

MEMORANDUM OF AGREEMENT

BETWEEN

THE PRESIDENT OF THE REPUBLIC OF PALU

AND

**THE CHAIRMEN OF THE HOUSE COMMITTEE ON RESOURCES
AND DEVELOPMENT AND THE SENATE COMMITTEE ON
RESOURCES, COMMERCE TRADE AND DEVELOPMENT**

WHEREAS, according to existing geological surveys and assessments conducted by or on behalf of various petroleum companies, potential may exist for the discovery of oil and gas reservoirs in the waters surrounding Kayangel State; and

WHEREAS, Palau Pacific Energy Inc. ("PPE") has executed an agreement with Kayangel State to conduct exploration, drilling, and production operations in an area of approximately 1.12 million acres around Velasco Reef in Kayangel State known as the Palau North Block; and

WHEREAS, PPE now seeks to drill exploratory wells to determine the nature and extent of the potential hydrocarbon reserves; and

WHEREAS, successful oil and gas production in Palau will have a major impact on the economy, society, and environment of the Republic; and

WHEREAS, knowledge of geological conditions is still too limited to determine whether all the necessary prerequisites exist for commercially exploitable quantities of oil and gas to be found in the Republic; and

WHEREAS, Palau currently has no comprehensive regime of laws and regulations to regulate the conduct of oil and gas exploration and exploitation activities in the Republic; and

WHEREAS, the House of Delegates has passed House Bill No. 7-16-1, HD1, the Palau National Petroleum Act, which is currently pending before the Senate; and

WHEREAS, the Olbiil Era Kelulau has passed Senate Joint Resolution No. 7-54, SD2, HD1, in which it requests that the President seek technical assistance from donor organizations to conduct a comprehensive study and provide advice in the form of recommendations to improve House Bill No. 7-16-1, HD1;

WHEREAS, further investigative work is likely to impact the design of the legal framework and of related incentives for the petroleum industry, taking account of the need to protect the environment, and the present structure of the Palauan economy, which derives its resources mainly from tourism; and

WHEREAS, the World Bank has agreed to administer a multi-donor trust fund which will be used to finance the preparation of a draft hydrocarbon code, model contract, and related environmental, operational, and fiscal regulations; taking into account the House Bill No. 7-16-1, HD1, the Palau National Petroleum Act; and

WHEREAS, the World Bank and the Government of the Faroe Islands have further agreed to provide technical assistance to the Government of Palau through an Oil and Gas Task Force in matters related to the establishment of the petroleum sector, including its macro-economic, environmental, and social impacts, if requested by the Oil and Gas Task Force; and

WHEREAS, the parties agree that a joint effort is necessary to respond effectively and efficiently to the challenges raised by the creation of the oil and gas sector in the Republic of Palau.

The parties agree as follows:

1. The President shall, by Executive Order, establish an Oil and Gas Task Force, composed of: two (2) members appointed by the President of the Republic; one (1) member appointed by the Senate; one (1) member appointed by the House of Delegates; one (1) member appointed by the Environmental Quality Protection Board; two (2) members appointed by the Chamber of Commerce - one (1) from the tourism sector, and one (1) from the fisheries sector - and two (2) members appointed by the Governors Association;
and

2. The Oil and Gas Task Force shall be created for a period of six (6) months from the effective date of this Memorandum of Agreement and shall undertake to prepare a report on the hydrocarbon potential of the Republic's territory, and on the potential impact of oil exploration and production on the Palauan environment, economy, and community.

3. The report shall contain recommendations on the opportunity of and alternative methods for developing the oil sector.

4. After the report is presented to the President and the Olbiil Era Kelulau, and comments and recommendations are provided to it, the Task Force shall:

Recommend the institutional set up for the management and oversight of the sector, including its financing, staffing, technical assistance, and capacity building needs; and

Oversee the preparation of hydrocarbon code, model agreement, and related environmental, operational, and tax regulations, taking into account any existing or proposed legislation,

for presentation to the President and to the Olbiil Era Kelulau.

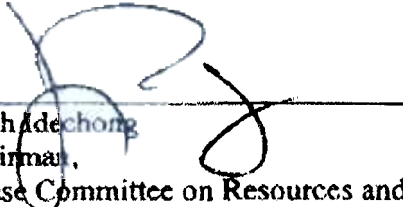
5. The Task Force shall provide recommendations on the design of sector policies, provided that the Government so requires; and

6. Upon completion of the Task Force's work, appropriate government agencies will be created by law, and will be tasked with the implementation of the relevant legislation, the promotion of Palau's hydrocarbon potential to the industry, and the oversight and administration of the petroleum sector.

So agreed and executed this 16th day of February, 2007.



Tommy E. Remengesau, Jr.
President of the Republic of Palau



Noah Adechong
Chairman,
House Committee on Resources and Development



Alfonso N. Diaz
Chairman,
Senate Committee on Resources, Commerce, Trade and Development