

Office of the Attorney General

Sao Tome and Principe

**Investigation and Review
Second Bid Round
Joint Development Zone
Nigeria and São Tomé and Príncipe**

December 2, 2005

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION	1
II. HISTORY OF THE SECOND BID ROUND.....	2
III. EVALUATION OF THE SECOND ROUND	10
IV. RECOMMENDATIONS AND ACTION.....	18
V. FURTHER INVESTIGATION AND ACTION.....	24
APPENDICES	
APPENDIX A – INDIVIDUALS INTERVIEWED	
APPENDIX B – INDEX OF DOCUMENTS REVIEWED	
APPENDIX C – SÃO TOMÉ 2004 LICENSING ROUND CHART	
APPENDIX D – OWNERSHIP INTERESTS AND DUE DILIGENCE REPORTS	
APPENDIX E – REPORT OF THE SÃO TOMÉ AND PRÍNCIPE NATIONAL PETROLEUM AGENCY (MAY 6, 2005)	
APPENDIX F – REPORT OF THE SÃO TOMÉ AND PRÍNCIPE NATIONAL ASSEMBLY’S 4 TH (PETROLEUM AFFAIRS) COMMISSION (MAY 16, 2005)	
APPENDIX G – THE ABUJA JOINT DECLARATION	
APPENDIX H – THE ERHC CONTRACT	

I. INTRODUCTION

This Report is the product of an investigation initiated by the Office of the Attorney General of São Tomé and Príncipe into the procedures and the transparency of the license awards for petroleum blocks in the 2004 Licensing Round conducted with respect to the Joint Development Zone of Nigeria and São Tomé and Príncipe (“Second Round”). The report is based upon data collected in the course of the investigation, including interviews with the individuals identified in this Report’s Appendix A, an examination of the documents listed in Appendix B, reference to industry norms, and a review of other publicly-available documents and background materials.¹

The purpose of open competitive bidding in the award of licenses is to obtain the highest economic value for the nation by awarding each block to the technically and financially qualified company or group offering the highest signature bonus and most extensive work commitment. The Second Round failed in this regard. The round was subject to serious procedural deficiencies and political manipulation, including the award of interests to many unqualified firms or firms with inferior qualifications, technically and financially. The prospect of such manipulation deters qualified companies from bidding, and, for those firms which do bid, may cause them to bid less because of the prospect that the value of any license will be diminished. Either way, signature bonuses and work commitments are reduced. Further, making awards to companies which do not have the technical and financial capacity for deep water drilling risks the successful and economic development of the blocks. These financial losses and increased risks are directly borne by Sao Tome and Principe.

The problems of the Second Round for Sao Tome and Principe were further exacerbated by the presence of Environmental Remediation Holding Corporation (ERHC)² and its asserted preferential rights. Because of reputational, financial, and technical concerns, the presence of ERHC discouraged the most qualified companies from bidding, lowering the level of bids. These concerns have subsequently caused several of ERHC’s proposed partners to drop out. Equally important, the option rights asserted by ERHC, even at the reduced bid levels, may, if recognized, result in the loss of

¹ In carrying out this investigation and preparing this report, the Office of the Attorney General requested professional assistance from the International Senior Lawyers Project (“ISLP”). ISLP is a U.S.-based non-profit organization which provides volunteer legal services by experienced lawyers to advance democracy and the rule of law and to promote equitable economic development around the world. See www.islp.org. The out-of-pocket expenses of the ISLP volunteers were funded by Revenue Watch, www.revenuewatch.org. Inquiries with respect to ISLP should be directed to Jean Berman, Executive Director, 1 (212) 880-5836.

² ERHC changed its name to ERHC Energy Inc. in February 2005.

nearly \$60 million of signature bonus money which would otherwise go directly to the government of Sao Tome and Principe.³

II. HISTORY OF THE SECOND BID ROUND

The Second Round refers to the second offering of licenses in the Joint Development Zone (“JDZ”) administered by the Joint Development Authority. The JDZ is a formerly disputed deep-water coastal area south of the median line between São Tomé and Príncipe and Nigeria.⁴ In order to avoid a prolonged legal conflict with respect to the area, Nigeria and São Tomé and Príncipe reached an agreement in August of 1999 to jointly explore and exploit the hydrocarbons in a 28,000 square kilometer area that now constitutes the JDZ. Under this agreement Nigeria receives 60 percent of any profits realized in the JDZ, and STP receives 40 percent. The two countries share operating costs in the same proportions. The formal treaty creating the JDZ was signed on February 21, 2001. A Joint Development Authority (“JDA”) based in Abuja, Nigeria was established to manage the JDZ. The JDA’s Board consists of four executive directors, two from each country. The Board reports to a Joint Ministerial Council (“JMC”) comprised of four ministers from each country.⁵ The JMC has the responsibility for all matters concerning the JDZ.

The First Round

In order to effectively analyze the Second Round, it is necessary to review the conduct and results of the initial JDZ licensing round that was initiated in late April 2003 (“First Round”). The First Round covered the first nine of 25 blocks in the JDZ, about one third of its area. The minimum bid per block was set at \$30 million.

On October 27, 2003, 20 companies tendered 33 bids for eight of the nine blocks. President de Menezes presided over the ceremony, and his opening speech warned of the risks of oil wealth becoming a curse and promised that the management of such wealth in

³ If all of the awards result in executed licenses and if the avoided signature bonuses of ERHC are subtracted from the proceeds otherwise going to Sao Tome and Principe, the loss to Sao Tome and Principe will be \$58,550,000.

⁴ In March 1998, to preserve its rights to the oil reserves in the adjacent waters, the São Toméan National Assembly delineated the country’s maritime boundaries and established a 200-mile Exclusive Economic Zone (“EEZ”). In May 1998, São Tomé and Príncipe filed a maritime boundary claim with the U.N. Law of the Sea Commission and the Gulf of Guinea Commission for the recognition of its maritime boundary. After filing its claim, the nation began negotiations with its neighbors to define the borders. Between 1998 and 2001, it successfully reached agreement with Equatorial Guinea and Gabon, but the nation’s dispute with Nigeria persisted until the establishment of the JDZ. The Treaty establishing the JDZ reserves the claims of both parties to the area covered by the JDZ.

⁵ Members of the Board and the JMC are appointed by the respective heads of state, but members of the JMC must be ministers or persons of equivalent rank.

São Tomé and Príncipe would be transparent and accountable. Based upon the highest bids, approximately \$500 million was offered for seven blocks. Fewer of the “major” multinational oil giants than expected participated in the auction, and even fewer companies with deepwater experience tendered bids. Those that did included Anadarko Petroleum Corporation (“Anadarko”), ChevronTexaco (“Chevron”), and the Norwegian company Statoil.

As part of the application to participate in the First Round, the JDZ specified the criteria by which each bidder would be evaluated, including such standard factors as a company’s experience and expertise in exploration, development and production; its proposed financial commitment to the JDZ block for which it bid; its work program commitment; its geological interpretation of the block; its environmental, health and safety proposals; and its proposals for including “local content.” The JDA Licensing Round Committee engaged in a two-step evaluation pursuant to which companies were evaluated based upon a numerical rating system. First, it decided upon those companies that it believed to be technically competent. From those companies, it proposed awards based upon commercial considerations. It was assisted in its evaluations by a due diligence report prepared by the experienced British company Clearwater Research Service which reviewed the financial and technical resources of the bidders, their involvement in litigation, and their commercial reputations. The JDA was assisted in structuring the round by Wood Mackenzie, a well-known British consulting group, but Wood Mackenzie did not participate in the selection of licensees.

In February 2004, ExxonMobil exercised certain preferential rights to take 40 percent of Block 1 at a cost of some \$49 million based on the high bid of Chevron of \$123 million. However, the company declined to exercise its preferential rights to 25 percent in two other blocks.⁶ Subsequently, in April 2004, the small company Environmental Remediation Holding Corporation (“ERHC”) exercised its preferential right to take 30 percent of Block 2, 20 percent of Block 3, 25 percent of Block 4, and 15 percent of Block 6, from all of which it was, unlike ExxonMobil, exempt from paying a signature bonus.⁷ ERHC also decided to take 15 percent and 20 percent stakes in Blocks 5 and 9, for which signature bonuses were payable.

Although the JDA Licensing Round Committee recommended awards in five blocks, the JMC, upon examination of all of the bids and the Licensing Committee’s report, decided to make a licensing award only in Block 1. This was the only block for which a company with significant deep-water experience tendered a bid above the minimum tender amount. That license was awarded to Chevron, 51 percent,

⁶ ExxonMobil reportedly was interested in participating in Blocks 2 and 4, but had concluded that the signature bonuses were too expensive.

⁷ ExxonMobil and ERHC both held certain preferential rights to licenses in the JDZ by virtue of prior activity and contracts.

ExxonMobil, 40 percent, and Equity Energy Resources (“EER”), 9 percent.⁸ The signature bonus of \$123 million was expected to yield São Tomé and Príncipe \$49 million, roughly eighty percent of the country’s GDP.⁹ The First Round was declared officially closed with only the Block 1 award. Officials announced that they were not satisfied with the bids tendered for the remaining blocks¹⁰ and that a second licensing round for the Blocks 2, 3, 4, and 6 would be organized in the near future. Additional testing would be conducted on Blocks 5, 7, 8, and 9 before those blocks would again be put on auction.¹¹ After lengthy negotiations, the parties finally signed the Production Sharing Contract for Block 1 (“Block 1 PSC”) on February 2, 2005. Thus far a copy of the contract has not been made public.

The Second Round

The JDA began very quickly to prepare for the JDZ’s Second Round. At its meeting on October 28-29, 2004, when it announced the closing of the First Round, the JDA announced that the Round would commence on November 15, 2004 and would offer equity in Blocks 2, 3, 4, 5 and 6, without prejudice to the pre-existing preferential rights of both ExxonMobil and ERHC. Guidelines for interested investors, *Updated Guidelines for Investors in the 2004 JDZ Licensing Round* (“Updated Guidelines”), were approved on November 11, 2004 by the JMC.

The bids were submitted and opened on December 15, 2004. Twenty-two companies participated in this round, submitting a total of 26 proposals. Preferential right holder ExxonMobil did not bid. ERHC, on the other hand, not only exercised its options to all of the blocks, it also formed a consortium with Devon Energy Corporation (“Devon”) and Pioneer Natural Resources Company (“Pioneer”) to bid for additional interests in Block 2, again with Devon for Block 3, and with Noble Energy, Inc. (“Noble”) for Block 4.¹² Even though the bids were publicly opened on December 15,

⁸ EER is a Nigerian registered company controlled by a group of Norwegians and Aliko Dangote, a prominent Nigerian businessman. EER was not a part of the Chevron bid; nor did it have any preferential rights. EER was inserted into the block by the JMC.

⁹ According to the World Bank the country’s GDP for 2004 was \$60 million. See http://www.worldbank.org/data/countrydata/aag/stp_aag.pdf. Estimates of São Tomé’s GDP vary widely, especially if adjusted for purchasing power parity.

¹⁰ It is widely believed that the remainder of this first bidding round was cancelled as both the Nigerian and the São Toméan government were disappointed with the signature bonuses that had been offered and wanted to avoid assigning blocks to companies that were not technically and financially qualified. It was suspected that several of the nine Nigerian companies that presented 23 of the bids were “vest pocket” companies that were speculating on the blocks for which they bid intending to sell any interest after the award.

¹¹ Block 5 was eventually included in the group of blocks subject to the Second Round.

¹² Although the ERHC/Devon and the ERHC/Noble groups were eventually awarded interests, Devon and Noble subsequently withdrew from the round.

there were five and a half months of negotiation between the bidders, São Tomé and Príncipe, and Nigeria before final awards were announced. The original bids, intermediate positions, and the final awards are shown in the tables of Appendix C.

On the day after the opening of the bids, the JDA Licensing Round Committee prepared a report that provided a technical and commercial evaluation of the bids, established the *bona fide* high bid for each Block,¹³ and recommended a set of awards to the JMC. Companies having a deficient technical score were eliminated from consideration (although later some such companies were given interests). The factors considered by the JDA Licensing Round Committee and their weighting were set forth in the Updated Guidelines. A technical score of 60 was set as the minimum by which a company could proceed in the evaluation process. Unlike the First Round, from the records made available to this office, the JDA Licensing Round Committee appears not to have provided a grid showing each company's score for each of the components of the technical evaluation, but simply provided a total score. The Committee did, however, provide a more detailed evaluation than that set out in the Updated Guidelines. As in the First Round, the Licensing Round Committee used its discretion to add points in certain instances to increase a company's scores to 60 or above.

The JMC met on December 21, 2004 and largely adopted the recommendations of the Licensing Round Committee, including the Committee's disqualification of Anadarko's staggered bids for Block 3 and 4 as "non-conforming." After the meeting, either on its own initiative or at the direction of the JMC,¹⁴ the JDA contacted two of the bidders for Block 2 and requested that their offers be increased. Shortly thereafter, on December 28, 2004, São Tomé and Príncipe urged the JDA to contact another bidder with a request to revise its bid for Block 4. It is not clear if all bidders were given this same opportunity. Because ExxonMobil had yet to exercise its preferential rights, no block awards as such were made in the December meeting.

In January 2005, there was a further exchange of recommendations between the JDA and its two member countries. After discussions with Anadarko, the JDA recommended the reinstatement of Anadarko's bid and accepted its bid of \$90 million for Block 4 and designated it the *bona fide* high signature bonus bid. São Tomé and Príncipe believed that the *bona fide* high bids should be further modified, urging the use of the highest bonus bid for Block 2 as the *bona fide* high bid and urging that the *bona fide* high bid for Block 4 be set at \$175 million, a bid that apparently had been elicited since the prior meeting of the JMC.

¹³ The *bona fide* high bid was intended to set the signature bonus to establish the amount Exxon or ERHC, where it was required to do so, would have to pay if it were to exercise its preferential rights.

¹⁴ Although nothing in the minutes of the JMC meeting reflects the direction to contact the bidder in Block 2, a subsequent report of the JDA notes that it acted at the direction of the JMC.

ExxonMobil subsequently declined to exercise its preferential rights, the effect of which was to allow ERHC's elections to stand.¹⁵ Between January and April, there were further discussions among the JDA, São Tomé and Príncipe and Nigeria. The results of those discussions were summarized in an April Memorandum of the JDA. Although São Tomé and Príncipe and Nigeria apparently had agreed on the divisions of Blocks 2, 5, and 6, the two countries disagreed on the division of Blocks 3 and 4.

According to the persons interviewed, the difference in the São Tomé and Príncipe and Nigerian positions at the time appears to have been: (1) São Toméan concern at the numerous Nigerian "vest pocket" companies and the lack of any companies belonging to São Toméans;¹⁶ (2) disagreement regarding which company should be the operator in Block 4; (3) dissatisfaction with the percentage that the Equator/ONGC Videsh¹⁷; (4) São Toméan concern at the precipitous process; and (5) São Toméan concern that nothing had been done to pare down the contractual interests of ERHC.¹⁸

Several witnesses stated that Block 4 appeared to be the most promising block in the second round. It drew a \$90 million bonus bid from Anadarko, and a \$150 million bonus bid from Conoil Producing.¹⁹ For reasons not explained, the \$150 million bid of Conoil Producing was ignored, but it may have been because of Conoil Producing's lack of deep-water experience. The focus was thus on Anadarko's bid, the next highest bid.

¹⁵ By a prior settlement agreement between ERHC and ExxonMobil, ERHC was precluded from participating in any block in which ExxonMobil exercised its rights.

¹⁶ One Nigerian entity, Equinox, had created a São Toméan affiliate with one São Toméan minority partner, Ana Isabel Rita, sister of President de Menezes' former Chief of Staff Mateus "Nando" Rita who was recently named Ambassador to Nigeria and Equatorial Guinea.

¹⁷ Equator Exploration Ltd. ("Equator") was founded in 2000. It owns Aqua Exploration Ltd. which makes claims to certain exploration and production rights in São Tomé and Príncipe's EEZ. Both companies are controlled by the Canadian Wade Cherwayko. ONGC Videsh is a wholly owned subsidiary of the Oil and Natural Gas Corporation (ONGC) Limited, India's largest multinational and its first integrated oil and gas major.

¹⁸ Much of the dissatisfaction expressed by the São Toméans interviewed regarding the Second Round appears to be attributable to the nation's contractual arrangement with ERHC, long the subject of controversy because of the perceived one-sided nature of the original agreement which relates back to 1997. The history of the current agreement is set out in Appendix H.

¹⁹ Conoil Producing is an affiliate of Con Oil, a substantial Nigerian company controlled by Mr. Mike Adenuga. It is engaged in oil marketing and trading and has some shallow water production. It is reputed to be the financially strongest of Nigeria's indigenous oil companies. According to prior due diligence reports Con Oil and its chairman are shadowed by allegations of links to the prior Nigerian military ruler, General Ibrahim Babangida, and former senior office holders.

As noted originally, the Licensing Committee found that the Anadarko bid was non-conforming, but then the bid was reinstated. ERHC/Noble, whose bonus bid had been less than Anadarko and which had been given a less favorable technical rating, was then permitted to raise its lower bid to match that provided by Anadarko.

One of São Tomé's primary interests was to secure Anadarko as the operator of Block 4 to take advantage of its deepwater experience and to recognize its high bid (second only to Conoil Producing).²⁰ However, in the block allocation supported by Nigeria, Anadarko was to be removed from Block 4 and instead would be given a 51 percent interest in Block 3 and be designated as the operator. ERHC/Noble would then be made the operator of Block 4. It appears that ERHC's partnership presence in the ERHC/Noble consortium weighed heavily in this preference of the Nigerian members of the JMC, but the Nigerians also argued that Noble had offered to drill an additional well in the early phase and that this in itself justified the selection of Noble/ERHC. Eventually Nigeria prevailed on the point. It is also worth noting that in certain notes there is an apparent recognition that Nigeria might have the right to designate which Nigerian companies were to receive awards provided that such designation was in the Nigerian share.

A meeting of the JMC to address the awards was called for April 26-28, 2005 in Abuja.²¹ Prior to the meeting the São Toméan members of the JMC met with President de Menezes at the Presidential Palace to discuss their tactics and objectives.²² Agreement was reached to resist concessions and to reserve final decision making to a later point. With this in mind, the delegation, led by the Minister of Natural Resources Arlindo Ceita Carvalho, went to Abuja. There according to various witnesses the delegation was put under tremendous pressure to agree to a final block allocation.

To increase the pressure and to appeal directly to President de Menezes, a delegation left Abuja during the meeting on Wednesday, April 27, 2005, and went directly to São Tomé to meet with President de Menezes. A personal representative of Nigerian President Obasanjo led this small group, accompanied by Mateus "Nando" Miera Rita, then Chief of Staff to President de Menezes and Ovidio Pequeno, the Foreign Minister of São Tomé and Príncipe. This group did not notify the National Assembly nor

²⁰ Several members of the National Assembly indicated that they preferred Anadarko in part because it had promised to locate its operational headquarters on São Tomé.

²¹ The report of the São Toméan National Petroleum Agency dated May 6, 2005 shows what appears to be the same JMC meeting as taking place on May 3, 2005. However, the report notes that this meeting was suspended and that a Nigerian delegation was sent to São Tomé and Príncipe. The date appears to be erroneous since the report itself was requested by President de Menezes on May 2, 2005.

²² Attendees at the JMC meeting included H.E. Oscar de Sousa, Minister of Defense, Mr. Mateus "Nando" Meira Rita, then Chief of Staff to the President, Angelo Bonfim, the President's legal advisor, Arlindo Ceita Carvalho, Minister of Natural Resources.

ask to meet with any Members of Parliament but spoke only with the President to argue the case for harmonization of positions. It is unclear specifically what transpired in the meeting between the delegation and the President.

At the same time in Abuja the meeting of the Joint Ministerial Council was coming to an end with no clear resolution. Carlos Gomes, Executive Director of the JDA appointed by President de Menezes, and the Nigerians pressed for a written memorandum setting forth the agreement. Although Natural Resources Minister Carvalho initially resisted, at the very last moment, virtually on departure for the airport a list was presented and signed by both delegation heads of the JMC as the "JMC Recommended Position." Although the Treaty governing the JDZ gives the JMC authority to make decisions, apparently the awards had to also be approved by both Presidents.²³ President Obasanjo initialed this document on Saturday April 30, 2005 immediately after the departure of the delegation.

The awards set out in the JMC Recommended Position included a 35 percent interest in Block 2 to the Devon/Pioneer/ERHC consortium.²⁴ Several other entities or consortia thereof received smaller percentage interests in this Block, including Equator Exploration Limited/ONGC Videsh Limited (15 percent), A. & Hatman Ltd. (10 percent), Foby Engineering Company (5 percent), and a group of companies including Momo Oil & Gas, Sojitz Petroleum Co., IMT, and Nissho-Iwai Corporation (5 percent). The Devon/Pioneer/ ERHC consortium also was named the operator of Block 2. ERHC also was awarded its pre-existing preferential right of 30 percent. The signature bonus for the block was \$71 million.

Anadarko was awarded 51 percent interest and was named operator in Block 3, and the Devon/Pioneer/ERHC consortium was awarded a 25 percent interest, which interest includes ERHC's 20 percent option. Again, smaller percentage interests were granted to smaller bidding entities. These smaller companies and consortia included Det Norske Oljeselskap ASA("DNO")/Equity Energy Resources ("EER") (10 percent), Equinox Energy Limited (10 percent), and Ophir Corporation/Broad Link Petroleum (4 percent). The signature bonus was \$40 million.

In Block 4, the Noble/ERHC consortium was granted a 35 percent interest and was named as the operator. ERHC's option exercise gained the company an additional 25 percent interest in Block 4. Other companies receiving percentage interests in this Block include Conoil Producing Ltd. (20 percent), Hercules Oil/Centurion Energy

²³ Many in the National Assembly assert that its approval or that of the Prime Minister was needed for the finalization of the block awards. Indeed, certain earlier instructions to the JDA by the President regarding awards were made after consultation and agreement with the Prime Minister. The different views of the President and the National Assembly regarding the President's authority remain unresolved.

²⁴ Ownership interests are set out in Appendix D.

International Inc. (10 percent), Godsonic Oil and Gas Ltd. (5 percent), and Overt Ventures Ltd./Addax Petroleum (5 percent). The signature bonus was \$90 million.

The International Commerce Co. Ltd./Oil Exploration Operations Company consortium was named operator of Block 5 with a 75 percent interest. ERHC exercised its preferential right to a 15 percent interest of this Block, and a group comprised of Sahara Ltd., Denham, Wood Group received 10 percent. The signature bonus was \$37 million.

Finally, the designated lead operator for Block 6 was the combination of Filthim-Huzod Oil & Gas, DNO/EER, and Sinopec Corp., with an interest of 85 percent. Based upon its preferential option, ERHC took a 15 percent interest in the block. The signature bonus was to be \$45 million, although in June the official announcement did not indicate what signature bonus would be payable.

The awards provided in the unsigned minutes were the subject of immediate criticism in São Tomé and Príncipe, and upon his return to São Tomé and Príncipe Minister Carvalho disavowed the recommendations as binding. Patrice Trovoada, a former advisor to the President, who although not a member of the JMC had accompanied the group to Abuja, promptly criticized the allocation and made accusations of corruption and undue influence that reached the Portuguese-speaking and western press. In the immediate aftermath, Minister Carvalho sought to resign, but the President insisted he remain.

This led to the initiation on May 2, 2005 of a parliamentary investigation by Committee 4 (Petroleum Affairs) of the São Toméan National Assembly. Minister Carvalho's testimony was of particular importance in the investigation. He reported, among other matters, that the allocations of the JMC were only recommendations, that he had not been legally authorized to execute any agreement at the meeting of the JMC, and that the resolution text prepared in Abuja, which should seal the commitment between the two states and which was presented to Mr. Carvalho in São Tomé, contained essential modifications when compared to the initial text. Mr. Carlos Gomes, Executive Director of the Joint Development Authority in Abuja, also appeared before the National Assembly. He testified at length in response to questions. His testimony, however, did not satisfy the National Assembly with regard to the process.

Concurrently, President de Menezes asked the São Toméan National Petroleum Agency for its views. The Agency issued a report dated May 6, 2005, appended hereto as Appendix E that was critical of various aspects of the Second Round process, particularly the favored treatment of ERHC. It also criticized the strategy of the JDA in awarding blocks as being "economically inefficient and legally problematic."

The National Assembly issued its report on May 16, 2005, a copy of which is attached as Appendix F. Based in part upon the National Petroleum Agency report, the Assembly questioned the inclusion of and awards to the numerous small Nigerian companies in the Second Round, the lack of time for analysis and input in the process, the

lack of due diligence, and various specific details about the final awards and the decisions thereabout. These same concerns led this office to initiate this review.

Following the protests in São Tomé and Príncipe and the National Assembly's report, President Obasanjo made a personal visit to São Tomé and Príncipe on Friday, May 22, 2005 and met with President de Menezes and various São Toméan officials. President Obasanjo apparently agreed to permit a limited due diligence as a formal matter, but insisted that the JMC meet in Nigeria the following week to confirm the awards.

The JMC did meet in accordance with President Obasanjo's wishes in Abuja on May 24-26, 2005 and adopted the same allocations as set out in the controversial memorandum of April 28, 2005. President de Menezes flew to Abuja and met with President Obasanjo at the end of the week and the license awards for the Second Round were announced at the airport just before President de Menezes departed. At the same time, the São Toméan share of the signature bonus for the First Round was released by the JDA from the Nigerian Hallmark Bank where it was being held. The funds were transferred to the nation's oil account at the Federal Reserve Bank of New York.²⁵

The JDA posted a Press Statement announcing the Second Round block awards on its official website. The results were widely reported in the international industry media. None of the awards has yet resulted in an executed contract, and, as of this date, at least two companies, Devon and Noble, have withdrawn. This has resulted in the further negotiation of leases with new parties completely outside of the original bids and bidding procedures.

III. EVALUATION OF THE SECOND ROUND

Based upon its investigation, the Office of the Attorney General has concluded that the award process of the Second Round lacked transparency and regularity and was subject to serious procedural deficiencies and political manipulation, including the award of interests to many unqualified firms or firms with inferior qualifications, technically and financially.

Given the potential significance of the oil reserves in the JDZ, experienced industry actors would reasonably expect that licensing activities within the Zone would be conducted in accordance with standard international petroleum practices. The process in the Second Round fell far below even that performed in a rudimentary offshore auction.

²⁵ The New York Federal Reserve is part of the Central Bank of the United States and has been designated by the government of São Tomé and Príncipe as the custodian for the São Toméan oil fund established pursuant to São Tomé and Príncipe's recently enacted oil management law.

The published Updated Guidelines provide *prima facie* evidence of this lack of transparency and regularity. The entire section on technical evaluation and the required showings comprise two brief paragraphs. The section on commercial evaluation is equally brief, all of 150 words. This lack of specificity undercuts the rigorous qualification process associated with established auctions, and it does not provide adequate notice to the bidders of the precise bid evaluation criteria by which they will be judged. Internationally, bidding instructions often exceed 200 pages and set forth in detail the factors on which bidders will be evaluated.²⁶ The vagueness of the JDA's Updated Guidelines obscures, rather than makes transparent, the decision-making process.²⁷ Moreover it is impossible to determine if the JDZ conducted the Second Round in accordance even with the overly general procedure set forth therein. This too demonstrates the lack of transparency of process.

The inadequacy and in some cases absence of due diligence also contributed significantly to this lack of transparency and regularity. There appears to have been no due diligence on the companies that did not participate in the First Round but did enter the Second Round. There is an undated report by two Nigerian consultants apparently prepared during the interval between President Obasanjo's visit to São Tomé and Príncipe in May 2005 and the meeting of the JMC four days later,²⁸ but is of limited content and appears to have had no effect on the award process. The final awards only ratified decisions made before the due diligence was conducted. The apparent failure to conduct even minimal screening of the bidders on the basic criteria of technical, financial, legal, management and administrative capacity almost certainly undermined industry and public confidence in the JDA's commitment to transparency.

This is evident if one considers the award results. The JDA announced that its technical evaluation criteria had an eliminatory character and that a company that was not satisfactorily qualified according to the technical criteria would not be evaluated commercially. This "knock out" process is consistent with international practice although ordinarily it would be conducted before the bidding. International offshore oil auctions routinely screen applicants based upon their technical qualifications. Licensing due diligence generally considers a number of technical competencies, including the countries in which the bidding company, its affiliates and parent companies have been

²⁶ One such bidding program has been established by the Agencia Nacional Do Petroleo, Gas Natural e Biocombustiveis ("ANP"), the Brazilian petroleum regulator. The ANP makes its bidding documents available in Portuguese and, in some cases, in English, on its excellent website. See <http://www.brasil-rounds.gov.br/index.asp>.

²⁷ It is worth noting that the Licensing Committee itself used a more discriminating and detailed matrix in making its initial evaluations and recommendations to the JMC.

²⁸ Due diligence on a number of bidders was available from the First Round report by Clearwater Research Service and may have been consulted by the JDA in the Second Round. This report was not updated for the Second Round. Appendix D presents certain basic information about the bidders and sets out which companies were subject to the First Round due diligence report and which were subject to Second Round due diligence report.

active in exploration and production activities; current production and investment (exploration and production) levels; description of key oil/gas fields or areas that are currently being operated or developed by the bidding company; the experience of the company in a variety of difficult operating conditions, including deepwater/ultra-deepwater, high temperature/pressure operation and environmentally sensitive areas; a company's oil equivalent production levels; the technical and industrial resources available to the company, and, in some cases, even the qualification and experience of the company's employees and contractors.

In the Second Round, however, the final selections are inexplicable if the bidding companies were evaluated and "bid qualified" based upon their deepwater exploration and production capability and experience. For instance, one company, A. & Hatman, was given a technical rating sufficient to meet the technical qualification cut off in spite of the fact that the subsequent due diligence report indicated that the company had no previous experience in oil and gas exploration, let alone deepwater exploration. Another company EER, which eventually was awarded an interest in Block 3, was deemed qualified to participate in the Second Round even though Nigeria in its own 2005 bid round disqualified the firm from bidding for deepwater blocks. Accordingly, it is not clear what technical criteria, if any, were considered.

The technical evaluations do not yield the only problematic results. Consider the financial qualifications, or seeming lack thereof, of several of the awardees in the Second Round. It appears that no financial statements were required or submitted, certified or otherwise. The Updated Guidelines require only that bidders provide evidence of good financial standing from a reputable bank or financial institution. This is not consistent with international practice. Even rudimentary auctions require that bidding companies submit annual reports, credit rating details, balance sheets and profit/loss data for a minimum of three years, with an opinion of qualified independent auditors; evidence of funds for drilling, removal (decommissioning) of facilities and allowance for contingencies and the funds available for assured access to expert help from outside sources in the event of an environmental or other incident, and any additional information supporting the financial capacity of the bidding company including a draft bank or parent company guarantee.²⁹ Again, when one considers the award list, it is difficult to determine how the JDA conducted the financial assessment or by what financial criteria, if any, the bidders were evaluated. The lack of a serious financial review process was compounded by the decision of the JDA, unlike many countries, not to require that bidding companies demonstrate their financial capability and commitment by posting bid bonds or paying significant application fees.

The commercial evaluation in the Second Round appears to have been based principally upon the signature bonus amount plus the production bonus, the latter being discounted to take into account the nature of the company making the commitment. Because of the preferential rights of Exxon/Mobil and ERHC, the Licensing Round

²⁹ Consider, for example, the bidding requirements established in auctions run by, *inter alia*, Petro VietNam, the ANP, the U.S. MMS, Timor-Leste, Egypt's GANOPE, and Jamaica.

Committee also determined *bona fide* high bids for each block. This process was itself not entirely consistent. For instance, one company was given full credit in the commercial evaluation for its signature bonus offer, yet another company with a lower signature bonus bid was listed as the high *bona fide* bid for that same block. Importantly, recall too that the Licensing Round Committee found initially that the Anadarko bids for Blocks 3 and 4 were non-conforming because of its “staggered bids” for the two blocks, but that when the bids were reinstated Anadarko was forced out of Block 4 and offered the operator position in Block 3. Accordingly, block interests were awarded to a substantial number of small companies that lack the technical capability and in many cases apparently the financial capability to engage in advanced deepwater exploration and production activities or to act as strategic partners. While it is possible that some of these companies do in fact have the requisite financial standing – if not the technical capacity – and thus would be suitable strategic partners, the lack of transparency in the Second Round prevents observers from confirming any such conclusion.

The JDA’s *Updated Guidelines* also required that it assess the bidders and their bids on the basis of the work programs that each offered and also its “local content” commitment to communities in the JDZ partner countries. While this is consistent with many international auctions, it is difficult for observers to determine how the JDA evaluated or weighed these factors. For example, the São Toméan National Assembly expressed a strong preference for Anadarko’s Block 4 bid in part because the company promised to locate its operational headquarters in São Tomé and Príncipe. The Nigerians, however, preferred the Nigerian linked ERHC consortium’s bid for Block 4 based upon its offer to drill an additional well in the early phase of the work program. Nigeria’s preference prevailed, but precisely why is nowhere explained, privately or publicly.

The lack of transparency and regularity with which the Second Round was conducted also is revealed in the failures of intra- and inter-governmental communication. Within São Tomé and Príncipe, many complained that political and public opposition to JDZ activities went unheeded by the São Toméan administration. The National Petroleum Agency and the National Assembly were not apprised of developments in the Second Round. In response to these complaints, the São Toméan members of the JMC claimed that they were under enormous pressure to conclude the Round, thus preventing JDA officials from providing regular updates to the São Toméans or to seek their input on matters pertaining to the Second Round. Some of this discontent may be attributable to what appears to be some confusion or disagreement within São Tomé and Príncipe about the allocation of authority among the various officials and governmental units. Regardless of their cause, however, these dysfunctional interactions further illustrate the Second Round’s lack of transparency.

This failure of communication exacerbated a general discomfort among the São Toméans with the balance of power and authority in the JDZ of Nigeria vis-à-vis São Tomé and Príncipe. São Toméans are not unaware of Nigeria’s size, its industry

experience, its position as a São Toméan creditor,³⁰ and its JDZ contractual authority. Many expressed concern that a failure to cooperate with Nigeria could result in a decision by the Nigerians to abandon the JDZ bid process and to proceed with its well publicized 2005 bid round. An additional concern expressed by some was that Nigeria would act to dissolve the JDZ and claim 60 percent of the area as its own. These perceptions had the potential to interfere with impartial decision-making and further clouded the transparency of the Second Round process.

Some of the lack of transparency and regularity in the Second Round may be attributable to the haste with which the Round was initiated. The JDA and other officials advanced several cogent justifications for the brevity of the Second Round. For example, the JDA felt compelled to respond quickly to its failure in the First Round to secure attractive licensees. The JDA also was concerned about its reputation for professionalism and integrity within the international oil industry community. Further, the JDA hoped to complete its Second Round in advance of the Nigerian offshore auction scheduled to take place in 2005. However, auctions with financial implications of this magnitude require that adequate time be made available to promote the bid round to attractive and qualified companies. Further, potentially interested companies who had not participated in the First Round needed to have adequate time to evaluate the data for the acreage being offered, to consider the financial and technical terms under which they might bid, and to prepare and submit timely bids. The abbreviated timeframe established for this Second Round was not consistent with these requirements.

Timing aside, the political jockeying in the award process is evident from the description of the negotiations over the five and a half month period between the opening of the bids and the final announcement of awards. This, of course, accounts for a large part of the apparent inconsistencies in the basis of awards. Further, the percentage participation of numerous small and apparently inexperienced companies not only raises questions about the assessment criteria, it also makes it unclear how the final awards correspond to the bids submitted in this Second Round. Consider for instance the lack of a rationale as to why some of the high bids did not receive awards. Some inexperienced entities bid in consortia, in particular ERHC bid with the US independent oil companies

³⁰ Nigeria advanced São Tomé and Príncipe money to sustain its share of the JDA's expenses and had provided São Tomé and Príncipe with certain oil products or crude oil on a preferential basis. Further, in May 2005, at the time of President Obasanjo's visit to São Tomé and Príncipe, Nigeria had not authorized the release of the São Toméan share of the \$123 million signature bonus that had been paid to the JDA for Block 1. The JDA had been instructed to deposit the signature bonus in a first class international bank pending distribution to the two countries, but the JDA instead deposited the money in a Nigerian bank, Hallmark, the same bank where the JDA operating account was held. The bank is now the subject of a Nigerian fraud investigation with respect to the disappearance of Nigeria's share of the First Round bid bonus. Fortunately, São Tomé and Príncipe was able to have the JDA release the monies owed to it upon completion of the Second Round and the funds were transferred to Sao Tome's oil account at the New York Federal Reserve Bank.

Devon, Pioneer and Noble.³¹ However, small companies earned participation interests in *all* of the blocks, and it is difficult to discern a rationale for the JDA's joinder of the various companies within the different blocks. While pre-formed consortia are often allowed to bid in international auctions, the forced insertion of parties into blocks is inconsistent with the basic principle of competitive bidding. It also is difficult to ascertain whether the bids of these companies are consistent with the final award configurations. Further, superficially, there are no companies in Blocks 5 and 6 that appear to have the technical capability in deep water to effectively perform as a block operator.

As the São Toméan National Petroleum Agency noted in its report, these insertions have the potential to result in economic distortions that are adverse to the interests of the JDA and to both São Tomé and Príncipe and Nigeria. The possibility of such insertions may discourage bidding by financially strong and technically competent parties and can lead to the failure of particular bid awards when the inserted companies are unable to meet the financial commitments, including necessary letters of credit or future capital call, for participation in a block.³² In effect the inserted companies are given a "free" option at the expense of the other bidders and the licensing countries. If they are not able to sell out their interest to the operator or if subsequent events (e.g., changes in market prices or information becoming available from drilling on other blocks) change the market valuation of the block, the companies can simply default without penalty and not enter into the production sharing agreement with the JDA or fail to pay the signature bonus when due.

Moreover, the distribution of interests within several of the blocks may prove to be detrimental to the long-term development program in the JDZ. The involuntary combination of a number of unrelated companies encumbers the ability of the operator to perform effectively and efficiently.³³ Multiple parties likely will increase the costs for, and the administrative burden on, both the members of the involuntary consortia and the JDA and may even cause a bid to fail entirely where the inserted parties are not able to satisfy their letter of credit and capital call requirements.³⁴ Moreover, such companies

³¹ Devon and Noble each subsequently withdrew from their consortia with ERHC even though the consortia had received an award.

³² The parties forced into a block must enter into a joint operating agreement before executing the production sharing agreement with the JDA or must buy out such interests. The production sharing agreement would typically require the posting of a letter of credit or appropriate parental guarantees by financially rated companies to guarantee the work program commitment and the company's ability to meet future capital calls. The inability of companies to provide such financial guarantees may require the operator to buy the interest out or to risk losing the block entirely.

³³ ExxonMobil was able to insist that ERHC not be a party to any block in which ExxonMobil exercised its rights. ERHC's preferential rights were limited accordingly.

³⁴ As noted above, production sharing agreements typically require the posting of a letter of credit or appropriate parental guarantees by financially rated companies to guarantee the work

may have reputational concerns, whether justifiable or not, that make them unattractive partners for Western firms subject to anti-bribery and other legislation such as the Foreign Corrupt Practices Act.

Just the possibility of such insertions may discourage bidding by financially strong and technically competent parties. This may be one reason for the lack of interest expressed in the Second Round blocks by many of the experienced industry companies despite the fact that, in the interim between the First Round and the Second Round, oil prices and the expectations regarding future oil prices had significantly increased. The lack of such bidders increases the likelihood that commitments will not in fact be fulfilled and may drive down signature bonuses and work commitments. It is notable that recent rounds conducted by Libya and others where procedures were highly transparent have resulted in both significant bidding by the majors and capture by the country of a very high proportion of future expected returns. In short, these block configurations likely did not serve the interests of the JDA or São Tomé and Príncipe.

The JDA maintains that its block interest allocations were designed to balance the JDA's need to attract reputable, experienced bidders with its desire to attract new investors and local enterprises, to promote technological transfer, and to encourage an increasing economic activity in both São Tomé and Príncipe and Nigeria. These are reasonable goals, but these needs, however, are met with the local content requirements typically imposed on bids.³⁵ Block interests are purely financial interests of benefit to the preferred investor. As noted earlier, the inserted companies, which are not operators, are in effect given a free option. They can shop their interest to the designated operator or to others, and if unsuccessful they can simply drop out by not paying their share of the signature bonus or by failing to meet subsequent capital calls.

To summarize, the JDA's conduct of the Second Round lacked transparency and regularity. The haste with which the Second Round was initiated did not allow the JDA adequate time to promote the Round, nor did it provide potential new investors sufficient time to evaluate the acreage being offered, to consider bid options, and to prepare and submit timely bids. Further, the content of the *Updated Guidelines* did not adequately inform bidders of the bid evaluation criteria, and the bidder qualification processes failed to screen bidders in a transparent fashion on the basic criteria of their technical, financial, legal, management; and administrative capacity.

The determination of the final allocation of interests in the blocks also lacks transparency. It is unclear why the JDA did not award interests to several of the high

program commitment, and each member would be required to post such a letter of credit as well as meeting capital calls as work progresses. Newspaper reports indicate that the inability of unwillingness of some of the smaller parties to provide the necessary financial guarantees has become an impediment to the execution of agreements pursuant to Second Round awards.

³⁵ Consider the Brazilian ANP's Seventh Bid Round Edital for its local content requirements.

bidders, and it is unclear why or how the JDA joined the various companies in each of the blocks. These irregularities not only appear to be inconsistent with the JDA's own Updated Guidelines, they also do not conform to industry norms.

The conduct of the Round is particularly disconcerting in light of São Tomé and Príncipe's often stated strong commitment to transparency and best practices. Beginning in 2003 President de Menezes sought examples of how to protect potential oil revenues. In late 2004, São Tomé and Príncipe's National Assembly unanimously approved a groundbreaking oil revenue management law, signed into law by President de Menezes at the end of 2004. The law provides for the creation of a National Oil Account for the deposit of all oil revenues; the sound management of the account, including the allocation of 10 percent of the annual oil revenue to the autonomous region of Príncipe; the establishment of a Permanent Reserve Fund to preserve a financial resource for future generations; the annual audit of the oil accounts by both the local Audit Office and international audit firms; the establishment of a Public Information Office; requirements for transparent procedures and the publication of various documents; and the creation of an eleven-member Oil Control Commission to monitor all payments and expenditures.³⁶ The law is applicable to all São Toméan officials, including those participating in the activities of the JDA. It requires those officials, in conjunction with the representatives of Nigeria, to implement the Abuja Joint Declaration.

The Abuja Joint Declaration, attached as Appendix G, is a nine-point agreement signed by Presidents Obasanjo and de Menezes providing for full transparency in payments, expenditure, and other transactions in the JDZ. In particular, all bids, all payments and all contracts are to be made public. The guidelines for reporting under the Declaration were to be consistent with those of the Extractive Industries Transparency Initiative ("EITI"). All the information to be made public was to appear on the JDA's website.³⁷ Unfortunately, the JDA has not complied with these requirements with respect to the First, let alone the Second Round.³⁸

These failures are not cheap. The inadequacy of the procedures reduces potential signature bonuses and the insertion of financially or technically unqualified companies risks could lead to inefficient development or worse no development, of the blocks. All of these costs will be borne by Sao Tome and Principe.

³⁶ The Oil Commission was assisted in the drafting of the law by a consulting group paid by the World Bank and a team from the Earth Institute of Columbia University working *pro bono*. The website of the Earth Institute provides detailed information on the law, <http://www.earthinstitute.columbia.edu/cgsd/STP/>.

³⁷ www.nigeriasaotomejda.com.

³⁸ The production sharing agreement signed with Chevron has not been made public by the JDA or either of the JDZ member governments. The only provision which has been made public is one requiring the disclosure of the already known signature bid.

IV. RECOMMENDATIONS AND ACTION

The serious deficiencies identified in the Second Round are rectifiable in the future by the adoption by the JDA of “best practice” bidding procedures currently being employed elsewhere and by the strict adherence to such standards. A number of countries have now adopted highly transparent, non-discretionary bid systems that limit the possibility of irregularities and, equally important, help maximize the amount of government revenue. Although exact structures vary, good general examples of such systems include the recent bid rounds in Libya which produced government take up to 90 percent in some cases, a similar system in Brazil,³⁹ and, in a number of respects, the recent bid round in Nigeria for its own territorial waters.⁴⁰

These and other systems incorporate a number of critical features.

1. Bidders or pre-formed consortia must meet technical and financial qualifications as well as exhibiting satisfactory health, safety and environmental records *in advance* of the bidding.⁴¹ These qualifications may differ for operators and strategic investors, but all members of any bidding coalition must be qualified. Technical qualification requires demonstrated experience, e.g., no party should be permitted to bid as operator for deepwater tracts without deepwater drilling experience. All bidders should be required to demonstrate their financial commitment to the bid process by posting a bid bond or other financial guarantee. Strategic investors and operators must demonstrate the financial capacity to carry their interests with either bank guarantees from first-class banks or parental guarantees from entities with investment grade credit. Particularly, in times such as these when financial transactions are subjected to such intense scrutiny, all controlling interests in the bidders must be identified.⁴²

Although financial capacity is a critical element in qualification, the requirements for bank and parental guarantees should not be unreasonably onerous as they have a cost,

³⁹ For information about the Brazilian system, see <http://www.brasil-rounds.gov.br/index.asp> (English version <http://www.brasil-rounds.gov.br/english/index.asp>).

⁴⁰ For an overview of the Nigerian process, see http://www.nnpc-nigeria.com/index.php?option=com_content&task=view&id=64&Itemid=2. Of note, the Nigerian Bid Round included an international observer. As of this writing his report has not yet become available.

⁴¹ In the case of a consortium, the production sharing agreement or license should require that the joint operating and other agreements among the members be subject to the approval of the governmental authorities.

⁴² To protect the financial and technical integrity of the project, the production sharing agreement should incorporate change of control provisions requiring governmental approval of such changes subject to certain exceptions. These provisions should apply to indirect changes in control by parties by making the agreement subject to termination if such changes are not approved. This prevent speculative bidding by technically unqualified companies.

and financial capability should not be so stringent as to prevent the participation of smaller companies in consortia. To protect the government in such cases, however, all members of any consortium should be jointly and severally liable to the government. This requires that the operator or stronger members of the consortium then take financial responsibility for any of the weaker members.⁴³ Joint and several liability is, of course, manifestly inconsistent with the insertion into the consortium of partners by the awarding authority.

All bidders should be publicly pre-qualified in advance of the bidding. This procedure avoids the ex-post technical evaluation that occurred in the Second Round and the allegations of abuse that accompanied such evaluation. It also limits the universe of bidders and inhibits politically-motivated insertions.

2. All of the elements of the bid should be fixed except for the variable or variables being bid. If more than one variable is being bid, the formula for relating the variable when determining the winners should be fixed. In each case, the form of the production sharing agreement or license agreement should be finalized in advance and made public, and no material variation should be permitted.⁴⁴ It is desirable before finalizing the form of the agreement to invite industry comment, but, prior to the actual bidding, the final contract should be made a part of the bid documents/requirements and should not be subject to negotiation after the bid opening. The use of standardized documents and pre-qualification should allow contracts or licenses to be signed and financial guarantees put in place within a fixed period such as 30 days after the bids are opened.⁴⁵ Any bidder not executing the agreement within such period should be

⁴³ The consortium members of course will have indemnification agreements amongst themselves, but the government must also be protected by requiring the joint and several liability of all members. A number of other critical issues of liability, e.g., liability under local law of the operator and other partners to third-parties, must be addressed. These may be addressed, however, in provisions in the production sharing agreement, including, for instance, provisions requiring insurance programs with the government as co-insured.

⁴⁴ Historically, production sharing agreements often were negotiated on an individual basis, a process which favored oil companies. This is no longer necessary, however, with the availability of strong public models of production sharing agreements and with the access of governments to experts to assist them in drawing up such agreements. As noted in the text, it is still possible to seek industry input by allowing a comment period on a draft agreement in advance of bidding and then by making a revised and final form of agreement part of the bidding protocol.

⁴⁵ Any bid round will have to take account of any remaining preferential rights of ExxonMobil and ERHC if those rights are left in place. This may require an interval between the opening of the bids and the final award to permit the exercise by ExxonMobil or ERHC of their respective rights. The bids as opened should be fixed subject only to such exercise. Any exercise should be subject to either company subscribing to both the production sharing contract (which should be standardized) and subscribing to a joint operating agreement as reasonably prescribed by the winner bidder or consortia and providing any financial guarantees required by either agreement. Failure to do so should extinguish the option.

disqualified and subject to the loss of its bond or guarantee. In addition to posting bids and televising the opening, the final contracts should be posted on the authority's website to assure conformity with the bid requirements.

The work program can be pre-established, or it can be one of the variables being bid. For instance, in the Libyan bid round the work program was one of the bid requirements; all bidders knew what obligations they would incur and could cost matters accordingly. In the Libyan bid, the government take and the signature bonus were the only variables, and the signature bonus was used only to break ties.⁴⁶ Thus, upon opening the bids, the Libyan authorities could immediately announce the winner. The actual ceremony was televised, and the winners were immediately announced.

If the work program is an element to be bid, as it was in the recent Nigerian round, there should be a standard formula for its evaluation. The Nigerians did this with pre-assigned values for wells to be drilled, seismic surveys to be performed, and discount rates to be applied.⁴⁷ A standard work sheet was provided to the bidder, which sheet provided the present value calculation of the value of the work program once the bidder filled in the number of wells and their timing. Thus, when the bid was opened, the present value of the work commitment was already established and could be added to the signature bonus to determine the high bid at the time the bids were opened.

3. The terms of the finalized production sharing agreement should include local content requirements (e.g., minimum percentages for local procurement) and local training (e.g., minimum percentages for employment of local professionals).⁴⁸ This

⁴⁶ Although there has been much focus on signature bonuses, especially important for São Tomé and Príncipe at the present time, relying on signature bonuses as the variable, instead of the share of government take, is likely to result in lower returns to the country. The signature bonus is money that is essentially "borrowed" from the oil company until production begins and the amount must be discounted by both the company's expected rates of return and the uncertainty associated with drilling.

⁴⁷ The use of assigned values for wells also avoids inflated estimates by bidders of the value of their work program.

⁴⁸ In its latest bid round Nigeria has provided for a minimum of local ownership by requiring that each consortium reserve 10 percent for local content vehicles, local companies which are separately qualified. That process itself has not been transparent, although perhaps with more experience it could be developed. One advantage to specifying simple percentages of local procurement and local hiring is that the requirements leave in place competitive selection and eliminates government discretion and the potential for corruption or favoritism. At the same time, it builds the oil support sector that allows local companies to become significant players. Particularly where two countries are as imbalanced in their populations and their experience with oil as are São Tomé and Príncipe and Nigeria, a reservation for local investors is likely to be problematic. The involvement of ERHC illustrates this dynamic. ERHC's preferential rights reportedly are being deducted from São Tomé and Príncipe's share of JDA revenues even though ERHC is controlled by the Nigerian company, Chrome. If a local company is to be required as a partner, the company should be part of the bidding consortium rather than being separately

ensures governments that their interests are protected without engaging in additional negotiation and often speculative counting of local benefits. It also avoids the possibility that a company may offer a project of particular attraction to a decision maker in exchange for more favored treatment. Between the specified local content and local employment requirements and the enhanced revenue of a transparent bidding process, the government will be able itself to determine what projects to undertake without adversely affecting the bid process. The government also will be able to ensure itself that it is getting top dollar for its resources. Specifying the local content and training requirements, including the allocation of these requirements between the partner countries, is particularly important in a joint development zone such as the JDZ where the two countries have vastly different resources and experience. The political issues, if the division of the local content requirement is not exactly along the lines of revenue sharing, can and should be resolved in advance of bidding.

4. To limit or avoid conflicts of interest, all members of the JDA and the JMC should be required to disclose publicly any economic interests which they or their families hold in any of the bidding entities. In addition the JDA should comport itself in accordance with the requirements of the Abuja Joint Declaration signed by President de Menezes and President Obasanjo. The provisions of the Declaration are consistent with best practice and will further insure the transparency and integrity of the bid process.

5. The JDA is not an autonomous body. Rather it is accountable to its creators, the governments of Nigeria and São Tomé and Príncipe and the citizens of those countries. Thus it is very important that the JDA maintain strong communications with both governments through meetings, wide circulation of documents, and informal professional contacts with the relevant agencies in both governments. Such communications are important for the better understanding of the issues confronting the JDA and to be sure that the representatives of each government can then be properly instructed. This is particularly important for São Tomé and Príncipe given the location of the JDA in Abuja. Abuja's remoteness has undoubtedly been an impediment to lawmakers and others in São Tomé and Príncipe to being fully informed of the JDA's work.

Informal and formal interchanges between professionals posted to the JDA and the professional staff of the respective governments would facilitate communication and, if effectively managed, could increase the efficiency of the JDA by potentially increasing the professionalism of the staff and by eliminating redundant or inconsistent activity. As noted previously, both Presidents de Menezes and Obasanjo have made a strong formal commitment to transparency. This commitment if fully and freely carried out should strengthen the JDA and its operations and in turn should increase the confidence of the two countries and their citizens in the JDA's activities.

selected, and the qualifications of the local company should ensure that it is more than simply a front for foreign interests. Only a single local partner should be required.

In implementing any of these procedures, the JDA may also want to consider the inclusion of international observers. Notably, Nigeria has done so in its latest round. Knowledgeable international professionals could not only assist the JDA with the structuring of its rounds, they also could through their presence and reports further enhance transparency and help rebuild industry confidence in the integrity of future bidding for blocks in the JDZ.

The adoption by the JDA of these reforms would have numerous advantages. First, it would remove allegations that its processes are political and would make awards more objectively verifiable. Secondly, by minimizing discretionary decisions the procedures will reduce both the opportunity and incentives for corrupt or politically motivated behavior on the part of bidders or officials. Thirdly, by re-establishing the integrity of the bid process and potentially eliminating unqualified companies, the procedures should attract to the bidding those companies who have the technical and financial resources to explore and develop São Tomé and Príncipe's territorial waters, including those in the JDZ. And fourthly, by taking full advantage of competition, it should allow the JDA to maximize its economic return, and hence the return to both São Tomé and Príncipe and Nigeria, on any future bidding for blocks in the JDZ.

One final recommendation is that the São Toméan government, the National Assembly and the President should take more advantage of the National Petroleum Agency in their work with the JMC and the JDA.⁴⁹ The leadership and staff of the NPA embody the country's oil expertise and which continues to grow as the NPA builds its own human capacity. Moreover, the professional staff of the NPA provides continuity and historical memory for the country as it moves forward with oil development and the implementation of oil policy.

In part to develop further its own capacities and to prepare itself for regulating future activity in the Exclusive Economic Zone, the NPA should have close links to the São Toméan professional staff posted to the JDA; indeed, it may be desirable to expand the role of the NPA by specifically providing that São Toméan appointees to the JDA be drawn from the permanent staff of the NPA. In any case there should be a close systematized liaison between personnel at the JDA and the NPA.

Major policy decisions are necessarily political decisions to be made by the government and the President, but those decisions should be informed by professional analysis and understanding. Moreover, once policy is established it requires oversight and implementation by well-qualified civil servants. This can be achieved most effectively by focusing capacity building efforts in the oil sector on the NPA and then utilizing the NPA to carry out and implement the policies of the nation.

One immediate challenge to the JDA may be the partial collapse of the Second Round itself. As of this writing no party awarded an interest has actually entered into a

⁴⁹ In the Second Round the National Petroleum Agency was not consulted at any stage until after the controversial awards of April 2005.

production sharing agreement with the JDA, and two parties to an operator group, Devon and Noble have withdrawn. Public reports further suggest that a number of awardees are unable or unwilling to provide the letters of credit or financial guarantees to the operator or to the JDA that would be necessary to assure that parties carry out the bid commitments.

Such behavior may reflect the actual financial condition of the prospective licensee or may be motivated by speculation as the interest holder buys time to await additional geological information⁵⁰ or changes in the oil market. And in the worst situations it may simply be motivated by the desire to force the operating interest to buy out the party's share so that the operator can in fact enter into a production sharing agreement. In any case it vividly demonstrates one of the problems of inserting parties into blocks and not requiring companies to qualify themselves financially before the bidding.⁵¹

As noted earlier the JDA has not in fact been able to execute agreements with the parties who received awards. To prevent further delay and to prevent speculation in licenses, this office recommends that the JMC should have the JDA require all parties for each block to execute with the JDA a production sharing agreement in the prescribed form by a fixed date and to deposit with the JDA an executed operating agreement among the parties.⁵² To limit speculation, the earliest possible date should be fixed for this performance. If an agreement is not executed by the set date, the award for the block should be vacated and it should be rebid pursuant to procedures consistent with the guidelines set out above.

⁵⁰ The value of the blocks may be affected very significantly as development in the Gulf of Guinea moves closer to the JDZ and as Block 1 is drilled. If the information from drilling in adjacent waters and structures or new seismic data is positive, the value of the leases will increase by some significant multiple. If the information is negative, awardees will try to back away from their commitments.

⁵¹ A similar problem has been encountered in Nigeria with respect to its latest bid round when parties were subject to mandatory "marriages" with local operating companies. Accordingly to press reports, only \$1 billion of the \$2.6 billion that was supposed to have been paid within 30 days of the bid opening in August has been committed to date. Under the announced rule any bidder that had not paid within 30 days was supposed to have its license cancelled, and the award was supposed to go to the second highest bidder. However, Nigeria has not taken such action and is apparently providing selective extensions, thus introducing another discretionary variable into the award process.

⁵² The JDA has already negotiated one production sharing agreement with Chevron for Block 1, and this agreement could be the model required of others to execute, modified only as necessary to reflect the agreed work program, necessary financial guarantees of future performance, and the transparency requirements of the Abuja Joint Declaration. This would be facilitated if the JDA were to make the Chevron production sharing agreement public in accordance with both best practices and the Abuja Joint Declaration. Although the JDA agreed to treat the Chevron agreement as confidential, this confidentiality commitment would appear to be beyond the authority of the JDA given the limitations provided in the Abuja Joint Declaration.

Where an operator fails to post the required financial commitment, the award for the block should also be vacated unless the JDA determines that another interest holder in the block is technically qualified to become the operator and that interest holder elects to do so and to provide the necessary letter of credit or financial guarantee. The time for any election by a party to become the substitute operator should itself be strictly limited.

The setting and enforcement of a fixed date for the execution of a production sharing agreement would enhance the likelihood that São Tomé and Príncipe and Nigeria will actually see the benefits promised in the bidding. To the extent that parties do have the financial capacity, and a desire, to go forward, the fixed date would assure both São Tomé and Príncipe and Nigeria earlier payment of the signature bonuses and an earlier start of the respective exploration periods. On the other hand the date would flush out situations where parties are not in fact prepared to go forward, allowing the JDA in such cases to revoke the awards and to move ahead either by promptly rebidding the blocks, following best practices, or to hold them until a more propitious moment for leasing.⁵³

V. FURTHER INVESTIGATION AND ACTION

This investigation was conducted on the basis of the JDA documents available to the São Toméan authorities in Sao Tome and Principe and voluntary statements by interested São Toméan individuals to the ISLP team assisting this office. Neither sworn testimony nor compulsory process was utilized in the investigation. Further, this office has not been able to examine the full records of the JDA available in Abuja nor has it been able to interview any officials there, even on a voluntary basis, other than those São Toméans who presented themselves in Sao Tome and Principe.

⁵³ As noted the values of the leases will be affected very significantly as new information becomes available. If the information from drilling in adjacent waters and structures or new seismic data is positive, the value of the leases will increase by some significant multiple. Of course, if the information is negative, it is possible that the remaining blocks will attract no interest.

Value will also be affected by expectations about future oil prices. At the time that the bids were opened for the Second Round, December 2004, the spot price of Brent crude oil was roughly \$40 per barrel. Today it is in the neighborhood of \$60 per barrel. Spot prices cannot form the basis for bids that depend upon production in the future, but it does appear that the future price expectations of most oil companies have increased recently as evidenced by the unexpectedly high bids in the Libyan and other current bid rounds.

It requires some judgment to determine which course is likely to maximize the financial benefits to São Tomé and Príncipe and Nigeria, and it may be beneficial for the JDA to consult with international experts as to the best strategy in this regard given what is currently known. At a minimum, it may be worth waiting for the results of 3-D seismic studies for Blocks 5 and 6 where such data does not currently exist.

This office has found serious procedural deficiencies in the conduct of the Second Round, but this office has not been able to establish on the available records and evidence the extent to which the conduct of the Second Round and the allocation of particular interests may have been improperly affected by conflicts of interest, political favoritism, or by payments or the transfer of value to any official or person, São Toméan or Nigerian. Nevertheless, the various ties identified in Appendix D strongly suggest the importance of political and other connections.

Many of the issues arising during the course of the investigation relate to the conduct of the Nigerian representatives to the JDA. Information relating to their conduct is subject to the control of the Nigerian authorities. Although this office has requested the assistance of the Nigerian Attorney General's office in this respect, no answer has been received.

Finally, São Tomé and Príncipe must address the existing contract with ERHC. Appendix H sets out the troubled and problematic history of this contract. All objective observers have found the contract in its various forms extraordinarily one sided, and yet the attempts to date to terminate the contract have always failed.

First, at every stage there is the suggestion that ERHC and its parent Chrome may have made improper payments to government officials or provided benefits to their families in order to secure the assistance of such officials in continuing the contract. Key officials in the past have been reported to have solicited bribes, and ERHC has provided known benefits to the families of key decision makers.⁵⁴ Such payments would be a violation of Sao Tomean law and may make the contract voidable. Since ERHC is a US publicly traded company, any improper payments by ERHC or Chrome as its agent to Sao Tomean or Nigerian officials would also violate the Foreign Corrupt Practices Act and would be subject to criminal prosecution in the United States. To this end this Office intends to refer this matter to the US Department of Justice and the Securities and Exchange Commission and to seek their assistance in investigating whether violations of US law have occurred and to make the results of that investigation available to the authorities in São Tomé and Príncipe.

Secondly, apart from fraud, São Tomé and Príncipe should again reexamine whether there are grounds for terminating the contract. Under the Constitution there is a question whether the officials signing the agreements had authority to alienate the nature resources of the country to the extent provided in the agreements. Further, in entering into the agreements the government may not have complied with procurement and other laws relating to the sale of natural resource interests or in the case of the 2003 Agreement the Treaty governing the JDZ. While some such failures might have been cured if the agreements had been approved by the National Assembly in a separate law, they were

⁵⁴ In 1999 ERHC (prior to Chrome's control) reported and later provided supporting affidavits that Carlos Gomes solicited a bribe which ERHC refused to pay. Gomes denied the charge. The contract was subsequently terminated, but after Chrome acquired control of ERHC, a new contract was renegotiated. See Appendix H.

not. Moreover, in the case of the 2001 Agreement and the 2003 Agreement, São Tomé and Príncipe was under considerable duress from the threatened actions of the Nigerian government in support of ERHC after control had passed to Chrome. And finally there are questions of unconscionability or mutuality given the enormous difference between the consideration paid by ERHC and the benefits it has received.

Third, even if the contract is left in place, São Tomé and Príncipe should seek to have Nigeria bear its share of the lost revenues from ERHC's exemption from paying the signature bonuses. The 2003 Agreement was explicitly acknowledged by the JDA, and any reduction of revenues should accrue to the JDA as a whole, not just to São Tomé and Príncipe. Under the Treaty all revenue is to be shared 60 percent to Nigeria and 40 percent to São Tomé. Examination of the 2003 Agreement, the Annex to that agreement, and the Treaty shows no evidence of an agreement between São Tomé and Príncipe and Nigeria to treat proceeds differently in blocks where ERHC obtained interests. Moreover, given the history of the 2003 Agreement, Nigeria's oversight of that agreement, and Chrome's ownership, it is appropriate as an equitable matter for Nigeria to bear its share of the reduction in signature bonuses paid to the JDA as a result of ERHC exercising its options under the 2003 Agreement.

APPENDICES

TABLE OF APPENDICES

APPENDIX A – INDIVIDUALS INTERVIEWED

APPENDIX B – INDEX OF DOCUMENTS REVIEWED

APPENDIX C – SÃO TOMÉ 2004 LICENSING ROUND CHART

APPENDIX D – OWNERSHIP INTERESTS AND DUE DILIGENCE REPORTS

**APPENDIX E – REPORT OF THE SÃO TOMÉ AND PRÍNCIPE NATIONAL
PETROLEUM AGENCY (MAY 6, 2005)**

**APPENDIX F – REPORT OF THE SÃO TOMÉ AND PRÍNCIPE NATIONAL
ASSEMBLY'S 4TH (PETROLEUM AFFAIRS) COMMISSION
(MAY 16, 2005)**

APPENDIX G – THE ABUJA JOINT DECLARATION

APPENDIX H – THE ERHC CONTRACT

APPENDIX A

INDIVIDUALS INTERVIEWED

Damião Vaz d'Almeida, former Prime Minister of São Tomé and Príncipe and vice-president of the Movement for the Liberation of São Tomé and Príncipe-Social Democratic Party (“MLSTP-PSD”)

Joaquim Rafael Branco, Director of Economic Affairs, National Petroleum Agency of São Tomé and Príncipe; former Minister of Natural Resources

Ângelo Bonfim, Legal Advisor to the President of São Tomé and Príncipe

Gabriel Arcanjo Ferreira da Costa, former Prime Minister, São Tomé and Príncipe; Vice-President of the UDD political party

Adelino Castelo David, former Minister of Planning and Finance of São Tomé and Príncipe and a former member of The Joint Ministerial Council (“JMC”) of the Nigeria-São Tomé Joint Development Authority (“JDA”)

Carlos Gomes, Chairman of the Board and Executive Director, Commercial and Investment Department, JDA Office in Abuja

Mateus ‘Nando’ Meira Rita, former Chief of Staff to the President de Menezes, now São Toméan Ambassador to Nigeria and Equatorial Guinea, Member of the Joint Ministerial Council

Carlos Neves, Vice President of the National Assembly of São Tomé and Príncipe; Chairman of the 4th Commission (Petroleum Affairs)

Delfim Neves, Member of the 4th Commission (Petroleum Affairs)

Alcino Pinto, Vice-Chairman of the 4th Commission (Petroleum Affairs)

Flavio Pires dos Santos, former Executive Director of the JDA in Abuja; Director in the JDA Office in São Tomé & Príncipe

Luís Alberto de Prazeres, Executive Director, National Petroleum Agency, São Tomé and Príncipe; former Director in the JDA Office in Abuja

Zafrino dos Santos Ceita, Accountant, JDA Office in São Tomé and Príncipe

Oscar Aguiar Sacramento e Sousa, Minister of Defense and Internal Affairs, São Tomé and Príncipe; Member, JMC

Eugenio Ten Jua, Assistant Director II, Commercial and Investment Department, JDA Office in Abuja

Edite Ten Jua, Legal Counsel, JDA Office in Abuja

Olegario Tiny, Assistant Director, JDA Office in São Tomé & Príncipe

Pedro Umbelina, Interim Assistant Director, JDA Office in São Tomé & Príncipe

Various Anonymous Individuals, a number of individuals interviewed wished to remain anonymous.

Key participants not interviewed: H.E. Ovidio Pequeno, Foreign Minister (abroad at time of interviews); Arlindo Ceita Carvalho, former Minister of Natural Resources and former Member of JMC (abroad at time of interviews)

APPENDIX B

INDEX OF DOCUMENTS REVIEWED

1	Nigeria – São Tomé & Príncipe, Joint Development Authority, Resolution of Third Party Interests and its Effect on Blocks Offered for Tender in the JDZ Year 2003 Licensing Round	05/02/03
2	Nigeria – São Tomé & Príncipe, Joint Development Authority, Press Statement	04/24/04
3	The Abuja Joint Declaration regarding Transparency in the Joint Development Zone between the Federal Republic of Nigeria and the Democratic Republic of São Tomé & Príncipe, by H.E. President Olusegun Obasanjo and H.E. President Fradique de Menezes	06/26/04
4	Nigeria – São Tomé & Príncipe, Joint Development Authority, 8 th Meeting of the Joint Ministerial Council of the Nigeria – São Tomé & Príncipe Joint Development Zone (JDZ)	10/29/04
5	Nigeria – São Tomé & Príncipe, Joint Development Authority, Resolution of Third Party Interests and its Effect on Blocks Offered for Tenders in the JDZ Year 2004 Licensing Round	11/04
6	Nigeria – São Tomé & Príncipe, Joint Development Authority, Guidelines for Investors in the 2004 JDZ Licensing Round	[11/11/04]
7	Report of the Licensing Round Committee of the Evaluation of Bids for the 2004 JDZ Licensing Round	12/04 [12/16/04]
8	JMC Meeting Folder, Special Meeting of the Joint Ministerial Council of the Nigeria – São Tomé & Príncipe Joint Development Authority	12/20-21/04
9	Letter to Alhaji Abubakar A. Tanko, Minister of State, Ministry of Foreign Affairs, Abuja, and Engr. Arlindo de Carvalho, Minister, Ministry of Natural Resources and Environment, São Tomé and Príncipe, from Carlos Gomes, Chairman of the Board, Nigeria – São Tomé & Príncipe, Joint Development Authority, RE: The 2004 JDZ Licensing Round	01/14/05
10	Letter to Mr. Carlos Gomes, Chairman of the Board, JDZ, from Arlindo Ceita de Carvalho, Minister of Natural Resources and Environment, Republica Democratica de S. Tome e Príncipe	01/18/05
11	Internal Memorandum to Mr. Carlos Gomes, Chairman of the Board, thru ED F&A, from Liaison Officer in the interim, RE: Letter from DRSTP Minister of NR&E to Chairman of the Board	01/21/05
12	Letter to Alhaji Abubakar A. Tanko, Minister of State, Ministry of Foreign Affairs, Abuja, and Engr. Arlindo de Carvalho, Minister, Ministry of Natural Resources and Environment, São Tomé and Príncipe, from Carlos Gomes, Chairman of the Board, Nigeria – São Tomé & Príncipe, Joint Development Authority, RE: The 2004 JDZ Licensing Round – Further Developments	01/25/05
13	Press Statement, Production Sharing Contract (PSC) on Block One in the Nigeria-São Tomé and Príncipe Joint Development Zone Signed	02/01/05

14	Memo No.: JMC-2005-04-3, Proposed Block Structure and Award for the 2004 JDZ Licensing Round	04/05
15	Nigeria – São Tomé & Príncipe, Joint Development Authority, Resolutions of the Joint Ministerial Council at the 9 th Meeting Held at Le Meridian Hotel, Abuja	04/26-28/05
16	JMC Recommended Position with initialed additions approved by Alhaji Abubakar A Tanko, for and on behalf of the Members of the Nigerian Joint Ministerial Council, and Engr. Arlindo de Carvalho, for and on behalf of the members DRSTP Joint Ministerial Council	[04/28/05?]
17	Position Paper - Joint Development Zone 2004 bidding round (Principles: Transparency, Technical and financial capabilities, Encourage indigenous participation)	[04/29/05]
18	Nigeria – São Tomé & Príncipe, Joint Development Zone (JDZ), Due Diligence Report on Some Companies that Participated in the 2004 JDZ Licensing Round	[05/2005?]
19	Letter to National Petroleum Agency from the Prime Minister's office, Damião Vaz de Almeida [Document in Portuguese]	05/02/05
20	Letter to Prime Minister from President de Menezes [Document in Portuguese]	[05/17/05]
21	Resolution No. 17/VII/05 of the National Assembly [Document in Portuguese]	05/19/05
22	Democratic Republic of São Tomé e Príncipe, National Assembly, Petroleum Affairs Commission, Report	05/19/05
23	Nigeria – São Tomé & Príncipe, Joint Development Authority, Resolutions of the Joint Ministerial Council at the Special Meeting held at Nicon Hilton Hotel, Abuja	05/24-26/05
24	Letter to the Chairman of the Board, Commercial and Investment Department, Nigeria-São Tomé & Príncipe Joint Development Authority, from Ali Emo, President & CEO, ERHC Energy, Inc., RE: Conclusion of the 2004 JDZ Licensing Round REF:3/M&I/JDA.92/104e	05/26/05
25	Press Statement, Announcement of Block Awards in the 2004 JDZ Licensing Round	05/31/05

APPENDIX C

SÃO TOMÉ 2004 LICENSING ROUND CHART

BLOCK 2

	Dec. 16, 2004 Licensing Round Committee Report						Jan. 14, 2005 JDA Letter	Jan. 18, 2005 DRSTP Letter	Jan. 25, 2005 JDA Letter	JMC April 2005 Memo	Unsigned Apr. 26-28 JMC Resolutions			April 29, 2005 Position Paper	May 24-26, 2005 JMC Resolutions	May 31, 2005 Final Awards		
Company	Technical		Commercial				Bona Fide High Bid	Revised Bona Fide High Bid	Revised Bona Fide High Bid		Harmonized Nigerian/DR STP position		Sign Bon.	Equity	Remark		Equity	Sign Bon
	Techn Eval	Rank	Bonus		Total						Equity	Remark						
Sign Bon			Rank	Comm. Offer	Rank													
A & Hatman LTD	61	4	80	3	88.4	1	Equator Exploration/O NGC Videsh - \$65 mil. Devon/Pioneer/ERHC - \$71 mil. (Equator Exploration/ONGC did not submit revised bid as requested)	Equator Exploration/ONGC Videsh – revised signature bonus \$85 mil.	Asking for harmonization of positions for Blocks 2 and 4	10	Nil	\$71 mil.	10	Nil	Adopted harmonized position on Blocks 2-6 as recommended at the April 26-28 JMC Meeting	10%	\$71 mil.	
Momo/OE/SOJITZ/Nisshoiwai/IMT	65	3	65	5	82.5	2				5	Nil		5	Nil		5%		
Equator Exploration/ONGC Videsh	71	2	65	5	71	3				10			15			30%		15%
Ocean Energy/Devon/Pioneer/ERHC	80	1	50	6	50.44	4				70 (incl existing rights)	Operator		65	Operator		60% Oper.		35% ⁵⁵ Oper. plus ERHC 30% rights
Continental Oil & Gas	40	5																
Foby Engineering Co. Ltd	34	6								5	Nil		5	Nil		10%		5%
Vintage Oil & Gas	25	7																

⁵⁵

Ocean Energy dropped from bidding group.

BLOCK 3

	Dec. 16, 2004 Licensing Round Committee Report						Jan. 14, 2005 JDA Letter	Jan. 18, 2005 DRST P Letter	Jan. 25, 2005 JDA Letter	JMC April 2005 Memo	Unsigned Apr. 26-28 JMC Resolutions			April 29, 2005 Position Paper	May 24-26, 2005 JMC Resolutions	May 31, 2005 Final Awards											
Company	Technical		Commercial				Bona Fide High Bid	Rev. Bona Fide High Bid	Rev. Bona Fide High Bid		Niger. Position		DRSTP Position		Sign Bon.	Equity	Remark		Equity	Sign Bon.							
	Techn Eval	Rank	Bonus		Total						Equity	Remark															
			Sign Bon.	Rank	Com. Offer	Rank																					
Ocean Energy/ Devon/ Pioneer/ ERHC	80	1	40	2	47	1	Ocean Energy/Devon/Pioneer/ERHC - \$40 mil.	Same	Same	Asking for harmonization of positions for Blocks 2 and 4	25	Nil	20	ERHC Existing Rights	\$40 mil.	25	Nil	30%	Adopted harmonized position on Blocks 2-6 as recommended at the April 26-28 JMC Meeting	25% ⁵⁶ (incl. ERHC 20% option)	\$40 mil.						
EER/DNO	70	3	41	1	41.5	2							51	Oper.								10	Nil	50% Oper.	10%		
Sahara Fields Ltd/ Denham/ Wood Group	66	4	37.5	3	40.7	3							5	Nil								10	Nil	10%			
Anadarko	80	1	NC	NC	NC	NC							55	Oper.										51	Oper.	51% Oper.	
Broadlink Pet./Ophir Energy Ltd	65	5	36	4	37.7	4							5	Nil								9	Nil	4	Nil	10%	4%
Equinox Oil & Gas/Equino & Energy /Arcadia/ Petro Chin.	60	6	35	5	37	5							10	Nil								10	Nil	10	Nil		10%

⁵⁶ Ocean Energy dropped from bidding group.

BLOCK 4

Company	Dec. 16, 2004 Licensing Round Committee Report						Bona Fide High Bid	Jan. 14, 2005 JDA Letter	Jan. 18, 2005 DRSTP Letter	Jan. 25, 2005 JDA Letter	JMC Apr. 2005 Memo				Unsigned Apr. 26-28 JMC Resolutions			Apr. 29, 2005 Position Paper	May 24-26, 2005 JMC Resol	May 31, 2005 Final Awards							
	Technical		Commercial					Rev. Bona Fide High Bid	Rev. Bona Fide High Bid	Niger. Position	DRSTP Position		Sign Bon.	Equity	Remark			Equity	Sign Bon.								
	TechnE val	Ran k	Bonus		Total						E q u i t.	Re mk								Equity	Re mk						
Conoil Producing	70	5	150	2	179	1	Hercules Oil Ltd - \$81 mil.	Anadarko Petroleum - \$90 mil. (*In light of clarifications by Anadarko)	Revisit all bids for new decision taking into consideration higher bonus offers, in particular \$175 mil.	Asking for harmonization of positions for Blocks 2 and 4	20	Nil	25	Nil	\$90 mil.	20	Nil	15%	Adopted harmonized position on Blocks 2-6 as recommended at the April 26-28 JMC Meeting	20%	\$90 mil.						
Anadarko	80	1	NC	NC	NC	NC																					
Hercules Oil Ltd	75	3	81	3	91.6	2							5	Nil		10	Nil			10		Nil				10% ⁵⁷	
ATLAS	70	5	70	4	78	3																					
EER/Roc Oil	70	5	67	5	66	4																					
Equator Exploration/O NGC Videsh	71	4	60	6	66	4																					
Godsonic Oil	60	9	60	6	65.5	6							5	Nil						5		Nil					5%
Overt Ventures /Addax Petr	66	8	60	6	63.9	7										10	Nil			5		Nil					5%
Noble/ERHC	80	1	57.285	9	62	8							70	Oper.		25 existing rights	Nil			60 (including rights)		Oper.	35%				35% Oper. plus ERHC 25% option
ECL	41	10																									

⁵⁷ Centerion added to bidding group.

BLOCK 5

	Dec. 16, 2004 Licensing Round Committee Report						Jan. 14, 2005 JDA Letter	Jan. 18, 2005 DRS TP Letter	Jan. 25, 2005 JDA Letter	JMC Apr. 2005 Memo	Unsigned Apr. 26-28 JMC Resolutions			Apr. 29, 2005 Position Paper	May 24-26, 2005 JMC Resol	May 31, 2005 Final Awards				
Company	Technical		Commercial				Bona Fide High Bid	Rev. Bona Fide High Bid	Rev. Bona Fide High Bid		Harmonized Nigerian/DRS TP Position		Sign Bon	Equity	Remark		Equity	Sign Bon		
	Tech nEval	Rank	Sign Bon.	Rank	Com. Offer	Rank					Equity	Remark								
ICC/Oil Exploration & Operations Company	68	1	37	1	43.1	1	ICC/Oil Exploration Operations Company - \$37 mil.	Same	Same	Asking for harmonization of positions for Blocks 2 and 4	75	Oper.	\$37 mil.	75	Oper.	No award, subject to due diligence	Adopted harmonized position on Blocks 2-6 as recommended at the April 26-28 JMC Meeting	75% Operator	\$37 mil.	
Sahara Fields Ltd/Denham/Wood Group	66	2	35	2	42.5	2					10	Nil		10				Nil		10%
<i>ERHC (*Existing Rights Only)</i>	N/A	N/A	N/A	N/A	N/A	N/A					15 existing rights	Nil		15 (Existing Rights)				Nil		Exercised 15% option

BLOCK 6

	Dec. 16, 2004 Licensing Round Committee Report						Jan. 14, 2005 JDA Letter	Jan. 18, 2005 DRS TP Letter	Jan. 25, 2005 JDA Letter	JMC Apr. 2005 Memo	Unsigned Apr. 26-28 JMC Resolutions			Apr. 29, 2005 Position Paper	May 24-26, 2005 JMC Resol	May 31, 2005 Final Awards			
Company	Technical		Commercial				Bona Fide High Bid	Rev. Bona Fide High Bid	Rev. Bona Fide High Bid		Harmonized Nigerian/DRS TP Position		Sign Bon	Equity	Remark		Equity	Sign Bon	
	Tech Eval	Rank	Bonus		Total						Equity	Remark							
			SignBon.	Rank	Com. Offer	Rank													
Filtim Huzod Oil & Gas Ltd/ SINOPEC/ EER-DNO	60	1	45	1	53.4	1	Filtim Huzod Oil & Gas Ltd/ SINOPEC/ EER-DNO - \$45 mil.	Same	Same	Asking for harmonization of positions for Blocks 2 and 4	85	Oper.	\$45 million	85	Operator	No award, subject to due diligence	Adopted harmonized position on Blocks 2-6 as recommended at the April 26-28 JMC Meeting	85% ⁵⁸ Operator	?
<i>ERHC (*Existing Rights Only)</i>	N/A	N/A	N/A	N/A	N/A	N/A					15 existing rights	Nil		15 (Existing Rights)	Nil				Exercised 15% option

⁵⁸ DNO added to bidding group.

APPENDIX D

OWNERSHIP INTERESTS AND DUE DILIGENCE REPORTS*

	COMPANY	DUE DILIGENCE		REMARKS/OWNERSHIP INTERESTS
		ROUND 1**	ROUND 2***	
Block 2				
	A & Hatman LTD		Yes	Private Nigerian company controlled by Anenih family; Chief Anthony Anenih was former Minister in Obasanjo government and PDP official.
	Momo Oil & Gas		Yes	Isle of Man Company; directors Mark Lewin, Martin Hall, and Niger Bolt; may be linked to Nigerian businessman Mohamed Asibelua, investment adviser to President de Menezes.
	SOJITZ			Japanese company, formed by merger of Nissho Iwai and Nichimen; may have links to Asibelua.
	NISSHO IWAI			Japanese financial entity.
	IMT Int.			Italian drill making company.
	Equator Exploration		Yes	Publicly-traded BVI company chaired by Wade Cherwayko, traded on London's AIM; due diligence suggests reputational concerns; Cherwayko, Miguel and Patrice Trovada are believed to have been instrumental in bringing about the 2001 deal between Sao Tome and ERHC.
	ONGC Videsh		Yes	Indian National Oil Company
	Devon		Yes	U.S. Independent/ withdrew
	Pioneer		Yes	U.S. Independent
	ERHC	Yes	Yes	US public company, controlled by Chrome Energy owned by Nigerian businessman Sir Emeka Offor, known to be an ally of President Obasanjo. Some shares held by Mateus "Nando" Meira Rita, formerly Chief of Staff to Sao Tome and Principe President and now Sao Tomean Ambassador to Nigeria and Equatorial Guinea. and Principe.

* This information has been taken from public documents, due diligence reports to the Joint Development Administration, and newspaper reports. It has not been subject to independent verification.

** Clearwater Research Services Ltd, January 2004.

*** Arrowhead Consulting Ltd and Sulaimon Associates Ltd, undated.

	COMPANY	DUE DILIGENCE		REMARKS/OWNERSHIP INTERESTS
		ROUND 1 **	ROUND 2 ***	
	Foby Engineering Co. Ltd	Yes	Yes	Respected Nigerian company, biggest indigenous dredging company in Africa, , owned by Nigerian businessman Emmanuel Efobi and Mrs. Sarah Efobi; company owns substantial shares in leading Nigerian First Atlantic Bank
Block 3				
	Devon		Yes	See Block 2
	ERHC	Yes	Yes	See Block 2
	EER			Partnership between Norwegian EER and individual shareholders, including Olav Eimstad who is also its president; significant interest owned by Nigerian businessman Aliko Dangote, supporter and funder of Nigerian President Obasanjo
	DNO (Det Norske Oljeselskap)		Yes	Norwegian public company
	Anadarko	Yes		Large publicly held U.S. Independent; CEO is James Hackett, formerly VP of Devon Energy and CEO of Ocean Energy
	Broadlink Pet.		Yes	Nigerian; Directors Mohammed Dikko Ladan, Othman Ladan Baki; ownership unknown
	Ophir Energy Ltd		Yes	South African/British/ Australian, allied to Mvelaphanda Resources, one of South Africa's largest black empowerment groups, whose CEO is ANC Tokyo Sexwale; set up by ex-directors of Australian Fusion Oil and Gas; .
	Equinox Oil & Gas		Yes	Nigerian company controlled by Mohamed Asibelua, investment adviser to President de Menezes; other shareholders include, Ahmed Mohammed, Aliyu Maccido, Balewa Uvo and Tim Osayimwen.
	Equinox Energy Limitada		Yes	Sao Tomean subsidiary of Equinox Oil and Gas, 90% owned by Mohamed Asebelua and 10% owned by Ana Isabel Meira Rita, sister of Mateus "Nando" Meira Rita, formerly Chief of Staff to Sao Tome and Principe President and now Sao Tomean Ambassador to Nigeria and Equatorial Guinea.
	Petrochina			Chinese State Company
Block 4				
	Conoil	Yes		Controlled by Nigerian businessman Mr. Mike Adenuga; Adenuga controls Globacom, a Nigerian telecommunications company and Equatorial Trust Bank; business partners with former Nigerian president General Ibrahim Babangida

	COMPANY	DUE DILIGENCE		REMARKS/OWNERSHIP INTERESTS
		ROUND 1 **	ROUND 2 ***	
	Hercules Oil Ltd			Nigerian, understood to be a start-up formed as part of the Centurion bid
	Centurion		Yes	Canadian public company; CEO, Said Arrata, was co-director with Wade Cherwayko of Abacan, a company that went bankrupt with \$1 billion in investments; major shareholder, Saudi Delta Oil
	Godsonic Oil and Gas		Yes	Nigerian; Okoye Godson, Colin Egemuonye and Michael Kayode directors; ownership unknown
	Overt		Yes	Nigerian; Lazama Ndionyenma, Pius Akinyelure and Lawrence Erhabor, directors; ownership unknown
	Addax		Yes	Swiss parent company
	Noble		Yes	U.S. Independent (withdrew)
	ERHC	Yes	Yes	See Block 2
Block 5				
	International Commerce Co. Ltd		Yes	Nigerian, initial directors and shareholders , Alh. Gambo Jimeta, former Minister of Agriculture and former Inspector General of Police, Alh. Mustapha Umar, and Dr Abe Mohabam
	OEOC Consortium		Yes	Iranian, thought to be linked to Akbar Hashemi Rafsanjani, the former Iranian president.
	Sahara	Yes		Assumed to be affiliated with Sahara Energy Fields, set up by Tonye Cole, Tope Shinobi, former presidential aide to President Obasanjo and Ade Odunis; company has a relationship with Ghana's Chief Kojo Nyenteki
	Denham			No available information
	Wood Group			
	ERHC	Yes	Yes	See Block 2
Block 6				
	Filtim-Huzod Oil & Gas	Yes		Nigerian businessman Chief Hope Uzodinma, PDP official, now close to President Obasanjo; close to several senior officers under military rule in the 1990s
	SINOPEC		Yes	Chinese State Company, publicly listed
	EER			See Block 3
	DNO ASA		Yes	See Block 3
	ERHC	Yes	Yes	See Block 2

APPENDIX E

REPORT OF THE SÃO TOMÉ AND PRÍNCIPE NATIONAL PETROLEUM AGENCY (MAY 6, 2005)

LEGAL OPINION

Subject: Licensing round of the five oil blocks subject to the second auction by the Nigeria – Sao Tome and Principe Joint Development Authority, organized in 2004.

I – Introduction

A. Legal Framework of the National Petroleum Agency

The National Petroleum Agency of Sao Tome and Principe, NPA-STP, was instituted by the Decree-Law N. 5/2004. Article 2 of the aforementioned Decree-Law establishes its mandate as follows:

- 1. The NPA-STP is the regulatory body of the oil industry, with the responsibility to execute the National Petroleum Council orientations.*
- 2. The NPA-STP carries out its functions under the auspices of the Minister responsible for the oil sector.*
- 3. The NPA-STP is charged with regulating, contracting and overseeing the economic activities within the oil industry.*

In turn, the Bylaws of the NPA-STP, annexed to the aforementioned decree-law, recognize within the scope of the specific attributions of the Executive Director in Article 16(g) that the Executive Director must “Maintain regular and daily relations with the Joint Authority of the Joint Development Zone.”

In fact, however, even though this rule is part of a Decree-Law a serious pathology obviously affects its efficacy. The Treaty between the Republic of Nigeria and the Democratic Republic of Sao Tome and Principe which creates the Joint Exploration Zone between the two countries and the Joint Authority has superior legal status domestically and does not establish a direct relationship between the NPA-STP and the Joint Authority.

Under the aforementioned Treaty, the relationship between the two State-Parties and the Joint Authority formally materializes through the Joint Ministerial Council meetings. The Minister responsible for the oil sector ensures the contact between the country and the Authority. In case of deadlock, an appeal is made to both Chiefs of State, under the terms and conditions established by the Treaty.

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Furthermore, no binding rule defines the nature or the content of such “*regular and daily relations*”, or expressly organizes and regulates the meaning and the scope of such relations.

Thus, it can be said that the relation between the NPA-STP and the matters which are object of activity and responsibility of the Joint Authority is residual and NPA-STP only answers requests made by any of the bodies whose relationship with the Joint Authority is formally and efficiently established, through the competent Minister.

Therefore, it is appropriate to reassert here that no authorized person or entity has ever requested a legal opinion or judgment from the Agency about the proposed adjudication of interests in the oil blocs to companies qualified in the second licensing round, organized by the Joint Authority.

B. Preliminary Considerations

In a letter dated from May 2, 2005, from His Excellency the Prime Minister and Chief of State, a legal opinion was requested to the National Petroleum Agency about the referenced matter. It is relevant to say that the subject matter of the legal opinion stands in the confluence of the political and the technical nature, the latter encompassing economic, legal, political and specifically technical dimensions. In the strict respect of the authorization conferred to the National Petroleum Agency by the law that created it, matters of political scope that find recourse in a proper forum will not be discussed by the Agency.

The context in which this legal opinion is requested also requires a fundamental clarification for the understanding of its meaning and scope. Indeed, this legal opinion has been requested *ex post*, that is, after the emergence of a big controversy that has extended beyond the limits of the national frontiers of the two State-Parties, involving protagonists of several political orientations and interests. The news and the contradictory and controversial declarations have already spread through the specialized and non-specialized international press, while the oil and financial community watches in disbelief to one more oil crisis and awaits, with apprehension, its resolution.

Given the profile and developments to date, it can be said that nothing will be like before. Nevertheless, the way to deal with yet this additional case at the heart of what has been called the “petroleum portfolio” and particularly the decisions that are made will condition the entire future evolution of the oil industry in this region, or at least in the Joint Exploration Zone.

The request for the legal opinion after a real or apparent decision, in which authorized institutions and/or entities have participated, is undoubtedly an element of complexity in the situation at hand and maybe of inhibition or at least of limitation and conditioning of the legal opinion that is expected to be issued by the NPA-STP.

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Attentive to the daily profusion of new elements, the Agency has, since the beginning of this crisis, been permanently questioned by the imperious need to deal with the current situation with tact and intelligence in the strategic management of the supreme interests of the Nation, which shall be clearly and objectively identified and protected in each development stage of this process.

This way, the national position shall imperiously reduce, if not avoid, additional “damages” to business and investments in the Joint Exploration Zone, which today is considered, internationally, a reference model to the oil industry and related activities. One must keep in mind that not only is the price of oil volatile, but so are the image of countries and the trust of international investors.

The bilateral relationship between the two State-Parties is another key matter in this portfolio. In no case should the advances in oil cooperation matters between the two countries be questioned, or the several “gains and benefits” obtained mainly by Sao Tome and Principe with this partnership forgotten.

II – Brief description of the first licensing round process in the Joint Exploration Zone in 2003

After gathering the necessary technical conditions such as:

- a) Seismic data packages
- b) Public tender guidelines
- c) Model of Production Sharing Contract
- d) Petroleum Regulation

among others, the Licensing Round was initiated with a public ceremony in which the representatives of the Oil Industry and the International Press were the privileged guests.

The so-called “Road Show” followed, where representatives of the Institution promoting the Licensing Round traveled to certain international oil industry centers (London and Houston) to help promote the product, in this case the carefully delimited areas called “blocks”.

Once the necessary information had been provided and before the deadline for bidders to present their proposals, the Institution that promoted the Licensing Round offered to provide any additional information to the bidders so that they could present the proposals in conformity with the published regulations.

After the Licensing Round deadline and the opening of the bids, the Institution proceeded first to the technical and then the financial evaluation observing the rules that were in general very clear.

It is customary to establish a minimum number of points for the technical evaluation so that the financial bid of a competitor can be evaluated.

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The minimum number of points adopted in the first Licensing Round at the Joint Exploration Zone for technical qualification was sixty (60) points.

To better support the evaluation of the moral and financial capacity of the Companies, it is customary to employ specialized international firms to perform the so-called Due Diligence, which consists of a discreet investigation of the integrity and the financial capacity of the competing companies. This procedure introduces a slight delay in the publication of the final Licensing Round result, but has the merit to add some assurance in the selection of the Companies. This procedure was adopted in the 2003 Licensing Round.

After evaluations were made according to the previously defined criteria, there was a first approach to the distribution of the blocks, or of their percentages, by the best ranked bidders, with emphasis on signature bonuses and the basic work program.

In the case of the Joint Authority, this first distribution was nothing more than a preliminary approach. Given the rights previously acquired by two companies due to agreements made before the Treaty, the distribution matrix of the blocks could only be completed after the companies' decision whether or not to exercise their options.

When the evaluation work was complete, the JDA prepared a substantiated report and sent it to both governments early enough so that it could be analyzed and the Joint Ministerial Council members could take a final position on each government's side.

With as specific matters as this one, it is customary for the Government or more specifically for its members directly related to the portfolio to seek advice and legal opinions from specialized bodies, be they internal or external. At the internal level, the Government requested a legal opinion from the Petroleum Cabinet about the Report sent by the Joint Authority. Once again, upon verifying the complexity of the matter, the Cabinet in its legal opinion urged the Government to contract a specialized Foreign Firm to analyze the Report since it was the first time the Cabinet was dealing with such matter. Nevertheless, the opinion of the aforementioned firm confirmed the Cabinet's conclusions.

Enough arguments and knowledge were gathered to defend the States' interests.

The final decision was made during the Joint Ministerial Council meeting through a Resolution.

It was established in one of the 2003 Ministerial Council meetings that this type of document should be sent to the governments at least fifteen days prior to the decision.

This was the procedure established by the Joint Authority at the 2003 Licensing Round.

III. Oil Exploration

A. Principles

The first goal of an efficient exploitation of oil resources is the optimization of the resource value in such way that costs are reduced and production volume and value are increased.

This goal can only be achieved if there is an assurance that operations will be awarded to efficient operators.

In practical terms, this goal is reached through the following measures already addressed in the previous chapter:

- a) Selection of the best companies able to operate efficiently.
- b) Adoption of licensing practices that are transparent and predictable in order to maintain the integrity and the efficiency of the selection process.
- c) Oversight and control of the Operators activities in order to ensure the execution of laws, regulations and internationally recognized practices.

B. Evolution of the 2004 Licensing Round at the JDZ

The Sao Tome and Principe/ Nigeria Joint Authority adopts some of these principles in its blocks adjudication policy by affirming in its Licensing Guidelines: ... “the need to obtain a coherent result that is internationally acceptable and that observes the scrutiny rigor of the Selection Committee work in its deliberations. Transparency and accountability were also fundamental in the work of the Committee.”

In the same document, the JDA, referring to the selection Committee, asserts that “it took into account the need to ensure a speedy development of the Joint Development Zone... at the same time that it paid attention to the efficiency and the long term potential, as well as the revenue maximization for both States.”

The JDA also asserts that it kept a balance between the need to attract new investors and local enterprises... and “the need to promote technological transfer and encourage an increasing economic activity in both States.”

Finally, the JDA affirms that it was guided by the necessity to have companies with experience and expertise in the development of oil resources and gas in all blocks.

3. These general principles were divided, in practice, in technical evaluation and commercial evaluation criteria. The technical evaluation criteria had an eliminatory character, that is, a company that was not satisfactorily qualified according to the technical criteria would not be evaluated commercially.

4. Similarly, it has been established in the oil industry and other businesses that the participating companies in an auction shall be submitted to an objective technical and

financial scrutiny by a competent firm. This process is known by the English expression “due diligence.”

C. 2004 Blocks Licensing Round Organization

1. By resolution of the JMC at its meeting of October 28/29, 2004, in Abuja, the Joint Authority announced the 2nd Licensing Round of oil blocks on November 15, with a deadline for December 15, 2004. 22 Companies participated in this public competitive round submitting a total of 26 proposals.
2. Thereafter the JDA submitted to the Joint Ministerial Council a Report containing an Executive Summary, the Evaluation Results and the Recommendations for the 2nd Licensing Round.
3. The Joint Ministerial Council met in Sao Tome and Principe on December 21, 2004, to analyze the Report, having made the following decisions:

a – to approve:

- the Evaluation Report of the 2004 Licensing Round
- the bona fide high bids proposed by the JDA as follows:

Block 2 – Equator Exploration/ ONGC Videsh	US\$ 65 million
Block 3 – Ocean Energy/ Devon/ Pioneer/ ERHC	US\$ 40 million
Block 4 – Hercules Oil Ltd	US\$ 81 million
Block 5 – ICC/ Oil Exploration	US\$ 37 million
Block 6 – Filtim Huzod Oil and Gas	US\$ 45 million

b – to instruct the JDA to notify Exxon Mobil of such results so that it could exercise its preferential rights, and to submit for consideration to the Joint Ministerial Council the proposed structure for operators in each block.

c – to note that the Joint Ministerial Council decision dated from December 21 had approved the dismissal of the proposal made by the company Anadarko for blocks 3 and 4.

d – the same Joint Ministerial Council also oriented the JDA to request that the company with the best offer for block 2, which appeared in second place in the same block, increase its offer, since the Council considered the winning offer very low.

e – A few days later, on December 28, 2004, the Santomean part notified the Nigerian part of its agreement regarding the decision to request the companies Equator Exploration/ ONGC Videsh and Devon/Pioneer/ERHC to increase their signature bonuses.

Regarding Block 4, and taking into account a complaint from Anadarko about the dismissal of its offer, the Santomean part notified the Nigerian part that the offer of that company should be revised.

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Finally, the Santomean part agreed upon the JDA recommendations regarding blocks 3, 5, and 6.

4. On January 14, taking into account the aforementioned facts, the Joint Authority submitted to both States Parties a memo reporting the diligences made to follow the instructions given to the JDA.

In view of such diligence the JDA proposed to the States a revision of paragraph 23.2 of the Licensing Round Committee Report regarding the “bona fide high bid” for the auction blocks.

This revision modified the proposition from December 21 as follows:

Devon/ Pioneer/ ERHC’s offer for Block 2 in the amount of US\$ 71 million became the highest offer, even though Equator Exploration/ONGC Videsh submitted an offer of US\$ 85 million.

For Block 3 the former situation was kept.

For Block 4, Anadarko’s offer in the amount of US\$ 90 million became the highest offer.

For Block 5 and 6, the offers and companies remained the same.

5. The Santomean part reacted to this memo with a letter in which it stated:
- i) its agreement regarding the proposals for blocks 3, 5, and 6.
 - ii) its preference for the Equator Exploration/ONGC Videsh Consortium offer in the amount of US\$ 85 million.
 - iii) regarding block 4 and taking into account the reconsideration of Anadarko, the Santomean part recommended that JDA revisited all offers considering all the highest offers, specially the one in the amount of US\$ 175 million.

In correspondence exchanged with Nigerian authorities, a decision was reached to dismiss of the Equator/ONGC Videsh proposal in the name of transparency because the deadline had not been observed.

However, the JMC awaited the Joint Authority memorandum proposing the final block structure to make a further decision.

6. On April 22, 2005, the President of the Joint Administration Authority’s Administrative Council visited Sao Tome and Principe and contacted the national authorities (the President of the Republic, the Prime Minister, the Minister of Natural Resources). During these meetings, he presented a set of unofficial proposals, which were further analyzed in a meeting between His Excellency the President of the Republic, the Prime Minister and the Santomean members on the JMC.

During such meeting, it was decided that the Santomean delegation would participate in the JMC meeting to be held on May 2-3 in Abuja, but that it would not approve any document under discussion.

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7. The meeting began on May 3 when it was presented to the members a Memo entitled “Proposed block structure and award for 2004 JDZ Licensing Round”, number JMC/2005/04/03, in which the Santomean and Nigerian positions were represented.

The discussion of such document resulted in the suspension of the meeting and the dispatch of a delegation to Sao Tome and Principe, on May 4, carrying a message from the Nigerian President to the Santomean President.

After the return of the delegation to Abuja, the meeting resumed and concluded with the signature of a recommendation by both delegation chiefs.

The recommendation addressed to the Heads of State contains the following suggestions regarding the distribution of participatory interests in the blocks, according to the chart below.

NIGERIA – SAO TOME AND PRINCIPE JDZ 2004
LICENSING ROUND
JMC RECOMMENDED POSITION

COMPANY/ BLOCK	SIGNATURE BONUS	EQUITY	REMARK
BLOCK 2	\$71 million		
Devon/ Pioneer/ EHRC (including existing rights)		65	OPERATOR
Equator Exploration/ ONGC Videsh		15	
A. & Hartman		10	Nil
Foby Engineering		5	Nil
Momo Oil & Gas		5	Nil
BLOCK 3	\$40 million		
Anadarko		51	OPERATOR
Devon/ EHRC (including existing rights)		25	Nil
DNO/ EER		10	Nil
Equinox		10	Nil
Ophir/ Broadlink		4	Nil
BLOCK 4	\$90 million		
Nobel/ ERHC (including existing rights)		60	OPERATOR
Conoil		20	Nil
Hercules		10	Nil
Godsonic Oil and Gas		5	Nil
Overt		5	Nil
BLOCK 5	\$37 million		
ICC/ OEOC Consortium		75	OPERATOR
ERHC (Existing Rights)		15	Nil
Sahara		10	Nil
BLOCK 6	\$45 million		
Filthin-Huzod Oil & Gas		85	OPERATOR
ERHC (Existing Rights)		15	Nil

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IV. CERTAIN FUNDAMENTAL ISSUES

The developments described above allows for some preliminary considerations about certain fundamental issues.

A. Decision-making process in the Joint Authority

A Committee in the Joint Authority was established to deal with the entire Licensing Round, following the orientation of a third Joint Ministerial Council meeting in Abuja on April 4, 2003.

The JDA Administration Council selected at its on April 4, 2003 meeting nine members able to bring merit to a committee derived from several departments.

This committee has a well-defined term of reference with twelve items and answers directly to the JDA Administration Council.

The Committee analyzes the proposals based on a set of rules and once a conclusion is reached it submits a report to the Administration Council for approval. Once approved at the JDA, the report is sent to the governments of the two countries for appreciation and final approval.

There being a disturbing factor in the JDA process while the previously acquired rights are not entirely exhausted, the initial Report cannot yet contain the final blocks distribution proposal by the bidders. The Companies with existing rights before the Licensing Round must be informed of what the JDA considers Bona Fide High Bid, so that they can decide whether or not to exercise such right. Therefore the notification process to ExxonMobil and ERHC implies in a delay of about 30 to 45 days.

After receipt of communication from such Companies about whether and as to which blocks they will exercise their existing rights, the blocks distribution matrix by the winning bidders can be concluded by the Authority and then submitted to the Joint Ministerial Council for final approval at the Council and through a Resolution.

The Ministers of the two countries shall seek possible consensus to reach a conclusion to be reflected in such resolution, and in seeking a consensus, it is obvious that the multiple consultation exercise with the respective Chiefs of State becomes mandatory, particularly when the positions diverge considerably.

With the Joint Ministerial Council Resolution in hand, which defines the final distribution of the blocks or their percentages to the bidders, the Joint Authority is then qualified to announce to the Industry the result of the Licensing Round.

It is important to note that such process may not be so linear; there can be situations that require more bilateral consultations between the Authority and the Companies for adjustments, and this exercise requires a lot of time.

B. The Distribution Policy of Participatory Interests

The distribution policy of participatory interests shall take into account the imperative of efficiency enunciated above in this opinion. Here it is important to underscore once more that the signature bonus is an element of little importance when taking into account the costs involved in the exploration and development of a block and the revenues along the production cycle.

The main concern of the country that owns the resources is that the operating companies should start producing as soon as possible with the lowest costs.

To grant blocks to several competing companies (specially if they do not constitute a consortium) may result in a set of companies in a single block with different levels of experience, technical and financial capacity, and organizational culture, that are required to collaborate for over twenty years. This strategy is economically inefficient and legally problematic. It requires that the most competent companies work with, or to negotiate the purchase of interests awarded to the less able or inexperienced companies. This practice is not consistent with the best practices in the industry.

Indeed, the concession of multiple participatory interests exposes the entire process to rent seeking behavior by the companies whose sole and main motivation is to obtain an interest to sell.

It is true that the JDA policy is to favor local companies (indigenous companies), which can be understood taking into account other stated goals (promote technological transfer, local content, etc). However, in the implementation of this policy there should be clear rules regarding the interest percentages to award (for example, no higher than 5%) or regarding the number of companies in a given block (for example, no more than two). This limit is important given that at the moment only the Nigerian part is in a position to benefit directly from this policy, opening the possibility to other people to obtain improper benefits eventually.

In this regard, the situation in Block 1 is illustrative of a good example, with two renowned companies (Chevron Texaco and ExxonMobil) and a smaller company (EER/DNO). Due diligence is, in this case, essential. Its completion before any concession decision eliminates a fundamental uncertainty level that prevents awarding blocks to companies that later will have difficulty in honoring agreements, and will have to be dismissed. This diligence is worthwhile especially for small companies, but also for the big companies. For instance, in a short period Enron, once a multinational reference company, declared bankruptcy.

The EHRC Rights Controversy

The ERHC topic became a recurrent topic in Sao Tome and Principe from the moment the national authorities decided to halt the arbitration resulting from the conflict that put

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the parties in opposite sides and decided for a negotiated solution with the new shareholders that acquired the majority of ERHC's capital stock.

After intense negotiations between Sao Tome and Principe and the new ERHC managers, the parts entered into a contract that terminated the dispute and created rights and obligations to the parties. Subsequently, following the initiative of the current President of the Republic and with the assistance from the World Bank and international consultants, the contract was renegotiated again, and the rights formerly awarded to ERHC were substantially reduced.

Regarding the Joint Development Zone, the ERHC rights materialized as participatory interests in the nine first blocs were agreed to be as follows:

1. First Choice 15%
2. Second Choice 15%
3. Third Choice 20%
4. Fourth Choice 30%
5. Fifth Choice 25%
6. Sixth Choice 20%

These rights were set forth in an Option Agreement signed by Sao Tome and Principe and ERHC, annexed to a draft administration agreement that was finally signed by ERHC and the Joint Authority for the execution and management of the awarded rights, as such rights pertain to the Joint Exploration Zone under the jurisdiction of the Joint Authority.

It should be mentioned that the exercise of the aforementioned rights by the ERHC is strictly conditioned on one hand by the rights of Sao Tome and Principe in the Joint Exploration Zone, which are limited to 40%, and on the other hand the exercise by ExxonMobil of its rights. As Sao Tome and Principe may only dispose of and award rights that it possesses, that is, 40%, it can be concluded that the sum of the rights exercised by ExxonMobil and ERHC cannot, according to the agreements signed by these two companies, exceed 40% in a single block.

Furthermore, Sao Tome and Principe granted a right of first refusal to ExxonMobil in the exercise of its rights, and then to ERHC. Consequently, ERHC could not exercise any right in a block where ExxonMobil exercises 40% and could not exercise more than 15% in a block where ExxonMobil exercises 25%. A Joint Ministerial Council decision during a meeting in Abuja on October 28-29, 2004, broke this balance without sufficiently pondering the impact on the future benefits of Sao Tome and Principe deriving from the second licensing round bonuses, or the nature and extent of the offers by the oil companies in the same licensing round.

The decision adopted by the Joint Ministerial Council consisted, in fact, of the authorization of ERHC to exercise its rights independently of the conditions established in the agreements entered into with Sao Tome and Principe or with the Joint Authority.

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However, if it is true that ExxonMobil did not exercise its rights, for reasons that were never explained to the National Petroleum Agency, allowing ERHC to exercise its rights *de facto* beforehand and consequently exercise its highest interests in the best blocks with the highest bonuses, and the lowest interests in the marginal blocks, it is no less true that the earlier disclosure of this information, together with the fact that ERHC publicly manifested its decision to form a consortium with other companies to participate in the licensing round and thus eventually obtain additional participatory rights, unequivocally constitutes a factor of dissuasion that may work in two levels. First, it may inhibit the participation of interested companies if they know that in a certain block ExxonMobil may exercise 25%, ERHC 30%, leaving only 45% for competitor companies, a share that was coveted by ERHC in an independent proposal or in association with other companies.

At a second moment, this combination of facts may undermine companies' impetus and enthusiasm, and condition the bonus level to be offered.

This important thing in this matter is that ERHC acquired rights that are part of its individual patrimony, independent of participation in the second licensing round. These rights derive from the contract initially entered into in 1997 and from the successive renegotiations in 2001 and 2003. Note that these rights cannot be denied nor can their exercise be objected to, under the penalty of noncompliance on the part of Sao Tome and Principe, subject to all consequences implied not only regarding the relationship between Sao Tome and Principe and Nigeria, but also regarding litigation and industry perception.

However, as ERHC was not prohibited to participate individually or in association in the second licensing round, the company took part of two consortia that submitted proposals and were qualified, thus acquiring attribution rights of "participatory interests" in certain blocks. Under the principles of transparency and professionalism there can be a discussion about the extent of the new interests to be awarded to the Consortia, but such rights cannot be denied.

Final Conclusions

- In several phases of this licensing round process the decision-making mechanism was affected by some anomalies, decisions were made in the absence of supporting documents, without legal opinions and with no respect to the established processes.
- The 2004 licensing round was evaluated based on the 2003 "due diligence" report, which did not include the new companies that participated in the 2004 licensing round, and did not foresee changes in the financial good standing of Companies that participated in the previous licensing round.
- The process of selection of companies that presented the "Bona fide high bid" was tainted by several episodes that indicate inconsistency in decision-making and disregard for previously established rules.

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- The execution of the policy of distribution of participatory interests to local companies has been deficient.

Recommendations

- Sao Tome and Principe shall deal with the matters discussed in this document with serenity, considering its long term interests.

- In concert with the Nigerian authorities, a careful appreciation of the participatory interests allocation shall be made, adopting uniform and objective criteria respecting the offers proposed.

- The operator designation criteria for blocks 3 and 4 shall be revisited.

- The interest in diversifying and opportunity to diversify the origin and the experience of the operators in the Zone shall be considered.

- An internal mechanism of and permanent coordination, regulation and decision-making prior to the Joint Ministerial Council shall be established.

- A pondered and quick decision about the matter shall be made to safeguard the good relations between Sao Tome and Nigeria, to favor a consonant development in the JDZ and to reinforce the credibility of the entire international oil community.

Sao Tome and Principe, on May 6, 2005.

For the National Petroleum Agency

[signature]
Luiz Alberto Prazeres
Executive Director

APPENDIX F

**REPORT OF THE SÃO TOMÉ AND PRÍNCIPE
NATIONAL ASSEMBLY'S 4TH (PETROLEUM AFFAIRS) COMMISSION
(MAY 16, 2005)**

Democratic Republic of São Tomé e Príncipe

National Assembly

Petroleum Affairs Commission

REPORT

1. Given the recent news circulating internationally that the process of licensing oil blocks number 2, 3, 4, 5 and 6 coming out the last meeting of the Joint Ministerial Council which took place in Abuja from April 26 to April 28 of the current year, was void *ab initio*, the Petroleum Affairs Commission held an urgent meeting on May 20, 2005, and decided:
 - To summon the Ministry of Natural Resources and Environment;
 - To summon the Representatives of São Tomé and Príncipe to the Joint Authority;

Such summoning were made with the purpose of obtaining clarification from the summoned entities.

2. On May 2nd, the Commission heard the Minister of Natural Resources and the Environment (MNRE), Engineer Arlindo Carvalho, who essentially declared that:
 - The delegation he headed was not authorized to undertake any obligations at the Joint Ministerial Council meeting;
 - Only upon his arrival at Abuja did Mr. Carvalho learn about a document proposed for discussion, containing the different negotiation positions of the two countries, as prepared by the Joint Development Authority;
 - He was subject to enormous pressure;
 - He was not part of the delegation that came to São Tomé to contact the President of the Republic, which was composed on the Saotomean part by the Minister of Foreign Affairs and by the Chief of Staff;
 - He did not know whether or not the Chief of Government had been contacted by the aforementioned delegation;
 - He did not have any opinion from the National Petroleum Agency regarding the ongoing process of oil block licensing;
 - He did not have sufficient support from our representation at the Joint Development Authority;

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- He did not make any decision about the licensing of the oil blocks, but rather only initialed a recommendation that does not bind the Country;
 - The text of the Resolution prepared in Abuja, which should seal the deal between the two States, and which was presented to him in São Tomé, had basic modifications compared to the initial text.
3. On May 3 , 2005, the Commission heard our Representatives to the Joint Development Authority, Engineer Carlos Bragança Gomes (President of the Administration Council) and Dr. Jorge Pereira dos Santos (Executive Director). The former, as President of the Administration Council, declared that
- The document mentioned by the MNRE, which was handed to him in Abuja, purported only to reflect the negotiation positions of the two States resulting of discussions had within the Authority, because contrary to what has been the norm, there was no consensus.
 - The Authority was not responsible for the changes introduced to the text of the Resolution that had been presented by the MNRE in São Tomé, since the Ministerial Council has its own Secretariat;
 - He acknowledged the acceptance in a meeting prior to the Joint Ministerial Council meeting, that the transfer of ERHC's first licensing round bids to the second round might inhibit the participation of other Oil Companies, and as a result, affect the final result;
 - The document initialed by the MNRE could represent a certain commitment on the part of Sao-Tomean authorities.
4. On May 4, 2005, continuing with the testimonies, the Commission heard the Santomean members of the Joint Ministerial Council, the Minister of Natural Resources and the Environment, the Minister of Foreign Affairs and Cooperation, and the Minister of Agriculture, Rural Development and Fishery, in the presence of our representatives to the Joint Development Authority.
5. In essence, no new elements were added to the previous statements. The Minister of Foreign Affairs and Cooperation declared that:
- No delegation came from Abuja to negotiate with the President of the Republic, but only a special envoy was sent by the President of Nigeria, bringing a message to the President of São Tomé, and that under guidance of the latter, he and the Chief of Staff, Engineer Meira Rita, should also come to São Tomé;
 - The document signed by the MNRE had the status of a recommendation only.
6. The 4th Commission assented to the request of Dr. Patrice Trovoada, then the Special Advisor to the President of the Republic for Oil Affairs, to provide clarifications with respect to the licensing round process.
7. Thus, on May 6, 2005, before the Commission, the Special Advisor to the President of the Republic declared that:
- There is a complete dysfunction at the Joint Development Authority and at the Ministerial Council. He gave as an example the fact that the bank account that

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- should have been established by the Joint Authority to receive the signature bonus was not executed;
- The structure of negotiation and follow-up are not working well, which affects the Sao Tome and Principe's bargaining power;
 - The previously mentioned issue regarding the authorization given to ERHC to transfer its options from the first licensing round to the second licensing round through a Ministerial Council Resolution approved at a meeting held on October 28 and 29, 2004, which he will contest to the utmost degree, deeply affects the Santomean interests.
 - He was removed from the Joint Ministerial Council meeting room because he was the only person that could object with valid arguments the positions taken by the opposing side;
 - The final resolution was not signed only for lack of sufficient time;
 - There was little transparency in the process of oil blocks licensing, giving as examples:
 - a) The opening of ONC Company's bid, which was ultimately dismissed even though it presented the best proposal, under the argument that the required documentation was not presented on time;
 - b) The re-inclusion of companies eliminated on technical grounds;
 - c) The participation of OWERT Company, which owns the Bank that is a major shareholder of Island Bank, currently operating in São Tomé;
 - d) The companies Mommoo Petroleum and Equinox belong to the same owner, Mr. Muahmed Aze Belu, who is a Special Advisor to the President of the Republic of São Tomé and Príncipe for Investments, and who also commercializes the oil barrels allocated by Nigeria to São Tomé through the Arcádia company.
 - e) The incompatibility generating a conflict of interests due to the participation of Engineer Meira Rita - a shareholder of ERHC - in the Joint Ministerial Council meetings;
 - f) The sentences that disappeared from the final version of the Resolution to be signed by the MNRE.
8. During the hearing with the MNRE, as it was verified that the Santomean delegation that went to Abuja was not supported by a prior technical opinion by the National Petroleum Agency (NPA), the 4th Commission required that the MNRE request such opinion from the NPA.
9. On May 10, 2005, the MNRE provided the 4th Commission with the NPA opinion, which revealed that the necessary measures were not taken to duly ensure and safeguard the interests of São Tomé and Príncipe, particularly regarding the promotion of the *local content* and the *due diligence* that should precede the licensing of the oil blocks. On the other hand, the NPA opinion makes reference to a fundamental fact throughout the licensing process in question, relating to "a resolution of the Joint Ministerial Council" (held on October 28-29, 2004) which disrupted the balance established for the priority of choice of oil blocks between Exxon Mobil and ERHC "without taking its impact sufficiently into account, either as

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to future São Tomé and Príncipe benefits from incoming second round bonuses or as to the nature and extent of the oil companies' bids in that round." "The resolution adopted by the Joint Ministerial Council consisted, in practical terms, of a permission to ERHC to exercise its rights regardless of the conditions established in the agreements entered into with São Tomé and Príncipe or with the Joint Authority."

Conclusions

10. The 4th Commission found, given the depth of the analysis performed by the NPA, that it confirmed its existing appreciation of the situation, as a result of the hearings carried out, to adopt the conclusions of the NPA, which are transcribed as follows:
 - a) In several stages of this licensing process the decision-making mechanism was affected by certain anomalies; decisions were made in the absence of supporting documents, without opinions and with disregard to the established processes;
 - b) The 2004 licensing round was evaluated based on the 2003 *due diligence* report, which did not include new companies that participated in the 2004 round, or even addressed any change in financial good standing of the Companies that participated in the earlier round;
 - c) The process of selection of the companies that presented *Bona fide high bid* was marked by several events indicating decision inconsistency and disregard for previously established rules;
 - d) Deficient execution of the policy of distribution of participatory interests to local companies.
11. The 4th Commission also concludes that the process of political guidance of the petroleum portfolio was greatly affected by the crisis brought about by the oil blocks licensing round as a result of the failures and mistakes found, which can seriously damage the interests of São Tomé and Príncipe. It is necessary that all involved in the process assume their political responsibility, at the appropriate level;
12. That the incompatibilities (unacceptable conflicts of interest) verified among our representatives violate the Law and affect the credibility of the process;
13. That the absence of official guidance has contributed decisively to the weakening of the Sao-Tomean negotiation position;

Recommendations

14. That the powers of each body established in the Constitution as to negotiations be respected;
15. Given the evaluation of the public statements made about the issue by different political actors and organizations indicating that the political responsibilities be investigated, the 4th Commission recommends that the Plenary create a Parliamentary Investigation Commission;
16. That the oil sector policy shall be clearly defined, taking into account the responsibility of each State Agency and its articulation;
17. That the Public Prosecutor be urged to initiate a normal procedure for the incidents;
18. That the decree-law instituting the National Petroleum Council be revoked.

São Tomé and Príncipe, on May 19 2005.

The President,

(signature)

/Carlos F. Agostinho das Neves/

APPENDIX G

THE ABUJA JOINT DECLARATION

THE ABUJA JOINT DECLARATION
REGARDING
TRANSPARENCY AND GOVERNANCE
IN THE
JOINT DEVELOPMENT ZONE

By H.E. President Olusegun Obasanjo
and
H.E. President Fradique de Menezes

June 26, 2004

Transparency is critical to good government and enhances the ability of our citizens to monitor the activities of government on their behalf and for the efficient and effective development and use of our oil and gas resources. To this end, we together endorse and adopt the following declaration of principles to govern the activities of the Joint Development Zone shared by Nigeria and São Tomé and Príncipe and to make the Joint Development Zone a unique model for cooperation by two African countries working together for oil development and transparency and good management of oil revenue:

2. All payments to the Joint Development Authority by oil companies shall be made public on an individual company basis, quarterly and annually, by the Joint Development Zone and by the companies. Our guidelines for this reporting are those adopted by the Extractive Industries Transparency Initiative.

3. The use of funds received by our respective governments from activities within the Joint Development Zone shall be monitored and audited, with such audits being made public in accordance with the laws of our respective states.

4. The Joint Development Authority shall publish an annual budget which shall be approved by the governments of Nigeria and São Tomé and Príncipe. The accounts and procurement contracts of the Joint Development Authority and any entity operating in the Joint Development Zone shall be subject to an annual audit by an independent and internationally recognized auditing firm. Such audits shall be made public.

5. The Joint Development Authority shall make public the basis for all awards of interest in the Joint Development Zone including the technical and due diligence analysis supporting such awards. All bids and supporting data, other than geological or similar proprietary data, shall be made public.

6. The Joint Development Authority in any Production Sharing Contract or third party agreement including any procurement contract shall specifically (i) require the reporting provided for in this declaration, (ii) provide that the agreement itself and all financial information regarding such agreement be made public, and (iii) require the contracting party to represent and affirm that no unlawful payment, benefit or advantage of any kind has been made to any employee of the Joint Development Authority or any public official to affect or influence any act, omission, or decision relating to such contract or agreement. Any failure to comply with these requirements and representations shall make such contract or agreement voidable by the Joint Development Authority or either of the two contracting governments.

7. All information which is to be made public pursuant to this Declaration shall be posted and maintained on the website of the Joint Development Authority in order to assure open access to such information for all individuals and groups.

8. We shall in recognition of the importance that our civil society attaches to the transparency in oil revenue management implement this declarations using a multistake holders platform, such as the National Stakeholders Working Group for the Nigeria Extractive Industry Transparency Initiative (NEITI) – a coalition of public sector, civil society and private sector membership.

9. Finally, we shall instruct our respective representatives to the Joint Development Authority to adhere to this declaration of principles forthwith, and in particular, to assure their application to any contracts to be awarded pursuant to the current bid round.

_____/s/
H.E. President Olusegun Obasanjo
Of the Federal Republic of Nigeria

_____/s/
President Fradique de
Menezes
Of the Democratic
Republic of Sao Tome
and Principe

APPENDIX H

THE ERHC CONTRACT

The existing contract between São Tomé and Príncipe and Environmental Remediation Holding Company (“ERHC”), if enforced, will result in the possible loss of nearly \$60 million in signature bonus revenue which would otherwise flow to the government of São Tomé and Príncipe.¹ This amount compares to São Tomé’s total annual budget of \$50 million.

The actual cost to São Tomé and Príncipe may be even significantly higher. The possibility of ERHC participation may have discouraged other more substantial companies from participating in the Second Bid Round, thus reducing competition for the blocks with the likely diminishment of the high bids. In the First Bid Round, Exxon/Mobil refused to participate in any block in which ERHC took an interest, and the Second Bid Round in which ERHC bid on all blocks was notable for the lack of participation by major international companies. Two of the large independents – Noble and Devon – that initially had agreed to partner with ERHC withdrew. Further, there remains the possibility of ERHC’s presence causing the entire Bid Round to fail or having the blocks let to companies which will be unable or unwilling to meet their drilling commitments if the market does not later support their valuations. Finally, ERHC retains extensive rights in the Exclusive Economic Zone of São Tomé and Príncipe. All of these factors work to the detriment of São Tomé and Príncipe.

This astonishing situation results from a series of agreements first executed in 1997, renegotiated once in 2001, and renegotiated then again in 2003. These agreements have repeatedly been characterized by knowledgeable industry observers as outside the range of industry norms and extraordinarily unfavorable to São Tomé and Príncipe. Although the agreements were terminated in 1999 by Prime Minister Guilherme Posser da Costa, a new agreement was entered into in 2001 under pressure from Nigeria after control of ERHC passed to the Nigerian company Chrome. Chrome is owned by Sir Emeka Offor, a well-connected Nigerian businessman and known confidante and campaign supporter of President Obasanjo. After wide criticism of the new agreement, President de Menezes declared it unenforceable, but, once again under pressure from Nigeria and other forces, a revised agreement was entered into in 2003. This agreement still is in effect. It is pursuant to the 2003 agreement that ERHC is claiming extensive rights to blocks in the JDZ at the expense of São Tomé and Príncipe.

¹ See attached Exhibit 1, which shows the distribution of revenues with and without the enforcement of the ERHC contract.

The 1997 Agreements

The first agreement with ERHC was a Letter of Understanding signed in May 1997 between São Tomé and Príncipe, ERHC, and a South African firm, Procura Financial Consultant (“PFC”). It was negotiated directly with President Miguel Trovoada’s office without outside consultation or assistance, and it was executed on behalf of São Tomé and Príncipe by the Prime Minister, Raúl Bragança Neto. At the time of the agreement, ERHC had no international oil or gas experience whatsoever. Its sole business line was servicing marginally producing oil and gas wells in the United States, including the provision of plug and abandonment services. Its total revenues in 1996 were \$60,477, and the company had a net loss for the year of \$728,248.²

This first agreement was followed closely by a Memorandum of Agreement (“MOA”) dated May 27, 1997 and a Memorandum of Understanding, modifying the MOA, dated September 30, 1997. Key terms of the agreement were:

- Both parties would receive 40% of production (or the profits of production, the contract language was ambiguous)³
- 20% would be allocated to recovery of costs
- Duration of the agreement was for twenty-five (25) years
- ERHC was to have “available” US\$5,000,000 for Feasibility Studies, Offices and Staff, otherwise undefined
- ERHC was to deliver another US\$5,000,000 to STP “upon the funding of ERHC/PFC...”⁴
- ERHC was to “have up to one hundred million USD (USD\$100,000,000) available for the development of the oil.”

In effect, for the promise of \$5million, the agreement made ERHC an equal partner with the government of Sao Tome and Principe and gave the company nearly plenary rights to explore and exploit the nation’s petroleum, gas, and mineral reserves for 25 years.

The initial agreements were followed by a joint venture agreement signed in Washington, DC in November 1997 during the course of a visit to the United States by the Prime Minister and a 10 person delegation sponsored by ERHC. The joint venture agreement provided for the formation of an oil and gas company, STPetro, to be jointly

² See <http://sec.gov/Archives/edgar/data/799235/0001014060-99-000004.txt>.

³ A subsequent World Bank study was unable to conclude whether the contract language really indicated 40% of the production or whether the intent was 40% of the profits of production.

⁴ *Supra* note 3 (“upon the funding”) is not defined within the agreement. However, in November 1997, ERHC paid São Tomé \$2,000,000 of the \$5,000,000 due. Subsequently, it paid the remaining \$3,000,000.

owned by the government and ERHC. The purpose of this company was to develop a deep water port and an offshore logistics center for the oil industry. The joint venture was realized in July 1998. São Tomé and Príncipe held 51% of the stock, all of which was capitalized with only \$100,000. The deep water port and the offshore logistics center project have yet to be developed.

Carlos Bragança Gomes, Prime Minister Bragança's nephew and government advisor, was appointed president of the new company, and Mateus 'Nando' Meira Rita, a former São Toméan Secretary of State, became its general manager. Although, as officers of the new joint venture, Gomes and Rita were responsible to all of the joint venture partners, including the government, the two men were also hired by ERHC as consultants for \$5,000 a month, a not insignificant sum in São Tomé and Príncipe at the time. In August 1998, the South African company, PFC, dropped out of the picture entirely, assigning all its rights and obligations to ERHC.

In 1999, Geoffrey Tirman became the majority shareholder in ERHC and took the lead in negotiating a revised agreement with São Tomé and Príncipe. Carlos Gomes, a paid consultant to ERHC, represented São Tomé in the negotiations. The parties failed to reach an agreement, and the São Toméan Prime Minister, Guilherme Posser da Costa, then declared the agreement with ERHC null and void, arguing that the company had not fulfilled its obligations, monetary and otherwise, under the MOA⁵. Tirman responded with an open letter to Posser da Costa accusing Carlos Gomes of corruption. Tirman alleged and later supporting affidavits that Carlos Gomes had demanded personal incentives and special monthly financial compensation from ERHC. Carlos Gomes denied the charge in a lengthy rebuttal. ERHC also filed a request for arbitration with the International Chamber of Commerce in Paris. The arbitration continued until terminated as part of the 2001 Agreement between São Tomé and ERHC.

Defining São Tomé and Príncipe's Exclusive Economic Zone; The Joint Development Zone Treaty

Pursuant to the MOU signed by the parties in 1997, ERHC assisted São Tomé with the filing of a claim for the recognition of a 200-mile Exclusive Economic Zone ("EEZ") with the U.N. Law of the Sea Commission in November 1997. Recognizing that the 200 mile zone could conflict with the zones claimed by neighboring countries, the São Tomé and Príncipe legislation provided for recognition of the median or equidistance line by treaty agreements with the neighboring states. Such treaties were entered into with Equatorial Guinea in 1999 and with Gabon in 2001. Nigeria resisted such agreement and claimed territory on the São Tomé and Príncipe side of the median line between the two countries.

⁵ ERHC was in dire financial straits at the time of these re-negotiations. The third fiscal quarter (June) of 1999 showed a net loss of \$5.1 million and a net operating loss of \$385,000.

Further, in September 1998, STPetro signed an agreement with Mobil New Exploration Ventures group (“Mobil”) to perform technical work in the territorial waters of São Tomé and Príncipe, including the area disputed by Nigeria.⁶ The results of the seismic surveys conducted pursuant to this agreement identified the blocks with a high probability of oil deposits, all of which were situated within the maritime border area which later became the JDZ.

Negotiations between the two countries finally commenced after a decision by Nigeria to lease blocks in the disputed territory, but talks were broken off in mid 2000. The principle issue was Nigeria’s refusal to recognize the median line, even though the median line would have been the traditional international rule and had been agreed with other neighboring countries. São Tomé and Príncipe eventually compromised on the issue, and, in February 2001, a treaty was signed by the two countries creating the JDZ and the JDA.⁷ Notably the territory incorporated in the JDZ was all on the São Tomé and Príncipe side of the median line. São Tomé apparently reached this agreement out of a concern that a legal conflict could indefinitely delay development, development that was critical to São Tomé and Príncipe, but which was not critical to Nigeria as Nigeria had alternative resources.

The 2001 Agreement

During this period, ERHC’s precarious financial state worsened. The U.S. Securities and Exchange Commission (“SEC”) was investigating the company, and ERHC had to negotiate with its creditors, paying some of them with company stock. Ultimately, the terminated contact with São Tomé and Príncipe was ERHC’s only asset. The company was saved from bankruptcy by the intervention of Sir Emeka Offor, a wealthy Nigerian businessman with close links to the former dictator Sani Abacha and to President Obasanjo. Offor, through his Nigerian company, Chrome Energy, acquired a controlling interest in ERHC contemporaneously with Nigeria’s settlement with São Tomé and Príncipe.

Once control of ERHC passed to Chrome, Nigeria brought serious pressure on São Tomé and Príncipe to settle with ERHC. ERHC/Chrome threatened that Nigeria would not ratify the JDZ treaty unless a settlement is reached, and one São Toméan advisor claimed that Nigeria would renegotiate the 60/40 split if an agreement were

⁶ In the agreement, Mobil committed to conduct surveys for oil reserves in twenty-two (22) deep-water blocks. In return, Mobil was granted an exclusive option on the evaluation, exploration, and production of oil in the entire EEZ. Mobil also agreed to pay substantial signature bonuses. The Agreement was subsequently modified. The modified agreement was the basis for the preferential rights of Exxon/Mobil, the merged entity formed in 1998, in Block 1.

⁷ A portion of the JDZ was initially excluded from the settlement, the “Special Regime Area,” with that portion left in the hands of Nigeria in return for certain commitments by Nigeria. The commitments were not honored, and the area was later returned for joint development as part of the JDZ.

reached. There were numerous allegations of payments by ERHC/Chrome to influence the negotiations.⁸

The results of the arbitration regarding the termination of the ERHC contract were scheduled to be announced in May 2001. Outside counsel for São Tomé and Príncipe advised São Tomé and Príncipe that it was likely to win the arbitration and that the 1997 agreements would be terminated, subject to return of funds advanced by ERHC with interest or other compensation.

Just before the judgment was expected, extensive negotiations took place in Paris in the presence of the Nigerian Ambassador. The São Toméan delegation included Patrice Trovoada, son of President Miguel Trovoada, and Rafael Branco, then Foreign Minister. Shortly before the ruling was to be announced, President Trovoada ordered the São Toméan representatives to terminate the arbitration and to sign the settlement agreement offered by ERHC.

The settlement agreement (the “2001 Agreement”) was executed for São Tomé and Príncipe by Luis Alberto dos Prazeres, then Minister of Natural Resources. Chude Mba and Sir Emeka Ofor executed the agreement for ERHC, and, in a very unusual step, the agreement was witnessed by Dubem Onyla, the Nigerian Minister of State for Foreign Affairs, and Rafael Branco, then Minister of Foreign Affairs for São Tomé and Príncipe.

The 2001 Agreement terminated the arbitration with prejudice and gave ERHC new, extensive rights that superseded the 1997 agreements. ERHC was granted a number of special rights, including:

- ERHC was to receive 10 percent of any “profit” oil,⁹ 5 percent of any signature bonuses, and one and a half percent of all revenues that the São Toméan government would receive from the JDZ;
- ERHC was granted a 15% working interest in two blocks in the JDZ of ERHC’s choice, subject to payment of bonus;
- ERHC was granted the right to select up to two blocks of ERHC’s choice in the EEZ (the territorial water of São Tomé and Príncipe outside of the JDZ) *without* payment of any signature bonuses.

⁸ One source quoted Patrice Trovoada as saying that “Chrome had enormous influence inside São Tomé & Príncipe. The President of São Tomé’s National Assembly worked for, and was paid by, Chrome. Chrome paid money to everybody in São Tomé.” ERHC made several large unexplained payments, including one of \$550,000 to Procura Finance Corporation and another to ST Energy, a British Virgin Islands registered Company headed by Wade Cherwayko. Cherwayko controls Equator Exploration which received an interest in Block 2.

⁹ “Profit” oil is that share of the oil production in the JDZ to which São Tomé and Príncipe would be entitled under the production sharing agreements after cost recovery.

In return ERHC gave up its interest in the now defunct STPetro. In effect, ERHC was granted very valuable rights without agreeing to perform any additional work. Notably, the agreement was explicitly conditioned upon the ratification of the Treaty governing the JDZ by both Nigeria and São Tomé and Príncipe.

The 2003 Agreement

Shortly after the 2001 Agreement was signed, both a highly experienced industry consultant working without pay and a major law firm commissioned by the World Bank reviewed the 2001 Agreement and its antecedents. Both reviews were highly critical, finding the agreement far outside industry norms and highly disadvantageous to São Tomé and Príncipe.

As a result of the legal reviews and public condemnation of 2001 Agreement, São Tomé and Príncipe's President Fradique de Menezes¹⁰ declared the 2001 Agreement unconscionable and unenforceable, and refused to honor its terms.¹¹ This was in spite of the fact the ERHC/Chrome had made payments to a company controlled by President de Menezes of at least \$100,000.¹²

Once again, Nigeria applied economic pressure on São Tomé and Príncipe by postponing the First Bid Round until São Tomé and Príncipe again reached agreement with ERHC. New negotiations commenced, and, in April 2003, ERHC and São Tomé and Príncipe entered into yet another agreement, the "2003 Agreement". Participating in the renegotiations were several São Toméans holding interests in ERHC.¹³

¹⁰ Mr. Fradique de Menezes became São Tomé and Príncipe's president on September 3, 2001.

¹¹ President de Menezes also announced that he wanted to revise agreements with Mobil (which later merged with Exxon) and with PGS, and both were renegotiated. The new Exxon/Mobil contract gave the company pre-emptive rights to a 40% interest in one block and 15% in another two blocks of its choice in the JDZ. Exxon/Mobil was required to match the signature bonuses and contract terms offered by other bidders. The terms of the renegotiated PGS agreement have not been disclosed.

¹² On February 21, 2002, Chrome admitted to making a payment to CGI, a company owned by President de Menezes. President de Menezes has said in a taped press conference that the money was for his political party, the MDFM, and that other parties also received money from Chrome and Nigerian interests. Although foreign funding of campaigns is apparently quite common, São Toméan law explicitly prohibits political party funding by foreign entities. *See Lei dos Partidos Políticos*, Art. 27, 4.

¹³ One public example was São Tomé and Príncipe's Foreign Minister, Mateus "Nando" Rita, who still owned 500,000 shares in ERHC and was a former company consultant.

Key terms of this agreement gave ERHC extensive rights to receive working interests in the JDZ without payment of signature bonuses. ERHC also received the right to conduct seismic activity in any block it selected. In turn ERHC relinquished its rights to receive the royalty and other financial rights embodied in the 2001 Agreement. ERHC retained its rights with respect to Exclusive Economic Zone of São Tomé and Príncipe outside of the JDZ. The agreement was also unusual in that it included an administrative annex signed by officials of the JDA implementing the agreement.

The terms of this agreement were widely discussed and again broadly criticized. While ERHC had surrendered its financial interests, it increased its JDZ participation rights from a total of a 30% working interest in two blocks, both subject to the payment of signature bonuses, to a total of 125% working interest spread over six blocks, ranging from 15% to 30% each. Additionally, ERHC was exempted from paying signature bonuses on four of the blocks. Industry analysts once again denounced the new contract, emphasizing that its terms were far out of line with industry practices. Industry participants also criticized the deal since it compelled them to co-operate with an inexperienced partner.

Once São Tomé reached agreement with ERHC, the Bid Round was rescheduled. ERHC attempted to exercise its option rights in the First Bid Round. However, because Exxon/Mobil, which refused to participate in any block in which ERHC had an interest, had certain preferential rights that it exercised for the only block that was awarded, ERHC was precluded from taking any interest.

In the Second Bid Round, however, ERHC both exercised its option rights and bid as an independent player. It was awarded interests in all five blocks that were let. Because of ERHC's exemption from the payment of its share of the signature bonus in four of the five blocks, it will avoid payment of US\$58,500,000, money which would otherwise be payable to São Tomé and Príncipe. *See Exhibit 1.*¹⁴

¹⁴ Exhibit 2 shows what the impact would be if the loss in signature bonus revenue resulting from the ERHC's options was charged to the JDA, and not just to São Tomé and Príncipe. This would reduce the loss to São Tomé and Príncipe from \$58,550,000 to \$23,420,000. The remaining loss would be borne by Nigeria.

Exhibit 1

Distribution of Signature Bonus Revenues
Signature bonuses not paid by ERHC subtracted from amounts due to Sao Tome and Principe
(\$ Million)

Block	Signature Bonus	Nigeria	Sao Tome and Principe w/o ERHC	ERHC (No Signature Bonus %)	ERHC Savings	Net to JDA	Net to Sao Tome and Principe	Net to Nigeria
2	71.00	42.60	28.40	0.30	21.30	49.70	7.10	42.60
3	40.00	24.00	16.00	0.20	8.00	32.00	8.00	24.00
4	90.00	54.00	36.00	0.25	22.50	67.50	13.50	54.00
5	37.00	22.20	14.80	0.00	0.00	37.00	14.80	22.20
6	45.00	27.00	18.00	0.15	6.75	38.25	11.25	27.00
Total	283.00	169.80	113.20	0.90	58.55	224.45	54.65	169.80

Exhibit 2

Distribution of Signature Bonus Revenues
Signature bonuses not paid by ERHC subtracted from amounts due to Sao Tome and Principe and Nigeria
(\$ Million)

Block	Signature Bonus	Nigeria	Sao Tome and Principe w/o ERHC	ERHC (No Signature Bonus %)	ERHC Savings	Net to JDA	Net to Sao Tome and Principe	Net to Nigeria
2	71.00	42.60	28.40	0.30	21.30	49.70	19.88	29.82
3	40.00	24.00	16.00	0.20	8.00	32.00	12.80	19.20
4	90.00	54.00	36.00	0.25	22.50	67.50	27.00	40.50
5	37.00	22.20	14.80	0.00	0.00	37.00	14.80	22.20
6	45.00	27.00	18.00	0.15	6.75	38.25	15.30	22.95
Total	283.00	169.80	113.20	0.90	58.55	224.45	89.78	134.67