

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 effectiveness 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 1<sup>st</sup> day of January in the Year of Our Lord, Nineteen Hundred and Eighty-three.

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