

HARDY EXPLORATION & PRODUCTION (INDIA) INC.

AUDIT REPORT AND AUDITED ACCOUNTS

YEAR 2004

**Independent Auditors' Report to the
Directors of Hardy Exploration and Production (India) Inc**

We have audited the financial statements of Hardy Exploration and Production (India) Inc for the year ended 31 December 2004 which comprise the Profit and Loss Account, the Balance Sheet, the Cash Flow Statement and the related notes numbered 1 to 22. These financial statements have been prepared under the historical cost convention and the accounting policies set out therein.

This report is made solely to the company's directors. Our audit work has been undertaken so that we might state to the company's directors those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company's directors for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

We report to you our opinion as to whether the financial statements give a true and fair view. We also report to you if, in our opinion, the company has not kept proper accounting records, or if we have not received all the information and explanations we require for our audit.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises only the statement of oil and gas reserves. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Unqualified Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31 December 2004 and of the profit for the year then ended.

Horwath Clark Whitehill LLP

Horwath Clark Whitehill LLP
Chartered accountants and registered auditors

29 May 2005
London

HARDY EXPLORATION & PRODUCTION (INDIA) INC.

Balance Sheet

As at 31 December 2004

	Notes	2004 US\$	2003 US\$
Fixed assets			
Intangible assets	9	8,504,685	7,434,532
Tangible assets	10	5,788,331	4,553,890
		14,293,016	11,988,422
Current assets			
Stocks		646,269	323,005
Debtors	11	2,867,145	937,021
Cash at bank and in hand		7,794,065	5,349,388
Deferred tax Asset		773,000	4,071,000
		12,080,479	10,680,414
Creditors: amounts falling due within one year	12	(5,548,709)	(3,793,984)
Net current assets		6,531,770	6,886,430
Total assets less current liabilities		20,824,786	18,874,852
Creditors: amounts falling due after more than one year	13	-	(1,748,751)
Provisions for liabilities and charges	14	(1,296,000)	(1,296,000)
Net assets		19,528,786	15,830,101
Capital and reserves			
Called up share capital - equity	15	40	40
Additional paid in capital	16	34,071,105	34,071,105
Profit and loss account	16	(14,542,359)	(18,241,044)
Equity shareholders' funds		19,528,786	15,830,101

The accounts were approved by the board of directors on 29 May 2005
and signed on its behalf by :

Yogeshwar Sharma

Yogeshwar Sharma
Director

The notes on pages 8 to 21 form an integral part of these financial statements.

HARDY EXPLORATION & PRODUCTION (INDIA) INC.
Profit and Loss Account
For the year ended 31 December 2004

	Notes	2004 US\$	2003 US\$
Turnover	2	13,564,651	8,930,390
Cost of sales			
Production costs		(3,002,584)	(3,114,369)
Increase /(decrease) in stock		250,915	(407,920)
Depletion		(1,418,018)	(875,659)
Decommissioning charge		(7,770)	(19,646)
Gross Profit		9,387,194	4,512,796
Administrative expenses		(1,982,123)	(1,515,259)
Operating Profit	3	7,405,071	2,997,537
Interest receivable and similar income	6	119,838	29,626
Interest payable and similar charges	7	(254,224)	(488,262)
Profit on ordinary activities before taxation		7,270,685	2,538,901
Tax on profit on ordinary activities			
-current	8	(274,000)	(2,130)
-deferred	8	(3,298,000)	4,071,000
		(3,572,000)	4,068,870
Profit for the financial year		3,698,685	6,607,771

The profit and loss account contains all the gains and losses recognised in the year and the profit for the year represents the only movement in shareholders' funds

The notes on pages 8 to 21 form an integral part of these financial statements.

HARDY EXPLORATION & PRODUCTION (INDIA) INC.

Statement of Cash Flows

For the year ended 31 December 2004

	Notes	2004 US\$	2003 US\$
Net cash inflow from operating activities	17	6,836,407	4,319,400
Returns on investments and servicing of finance			
Interest received		119,838	29,626
Interest paid		(302,492)	(385,211)
Net cash outflow from return on investments and servicing of finance		(182,654)	(355,585)
Taxation		-	(2,130)
Capital expenditure and financial investment			
Expenditure on exploration assets		(1,070,153)	(316,669)
Expenditure on development/producing assets		(2,930,605)	(54,391)
Purchase of other fixed assets		(46,834)	(2,190)
Proceeds from disposal of interests in development assets		280,000	-
Net cash outflow from capital expenditure and financial investment		(3,767,592)	(373,250)
Net cash inflow before financing		2,886,161	3,588,435
Financing			
Repayment of bank loan		(441,484)	(341,285)
		(441,484)	(341,285)
Increase in cash for the year		2,444,677	3,247,150

The notes on pages 8 to 21 form an integral part of these financial statements.

HARDY EXPLORATION & PRODUCTION (INDIA) INC.
Notes to the Accounts
For the year ended 31 December 2004

1. Accounting Policies

The following accounting policies have been applied in preparation of financial statement of Hardy Exploration & Production (India) Inc ("HEPI").

a) Accounting convention

The accounts are prepared under the historical cost convention.

b) Accounting standards

HEPI prepares its accounts in accordance with the accounting standards of the United Kingdom and in accordance with the Statement of Recommended Practice ("SORP") issued by the Oil Industry Accounting Committee, United Kingdom; Accounting for Oil and Gas Exploration, Development, Production and Decommissioning Activities.

c) Basis of joint arrangements not entities

The company conducts the majority of its exploration, development and production through unincorporated joint arrangements with other companies. The accounts reflect the company's share of production and costs attributable to its participating interests under the proportional consolidation method.

d) Turnover

Turnover represents the sale value of the company's share of oil sold in the year, tariff, and the income from technical services to third parties if any.

e) Fixed assets

HEPI follows the full cost method of accounting for oil and gas assets. Under this method, all expenditure incurred in connection with and directly attributable to the acquisition, exploration, appraisal and development of oil and gas assets, interest payable and exchange differences incurred on borrowings directly attributable to development projects if any is capitalized.

Exploration assets comprise the pre-license, license acquisition, exploration and appraisal costs relating either to unevaluated properties or properties awaiting further evaluation. When a decision to develop these properties has been taken or there is evidence of impairment, the costs are transferred as development cost to the cost pools within 'Development/producing assets' when the commercial reserves attributable to the underlying asset have been established.

HARDY EXPLORATION & PRODUCTION (INDIA) INC.
Notes to the Accounts continued
For the year ended 31 December 2004

Further expenditure on fixed assets in the production phase is capitalized where future economic benefit is enhanced.

In case of any disposal of oil and gas assets, net proceeds from any such disposal are credited against the previously capitalized costs.

f) Depletion, impairment and depreciation

Depletion

HEPI depletes expenditure on oil and gas production and development on a unit of production basis, based on proved and probable reserves.

Impairment

Exploration assets are reviewed regularly for indications of impairment if any, where circumstances indicate that the carrying value might not be recoverable. In such circumstances if the exploration asset has a corresponding development / producing cost pool, then the exploration costs are transferred to the cost pool and are written off on a unit of production basis through the depletion charge. In cases, where no such development/producing cost pool exists, the impairment of exploration costs is charged to the profit and loss account. Impairment reviews on development / producing oil and gas assets are carried out for each cost pool on each year by comparing the net book value of the pool with the associated discounted future cash flows. If the net book value is higher, then the difference is written off to the profit and loss account as impairment.

Depreciation

Fixed assets, other than oil and gas assets, are depreciated over their expected useful economic lives as follows:

	Annual Rate (%)	Depreciation Method
Leasehold improvements	over lease period	straight line
Furniture and fixtures	20%	straight line
IT and Computers	33%	straight line
Other Equipments	20%	straight line

HARDY EXPLORATION & PRODUCTION (INDIA) INC.
Notes to the Accounts continued
For the year ended 31 December 2004

g) Decommissioning

At the end of the producing life of a field, costs are to be incurred in removing, decommissioning facilities, plugging and abandoning the wells. Decommissioning costs are estimated and stated at an amount representing the costs, which would be incurred should decommissioning occur at the balance sheet date and the estimates are reassessed on each year. The decommissioning asset is included within fixed assets with the cost of the related assets installed and are adjusted for any revision to the decommissioning costs and the provision there for. The amortization of the asset, calculated on a unit of production basis based on proved and probable reserves, is shown as "Decommissioning charge" in the profit and loss account.

h) Foreign currencies

HEPI maintains the accounts of the company in US Dollars. Foreign currency transactions are accounted for at the exchange rate ruling on the date of the transaction. At the year end all foreign currency assets are restated at the average of the buying and the selling exchange rates prevailing at the balance sheet date. Exchange difference arising out of actual payments / realizations and from the year end restatement referred to above are dealt with in the profit and loss account.

Rates of exchange were as follows:

	31 December 2004	31 December 2003
£ to US \$	1.9485	1.7157
US \$ to Indian Rupees	43.6800	45.5600

i) Deferred taxation

Deferred tax is recognized in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more or a right to pay less or to receive more tax.

Deferred tax assets are recognized only to the extent that the directors consider that it is more likely than not there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

j) Leasing commitments

Rental charges or charter hire charges payable under operating leases are charged to the profit & loss account as part of production expenses over the lease term.

HARDY EXPLORATION & PRODUCTION (INDIA) INC.
Notes to the Accounts continued
For the year ended 31 December 2004

k) Disclosures

The deferred tax asset of \$4,713,000 was introduced in the 2003 accounts originally as a reserve movement. The 2003 profit and loss account has been restated to include this amount as a deferred tax credit to the profit and loss account in that year. The effect of this adjustments on the comparative amounts is to increase the profit for the financial year to US\$ 6607,771 compared to US\$ 1,894,771 as originally reported.

2 Turnover

	2004 US\$		2003 US\$	
	India	London	India	London
Continuing Operations				
- Oil sales	13,447,529	-	9,396,985	-
- Profit oil to Govt.	(790,518)	-	(659,398)	-
- Other income	17,955	889,685	5,685	187,118
	12,674,966	889,685	8,743,272	187,118

Other income relates to technical services to third parties, overhead recovery from joint venture operations and miscellaneous receipts if any.

3 Operating Profit

Operating profit is stated after charging:

	2004 US\$	2003 US\$
Depreciation	37,210	47,173
Depletion	1,418,018	875,659
Decommissioning	7,770	19,646
Operating lease costs - plant & machinery	1,733,202	1,892,600
- land & buildings	136,323	155,828
Auditors' remuneration	20,469	21,827

The Company has a policy in place for the award of non-auditor work to the auditors, which in certain circumstances, requires approval. The auditors' received no remuneration for non-audit services in the year.

HARDY EXPLORATION & PRODUCTION (INDIA) INC.

Notes to the Accounts continued

For the year ended 31 December 2004

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HARDY EXPLORATION & PRODUCTION (INDIA) INC.

Notes to the Accounts continued

For the year ended 31 December 2004

4 Staff Costs

	2004 US\$	2003 US\$
Wages and salaries	1,366,575	1,329,147
Social security costs	41,916	35,979
Other pension costs	9,329	13,500
	<hr/>	<hr/>
	1,417,820	1,378,626

Staff costs are shown gross before amounts recharged to joint ventures

The weighted average monthly number of employees, including directors and individuals employed by the company working on joint venture operations are as follows:

	2004	2003
Management and administration	14	16
Operations	23	23
	<hr/>	<hr/>
	37	39

5 Director's Emoluments

Details of remunerations are set out in as follows:

	2004 US\$	2003 US\$
Director's Emoluments	563,579	507,360
Highest Paid	260,939	259,648

HARDY EXPLORATION & PRODUCTION (INDIA) INC.
Notes to the Accounts continued
For the year ended 31 December 2004

6 Interest receivable and similar income

	2004 US\$	2003 US\$
Bank interest	58,395	29,626
Other interest	61,443	-
	<hr/>	<hr/>
	119,838	29,626

7 Interest payable and similar charges

	2004 US\$	2003 US\$
Bank loan and overdraft interest	197,974	433,012
Other finance charges	56,250	56,250
	<hr/>	<hr/>
	254,224	488,262

HARDY EXPLORATION & PRODUCTION (INDIA) INC.

Notes to the Accounts continued

For the year ended 31 December 2004

8 Taxation

a) Analysis of taxation charge in year

	2004 US\$	2003 US\$
Current tax charge		
UK Corporation Tax		
<hr/>		
Foreign Tax		
India		
Minimum Alternate Tax on profits for the year	179,000	2,130
	<hr/>	<hr/>
	179,000	2,130
<hr/>		
Foreign tax		
USA		
Alternate Minimum Tax on profits for the year	95,000	-
	<hr/>	<hr/>
	95,000	-
<hr/>		
Total current tax charge	274,000	2,130
<hr/>		
Total deferred tax charges	3,298,000	(4,071,000)
<hr/>		
Tax on profit on ordinary activities	3,573,706	(4,068,870)
<hr/>		
Deferred tax charge:		
Deferred Tax Asset at the beginning of the year	4,071,000	-
Reversal of timing differences charged	(3,298,000)	(4,071,000)
	<hr/>	<hr/>
Deferred Tax Asset	773,000	4,071,000
<hr/>		
Deferred tax charges	3,298,000	(4,071,000)
<hr/>		

HARDY EXPLORATION & PRODUCTION (INDIA) INC.
Notes to the Accounts continued
For the year ended 31 December 2004

Deferred tax analysis

	2004 US\$	2003 US\$
Differences between accumulated depletion and depreciation and capital	(2,492,000)	(1,477,000)
Other timing differences	546,000	532,000
Tax losses	2,719,000	5,016,000
<hr/>		
Deferred Tax Asset	773,000	4,071,000

b) Factors affecting tax charge for year

	2004 US\$	2003 US\$
Profit on ordinary activities before tax	7,270,685	2,538,901
Profit on ordinary activities before tax multiplied by the rate of tax in UK of 30%	2,181,206	761,670
Capital allowances in excess of depreciation and Utilisation of tax losses	(2,181,206)	(761,670)
Effects of non taxable income	-	-
Foreign tax on overseas income	274,000	2,130
<hr/>		
Total current tax charge	274,000	2,130

c) Factors that may affect future corporate tax charges

At 31 December 2004 HEPI had losses of approximately US\$ 2.99 million, US\$ 9.76 million and US\$ 8.31 million are eligible for capital allowance and Mineral extraction allowance are available for offset against trading profits chargeable to UK corporation Tax.

HEPI's operations in India, where relief from tax on profits is available for a set of period of time, known as a tax holiday. Further, double taxation avoidance agreement exists between India and UK, whereby foreign tax credit is available to Hardy.

HARDY EXPLORATION & PRODUCTION (INDIA) INC.
Notes to the Accounts continued
For the year ended 31 December 2004

9. Intangible assets

Oil and Gas Exploration Assets

	US\$
Costs and net book value	
At 1 January 2004	7,434,532
Additions	1,070,153
<hr/>	
At 31 December 2004	8,504,685
<hr/>	
At 31 December 2003	7,434,532
<hr/>	

10. Tangible Assets

Oil and gas assets represent interest in producing oil and gas assets falling under the one cost pool- India. Other tangible assets consisting of office furniture, computers, workstations and office equipment.

Oil and Gas Development / Producing Assets

	Oil and gas assets US\$	Other assets US\$	Total US\$
Cost			
At 1 January 2004	21,296,142	2,456,380	23,752,522
Additions	2,930,605	46,834	2,977,439
Disposals	(280,000)	(141,580)	(421,580)
At 31 December 2004	23,946,747	2,361,634	26,308,381
<hr/>			
Depletion, depreciation and amortisation			
At 1 January 2004	16,788,735	2,409,897	19,198,632
Charge for the year	1,425,788	37,210	1,462,998
Disposals	-	(141,580)	(141,580)
At 31 December 2004	18,214,523	2,305,527	20,520,050
<hr/>			
Net book value at 31 December 2004	5,732,224	56,107	5,788,331
<hr/>			
Net book value at 31 December 2003	4,507,407	46,483	4,553,890
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Proceeds from the disposal of the Sangapur interest were deducted from development assets and there by the resulting loss on sale of Sangapur US\$ 282,682 was capitalized.

HARDY EXPLORATION & PRODUCTION (INDIA) INC.
Notes to the Accounts continued
For the year ended 31 December 2004

11. Debtors

	2004 US\$	2003 US\$
Trade debtors	1,514,155	536,737
Owed by parent company	781,745	70,939
Other debtors	543,636	322,931
Prepayments and accrued Income	27,609	6,414
	<hr/> 2,867,145	<hr/> 937,021

12. Creditors – amounts falling due within one year

	2004 US\$	2003 US\$
Secured bank loan	1,805,001	441,484
Trade creditors	1,226,819	1,135,311
Other creditors	724,835	952,512
Taxation	274,000	-
Accruals	1,518,054	1,264,677
	<hr/> 5,548,709	<hr/> 3,793,984

13. Creditors – amounts falling due after more than one year

	2004 US\$	2003 US\$
Secured Bank Loan	<hr/> -	<hr/> 1,748,751

HARDY EXPLORATION & PRODUCTION (INDIA) INC.
Notes to the Accounts continued
For the year ended 31 December 2004

14. Provisions

Provisions for liabilities and charges

	2004 US\$
Decommissioning	
At 1 January 2004	1,296,000
Change in decommissioning estimate	-
<hr/>	
At 31 December 2004	1,296,000

The provision has been made by estimating the decommissioning cost at the current prices with the existing technology. Decommissioning costs are expected to be incurred between 2012 to 2013.

15. Share Capital

	Number \$0.01 Ordinary Shares "000"
Authorised ordinary shares	
At 1 January and 31 December 2004	1,000
<hr/>	
	Number \$0.01 Ordinary Shares
Allotted, issued and fully paid ordinary shares	
At 1 January and 31 December 2004	4,000

HARDY EXPLORATION & PRODUCTION (INDIA) INC.
Notes to the Accounts continued
For the year ended 31 December 2004

16. Reserves

	Additional paid in capital US\$	Profit & Loss A/c US\$
At 1 January 2004	34,071,105	(18,241,044)
Retained profit for the period	-	3,698,685
<hr/>		
At 31 December 2004	34,071,105	(14,542,359)

17. Reconciliation of operating profit to operating cash flows

	2004 US\$	2003 US\$
Operating Profit	7,405,071	2,997,537
Depletion and depreciation	1,455,228	922,832
Decommissioning charge	7,770	19,646
(Increase)/ decrease in debtors	(1,930,124)	1,361,749
Increase / (decrease) in creditors	221,726	(1,390,284)
(Increase)/ decrease in stocks	(323,264)	407,920
<hr/>		
Net cash inflow from operating activities	6,836,407	4,319,400

HARDY EXPLORATION & PRODUCTION (INDIA) INC.
Notes to the Accounts continued
For the year ended 31 December 2004

18. Net Funds / (Debt)

a) Analysis of net funds / (debt)

	At 1, January 2004 US\$	Cashflows US\$	Non cashflows US\$	At 31 December 2004 US\$
Cash at bank	5,349,388	2,444,677	-	7,794,065
Debts due within one year	(441,484)	441,484	(1,805,001)	(1,805,001)
Loans due more than one year	(1,748,751)	-	1,748,751	-
	-	-	-	-
	3,159,153	2,886,161	(56,250)	5,989,064

b) Reconciliation of net cash flow to movement in net funds

	2004 US\$	2003 US\$
(Decrease) / increase in cash in the year	2,444,677	3,247,150
Cash inflow from drawdown of debt financing	441,484	341,285
Change in net funds resulting from non-cashflows	(56,250)	(56,250)
Net Funds as at 1 st January 2004	3,159,153	(373,032)
	-	-
Net funds at 31 December 2004	5,989,064	3,159,153

19. Financial Instruments

The credit facility balance of US\$ 1,861,251 shown in note 16 represents US dollar borrowings. Borrowing under the credit facility are at floating interest rates of quarterly US LIBOR rates plus 2%. The maturity profile of the company's financial liabilities, other than short-term creditors such as trade creditors and accruals as at 31st December 2004 was as follows:

In one year or less	US\$ 1,861,251
In more than one year but not more than two years	-
In more than two years but not more than five years	-
In more than five years	-

HARDY EXPLORATION & PRODUCTION (INDIA) INC.
Notes to the Accounts continued
For the year ended 31 December 2004

20. Capital commitments

As 31 December 2004 the company had no outstanding capital commitments (2003 - US\$ Nil).

21. Other non-cancelable financial commitments

Annual commitments under non-cancelable operating leases are as follows:

	2004 US\$	2003 US\$
Land and buildings, expiring within:		
One year	128,398	136,323
Two to five years	128,398	128,398
After five years	-	-
Other operating leases, expiring within:		
One year	1,767,330	923,345
Two to five years	1,767,330	-
After five years	-	-

Other operating lease commitments represent Hardy's share of operating lease for floating production system entered into by unincorporated joint venture for its participating interest.

At 31 December 2004 the company has provided performance guarantees amounting to \$2,138,430. Cash collateral has been provided of \$817,000. This amount is included within cash at bank but is not available for the company's working capital requirements.

22. Contingent Liabilities

Members of CY-OS-90/1 for unincorporated joint venture partners are currently in dispute with Frontier Aban Drilling (India) Limited for US\$ 3.74 million on account of charter hire charges of drillship hire for drilling a development well in CY-OS-90/1, which was damaged. Hardy's share of the above is US\$ 673,000 for its 18% Participating Interest in the block. Members of the Joint Venture have submitted a counter claim against Frontier. The matter is before the arbitration tribunal for adjudication.