the GOVERNMENT to established reservations or grant mining rights on petroleum concessions;
- (d) Article 20, granting exploration and exploitation concessionaires the right to enter private lands covered by their concessions;
- (e) Article 21, referring to easements and the exercise of the right of eminent domain over private lands for the purpose of carrying out any work essential to petroleum operations;
- (f) Article 22, providing of easement over public land for the purpose of carrying out any work essential to petroleum operations; and
- (g) Article 23, which grants concessionaires the right to utilize for any of the work to which the concession relates, timber, water, and clay from any public lands within their concessions,

SEC. 31. *Preference to Local Labor.* The contractor shall give priority in employment to qualified personnel in the municipality or municipalities or province where the exploration or production operations are located.

SEC. 32. *Foreign Assistance.* Nothing in this Act or of any other law shall preclude the GOVERNMENT of the Republic of the Philippines, through the Petroleum Board or any other proper office or agency, from the negotiating or entering into any agreement with any foreign country or government for assistance in terms of equipment, technical know-how and financing for the exploration and production of indigenous crude oil and its by-products.

SEC. 33. *Funds.* To carry out the purpose of this Act, there is hereby appropriated; out of any funds in the National Treasury not otherwise appropriated the sum of five hundred thousand pesos for the fiscal year nineteen hundred ninety four. Hereafter the necessary appropriations shall be included in subsequent General Appropriations Act.

SEC. 34. *Repealing Clause.* All laws, executive orders and regulations inconsistent with the provisions of this Act are hereby repealed, provided that no existing rights shall be prejudiced thereby.

SEC. 35. *Effective Date.* This Act shall take effect upon its approval.

Done in the City of Manila, this _____ day of December in the year of our Lord Nineteen Hundred and Ninety Three.

(SDG.) FERDINAND E. MARCOS
President of the Philippines

OFFICE OF THE PRESIDENT
OF THE PHILIPPINES
Malacañang

PRESIDENTIAL DECREE NO. 1857

AN ACT GRANTING NEW INCENTIVES TO PETROLEUM SERVICE CONTRACTORS, AND FOR THIS PURPOSE AMENDING CERTAIN SECTIONS OF PRESIDENTIAL DECREE NUMBERED EIGHTY-SEVEN, AS AMENDED, OTHERWISE KNOWN AS "THE OIL EXPLORATION AND DEVELOPMENT ACT OF 1972".

WHEREAS, one of the more important policy decisions in the area of oil and gas exploration and development is the adoption of the service contract system embodied in Presidential Decree No. 87, as amended, also known and cited as the "Oil Exploration and Development Act of 1972";

WHEREAS, the service contract system which attracted foreign capital and expertise in an area where local resources are not adequate, allows maximum benefits to the Philippine GOVERNMENT and at the same time providing reasonable returns to companies that render financial and technical services and assume all the risk of oil exploration;

WHEREAS, while the results from the implementation of the service contract system has so far been encouraging giving the country several hydrocarbon discoveries and three producing oilfields, it is necessary that we offer improved fiscal and contractual terms to service contractors in order for the Philippines to continue her oil exploration momentum in the light of current worldwide developments that has caused drastic cutbacks in exploration budgets of most exploration companies;

WHEREAS, eight (8) exploratory wells have been drilled so far in water deeper than 200 meters or 600 feet, of which two (2) are discoveries, which give deepwater drilling new significance in Philippine petroleum operations;

WHEREAS, there is a need to provide for a new set of incentives to revitalize interest and encourage more drilling activity in our country, with special reference to deepwater oil exploration.

NOW, THEREFORE, I, FERDINAND E. MARCOS, President of the Philippines, by virtue of the powers vested in me by the Constitution, do hereby decree as follows;

SECTION 1. Section three of Presidential Decree numbered Eighty-Seven, is hereby amended by adding, after subparagraph (u) thereof, three new subparagraphs to be known as subparagraphs (v), (w), and (x) to read as follows:

"(v)"Deepwater Contract" refers to a service contract at least eighty-five percent (85%) of the total contract area are in water depths beyond 200 meters.

"(w)"Deepwater Contractor" means the contractor in a deepwater contract, whether acting alone or in consortium with others."

"(x)"Deepwater well" refers to a well drilled on water depths beyond 200 meter, whether within or without a deepwater contract."

SECTION 2. Subparagraph (1) of the second paragraph of Section 8 of the same decree, is hereby amended to read as follows:

"(1) On behalf of the GOVERNMENT, reimburse the CONTRACTOR for all operating expenses not exceeding seventy percent (70%) of the gross proceeds from production in any year, *Provided*, that if in any year, the operating expenses exceed seventy percent (70%) of gross proceeds from production, then the unrecovered expenses shall be recovered from the operations of succeeding years,

"The provisions of Section 21, 22 and 23 hereof to the contrary notwithstanding, reimbursement of all operating expenses of the contractor includes amortization, depreciation and interest as provided hereunder:

"(a) Amortization and Depreciation-Intangible exploration costs may be reimbursed in full. All tangible exploration costs such as capital assets are to be depreciated for a period of five (5) years under the straight-line or double-declining balance method of depreciation at the option of the contractor."

"(b) Any interest or other paid or suffered in respect of the financing as approved by the GOVERNMENT of its development and production operations, shall be reimbursed to the extent of two-thirds (2/3) of the amount thereof, except interest on loans or indebtedness incurred to finance exploration operations.

SECTION 3. A new section to be known as Section TEN-A, is hereby inserted between sections ten and eleven of the same decree to read as follows:

"SECTION 10. *A Deepwater Contract, Deepwater CONTRACTOR and Deepwater Well.*

"(a) Cross Recovery Allowed - Subject to cost recovery limitation as provided in the Contract, there shall be allowed the gross recovery of the operating expenses incurred by a deepwater contractor or its affiliate in two or more areas under different deepwater contract and in the drilling of deepwater wells as if they are covered by a single contract,

"(b) Cross Recovery Rules

(1) Year to which Cross Recovery may be carried - Operating expenses incurred preceding the date of production shall be cross-recoverable starting on the date of production:

(2) Amount of Cross Recovery

(a) The entire amount of operating expenses incurred within ten (10) years preceding the date of production shall be cross-recoverable;

(b) Operating expenses incurred more than 10 years preceding the date of production shall be reduced by an amount equal to twenty percent (20%) thereof, for each year beyond ten (10) years preceding the date of production.

- (3) Time to Avail Incentive - Cross Recovery of operating expenses set forth in this section shall be allowed for a period of ten (10) years from the effectivity of this amendatory decree, unless extended by law.

"(c) Cross Recovery Defined - For purposes of this section, the term "Cross recovery" means that the operating expenses incurred by a deepwater contractor or its affiliate in two or more areas under different deepwater contracts and the operating expenses it incurred in the drilling of deepwater wells may be recovered from the gross proceeds resulting from the sale of all petroleum produced within any one or more of the deepwater contracts (or contracts where the deepwater well is located), as if they are covered by a single contract.

"(d) Operating Expenses Defined - For purpose of this section, the term "Operating Expenses" means the total expenditures for petroleum operation incurred by the contractor, both within and without the Philippines except administrative items, as provided in the service contract.

"(e) Special Rules

(1) Cross Recovery may be allowed under the service contract in other areas upon the determination and recommendation of the Secretary of Energy and subject to the approval by the President, taking into consideration factor such as exploration conditions, high operation cost, location, requirements for terminal facilities.

(2) Cross Recovery shall apply to any corporation authorized to engage in petroleum operations in the Philippines pursuant to a service contract entered into by said corporation and the DEPARTMENT for:

(a) Contracts entered into pursuant to this decree, as amended, before the effectivity of this amendatory decree; and

(b) New contracts entered into after the effectivity of this mandatory decree."

"(f) Exploration Period in Deepwater Contract and Deepwater Well Contract - The provisions of subparagraph (e), Section Nine of the Decree shall apply to deepwater contract and deepwater well, except that when petroleum has been discovered by the end of the tenth year in deepwater contract and deepwater well, the deepwater contract or contract for deepwater well shall be further extended to determine whether the discovery is in commercial quantity, in which event, another extension for a period not exceeding five (5) years shall be granted. In the event the deepwater contract or contract for deepwater well shall remain in force for production purpose, the extension period not exceeding five years shall be credited as part of the initial twenty-five years production term."

SECTION 4. Section twelve of the same decree is hereby amended by adding, after subparagraph (h) thereof, a new subparagraph to be known as subparagraph (i) to read as follows:

"(i) Exemption from the investment requirements of foreign corporations under Section 126 in relation to Section 148 of the Corporation Code of the Philippines."

SECTION 5. The DEPARTMENT shall be vested with the authority to promulgate such rules and regulations as may be necessary to implement the provision of this decree, subject to the approval of the Secretary of Energy.

SECTION 6. Any provision of existing general and special laws inconsistent with the provisions of this decree is hereby modified, amended or repealed accordingly.

SECTION 7. This Decree shall take effect upon its approval.

DONE in the City of Manila this 1st day of January in the Year of Our Lord, Nineteen Hundred and Eighty-three.

(SDG.) FERDINAND E. MARCOS
President of the Philippines

**OFFICE OF THE PRESIDENT
OF THE PHILIPPINES
Malacañang**

PRESIDENTIAL DECREE NO. 1857

AN ACT GRANTING NEW INCENTIVES OF PETROLEUM SERVICE CONTRACTORS, AND FOR THIS PURPOSE AMENDING CERTAIN SECTIONS OF PRESIDENTIAL DECREE NUMBERED EIGHTY-SEVEN, AS AMENDED, OTHERWISE KNOWN AS "THE OIL EXPLORATION AND DEVELOPMENT ACT OF 1972"

WHEREAS, one of the more important policy decisions in the area of oil and gas exploration and development is the adoption of the service contract system embodied in Presidential Decree NO. 87, as amended, also known and cited as the "Oil Exploration and Development Act of 1972";

WHEREAS, the service contract system which attracted foreign capital and expertise in an area where local resources are not adequate, allows maximum benefits to the Philippine GOVERNMENT and at the same time providing reasonable returns to companies that render financial and technical services and assume all the risk of oil exploration;

WHEREAS, while the results from the implementation of the service contract system has so far been encouraging giving the country several hydrocarbon discoveries and three producing oilfields, it is necessary that we offer improved fiscal and contractual terms to service contractors in order for the Philippines to continue her oil exploration momentum in the light of current worldwide developments that has caused drastic cutbacks in exploration budgets of most exploration companies;

WHEREAS, eight (8) exploratory wells have been drilled so far in waters deepwater than 200 meters or 600 feet, of which two (2) are discoveries, which give deepwater drilling new significance in Philippine petroleum operations;

WHEREAS, there is a need to provide for a new set of incentives to revitalize interest and encourage more drilling activity in our country, with special reference to deepwater oil exploration;

NOW, THEREFORE, I, FERDINAND E. MARCOS, President of the Philippines, by virtue of the powers vested in me by the Constitution, do hereby decree as follows;

SECTION 1. Section three of Presidential Decree numbered Eighty-Seven, is hereby amended by adding, after subparagraph (u) thereof, three new subparagraphs to be known as subparagraphs (v), (w) and (x) to read as follows:

“(v) “Deepwater Contract” refers to a service contract at least eighty-five percent (85%) of the total contract area are in water depths beyond 200 meters.

“(w) “Deepwater Contractor” means the contractor in a deepwater contract, whether acting alone or in a consortium with others.

“(x) “Deepwater well” refers to a well drilled on water depths beyond 200 meters, whether within or without a deepwater contract.”

SECTION 2. Subparagraph (1) of the second paragraph of Section 8 of the same decree is hereby amended to read as follows:

“(1) On behalf of the Government, reimburse the Contractor for all operating expenses not exceeding seventy percent (70%) of the gross proceeds from production in any year, Provided, that if in any year, the operating expenses exceed seventy percent (70%) of gross proceeds from

production, then the unrecovered expenses shall be recovered from the operations of succeeding years.

“The provisions of Section 21, 22 and 23 hereof to the contrary notwithstanding, reimbursement of all operating expenses of the contractor includes amortization, depreciation and interest as provided hereunder;

“(a) *Amortization and Depreciation* - Intangible exploration costs may be reimbursed in full. All tangible exploration costs such as capital assets are to be depreciated for a period of five (5) years under the straight-line or double-declining balance method of depreciation at the option of the Contractor.”

“(b) Any interest or other paid or suffered in respect of the financing as approved by the Government of its development and production operations, shall be reimbursed to the extent of two-thirds (2/3) of the amount thereof, except interest on loans or indebtedness incurred to finance exploration operations.

SECTION 3. A new section to be known as Section Ten-A, is hereby inserted between sections ten and eleven of the same decree to read as follows:

“SECTION 10 A. Deepwater Contract, Deepwater CONTRACTOR and Deepwater Well.

“(a) *Gross Recovery Allowed* – Subject to cost recovery limitation as provided in the Contract, there shall be allowed the gross recovery of the operating expenses incurred by a deepwater contractor or its affiliate in two or more areas under different deepwater contract and in the drilling of deepwater wells as if they are covered by a single contract.

“(b) *Cross Recovery Rules*

- (1) *Year to which Cross Recovery may be carried* – Operating expenses incurred preceding the date of production shall be cross-recoverable starting on the date of production:
- (2) *Amount of Cross Recovery*
 - (a) The entire amount of operating expenses incurred within ten (10) years preceding the date of production shall be cross-recoverable;
 - (b) Operating expenses incurred more than 10 years preceding the date of production shall be reduced by an amount equal to twenty percent (20%) thereof, for each year beyond ten (10) years preceding the date of production.
- (3) *Time to Avail Incentive* – Cross Recovery of operating expenses set forth in this section shall be allowed for a period of ten (10) years from the effectivity of this amendatory decree, unless extended by law.

“(c) *Cross Recovery Defined* – For purposes of this section, the term “Cross Recovery” means that the operating expenses incurred by a deepwater contractor or its affiliate in two or more areas under different deepwater contracts and the operating expenses it incurred in the drilling of deepwater wells may be recovered from the gross proceeds resulting from the sale of all petroleum produced within any one or more of the deepwater contracts (or contract where the deepwater well is located), as if they are covered by a single contract.

“(d) *Operating Expenses Defined* – For purposes of this section, the term “Operating Expenses” means the total expenditures for petroleum operation incurred by the contractor, both within and without the Philippines except administrative items, as provided in the service contract.

“(e) *Special Rules*

- (1) Cross Recovery may be allowed under the service contract in other areas upon the determination and recommendation of the Minister of Energy and subject to the approval by the President, taking into consideration factors such as exploration conditions, high operation cost, location, requirements for transport and terminal facilities.
- (2) Cross Recovery shall apply to any corporation authorized to engage in petroleum operations in the Philippines pursuant to a service contract entered into by said corporation and the Bureau of Energy Development for:
 - (a) Contracts entered into pursuant to this decree, as amended, before the effectivity of this amendatory decree; and
 - (b) New contracts entered into after the effectivity of this amendatory decree.

“(f) *Exploration Period in Deepwater Contract and Deepwater Well Contract* – The provisions of subparagraph (e), Section Nine of the Decree shall apply to deepwater contract and deepwater well, except that when petroleum has been discovered by the end of the tenth year in deepwater contract and deepwater well, the deepwater contract or contract for deepwater well shall be further extended to determine whether the discovery is in commercial quantity, in which event, another extension for a period not exceeding five (5) years shall be granted. In the event the deepwater contract or contract for deepwater well shall remain in force for production purpose, the extension period of not exceeding five years shall be credited as part of the initial twenty-five (25) years production term.”

SECTION 4. Section twelve of the same decree is hereby amended by adding, after subparagraph (h) thereof, a new subparagraph to be known as subparagraph (I) to read as follows:

“(i) Exemption from the investment requirements of foreign corporations under Section 126 in relation to Section 148 of the Corporation Code of the Philippines.”

SECTION 5. The Bureau of Energy Development shall be vested with the authority to promulgate such rules and regulations as may be necessary to implement to provisions of this decree, subject to the approval of the Minister of Energy.

SECTION 6. Any provision of existing general and special laws inconsistent with the provisions of this decree is hereby modified, amended or repealed accordingly.

SECTION 7. This Decree shall take effect upon its approval.

DONE in the City of Manila this 1st day of January in the Year of Our Lord, Nineteen Hundred and Eighty-three.

(SGD.) FERDINAND E. MARCOS
President of the Philippines