

JOINT DETERMINATION OF COMMERCIALITY

KNOW ALL MEN BY THESE PRESENTS:

This JOINT DETERMINATION OF COMMERCIALITY is made by and between:

THE DEPARTMENT OF ENERGY, an agency of the Republic of the Philippines created under Republic Act (R.A.) No. 7638 with principal office address at Energy Center, Merritt Road, Fort Bonifacio, Taguig City, Metro Manila, represented herein by its Undersecretary, **HONORABLE GUILLERMO R. BALCE**, hereinafter referred to as "DOE";

- and -

FORUM EXPLORATION, INC., a corporation organized and existing under the laws of the Republic of the Philippines with office address at 14th Floor, Pearlbank Centre, 146 Valero Street, Salcedo Village, Makati City, represented herein by its President and Chief Executive Officer, **DAVID R. ROBINSON**, hereinafter referred to as "CONTRACTOR";

The DOE and CONTRACTOR are hereinafter collectively referred to as "Parties" and individually as "Party".

WITNESSETH: That

WHEREAS, the DOE representing the Government of the Republic of the Philippines, and the CONTRACTOR by themselves are Parties to Service Contract (SC) No. 40 over an area located in northern Cebu and having an Effective Date of 19 February 1994;

WHEREAS, the CONTRACTOR has, during the period between 1994 and 1995, drilled appraisal wells over the Libertad structure earlier discovered in the Contract Area;

NOW, THEREFORE, in view of the foregoing premises, the Parties hereby stipulate and agree as follows:

1. That the Libertad Gas Field located in Bogo, Cebu which contains Natural Gas and is hereby jointly determined to be in Commercial Quantity as contemplated by Section 6.1(b) of SC 40;
2. For the avoidance of doubt, it is hereby acknowledged and confirmed by the Parties that:

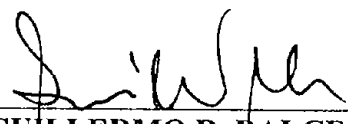
attached to this Joint Determination, constitute a Production Area under SC 40;

- b. the CONTRACTOR shall submit to the DOE for approval the Retention Area as defined under Section 4 of SC 40;
- c. the CONTRACTOR shall submit to the DOE the Gas Production Development Program and the Gas Sales Agreement with the prospective end-user for approval pursuant to the pertinent provision of SC 40.

IN WITNESS WHEREOF, the Parties have signed this JOINT DETERMINATION OF COMMERCIALITY in the City of Taguig, Metro Manila, Philippines on the 25th day of November 2005 as follows:

For: the DEPARTMENT OF ENERGY

For: FORUM EXPLORATION, INC.



GUILLERMO R. BALCE
Undersecretary



DAVID R. ROBINSON
President and Chief Executive Officer



WITNESS



WITNESS

**REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF ENERGY
Manila**

**SERVICE CONTRACT
(PRODUCTION SHARING)**

between

DEPARTMENT OF ENERGY

and

COPLEX (CEBU) LIMITED

and

E. F. DURKEE AND ASSOCIATES, INC.

WITNESSETH

WHEREAS, all petroleum, crude oil, crude, natural gas and/or casinghead petroleum spirit of the Philippines belong to the State and their disposition, exploration, development, exploitation and utilization are governed by Presidential Decree No. 87, as amended, otherwise known as the Oil Exploration and Development Act of 1972, and Section 2 Article XII of the 1987 Constitution;

WHEREAS, the Oil Exploration and Development Act of 1972 (hereinafter called the "Act"), declares it 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;

WHEREAS, Section 2 Article XII of the 1987 Constitution provides that the President may enter into agreement with foreign-owned corporations involving either technical or financial assistance for large-scale exploration, development and utilization of, among others, 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 and for the promotion of the development and use of local scientific and technical resources;

WHEREAS, CONTRACTOR has the financial resources, technical competence and professional skills necessary to carry out the Petroleum Operations;

WHEREAS, CONTRACTOR wishes to enter into such a Service Contract governing the Contract Area as hereinafter defined; and

NOW, THEREFORE, in consideration of the sum of US\$100,000 in hand paid, the receipt and sufficiency of which is hereby acknowledged, and of the mutual covenants and the conditions herein contained, it is hereby stipulated and agreed as follows :

REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF ENERGY
Manila

SERVICE CONTRACT
(PRODUCTION SHARING)

THIS CONTRACT, made and entered into this 9th day of February 1995 in the City of Manila by and between :

The GOVERNMENT OF THE REPUBLIC OF THE PHILIPPINES,
DEPARTMENT OF ENERGY, established pursuant to Republic Act No. 7638
as First Party;

and

COPLEX (CEBU) LIMITED, Offices of Maples and Calder, P.O. Box 309,
Grand Cayman, Cayman Islands British West Indies, represented by its
Managing Director, Mr. Kenneth J. Fellowes;

and

E. F. DURKEE AND ASSOCIATES, INC., Ste. 7B Floor, 112 Legaspi Street
Legaspi Village, Makati, Metro Manila, Philippines, represented by its
General Manager, Mr. E. F. Durkee.

All the above companies are herein collectively called Second Party and
hereinafter referred to as the CONTRACTOR.

In the implementation of this Contract, the GOVERNMENT shall act
through and be represented by the DEPARTMENT OF ENERGY, hereinafter
called DEPARTMENT. The GOVERNMENT and/or the DEPARTMENT and
CONTRACTOR are hereinafter referred to collectively as the Parties.

for

SECTION I
SCOPE

- 1.1 This Contract is a Service Contract entered into pursuant to Section 7 of the Act with all necessary technology and financing as well as the required services to be furnished by CONTRACTOR in accordance with the provisions herein contained. The CONTRACTOR shall undertake and execute the Petroleum Operations contemplated hereunder under the full control and supervision of the DEPARTMENT.
- 1.2 CONTRACTOR shall be responsible to the DEPARTMENT for the execution of such operations in accordance with the provisions of this Contract, and is hereby appointed and constituted the exclusive party to conduct the Petroleum Operations. The DEPARTMENT shall have the right to require performance of any or all obligations under this Contract against any or all of the Second Party.
- 1.3 CONTRACTOR shall assume all exploration risks such that if no Petroleum in Commercial Quantity is discovered and produced, it will not be entitled to reimbursement.
- 1.4 During the term of this Contract, the total production achieved in the conduct of such operations shall be accounted for between the Parties in accordance with Section VII hereof.

For

SECTION II

DEFINITIONS

In the text of this Contract, the words and terms defined in Section 3 of the Act shall, unless otherwise specified herein, have meaning in accordance with such definitions.

- 2.1 Contract Area - means at any time the Area within the mining territory of the Republic of the Philippines which is the subject of Contract. The Contract Area is outlined and more particularly described in Annex A attached hereto.
- 2.2 Petroleum - means any crude or mineral oil, hydrocarbon gas, condensate, bitumen, asphalt, mineral gas and all other similar or naturally associated substances with the exemption of coal, peat, bituminous shale and/or other stratified mineral fuel deposits.
- 2.3 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.
- 2.4 Natural Gas - means gas obtained from boreholes and wells and consisting primarily of hydrocarbons.
- 2.5 Casinghead Petroleum Spirit - means any liquid hydrocarbons obtained from natural gas by separation or by any chemical or physical process.
- 2.6 Petroleum Operation or Operations - means searching for and obtaining Petroleum within the Philippines through drilling and pressure or suction or the like, and all other operations incidental

thereto. It includes the transportation, storage, handling and sale (whether for export or 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 transactions in the products so refined.

- 2.7 Petroleum in Commercial Quantity - means Petroleum in such quantities which will permit its being economically developed as determined jointly by the CONTRACTOR and approved by the DEPARTMENT 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.
- 2.8 Operating Expenses - means the total expenditure incurred by the CONTRACTOR both within and outside the Philippines in all Petroleum Operations pursuant to this Contract and the Geophysical Survey and Exploration Contract and determined in accordance with the Accounting Procedure attached hereto and made a part hereof as Annex B. These expenses will include, but not be limited to, the cost of seismic surveys, reprocessing of seismic, geological, and geophysical studies, drilling, equipping and completing wells, engineering studies, construction of well platforms, tank batteries, pipelines, systems and terminals, the cost of operating and maintaining all such facilities.
- 2.9 Effective Date - means the first day after the expiration of the twelve (12) months from the Effective Date of the Geophysical Survey and Exploration Contract if the CONTRACTOR makes said optional election.
- 2.10 Foreign Exchange - means currency other than that of the Republic of the Philippines that are freely convertible into gold or currencies eligible to form part of the country international reserves acceptable to the DEPARTMENT and to the CONTRACTOR.

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- 2.11 Calendar Year or Year - means a period of twelve (12) consecutive months commencing with January 1 and ending on the following December 31, according to the Gregorian Calendar.
- 2.12 Contract Year - means a period of twelve (12) consecutive months according to the Gregorian Calendar counted from the Effective Date of this Contract from the anniversary of such Effective Date.
- 2.13 Production Area - means that portion of the Contract Area where all reservoirs containing petroleum in Commercial Quantity are delineated by the CONTRACTOR with the approval of the DEPARTMENT .
- 2.14 Gross Income - means the gross proceeds from the sale of crude, natural gas and/or casinghead petroleum spirit produced under the Contract and sold during the taxable year at posted or market price, as the case may be, all as determined pursuant to Section VII, and such other income which are incidental to and arising from any one or more of the Petroleum Operations of the CONTRACTOR.
- 2.15 Posted Price - means that FOB price established by the CONTRACTOR and the DEPARTMENT 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 the fair market export values for Crude Oil of comparable grade, gravity and quality.
- 2.16 Market Price - means the price which is realized for Petroleum produced under this Contract if sold in a transaction between independent persons dealing at arms length in a free market.
- 2.17 Barrel - means 42 U.S. gallons or 9,702 cubic inches at a temperature of 60 degrees Fahrenheit.

fair

- 2.18 Government - means the GOVERNMENT of the Republic of the Philippines.
- 2.19 Affiliate - means (a) company in which one of the Second Parties holds directly or indirectly at least fifty (50%) of its outstanding shares entitled to vote; or (b) a company which holds directly or indirectly at least fifty percent (50%) of the CONTRACTOR's outstanding shares entitled to vote; or (c) a company in which at least fifty percent (50%) of its shares outstanding and entitled to vote are owned by a company which owns directly or indirectly at least fifty percent (50%) of the shares outstanding and entitled to vote of the CONTRACTOR.
- 2.20 Crude Oil Exported - shall include not only Crude Oil exported as such but also indigenous Crude Oil refined in the Philippines for export.
- 2.21 Contract - means the Service Contract.
- 2.22 Philippine Corporation - means a corporation organized under Philippine Laws at least sixty percent (60%) of the capital of which is owned and held by citizens of the Philippines.
- 2.23 Taxable Net Income - means the Gross Income less the deduction provided in Sub-section 8.1 below.
- 2.24 Filipino Participation Incentive Allowance (FPIA) - means the allowance up to 7.5% of Gross Proceeds as granted to CONTRACTOR pursuant to Sub-section 6.2 (i).
- 2.25 Geophysical Survey and Exploration Contract - means the Geophysical Survey and Exploration Contract dated 19 February 1993 covering an area out of which the Contract Area is carved.

- 2.26 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.
- 2.27 Deepwater Contractor - means the CONTRACTOR in a Deepwater Contract, whether acting alone or in consortium with others.
- 2.28 Deepwater Well - refers to a well(s) drilled on water depths beyond 200 meters, whether within or without a Deepwater Contract.

SECTION III

TERM

- 3.1 The exploration period under this Contract shall be seven (7) years from the Effective Date, extendable for three (3) years if (a) the CONTRACTOR has not been in default in its exploration work obligations and other obligations; or (b) has drilled a minimum of 25,000 feet of test wells, and (c) has provided a work obligation for the extension acceptable to the DEPARTMENT after which times this Contract shall automatically terminate unless Petroleum has been discovered by the end of the tenth year and the CONTRACTOR request a further extension of one (1) year to determine whether the discovery is in Commercial Quantity, in which event, another extension of one (1) year for exploration will be granted.
- 3.2 Where Petroleum in Commercial Quantity is discovered during the exploration period, this Contract shall, as to any Production Areas delineated pursuant to Sub-section 6.1 (b) below, remain in force during the balance of the exploration period or any extension thereof and for an additional period of twenty-five (25) years, thereafter renewable for a period not exceeding an additional fifteen (15) years

under such terms and conditions as may be granted upon by the PARTIES at the time of the renewal.

- 3.3 In the event CONTRACTOR has drilled an Option Well pursuant to Section 3.1 of the Geophysical Survey and Exploration Contract, the Option Well shall be deemed as satisfying the Work Commitment and Amount for Contract Year I, pursuant to the Work Program outlined in Section 5.3 of this Service Contract. Further, the effectiveness of this Contract shall relate back to the first day of the thirteenth (13) month after the Effective Date of the Geophysical Survey and Exploration Contract.

SECTION IV EXCLUSION OF AREAS

- 4.1 On or before the end of the Fifth Contract Year, CONTRACTOR shall surrender twenty five percent (25%) of the initial Contract Area.
- 4.2 On or before the end of the initial seven (7) year exploration period, if CONTRACTOR elects to extend the period for an additional three (3) years, CONTRACTOR shall surrender an additional area equal to twenty five percent (25%) of the remaining Contract Area.
- 4.3 In the event that CONTRACTOR has delineated any Production Areas pursuant to Sub-section 6.1 (b) below, the extent of such Production Areas shall be deducted from the initial Contract Area for the purpose of determining the size of such area that must be surrendered pursuant to Sub-sections 4.1 and 4.2 above.
- 4.4 If Petroleum in Commercial Quantity has been discovered during the exploration period, or any extension thereof, the CONTRACTOR may retain after the exploration period and during the effectivity of the

Contract, twelve and one half percent (12.5%) of the initial area in addition to the delineated Production Area if CONTRACTOR has provided an annual work program for the area to be retained acceptable to the DEPARTMENT ; Provided, however, That the CONTRACTOR shall pay annual rentals on such twelve and one half percent (12.5%) retained area Forty pesos (P40.00) per hectare or fraction thereof; Provided, finally, That such annual rentals shall be reduced by the amount spent by CONTRACTOR for exploration during the Contract Year.

- 4.5 CONTRACTOR shall have the right on at least thirty (30) days Notice to the DEPARTMENT to surrender all or any portion of the Contract Area without any liability or cost. Any portion so surrendered shall be credited against that portion of the Contract Area which CONTRACTOR is next required to surrender under the provisions of Sub-sections 4.1 and 4.2 hereof. The areas being surrendered shall be of sufficient size and convenient shape to enable Petroleum operations to be conducted thereon.
- 4.6 With respect to the mandatory surrenders pursuant to Sub-sections 4.1 and 4.2 as qualified by Sub-section 4.3, CONTRACTOR shall advise the DEPARTMENT of the portion to be surrendered at least thirty days (30) in advance of the date of surrender. The areas being surrendered shall each be of sufficient size and convenient shape to enable the Petroleum Operations to be conducted thereon.

SECTION V

WORK PROGRAM AND EXPENDITURES

- 5.1 CONTRACTOR shall be obligated to drill and spend in direct prosecution of this Contract not less than the number of wells and amounts hereinafter specified:

For

<u>Contract Year</u>	<u>Shallow Water/ Onshore Work Commitment</u>	<u>Amounts</u>
Years 1 & 2	3 (onshore)	US\$ 2.0 MM
Year 3	1	US\$ 2.0 MM
Year 4	1	US\$ 2.0 MM
Year 5	2	US\$ 4.0 MM
Year 6	2	US\$ 4.0 MM
Year 7	2	US\$ 4.0 MM

This first exploratory test well shall be commenced not later than the end of the first Contract Year. Thereafter, the drilling program shall continue in the years specified above until the programmed funds are expended or the drilling commitments are fulfilled or until petroleum is discovered in Commercial Quantity, whichever first occurs and in the later event, CONTRACTOR will devote the remainder of the programmed funds to the delineation and development in supplement to such funds as may be needed to pursue actively the delineation and development program developed and presented for approval of the DEPARTMENT within ninety (90) days after the declaration of discovery of Petroleum in Commercial Quantity; Provided, however, That upon thirty (30) days notice prior to the commencement of any new Contract Year, with the exception of the first two contract years in the first proviso, CONTRACTOR may relinquish the non-Production Areas(s) and be relieved of any future work program commitment for exploratory drilling with the exception of the first two years; Provided, however, If during any Contract Year, CONTRACTOR shall spend more than the amount of money required to be spent by CONTRACTOR, the excess may be credited against the amount of money required by the CONTRACTOR during the succeeding Contract Year(s) and Provided, further, That should the CONTRACTOR fail to comply with the work obligations provided for in this Contract for any contract year, it shall pay to the GOVERNMENT the amount it

should have spent but did not in a direct prosecution of its work obligations. For purposes of these provisions, failure to meet a commitment to drill a well shall be deemed a failure to spend the amount committed above which is left unspent or One Million United States Dollars (US\$ 1,000,000) whichever is higher.

- 5.2 Within a period of three (3) months after the Effective Date of this Contract and three (3) months prior to the beginning of each succeeding Contract Year, CONTRACTOR shall prepare and submit a Work Program and Budget for the Contract Area setting forth the Petroleum Operations which CONTRACTOR proposes to carry out during the ensuing Contract Year and shall advise the DEPARTMENT of any significant changes thereon.
- 5.3 Should the CONTRACTOR drill two(2) deepwater test wells during the first two (2) years of this Service Contract, then the CONTRACTOR will have fulfilled its obligations under the above shallow water program.
- 5.4 In case the CONTRACTOR surrenders or abandons wholly or partly the area covered by this Contract within two (2) years from its Effective Date, it shall in respect of the abandoned area, pay the GOVERNMENT the amount it should have spent, but did not, for exploration work during said two (2) years as specified under Section 5.1 for which payment, among other obligations, the performance guarantee posted by the contractor shall be answerable.

for

SECTION VI
RIGHTS AND OBLIGATIONS OF THE PARTIES

6.1 CONTRACTOR shall have the following obligations:

- a. Perform all petroleum operations and provide all necessary services and technology in connection therewith; Provided, That no foreign exchnage requirements of the operation shall be funded from the Philippine banking systems; unless otherwise allowed by existing rules and regulations;
- b. Upon each discovery of petroleum in quantities that may be commercial as determined jointly by the CONTRACTOR and the DEPARTMENT, delineate in consultation with the DEPARTMENT the reservoir in a prudent and diligent manner and in accordance with good oil field practices within one hundred and eighty (180) day period. If after such delineation it is determined that the reservoir contains petroleum in commercial quantity, the area so delineated shall constitute a production area;
- c. Be subject to the provisions of law of general application relating to labor, health, safety and ecology;
- d. Once petroleum in commercial quantity is discovered, operate the field 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;

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- e. Furnish the DEPARTMENT with geological and other information, data and reports relative to the operation except for proprietary techniques and interpretations used in developing siad information, data and reports;
- f. Maintain detailed technical records and accounts of its operation;
- g. Conform to regulations regarding, among others, safety, demarcation of the Contract Area, non-interference with the rights of other petroleum, mineral and natural resources operators;
- h. 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 DEPARTMENT ;
- i. Allow examiners of the Bureau of Internal Revenue and other representatives authorized by the DEPARTMENT at all reasonable times full access to accounts, books, and records relating to Petroleum Operations hereunder for tax and other fiscal purposes;
- j. Be subject to Philippine income tax;
- k. Give priority in employment to qualified personnel in the minicipality or municipalities or province where the exploration or production operations are located;
- l. Within sixty (60) days after the Effective Date of the Contract, post a bond or other guarantee of sufficient amount in favor of the GOVERNMENT and with surety or sureties satisfactory to the DEPARTMENT , conditioned upon the faithful performance

by the CONTRACTOR of any or all of the obligations under and pursuant to this Contract; and

- m. After commercial production commences in the Contract Area, supply from such production a portion of the domestic requirements of the Republic of the Philippines on a pro-rata basis, which portion shall be sold at Market price and shall be determined as follows: In respect of each year multiply the total quantity of Crude Oil required for domestic consumption by the ratio of the total quantity of Crude Oil produced from the Contract Area to the entire Philippine production of Crude Oil.

6.2 CONTRACTOR shall be entitled to the rights and privileges provided in Section 12 of Presidential Decree 87 as amended.

6.3 The DEPARTMENT shall assume and pay on behalf of the CONTRACTOR and/or Operator all income and corporate taxes payable to the Republic of the Philippines based on income or profit derived from Petroleum Operations. The DEPARTMENT shall furnish to each of the companies jointly referred to as CONTRACTOR the respective official receipts issued to the name of each company separately by and duly empowered GOVERNMENT authority, acknowledging the payment of said taxes.

SECTION VII

RECOVERY OF OPERATING EXPENSES AND ACCOUNTING FOR PROCEEDS OF PRODUCTION

7.1 CONTRACTOR, if authorized by the DEPARTMENT to market its share of Petroleum produced and saved from Contract Area, shall account for the proceeds from such sales as provided in this Section VII. CONTRACTOR shall have the right and privilege of receiving in

kind and disposing of its portion of the petroleum produced and saved from the Contract Area.

7.2 CONTRACTOR will recover from the gross proceeds resulting from the sale of all Petroleum produced under this Contract an amount equal to the full and complete recovery of all initial Operating Expenses, lifting costs and other investments, including all expenditures incurred under the Geophysical Survey and Exploration Contract dated 19th day of February 1993; Provided, thereafter, That the amount so recovered shall not exceed seventy percent (70%) of the gross proceeds from production in any year; Provided, further, That if in any year the operating costs exceeds seventy percent (70%) of the gross proceeds from the production or there are no gross proceeds, then the unrecovered expenses shall be recovered from the gross proceeds in succeeding years.

7.3 a. If the CONTRACTOR has been authorized to market the DEPARTMENT share of production, it shall within three (3) working days from collection date but in no case beyond sixty (60) days from lifting date, remit to the DEPARTMENT an amount equal to sixty percent (60%) of estimated net proceeds from each Petroleum Lifting Operations. This payment shall be calculated in accordance with the US dollar amounts recorded in the books and accounts pursuant to Section XV. The payment corresponding to the lifting date of each month shall include any adjustments on the GOVERNMENT's share of the preceding calendar quarter.

In the event that CONTRACTOR is not paid within sixty (60) days from the lifting date, CONTRACTOR shall immediately inform the DEPARTMENT. Should delays in collection continue, the Parties shall immediately meet to resolve the sixty (60) day payment requirement. Further, in the event collection within sixty (60) days from the lifting date remains a problem

for four (4) months or in the event that a single payment is not paid for an inordinate period, then CONTRACTOR shall meet with the DEPARTMENT within thirty (30) days, and if the problem is not completely resolved within thirty (30) days thereafter, CONTRACTOR, at its option, may extend the sixty (60) days from lifting date payment requirements until it collects the entire amount owed on each lifting dispute.

- b. The DEPARTMENT shall be entitled to receive in kind petroleum equal in value to sixty percent (60%) of net proceeds.
- c. For purposes of Section VII, net proceeds means the difference between gross income and the sum of the operating expenses recovered pursuant to Section 7.2 and the Filipino Participation Incentive Allowance as granted by Sub-section 6.2 (j).

7.4 CONTRACTOR will retain an amount equal to its fee of forty percent (40%) of the net proceeds from the Petroleum Operations.

7.5 If the DEPARTMENT and the CONTRACTOR elect to take their respective shares in kind, the Parties to this Contract will enter into separate agreement providing among others, for the manner and form of deliveries and appropriate quarterly adjustments.

7.6 For the purpose of determining gross proceeds, Petroleum shall be valued as follows:

- a. All Crude Oil sold for consumption in the Philippines shall be valued at the higher of Market Price or Posted Price for such crude oil;
- b. All Crude Oil exported shall be valued at the Posted Price;

For

- c. All Natural Gas and/or Casinghead Petroleum Spirit exported or sold for consumption in the Philippines shall be valued at the prevailing market price thereof;
- d. Reasonable commissions or brokerage incurred in connection with sales to third parties, if any, shall be deducted from gross proceeds but shall not exceed the customary and prevailing rate; and
- e. Filipino Participation Incentive Allowance, if any, shall be deducted from gross proceeds. This Allowance shall be computed on a sliding scale, as provided in the appropriate circular issued by the DEPARTMENT, provided that the Filipino Participation Incentive Allowance shall be granted under this Contract if qualifying Filipino Participation is secured prior to the commencement of the first drilling operation. The allowance shall be deducted from the higher of Section 7.6 (a) and 7.6 (b).

SECTION VIII
INCOME TAXES

- 8.1 CONTRACTOR shall be liable each taxable year for Philippine income tax under the provisions of the National Internal Revenue Code and the Oil Exploration and Development Act of 1972, as amended. The CONTRACTOR's gross income shall consist of:
- a. Gross proceeds determined in accordance with Section 7.6 above; and
 - b. Such other income which is incidental to and/or arising from any Petroleum Operation or other aspects of the contract.

In computing the Taxable Net Income, CONTRACTOR shall be allowed to deduct all operating expenses and all other costs recovered pursuant to Section 7.2 above.

- 8.2 In ascertaining the CONTRACTOR's 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.
- 8.3 CONTRACTOR shall render to the DEPARTMENT 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 DEPARTMENT 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.
- 8.4 The DEPARTMENT will pay the CONTRACTOR's income taxes and upon payment by it of CONTRACTOR's income taxes, shall timely pay and procure official receipts in the name of CONTRACTOR and/or Operator evidencing such payments. Each of the second parties shall be subject to tax separately on its share of income and the DEPARTMENT shall pay and supply each with an individual receipt in its own name.

SECTION IX

PAYMENTS

- 9.1 All payments which this Contract obligates CONTRACTOR to make to the DEPARTMENT shall be in Foreign Exchange at a bank to be designated by the DEPARTMENT and agreed upon by the Central Bank of the Philippines except that CONTRACTOR or Operator may

make such payment in Philippine Pesos, to the extent that such currency be realized as a result of the domestic sale of Crude Oil or Natural Gas. All such payments shall be translated at the applicable exchange rates as defined in the Accounting Procedures attached hereto as Annex B.

SECTION X
NATURAL GAS


- 10.1 For the purposes of this Section, Associated Gas shall mean Natural Gas commonly known as gas-cap which overlies and is in contact with quantities of Crude Oil in the same reservoir; or is solution gas dissolved in Crude Oil in the reservoir. Non-Associated Gas means Natural Gas other than Associated Gas.
- 10.2 CONTRACTOR shall be given the first priority in the use of Associated Gas for the conduct of Petroleum Operations including, without limitation, for fuel recycling and repressurization at no cost or expense. Thereafter, and to the extent that CONTRACTOR does not exercise its first priority, next priority shall be given to supplying any prospective demand for Natural Gas in the Philippines at a competitive price. Should CONTRACTOR not elect to market all or any part thereof, the DEPARTMENT may at its own risk and expense, and after reimbursing CONTRACTOR and/or Operator, take such excess Associated Gas at and as it passes out of the separator or other on-site treatment facility. Any Associated Gas produced from the Contract Area, to the extent not used in Petroleum Operations, sold by CONTRACTOR or taken by the DEPARTMENT, may be flared if the CONTRACTOR and the DEPARTMENT do not deem processing thereof to be economical.

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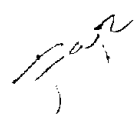
10.3 Where Non-Associated Gas is discovered which in the opinion of the CONTRACTOR may be commercial, CONTRACTOR and the DEPARTMENT shall define the areal extent of the discovery. Thereafter operations with respect to the discovery shall be conducted pursuant to Section 6.1 (b) and the CONTRACTOR shall submit to the DEPARTMENT a comprehensive development plan and for a scheme to market the Non-Associated Gas based upon normally acceptable commercial considerations as may be appropriate under the circumstances. Any such development plan shall include a realistic gas demand forecast at each corresponding outlet, a sequence and timing of field development and the proposed project structure. The fiscal terms shall be the same as is provided herein for Crude Oil. The Market Price for such Non-Associated Gas sold by CONTRACTOR for consumption in the Philippines shall be determined by parties taking into account, among others, the heating values and FOB prices (excluding duties and taxes) of competitive alternative fuels, available locally or in the world market, whichever alternative fuel cost is the lowest.

SECTION XI


ASSETS AND EQUIPMENT

- 11.1 CONTRACTOR shall acquire for the Petroleum Operations only such assets as are reasonable estimated to be required in carrying out the Petroleum Operations.
- 11.2 CONTRACTOR may also utilize in the Petroleum Operations equipment owned and made available by CONTRACTOR and charges to the Petroleum Operations account for use of such equipment shall be made as provided in the Accounting Procedure.
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11.3 The ownership of all materials, equipment and facilities erected or placed within the Contract Area covered by this Service Contract shall be transferred to the Republic of the Philippines immediately after recoupment by CONTRACTOR of all costs pertaining to such materials, equipment and facilities. The ownership of all materials, equipment and facilities located outside the Contract Area but covered by this Service Contract shall be transferred to the Republic of the Philippines upon termination of this Service Contract. CONTRACTOR will not remove any materials, equipment or facilities covered by this Service Contract from the Republic of the Philippines without the prior consent of the Republic of the Philippines. The Republic of the Philippines shall assume ownership of the materials, equipment and facilities subject to all financing agreements, liens, and other burdens thereon or shall delay assuming ownership pending the satisfaction and release of any such burdens. After the transfer of ownership to the Republic of the Philippines, CONTRACTOR shall have the right to use the materials, equipment and facilities free of charge, shall have the right to transfer the materials, equipment and facilities from block to block within the Contract Area, shall continue to maintain, repair or replace materials, equipment and facilities as deemed necessary in accordance with generally accepted offshore oil field and marine practices, and shall be permitted to fully recoup all expenditures for such purposes. The provisions of this paragraph shall not apply to leased or chartered materials, equipment and facilities. Provided, further, In the event the Bureau of Internal Revenue or any other agency assesses or levies a tax on the CONTRACTOR due to its use of the above materials, equipment and facilities, free of charge, the DEPARTMENT will immediately reimburse the CONTRACTOR, in cash, for the full amount of any such taxes and the necessary gross to keep the CONTRACTOR whole.



SECTION XII
CONSULTATION AND ARBITRATION

- 12.1 Disputes, if any, arising between the DEPARTMENT and CONTRACTOR relating to this Contract or the interpretation and performance of any of the clauses of this Contract, and which cannot be settled amicably, shall be settled by arbitration. The DEPARTMENT on the one hand and CONTRACTOR on the other hand, shall each appoint one arbitrator within thirty (30) days after receipt of a written request of the other Party to do so. Such arbitrators shall, at the request of the other Party, if the Parties do not otherwise agree, be appointed by the President of the International Chamber of Commerce. If the first two arbitrators appointed as aforesaid fail to agree on a third within thirty (30) days following the appointment of the second arbitrator, the third arbitrator shall, if the Parties do not otherwise agree, be appointed, at the request of either PARTY, by the President of the International Chamber of Commerce. If an arbitrator fails or is unable to act, his successor will be appointed in the same manner as the arbitrator whom he succeeds. Unless the Parties agree otherwise, the Philippines shall be the venue of the arbitration proceedings.
- 12.2 The decision of a majority of the arbitrators shall be final and binding upon the Parties. Judgement upon the award rendered may be entered in any court having jurisdiction or application may be made to such court for a judicial acceptance of the award and an order of enforcement, as the case may be.
- 12.3 Except as provided in this Section, arbitration shall be conducted in accordance with the Rules of Arbitration of the International Chamber of Commerce, then in effect.
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SECTION XIII
EMPLOYMENT AND TRAINING OF PHILIPPINE PERSONNEL

- 13.1 CONTRACTOR agrees to employ qualified Filipino personnel in the Operations through its contractors and/or vendors and after commercial production commences, will undertake, upon prior approval of the DEPARTMENT the schooling and training of Filipino personnel for labor and staff position, including administrative, technical and executive management position. CONTRACTOR shall undertake upon prior approval of the DEPARTMENT a program of training assistance for DEPARTMENT personnel. CONTRACTOR's total training commitment shall be Ten Thousand United States Dollars (US\$10,000) per year excluding any Moratorium Period and a mutually agreed amount during the production phase.
- 13.2 Cost and expenses of training Filipino personnel for CONTRACTOR's own employment shall be included in Operating Expenses. Costs and expenses of a program of training for DEPARTMENT personnel shall be on a basis to be agreed upon by the DEPARTMENT and CONTRACTOR.

SECTION XIV
TERMINATION

This contract shall be terminated and CONTRACTOR shall be relieved of its obligations :

- 14.1 As provided in Section 3.1 hereof; or
- 14.2 On expiration of the term, or extension thereof provided for in Sub-section 3.2 hereof; or

for

14.3 Upon surrender by CONTRACTOR of the entire Contract Area pursuant to Sub-section 4.5.

SECTION XV
BOOKS AND ACCOUNTS AND AUDITS

15.1 Books and Accounts

CONTRACTOR shall be responsible for keeping complete books and accounts, both in United States and Philippine currency, reflecting all transactions in connection with Petroleum Operations in accordance with Accounting Procedure attached hereto as Annex B.

15.2 Audits

The DEPARTMENT shall have the right to inspect and audit CONTRACTOR's books and accounts relating to this Contract for any Calendar year within one (1) year period following the end of such Calendar Year. Any such audit will be completed within twelve (12) months after its commencement. Any exception must be made in writing sixty (60) days following the completion of such audit and failure to give such written exception within such time shall establish the correctness of CONTRACTOR's books and accounts for the period of such audit.

SECTION XVI
OTHER PROVISIONS

16.1 Notices

Any notice required or given by either Party to the other Party shall be in writing and shall be effective when a copy thereof is handed to or

E.F.Durkee and Associates, Inc.
Suite 7B, LPL Towers
112 Legaspi Street, Legaspi Village
Makati, Metro Manila
Philippines
Telephone : 818 8768
Facsimile : 817 9096

Any Party may substitute or change such address on written notice thereof to the others.

16.2 Governing Law

The laws of the Republic of the Philippines shall apply to this Contract.

16.3 Suspension of Obligations

- a. Any failure or delay on the part of either Party in the performance of its obligations or duties hereunder shall be excused to the extent attributable to Force Majeure;
- b. If operations are delayed, curtailed or prevented by such causes, then the time for enjoying the rights and carrying out the obligations thereby affected, and all rights and obligations hereunder shall be extended for a period equal to the period thus involved;
- c. Force Majeure shall include Acts of God, unavoidable accidents, acts of war or conditions arising out of or attributed to war (declared or undeclared), civil unrest, laws, rules, regulations and orders by any GOVERNMENT or governmental agency, strikes, lockouts and other labor or political disturbances,

insurrections, riots, and other civil disturbances and all other beyond the control of the Party concerned Provided, however, That as to the DEPARTMENT only, laws, rules, and regulations and orders by GOVERNMENT or any governmental agency of the Republic of the Philippines shall not constitute Force Majeure; and

- d. The Party whose ability to perform its obligations is so affected shall notify the other Party thereof in writing stating the cause and both Parties shall do all reasonably within their power to remove such cause.

16.4 Assignments

The rights and obligations of Second Party under this Contract shall not be assigned or transferred without the prior approval of the DEPARTMENT ; Provided, That with respect to the assignment or transfer of such rights and obligations to an Affiliate of the transferor, the approval thereof by the DEPARTMENT 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 (50%) of the CONTRACTOR's outstanding shares entitled to vote and each transferee shall be maintained during the existence of the Contract.

16.5 Petrochemical Facility

At such time as CONTRACTOR has established Commercial Production as defined in Section 2.7, CONTRACTOR will undertake technical and economic studies as to the feasibility of establishing a petrochemical facility in the Philippines to utilize a portion of such production. CONTRACTOR will conduct such studies at its sole cost and expense. To the extent that it is mutually agreed between all

parties that such studies indicate that such facilities would be technically economically feasible, CONTRACTOR will finance and construct or cause to be financed and constructed such facility.

SECTION XVII
PAYMENTS BY CONTRACTOR

- 17.1 CONTRACTOR shall, within ninety (90) days following the first sale and receipt of production from a discovery of Petroleum in Commercial Quantity, pay to the First Party the total sum of Fifty Thousand United States Dollars (US\$50,000) for onshore fields and Two Hundred Thousand United States Dollars (US\$200,000) for offshore fields.
- 17.2 If and when there shall be produced from the Contract Area twenty-five thousand (25,000) barrels of oil per day (BOPD) at an average rate for ninety (90) consecutive days, CONTRACTOR shall, within sixty (60) days following the expiration of said ninety (90)- day period, pay to the First Party the total sum of Seven Hundred Fifty Thousand United States Dollars (US\$750,000); Provided, It is understood that CONTRACTOR, in order to sustain said rate of twenty-five thousand (25,000) BOPD for said ninety (90)- day period, shall not be required to operate the Contract Area other than as a reasonably prudent operator following sound oil field practice prevalent in the industry.
- 17.3 If and when there shall be produced from the Contract Area fifty thousand (50,000) barrels of oil per day (BOPD) at an average rate for ninety (90) consecutive days, CONTRACTOR shall, within sixty (60) days following the expiration of said ninety (90)- day period, pay to First Party the total sum of One Million United States Dollars (US\$1,000,000); Provided, It is understood that CONTRACTORS, in order to sustain said rate of fifty thousand (50,000) BOPD for said ninety (90)- day period, shall not be required to operate the Contract

Area other than as a reasonably prudent operator following sound oil field practice prevalent in the industry.

SECTION XVIII
DEEPWATER CONTRACT

18.1 With regard to the recovery of Operating Expenses of CONTRACTOR as a Deepwater CONTRACTOR, the following recovery shall be allowed:

- a. Cross Recovery Allowed - There shall be allowed the cross recovery of the Operating Expenses incurred by a Deepwater CONTRACTOR or its Affiliate in two (2) or more areas under different Deepwater Contracts and in the drilling of Deepwater Wells(s) 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 of Operating Expenses incurred within ten (10) Years preceding the date of production shall be cross-recoverable;
 - b) Operating Expenses incurred more than ten (10) years preceding the date of production shall be reduced by an amount equal to twenty (20%)

percent thereof, for each year beyond ten (10) years preceding the date of production.

- c. Cross Recovery Defined - For purposes of this Section, the term Cross Recovery means that the Operating Expenses incurred by a Deepwater CONTRACTOR, its Affiliate or assignees in two (2) 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; and
- d. Operating Expenses Defined - For purposes of this Section, the term Operating Expenses means the total expenditures for Petroleum Operations incurred by the CONTRACTOR, both within and without the Philippines.

18.2 The provision of this Section XVIII, as well as provisions elsewhere specified which are applicable to Deepwater Contracts or Deepwater Wells, as provided in Presidential Decree No. 1857, shall apply to this Contract as long as this Contract remains as a Deepwater Contract or in cases of drilling of Deepwater wells, as the case may be.

SECTION XIX

EFFECTIVITY

19.1 This Contract shall come into effect on the Effective Date.

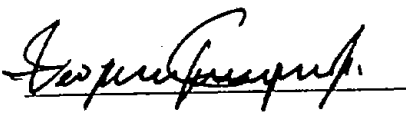

19.2 This Contract shall not be annulled, amended or modified in any respect except by the mutual consent in writing of the Parties hereto.




IN WITNESS WHEREOF, the Parties hereto have executed this Contract as of the day and year first above written.

GOVERNMENT OF THE REPUBLIC OF THE PHILIPPINES

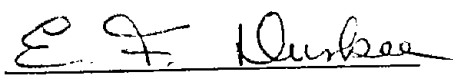
By authority of the President:


TEOFISTO GUINGONA, JR.
 Executive Secretary
Sm

COPLEX (CEBU) LIMITED

By: 
KENNETH J. FELLOWES
Managing Director

E.F. DURKEE AND ASSOCIATES INC.

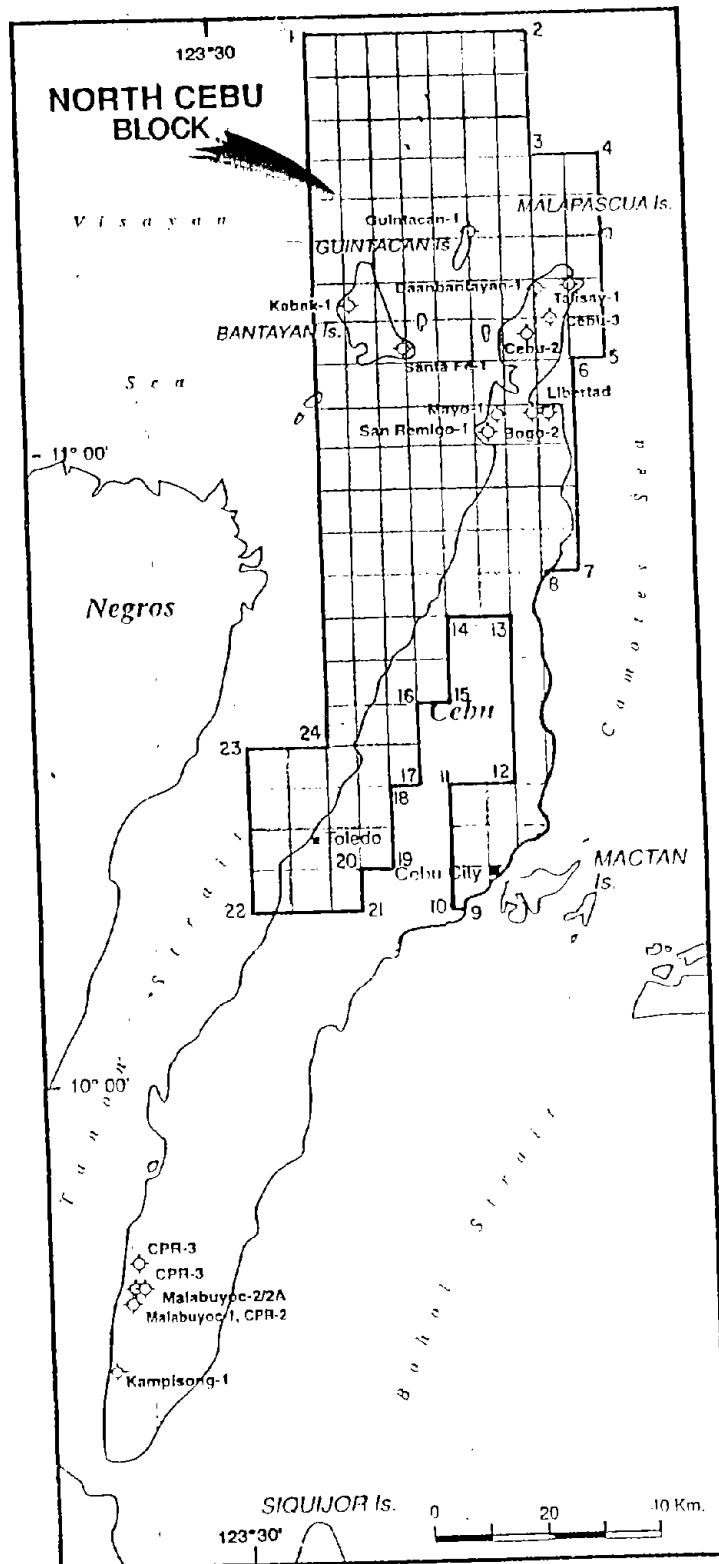
By: 
E.F. DURKEE
General Manager

ANNEX A
TO SERVICE (PRODUCTION SHARING) CONTRACT
DATED _____ 1994

NORTHERN CEBU

<u>POINTS</u>	<u>NORTH LATITUDE</u>	<u>EAST LONGITUDE</u>
1	11° 40'	123° 39'
2	11° 40'	124° 00'
3	11° 28'	124° 00'
4	11° 28'	124° 06'
5	11° 08'	124° 06'
6	11° 08'	124° 03'
7	10° 48'	124° 03'
8	10° 48'	East coast line of Cebu
Thence southward along the east coast of Cebu		
9	10° 16'	East coast line of Cebu
10	10° 16'	123° 51'
11	10° 28'	123° 51'
12	10° 28'	123° 57'
13	10° 44'	123° 57'
14	10° 44'	123° 51'
15	10° 36'	123° 51'
16	10° 36'	123° 48'
17	10° 28'	123° 48'
18	10° 28'	123° 45'
19	10° 20'	123° 45'
20	10° 20'	123° 42'
21	10° 16'	123° 42'
22	10° 16'	123° 33'
23	10° 32'	123° 33'
24	10° 32'	123° 39'

For



SERVICE CONTRACT AREA OF APPLICATION
NORTHERN CEBU, PHILIPPINES
AREA = 611,253 Has.

Faye

ANNEX B
ACCOUNTING PROCEDURES

Attached to and made an integral part of the Contract between the GOVERNMENT OF THE PHILIPPINES, DEPARTMENT OF ENERGY and CONTRACTOR dated _____ day of _____, 19__.

ARTICLE I GENERAL PROVISIONS

1. A. Definitions

The Accounting Provisions herein provided for are to be followed and observed in the performance of all obligations under the Service Contract (Contract) to which this is attached. The terms appearing in this Annex B shall have the same meaning as those defined in the Contract.

B. For purposes of Article II, Paragraph 10 and 11, CONTRACTOR herein shall refer to the Operator who is the Party designated in accordance with the CONTRACTOR's Operating Agreement to conduct the Operations in the Contract Area for the joint account of the CONTRACTOR.

2. Accounts and Currency Exchange

CONTRACTOR shall maintain accounting records for the Petroleum Operations in accordance with generally accepted accounting practices used in the petroleum industry and in such a manner that all revenues and expenditures will be segregated or can be allocated to appropriate Contract Areas. All revenues and expenditures applicable to the Petroleum Operations shall be recorded in the both U.S. and Philippine Currency. Any transactions between U.S. Dollars and Philippine Pesos shall be stated at the applicable exchange rate. For these purpose, the applicable exchange rate shall be Inter-bank Guiding Rate for U.S. Dollars as quoted by the Philippine National

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Bank, Manila at the close of business on the last banking day of the month of disbursement or receipt, or if there were no such quotations on that day, then such rates on the most recent day in such preceding month during which there were such quotations or on such other basis as may be agreed upon by the Parties. Provided, however, That in the event of a significant change in the rate of exchange after the end of the preceding month, then all transactions after such re-evaluations until the end of that month shall be translated at the rates in effect on the day of the transaction.

Any advances made, expenditures incurred or receipts realized in any currency other than Philippine Pesos or U.S. Dollars shall first be translated into U.S. Dollars at the average of T/T selling and buying rates in the New York money market at the date of transaction. If there were no such quotations on the date of transaction, then the average rate on the most recent date shall be applicable.

It is agreed, however, that any adjustment resulting from the exchange of currency required for the use of this Operation or from the translation above listed, shall be charged or credited to the Operating Expenses. The matter of translation rates will be reconsidered if it is determined that the above methods result in inequities.

3. Statements

In implementation of Section VII of the Contract, CONTRACTOR shall render to the DEPARTMENT a statement of all charges and credits to the Operations summarized by appropriate classification indicative of the nature thereof.

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4. Adjustments

Subject to the provisions of Section 15.2 of the Contract, all statements rendered to the DEPARTMENT by the CONTRACTOR during any calendar year shall conclusively be presumed to be true and correct and reasonable unless within the period provided in said section, the DEPARTMENT takes written exception thereto and makes claim on CONTRACTOR for adjustment. Failure on the part of the DEPARTMENT to make written claim on CONTRACTOR for adjustment within such period shall establish the correctness and reasonableness thereof and preclude the filing of exceptions thereto or making of claims for adjustments thereon.

5. Audits

Audits shall be conducted in the manner and at the times stipulated by Section 15.2 of the Contract.

6. Conflicts

If there should be any conflict between the provisions of this Accounting Procedure and the Contract, the latter, shall control.

ARTICLE II OPERATING EXPENSES

Subject to the provisions of the Contract and the limitations herein prescribed, CONTRACTOR shall charge among, other items, the Operating Expenses with the following items:

1. Surface Rights

All direct costs attributed to the acquisition renewal or relinquishment of surface rights acquired and maintained in force for

the Operations hereunder when paid by the CONTRACTOR in accordance with the provisions of the Contract except processing fees, bonuses, rentals and other payments made to the DEPARTMENT and the costs attributable to posting the performance guaranty deposits required under this Contract.

2. Labor

- A. Salaries and wages of CONTRACTOR's employees directly engaged for the benefit of the Operations in the exploration, development, maintenance and operation of the Contract Area. Salaries and wages shall include everything constituting gross pay to employees as reflected on the CONTRACTOR's payrolls.

To the extent not included in the salaries and wages the Operating Expenses shall also be charged with overtime, rest day pay, holiday, vacation pay and vacation travel pay, sickness and disability benefits, bonuses, and other customary allowances applicable to the salaries and wages chargeable hereunder and in Paragraph 10 of this Article II.

- B. Costs of expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to CONTRACTOR's labor cost of salaries and wages as provided under Sub-paragraph 2A and Paragraph 10 of this Article II.

3. Employee Benefits

- A. For CONTRACTOR's employees participating under Home Office Based benefit plans, CONTRACTOR's cost of established plans for employee's group life insurance, pension retirement, thrift, and other benefits of a like nature shall be charged at a

percentage rate based on CONTRACTOR's cost experience for the preceding year applied to the amount of salaries and wages chargeable under Sub-paragraph 2A and Paragraph 10 of this Article.

- B. CONTRACTOR's employees participating in Non-Home Office Based benefit plans shall be charged at a percentage rate reflecting actual payments or accruals made by the CONTRACTOR applicable to such employees; actual payments against any amounts accrued will not be chargeable to the Operating Expenses.
- C. CONTRACTOR's cost experience rates in 3B above shall be redetermined during the first quarter of the following year and charges to Operational Expenses will be adjusted accordingly.

4. Material

Material, equipment, and supplies purchased or furnished by CONTRACTOR and subsequently used in the Operations and which are not classified as tangible investments under Paragraph 13 of this Article II. These materials, equipments and supplies shall be valued as follows:

- A. New Material, Equipment and Supplies Purchased (Condition A) shall be valued at new price which shall include such costs as export broker's fees, transportation charges, loading and unloading fees and license fees associated with procurement of materials and equipment, duties and customs fees and in-transit losses not recovered through insurance and installation cost.

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B. Good Used Material, Equipment and Supplies being used as material, equipment and supply in sound and serviceable condition suitable for reuse without reconditioning shall be valued at:

1. Seventy-five percent (75%) of current new price of the said material, equipment and supplies if such was originally charged to Operating Expenses as new.
2. Sixty-five percent (65%) of current new price if said material, equipment and supplies was originally charged to the Operating Expenses as second hand at seventy-five percent (75%) of new price.

C. Other Used Material, Equipment and Supplies:

Used Material, equipment and supplies being used shall be valued at fifty percent (50%) of current new price.

1. If after reconditioning, said used material, equipment and supplies will be further serviceable for original function as good second hand material.
2. If said used material, equipment and supplies is serviceable for original function but substantially not suitable for reconditioning.

D. Bad Order Material and Equipment

Material and equipment which are no longer usable for its original purpose without excessive repairs but are still usable for some other purposes shall be value on a basis comparable with that of items normally used for that purpose.

E. Junks

Junks, being obsolete and scrap material, equipment and supplies shall be valued at prevailing prices.

F. Temporarily Used Materials, Equipment and Supplies

When the use of material, equipment and supplies is temporary and its services does not justify the reduction in price as provided in Paragraph B(2) above, such material, equipment and supplies shall be priced on the basis that will leave a net charge to Operating Expenses consistent with the value of the service rendered.

As far as it is reasonable, practical and consistent with efficient and economical operation, only material in operator's sole opinion shall be purchased for or transferred for use in the Operations as may be required for immediate use; and the accumulation of surplus stocks shall be avoided. CONTRACTOR does not warrant the materials purchased for the Petroleum Operations, and in case of defective materials, credit shall not be passed until adjustment has been received by the CONTRACTOR from the manufacturer or its agents. Contractor agrees that it shall exercise good business judgment and good faith in pursuing warranties and guarantees received from the manufacturer of defective materials or its agents.

5. Transportation

Transportation of employees, equipment, material and supplies necessary for the Operations; Employees transportation cost will include travel costs for employees and their families paid by CONTRACTOR in conformity with CONTRACTOR's established policy manual. Transportation costs for returning an employee and his

family to their Country of Origin shall be chargeable to the Operating Expenses provided that Operating Expenses shall not be charged expenses incurred in moving an employee beyond his point of origin established at the time of his transfer to the Philippines.

6. Services

- A. Outside Services: The cost of consultants, contract services and utilities procured from outside sources, domestic and foreign, including but not limited to, all such services as are rendered in connection with geological, geophysical, drilling, engineering, legal, tax, development activities, etc.
- B. In the event the CONTRACTOR from time to time utilizes skilled personnel not regularly residing in the Philippines for performance of services either in the Philippines or elsewhere for benefit of the Petroleum Operations whose time in full or in part is not otherwise charged hereunder, a proper proportion of the direct and indirect salary and travel expenses of such personnel (including reasonable living expenses while in the Philippines) together with any taxes on such salaries or otherwise imposed upon the employee's service in the Philippines which are payable to the Philippine Government and for which the CONTRACTOR assumed responsibility, and any accident or sickness compensation and/or hospitalization cost incurred shall be charged to Operating Expenses.
- C. Data processing and computer services and other related services and/or operations acquired for the direct benefit of the Operations may be contracted through third parties or by arrangement for time rental of computer services from the CONTRACTOR's Affiliates even though such computer facilities are physically located outside the country. In either case, contract for computer services must be competitively priced.

Charges to the Operating Expenses under this provision for services directly benefitting the Operations shall be in addition to any charges allowed under Paragraph 10 and 11 of this Article II.

D. Use of Exclusively Owned Facilities

1. Equipment owned by the Second Party/Parties or any Affiliate or either of them, and not previously charged to the Operating Expenses, either directly or indirectly, may be utilized in the Operations. For the use of any such wholly- owned equipment, the Operating Expenses shall be charged a rental rate commensurate with the cost of ownership and operation, but not to exceed commercial rates for the use of like equipment.
2. A fair rate shall be charged for laboratory services performed by the Second Party/Parties or their Affiliates for the benefit of the Petroleum Operations, such as but not limited to gas, water, core and any other analyses and tests provided such charges shall not exceed those currently prevailing if performed by outside technical service companies.

E. Charges to the Operating Expenses for technical services as contemplated by Paragraph 6B and 6C and 6D above shall be included on the basis upon which overhead charges are applied under Paragraph 11 of this Article II.

7. Damage and Losses

All costs or expenses necessary to replace or repair damages or losses not recovered from insurance incurred by fire, flood, storm, theft, accident, or any other cause. CONTRACTOR shall furnish the

DEPARTMENT written notice of damages or losses incurred as soon as practicable after report of the same has been received by CONTRACTOR.

8. Legal Expenses

All costs and expenses of litigation, or legal services otherwise necessary or expedient for the protection of the joint interests, including attorney's fees and expenses as hereinafter provided, together with all judgments obtained against the Parties or any of them on account of the Petroleum Operations, and actual expenses incurred in securing evidence for the purpose of defending against the Operations or the subject matter of the Contract. In the event actions or claims affecting interests under the Contract shall be handled by legal staff not otherwise charged to Operating Expenses of one or more of the Parties, a charge commensurate with cost of providing and furnishing such services may be made against the Operating Expenses if prior approval by Operator is granted.

9. Insurance and Claims

- A. Premiums paid for insurance required to be carried for the Petroleum Operations conducted under the Contract, together with all the expenditures incurred and paid in settlement of any and all losses, claims, damages, judgments, and other expenses, including legal services not recovered from insurance carrier.
- B. All actual expenditures incurred and paid by CONTRACTOR in settlement of any and all losses, claims, damages, judgement, and any other expenses not covered by insurance, including legal services, shall be charged to the Operating Expenses.

for

10. Administrative Overhead - Inside the Philippines

- A. Principal office used herein means costs and expenses incurred by the CONTRACTOR for an office and staff established in Manila which may serve all activities in the Philippines including the Petroleum Operations under the Contract. Allocation of such costs and expenses between the CONTRACTOR's other activities and Petroleum Operations activities hereunder shall be made on actual expenditures or other equitable basis. Examples of such Principal Office services which are chargeable to the Operations include, but are not necessarily limited to the following:
- a. Local manager and staff
 - b. Accounting
 - c. Legal
 - d. Personnel Administration
 - e. Communications
 - f. Purchasing/Marketing
 - g. Housing/Rent
 - h. Engineering/Production/Drilling
- B. District Office(s) as used herein means cost and expenses incurred by the CONTRACTOR for an office(s) which may be establish to serve the Operations at the vicinity of the Operations. Allocation of such costs and expenses between the

CONTRACTOR's other activities and the Operations activities hereunder shall be made on actual expenditures or other equitable basis. Examples of such District Office(s) services which are chargeable to the Operations include, but are not necessarily limited to the following:

- a. Field or District Superintendent and complete Staff
- b. Geological and Geophysical Staffs
- c. Engineering, Production and Drilling Staff
- d. Communications/PR
- e. Camp and Commissary Facilities/Housing/Rent
- f. Clerical Staff/Production/Accounting/etc.

11. Administrative Overhead - Outside the Philippines

- A. CONTRACTOR's administrative overhead - outside the Philippines applicable to Operations shall be charged each month on the following percentage of adjusted net expenditures:

For first U.S. \$2,000,000 per year - 3% but not less than U.S.\$6,000 per year.

For next U.S.\$1,000,000 per year - 2%

Over U.S.\$3,000,000 per year - 1%

- B. Net expenditures for purposes of applying the percentage charges stipulated in Sub-paragraph 11A above shall be

adjusted to exclude the following:

1. Administrative overhead charged under 11A above
 2. The signature bonus and payments made in accordance with Section XVII and the costs attributable to the posting of performance quarterly deposits and rental payable under Section 4.4 of the Contract.
 3. Surface taxes and rentals
 4. Major construction projects covered by 11C below.
 5. Settlements of judgements or claims in excess of U.S.\$5,000 per transaction.
 6. Credits received from sale of assets (including division in kind) amounting to more than U.S.\$5,000 per transaction.
 7. Foreign exchange adjustments
 8. Pipeline tariff costs paid to outsider.
- C. A fee for CONTRACTOR's Administrative Overhead for major construction projects such as but not limited to offshore platforms, pipelines, gas and/or water repressuring and processing plants, tanker loading and terminal facilities, shall be agreed to by the Parties. If CONTRACTOR also performs engineering and design services outside of the Philippines for such major construction projects, the CONTRACTOR shall be entitled to charge the Operating Expenses a service fee agreed to by the Parties.

for

- D. Cost studies will be performed, at least on an annual basis, to verify that the costs charged for administrative overhead and personnel costs equitably compensate the CONTRACTOR for actual costs incurred in that Year and that there is not over or under recovery of such costs from the Contract. Upon the request of either Party, these costs shall be reviewed and future charges adjusted so that actual costs are recovered. Notwithstanding any other clause, it is the intention of both Parties to this Contract that the CONTRACTOR shall neither profit nor lose through the carrying out of its duties and with particular reference to the expenses it incurs in its home office for personnel and administrative costs.

12. Other Expenditures

Any expenditures, other than expenditures which are covered and dealt with by the foregoing provisions of this Article II, necessarily incurred by the CONTRACTOR for the Operations hereunder.

13. Recovery of Capital Expenditures

A. Tangible Investment

The initial cost of physical assets classified as depreciable in accordance with generally accepted petroleum industry accounting principles purchased, fabricated by and/or for the CONTRACTOR, and used by CONTRACTOR in its Operation shall include such costs as export brokers fees, purchasing agents fees, transportation charges, loading and unloading fees, licenses fees associated with the procurement of materials and equipment, duties and customs fees, in-transit losses not recovered through insurance, installation costs necessary to put the asset ready for use, etc. The total cost of the assets shall be allocated to Operating Expenses over a ten (10) year period

under the straight-line or double-declining balance method at the option of the CONTRACTOR, beginning in the Calendar Year in which Petroleum Production starts or in the Calendar Year in which the costs are incurred whichever is later.

B. Intangible Investment

Notwithstanding any other provision of this Accounting Procedure and Contract, all intangible investments shall be reimbursed in full.

C. Leasehold Improvements

Improvements or betterments on leasehold which can be capitalized in accordance with generally accepted petroleum industry accounting practice shall be allocated to Operating Expenses in accordance with depreciation principle established in Paragraph 13-above. Such improvements shall include but not be limited to office improvements, additional equipment and other improvements installed on a ship operated under a bareboat charter, etc.

