



SERVICE CONTRACTS UNDER PD 87: OPPORTUNITIES(?) FOR JOINT DEVELOPMENT WITH CHINA

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CONSTITUTIONAL FRAMEWORK

The background is a gradient of teal and blue, with a subtle pattern of small white dots. On the right side, there is a large, faint circular scale with numbers from 0 to 210. There are also several faint circular lines and arrows scattered across the background, suggesting a sense of motion or a technical diagram.

CONSTITUTIONAL NORMS ON FOREIGN PARTICIPATION

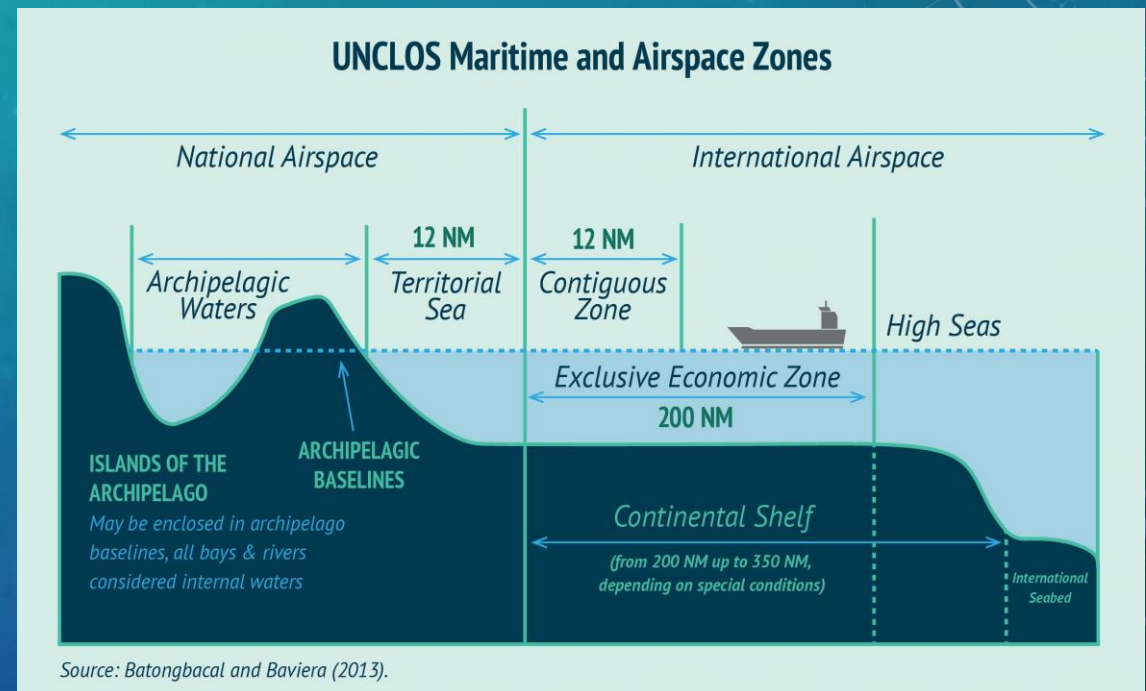
- Exclusive Filipino use - Archipelagic waters, Territorial sea, EEZ – No JD allowed
 - “The State shall protect the nation’s marine wealth in its archipelagic waters, territorial sea, and exclusive economic zone, and reserve its use and enjoyment exclusively to Filipino citizens.” (Art. XII, s. 2, para. 2)
- Continental (“insular”) shelf – No mention!
 - “The President may enter into agreements with foreign-owned corporations involving either technical or financial assistance for large-scale exploration, development, and utilization of minerals, petroleum, and other mineral oils according to the general terms and conditions provided by law, based on real contributions to the economic growth and general welfare of the country. In such agreements, the State shall promote the development and use of local scientific and technical resources.” (Art. XII, s. 2, para. 2)

CONSTITUTIONAL NORMS ON FOREIGN PARTICIPATION

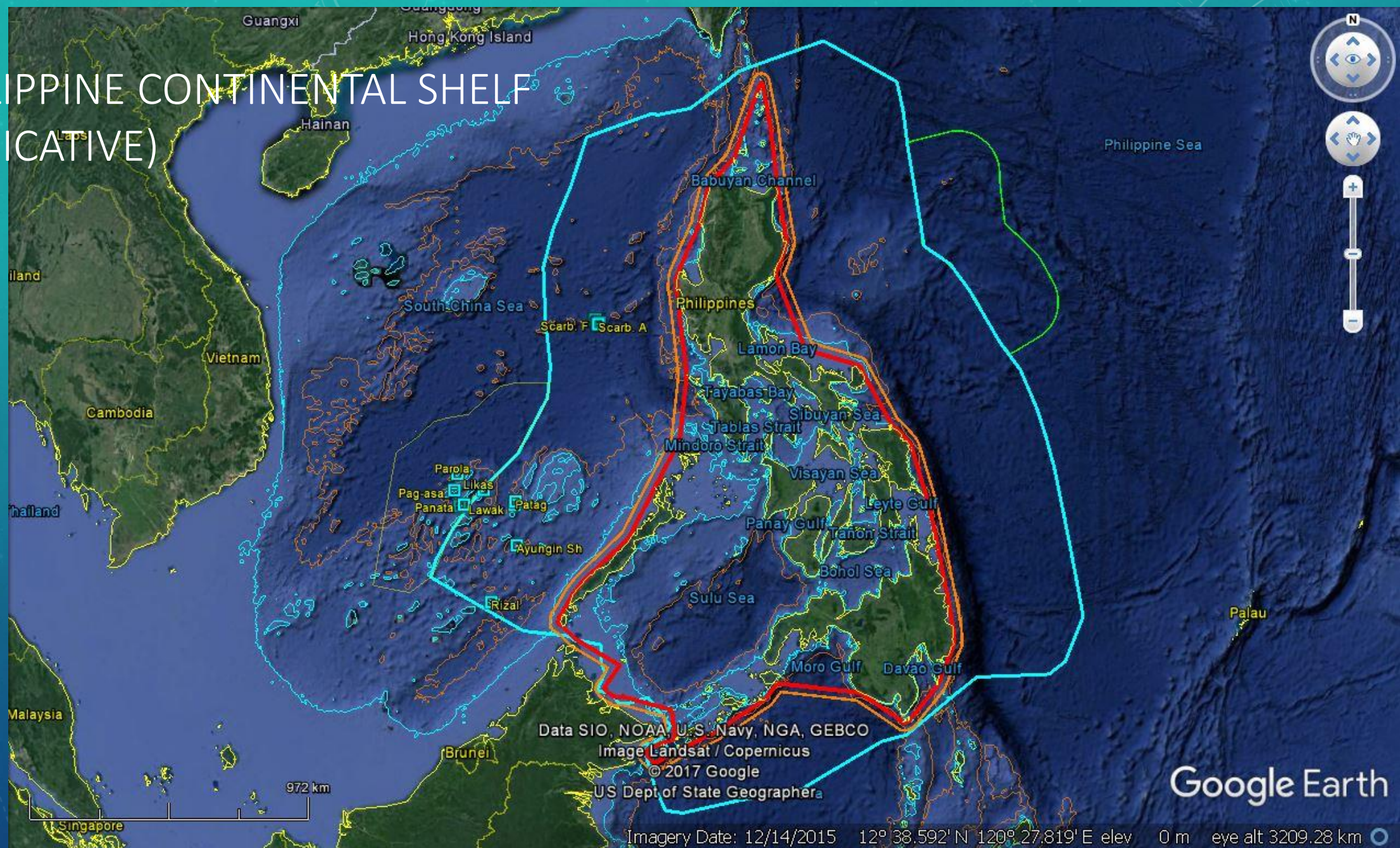
- L'Bugal B'laan v. Ramos, GR 127882, 01 Dec 2004
 - All natural resources owned by the State; except for agricultural lands, natural resources cannot be alienated by the State
 - The exploration, development and utilization of natural resources shall be under the full control and supervision of the State.
 - The State may undertake exploration, development, utilization :
 - By itself directly and solely
 - By (a) co-production, (b) joint venture, or (c) production-sharing agreements, with Filipino citizens or corporations at least 60% of the capital of which is Filipino owned
 - Small-scale utilization of natural resources may be undertaken by Filipino citizens
 - For large-scale exploration, development, utilization of minerals, petroleum and other mineral roils, the State may enter into FTAA according to terms and conditions provided by law
 - May be 100% foreign owned

MARITIME ZONES IN 1982 UNCLOS

- Internal waters – under full sovereignty
- Archipelagic waters – full sovereignty subject to archipelagic sea lanes passage and innocent passage
- Territorial sea – full sovereignty subject to innocent passage
- Contiguous zone – Specific jurisdictional extensions; customs, fiscal, immigration, sanitary regulations enforcement
- EEZ – sovereign rights over living resources, plus ocean energy resources and specific jurisdictions
- Continental shelf – sovereign rights plus associated jurisdictions



PHILIPPINE CONTINENTAL SHELF (INDICATIVE)



CONSTITUTIONAL NORMS ON FOREIGN PARTICIPATION

- No specific/express prohibition of foreign participation in study or exploration of maritime zones
 - See UNCLOS Art 245, 266
 - Coastal State has exclusive right to regulate, authorize and conduct marine scientific research in its territorial sea
 - Coastal State permission required for the conduct of marine scientific research in the continental shelf and EEZ
 - Permission may be denied only for specific reasons
 - Coastal State allowed to regulate as necessary

PETROLEUM LEGISLATION

PD 87 (OIL EXPLORATION & DEVELOPMENT ACT, 1972)

Provision

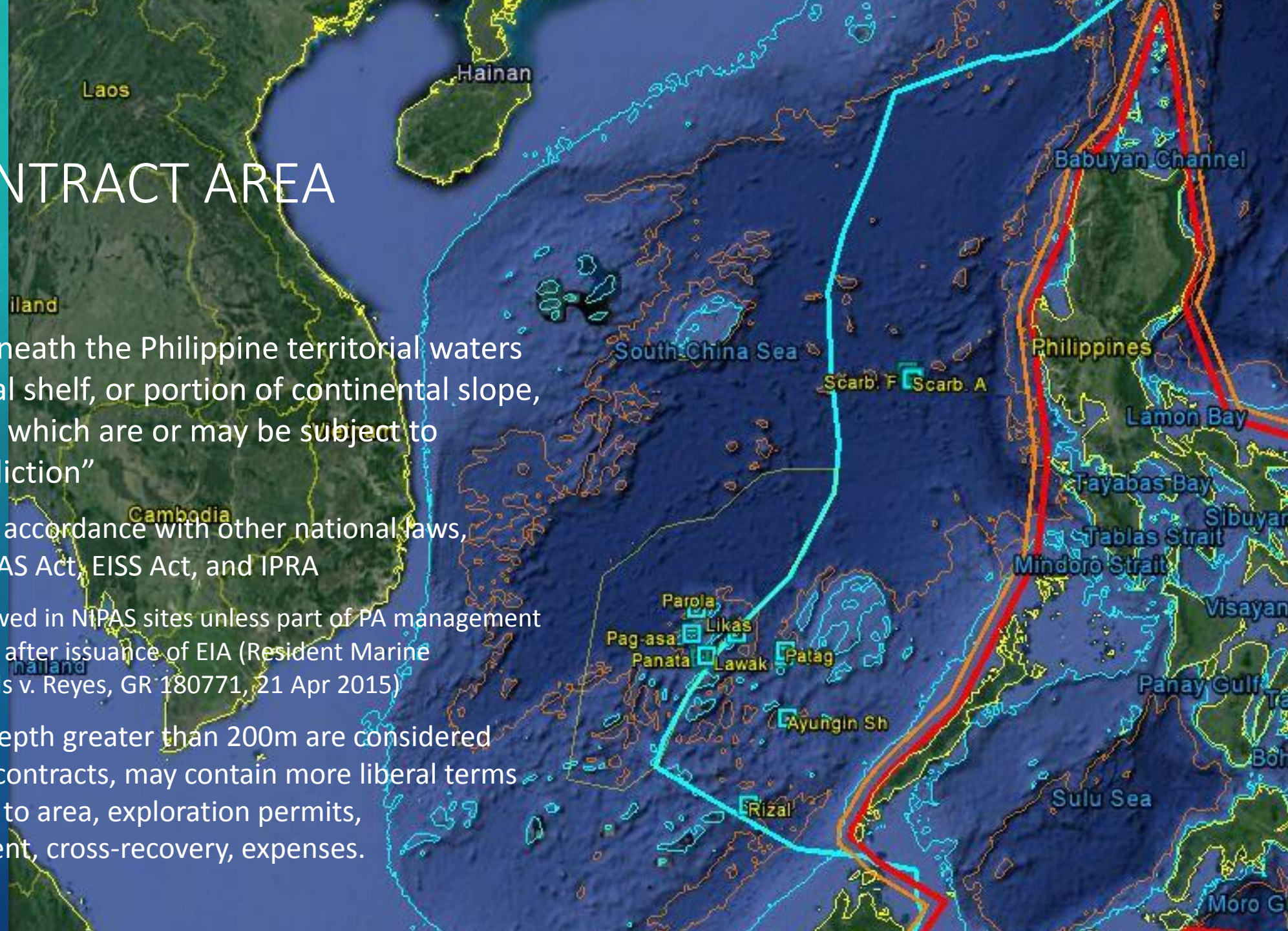
- Hasten discovery and production of indigenous petroleum
- Under arrangements calculated to yield maximum benefit to the Filipino people and revenue to the government
- Assure just returns to participating private enterprises, particularly those that provide necessary services, financing and technology and assume all exploration risks

Comment

- JD arrangement may necessitate less than maximum benefit/revenue to people
- “Just returns” to participating private enterprises become less of a consideration

PD 87; CONTRACT AREA

- “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”
 - Should be in accordance with other national laws, specially NIPAS Act, EISS Act, and IPRA
 - Not allowed in NIPAS sites unless part of PA management plan and after issuance of EIA (Resident Marine Mammals v. Reyes, GR 180771, 21 Apr 2015)
 - Areas with depth greater than 200m are considered deep-water contracts, may contain more liberal terms with respect to area, exploration permits, relinquishment, cross-recovery, expenses.



PD 87; CONTRACT TERM

Provision

- Service contract is for 7-10 years; extendible if petroleum discovered on 7th to 10th year
- Contractor may request 2-year moratorium if a commercial discovery is made but extraction not yet technologically feasible
- If contract goes into production, contract remains in force for balance of exploration term plus 25 years
- In no case will contract be enforceable for more than 50 years

Comment

- Private contractors subject to contract enforcement under domestic law; 7 / 10 year periods may not be enforceable
- JD term not unprecedented

PD 87; ASSIGNMENTS, OBLIGATIONS, RELINQUISHMENT

Provision

- Any transfer and assignment of rights & obligations under SC requires approval by government, unless between contractor and affiliate
- Contractor must submit work program and commitments; if abandoned, contractor must pay government its committed costs
- At least 25% of initial area of SC must be relinquished at end of 5 years; another 25% at end of 7 years if it is extended to 10 years

Comment

- Joint approval needed for any transfer or assignment of any obligations to sub-contractors
- Work program not unilaterally enforceable
- Relinquishment provisions not applicable; presumes area is to be made available to other contractors

PD 87; EQUITY & FISCAL TERMS

Area	Per PD 87 Onshore 50,000 to 750,000 hectares Offshore 80,000 to 1,500,000 hectares ~ 420,000 to 984,000 hectares (current areas for offer)
Contract Duration	-7 years for exploration; can be extended up to 3 years; -25 years for production; can be extended for another 15 years provided that the total number of years of the contract shall not exceed 50 years
Filipino Participation Incentive Allowance (FPIA)	Minimum of 1.5% and maximum of 7.5% of gross proceeds for service contractor allows at least 15% participation by Filipino companies
Cost Recovery	-70% maximum of gross proceeds or actual expenses per calendar year; unrecovered costs for the current calendar year to be carried over in the succeeding calendar year -100 % recoverable costs for non-capital expenditures; -capital expenditures depreciated over 5 to 10 years;
Production Sharing	Government = 60% of net proceeds Contractor = 40% of net proceeds
Corporate Income Tax Rate	30% of grossed-up net proceeds of Contractor on petroleum operations (paid out of government share)

PD 87; EQUITY AND FISCAL TERMS

Signature Bonus	Minimum of USD 50,000
Developmental Assistance	<p>Minimum of USD 60,000* (75% for the DEPARTMENT and 25% for the scholarship and institutional assistance to universities/ colleges identified by the DEPARTMENT)</p> <p>In succeeding years: Exploration phase – USD 5,000 for scholarship per year (cumulative) Production phase – to be negotiated based on production rate (minimum of USD 10,000 per year cumulative)</p>
Prod. Bonuses - Oil	<p>Minimum of: *</p> <p>USD 300,000 at start of production; USD 500,000 at 25,000 BOPD; USD 1 MM at 50,000 BOPD; and USD 2 MM at 75,000 BOPD</p>
Prod. Bonuses - Gas	<p>Minimum of: *</p> <p>USD 300,000 at start of production; USD 500,000 at 250 MMCFGD; USD 1 MM at 500 MMCFGD; and USD 2 MM at 750 MMCFGD</p>
Training Allowance	<p>Minimum of USD 20,000 per year during exploration period (cumulative); Minimum of USD 50,000 per year during production year (cumulative, to be negotiated based on production rate)</p>
Corporate Social Responsibility in the host community or vicinity of Contract Area	To be determined by the Contractor and the Department.

PD 87; COMPUTATION OF PROFIT-SHARING

SC Profit Sharing

Gross Proceeds	100.00 %
Less: Filipino Participation Incentive Allowance (FPIA) if applicable	7.50 *
Recoverable Cost	<u>70.00</u> **
Net Proceeds	22.50
Less: Contractor's Share	<u>9.00</u> (A)
Government Share	13.50
Less: Income Tax (Contractor's Share / 70%) x 30%***	<u>3.86</u>
Net Government Share	9.64
Less: LGU Share (40%)	<u>3.86</u>
National Government Share	<u>5.78</u>

** Percentage of FPIA varies from 1.5 to a maximum of 7.5% depending on the participating interest of Filipino partners*

*** % of Gross Proceeds or actual recoverable cost whichever is lower*

**** Income Tax Rate starting January 2009 (A) 40% of the Net Proceeds*

PD 87; ASSUMED APPLICATION OF OTHER LAWS

Subject / Legislation

- Labor Code
- National Internal Revenue Code
- Tariff and Customs Code
- Immigration Act (permits, licenses, etc)
- Civil Code (contracts, liabilities, etc)
- Dispute settlement (PH courts, tribunals)
- Environment laws (PD 1586, etc)
- Health (quarantine, occupational hazards, standards, etc)
- Safety (standards, industry codes, etc)
- Criminal law
- Security of operations, installations (security, search & rescue)

Comment

- Model service contract does not contain specifics because it is assumed that PH laws apply
- Application of laws, regulations need to be determined by agreement between the parties

MODEL SERVICE CONTRACT

Provision

- Public document with fixed standards terms and conditions; negotiations mostly center on contract area, work program, expenditures
- Clear and transparent basis for contract between gov't and private contractor

Comment

- Will not suffice for a JD arrangement
- JD agreement will need to be a special customized agreement
 - Special benefits/provisions
 - Will it be competitive?

RECENT CHANGES IN PHILIPPINE PETROLEUM REGIME

- Energy Investment Coordinating Council, EO 30, 28 Jun 2017
- Simplified approval process for energy contracts
 - Automatic approval of application for permits within 5 days, if no decision within 30 days
 - Decisions made on assumption that permits have been issued
- Shift from contracting rounds (open public bidding) to unsolicited / negotiated proposals?
 - Movement away from transparent, competitive bidding
 - Possibly open to original practice of negotiated concessions
 - Not necessarily in accordance with Model Service Contract?
- Changes would accommodate JD process

CONCLUDING REMARKS

CONCLUDING OBSERVATIONS

- Constitutional status pending decision by SC, but on its face, not directly/expressly prohibited for petroleum
- JD will be a sui generis legal regime
 - Specific treaty required ; domestic law (Constitution, statute), regulations not enough
 - Terms of agreement, division of labor, work commitment, etc. need to be specified
 - Must determine allocation of jurisdictions, application of laws & regulations
- Key challenges:
 - Transparency (process, contract)
 - Fairness (area, sharing)
- Foreign State as a service contractor – not as easy as it sounds!