

Republic of the Philippines
HOUSE OF REPRESENTATIVES
Quezon City, Metro Manila

First Regular Session

HOUSE BILL NO. 3019



Introduced by Hon. Arnulfo P. Fuentebella

EXPLANATORY NOTE

In this century and perhaps beyond, industries of nations remain basically oil-based. Along with this reality is the fact that fossil fuel is depletable and existing oil fields worldwide have limited commercial lives. The known oil fields in the world such as the Yates Field of West Texas, which has produced over 1 billion barrels of oil since 1926 is expected to be depleted in 30 years with its remaining reserves of 900 million barrels. Kuwait's Burgan Field with reserves of 72 billion barrels and Saudi Arabia's Ghawar Field with remaining reserves of 83 billion barrels would probably be depleted half a century.

The threshold issue for our country today is not our overall energy policy but what can be pragmatically accomplished with the existing realities and the inescapable fact that the Philippines, despite its 13 explorable basins covering more than 700 square kilometers, remains a net oil-importing country.

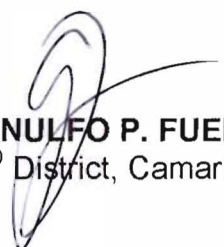
The lessons of the 1973 oil crunch remain as valid today as then. When the government launched its 10-year energy self-sufficiency program in 1973, the oil bill of our country reached US\$ 1.2 billion a year with an average daily consumption of about 220,000 barrels of oil per day (BOPD). Our dependence on imported crude oil and coal represented 92.02% of our requirement. The minor successes such as oil, geothermal, coal and hydro-resources, including new and renewable energy resources brought down our dependence on imported fuels from 1973 level of 92% to 46.6% in 2003.

The Department of Energy reported that after the Oil Exploration and Development Act of 1972 (PD 87) was enacted, 24 local oil exploration companies and 39 foreign companies participated actively in seismic and drilling operations in the country. Such activities resulted in the shooting, processing and interpretation of some 160,722 line kilometers of seismic lines and drilling of 46 onshore and 119 offshore wells or a total of 165 wells as of 1991. As of 2001 the actual oil production was 474,758 barrels and 4,950M standard cubic feet of gas.

With the high-risk and capital-intensive nature of oil and gas exploration activities, there is indeed a need to revisit the fiscal incentives and contractual arrangements for petroleum exploration and projects in the Philippines. Based on the evaluation of international exploration companies, the current geological and

geophysical nature of our country's sedimentary basins is ranked as a high-risk exploration destination. There is a need to provide the right package that will draw more investments in petroleum exploration activities for which this piece of legislation proposes.

Early approval of this bill is earnestly requested.



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3RD District, Camarines Sur

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HOUSE BILL NO. 3019

Introduced by Honorable Arnulfo P. Fuentesbella

AN ACT
PROMOTING EXPLORATION, DISCOVERY AND PRODUCTION OF
INDIGENOUS OIL AND GAS AND FOR OTHER PURPOSES

Be it enacted by the Senate and the House of Representatives of the Philippines in session assembled.

SECTION 1. Short Title. - This Act shall be known as the "Oil and Gas Act of 2004".

SEC. 2. Declaration of Policy. - In pursuance to the constitutional mandate, it is hereby declared that the exploration, development and utilization of indigenous petroleum shall be under the full control and supervision of the State. It is further 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 will yield maximum benefit to the Filipino people and revenues to the State for use in furtherance of national economic development. It is also the policy of the state to provide a reasonable rate of return to participating private and public enterprises to enable them to provide the necessary services, financing and technology and to fully assume all exploratory risks.

In furtherance hereof, it is further declared that any geophysical survey or service contract which carries a firm commitment of the contractor for the acquisition and/or processing of a minimum mileage of seismic data, sufficient to cover the contract area or a substantial portion thereof, or the drilling of an exploratory well within the contract area entered into by the President with corporations, whether Filipino or foreign-owned, are considered large-scale undertakings within the context of Article XII, Section 2 of the Constitution.

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

a) **"Allowable Recoverable Costs" or "ARC"** means the costs defined in Section 13 hereof.

b) **"Barrel"** means a volume of liquids equal to 42 US gallons or 9,702 cubic inches at a temperature of 60 degrees Fahrenheit.

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

c) **"BOPD"** means barrels of oil per day.

d) **"City Gate Price"** means the price of gas at the main consumption area in the Philippines.

e) **"Contract"** means a geophysical survey contract, service contract, or pipeline transportation contract.

f) **"Contract Area"** means the area awarded under a contract.

g) **"Contractor"** means the parties identified as such in a geophysical survey contract, service contract, and pipeline transportation contract and may consist of one or more interest holders.

h) **"Cross Recovery Allowance"** means the allowance pursuant to Section 13, paragraph (c) hereof in accordance with the regulations.

i) **DOE** means the Department of Energy created under Republic Act No. 7638.

j) **"Development Allowance"** means the allowance pursuant to Section 13, paragraph (b) hereof in accordance with the regulations.

k) **"Development Costs"** means the development costs directly attributable to the contract area in accordance with the regulations.

l) **Energy Regulatory Commission (ERC)** means Energy Regulatory Commission created under Republic Act No. 9136.

m) **"Exploration Costs"** means the exploration costs directly attributable to the contract area in accordance with the regulations.

n) **"Filipino Company"** means a company, corporation or entity of which at least 60% of the subscribed share capital is owned and controlled by Filipino citizens.

o) **"Filipino Participation Incentive Allowance" or "FPIA"** means the allowance as provided in Section 12 hereof.

p) **"Gas"** means gas produced from wells and consisting primarily of gaseous hydrocarbons.

q) **“Geophysical Survey Contract”** means a contract in accordance with Section 8 of this Act.

r) **“Government”** means the Government of the Philippines.

s) **“Gross Proceeds”** means the revenues realized from the sale, based on market price, of oil and gas produced and saved from the contract area as well as other income incidental to and/or arising from any petroleum operations under a service agreement during the taxable year.

t) **“Initial Overhead Cost Allowance”** means the allowance pursuant to paragraph (d), Section 13 hereof in accordance with the regulations.

u) **“Interest Holder”** means any person, company, corporation or entity that has an interest in the costs, revenues, and/or production related to a contract.

v) **Market Price**, with respect to oil, means the price which would be realized from oil produced under a contract as hereinafter defined, if sold in a transaction between independent persons dealing of their own volition at arm's length and on a non-exclusive basis and based on international market conditions. With respect to gas, it means the price as determined in accordance with the provisions of Section 15 hereof.

w) **Net Proceeds** means the balance after deducting from the gross proceeds, the allowable recoverable costs and the applicable allowances provided in this Act.

x) **Oil** means liquid- or solid- hydrocarbons, casinghead petroleum spirits, bitumen, asphalt and similar or associated substances, in their natural state before the same had been refined or otherwise treated. It does not include oil produced through destructive distillation of coal, bituminous shells or other deposits.

y) **Operating Costs** means the operating costs directly attributable to the contract area in accordance with the regulations.

z) **Petroleum** means oil and gas.

aa) **Petroleum in Commercial Quantities** means a discovery of petroleum in one or more wells within the contact area in such quantities which will permit its being economically developed as determined by the contractor and approved by the DOE 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 has been discovered.

bb) **Petroleum Operation** means searching for and obtaining petroleum in the onshore or offshore areas subject to the jurisdiction of 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:

- 1) transportation of petroleum outside the Philippines;
- 2) processing or refining at a refinery; or
- 3) any transaction in the products so refined.

cc) Pipeline Transportation Contract means a contract in accordance with Section 16 of this Act.

dd) Production area means the surface area that covers the structure or feature in which the discovery of petroleum in commercial quantities has been established as delineated under the provisions of the contract.

ee) Regulation means the regulation that will be promulgated by the DOE pursuant to Section 26 of this Act.

ff) Residual Proceeds mean the balance after deducting from the Government's share of net proceeds, the contractor's income tax liabilities.

gg) Service Agreement means a service contract described under Sections 9 to 15 of this Act.

hh) Waste, in addition to its ordinary meaning, means waste as understood in the oil and gas industry and in particular, but without limiting the generality of the foregoing, includes:

- 1) the inefficient or excessive use or dissipation of reservoir energy;
- 2) the locating, spacing, or drilling of a well within a field or within part of a field or the operating of any well that, having regard to sound engineering and economic principles, result in a reduction in the quantity of oil or gas that can be recovered from a field;
- 3) the drilling, equipping, completing, operating or producing of any well in a manner that causes or is likely to cause the unnecessary or excessive loss or destruction of oil or gas after extracting from the reservoir;
- 4) the inefficient storage of oil or gas above ground or underground;
- 5) the production of oil or gas in excess of available storage, transportation, or marketing facilities;
- 6) the escape or flaring of gas that could be economically recovered and processed or economically injected into an underground reservoir; or
- 7) the failure to use suitable artificial, secondary or supplementary recovery methods in a field when it appears that such methods would result in

increasing the quantity of oil or gas, or both, ultimately recoverable under sound engineering and economic principles.

SEC. 4. Powers of the Government. - The State may directly explore for, develop and produce indigenous petroleum. It may with a view to accelerate the exploration, development and production of indigenous petroleum award contracts, as hereinafter provided, to technically and financially qualified contractors, in the onshore or the offshore areas or a combination thereof subject to the jurisdiction of the Government.

NATURE AND EXECUTION OF CONTRACTS

SEC. 5. Nature of Contracts. - The Government may award:

(a) Geophysical Survey Contracts, for the purpose of carrying out geophysical surveys, with the option to drill up to two exploratory wells and to enter into a service contract, or

(b) Service Contracts, for the purpose of carrying out petroleum operations, except pipeline transportation outside the contract area, at the sole cost and risk of the contractor, whereby the contractor shall receive as sole compensation for his services the FPIA, if applicable, the amount of cost recovery allowed under the contract, and the stipulated service fee which shall be sourced from the proceeds of sale of the petroleum produced under the contract. The contractor shall have the preferential right to enter into one or more pipeline transportation contracts, or

(c) Pipeline Transportation Contracts, for the purpose of carrying out the transportation of oil and gas through pipelines outside the contract area to the main user of the petroleum or to any terminal for further distribution or export.

SEC. 6. Execution of Contract. - Every contract herein authorized shall be concluded by the Department of Energy and approved and entered into by the President. The President shall notify Congress, in writing, of every contract entered into within thirty (30) days from its execution, pursuant to Article XII, Section 2, paragraph 4 of the Constitution.

The Department of Energy, with a view to select the best contractor, may adopt any of the following procedure:

a) follow a public bidding procedure for a specific area on the basis of:

(i) a single bid criterion, or

(ii) the submission of proposals with regard to work program, levels of the service fee, the cost recovery limits of the ARC, the level of participation by Filipino companies, or such other criteria as the DOE may publicly establish, or

b) hold negotiations for areas which the DOE has made a public announcement that insufficient interest is expressed by the petroleum industry to warrant a public bidding procedure.

SEC. 7. Publicity. - Any activities related to the implementation of Section 6 of this Act shall be given the widest publicity in and outside the country. The DOE shall publish model contracts as well as announce at least three months in advance any intention to offer areas for bidding to include the evaluation criteria to be applied and the respective weights to be given to different elements for each criterion.

GEOPHYSICAL SURVEY CONTRACTS

SEC. 8. Geophysical Survey Contracts. - Geophysical survey contracts shall have a term of not more than three years and shall entitle the contractor to drill up to a maximum of two wells. Under a geophysical survey contract, the contractor shall have the option to enter into a service contract in the form in which it is appended as an annex to the contract.

Any well drilled under a geophysical survey contract can be credited towards the work obligations under a service contract: *Provided, however,* That the initial exploration period of such contract shall be reduced with a period equal to the number of days between the spud date of the first option well and the rig release date of the first or second option well as the case may be.

All or a substantial part of the contract area of the service contract shall be selected from the contract area of the geophysical survey contract. If the contractor fails to sign the respective service contract within the term of the geophysical survey contract, or any extension thereof, the contract area shall stand relinquished in its entirety upon the expiry of the term of the geophysical survey contract.

A geophysical survey contract shall stipulate a geophysical program.

SERVICE CONTRACTS

SEC. 9. Size of Contract Area. - The initial size of the contract area under a service contract in the onshore or offshore shall not exceed seven hundred fifty thousand (700,000) hectares.

SEC. 10. Obligations of the Contractor. - The contractor of a service contract shall have the following obligations:

a) Under the general management, control and supervision of the State through the DOE, to carry out the petroleum operations in accordance with this Act and its regulations;

b) Provide all necessary financing, services and technology at his own cost and risk;

c) Perform the minimum exploration and development work obligations stipulated under the contract, which may exceed but shall not be less than the minimum obligations stipulated under this Act;

d) Once petroleum in commercial quantities is discovered, develop and produce the field on behalf of the State in accordance with modern good economic

recovery of the petroleum; avoiding hazards to life, health and property; avoiding pollution of air, land and waters; avoiding waste as defined in paragraph hh Sec. 3 hereof and pursuant to an efficient and economic program of operations;

e) Establish, in accordance with the regulations, not later than five (5) years prior to the anticipated termination of the production operations, a sinking fund, at the disposal of the DOE, sufficient to cover the proper decommissioning of the equipment and structures and abandonment of wells and operations. Contributions to the sinking fund shall constitute an ARC;

f) Assume all exploratory and development risks, such that if no petroleum in commercial quantities is discovered or the discovered petroleum is insufficient to recover all costs, the contractor will not be entitled to any compensation or reimbursements;

g) Be subject to Philippine income tax; and

h) To comply with all provisions of Section 17 hereof, in case it decides to construct and operate a petroleum pipeline outside its contract.

SEC. 11. Minimum Terms and Conditions. - Every service contract shall, in addition to the minimum conditions provided in this Act, contain the following minimum terms and conditions:

b) Every contractor shall undertake minimum work obligations in accordance with the work program stipulated in the contract, which shall require at least three (3) exploratory wells to be drilled to a minimum stipulated depth before the end of the second year from the effective date of the contract, and at least one (1) further exploratory well to a minimum stipulated depth before the end of each succeeding year until a discovery shall have been made. Additional exploratory wells drilled beyond the minimum committed for any period may be carried forward to satisfy obligations to drill exploratory wells during a subsequent period. The DOE may stipulate a less intensive work program in the contract for contract areas located in water depths beyond 200 meters or in known high pressure areas as determined by the DOE;

b) The exploration period shall be a maximum of ten (10) years, consisting of an initial exploration phase of two (2) years and successive phases of one (1) year each; *Provided*, That the contractor has not been in default in its work obligations. If by the expiry of the exploration period or any extended exploration period, no discovery of petroleum in commercial quantities is made, the contract shall terminate and the contract area in its entirety shall be relinquished by the contractor: *Provided*, That:

(1) where the contractor has discovered petroleum and is committed to the execution of an appraisal program, acceptable to the DOE, the DOE may grant two successive one (1) year extensions of the exploration period to enable the contractor to declare either a discovery of petroleum in commercial quantities or a significant gas discovery; or

(2) where a contractor has made a significant gas discovery, he shall be entitled to retain the part of the contract area still retained by him for a maximum period of five years, renewable every under such term and conditions as stipulated in the contract, from the date on which the significant gas discovery was made. All such extensions shall be on the basis that the contractor shall continue the exploration activities in accordance with the work programs approved under the contract;

c) If petroleum is discovered in an exploratory well, the contractor shall, within the period stipulated in the contract, submit an appraisal timeframe within which an appraisal program is to be completed in accordance with the contract. If the contractor does not submit such an appraisal program within the stipulated period, the contractor shall relinquish the area containing the geological structure or feature in which the discovery is made. If upon the completion of the appraisal program the discovery is determined not to be a significant discovery of petroleum in commercial quantities, the appraisal area shall be relinquished at such time when the next mandatory relinquishment is due. Such relinquishment shall be credited against the contractor's mandatory relinquishment obligations;

d) Every contract shall provide for the mandatory relinquishment of at least 40% of the original contract area by the end of the fifth year, and a further 25% of the original contract area by the end of the seventh year from the effective date. If a discovery of petroleum in commercial quantities is made within the exploration period, or any extended exploration period, the contractor shall be entitled, subject to paragraph (c) above, to retain in addition to any production area or significant gas discovery area, delineated in accordance with the contract, a further area equivalent to 12.5% of the original contract area for a further period until the twentieth year from the effective date on the basis that the contractor shall continue exploration in accordance with work programs approved under the contract;

e) Where oil in commercial quantities is discovered during the exploration period in any part of the contracted area still retained by the contractor, the contract with respect to that area shall remain in force during the balance of the exploration period, and in respect of gas, until the end of the significant gas discovery period, and thereafter, the contract shall, in respect of production areas delineated in accordance with the contract for production purposes, be renewed for a period not exceeding twenty-five (25) years;

(1) 35 years for any production area primarily producing oil, consisting of the initial exploration period and the extended period for production purposes; and

(2) 45 years for any production area primarily producing gas, consisting of the initial exploration period, any extended exploration period, the significant gas discovery period and the extended period for production purposes;

f) All materials, equipment, plants and other installations erected or placed in the contract area, shall remain the property of the contractor until the termination of the contract and, subsequently, such property shall be transferred to the State:

Provided, however, That any item or a movable nature under a rental or lease agreement in accordance with the regulations, shall remain the property of the owner identified in the rental or lease agreement; and

- g) The contractor shall be subject to the laws of the government.

SEC. 12. Filipino Participation Incentive Allowance. - Any service contract entered into by the President in which Filipino citizens or companies have a minimum participating interest of twenty-five percent in the contract area shall be granted a Filipino Participation Incentive Allowance (FPIA) not exceeding seven and one-half percent of the gross proceeds. For areas which have been declared as non-commercial fields, the Filipino companies shall be granted an FPIA not exceeding ten percent of the gross proceeds.

SEC. 13. Allowable Recoverable Costs (ARC). - Prior to determining the net proceeds, each interest holder shall be entitled to recover, on a monthly basis, the ARC, which shall consist of the operating costs, exploration costs, development costs, development allowances, and cross recovery allowances: *Provided, however, That the total of the ARC during any month shall not exceed a maximum of 70% of the gross proceeds of gas for export and oil for commercial fields, a maximum of 80% of the gross proceeds of gas for domestic consumption for commercial fields, and a maximum of 90% of the gross proceeds for non-commercial fields: Provided, further, That any amount that cannot be recovered during any month can be recovered in the succeeding months.*

The determination of the ARC shall be subject to the following provisions:

- (a) The following costs shall not be recoverable:

- (I) any overhead expense incurred outside the Philippines over and above the percentage permitted in the accounting procedures, or any overhead expense incurred by the interest holders in the Philippines not directly attributable to petroleum operations;
- (II) any interest or other financing costs;
- (III) any cost not reasonably required for petroleum operations; and
- (IV) any other non-recoverable costs identified in the accounting procedures.

- b) The development allowance shall be computed as follows:

- (I) 30% of any development costs attributable to gas for export and oil, for commercial fields;
- (II) 50% of any development costs attributable to gas for domestic consumption, for commercial fields; and

- (III) 40% of any development costs attributable to gas for export and oil, for non-commercial fields; and
- (IV) 60% of any development costs attributable to gas for domestic consumption, for non-commercial fields.

c) There shall be a cross recovery allowance equal to the share of the interest holder in any petroleum exploration costs incurred outside the contract area anywhere in the Philippines directly attributable to other service contract or geophysical survey contract which did not result in the discovery of petroleum in commercial quantities in such other contract areas: *Provided*, That such cross recovery cannot be transferred to another interest holder or party and: *Provided, further*, That such exploration costs can only be fully recovered for a period of ten (10) years following the year in which the costs were incurred and thereafter the cross recovery shall be reduced as follows:

- (I) up to 80% of the original amount in the eleventh year;
- (II) up to 60% of the original amount in the twelfth year;
- (III) up to 40% of the original amount in the thirteenth year;
- (IV) thereafter, the amount can no longer be recovered;

The initial overhead cost allowance shall be 5% of the gross proceeds of the first 10,000 barrels of oil and the first 100 billion BTU of gas from a contract area.

SEC. 14. Obligation to Supply Petroleum Demand in the Philippines. -

The contractor shall be entitled to take and dispose of and market either domestically or for export petroleum produced under the contract, in accordance with the terms thereof, subject to supplying the domestic requirements of the State. No petroleum shall be exported from the Philippines unless the DOE has approved the export price or price formula and the DOE has determined that such oil or gas is not required or cannot be used economically for domestic purposes based on a reasonable estimation of the possible economic oil and gas requirements of the Philippines for a 25-year period.

The contractor shall have the right to be paid in full market price in US\$ for any supplies made in accordance with the contract to meet such domestic requirements.

SEC. 15. Gas Prices for Domestic Consumption. - The contractor shall have the right to sell freely any gas to domestic users in the Philippines, for such prices and such volumes as the contractor may agree upon, subject to the following limitations:

a) The market price at the measuring point in the production area shall not exceed the ceiling price. The ceiling price shall be approved by the Energy Regulatory Commission, in accordance with the applicable regulations, as the city

gate price less the pipeline transport tariff from the measuring point in which is define the field to the said city gate and shall be determined on the basis of the net energy equivalent value of competing energy resources less a discount required in order to induce power plants and/or large industrial consumers in the area to shift from using other energy resources to gas.

b) Subject to paragraph (c) hereof, the contractor shall not be required to sell any gas below the floor price at the measuring point in the gas field; which shall be stipulated in the contract and shall represent a price or a price formula that would provide the contractor with the minimum rate of return on investments attributable to the production of gas destined for domestic consumption that would attract an independent private investor to invest in the development of gas;

c) The Energy Regulatory Commission shall announce within six (6) months after the approval of this Act, after reasonable consultation with the various agencies or entities situated in the Metro Manila area, a specific minimum volume or volumes that such agencies or entities commit to take for the ceiling price or discounts of the ceiling price, from those producers which are capable of delivering gas first to the main consumption area: *Provided, however,* That the ERC shall not commit such volume to any contractor prior to entering into a firm supply contract on the basis of sufficient proved reserves and an approved development plan. The ERC may adjust this volume from time to time depending on changes in market conditions.

SEC. 16. Determination of Service Fee. - Each interest holder shall be entitled to a service fee which shall be not more than 40% of the net proceeds of sale of the petroleum under the contract. The interest holder shall share these net proceeds on the basis of a sliding scale for oil and separately for gas based on the average level of production from the contract area for oil and gas. Such scales may vary depending on factors, such as water depth, well depth, well productivity or other logistical and economic factors typically determining the profitability of oil and gas fields in the Philippines.

With respect to onshore contract areas for oil, the contractor shall be entitled to a service fee based on the average level of production which shall not be more than the following sliding scale:

Level of Production	% Net Proceeds to the Contractor
(i) from 0 to 40,000 BOPD	40%
(ii) for the part of the production from 40,001 to 80,000 BOPD	30%
(iii) for the part of the production exceeding 80,001 BOPD	20%

The DOE may, under less favorable geological and well productivity conditions or for offshore areas or for gasfields, stipulate in the contract sliding scales which are more favorable to the contractor: *Provided,* That the minimum percentage to the State shall not be less than 60%.

PIPELINE TRANSPORTATION CONTRACTS

SEC. 17. Pipeline Transportation Contracts. - A pipeline transportation contract shall be for a term of 25 years renewable for another 25 years and shall contain the following:

(a) The contractor shall have the privilege to:

- (i) transport oil or gas from the contract area or from any third party to the main user of the petroleum or to any terminal for further distribution or export;
- (ii) where the interest holder of a pipeline transportation contract is also interest holder of a service contract, the privilege to use the pipeline with priority for the transportation of oil and/or gas from his contract area, with the obligation to make the pipeline available to third parties where capacity permits and the petroleum is compatible with that of the petroleum transported in the pipeline;
- (iii) charge tariff per barrel of MMBtu throughput, which shall be sufficient to:
 - (1) cover all operating and maintenance costs,
 - (2) pay income tax,
 - (3) permit depreciation of the capital investments over the useful life of such assets for twenty years, whichever is shorter.
 - (4) Pay the reasonable financing costs,
 - (5) Provide for a reasonable return on investment; and
- (iv) construct and operate additions to and expansions of pipeline where it proves to be necessary to satisfy the requirements of the users of the pipeline.

(b) The Government shall assist in the acquisition of the respective right-of-way and right of eminent domain: *Provided*, That the contractor shall pay for all reasonable cost related to such acquisition.

(c) The contractor shall have the obligation to:

- (i) construct, test and operate the pipeline
- (ii) transport any part of the petroleum that the Government has decided to take in kind form the contract areas connected to the pipeline, and

- (iii) charge tariff and provide services to third parties on a non-discriminatory basis, subject to internationally accepted and safe petroleum industry practices in case of transportation of incompatible types of oil and gas; and
- (iv) submit, for approval by the DOE, any routing of a pipeline

SEC. 18. Performance Guarantees. - The contractor shall within 60 days following the effective date of a contract and subsequently prior to any new phase of the committed work programs and prior to such other dates as the contract may stipulate, post a bond or guarantee equal to all or a substantial percentage of the estimated costs of the work program to which the contractor commits for the succeeding period, and such bond or guarantee shall not be released until the work program has been executed: *Provided, however,* That the guarantee can be released on a well by well basis where the contractor has committed to a multi-well program.

SEC. 19. Privileges of the Contractor. - The provision 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 value-added 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, quality and delivery time are not manufactured domestically; are directly and actually needed and will be used exclusively by the contractor or a subcontractor in the petroleum operations; 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 DOE was obtained by the contractor before the importation of the said items which approval shall not be unreasonably withheld: *Provided, however,* That the contractor or the subcontractor may not sell, transfer or dispose of such items without the prior approval of the DOE and payment of taxes due to Government: *Provided, finally,* That the DOE shall allow and approve of the sale, transfer or disposition of the said items without tax if made (1) to another contractor, (2) for reasons of obsolescence, or (3) for purposes of replacement to improve and/or expand the petroleum operations.
- (c) Exemption from pre-inspection requirements of spare parts, materials, equipment and machineries to be imported into the country which will be used in the operations during the exploration period;
- (d) Exemption, upon the approval of the DOE, from laws, regulations and/or ordinances restricting the (1) construction, installation and operation of power plants for the exclusive use of the contractor, (2) exportation of machinery, equipment and materials which were imported solely for the petroleum operations when no longer needed;

(e) Exemption from publication requirements under Republic Act No.5455 and the provisions of Republic Act No. 6173 with respect to the exploration, exportation or sale or disposition of oil and gas discovered and produced in the Philippines;

(f) Subject to the provisions of this Act, the exportation of petroleum;

(g) Entry, upon the sole approval of the DOE, 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 the contract: *Provided*, That in case the employment of any such alien with the contractor ceases, the applicable laws on immigration shall apply to such personnel and their immediate families: *Provided, further*, That Filipinos shall be given preference to positions for which they have adequate training: *Provided, finally*, That the contractor shall adopt and implement a training program for Filipinos along technical and specialized lines, which program shall be reported to the DOE;

(h) Rights and obligations in any contract under this Act shall be deemed as essential considerations for the conclusion thereof and shall not be unilaterally changed or impaired; and

(i) Have at all times the right to ingress to and egress from the contract area or pipeline right of way and any facilities used for the petroleum operations wherever located.

SEC. 20. Assignment. - The rights and obligations under a contract cannot be assigned without the prior approval of the DOE.

SEC. 21. Arbitration. - The DOE may stipulate in a contract that disputes in the implementation thereof between the Government and the contractor may be settled in accordance with generally accepted arbitration practices.

SEC. 22. Full Disclosure. - Any contractor shall report any interest held by any interest holder in a contract to the DOE, and where more than one interest holder have an interest in any contract, the interest holders shall enter into an operating agreement, which shall be submitted forthwith to the DOE, and which clearly spells out the respective interests that the various interest holders may have in the production, gross revenues, allowable recoverable costs, and other items stipulated in the contract. Any interest holder shall report any change in interest in any contract to the DOE. The operator shall be responsible that the determination of the payment of service fee made each interest holder shall conform to the obligations under the contract. Furthermore, the Filipino companies shall furnish such information as the Government may require to verify that the company is in fact a Filipino company as defined in this Act.

SEC. 23. Repatriation of Capital and Retention of Profits Abroad. - Subject to the regulations of the Bangko Sentral ng Pilipinas (BSP), the contractor shall be entitled to:

(a) repatriate over a reasonable period of time the capital investment actually brought into the country in foreign exchange or other assets registered with the Bangko Central ng Pilipinas (BSP);

(b) retain abroad all foreign exchange representing proceeds arising from exports accruing to the contractor over and above:

- (1) the foreign exchange to be converted into pesos in an amount sufficient to cover the costs of contractor's petroleum operations payable in Philippine currency;
- (2) the revenue due to the Government on such exports;
- (3) convert into foreign exchange and remit abroad at prevailing rates not less favorable to the contractor than those available to any purchaser of foreign exchange, any excess balances of their peso earnings from petroleum production and sale over and above the current working capital they require; and
- (4) convert foreign exchange into Philippine currency for all purposes in connection with the petroleum operations at prevailing rates not less favorable to contractor than those available to any purchaser of such currency.

Sec. 24. Settlement of Financial Obligations. - Any financial obligations from the contractor to the Government or vice versa shall be promptly settled and the contract shall set out the penalties available to late payment.

Sec. 25. Transfer of Technology and Training. - Every contract shall include modern and adequate provisions for transfer of technology and training of Filipino personnel. The costs for such training shall be part of the ARC.

Sec. 26. Income Tax. - Subject to the specific provisions of this Act, the income tax for each interest holder shall be assessed on the basis of the provisions of the laws of the Philippines: *Provided, however,* That the following special provisions shall apply:

- a) Gross income shall be equal to gross proceeds as defined in this Act;
- b) In computing the taxable net income, the FPIA and the ARC shall be allowed as deductions; and
- c) In computing the taxable net income, no deductions shall be allowed for interests or other considerations paid or suffered with respect to financing of its petroleum operations.

The interest holder shall render to the DOE a return for each taxable year in duplicate in such form as provided by law. The return shall be filed by the DOE with

the Bureau of Internal Revenue within the period specified in the National Internal Revenue Code and according to the rules and regulations promulgated therein.

Sec. 27. Petroleum Exploration Drilling Fund (PEDF). - A special trust account to be known as Petroleum Exploration Drilling Fund (PEDF) is hereby established in order to assist the Filipino companies in the exploration of petroleum. The capital base for the PEDF shall be built up from and composed of fifty percent (50%) of the residual proceeds from existing and future oil and gas production up to a maximum amount of Php5 Billion per year including the interest thereon.

The amount collected for the PEDF in any year shall be disbursed during the subsequent year as grants to Filipino companies and the amount of interest such companies hold in any contract.

Each year the funds shall be disbursed by the DOE in the order of time sequence in which the Filipino companies submit the required information to the DOE, until the PEDF is exhausted. In the event the PEDF is not fully disbursed during any given year, the remainder will be carried over to the following year: *Provided, however,* That any amount in excess of Php5 Billion shall be remitted to the National Treasury.

Where the Filipino interest holder has submitted to the DOE the information required with respect to the results of an exploration or appraisal well, the DOE shall disburse the interest holder's share multiplied by:

- a) for the first 1000 meters drilled, in the onshore, US \$ 100 per meter drilled and in the offshore, US \$ 300 per meter drilled;
- b) for the part of the well between 1001 and 2000 meters for the onshore US \$ 300 per meter drilled and for the offshore US \$ 600 per meter drilled;
- c) for the part of the well between 2001 and 3000 meters, in the onshore US \$ 500 per meter drilled and in the offshore US \$ 700 per meter drilled; and
- d) for the part of the well in excess of 3000 meters in the onshore or offshore US \$ 800 per meter drilled.

In case of the drilling of exploration or appraisal wells, the DOE shall be authorized to disburse advances up to not more than 75% of the applicable grants during the drilling of such wells on the basis of well logs submitted to the DOE by the respective interest holders.

The DOE is authorized, in accordance with the regulations, to adjust the amount upwards after years of low level of drilling activity and downwards after years of intensive drilling activity in order to encourage the full disbursement and the widest possible use of the PDEF from time to time.

Sec. 28. Functions of the Department of Energy (DOE). - In addition to the other functions specified under this Act, the DOE shall prepare and promulgate

regulations necessary for the implementation of this Act within six months upon the approval of this Act. The DOE shall be responsible for the enforcement of such regulations.

Without prejudice to the general power of promulgating regulations, the following may be made from time to time on any of the following matters:

- a) Rights and powers of inspectors of Government and assistance to be given to them;
- b) Supply of information, data, samples and other materials required by the Government;
- c) Standards with respect to quality, verification and application of metering and measuring equipment;
- d) Methods to be used for maintaining records and information;
- e) Accounting procedures to be employed;
- f) Methods and practices to be employed to prevent waste of petroleum and damage to reservoirs and maximum economic recovery of petroleum, to prevent unintentional entrance of fluids into petroleum or other reservoirs, and to ensure the application of other good and modern petroleum industry methods and practices;
- g) Standards for equipment and materials, drilling, well testing and other procedures required to ensure that petroleum operations are executed in a diligent, conscientious and workmanlike manner;
- h) Abandonment procedures for wells, removal of equipment and facilities, and site restoration and reforestation;
- i) Environmental, health, and safety matters related to petroleum operations;
- j) Mitigating and remedial measures to compensate for negative environmental, social or economic impacts;
- k) Measures to be employed in order to prevent interference with fisheries, navigation or mining and other petroleum activities;
- l) Procedures to ensure that goods, materials, equipment and services are being obtained from the Philippines which are competitive in price, quality and delivery time;
- m) Procedures to ensure the employment of Filipinos with suitable qualifications;
- n) The monitoring of training programs stipulated in the contracts;

o) Information requirements and inspection procedures to be employed in order to verify that Filipino companies have not engaged in arrangements that have the effect of removing or diluting the true 60% control and ownership of these companies by Filipino citizens;

p) The manner and form of income tax payment, the reimbursement of ARC, the payment of the service fee of the contractor, and the payment of the FPIA, if any;

q) The contents of and procedures with respect to acceptable bonds or other performance guarantees to guarantee the contractual obligations;

r) The assessment of charges for services rendered to implement the intent and provisions of this Act;

s) Criteria for determining the technical and financial competence of the contractor; and

t) Such other matters necessary to implement the provisions of this Act.

SEC. 29. Other Functions of the Department of Energy (DOE). - The DOE shall:

a) Undertake intensive studies and research in petroleum industry practices, procedures and policies;

b) Coordinate and budget for the training of government officials in petroleum industry matters;

c) Appoint, discipline and remove, and determine the compensation of its technical staff and other personnel, Provided, That positions which are highly technical and primarily confidential as may be determined by the Civil Service Commission shall not be subject to the Civil Service laws and rules, and of the Wage and Position Classification Office;

d) Within four months after the close of every fiscal year, submit income tax of each interest holder within the period specified in the National Internal Revenue Code according to the rules and regulations promulgated therein.

e) Generally exercise all powers necessary or incidental to attain the objectives of this Act.

SEC. 30. Information Management Role of the DOE. - Every contractor shall provide the DOE with all geochemical, geophysical, geological, technical and economic data, information, samples and reports that the DOE may require in accordance with the regulations. Geochemical, geophysical, geological and technical data shall remain confidential for a period stipulated in the regulations not

exceeding five years. In order to enhance the knowledge about the petroleum potential of the Philippines, the DOE shall make the non-confidential data accessible to all interested parties. Furthermore, the DOE may use ten percent of the PEDF for specific geochemical, geophysical or geological programs to be carried out by the DOE in order to gather data which shall be made available through the non-confidential database.

PENALTIES

SEC. 31. Penalties. - Any person who makes a false statement or is guilty of misrepresentation for the purpose of inducing the award of a contract or to obtain any privilege under such contract or under this Act, shall be punished by a fine of not less than Php1 Million or an imprisonment of not less than 18 months or both at the discretion of the court. The contract induced by such misrepresentation or false statement shall automatically be canceled and any privilege so obtained shall be withdrawn. Any person who is in breach of a duty imposed by this Act or its regulations shall be liable to pay a fine of not less than Php1 Million or an imprisonment of not less than 18 months or both at the discretion of the court. The contract induced by such misrepresentation or false statement shall be automatically canceled and any privilege so obtained shall be withdrawn.

Any person who is in breach of a duty imposed by this Act or its regulations shall be liable to pay a fine not less than P500,000.00 or an imprisonment of not less than 18 months or both at the discretion of the court.

Where a contractor is guilty of selling, transferring or disposing of any machinery, equipment, spare parts or materials, in respect of which an exemption was granted under Section 18 of this Act without the necessary authorization of the DOE, he shall without prejudice to any other penalty to which he may be liable under the law be obliged to pay an amount equal to five times the tax exemption granted.

Where an interest holder obtains a grant pursuant to Section 25 hereof by making a false statement or misrepresentation shall in addition to any other penalty under the law be obliged to refund to the PEDF five times the amount of the grant provided.

Where a contractor is guilty of waste as defined in Section 3 of this Act, the DOE may, after due notice and hearing, order to close its petroleum operations until the waste has stopped. The DOE may, without any hearing/investigation, make an order requiring all operations to be shut down if in his opinion, it is necessary to do so to prevent damage to persons or property or to prevent pollution: *Provided, however,* That as soon as possible after making such order and in any event within fifteen days thereafter, the DOE shall give the contractor an opportunity to be heard. After concluding the investigation, the DOE may disregard, reverse or confirm the order made.

FOREIGN ASSISTANCE

SEC. 32. Foreign Assistance. - Nothing in this Act or any other law shall preclude the government, through the DOE or other government agency, from

negotiating or entering into any agreement with any foreign country or government for assistance in terms of equipment, technical know-how and financing for exploration, development, production and transportation of petroleum and its by-products.

SEC. 33. Existing Contracts. - Contractors of existing contracts shall have the right by notifying the DOE, within the period of eighteen months following the enactment of the Act, to elect to accept all obligations and privileges under this Act, and to enter into a new contract complying with the provisions of this Act: *Provided, however,* That such new contract shall not reduce any work commitments to which the contractor was previously committed: *Provided, further,* That the original contract area awarded to such contractor may be retained, subject to the relinquishment obligations under this Act. Where contractors do not elect to accept the conditions of this Act, the vested obligations and privileges of such contractors under the existing contract shall continue unaltered.

SEC. 34. Repealing Clause. - Presidential Decree No. 87 is hereby repealed with the exception of:

a) Section 30 of the said Decree, for the purpose of making the provisions of the Petroleum Act of 1949 referred to in said section remain effective to all existing contracts and contracts to be entered into under this Act;

b) Its application to any contract entered into prior to the promulgation of this Act and not converted pursuant to Section 32 hereof.

Furthermore, all laws, Presidential Decrees, Executive Orders, rules and regulations or parts thereof, inconsistent with the provisions of this Act, are hereby repealed or modified accordingly.

SEC. 35. Effectivity. - This Act shall take effect upon its approval.

Approved,