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THE REPUBLIC OF UGANDA

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PRODUCTION SHARING AGREEMENT

FOR

**PETROLEUM EXPLORATION, DEVELOPMENT
AND
PRODUCTION**

IN THE

MINISTRY OF ENERGY &
MINERAL DEVELOPMENT
☆ 23 JAN 2007
P.O. BOX 100
RESTURCENT

REPUBLIC OF UGANDA

BY AND BETWEEN

**THE GOVERNMENT OF THE REPUBLIC OF
UGANDA**

AND

PETROBRAS OIL AND GAS LIMITED

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THIS AGREEMENT is made and entered into this _____ day of _____ by and between the Government of the Republic of Uganda, acting through the Ministry of Energy and Mineral Development, of P.O Box 7270 Kampala, Uganda (hereinafter referred to as "Government") and Heritage Oil and Gas Limited, a company organized and existing under the laws of Isle of Man of United Kingdom and registered at Harbour Yard, Chelsea Harbour, London SW10 0XD, United Kingdom and Energy Africa Uganda Limited of 5 Park Square, Castletown, Isle of Man, IL9, 1LA a company duly organized and existing under the laws of Isle of Man, United Kingdom and registered under Chapter 110 of the laws of Uganda (hereafter referred to jointly as the "Licensee").

WHEREAS, Petroleum in or under any land or water in Uganda is the property of the Republic of Uganda;

WHEREAS, the Petroleum (Exploration and Production) Act Chapter 150 of the Laws of Uganda 2000 makes provision with respect to exploring for and producing Petroleum and authorises the Minister responsible for petroleum exploration and production to grant Exploration and Production Licences to any person or entity, subject to certain limitations and conditions;

WHEREAS, Section 3 of the Act authorises the Government to enter into an agreement not inconsistent with the Act, with any person or entity in respect of, inter alia, the terms and conditions of the grant of a Licence under the Act;

WHEREAS, Licensee has applied for an Exploration Licence over the area described in Annex A hereof and shown on the map in Annex A hereof and the Minister, in accordance with Section 3 of the Act, intends to grant the said Licence; and

WHEREAS, Licensee intends, on terms and conditions set out under this Agreement and has represented that he/she has or can obtain resources, to undertake Petroleum Operations in the area aforesaid and has for that purpose the necessary financial capacity, technical competence and professional skill to carry out such Operations;

NOW, THEREFORE, the parties hereto agree as follows:

STATE PARTICIPATION

Government or its Nominee shall enter into a Joint Venture Agreement with Heritage thereby allowing for State Participation for not more than 15%. Heritage shall carry Government or its Nominee until the production of first oil and the carried costs shall be recovered along with other costs under the "Cost Recovery" here below stated.

COST RECOVERY

All exploration, development, production and operating expenditures incurred by Heritage shall be recovered from 60% of gross oil production and 70% of gross gas production after deduction of royalty. This shall include carried costs of Government or its Nominee.

PRODUCTION SHARING

After deduction of Royalty and the Cost Recovery oil for the company's investment, the remaining oil will be shared between Government and the Company as shown below:

<u>Production BOPD</u>	<u>Government Production Share</u>	<u>Licensee Production Share</u>
(i) Where production does not exceed 5,000	46%	54%
(ii) Where production is higher than 5000 but does not exceed 10,000	48.5%	51.5%
(iii) Where production is higher than 10,000 but does not exceed 20,000	53.5%	46.5%
(iv) Where production is higher than 20,000 but does not exceed 30,000	58.5%	41.5%
(v) Where production is higher than 30,000 but does not exceed 40,000	63.5%	36.5%
(vi) Where production is higher than 40,000	68.5%	31.5%

Responsibilities and Grant of Rights

- 3.1. Contemporaneously herewith, Licensee is granted, under and in accordance with the Act, an Exploration Licence in respect of the Contract Area in the form set forth in Annex "B-1". The said Exploration Licence shall have a term not exceeding two (2) years ("First Exploration Period"), counted from the Effective Date. Not less than ninety (90) days prior to the expiration of the First Exploration Period, Licensee may apply to the Government for renewal of the Exploration Licence covering the Contract Area. Such renewal shall be granted to Licensee subject to Licensee having (i) fulfilled its obligations under the Act and this Agreement, including its relinquishment obligations under paragraph 3.5, during the First Exploration Period, and (ii) submitted with such application an undertaking to comply with the minimum work and expenditure obligations for the Second Exploration Period specified in Article 4. A maximum successive renewals of said Exploration Licence not exceeding two (2) years each ("Second Exploration Period" and "Third Exploration Period") shall, subject to the requirements of the Act, be granted to Licensee upon application by Licensee to the Government in the prescribed manner.
- 3.2. Notwithstanding the provisions of the preceding paragraph and without prejudice to the provisions of paragraph 3.4.2, in the event that on the ninetieth day before the date on which an Exploration Licence is due to expire, Licensee is in the process of completing seismic or drilling operations under this Agreement, or the processing or interpretation of data resulting therefrom, and provided that said operations are being conducted diligently and starting in good time and in accordance with Good Oilfield Practices, Licensee may apply for the renewal of any Exploration Licence pursuant to paragraph 3.1 before but in no case later than fifteen (15) days prior to the date of expiry of the then current period of validity of said Licence.
- 3.3. Licensee shall, subject to the Act and Regulations and the terms and conditions herein set forth, have the exclusive right to conduct Petroleum Operations within the Contract Area for the term of the Exploration Licence and any Production Licence granted to it in accordance with all applicable legislation and provisions of this Agreement.



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3.4 Licensee, on giving to the Government not less than ninety (90) days notice in writing (the "Surrender notice"), may:

3.4.1 Surrender its rights and be relieved of its obligations in respect of the whole of the Contract Area if its minimum work and financial obligations under Article 4 hereof in respect of the relevant Exploration Period have been fulfilled in accordance with Section 51 of the Act;

3.4.2 in respect of the Exploration Licence or any renewal thereof, elect to surrender its rights in respect of the whole of the Contract Area and be relieved of its minimum work and financial obligations under Article 4 hereof in respect of the then current Exploration Period at any time within sixty days following the date on which the Licensee completes:

- a) the interpretation of seismic works exceeding those provided under paragraph 4.2.1 (i) and actually being executed at the end of the preceding Exploration Period; or
- b) the drilling, testing or plugging of any Exploration Well actually being executed at the end of the preceding Exploration Period in which event(s) the Surrender Notice shall be reduced to thirty (30) days; and

3.4.3 at any time after the grant of the Exploration Licence, surrender its rights in respect of any block or blocks forming part of the Contract Area and be relieved of its obligations in respect of any block or blocks forming part of the Contract Area provided, however, that no surrender by Licensee of its rights over any part of the Contract Area shall relieve Licensee of its obligation to satisfy the minimum work and financial obligations referred to in Article 4 hereof in respect of the Exploration Period during which it gives the Surrender Notice.

3.5

3.5.1 If Licensee applies for a renewal of the Exploration Licence on or before the end of the First Exploration Period, the Licensee shall in accordance with the provisions of Section 15 of the Act relinquish the number of blocks constituting in total area not more than thirty percent (30%) of the original Contract Area; unless:

- (i) Licensee provides to Government a satisfactory Work Programme for that area for the period for which renewal is sought;
- (ii) Licensee has fulfilled all the obligations in the preceding period.

Provided that activities in one area will not be an excuse for not fulfilling the obligations of the Work Programme in 3.5.1 (i) hereinabove.

3.5.2 If Licensee applies for the second renewal of the Exploration Licence on or before the end of the Second Exploration Period, Licensee shall relinquish an additional number of blocks constituting in total area not more than twenty five percent (25%) of the original Contract Area; unless Licensee fulfills the conditions in 3.5.1 (i) (ii) above.

3.5.3 The Licensee shall relinquish land within the Contract Area so as to comply to the satisfaction of the Minister with the following requirements:

- a) no relinquishment of a part only of a Block shall be permitted except in the case of such part only of a Block existing as such in the Contract Area;
- b) the area(s) to be relinquished shall consist of a number of contiguous Blocks so arranged that so far as possible:
 - (i) Each Block other than the Blocks defining the boundaries of such shall be contiguous on all sides with other Blocks;
 - (ii) The shape of the relinquished area should be approximately rectangular;
 - (iii) The direction of its boundaries should be roughly north-south and east-west; and
 - (iv) Its longer boundaries should not be more than three times the length of its shorter boundaries.



- 3.5.4 Any areas which Licensee elects to surrender pursuant to paragraph 3.4.3 shall be credited against the area which Licensee is next required to relinquish pursuant to this paragraph 3.5. Licensee shall not be required to relinquish pursuant to this paragraph 3.5 any area which constitutes a Discovery or Development Area or any part thereof and said Discovery or Development Area shall be subtracted from the original Contract Area for the purpose of calculating the area to be relinquished pursuant to paragraph 3.5.1.
- 3.6 The Government reserves the right to grant licences to other legal persons to prospect for, explore for and mine minerals within the Contract Area, and further reserves to itself the right to so prospect, explore and mine directly. Licensee shall use its best efforts to avoid obstruction or interference with such Licensees' or Government operations and similarly the Government shall use its best efforts to ensure that its own operations or those of third parties do no obstruct or interfere with Licensee's Petroleum Operations within the Contract Area.
- 3.7 In the event that Licensee discovers minerals other than Petroleum in the Contract Area which may be of economic value, it shall report such discovery to the government within thirty (30) days of the making of such discovery and shall supply a sample of such minerals to the Government.
- 3.8 If more than one person or entity comprises Licensee, the duties and obligations of the persons or entities constituting Licensee hereunder shall be joint and several.
- 3.9 The Government shall in as far as is permitted by the law assist the Licensee to obtain rights of ingress to and egress from the Contract Area and any petroleum facilities used in Petroleum Operations and to obtain rights of way and rights to construct related Petroleum Operations facilities as may be reasonably required by the Licensee. The Licensee shall meet all the associated costs and expenses.

whose locations and depths Government and Licensee shall agree on. The acquisition, processing and interpretation of 200 line kilometers of 2D or 3D contingent seismic data.

(ii) Minimum Exploration Expenditure	US\$ 6.0 million
Drilling	US\$ 6.0 million
Drilling (Contingent)	US\$ 3.0 million
Seismic Data (contingent)	US\$ 1.5 million

4.2.3 Third Exploration Period.

Commencing on the day on which the Exploration Licence is renewed pursuant to Article 3 hereof and terminating on the second anniversary of such date.

(i) **Minimum Work Programme:**

Acquisition, processing and interpretation of additional 2D or 3D seismic data and the drilling of two exploration wells whose location and depth Government and Licensee shall agree on.

(ii) Minimum Exploration Expenditure	US\$ 7.5 million
Seismic data	US\$ 1.5 million
Drilling	US\$ 6.0 million

4.3 For the purpose of this Article, Exploration Wells shall, except as provided in Article 4.2, be drilled on a location determined by Licensee and the Government and to a depth necessary for the evaluation of the sedimentary section established by the available data as the deepest objective formation and consistent with Good Oilfield Practices, unless before reaching the aforementioned depth:

- a) basement is encountered;
- b) further drilling would present a foreseeable danger which cannot reasonably be contained;
- c) impenetrable formations are encountered;

- d) significant hydrocarbon-bearing formations are encountered which require protecting, thereby preventing such depth from being reached.

In such circumstances, the drilling of any Exploration Well may be terminated at a lesser depth and such Well shall, except where the circumstances described in subparagraphs (a), (b) and (c) immediately above occur before Licensee has attained two thirds of the target depth provided for in the drilling programme, relating to such well, be deemed to have satisfied the minimum depth criteria provided for hereunder. In all other circumstances in which a Well is terminated at a lesser depth, Licensee shall have the option to either (i) drill a substitute Exploration Well or (ii) pay to the Government the amount by which the drilling budget for such well on a dry hole basis, pursuant to paragraph 4.2 exceeds actual expenditures incurred in the drilling thereof.

For the purpose of this paragraph 4.3, the term "Basement" shall mean the geological basement below which hydrocarbons cannot be found and produced.

- 4 Compliance with the required minimum Exploration Expenditures in any Exploration Period shall not relieve Licensee of its obligation to comply with the required minimum Work Programme for such Exploration Period nor shall compliance with the required minimum Work Programme for any Exploration Period relieve Licensee of its obligation to comply with the required minimum Exploration Expenditures for such Exploration Period.

The required minimum Exploration Expenditure stipulated in paragraph 4.2 for each Exploration Period (other than the First Exploration Period), shall be adjusted at the end of (i) the First Exploration Period, in the case of the minimum Exploration Expenditures for the Second Exploration Period, (ii) the Second Exploration Period, in the case of the minimum Exploration Expenditures for the Third Exploration Period, as follows:

$$I' = \frac{I \times B}{A}$$

- I' = minimum Exploration Expenditures for the First Exploration Period or Second and Third, as the case may be;



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I = minimum Exploration Expenditures stipulated in paragraph 4.2 for the period in question;

A = "U.S. Industrial Goods Wholesale Price Index" as first reported in "International Financial Statistics" as published by the International Monetary Fund for the Calendar Month of the Effective Date;

B = "U.S. Industrial Goods Wholesale Price Index" as first reported in "International Financial Statistics" as published by the International Monetary Fund of the Calendar Month in which the period in question commences.

4.6 The Exploration Licences issued to Licensee pursuant to Article 3 and any available renewal thereof shall be on terms and conditions relating to Minimum Work Programmes and Exploration Expenditures which correspond to the obligations of Licensee under this Article and it is accordingly understood and agreed that any discharge by Licensee of its obligations under this Article in respect of any Exploration Period will discharge for that period the minimum work and expenditure obligations of Licensee in respect of the Exploration Licences issued pursuant to Article 3 and the terms and conditions of such Licences and any renewal thereof shall be drawn accordingly.

4.7 (a) On or before the Effective Date, the Licensee shall provide an Insurance/Performance Bond in the form set forth in Annex D-I, and amounting to United States Dollars five hundred (USD 500,000.00) which shall, inter alia, guarantee the payment by Licensee of the sums, if any, due and payable to the Government pursuant to paragraph 4.7(b) and (c) hereunder.

(b) If, upon the expiration of the Exploration Licences, or upon the date of termination of this Agreement, or upon surrender of the entire Contract Area by Licensee pursuant to paragraph 3.4, whichever first occurs, Licensee has not expended for Exploration Operations sums (including any sums previously paid pursuant to paragraph 4.7(c)) at least equal to the total minimum Exploration Expenditures (as adjusted pursuant to paragraph 4.5) required hereunder for the period in question, the shortfall

negotiations with Heritage Oil and Gas Limited Exploration Area 3A (EA3A) have been attached map. The main elements of the A) are as follows: -

WORK PROGRAMME

Heritage is being granted an exploration basin.

Exploration duration is six years, sub-d

- ◆ First Exploration Period
- ◆ Second Exploration Period
- ◆ Third Exploration Period

During the First Exploration Period, Heritage will acquire seismic data over an area of 150sqkm at a cost of US\$ 6 million and also drill two (2) firm wells at a cost of US\$ 6 million.

During the Second Exploration Period, Heritage will acquire seismic data at a cost of less than US\$ 6 million, whose location will be determined by the company. The company will also have a contingency fund of less than US\$6.00 million and seismic data over an area of 150sqkm.

During the Third Exploration Period, Heritage will acquire seismic data over an area of 150sqkm at a cost of US\$ 6 million.

ARTICLE 7

Discovery, Development and Production

- 1 Where, pursuant to Section 17 of the Act, notice has been given to the Government of a Discovery in the Contract Area, Licensee shall forthwith inform the Government of the steps it proposes to take to satisfy the requirements of Section 17(1)(a)(iii) of the Act.
 - 2 Unless, following a Discovery by Licensee in the Contract Area, Licensee gives in respect of such Discovery a notice to the Minister for the purpose of paragraph A of the provision to section 17 (1) (b) of the Act or unless the provisions of paragraph B of that Proviso are otherwise applicable, Licensee shall promptly after the technical evaluation of the test results relating to such Discovery has been completed, prepare and submit for the consideration of the Advisory Committee its proposals for an Appraisal Programme to meet its obligations as Licensee under the Act. Notwithstanding the foregoing, in the event that Licensee notifies the Government within thirty (30) days following the date on which its technical evaluation of the test results relating to a Discovery has been submitted to the Government, the said Discovery does not in and of itself warrant immediate appraisal and provides reasonable justification therefor, an exemption from the requirements of Section 17 (1)(b) of the Act may be granted by the Minister, pursuant to paragraph B of the proviso to that Section, for so long thereafter as Licensee is carrying out continuous Exploration Operations in the Contract Area.
- As soon as the Advisory Committee has, pursuant to paragraph 5.3.2, reviewed and approved an Appraisal Programme submitted by Licensee as aforesaid, Licensee shall promptly thereafter commence implementation thereof.
- (i) If during the term of any Exploration Licence or renewals thereof granted pursuant to this Agreement, Licensee makes a Discovery of Petroleum in the Contract Area which alone, or in conjunction with other discoveries previously made in the Contract Area might be developed and brought into early production with a view to satisfying the internal consumption requirements of Uganda, the Government may notify Licensee accordingly upon which the Parties shall meet to determine whether the development of the said Discovery or Discoveries would be economically and technically feasible.

- (ii) In determining whether the Discovery or Discoveries as the case may be is (are) economically and technically feasible, the Parties shall consider whether an early production scheme would, inter alia, jeopardise the subsequent recovery of Petroleum from the Petroleum Reservoir(s), create a health or safety risk or would otherwise involve a departure from the standards of Good Oilfield Practice.
- (iii) In the event that the Parties determine the Discovery or Discoveries as the case may be to be economically and technically feasible and agree upon the terms and conditions for the implementation of an early production scheme (including offtake arrangements), a Production Licence shall be granted to Licensee in respect of the Discovery Area(s) subject thereto and thereafter Licensee shall complete the facilities necessary for the Government to take delivery of production from the said Discovery Area(s) ex-field and all costs associated with the taking of delivery therefrom shall be for the Government's account.

The production shall be sold at Market Price as computed in accordance with Article 15 and payment shall be made in United States Dollars within 60 days following the end of the Calendar month in which deliveries are made.

It is understood, however, that Licensee shall not be required to produce crude oil at a rate higher than the Maximum Efficient Rate in connection with the scheme.

- (iv) Any crude oil production delivered to the Government pursuant to the provisions of this Article 7.4 (iii) shall serve to reduce Licensee's obligation to otherwise supply crude oil for the internal consumption requirements of Uganda pursuant to Paragraph 18.1 and will not prejudice Licensee's rights under paragraph 7.8 thereafter in respect of the subsequent grant of a Production Licence in relation to a wider Discovery Area(s) which includes the said Discovery Area(s). It is understood, however, that crude oil production shall continue to be made available to the Government in accordance with the terms and conditions agreed to in 7.4 (iii) above.
- (v) Nothing in this Article shall require Licensee to undertake the completion of the field facilities required for the early production scheme in the event that Licensee reasonably determines that such scheme (including the terms

and conditions for the implementation thereof) is not economically or technically feasible.

7.5 Before applying for a Production Licence pursuant to Section 19 of the Act, Licensee shall consult with the Advisory Committee in connection with the preparation of a Development Plan to be submitted by Licensee to the Minister in accordance with Section 20 of the Act.

7.6 If the Parties are unable to settle amicably any dispute or difference as to whether the Development Plan meets the requirements of Section 22 of the Act within twelve (12) Calendar Months of the date of the Minister's aforesaid notification, either Party may refer the matter to a sole expert pursuant to Article 26.

If, as a consequence of the said award, Licensee determines that the development project (in respect of which the Development Plan was submitted) ceases to be commercially attractive, Licensee may so notify the Government in writing within six (6) Calendar Months of the date of said award, whereupon the Government shall have the right to require Licensee to relinquish its rights with respect to the Discovery Areas which are the subject of such Development Plan and to forfeit its rights to any subsequent production therefrom.

7.7 Upon submission by Licensee of a Development Plan that meets the requirements of Section 22 of the Act together with the application for a Production Licence, the Minister shall promptly issue to Licensee a Production Licence in the form attached hereto in Annex "B-II" covering the Development Area for a period not exceeding twenty five (25) years counted from its date of issuance.

A Production Licence shall be renewable, upon application, by Licensee in the prescribed manner, for a term equal to the period between the initial grant of such Production Licence and the commencement of Commercial Production, but in no event exceeding five (5) years. The Minister shall not impose conditions for the granting or renewal of a Petroleum Production Licence under Sections 21(a) and 27 of the Act which are inconsistent with the terms of this Agreement or the requirements of the Act.

7.8 Licensee shall use its best efforts to produce Crude Oil from each Development Area at the Maximum Efficient Rate. The Maximum Efficient Rate of production for Crude Oil and the production rate for Non-associated Gas shall be estimated in the Development Plan for each such area.



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Such rates shall be reviewed annually at the time of submission by Licensee of the annual Work Programme and Budget to the Advisory Committee pursuant to paragraph 5.3.3 and revised, if necessary, by mutual agreement.

- 7.9 Not less than sixty (60) days prior to the beginning of each Calendar Year following the commencement of Commercial Production, Licensee shall prepare and furnish to the Government for its review and approval (which approval shall not be unreasonably withheld) a forecast statement setting forth by Calendar Quarter, the total quantity of Crude Oil (by quality, grade and gravity) and Natural Gas that Licensee estimates can be produced, saved and transported hereunder from each Development Area during such Calendar year in accordance with Good Oilfield Practices. Licensee shall endeavour to produce in each Calendar Year the forecast quantity.
- 7.10 In the event that Licensee wishes to establish a refinery to refine the Crude Oil and Natural Gas that the Licensee estimates can be produced, Government may grant the Licensee the right to establish such refinery.



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ARTICLE 10

Royalty

In respect of the requirements of Section 46 of the Act, Licensee shall pay to Government the following Royalty on the Gross Total Daily Production in Barrels of oil per day (BOPD) for each Contract Area, such Gross Total Daily Production defined as the total output of crude oil (including liquid petroleum gas) less all water and sediments produced and all amounts of hydrocarbons re-injected into the Petroleum Reservoir.

<u>Gross Total Daily Production (BOPD)</u>	<u>Royalty</u>
i) Where the production does not exceed 2,500	5%
ii) Where the production is higher than 2,500 but does not exceed 5,000	7.5%
ii) Where the production is higher than 5,000 but does not exceed 7,500	10%
v) Where the production exceeds 7,500	12.5%

The Royalty stipulated in paragraph 10.1 shall be received by government on a monthly basis whether in kind or in cash depending on Government's preference. Government shall have the right to receive Royalty in cash Dollars, on a Monthly basis, notifying the Licensee of its choice 30 days in advance. If such notification not made by Government, the Royalty shall be collected by Government in kind at the point of collection.

Royalty shall be calculated on a daily basis on an incremental basis and not on total daily production..

The BOPD calculation shall be as follows:

ARTICLE 11

State Participation.

Government or its Nominee may elect to enter into a Joint Venture Agreement with Licensee thereby allowing for State Participation for no more than fifteen percent (15%) and Government shall inform Licensee of its decision in writing within 120 days of the receipt of the application for a Production Licence. Government or its Nominee shall be entitled to participate in Development Area by Development Area. Licensee agrees to carry the costs of Government or its Nominee through development to production. These costs are recoverable including interest at the London Inter Bank Offer Rate (LIBOR) quoted at or about 11:00 am on the date next to when they were incurred by the Licensee. These costs will be repaid out of the Licensee's cost recovery oil. Government will be responsible for any taxes arising out of its share of the Joint Venture.

- (a) For purposes of this provision the Venture Assets attributable to a Development Area (hereinafter called the "Joint Venture Assets") are:
- (i) In case of the first Production Licence granted, the Production Licence and any real or personal property wherever the same may be situated, acquired for the purpose of carrying on Joint Operations in the Development Area subject thereto or acquired for the purpose of carrying on Petroleum Operations in the Contract Area where such property was acquired before the grant of the first Production Licence;
 - (ii) in the case of a second or subsequent Production Licence granted, that Production Licence and any real or personal property acquired for the purpose of carrying on Joint Operations in that Development Area or acquired for the purpose of carrying on Petroleum Operations or Joint Operations in the Contract Area where such property was acquired after the date on which a Production Licence was last granted and before the grant of the second or, as the case maybe the next subsequent Production Licence.



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(b) Immediately following the grant of each Production Licence, Licensee, or each entity comprising Licensee at that time, will

promptly take such action as may be necessary to assign to the Nominee of the Government, an undivided proportionate share in the Venture Assets equal to the Nominee of the Government's Participating Percentage Interest with effect that thereafter, Licensee, or each such entity, shall have an interest in the Joint Venture Assets (hereinafter referred to as its "Joint Venture Interest") equal to its Participating Interest in those Assets immediately before the grant of such Production Licence reduced by the product of that interest and the Joint Venture Interest acquired by the Nominee of the Government.

11.3 "Participation Share of Production" means a proportion of the Petroleum produced and saved from the Contract Area and not used or lost in Joint Operations and such proportion attributable to Licensee and the Nominee of the Government shall be equal to their respective Joint Venture Interests in Joint Venture Assets.

ARTICLE 12

Cost Recovery

- 12.1 For purposes of Cost Recovery, ring-fencing around each Contract Area shall apply. In the event that a Licensee has more than one Contract Area, the calculations shall be done on a contract by contract basis. There shall be no consolidation.
- 12.2 All Exploration, Development, Production and Operating expenditures, as defined in Annex C, incurred by the Licensee shall be recovered from 60% of gross oil production and 70% for gas after deduction of the Royalty specified in paragraph 10.1.
- 12.3 The Licensee shall carry forward to subsequent years all unrecovered costs until full recovery is completed
- 2.4 Not less than thirty (30) days prior to the beginning of each Calendar Year, Licensee shall prepare and furnish to the Government for approval, which approval shall not be unreasonably withheld, an estimate by Quarters for the forthcoming Calendar Year of (i) all Contract Revenues and Contract Expenses to be incurred, (ii) Income Tax of Licensee (or each entity comprising Licensee, as the case may be) in respect of taxable income derived from Petroleum Operations carried out hereunder, for such Calendar Year. Such estimate shall be consistent with the forecast statement furnished pursuant to paragraph 7.8 and the annual Work Programme Budget approved by the Advisory Committee pursuant to Article 5, and shall set forth the other assumptions and projections upon which it is based. Quarterly updates of such estimate shall be submitted by Licensee to the Government for approval (which approval shall not be unreasonably withheld) within thirty (30) days after the end of each Quarter.



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ARTICLE 13

Production Sharing

After the cost recovery specified in paragraph 12.2, the following Government/Licensee split will apply on the remaining total daily production (Profit Oil).

<u>Production BOPD</u>	<u>Government Production Share</u>	<u>Licensee Production Share</u>
(i) Where production does not exceed 5,000	46%	54%
(ii) Where production is higher than 5000 but does not exceed 10,000	48.5%	51.5%
(iii) Where production is higher than 10,000 but does not exceed 20,000	53.5%	46.5%
(iv) Where production is higher than 20,000 but does not exceed 30,000	58.5%	41.5%
(v) Where production is higher than 30,000 but does not exceed 40,000	63.5%	36.5%
(vi) Where production is higher than 40,000	68.5%	31.5%

The Government/Licensee profit oil split is based on incremental production.

Government shall have the right to receive its share of Profit Oil in cash Dollars, on a Quarter basis, notifying the Licensee of its choice 30 days in advance. If such



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ARTICLE

Taxation

All central, district administrative, municipal and other local administrators' or other taxes, duties, levies or other lawful impositions applicable to Licensee shall be paid by the Licensee in accordance with the laws of Uganda in a timely fashion.

ARTICLE 15

Valuation and Measurement of Petroleum

- 15.1 Crude Oil shall, for all purposes of this Agreement, be valued at the end of each Month as follows:
- 15.1.1 Except as provided in paragraph 15.1.2, the market price ("Market Price") used to value Crude Oil shall, where arm's length sales transactions in freely convertible currencies of Crude Oil to third parties have been made during the preceding month, be the weighted average of the per Barrel net realised price obtained FOB the Seaboard Terminal or any other point of export for such arm's length third party sales less, in the event that a separate pipeline company is formed pursuant to paragraph 16.2 the average tariff charge per Barrel for such month imposed by the pipeline company for transporting the oil from the Delivery Point to the Seaboard Terminal or any other point of export.
- 15.1.2 If less than fifty percent (50%), by volume, of Crude Oil sales from the Contract Area during such month fall under paragraph 15.1.1, the Market Price for such month shall be the simple arithmetical average of the prevailing per Barrel selling prices in such quarter of a basket of the three (3) most similar internationally traded crude oils listed by the American Petroleum Institute (API) and chosen from the major crude oil producing countries in the Arabian Gulf and Africa, taking into account differences in point of sale, quality, grade, gravity or sulphur content and any special terms and conditions relating to the sale of such crude oils, less, in the event that a separate pipeline company is formed pursuant to paragraph 16.2, the average tariff charge per Barrel for that month imposed by the pipeline company for the transportation of Crude Oil hereunder from the Delivery Point to the FOB Seaboard Terminal or any other point of export.
- 15.1.3 For the purposes of determining the Market Price as described above, no account shall be taken of Crude Oil sales to Affiliated Companies or restricted or distress transactions or any transactions not at arm's length including government to government, barter or discount deals.



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- 15.1.4 The Market Price shall be determined at the end of each month in States Dollars in accordance with paragraph 15.1.
- 15.2 Any disagreement concerning the determination of Market Price under paragraph 15.1 shall be first considered by a pricing committee composed of two representatives from the Government and two (2) representatives from Licensee. In the event the pricing committee cannot reach a unanimous decision within thirty (30) days of the end of the relevant month, either party may refer the matter for determination by an expert in accordance with paragraph 26.2. During the period of referral, which shall in no event take longer than thirty (30) days, the Market Price for the preceding month shall apply and adjustments, if any, shall be made for the following month based on the decision of the expert.
- 15.3 Natural Gas shall be valued in accordance with the provisions of paragraph 15.1.
- 15.4 Licensee shall install, operate and maintain at the Delivery Point equipment for measuring the volume and quality of the Petroleum produced and save hereunder including gravity, density, temperature and pressure measuring devices and other devices that may be required for the purposes of implementing the License Agreement. All measurement equipment and devices shall, prior to installation or usage, be approved by the Government, which approval shall not be unreasonably withheld or delayed. The Government or its authorized representatives, at its own expense and risk (save where injury or damage results from the Gross Negligence or Willful Misconduct of Licensee), shall have the right to inspect and require Licensee to test in its presence such equipment and devices at all reasonable times. The equipment and devices used or installed pursuant to this paragraph shall not be replaced or altered without the prior approval of the Government, which approval shall not be unreasonably withheld or delayed; provided, however, that in the case of urgency or so as to prevent interruption of ongoing production, Licensee may proceed with such replacement or alteration without the prior approval of the Government but shall immediately thereafter notify the Government of such replacement or alteration.
- 15.5 Licensee shall undertake to measure the volume and quality of the Petroleum produced and saved hereunder, consistent with generally accepted practices in the international petroleum industry, with the frequency and according to procedures which shall be approved by the Government, which approval shall not be unreasonably withheld or delayed.



Pipeline Transportation

- 16.1 Licensee shall have the right to take and transport to an ocean port or other point of loading for export all Petroleum to which it is entitled hereunder and, in connection therewith, shall have the right to construct, operate and maintain an export pipeline, pumping stations, storage and related Seaboard Terminal or other facilities. The Government shall assist Licensee on matters involving rights of way, licences or other authorizations required under Uganda law in connection with such facilities and shall assist Licensee in its negotiations with neighboring countries regarding rights of way and other conditions relating to the construction, operation and maintenance of such facilities in such countries
- 16.2 It is understood by the Parties hereto that the construction, financing, operation and maintenance of an export pipeline, pumping stations and related Seaboard Terminal or other facilities shall be carried on through a separate pipeline company ("the Pipeline Company") which shall be responsible for the handling and transportation of Petroleum from the Delivery Point in Uganda to the ocean port or other point of loading. In such event, the operations of the Pipeline Company will not be included within the meaning of Petroleum Operations under this Agreement and any related Licences.
- 16.3 Any Development Plan submitted to the Minister by Licensee pursuant to Section 20 of the Act shall include Licensee's proposals with regard to the arrangements for the transportation to the terminal of each of the Parties' production entitlements hereunder.
- In the event the said transportation arrangements involve the formation of a separate Pipeline Company pursuant to paragraph 16.2, such proposals shall, unless otherwise agreed, be consistent with the following principles:
- (a) each Party shall assume and pay the transportation tariffs charged by the Pipeline Company related to their respective shares of the Petroleum transported, which obligation may, in the case of the Nominee or the Government, be discharged by each of the Nominee and the Government foregoing in favour of the Pipeline Company a portion of their respective production entitlements so transported equal in value to the tariffs due in respect of the transportation of such production entitlements from the Delivery Point to the FOB seaboard terminal point of export;

- (b) the transportation tariff charged, to the extent that the Parties hereto are able to determine the same, shall be set at a level at which the Pipeline Company will cover the costs of constructing, financing, operating and maintaining the export pipeline and related facilities together with a reasonable return thereon; such return will be determined having regard to the risks assumed by shareholders of the Pipeline Company in outlaying the funds for the construction, operation and maintenance of such facilities and the cost of borrowing such funds as are required; and
- (c) in the case of proposals by Licensee for the initial construction of the export pipeline, such proposals shall ensure that the pipeline and related facilities are of sufficient design capacity to handle and transport to the Seaboard Terminal or other delivery point, the estimated production entitlements of all Parties hereto from the Contract Area. If at any time, the throughput capacity of such facilities should be insufficient to handle and transport the respective production entitlements of such Parties, available capacity shall be shared between the Parties in the proportion which each Party's production entitlement bears to the total quantity of production which would otherwise be available for transportation hereunder.

The Government or its Nominee shall be fully involved in the determination of the tariff charges for the pipeline.

Transportation tariff charges of the Pipeline Company to the Delivery Point shall be allowable Contract Expenses hereunder.

Transportation tariff charges of the Pipeline Company, and any costs incurred beyond the Delivery Point shall not be allowable Contract Expenses hereunder.



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ARTICLE

Domestic Requirements

- 18.1 Out of the total quantity of Crude Oil production to which the Licensee is entitled in each Calendar Quarter, the Government may elect to take a quantity of Crude Oil, of the gravity, grade and quality of its choice, that the Government requires to satisfy the requirements of internal consumption in Uganda for such Calendar Year. The Government shall reimburse the Licensee for such quantity in United States Dollars at the price as calculated pursuant to paragraph 15.1 hereof within thirty (30) days after the end of the Calendar Month in which such delivery takes place, unless otherwise agreed between the parties. The maximum quantity of Crude Oil that the Government may take to satisfy the internal consumption requirements of the country shall be calculated by multiplying the total quantity of Crude Oil produced from the Contract Area during the period under consideration, less consumption of Crude Oil incidental to Petroleum Operations, by a fraction, the numerator of which is the internal consumption requirements of Uganda during the period, and the denominator of which is the volume of Crude Oil produced in Uganda by all Licensees (including Licensee). Any Crude Oil production dedicated to an early production scheme in any such Calendar Year pursuant to paragraph 7.4 shall be deducted from the maximum quantity so determined for such Calendar Year.
- 18.2 If the Government elects to exercise its rights under paragraph 18.1, it shall notify Licensee in writing not less than ninety (90) days prior to the commencement of each six (6) Calendar Months of each Calendar Year specifying the quantity, and designating the grade and quality, that it elects to take in kind based upon the production forecasts and annual and quarterly estimates, furnished to the Government pursuant to paragraphs 7.8 and 15.5. Any adjusting payments or refunds shall be made within ninety (90) days of the end of each Calendar Year on the basis of actual quantities.

ARTICLE 19

Natural Gas

- 19.1 Licensee shall have the right to use Associated Gas for Petroleum Operations, including, but not limited to, reinjection for pressure maintenance, and improving the recovery of Petroleum, power generation and recycling operations. The quantities of Associated Gas used in this way shall not be subjected to any tax, fee or levy of any kind.
- 19.2 Where Non-associated Gas has been discovered in the Contract Area and Licensee has not pursuant to paragraph 7.2 given in respect of the Discovery a notice to the Minister for the purpose of paragraph A of the proviso to Section 17(1)(b) of the Act, the Parties shall, unless the provisions of paragraph B of such proviso are otherwise applicable, as soon as possible after completion by Licensee of an appraisal programme, or sooner if so agreed, meet together with a view to reaching an agreement on the development, production, processing and sale of such gas.
- 19.3 Associated Gas which is not used in Petroleum Operations, and the processing and utilisation of which, in the reasonable opinion of Licensee is not economical, shall be returned to the subsurface structure, or may be flared with the consent of the Government, which consent shall not be unreasonably withheld or delayed. In the event that Licensee chooses to process and sell Associated Gas, Licensee shall notify the Government of the same and upon such notification, the Government and Licensee shall, as soon as practicable thereafter, meet together with a view to reaching an agreement on the processing and sale of such gas. In the event Licensee chooses not to process and sell Associated Gas, the Government may elect to offtake at the outlet flange of the gas-oil separator and use such Associated Gas which is not required for Petroleum Operations, in which event, Licensee may flare such gas until such time as the facilities are in place to enable the Government to take delivery thereof. There shall be no charge to the Government for such Associated Gas, provided that the cost to gather such Associated Gas at the point of being flared and to process and utilize it shall be for the account of the Government.
- 19.4 The value to be attributed to Natural Gas shall:
- 19.4.1 for arm's length sales to third parties, be equal to the net realised price obtained for such Natural Gas at the Delivery Point;



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19.4.2 for sales other than at arm's length to third parties, be determined by agreement between the Government and Licensee, provided, however, that such price or value shall reflect the following:

- (i) the quantity and quality of the Natural Gas;
- (ii) the price at which arms length sales of Natural Gas from other sources in Uganda, if any, are then being made;
- (iii) the price at which arms length sales, if any, of Natural Gas imported into Uganda are being made;
- (iv) the purpose for which the Natural Gas is to be used; and
- (v) the international market price of competing or alternative fuels or feedstocks.

19.4.3 Arm's length third party sales shall not include sales to Affiliated Companies of Licensee or to the Government, any Ugandan public authority or any other entity controlled directly or indirectly by the Government.



Training and Employment

- 21.1 Licensee agrees to train and employ suitably qualified Ugandan citizens in Petroleum Operations and, following the commencement of Commercial Production, to undertake the schooling and training of Ugandan citizens for positions, including administrative and executive management positions. Licensee will also require its Sublicensees to do the same. Licensee undertake gradually replace its expatriate staff with suitably qualified and experienced Ugandan citizens as are then available but, if the Licensee satisfies the Advisory Committee that no suitably qualified and experienced Ugandan citizens available who are capable of filling key senior management or technical positions, Licensee shall employ expatriate staff in such positions. An annual programme for training and phasing in of Ugandan citizens shall be established by Licensee and shall be submitted for approval to the Advisory Committee, along with the annual Work Programmes and Budgets referred to in Article 6. Within thirty (30) days of the end of each Calendar Year, Licensee shall submit a written report to the Government describing the number of personnel employed, their nationality, their positions and the status of training programmes for Ugandan citizens.
- 21.2 Licensee shall also be required to establish an annual programme, satisfactory to the Government, to train personnel of the Government to undertake skilled and technical jobs in Petroleum Operations.
- 21.3 Licensee shall deposit with government, or its Nominee, on the Effective Date and each anniversary of the Effective Date thereafter, the following amounts for training of Government personnel selected by the Government and other associated costs for each twelve (12) Calendar Months period.
- | | |
|---|------------------------------|
| First Exploration Period | US \$ 75,000 per 12 months. |
| Second Exploration Period | US \$ 75,000 per 12 months. |
| Third Exploration Period | US \$ 75,000 per 12 months. |
| Following the grant of a petroleum production license | US \$ 200,000 per 12 months. |
- 21.4 Subject to the provisions of paragraph 21.1, Licensee shall be free to employ foreign nationals to the extent that suitably qualified and experienced Ugandan nationals cannot be found to fill a position.

MAP ACCOMPANYING ANNEX A

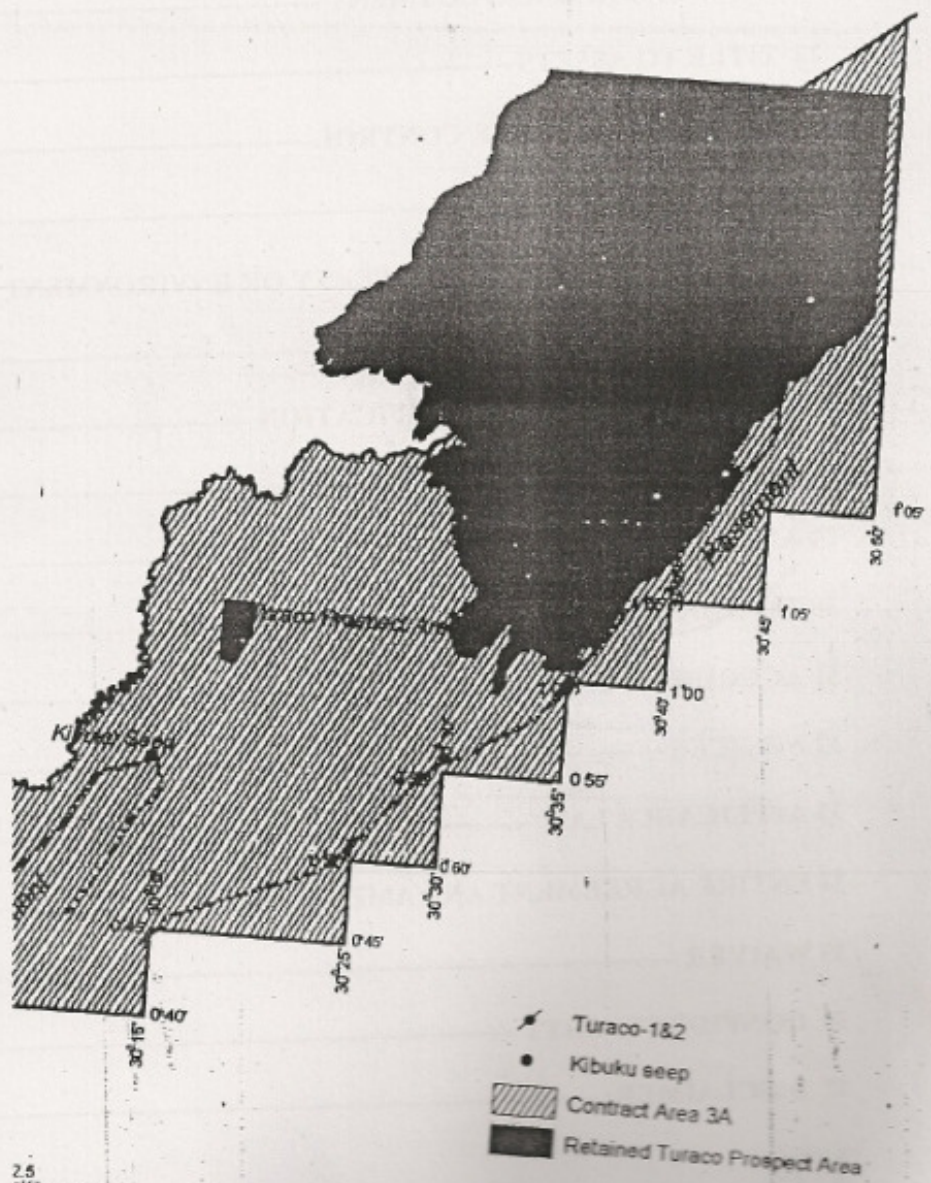


Table 1 - COMPARISON OF THE MAJOR ELEMENTS OF THE PRODUCTION SHARING AGREEMENT FOR EXPLORATION AREA 3A (EA3A) WITH THOSE OF THE PSA'S SIGNED PREVIOUSLY.

ITEM	EA3 - 1997	EA2 - 2001	EA1 - 2004	EA3A - 2004
Work Programme	150 line-km of seismic data during 1 st Exploration Period at a cost of US\$ 0.75m, during 2 nd Exploration Period, additional 150 km of seismic and drilling one well at a cost of US\$4m.	500 line-km of seismic data and drilling one well during 1 st Exploration Period at a cost of US\$3.0m, during 2 nd Exploration Period, additional 500 km of seismic and drilling one well at a cost of US\$3m. During the 3 rd Exploration Period, additional 500 km of seismic and drilling one well at a cost of US\$2.7m.	Geological and geophysical studies and 150 line-km of seismic data during 1 st Exploration Period at a cost of US\$2.0m, during 2 nd Exploration Period, drilling two exploration wells at a cost of US\$3m. During the 3 rd Exploration Period, additional seismic and drilling two well at a cost of US\$4.5m.	150 sqkm of 3D seismic data and drilling two wells during the 1 st Exploration Period at a cost of US\$ 9.00 million. Drilling of two wells during the second Exploration Period at a cost of US\$ 6.00million. Drilling of two wells and acquisition of seismic data at a minimum cost of US\$ 7.5 million during the Third Exploration Period.
Royalty	BOPD Royalty 0 - 2,500 5% 2,501 - 4,800 7.5% 4,801 - 7,530 10% >7,530 12.5%	BOPD Royalty 0-2,500 5% 2,501-5,000 7.5% 5,001-7,500 10% >7,500 12.5%	BOPD Royalty 0-2,500 5% 2,501-5,000 7.5% 5,001-7,500 10% >7,500 12.5%	BOPD Royalty 0-2,500 5% 2,501-5,000 7.5% 5,001-7,500 10% >7,500 12.5%
Cost Recovery	75%, 85% for oil and gas respectively for the first US\$10m and 60%, 70% respectively thereafter.	Costs to be recovered from 60% for oil and 70% for gas.	Costs to be recovered from 60% for oil and 70% for gas.	Costs to be recovered from 60% for oil and 70% for gas.
Uplift on Capital	20%	- Nil	Nil	Nil
Signature Bonus	Nil	Nil	US\$200,000	US\$ 300,000
Surface rental	US\$2.5/km ² during the 1 st Exploration Period, US\$5.0/km ² during 2 nd Exploration. Period and US\$500/km ² during production	US\$2.5/km ² during the 1 st Exploration Period, US\$5.0/km ² during 2 nd Exploration. Period, and US\$500/km ² during production	US\$2.5/km ² during the 1 st Exploration Period, US\$5.0/km ² during 2 nd Exploration. Period, and US\$500/km ² during production	US\$2.5/km ² during the 1 st Exploration Period, US\$5.0/km ² during 2 nd Exploration. Period, and US\$7.5/km ² during the 3 rd Exploration. Period, and US\$500/km ² during production

	At 15% but imbedded in profit oil share	At 10% or according to the tax laws of Uganda	At 30% or according to the tax laws of Uganda	At 30% or according to the tax laws of Uganda		
Share of Profit Oil	BOPD 0-5000 5001-10000 10001-20000 20001-3000 30001-40000 >40000	GoU 50% 55% 60% 67% 70% 75%	HOG 50% 45% 40% 33% 30% 25%	BOPD 0-5000 5001-10000 10001-20000 20001-30000 30001-40000 >40000	GoU 46% 48.5% 53.5% 58.5% 63.5% 68.5%	Heritage 54% 51.5% 46.5% 41.5% 36.5% 31.5%
Ring Fencing	For purposes of recovery, share and taxation, fencing around each licence area	For purposes of cost recovery, production share and taxation, ring fencing around each licence area	For purposes of cost recovery, production share and taxation, ring fencing around each licence area	For purposes of cost recovery, production share and taxation, ring fencing around each licence area		
Training	US\$50,000 exploration US\$125,000 production	US\$50,000 exploration US\$150,000 production	US\$75,000 during exploration and US\$200,000 during production	US\$75,000 during exploration and US\$200,000 during production		
State participation	To be negotiated later (after discovery?)	Not more than 15%	15% carried interest	15% carried interest		