

FIRST AMENDMENT AGREEMENT

relating to

the amendments to the Production Sharing Contract relating to the Sarsang Block

between

THE KURDISTAN REGIONAL GOVERNMENT OF IRAQ

and

HKN ENERGY LTD.

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ANNEX 1 Outstanding Minimum Exploration Obligations

FIRST AMENDMENT AGREEMENT

This agreement (the “**Agreement**”) is entered into as of 26 August 2010 (the “**Agreement Date**”) between:

- (1) **THE KURDISTAN REGIONAL GOVERNMENT OF IRAQ** (the “**Government**”); and
- (2) **HKN ENERGY LTD.**, a company established and existing under the laws of the Cayman Islands, whose registered office is at Ugland House, South Church Street, George Town, Grand Cayman, Cayman Islands (“**HKN**”)

(each a “**Party**” and collectively, the “**Parties**”).

RECITALS

- (A) The Government and HKN are parties to a Production Sharing Contract dated 6 November 2007 in respect of the Sarsang Block in the Kurdistan Region of Iraq (the “**Contract**”).
- (B) The Parties wish to render void the Government’s nomination of a Third Party Participant pursuant to a letter to HKN dated 18 July 2008 (the “**TPI Nomination Letter**”) in favor of the Kurdistan Exploration and Production Company established by the Oil and Gas Law of the Kurdistan Region – Iraq (Law No. 22 of 2007) (“**KEPCO**”), as Third Party Participant in the amount of 25%.
- (C) The Parties wish to amend the Contract to provide for the Government to hold the Third Party Interest from the Effective Date as a carried interest until such time as the Government exercises the Option of Third Party Participation or such time as such option lapses.
- (D) The Parties further wish to amend the Contract to extend the period during which the Government may exercise the Option of Third Party Participation to enable the Government to nominate a Third Party Participant. The Parties are further willing to agree to such amendments of the Contract as are necessary to extend the period during which the Option of Third Party Participation may be exercised to the date which is 180 days after the completion of the drilling of the First Exploration Well.
- (E) The Parties further wish to amend the Contract to obligate HKN and future holders of all or part of the participating interest held by HKN at the Effective Date to pay capacity building payments to the Government. HKN is willing to agree to charge its participating interest with the capacity building payment obligations, and the Parties are willing to agree to the appropriate amendments to the Contract.

- (F) The Government will deposit all capacity building payments into a segregated account for use solely to support and finance infrastructure and capacity building projects in the Kurdistan Region.
- (G) The Parties further wish to confirm that the First Sub-Period of the Exploration Period is extended until 31 January 2011.

1. DEFINITIONS AND INTERPRETATION

- 1.1 Unless otherwise defined herein (including the recitals) capitalised terms have the meanings ascribed to them in the Contract (before amendment by this Agreement). As used in this Agreement:

“**Agreement**” is defined in the preamble.

“**Agreement Date**” is defined in the preamble.

“**Contract**” is defined in Recital (A).

“**Government**” is defined in the preamble.

“**HKN**” is defined in the preamble.

“**KEPCO**” is defined in Recital (B).

“**Party**” and “**Parties**” are defined in the preamble.

“**Third Party**” is defined in Clause 6.2.

“**TPI Nomination Letter**” is defined in Recital (B).

- 1.2 The descriptive headings in this Agreement are for convenience only, do not constitute a part of this Agreement, and do not affect the construction or interpretation of this Agreement. A reference to a “Clause” is a reference to a clause of this Agreement.
- 1.3 Nothing in this Agreement shall be construed to impair the entitlement of the Government to exercise the Option of Government Participation in accordance with Article 4.1 of the Contract.

2. VOIDING OF TPI NOMINATION LETTER

- 2.1 The Parties agree that the TPI Nomination Letter and the nomination of a Third Party Participant as set out in the TPI Nomination Letter shall be deemed for all purposes to be withdrawn and void *ab initio* and without any effect under the Contract or otherwise.

- 2.2 The Government shall cause KEPCO never to make any Claim against HKN arising out of or relating to the purported nomination of KEPCO as a Third Party Participant pursuant to the TPI Nomination Letter.
- 2.3 HKN waives and releases KEPCO from any Claims that HKN may have against the Government and the KEPCO arising out of or relating to the nomination of KEPCO as the Third Party Participant pursuant to the TPI Nomination Letter, whether known or unknown. The waiver and release includes any Claims arising out of or related to any cash calls made by HKN to KEPCO.
- 2.4 For purposes of this Clause 2, “**Claim**” means any liability, loss, claim, counterclaim, lien, charge, cost and expense, interest, award, judgment, damages, diminution in value, fees or other charge.

3. AMENDMENTS TO CONTRACT

- 3.1 The Contract is amended as provided in this Clause 3.

Recitals

- 3.2 The recitals are amended:

- (a) by adding a new paragraph (D):

“(D) This Contract was amended pursuant to the First Amendment Agreement between the Parties dated 26 August 2010;”

- (b) by renumbering the existing paragraph (D): “(E)”; and

- (c) by renumbering the existing paragraph (E): “(F)”.

Third Party Interest and Extension of Option Period

- 3.3 In Article 1.1, the definitions of “**CONTRACTOR**” and “**CONTRACTOR Entity**” are deleted in their entirety and restated as follows:

“**CONTRACTOR** means, individually and jointly, each Contractor Entity.

CONTRACTOR Entity means HKN and its permitted assignees pursuant to Article 39. At such time as the **GOVERNMENT** may exercise the Option of Government Participation, a holder of the Government Interest is a **CONTRACTOR Entity**. The **GOVERNMENT** as holder of the Third Party Interest is not a **CONTRACTOR Entity**. At any time when there is only one entity constituting the **CONTRACTOR**, any reference to “the entities constituting the **CONTRACTOR**” or the “**CONTRACTOR Entities**” or similar reference, shall be deemed to mean “the entity constituting the **CONTRACTOR**”. As of the Effective Date, HKN, as the only **CONTRACTOR Entity**, owns an undivided interest in the Petroleum Operations in respect of the entire Contract Area:

HKN

75%.

The remaining twenty-five per cent (25%) is the Third Party Interest held by the **GOVERNMENT** in accordance with Article 4.8.”

- 3.4 New definitions are added in Article 1.1, in the appropriate alphabetical order, as follows:

“**Government Carried Interest** is defined in Article 4.11A.

Nomination Deadline Date means the date that is one hundred and eighty (180) days after the day on which the drilling of the First Exploration Well pursuant to Article 10.2(e) is completed.

Non-Government Contractor Entities means all Contractor Entities other than the holder of the Government Interest, each a “Non-Government Contractor Entity”.

Non-Government Contractor Entities’ Participating Interest means the aggregate of participating interests in the Contract of the Non-Government Contractor Entities.”

- 3.5 Articles 4.3(c), (d) and (e) are deleted in their entirety, and restated:

“(c) the Public Company will not have any liability to the **CONTRACTOR** to contribute its Government Interest share of any expense, including Petroleum Costs and bonuses, incurred before the First Commercial Declaration Date. The Government Interest share of any such expense incurred before the First Commercial Declaration Date is the exclusive obligation of the Non-Government Contractor Entities. Each Non-Government Contractor Entity shall pay a proportion of Petroleum Costs incurred before the First Commercial Declaration Date that corresponds with its proportion of the Non-Government Contractor Entities’ Participating Interest. Each Non-Government Contractor Entity will be entitled (through the **CONTRACTOR**) to recover all such Petroleum Costs in accordance with Article 25;

(d) if, pursuant to the terms of the Joint Operating Agreement, the Public Company as holder of the Government Interest participates in the development of a Commercial Discovery, it shall be liable to the Non-Government Contractor Entities to contribute its Government Interest share of all Petroleum Costs incurred on or after the First Commercial Declaration Date. The Public Company as holder of the Government Interest may (through the **CONTRACTOR**) recover all such Petroleum Costs in accordance with Article 25. In no circumstances will the Public Company, as holder of the Government Interest, be liable for any expense, including any bonus payable under this Contract, other than its share of Petroleum Costs incurred on or after the First Commercial Declaration Date;

- (e) if such Option of Government Participation is exercised on or after the First Commercial Declaration Date, the Public Company holding the Government Interest shall, within thirty (30) days of the date on which the **GOVERNMENT** notified the **CONTRACTOR** of its election, reimburse the Non-Government Contractor Entities for all Petroleum Costs for which it is liable pursuant to Article 4.3(d) and which have been incurred by such Non-Government Contractor Entities on or after the First Commercial Declaration Date but prior to and including the date of the notice pursuant to which the **GOVERNMENT** exercises its Option of Government Participation. The Public Company holding the Government Interest is liable to the Non-Government Contractor Entities to contribute its Government Interest share of all Petroleum Costs incurred on or after the date on which the Option of Government Participation is exercised. Such Public Company may (through the **CONTRACTOR**) recover all such Petroleum Costs, including those which it has reimbursed to the Non-Government Contractor Entities pursuant to this Article 4.3(e), in accordance with Article 25; and”.

3.6 Articles 4.8 through 4.12 are deleted in their entirety and restated:

- “4.8 The **GOVERNMENT** holds the Third Party Interest effective from the Effective Date. The **Third Party Interest** is an undivided interest of twenty-five per cent (25%) in respect of the entire Contract Area.

The **GOVERNMENT** as holder of the Third Party Interest will not have any liability to the **CONTRACTOR** Entities to contribute its Government Carried Interest share of any expense, including Petroleum Costs and bonuses, whenever those expenses may be incurred. While the **GOVERNMENT** holds the Third Party Interest, the Third Party Interest share of such expenses will be the obligation of the Non-Government Contractor Entities. The Non-Government Contractor Entities will be entitled (through the **CONTRACTOR**) to recover the Government Carried Interest share of Petroleum Costs in accordance with Article 25.

The **GOVERNMENT** may assign the Third Party Interest to a third party or third parties in accordance with this Article 4 (**Option of Third Party Participation**).

- 4.9 The **GOVERNMENT** may exercise the Option of Third Party Participation at any time prior to and including the Nomination Deadline Date by nominating to the **CONTRACTOR**, in writing, the size of the Third Party Interest and a nominated company. A company nominated in accordance with this Article 4.9 is the **Third Party Participant**.
- 4.10A If the **GOVERNMENT** nominates a Third Party Participant in accordance with Article 4.9, the Parties agree that, from the date of the nomination, that nominee holds the Third Party Interest on and from the date of such

nomination, and that nominee will automatically be, on and from that date, the Third Party Participant. The Parties agree that, from the date of the nomination of the Third Party Participant, this Contract will be automatically novated so that the nominee is a party to this Contract and has all the rights and obligations of the Third Party Participant. The Parties agree that the provisions of Articles 39.1, 39.2 and 39.3 shall not apply to a nomination and assignment pursuant to Article 4.9 and this Article 4.10A.

- 4.10B If any documentation is required to complete an assignment and novation referred to in Article 4.10A, and in the event of the refusal of a **CONTRACTOR** Entity to execute such documentation, then such **CONTRACTOR** Entity irrevocably constitutes and appoints the **GOVERNMENT** (or any other person which at any time during the term of the Contract may be nominated by the **GOVERNMENT**) to act alone, and with full power of substitution, as its true and lawful attorney and agent, with full power and authority in its name, place and stead to execute, file and record when as and where required, any and all of such documentation and hereby ratifies such execution, recording and filing. Each of the **CONTRACTOR** Entities confirms that the power of attorney granted is irrevocable and will survive its insolvency, dissolution, winding-up or bankruptcy and extend to bind its trustees, administrators, successors and assigns. Each of the **CONTRACTOR** Entities waives any and all defences which may be available to contest, negate or disaffirm the action of the **GOVERNMENT** taken under such power of attorney.

Government Carried Interest

- 4.11A If on the Nomination Deadline Date, the **GOVERNMENT** has not nominated a Third Party Participant pursuant to Article 4.9, then:
- (a) the Parties shall procure that fifty per cent (50%) of the Third Party Interest is assigned to the Non-Government Contractor Entities so that each Non-Government Contractor Entity is assigned a proportion of such interest that corresponds with its proportion of the Non-Government Contractor Entities' Participating Interest as of the day immediately after the Nomination Deadline Date; and
 - (b) fifty per cent (50%) of the Third Party Interest is, notwithstanding the provisions of Article 39 or any other Article in this Contract, automatically assigned to a Public Company to be nominated by the **GOVERNMENT** (the "**Government Carried Interest**").
- 4.11B If a Public Company holds the Government Carried Interest pursuant to Article 4.11A, the Public Company will not have any liability to the **CONTRACTOR** Entities to contribute its Government Carried Interest

share of any expense, including Petroleum Costs and bonuses, whenever those expenses may be incurred. The Government Carried Interest share of such expenses will be the obligation of the Non-Government Contractor Entities. The Non-Government Contractor Entities will be entitled (through the **CONTRACTOR**) to recover the Government Carried Interest share of Petroleum Costs in accordance with Article 25.

4.11C The Government Carried Interest is not subject to reduction pursuant to Article 4.13 or any other provision of this Contract.

4.11D If a Public Company holds the Government Carried Interest pursuant to this Article 4, the Public Company may, at its discretion, and without the consent of the other **CONTRACTOR** Entities, assign part or all of the Government Carried Interest to a third party:

- (a) which is another Public Company authorised by the **GOVERNMENT**; or
- (b) which is not a Public Company;

and the provisions of Articles 39.1, 39.2 and 39.3 shall not apply. In no event shall an assignment be made which would result in the assignor or assignee holding less than a five per cent (5%) participating interest.

4.11E A Public Company that holds the Government Carried Interest pursuant to this Article 4 will be individually and separately liable (and not jointly and severally liable with the other **CONTRACTOR** Entities) to the **GOVERNMENT** for any obligations, duties and liabilities under this Contract as a **CONTRACTOR** Entity. Any failure by such Public Company to perform any obligation, or to satisfy any duty or liability, under this Contract as a **CONTRACTOR** Entity will not be considered a default of the other **CONTRACTOR** Entities. The **GOVERNMENT** shall not invoke such failure as a reason to terminate this Contract or to exercise any other rights or remedies in respect of such failure that may be available to it. The capacity of a Public Company as a **CONTRACTOR** Entity, as it may arise pursuant to the provisions of this Contract, shall in no event cancel or affect the rights of the other **CONTRACTOR** Entities to seek to settle a dispute or to refer such dispute to arbitration or expert determination in accordance with the provisions of Article 42.

4.11F Following any assignment by a Public Company of part or all of the Government Carried Interest to a third party in accordance with the provisions of Article 4.11D:

- (a) an assignee which is another Public Company shall have the same rights and responsibilities held by the Public Company in relation to the assigned interest prior to the assignment; and

- (b) an assignee which is not a Public Company shall have the same rights and responsibilities held by the Public Company set out in Article 4.11B, and shall be jointly and severally liable with the other **CONTRACTOR** Entities.

4.11G Following any assignment by a Public Company of part or all of a Government Carried Interest to a third party which is not a Public Company in accordance with the provisions of Article 4.11D, the provisions of Articles 39.1, 39.2 and 39.3 shall apply to any subsequent assignment of such interest.

4.12 If the Option of Third Party Participation is exercised in accordance with Articles 4.9:

- (a) the effective date of such participation shall be the Effective Date, notwithstanding that the exercise of the Option of Third Party Participation under Article 4.9 occurs after such date;
- (b) the Third Party Participant shall, within sixty (60) days of the date on which the **GOVERNMENT** nominates the Third Party Participant, pay to the **CONTRACTOR**, by way of cleared funds to a bank account nominated by the **CONTRACTOR**, an amount equivalent to the proportion of Petroleum Costs incurred by the **CONTRACTOR** until the date of such payment attributable to the Third Party Interest (which Petroleum Costs do not include bonuses payable under this Contract). The Third Party Participant may (through the **CONTRACTOR**) recover all such Petroleum Costs in accordance with Article 25;
- (c) the Third Party Interest shall not be a carried interest; and
- (d) the Third Party Participant shall participate as a **CONTRACTOR** Entity under this Contract as if it had been a **CONTRACTOR** Entity from the Effective Date, with all its rights and obligations under this Contract.”

Capacity Building Payments

3.7 New definitions are added in Article 1.1, in the appropriate alphabetical order, as follows:

“**Annual Reconciliation Statement** is defined in Article 32.3.2(c).

Capacity Building Account means a segregated bank account with a reputable bank in the name of, and maintained by, the **GOVERNMENT**, the sole purpose of which is to support and finance certain infrastructure and capacity building projects to be identified by the **GOVERNMENT** in its sole discretion in the Kurdistan Region.

Capacity Building Payment means the amount of the Capacity Building Value.

Capacity Building Payment Instalments means each obligation of a Charged Interest Holder to pay an amount equal to the Capacity Building Value attributed to such Charged Interest Holder as provided by Article 32.3.

Capacity Building Value means, in respect of any period of determination: for each Charged Interest Holder, an amount in Dollars equal to the value, established in accordance with Article 27, of twenty per cent (20%) of the Profit Petroleum attributed to such Charged Interest Holder pursuant to this Contract as at any time and period of determination.

Charged Interest means, until such time as the **GOVERNMENT** may exercise the Option of Government Participation pursuant to Article 4.1, all or any part of the seventy-five per cent (75%) participation interest deemed held by HKN in the Contract as of the Effective Date. At such time as the **GOVERNMENT** may exercise the Option of Government Participation, the Charged Interest shall be reduced in proportion to the size of the Government Interest, provided that in no event shall the Government Interest exceed twenty-five per cent (25%).

Charged Interest Holder means a **CONTRACTOR** Entity if and to the extent it is the holder of a Charged Interest, and at any time when there is more than one **CONTRACTOR** Entity which is a holder of a Charged Interest, those **CONTRACTOR** Entities. As of the Effective Date, HKN is the only Charged Interest Holder.

Charged Interest Holders Monthly Statement is defined in Article 32.3.2(a).

First Amendment Agreement means the First Amendment Agreement between the **GOVERNMENT** and HKN dated 26 August 2010.

Loss or Expense is defined in Article 32.3.8(c).

Non-Government Contractor Entities means all Contractor Entities other than the holder of the Government Interest, each a “Non-Government Contractor Entity”.

Non-Government Contractor Entities’ Participating Interest means the aggregate of participating interests in the Contract of the Non-Government Contractor Entities.

Rights Sale means a sale, assignment, or other disposal of the **GOVERNMENT**’s rights to receive Capacity Building Payment Instalments from a Charged Interest Holder, whether for a lump sum payment or in instalment payments, and whether the purchaser assumes all payment risk and all risk as to the amount of Capacity Building Payment Instalments, or otherwise.”

- 3.8 In Article 16.14, after the words in the first sentence “The **GOVERNMENT** and” the following is inserted: “, subject to Articles 32.3.6(a) and (b),”.

3.9 In Article 26.9, the following sentence is added to the end of the Article:

“Notwithstanding the other provisions of this Article 26.9, where a Charged Interest Holder is in breach of any of its obligations in respect of the payment of Capacity Building Payment Instalments under Article 32.3, the **GOVERNMENT** will have the rights set forth in Articles 32.3.6 through 32.3.8.”

3.10 Articles 27.1 and 27.2 and Paragraphs 7 and 8 are amended by adding, after the word “Quarter” in each instance in each Article and Paragraph, the words “and Month”; and in Paragraph 7.2, the words “twenty-one (21)” are deleted and replaced by “ten (10)”.

3.11 Article 27.4 is deleted and restated in its entirety:

“By the tenth (10th) day of each Month, the **CONTRACTOR** shall provide a statement to the **GOVERNMENT** showing the **CONTRACTOR**’s calculations of the value of Petroleum produced and sold from the Contract Area for the previous Month. Such statement shall include the following information:

- (a) quantities of Crude Oil sold by the **CONTRACTOR** Entities during the preceding Month constituting Arm’s Length Sales together with corresponding sale prices;
- (b) quantities of Crude Oil sold by the **CONTRACTOR** Entities during the preceding Month that do not fall in the category referred to in paragraph (a) above, together with sale prices applied during such Month;
- (c) inventory in storage belonging to the **CONTRACTOR** Entities at the beginning and at the end of the Month; and
- (d) quantities of Natural Gas sold by the **CONTRACTOR** Entities and the **GOVERNMENT** together with sale prices realised.

Concurrently with the delivery of the monthly statement, the **CONTRACTOR** shall deliver the Charged Interest Holders Monthly Statement to the **GOVERNMENT** as provided in Article 32.3.2(a).”

3.12 In Article 29.1, after the words “shall be in Dollars and shall”, the following words are added:

“except as provided in the next sentence and Articles 32.3.10 through 32.3.12.”;

and the following sentence is added at the end of Article 29.1:

“The right of offset provided in this Article 29.1 will not apply in respect of the obligation of a Charged Interest Holder to make Capacity Building Payments as further provided in Articles 32.3.10 through 32.3.12.”

3.13 A new Article 32.3 is added:

Capacity Building Payments

- 32.3 Each Charged Interest Holder is bound by the provisions of this Article.
- 32.3.1 The obligations of a **CONTRACTOR** Entity, to the extent it is a Charged Interest Holder, as set forth in this Article 32.3, attach to, and may not be severed from, the Charged Interest.
- 32.3.2 In respect of the Capacity Building Payment Instalments:
- (a) on or before the tenth (10th) day of each Month in the Development Period, the **CONTRACTOR** shall provide to the **GOVERNMENT**, together with the monthly production statement prepared by the **CONTRACTOR** in accordance with Article 27.4 and Paragraph 6.1, and the monthly valuation statement in accordance with Article 25 and Paragraph 7.1, a statement (the "**Charged Interest Holders Monthly Statement**") setting out the **CONTRACTOR**'s calculation of the Capacity Building Value attributable to each Charged Interest Holder for the preceding Month. In each Charged Interest Holders Monthly Statement, the **CONTRACTOR** shall detail each item taken into account in making its calculation of the amounts due from each Charged Interest Holder, the quantities of Profit Petroleum produced during the Month covered by such Charged Interest Holders Monthly Statement, the volumes of such production sold, the Capacity Building Value attributed to such sales, and the Capacity Building Payment Instalments required to be paid with respect thereto by each Charged Interest Holder;
- (b) on the same date on which the **CONTRACTOR** provides the Charged Interest Holders Monthly Statement to the **GOVERNMENT** in accordance with Article 32.3.2(a), each Charged Interest Holder shall pay (except as provided in the next sentence) the Capacity Building Payment Instalment as shown as owed by such Charged Interest Holder in the Charged Interest Holders Monthly Statement. If:
- (1) a Charged Interest Holder has sold its Profit Petroleum to
- (i) the **GOVERNMENT** or a Public Company (or a company or an entity owned and controlled, directly or indirectly, by a Public Company or the **GOVERNMENT**),
- (ii) the State Oil Marketing Organisation (SOMO) or any entity owned and controlled by the Government of Iraq; and
- if

- (2) any such counterparty as identified in (1) has not paid the Charged Interest Holder for the Petroleum lifted by such entity, then:
- (3) the Charged Interest Holder is only obligated to pay the Capacity Building Payment when, if, and to the extent the Charged Interest Holder has received payment by such counterparty.

The preceding sentence does not apply with respect to, and to the extent of sales of a Charged Interest Holder's Profit Petroleum to any other counterparties;

- (c) within thirty (30) calendar days following the date on which the **CONTRACTOR** delivered the Final End-of-Year Statement to the **GOVERNMENT** for each Calendar Year in accordance with Article 26.13 and Paragraph 10, and based on the information in such Final End-of-Year Statement, the **CONTRACTOR** shall provide to the **GOVERNMENT**, in respect of each Charged Interest Holder, a written reconciliation of the aggregate amount of the Capacity Building Value and the aggregate payments of the Capacity Building Payment Instalments during such Calendar Year period (the "**Annual Reconciliation Statement**");
- (d) if the results of an Annual Reconciliation Statement show that a Charged Interest Holder has, in the aggregate over the Calendar Year period covered by the Annual Reconciliation Statement, made Capacity Building Payment Instalments in an amount less than the aggregate Capacity Building Value attributed to such Charged Interest Holder during such Calendar Year period, such Charged Interest Holder shall pay (subject to the same exception as provided in the second and third sentences of Article 32.3.2(b)) the amount of the underpayment as shown in the Annual Reconciliation Statement within thirty (30) calendar days following the same date the **CONTRACTOR** delivered the Annual Reconciliation Statement to the **GOVERNMENT**;
- (e) if the results of an Annual Reconciliation Statement show that a Charged Interest Holder has, in the aggregate over the Calendar Year period covered by the Annual Reconciliation Statement, made Capacity Building Payment Instalments in excess of the Capacity Building Value attributed to it during such Calendar Year period, and if and to the extent the **GOVERNMENT** has agreed with the **CONTRACTOR** and

the affected Charged Interest Holder in respect of the amount of such overpayment, such Charged Interest Holder may deduct such overpayment to the extent that the **GOVERNMENT** has agreed with the amount of such overpayment from the next following payments of Capacity Building Payment Instalments. In no event will a Charged Interest Holder be entitled to deduct more than fifteen per cent (15%) of the amount otherwise payable from the next following payments of Capacity Building Payment Instalments. The right of set-off against Capacity Building Payment Instalments will be a Charged Interest Holder's only remedy in respect of any overpayment, and the **GOVERNMENT** will have no obligation to make any reimbursement or other compensating payments to the Charged Interest Holder;

- (f) if a Charged Interest Holder fails to pay all or part of a Capacity Building Payment when due, the Charged Interest Holder shall pay interest on the unpaid amount at an annual rate of LIBOR plus two per cent (2%) compounded monthly from and including the date the payment was due to, but not including, the date paid; and
- (g) if any Capacity Building Payment is due to be paid to the **GOVERNMENT** on a day that is either not a banking day in either the place where the Capacity Building Account is maintained, or the location of the financial institution through which a Charged Interest Holder will make such payment, then the Capacity Building Payment will be due on the next following banking day. A "banking day" is a day (other than a Saturday, Sunday, or public holiday) on which banks are open for general business in the specified locations.

Capacity Building Account

32.3.3 The **GOVERNMENT** shall:

- (a) establish and maintain the Capacity Building Account; and
- (b) deposit all Capacity Building Payments received by the **GOVERNMENT** into the Capacity Building Account.

Rights Sale

32.3.4 The **GOVERNMENT** may enter into a Rights Sale without the consent of the **CONTRACTOR** or any **CONTRACTOR** Entity.

Separate Liability

32.3.5 Each Charged Interest Holder is separately liable (and not jointly and severally liable with any other Charged Interest Holder) to the **GOVERNMENT** for its obligations, duties and liabilities under this Article 32.3. A **CONTRACTOR** Entity that is not a Charged Interest Holder will have no liability to the **GOVERNMENT** for any claim by the **GOVERNMENT** arising out of or related to the breach of any Charged Interest Holder's obligations under this Article 32.3.

Breach; Indemnity

32.3.6 (a) If a Charged Interest Holder fails to pay a Capacity Building Payment in full when due, the **GOVERNMENT** will, notwithstanding any other provision of this Contract, any lifting agreement, any sales or marketing agreement, or any other agreement, automatically be entitled, on not less than sixty (60) days prior notice to the defaulting Charged Interest Holder and the **CONTRACTOR** in the case of the first default, and not less than thirty (30) days in the case of any subsequent default, to:

(1) lift, at the Delivery Point or at such other point as the **GOVERNMENT** may decide, up to twenty per cent (20%) of such defaulting Charged Interest Holder's Profit Petroleum; and

(2) continue to lift up to twenty per cent (20%) of such defaulting Charged Interest Holder's Profit Petroleum for the remainder of the Development Period.

(b) A defaulting Charged Interest Holder will have a single cure period of thirty (30) days only in respect of its first default. If the defaulting Charged Interest Holder pays the defaulted Capacity Building Payments in full plus interest in accordance with Article 32.3.2(f) in such thirty (30) day period, the **GOVERNMENT** shall not exercise its lifting rights under this Article 32.3.6 in respect of such defaulting Charged Interest Holder. In the case of any subsequent default, the **GOVERNMENT** may exercise its right to lift whether or not the defaulting Charged Interest Holder cures its default in the thirty (30) day notice period.

32.3.7 The lifting rights of the **GOVERNMENT** pursuant to Article 32.3.6 are exercisable by way of set-off, without first resort to legal process, and without any liability or claims of the defaulting

Charged Interest Holder, the **CONTRACTOR**, the Operator, or any other Person, and regardless of any provisions of any lifting agreement or provision of a joint operating agreement or any other agreement to which the **CONTRACTOR** or a defaulting Charged Interest Holder is a party. The **CONTRACTOR** shall ensure that all agreements in respect of the lifting or sale of Petroleum reflect the **GOVERNMENT**'s priority rights as set forth in Article 32.3.6 and this Article 32.3.7.

- 32.3.8 (a) A defaulting Charged Interest Holder shall indemnify the **GOVERNMENT** from any Loss or Expense (as defined in Article 32.3.8(c), below) that may in any way arise from the exercise by the **GOVERNMENT** of its rights in respect of such defaulting Charged Interest Holder under Articles 32.3.6 and 32.3.7.
- (b) The **GOVERNMENT** will retain control over the defence of, and any resolution or settlement relating to, such Loss or Expense. A defaulting Charged Interest Holder shall cooperate with the **GOVERNMENT** and provide reasonable assistance in defending any claims against the **GOVERNMENT**.
- (c) "**Loss or Expense**" means any liability, loss, claim, settlement payment, cost and expense, interest, award, judgment, damages (including punitive damages), diminution in value, fees or other charge and, to the extent permitted by applicable law, any court filing fee, court cost, arbitration fee or cost, witness fee, and each other fee and cost of investigating and defending or asserting a claim for indemnification, including attorneys' fees, other professionals' fees, and disbursements; but does not include consequential damages. A claim set forth in a notice from the **GOVERNMENT** to a defaulting Charged Interest Holder will be conclusively deemed a Loss or Expense if the Charged Interest Holder fails to dispute the **GOVERNMENT**'s liability by the end of a thirty (30) day period following the effective date of the notice from the **GOVERNMENT**. The Charged Interest Holder shall promptly pay the deemed Loss or Expense on demand.
- 32.3.9 The **GOVERNMENT**'s rights under Articles 32.3.6 through 32.3.8 are not exclusive and are without prejudice to the **GOVERNMENT**'s termination rights under Article 45.

Payments; No Set-off or Deduction

- 32.3.10 Except as provided in Article 32.3.2(e) and notwithstanding any provision in this Contract to the contrary, each Charged Interest

Holder shall pay all Capacity Building Payments without (and free and clear of any deduction for) set-off or counterclaim.

- 32.3.11 Each Charged Interest Holder acknowledges and accepts that a fundamental principle of this Article 32.3 is that such Charged Interest Holder must pay the Capacity Building Payments owed by it as and when required. Accordingly, in respect of its obligations under this Article 32.3 only and except as provided in Article 32.3.2(e), each Charged Interest Holder hereby waives any right to raise by way of set off or invoke as a defence to its obligations to pay Capacity Building Payments pursuant to this Article 32.3, whether in law or equity, any failure by the **GOVERNMENT** or any **CONTRACTOR** Entity to pay amounts due and owing under the Contract or any alleged claim that such Charged Interest Holder may have against the **GOVERNMENT**, Operator, other **CONTRACTOR** Entity, or any other Person, whether such claim arises under or relates to this Contract or otherwise.
- 32.3.12 Each Charged Interest Holder shall make Capacity Building Payments to the **GOVERNMENT** by wire transfer of immediately available funds in Dollars in accordance with wire instructions provided by the **GOVERNMENT**. The making of any payments by a Charged Interest Holder under this Article 32.3, or the acceptance or use of any payments by the **GOVERNMENT**, does not impair the rights of such Charged Interest Holder or the **GOVERNMENT** under Article 15. Any dispute between the **GOVERNMENT** and a Charged Interest Holder in respect of the calculation of each of the Capacity Building Value and the Capacity Building Payment due with respect thereto is subject to Article 15.9.

Assignment, Reversion

- 32.3.13 (a) If a Charged Interest Holder assigns and novates all or any part of its Charged Interest, the assignee will be a Charged Interest Holder to the extent of such assignment and novation.
- (b) If (i) a Charged Interest Holder withdraws as a **CONTRACTOR** Entity, or (ii) the **GOVERNMENT** terminates a Charged Interest Holder as a **CONTRACTOR** Entity; and if in the cases of clauses (i) or (ii) all or part of the Charged Interest of the Charged Interest Holder is either assigned and novated or reverts to the remaining **CONTRACTOR** Entities as provided in Article 45, then, in either such case, such assignee or each remaining **CONTRACTOR** Entity, as the case may be, will be a

Charged Interest Holder to the extent of such assignment and novation or reversion, as applicable, provided that the withdrawing or terminating Charged Interest Holder will be solely liable for any unpaid Capacity Building Payments attributable to its Charged Interest prior to the date of withdrawal or termination.”

3.14 In Article 32:

- (a) the existing Article 32.3 is renumbered “32.4”;
- (b) the existing Article 32.4 is renumbered “32.5”;
- (c) the existing Article 32.5 is renumbered “32.6”;
- (d) the existing Article 32.6 is renumbered “32.7”, and in that Article, after the word “bonus”, the words “or payment” are added; and
- (e) the existing Article 32.7 is renumbered “32.8”, and in that Article:
 - (i) after the word “bonus”, the words “or payment” are added; and
 - (ii) the words “or by banker’s draft and on receipt thereof the **GOVERNMENT** shall forthwith issue a written receipt to the **CONTRACTOR** duly executed by the Minister of Natural Resources of the **GOVERNMENT** or such other officer of the **GOVERNMENT** who shall be duly authorised to issue such receipt under Kurdistan Region Law” are deleted.

3.15 Article 39.2 is deleted and restated:

“Except as provided in Article 32.3, each **CONTRACTOR** Entity shall have the right to sell, assign, transfer or otherwise dispose of all or part of its rights and interests under this Contract to any third party (not being an Affiliated Company or another **CONTRACTOR** Entity) with the prior consent of the **GOVERNMENT** and each other **CONTRACTOR** Entity (if any), which consent shall not be unreasonably delayed or withheld. Any **CONTRACTOR** Entity proposing to sell, assign, transfer or otherwise dispose of all or part of its rights and interests under this Contract to any such third party shall request such consent in writing, which request shall be accompanied by reasonable evidence of the technical and financial capability of the proposed third party assignee.”

3.16 In Article 41, the following is added at the end of the Article: “Notwithstanding the foregoing, this Article 41 will not apply to the **GOVERNMENT** in respect of any claim or proceeding arising out of or related to the exercise of rights by the **GOVERNMENT** as set forth in Articles 32.3.6 through 32.3.9, in respect of which the **GOVERNMENT** expressly reserves all sovereign immunities.”

3.17 In Article 42.1, the following sentence is added at the end of the first sentence:

“This Article 42.1 does not apply to any Dispute arising out of, or relating to, the exercise of rights by the **GOVERNMENT** as set forth in Article 32.3.6, which Disputes shall, except only as provided in Article 32.3.12, be subject to the exclusive jurisdiction of the courts of the Kurdistan Region located in Erbil.”

3.18 In Article 45.6, after “31,” is added “32.3,”.

3.19 The following further amendments are made:

- (a) in the definition of “Production Bonus” in Article 1.1, the words “32.3 or 32.4” are replaced with “32.4 or 32.5”;
- (b) in Paragraph 3.1.9, the words “with the exception of Taxes described in Article 31.2) and bonus payments” are deleted and replaced with “with the exception of Taxes (described in Article 31.2), bonus payments, Capacity Building Payments, and any other payments”;
- (c) in Paragraphs 4.4 and 13.3.2(h), after the word “bonuses” in each instance, “, Capacity Building Payments, or other payments” is added;
- (d) the heading for Article 32 is deleted and restated:

“**ARTICLE 32 - BONUSES; CAPACITY BUILDING PAYMENTS**”; and
- (e) in Article 39.6, the following is added at the end of the sentence following the words “Article 4”:

“and Article 32.3.”

4. FIRST SUB-PERIOD EXTENSION

4.1 The Parties acknowledge that the First Sub-Period of the Exploration Period will, unless an extension takes place pursuant to Article 6.5, expire on 31 January 2011.

4.2 The outstanding Minimum Exploration Obligations for the First Sub-Period of the Exploration Period are set forth in Annex 1.

5. REPRESENTATIONS

5.1 HKN makes the following representations:

5.1.1 its entry into and performance of this Agreement have been authorised by all necessary company action;

5.1.2 this Agreement constitutes a valid, legal, and binding agreement of it;

- 5.1.3** it has received all authorisations and consents required under the law under which it is organised that are or will be necessary for the entry into and performance by it, and the validity and enforceability against it, of this Agreement;
- 5.1.4** except as provided in the next sentence, there is no law or agreement to which it is a party that conflicts with, or prevents entry into, delivery, and performance by it of, or calls into question the validity, legality and enforceability against it of, this Agreement. No representation is made in respect of the laws of the Kurdistan Region or Iraq;
- 5.1.5** it is not a party to any administrative or judicial proceeding, litigation, or arbitration that could affect the validity or enforceability of this Agreement as to it;
- 5.1.6** neither it nor any of its Affiliates has made, offered, or authorised (and has not agreed to make and does not expect will be made), with respect to the matters which are the subject of this Agreement or the Contract, any payment, gift, promise or other advantage, whether directly or through any other Person, to or for the use or benefit of any public official (*i.e.*, any person holding a legislative, administrative or judicial office, including any person employed by or acting on behalf of the Government) or any political party or political party official or candidate for office, where such payment, gift, promise or advantage violates (i) the laws of the Kurdistan Region or of Iraq, (ii) the laws of the place of its incorporation or its principal place of business, or (iii) the principles described in the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, signed in Paris on 17 December 1997, which entered into force on 15 February 1999, and the Convention's Commentaries. No part of its participating interest under (including any profits it may derive in respect of) the Contract is held (or to be held pursuant to this Agreement) or payable to, directly or indirectly, to or for the benefit (directly or indirectly) of any public official or any political party or political party official or candidate for office of the Kurdistan Region or Iraq; and
- 5.1.7** it is wholly-owned by Hillwood International Energy, L.P., a limited partnership established and existing under the laws of Texas, United States of America, whose registered office is at 5430 Lyndon B. Johnson Freeway, Suite 800, Dallas, Texas 75240-2606, United States of America.

6. GENERAL PROVISIONS

- 6.1** Articles 36 (*Information and Confidentiality*), 39 (*Assignment and Change of Control*), 41 (*Waiver of Sovereign Immunity*), 42.1 (*Negotiation, Mediation and Arbitration*), and 44 (*Notices*) of the Contract shall apply to this Agreement.

- 6.2** This Agreement does not create any right under the Contracts (Rights of Third Parties) Act 1999 that is enforceable by any Person who is not a party (a “**Third Party**”). The Parties may rescind or vary the terms of this Agreement without notice to or the consent of any Third Party.
- 6.3** This Agreement constitutes the final, complete and exclusive expression of the Parties’ agreement on the matters contained in this Agreement. All prior and contemporaneous negotiations and agreements between the Parties on the matters contained in this Agreement are expressly merged into and superseded by this Agreement. The provisions of this Agreement may not be explained, supplemented or qualified through evidence of trade usage or a prior course of dealings. In entering into this Agreement, neither Party has relied upon any statement, representation, warranty or agreement of the other party except for those expressly contained in this Agreement. There are no conditions precedent to the effectiveness of this Agreement, other than those expressly stated in this Agreement.
- 6.4** Each Party shall timely exercise all commercially reasonable endeavours to take, or cause to be taken, all actions necessary or desirable to consummate and make effective the transactions this Agreement contemplates.
- 6.5** The Parties may amend this Agreement only by an agreement of the Parties that identifies itself as an amendment to this Agreement. The Parties may waive any provision in this Agreement only by a writing executed by the Party against whom the waiver is sought to be enforced. Any amendment, waiver, or consent signed by the Minister of Natural Resources is binding on the Government. No failure or delay in exercising any right or remedy, or in requiring the satisfaction of any condition, under this Agreement by a Party, and no act, omission or course of dealing between any of the Parties, will operate as a waiver or estoppel of any right, remedy, or condition. A waiver made in writing on one occasion will be effective only in that instance and only for the purpose stated. A waiver once given is not to be construed as a waiver on any future occasion. No waiver or amendment in respect of this Agreement will constitute a waiver or amendment of any other agreement between the Parties.
- 6.6** The Parties may execute this Agreement in two counterparts, each of which constitutes an original, and all of which, collectively, constitute only one agreement. The signatures of all of the Parties need not appear on the same counterpart, and delivery of an executed counterpart signature page by facsimile or electronic scan is as effective as executing and delivering this Agreement in the presence of the other Parties. This Agreement is effective upon delivery of one executed counterpart from each Party to the other Parties. In proving this Agreement, a Party must produce or account only for the executed counterpart of the Party to be charged.
- 6.7** If this Agreement is reasonably proven to have been obtained in violation of Kurdistan Region Law or the laws of Iraq concerning corruption, this Agreement shall be deemed void *ab initio*.

- 6.8** This Agreement (and any non-contractual obligations arising out of or in connection with it) is governed by English law.

[Signature page follows.]

For and on behalf of **HKN Energy Ltd.:**

Signature: A.C. All
Title: Director
Name: Arthur T. Smith

For and on behalf of **the Kurdistan Regional Government of Iraq:**

Prime Minister
Kurdistan Regional Government
On behalf of the Regional Council for the Oil and
Gas Affairs of the Kurdistan Region – Iraq

Minister of Natural Resources
Kurdistan Regional Government
On behalf of the Ministry of Natural
Resources in the Kurdistan Region

Signature:.....
Barham Salih

Signature:.....
Ashti Hawrami

[Signature page to the Sarsang First Amendment Agreement.]

For and on behalf of **HKN Energy Ltd.:**


Signature.....
Title:
Name:.....

For and on behalf of the **Kurdistan Regional Government of Iraq:**

Prime Minister
Kurdistan Regional Government
On behalf of the Regional Council for the Oil and
Gas Affairs of the Kurdistan Region – Iraq

Signature: 
Barham Salih

Minister of Natural Resources
Kurdistan Regional Government
On behalf of the Ministry of Natural
Resources in the Kurdistan Region

Signature: 
Ashti Hawrami

[Signature page to the Sarsang First Amendment Agreement.]

Annex 1

Outstanding Minimum Exploration Obligations for the First Sub-Period of the Exploration Period (to be completed by 31 January 2011)

Swara Tika 1 Exploration Well

1. Drill 26" Hole and Set 20" Casing at top of Bekhme (+/- 534m BRT):

This section will spud in the Pila Spi and will be drilled through the Tertiary section which includes the Gercus, Khurmala, Kolosh, and Agra formations. As these formations are outcropped in the area, no pressures are expected to be encountered. The main hazard is perceived to be lost circulation with potential fluid breach to surface as well as the wellbore instability expected drilling the Kolosh. Wireline Gyro will be run to determine wellbore inclination and azimuth.

2. Drill 12-1/4" Hole and Set 9-5/8" Casing at the top of Kurrachine (+/- 2462m BRT):

This section will be drilled through the Cretaceous section which includes the Bekhme, Qamchuqa, Sarmord, Chia Gara and Barsarin formations and Jurassic section which includes the Sargelu, Sekhaniyan, Butmah and Baluti formations.

Regionally, the targeted zones Bekhme, Qamchuqa, Sekhaniyan and Butmah formations are sour (up to 2%) and normally pressured. Losses throughout the Cretaceous and Jurassic section are very likely. There may be potential well bore instability problems associated with the Chia Gara, Barsarin & Baluti shale section. Provisions will be made to perform open hole DST(s) immediately upon exposing the Qamchuqa, Sekhaniyan. DST(s) will be contingent on positive shows, LWD information and wellbore stability. Wireline Gyro will be run to determine wellbore inclination and azimuth

3. Drill 8-1/2" Hole into top of Geli Khane (+/- 3315.5m BRT):

This section will be drilled through the Kurrachine formation and as it is a targeted reservoir provisions. Regionally, the Kurrachine is sour (up to 2%) and over-pressured (requiring 14ppg drilling fluid in an offset well). Lost circulation can be expected as well as low ROP. DST of the Kurrachine will be contingent on positive Mudlogging shows, LWD information and wellbore stability. LWD information and wellbore stability. Wireline Gyro will be run to determine wellbore inclination and azimuth.

4. Set 7" Liner at top of Geli Khane (+/- 3315.5m BRT):

The setting of a 7" liner and running of 4-1/2" completion will be contingent on results of the DST's and further evaluation requirements.

5. Commercial Hydrocarbons in the Cretaceous and Jurassic:

In the event commercial hydrocarbons are discovered within the Qamchuqa and/or Bekhme, Sekhaniyan, Butmah and no commercial hydrocarbons are discovered in Kurrachine, the lower section of the well will be P&A.

6. Contingencies:

Upon successful drilling of the Cretaceous (1657m BRT), a FIT will be conducted to determine the integrity of the drilled hole. FIT must be greater than 12ppg to continue drilling the Jurassic (TD 2462m). If FIT is less than 12ppg, LCM will be pumped in an effort to increase FIT to +12ppg. If the LCM treatments fail, then the 12-1/4" hole will be opened to 17-1/2" and 13-3/8" casing run to the Cretaceous TD. The Jurassic section would then be drilled with 12-1/4" and 9-5/8" casing run to surface. The Triassic section would be drilled with 8-1/2" hole and 7" liner set (depending upon evaluation of logs).

Should the planned casing point not be achieved in any of the well sections, the casing will be set as deep as possible and the next hole size drilled to the originally planned casing point.

Drill Stem Testing

For safety reasons, we will only conduct open-hole tests in daylight hours, thus the 12-hour limit on bottom. We will plan to be in the hole and ready to set the packer at first daylight. Depending on test conditions/results, we will pull the tools, insure the well is stable and begin POOH before dark. DST packer to be set in stable/gauge section of hole. LWD Sonic will be used to determine relative rugosity and WSG may elect to call a multiarmed caliper run to ensure good seat.