HOLLIS EDEN PHARMACEUTICALS INC /DE/
Form S-3
March 16, 2004
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As filed with the Securities and Exchange Commission on March 16, 2004

Registration No. 333-

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM S-3

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

HOLLIS-EDEN PHARMACEUTICALS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**13-3697002**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

4435 Eastgate Mall, Suite 400, San Diego, California 92121, (858) 587-9333

(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

Richard B. Hollis

Chairman of the Board and Chief Executive Officer

HOLLIS-EDEN PHARMACEUTICALS, INC.

4435 EASTGATE MALL, SUITE 400, San Diego, California 92121, (858) 587-9333

(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

Eric J. Loumeau, Esq.

HOLLIS-EDEN PHARMACEUTICALS, INC.

4435 Eastgate Mall, Suite 400, San Diego, California 92121, (858) 587-9333

Approximate date of commencement of proposed sale to the public:

As soon as practicable after the effective date of this Registration Statement.

If the only securities being registered on this form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. ¨

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. x

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨ _____

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨ _____

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. ¨

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered (1)	Proposed Maximum Offering Price Per Share (2)	Proposed Maximum Aggregate Offering Price (2)	Amount of Registration Fee
Common Stock (3)	323,589	$ 12.25	$ 3,963,965	$ 503

(1) Pursuant to Rule 416(a) of the Securities Act of 1933, as amended, this registration statement also covers such additional shares as may hereafter be offered or issued as a result of stock splits, stock dividends or similar transactions.

(2) Estimated solely for the purpose of calculating the amount of the registration fee pursuant to Rule 457(c) of the Securities Act of 1933. The price per share and aggregate offering price are based upon the average of the high and low sales prices of Hollis-Eden s common stock on March 10, 2004 as reported on The Nasdaq National Market.

(3) Each share of the registrant s common stock being registered hereunder includes Series A junior participating preferred stock purchase rights. Prior to the occurrence of certain events, the Series A junior participating preferred stock purchase rights will not be exercisable or evidenced separately from the registrant s common stock, and they have no value except as reflected in the market price of the shares to which they are attached.

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act or until the registration statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

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The information in this prospectus is not complete and may be changed. The selling stockholders may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

SUBJECT TO COMPLETION

Preliminary Prospectus Dated March 16, 2004

PROSPECTUS

323,589 Shares

HOLLIS-EDEN PHARMACEUTICALS, INC.

Common Stock

This prospectus relates to the resale, from time to time, of up to 323,589 shares of common stock of Hollis-Eden Pharmaceuticals, Inc., par value $0.01 per share, by the selling stockholders named in this prospectus in the section SELLING STOCKHOLDERS, including their pledgees, assignees and successors-in-interest, whom we collectively refer to in this document as the Selling Stockholders. On February 24, 2004, we consummated the acquisition of Congressional Pharmaceutical Corporation (CPC) pursuant to which we: (i) agreed to issue to the Selling Stockholders a total of 48,589 shares of our common stock, of which 4,362 shares will be issued in repayment of a loan, and (ii) agreed to issue to the Selling Stockholders up to a total of 275,000 additional shares of our common stock based on the achievement of certain development milestones. We will not receive any of the proceeds from the sale of any of the shares covered by this prospectus. References in this prospectus to our company, we, our, and us refer to Hollis-Eden Pharmaceuticals, Inc.

Hollis-Eden s common stock is listed on The Nasdaq National Market under the symbol HEPH. The closing sale price of the common stock, as reported on The Nasdaq National Market on March 10, 2004, was $11.92 per share.

Investing in our common stock involves a high degree of risk. ***See Risk Factors, beginning on page 3.***

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is , 2004.

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This prospectus is part of a registration statement we filed with the Securities and Exchange Commission. You should rely only on the information contained in or incorporated by reference in this prospectus. The SEC allows us to incorporate by reference information that we file with them, which means that we can disclose important information to you by referring you to those documents. The information incorporated by reference is considered to be part of this prospectus, and information that we file later with the SEC will automatically update and supersede this information.

HOLLIS-EDEN PHARMACEUTICALS

Hollis-Eden Pharmaceuticals, Inc., a development-stage pharmaceutical company, is engaged in the discovery, development and commercialization of products for the treatment of diseases and disorders in which the body is unable to mount an appropriate immune response. Our initial development efforts target radiation and chemotherapy induced immune suppression and immune dysregulation caused by infectious diseases such as HIV, malaria and tuberculosis.

Hollis-Eden s executive offices are located at 4435 Eastgate Mall, Suite 400, San Diego, California 92121, telephone number (858) 587-9333.

USE OF PROCEEDS

Hollis-Eden will not receive any proceeds from the sale of the shares of common stock offered by the Selling Stockholders.

RISK FACTORS

An investment in Hollis-Eden shares involves a high degree of risk. You should consider the following discussion of risks, in addition to other information contained in this annual report. If any of the following risks actually occurs, our business, financial condition, results of operations and future growth prospects would likely be materially adversely affected. This annual report also contains forward-looking statements that involve risks and uncertainties.

If we do not obtain government regulatory approval for our products, we cannot sell our products and we will not generate revenues.

Our principal development efforts are currently centered around immune regulating hormones, a class of drug candidates which we believe shows promise for the treatment of a variety of infectious diseases and immune system and metabolic disorders. However, all drug candidates require U.S. FDA and foreign government approvals before they can be commercialized. These regulations change from time to time and new regulations may be adopted. None of our drug candidates has been approved for commercial sale. We may incur significant additional operating losses over the next several years as we fund development, clinical testing and other expenses while seeking regulatory approval. While limited clinical trials of our drug candidates have been conducted to date, significant additional trials are required, and we may not be able to demonstrate that these drug candidates are safe or effective. If we are unable to demonstrate the safety and effectiveness of a particular drug candidate to the satisfaction of regulatory authorities, the drug candidate will not obtain required government approval. If we do not receive FDA or foreign approvals for our products, we will not be able to sell our products and will not generate revenues. If we receive regulatory

approval of a product, such approval may impose limitations on the indicated uses for which we may market the product, which may limit our ability to generate significant revenues.

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If we do not successfully commercialize our products, we may never achieve profitability.

We have experienced significant operating losses to date because of the substantial expenses we have incurred to acquire and fund development of our drug candidates. We have never had operating revenues and have never commercially introduced a product. Our accumulated deficit was approximately $107.1 million as of December 31, 2003. Our net losses for fiscal years 2003, 2002 and 2001 were $25.7 million, $17.5 million and $15.8 million, respectively. Many of our research and development programs are at an early stage. Potential drug candidates are subject to inherent risks of failure. These risks include the possibilities that no drug candidate will be found safe or effective, meet applicable regulatory standards or receive the necessary regulatory clearances. Even safe and effective drug candidates may never be developed into commercially successful drugs. If we are unable to develop safe, commercially viable drugs, we may never achieve profitability. If we become profitable, we may not remain profitable.

The market for treating severe acute radiation injury is uncertain.

We do not believe any drug has ever been approved and commercialized for the treatment of severe acute radiation injury. In addition, the incidence of large-scale exposure to nuclear or radiological events has been low. Accordingly, even if NEUMUNE™ (HE2100), our lead drug candidate to treat acute radiation injury, is approved by the FDA, we cannot predict with any certainty the size of this market. The potential market for NEUMUNE is largely dependent on the size of stockpiling orders, if any, procured by the U.S. and foreign governments. While a number of governments have historically stockpiled drugs to treat indications such as smallpox, anthrax exposure, plague, tularemia and certain long-term effects of radiation exposure, we are unaware of any significant stockpiling orders for drugs to treat the acute effects of radiation injury. Due to these uncertainties, we cannot guarantee that we will receive any stockpiling orders for NEUMUNE or that NEUMUNE will achieve market acceptance by the general public.

As a result of our intensely competitive industry, we may not gain enough market share to be profitable.

The biotechnology and pharmaceutical industries are intensely competitive. We have numerous competitors in the United States and elsewhere. Because we are pursuing potentially large markets, our competitors include major, multinational pharmaceutical and chemical companies, specialized biotechnology firms and universities and other research institutions. Several of these entities have already successfully marketed and commercialized products that will compete with our products, assuming that our products gain regulatory approval. Companies such as GlaxoSmithKline, Merck & Company, Roche Pharmaceuticals, Pfizer Inc. and Abbott Laboratories have significant market share for the treatment of a number of infectious diseases such as HIV. In addition, biotechnology companies such as Gilead Sciences Inc., Chiron Corporation and Vertex Pharmaceuticals Inc., as well as many others, have research and development programs in these fields. A large number of companies, including Merck & Company, Pfizer Inc., Johnson & Johnson Inc. and Amgen Inc. are also developing and marketing new drugs for the treatment of chronic inflammatory conditions. Companies such as Amgen Inc. have developed or are developing products to boost neutrophils after chemotherapy.

Many of these competitors have greater financial and other resources, larger research and development staffs and more effective marketing and manufacturing organizations than we do. In addition, academic and government institutions have become increasingly aware of the commercial value of their research findings. These institutions are now more likely to enter into exclusive licensing agreements with commercial enterprises, including our competitors, to develop and market commercial products.

Our competitors may succeed in developing or licensing technologies and drugs that are more effective or less costly than any we are developing. Our competitors may succeed in obtaining FDA or other regulatory approvals for drug candidates before we do. If competing drug

candidates prove to be more effective or less costly than our drug candidates, our drug candidates, even if approved for sale, may not be able to compete successfully with our competitors existing products or new products under development. If we are unable to compete successfully, we may never be able to sell enough products at a price sufficient to permit us to generate profits.

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We may need to raise additional money before we achieve profitability; if we fail to raise additional money, it could be difficult to continue our business.

As of December 31, 2003, our cash and cash equivalents totaled approximately $84.9 million. Based on our current plans, we believe these financial resources, and interest earned thereon, will be sufficient to meet our operating expenses and capital requirements at least well into 2006. However, changes in our research and development plans or other events affecting our operating expenses may result in the expenditure of such cash before that time. We may require substantial additional funds in order to finance our drug discovery and development programs, fund operating expenses, pursue regulatory clearances, develop manufacturing, marketing and sales capabilities, and prosecute and defend our intellectual property rights. We may seek additional funding through public or private financing or through collaborative arrangements with strategic partners.

You should be aware that in the future:

- we may not obtain additional financial resources when necessary or on terms favorable to us, if at all; and
- any available additional financing may not be adequate.

If we cannot raise additional funds when needed, or on acceptable terms, we will not be able to continue to develop our drug candidates.

Failure to protect our proprietary technology could impair our competitive position.

We own or have obtained a license to over 100 issued U.S. and foreign patents and over 100 pending U.S. and foreign patent applications. Our success will depend in part on our ability to obtain additional United States and foreign patent protection for our drug candidates and processes, preserve our trade secrets and operate without infringing the proprietary rights of third parties. We place considerable importance on obtaining patent protection for significant new technologies, products and processes. Legal standards relating to the validity of patents covering pharmaceutical and biotechnology inventions and the scope of claims made under such patents are still developing. In some of the countries in which we intend to market our products, pharmaceuticals are either not patentable or have only recently become patentable. Past enforcement of intellectual property rights in many of these countries has been limited or non-existent. Future enforcement of patents and proprietary rights in many other countries may be problematic or unpredictable. Moreover, the issuance of a patent in one country does not assure the issuance of a similar patent in another country. Claim interpretation and infringement laws vary by nation, so the extent of any patent protection is uncertain and may vary in different jurisdictions. Our domestic patent position is also highly uncertain and involves complex legal and factual questions. The applicant or inventors of subject matter covered by patent applications or patents owned by or licensed to us may not have been the first to invent or the first to file patent applications for such inventions. Due to uncertainties regarding patent law and the circumstances surrounding our patent applications, the pending or future patent applications we own or have licensed may not result in the issuance of any patents. Existing or future patents owned by or licensed to us may be challenged, infringed upon, invalidated, found to be unenforceable or circumvented by others. Further, any rights we may have under any issued patents may not provide us with sufficient protection against competitive products or otherwise cover commercially valuable products or processes.

Litigation or other disputes regarding patents and other proprietary rights may be expensive, cause delays in bringing products to market and harm our ability to operate.

The manufacture, use or sale of our drug candidates may infringe on the patent rights of others. If we are unable to avoid infringement of the patent rights of others, we may be required to seek a license, defend an infringement action or challenge the validity of the patents in court. Patent litigation is costly and time consuming. We may not have sufficient resources to bring these actions to a successful conclusion. In addition, if

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we do not obtain a license, develop or obtain non-infringing technology, or fail to successfully defend an infringement action or have the patents we are alleged to infringe declared invalid, we may

- incur substantial money damages;
- encounter significant delays in bringing our drug candidates to market;
- be precluded from participating in the manufacture, use or sale of our drug candidates or methods of treatment without first obtaining licenses to do so; and/or
- not be able to obtain any required license on favorable terms, if at all.

In addition, if another party claims the same subject matter or subject matter overlapping with the subject matter that we have claimed in a United States patent application or patent, we may decide or be required to participate in interference proceedings in the United States Patent and Trademark Office in order to determine the priority of invention. Loss of such an interference proceeding would deprive us of patent protection sought or previously obtained and could prevent us from commercializing our products. Participation in such proceedings could result in substantial costs, whether or not the eventual outcome is favorable. These additional costs could adversely affect our financial results.

Confidentiality agreements with employees and others may not adequately prevent disclosure of trade secrets and other proprietary information.

In order to protect our proprietary technology and processes, we also rely in part on confidentiality agreements with our employees, consultants, outside scientific collaborators and sponsored researchers and other advisors. These agreements may not effectively prevent disclosure of confidential information and may not provide an adequate remedy in the event of unauthorized disclosure of confidential information. In addition, others may independently discover trade secrets and proprietary information. Costly and time-consuming litigation could be necessary to enforce and determine the scope of our proprietary rights, and failure to obtain or maintain trade secret protection could adversely affect our competitive business position.

Existing pricing regulations and reimbursement limitations may reduce our potential profits from the sale of our products.

The requirements governing product licensing, pricing and reimbursement vary widely from country to country. Some countries require approval of the sale price of a drug before it can be marketed. In many countries, the pricing review period begins after product-licensing approval is granted. As a result, we may obtain regulatory approval for a drug candidate in a particular country, but then be subject to price regulations that reduce our profits from the sale of the product. In some foreign markets pricing of prescription pharmaceuticals is subject to continuing government control even after initial marketing approval. In addition, certain governments may grant third parties a license to manufacture our product without our permission. Such compulsory licenses typically would be on terms that are less favorable to us and would have the effect of reducing our revenues.

Varying price regulation between countries can lead to inconsistent prices and some re-selling by third parties of products from markets where products are sold at lower prices to markets where those products are sold at higher prices. This practice of exploiting price differences between

countries could undermine our sales in markets with higher prices and reduce the sales of our future products, if any.

While we do not have any applications for regulatory approval of our products currently pending, the decline in the size of the markets in which we may in the future sell commercial products could cause the perceived market value of our business and the price of our common stock to decline.

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Our ability to commercialize our products successfully also will depend in part on the extent to which reimbursement for the cost of our products and related treatments will be available from government health administration authorities, private health insurers and other organizations. Third-party payors are increasingly challenging the prices charged for medical products and services. If we succeed in bringing any of our potential products to the market, such products may not be considered cost effective and reimbursement may not be available or sufficient to allow us to sell such products on a profitable or competitive basis.

Delays in the conduct or completion of our preclinical or clinical studies or the analysis of the data from our preclinical or clinical studies may result in delays in our planned filings for regulatory approvals, or adversely affect our ability to enter into collaborative arrangements.

The current status of our drug candidates is set forth below. We have either completed or are in the midst of:

- animal efficacy studies with NEUMUNE in the United States for the treatment of radiation exposure and chemotherapy protection;
- Phase II clinical trials with IMMUNITIN™ (HE2000) in South Africa and Phase I/II clinical trials with IMMUNITIN in the United States for the treatment of HIV/AIDS;
- Phase II clinical trials with IMMUNITIN in Thailand for the treatment of malaria.

We may encounter problems with some or all of our completed or ongoing studies that may cause us or regulatory authorities to delay or suspend our ongoing studies or delay the analysis of data from our completed or ongoing studies. We rely, in part, on third parties to assist us in managing and monitoring our preclinical and clinical studies. We generally do not have control over the amount and timing of resources that our business partners devote to our drug candidates. Our reliance on these third parties may result in delays in completing or failure to complete studies if third parties fail to perform their obligations to us. If the results of our ongoing and planned studies for our drug candidates are not available when we expect or if we encounter any delay in the analysis of the results of our studies for our drug candidates:

- we may not have the financial resources to continue research and development of any of our drug candidates; and
- we may not be able to enter into collaborative arrangements relating to any drug candidate subject to delay in regulatory filing.

Any of the following reasons, among others, could delay or suspend the completion of our ongoing and future studies:

- delays in enrolling volunteers;
- interruptions in the manufacturing of our drug candidates or other delays in the delivery of materials required for the conduct of our studies;
- lower than anticipated retention rate of volunteers in a trial;

unfavorable efficacy results;

serious side effects experienced by study participants relating to the drug candidate;

new communications from regulatory agencies about how to best conduct these studies; or

failure to raise additional funds.

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If the manufacturers of our products do not comply with current Good Manufacturing Practices regulations, or cannot produce the amount of products we need to continue our development, we will fall behind on our business objectives.

An outside manufacturer, Hovione Soc. Química, S.A., is currently the primary producer of the active pharmaceutical ingredient for our drug candidate IMMUNITIN, and may produce other compounds for us in the future. Manufacturers producing our drug candidates must follow current Good Manufacturing Practices regulations enforced by the FDA and foreign equivalents. If a manufacturer of our drug candidates does not conform to the Good Manufacturing Practices regulations and cannot be brought up to such a standard, we will be required to find alternative manufacturers that do conform. This may be a long and difficult process, and may delay our ability to receive FDA or foreign regulatory approval of our products.

We also rely on our manufacturers to supply us with a sufficient quantity of our drug candidates to conduct clinical trials. If we have difficulty in the future obtaining our required quantity and quality of supply, we could experience significant delays in our development programs and regulatory process.

Our ability to achieve any significant revenue may depend on our ability to establish effective sales and marketing capabilities.

Our efforts to date have focused on the development and evaluation of our drug candidates. As we continue clinical studies and prepare for commercialization of our drug candidates, we may need to build a sales and marketing infrastructure. As a company, we have no experience in the sales and marketing of pharmaceutical products. If we fail to establish a sufficient marketing and sales force or to make alternative arrangements to have our products marketed and sold by others on attractive terms, it will impair our ability to commercialize our drug candidates and to enter new or existing markets. Our inability to effectively enter these markets would materially and adversely affect our ability to generate significant revenues.

If we were to lose the services of Richard B. Hollis, or fail to attract or retain qualified personnel in the future, our business objectives would be more difficult to implement, adversely affecting our operations.

Our ability to successfully implement our business strategy depends highly upon our Chief Executive Officer, Richard B. Hollis. The loss of Mr. Hollis services could impede the achievement of our objectives. We also highly depend on our ability to hire and retain qualified scientific and technical personnel. The competition for these employees is intense. Thus, we may not be able to continue to hire and retain the qualified personnel needed for our business. Loss of the services of or the failure to recruit key scientific and technical personnel could adversely affect our business, operating results and financial condition.

We may face product liability claims related to the use or misuse of our products, which may cause us to incur significant losses.

We are currently exposed to the risk of product liability claims due to administration of our drug candidates in clinical trials, since the use or misuse of our drug candidates during a clinical trial could potentially result in injury or death. If we are able to commercialize our products, we will also be subject to the risk of losses in the future due to product liability claims in the event that the use or misuse of our commercial products results in injury or death. We currently maintain liability insurance on a claims-made basis in an aggregate amount of $5 million. Because we cannot predict the magnitude or the number of claims that may be brought against us in the future, we do not know whether the insurance policies coverage limits are adequate. The insurance is expensive, difficult to obtain and may not be available in the future on

acceptable terms, or at all. Any claims against us, regardless of their merit, could substantially increase our costs and cause us to incur significant losses.

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Trading in our securities could be subject to extreme price fluctuations that could adversely affect your investment.

The market prices for securities of life sciences companies, particularly those that are not profitable, have been highly volatile, especially recently. Publicized events and announcements may have a significant impact on the market price of our common stock. For example:

- biological or medical discoveries by competitors;
- public concern about the safety of our drug candidates;
- delays in the conduct or analysis of our clinical trials;
- unfavorable results from clinical trials;
- unfavorable developments concerning patents or other proprietary rights; or
- unfavorable domestic or foreign regulatory developments;

may have the effect of temporarily or permanently driving down the price of our common stock. In addition, the stock market from time to time experiences extreme price and volume fluctuations which particularly affect the market prices for emerging and life sciences companies, such as ours, and which are often unrelated to the operating performance of the affected companies. For example, our stock price has ranged from $5.00 to $36.25 between January 1, 2003 and March 5, 2004.

These broad market fluctuations may adversely affect the ability of a stockholder to dispose of his shares at a price equal to or above the price at which the shares were purchased. In addition, in the past, following periods of volatility in the market price of a company s securities, securities class-action litigation has often been instituted against that company. This type of litigation, if instituted, could result in substantial costs and a diversion of management s attention and resources, which could materially adversely affect our business, financial condition and results of operations.

We may be delisted from The Nasdaq National Market, which could materially limit the trading market for our common stock.

Our common stock is quoted on The Nasdaq National Market. In order to continue to be included in The Nasdaq National Market, a company must meet Nasdaq s maintenance criteria. We may not be able to continue to meet these listing criteria. Failure to meet Nasdaq s maintenance criteria may result in the delisting of our common stock from The Nasdaq National Market. If our common stock is delisted, in order to have our common stock relisted on The Nasdaq National Market we would be required to meet the criteria for initial listing, which are more stringent than the maintenance criteria. Accordingly, if we were delisted we may not be able to have our common stock relisted on The Nasdaq National Market. If our common stock is removed from listing on The Nasdaq National Market, it may become more difficult for us to raise funds through the sale of our common stock or securities convertible into our common stock.

Because stock ownership is concentrated, you and other investors will have minimal influence on stockholders decisions.

Assuming that outstanding warrants and options have not been exercised, Richard B. Hollis, our Chief Executive Officer, owns approximately 14% of our outstanding common stock as of March 5, 2004. Assuming that Mr. Hollis exercises all of his outstanding warrants and options that vest within 60 days of March 5, 2004, Mr. Hollis would beneficially own approximately 20% of our outstanding common stock. As a result, Mr. Hollis may be able to significantly influence the management of Hollis-Eden and all matters requiring stockholder approval, including the election of directors. Such concentration of ownership may also have the effect of delaying or preventing a change in control of Hollis-Eden.

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Substantial sales of our stock may impact the market price of our common stock.

Future sales of substantial amounts of our common stock, including shares that we may issue upon exercise of options and warrants, could adversely affect the market price of our common stock. Further, if we raise additional funds through the issuance of common stock or securities convertible into or exercisable for common stock, the percentage ownership of our stockholders will be reduced and the price of our common stock may fall.

Issuing preferred stock with rights senior to those of our common stock could adversely affect holders of common stock.

Our charter documents give our board of directors the authority to issue series of preferred stock without a vote or action by our stockholders. The board also has the authority to determine the terms of preferred stock, including price, preferences and voting rights. The rights granted to holders of preferred stock may adversely affect the rights of holders of our common stock. For example, a series of preferred stock may be granted the right to receive a liquidation preference a pre-set distribution in the event of a liquidation that would reduce the amount available for distribution to holders of common stock. In addition, the issuance of preferred stock could make it more difficult for a third party to acquire a majority of our outstanding voting stock. As a result, common stockholders could be prevented from participating in transactions that would offer an optimal price for their shares.

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WHERE YOU CAN GET MORE INFORMATION

We are a reporting company and file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy these reports, proxy statements and other information at the SEC s public reference rooms at 450 Fifth Street, N.W., Washington, D.C. 20549. You can request copies of these documents by writing to the SEC and paying a fee for the copying cost. Please call the SEC at 1-800-SEC-0330 for more information about the operation of the public reference rooms. Our SEC filings are also available at the SEC s Web site at http://www.sec.gov.

We incorporate by reference the documents listed below, except as modified by this registration statement, and any future filings we may make with the SEC under Section 13 (a), 13(c), 14 or 15 (d) of the Securities Exchange Act of 1934:

Annual Report on Form 10-K for the year ended December 31, 2003;

Current Report on Form 8-K filed with the SEC on February 26, 2004;

Notice of Annual Meeting and Proxy Statement for the 2003 Annual Meeting of Stockholders held on June 20, 2003; and

The description of our common stock included in our registration statement on Form S-4, No. 333-18725, as amended.

You may request a copy of these filings at no cost, by writing or telephoning us at the following address or telephone number:

Hollis-Eden Pharmaceuticals, Inc.

4435 Eastgate Mall, Suite 400

San Diego, CA 92121

Attn: Chief Accounting Officer

(858) 587-9333

These filings are also available free of charge on our website, at www.holliseden.com, as soon as reasonably practicable after we have electronically filed them with, or forwarded them to, the SEC. Information contained on our website is not part of this prospectus. You should rely only on the information contained or incorporated by reference in this prospectus and any prospectus supplement. We have not authorized anyone to provide you with information different from that contained in this prospectus or any prospectus supplement. The information contained in this prospectus and any prospectus supplement is accurate only as of the date of this prospectus and any prospectus supplement and, with respect to material incorporated by reference herein or in any prospectus supplement, the dates of such referenced material.

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FORWARD-LOOKING STATEMENTS

This prospectus contains forward-looking statements that involve risks and uncertainties. These include statements about our expectations, plans, objectives, assumptions or future events. In some cases, you can identify forward-looking statements by terminology such as anticipate, estimate, plans, potential, projects, continuing, ongoing, expects, management believes, we believe, we intend and similar exp statements involve estimates, assumptions and uncertainties that could cause actual results to differ materially from those expressed for the reasons described in this prospectus. You should not place undue reliance on these forward-looking statements.

You should be aware that our actual results could differ materially from those contained in the forward-looking statements due to a number of factors, including:

- failure to achieve positive results in preclinical or clinical studies;
- failure to obtain government regulatory approvals;
- competitive factors;
- our ability to raise additional capital;
- uncertainty regarding our patents and patent rights;
- relationships with our consultants, academic collaborators and other third-party service providers; and
- our ability to enter into future collaborative arrangements.

You should also consider carefully the statements under Risk Factors and other sections of this prospectus, which address additional factors that could cause our actual results to differ from those set forth in the forward-looking statements and could materially and adversely affect our business, operating results and financial condition. All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the applicable cautionary statements.

The forward-looking statements speak only as of the date on which they are made, and, except to the extent required by federal securities laws, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

We use data and industry forecasts throughout this prospectus, which we have obtained from internal surveys, market research, publicly available information and industry publications. Industry publications generally state that the information they provide has been obtained from sources believed to be reliable but that the accuracy and completeness of such information is not guaranteed. Similarly, we believe that the

surveys and market research we or others have performed are reliable, but we have not independently verified this information. We do not represent that any such information is accurate.

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SELLING STOCKHOLDERS

Summary

On February 24, 2004, we acquired all of the capital stock of Congressional Pharmaceutical Corporation (CPC). In exchange for CPC s capital stock, we agreed to issue 48,589 shares of our common stock to CPC stockholders, of which 4,362 shares will be issued in repayment of a loan to CPC, as well as the right to receive up to 275,000 additional shares of our common stock based on the achievement of certain development milestones. In addition to the capital stock, we received exclusive intellectual property rights licensed from the University of Chicago to develop a series of compounds that have the potential to protect against DNA mutations. We agreed to issue shares of our common stock to the following CPC stockholders: Daniel L. Smith, Gil Price, Dave Grdina, Jeff Murley, Yasushi Kataoka, The University of Chicago, Anthony J. Valdella and Sally J. Valdella, David Ryan, James E. Sellman and Barbara B. Sellman, N. Mathew Lisagor, Mark G. and Margarita S. Treuth, Gust Kouvaris, Gregg Allan Zeleniak, Gene Logic Inc., Richard B. Toren, Margaret L. and William R. Miller, Robert Bret Hart, Orrick Investments 2002 LLC and James Smith. Daniel L. Smith and Gil Price were directors and officers (President, CFO and Secretary and CEO, respectively) of CPC before the merger.

These shares of common stock have been or will be issued pursuant to the Agreement and Plan of Merger and Reorganization, dated as of February 24, 2004 between CPC and us. Pursuant to the Merger Agreement, we agreed to file with the SEC a registration statement covering the resale of all of our common stock covered by this prospectus pursuant to Rule 415 of the Securities Act. Accordingly, we filed a Registration Statement on Form S-3, of which this prospectus forms a part, on March 16, 2004, with respect to the resale of these shares from time to time.

Selling Stockholders Table

The following table sets forth the names of the Selling Stockholders, and the number of shares of common stock owned beneficially by them as of March 10, 2004 that may be offered under the terms of this prospectus. This information is based upon information provided by each Selling Stockholder. The applicable percentages of ownership are based on an aggregate of 19,212,647 shares issued and outstanding on March 1, 2004. The number of shares beneficially owned by each Selling Stockholder is determined under rules promulgated by the SEC, and is not necessarily indicative of beneficial ownership for any other purpose. The term Selling Stockholders includes the stockholders listed below and their transferees, pledges, donees or other successors. Although we have assumed for purposes of the table below that the Selling Stockholders will sell all of the shares offered by this prospectus, because the Selling Stockholders may offer from time to time all or some of their shares covered under this prospectus, or in another permitted manner, no assurances can be given as to the actual number of shares that will be resold by the Selling Stockholders or that will be held by the Selling Stockholders after completion of the resales. Except as described above, none of the Selling Stockholders has, or within the past three years has had, any position, office or other material relationship with us or any of our predecessors or affiliates.

Name	Number of Shares Being Offered	Percent of Shares Beneficially Owned After Offering
Gil Price(1)	110,361	*
Daniel L. Smith(2)	107,953	*
Dave Grdina(3)	51,717	*
The University of Chicago(4)	14,022	*
Anthony J. Valdella & Sally J. Valdella(5)	10,774	*
James Smith(6)	6,464	*

David Ryan(7)	3,231	*
James E. Sellman and Barbara B. Sellman(8)	3,231	*
N. Mathew Lisagor(9)	2,693	*

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Name	Number of Shares Being Offered	Percent of Shares Beneficially Owned After Offering
Mark G. and Margarita S. Treuth(10)	2,693	*
Jeff Murley(11)	1,723	*
Yasushi Kataoka(12)	1,723	*
Orrick Investments 2002 LLC(13)	1,615	*
Gust Kouvaris(14)	1,077	*
Gregg Allan Zeleniak(15)	1,077	*
Robert Bret Hart(16)	1,077	*
Richard B. Toren(17)	1,077	*
Margaret L. and William R. Miller(18)	538	*
Gene Logic Inc.(19)	538	*

* Less than 1%

(1) Includes 93,313 shares of Common Stock issuable on the achievement of certain developmental milestones and 2,038 shares of Common Stock in repayment of a loan.

(2) Includes 90,992 shares of Common Stock issuable on the achievement of certain developmental milestones and 2,324 shares of Common Stock in repayment of a loan.

(3) Includes 44,551 shares of Common Stock issuable on the achievement of certain developmental milestones.

(4) Includes 12,079 shares of Common Stock issuable on the achievement of certain developmental milestones.

(5) Includes 9,281 shares of Common Stock issuable on the achievement of certain developmental milestones.

(6) Includes 5,569 shares of Common Stock issuable on the achievement of certain developmental milestones.

(7) Includes 2,784 shares of Common Stock issuable on the achievement of certain developmental milestones.

(8) Includes 2,784 shares of Common Stock issuable on the achievement of certain developmental milestones.

(9) Includes 2,320 shares of Common Stock issuable on the achievement of certain developmental milestones.

(10) Includes 2,320 shares of Common Stock issuable on the achievement of certain developmental milestones.

(11) Includes 1,485 shares of Common Stock issuable on the achievement of certain developmental milestones.

(12) Includes 1,485 shares of Common Stock issuable on the achievement of certain developmental milestones.

(13) Includes 1,392 shares of Common Stock issuable on the achievement of certain developmental milestones.

(14) Includes 928 shares of Common Stock issuable on the achievement of certain developmental milestones.

(15) Includes 928 shares of Common Stock issuable on the achievement of certain developmental milestones.

(16) Includes 928 shares of Common Stock issuable on the achievement of certain developmental milestones.

(17) Includes 928 shares of Common Stock issuable on the achievement of certain developmental milestones.

(18) Includes 464 shares of Common Stock issuable on the achievement of certain developmental milestones.

(19) Includes 464 shares of Common Stock issuable on the achievement of certain developmental milestones.

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PLAN OF DISTRIBUTION

The Selling Stockholders and any of their pledgees, assignees and successors-in-interest may, from time to time, sell any or all of their shares of Common Stock on any stock exchange, market or trading facility on which the Common Stock is traded or in private transactions. These sales may be at market prices prevailing at the time of sale, at prices related to such prevailing market prices, or at fixed or negotiated prices. The Selling Stockholders may use any one or more of the following methods when selling shares:

- ordinary brokerage transactions and transactions in which the broker-dealer solicits purchasers;
- block trades in which the broker-dealer will attempt to sell the shares as agent but may position and resell a portion of the block as principal to facilitate the transaction;
- purchases by a broker-dealer as principal and resale by the broker-dealer for its account;
- an exchange distribution in accordance with the rules of the applicable exchange;
- privately negotiated transactions;
- short sales;
- broker-dealers may agree with the Selling Stockholders to sell a specified number of such shares at a stipulated price per share;
- a combination of any such methods of sale; and
- any other method permitted pursuant to applicable law.

The Selling Stockholders may also sell shares under Rule 144 under the Securities Act, if available, rather than under this prospectus. Broker-dealers engaged by the Selling Stockholders may arrange for other brokers-dealers to participate in sales. Broker-dealers may receive commissions or discounts from the Selling Stockholders (or, if any broker-dealer acts as agent for the purchaser of shares, from the purchaser) in amounts to be negotiated. The Selling Stockholders do not expect these commissions and discounts to exceed what is customary in the types of transactions involved.

The Selling Stockholders may from time to time pledge or grant a security interest in some or all of the shares of Common Stock owned by them and, if they default in the performance of their secured obligations, the pledgees or secured parties may offer and sell the shares of Common Stock from time to time under this prospectus, or under an amendment to this prospectus under Rule 424(b)(3) or other applicable provision of the Securities Act of 1933 amending the list of selling stockholders to include the pledgee, transferee or other successors in interest as selling stockholders under this prospectus.

The Selling Stockholders also may transfer the shares of Common Stock in other circumstances, in which case the transferees, pledgees or other successors in interest will be the selling beneficial owners for purposes of this prospectus.

The Selling Stockholders and any broker-dealers or agents that are involved in selling the shares may be deemed to be underwriters within the meaning of the Securities Act in connection with such sales. In such event, any commissions received by such broker-dealers or agents and any profit on the resale of the shares purchased by them may be deemed to be underwriting commissions or discounts under the Securities Act. The Selling Stockholders have informed us that none of them have any agreement or understanding, directly or indirectly, with any person to distribute the Common Stock.

We are required to pay all fees and expenses incurred by us incident to the registration of the shares. We estimate that our expenses in connection with this offering will be $5,503.

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LEGAL MATTERS

Cooley Godward LLP, San Diego, California will pass upon the validity of the issuance of the common stock offered by this prospectus.

EXPERTS

The financial statements incorporated by reference in this Prospectus, have been audited by BDO Seidman, LLP, independent certified public accountants, to the extent and for the periods set forth in their report incorporated herein by reference, and are incorporated herein in reliance upon such report given upon the authority of said firm as experts in auditing and accounting.

We have not authorized any dealer, salesperson or other person to give any information or to make any representations not contained in this prospectus or any prospectus supplement. You must not rely on any unauthorized information. This prospectus is not an offer of these securities in any state where an offer is not permitted. The information in this prospectus is current as of March 16, 2004. You should not assume that this prospectus is accurate as of any other date.

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PART II

INFORMATION NOT REQUIRED IN PROSPECTUS

Item 14. Other Expenses of Issuance and Distribution.

The expenses in connection with the issuance and distribution of the securities being registered are set forth in the following table (all amounts except the registration fee are estimated):

SEC Registration Fee	$	503
Legal fees and expenses		3,000
Accounting fees and expenses		2,000
Total	$	5,503www.oanda.com)). The Company also reimburses ordinary out-of-pocket expenses for attending Board and Committee meetings. Directors who are also employees of the Company receive no additional compensation for service as a director. The Company does not provide retirement benefits to directors under any current program.

Options. Each non-employee director that was serving in 2005 received options to purchase 75,000 shares of the Company s Common Stock in fiscal 2005. Each option grant, vesting over two years in three equal tranches with the first tranche vesting immediately and having a seven-year term, permits the holder to purchase shares at $1.00 per share, which exceeded their fair market value on the date of grant, which was $0.86. Unless the termination is by reason of the death, retirement or permanent disability of the optionholder, all of these options must be exercised within 3 months of termination, but in no event longer than the original expiration date of the option.

The following table shows the compensation paid to all persons who were non-employee directors, including their respective affiliates, during the fiscal year ended December 31, 2005:

Name	Directors Fees and Other Compensation $	Consulting Payments $	Options Granted
Russ Hammond	84,294(1)		75,000
Nils N. Trulsvik	84,294(1)		75,000
Michael Ayre	80,853(1)		75,000

(1) Using December 31, 2005 exchange rate of £1 = $1.720 (as quoted on www.oanda.com).

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COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

During 2005, the Company s Compensation Committee consisted of Nils N. Trulsvik and Russ Hammond, both currently non-employee directors. See Section entitled *Certain Relationships and Related Transactions* below.

CODE OF BUSINESS CONDUCT AND ETHICS

The Company has adopted a written *Code of Business Conduct and Ethics,* which sets forth the Company s standards of expected business conduct and which is applicable to all employees, including the Chief Executive Officer, the principal Financial Officer, principal accounting officer or controller, and persons performing similar functions (each a Principal Officer), as well as the directors of the Company. This *Code of Business Conduct and Ethics* is filed as Exhibit 14.1 to the Company s Annual Report on Form 10-K for the fiscal year ended 2004, filed with the Securities and Exchange Commission. A copy of the Company s *Code of Business Conduct and Ethics* is available on the Company s website **(www.canargo.com)**. The Company intends to post amendments to or waivers from its *Code of Business Conduct and Ethics* (to the extent applicable to or affecting any Principal Officer or director) at this location on its website.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Dr. David Robson, Liz Landles and Richard Battey each provide all of their services to the Company through Vazon Energy Limited, of which Dr. Robson is the Chairman and Managing Director. See *Executive Compensation Employment Agreements and other Arrangements* below for a description of Vazon Energy Limited s agreement with the Company.

Mr. Russ Hammond, a non-employee director of the Company, is also an Investment Advisor to Provincial Securities Limited who became a minority shareholder in the Norio and North Kumisi (Block XI^{c}) Production Sharing Agreement through a farm-in agreement to the Norio MK72 well. On September 4, 2003 the Company concluded a deal to purchase Provincial Securities Limited s minority interest in CanArgo Norio Ltd by a share swap for shares in the Company. The purchase was achieved by issuing 6 million restricted Common Shares in the Company to the minority interest holders in CanArgo Norio Ltd. Of the interests in CanArgo Norio Ltd, Provincial Securities Limited owned 4% and received 2,234,719 shares of the Company s Common Stock. Provincial Securities Limited also had an interest in Tethys Petroleum Investments Limited (Tethys), a company which was established to develop potential projects in Kazakhstan, until June 2005 when the Company acquired the 55% interest in Tethys which it did not own. Mr. Hammond did not receive any compensation in connection with these transactions and disclaims any beneficial ownership of Provincial Securities Limited or of any shares of the Company s common stock owned by Provincial Securities Limited. Mr. Julian Hammond, Mr. Hammond s son, is employed by the Company as an independent consultant holding the position of Investor Relations Manager at an annual salary of £85,000 Pounds Sterling (£) and has been awarded an aggregate of 590,000 options to purchase shares of Common Stock under our Stock Option Plans at a weighted average exercise price of $0.38.
Mr. Hammond disclaims ownership of his son s shares.

Transactions with affiliates or other related parties including management of affiliates are to be undertaken on the same basis as third party arms-length transactions. Transactions with affiliates and other related parties are reviewed and voted on by the Board with any potential related parties absent from such discussions or votes.

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EXECUTIVE COMPENSATION

The following tables and descriptive materials set forth information concerning compensation earned for services rendered to the Company and its subsidiaries by the Chief Executive Officer (the CEO) and the Company next three most highly compensated executive officers for the Company s fiscal years 2005, 2004 and 2003. Collectively, together with the CEO, these are the Named Officers .

			Annual Compensation			
			Salary(6)			
and Principal Position		Year	GBP (£)	$ Equiv	Bonus $	Securities Underlying Options/SA
Robson		2005	225,000	365,560		2,800,000
	Chairman,	2004	175,000	337,225	150,000	3,500,000
	President & Chief Executive Officer(1)	2003	150,000	266,775	17,573	3,000,000
t McDonnell						
162,500 279,546 1,410,000 14,625 25,159						
ive Director, Chief						
140,000 269,780 150,000 1,200,000 12,600 24,280 Operating						
and Chief Commercial						
(2) 2003 120,000 213,420 600,000 10,800 19,207						
ndles						
102,500 176,329 700,000 9,225 15,870						
ate Secretary and						
73,625 141,875 75,000 610,000 6,626 12,769						
ive Vice President(3)						
57,000 101,374 200,000 5,130 9,124						
l Battey						
80,000 137,623 555,000 7,200 12,386						
Financial Officer(4)						
		2003				

(1) Dr. Robson, Chairman and Chief Executive Officer, has served the Company since July 15, 1998 and provides services to the Company through Vazon Energy Limited.

(2) Mr. McDonnell has served as Chief Commercial Officer since April 1, 2001. Prior to that, he served as Commercial Manager from December 1, 2000. From September 18, 2002 until May 6, 2005 he was Chief Financial Officer of the Company. On May 6, 2005, he was appointed as Chief Operating Officer. On May 2, 2003 he was appointed Director.

(3) Mrs. Landles has served as Company Secretary since August 1, 2002 and as Executive Vice President since November 8, 2005.

(4) Mr. Battey was appointed as Chief Financial Officer on May 6, 2005 and provides services to the Company through Vazon Energy Limited.

(5) Primarily the Company s contributions to or accruals with respect to non-Company sponsored individual retirement and pension plans.

(6) Salaries and Other Compensation, excluding bonuses, were paid in UK Pounds Sterling (GBP). Bonuses were paid in US Dollars ($). Exchange rates used to convert from GBP to $ used were as follows; for 2003 the year end rate of 1 GBP = $1.778, for 2004 the year end rate of 1 GBP = $1.927 and for 2005 the year end rate of 1 GBP = $1.720.

On May 6, 2005, Mr. Richard Battey was employed by the Company as its Chief Financial Officer at a base salary of £120,000 per annum. Upon commencing his employment, he received a grant of an option to purchase 510,000 shares of the Company s Common Stock. Each option grant, vesting over 2 years in 3 equal tranches with the first tranche vesting immediately and having a seven-year term, permits the holder to purchase shares at $0.88 per share, which exceeded their fair market value on the date of grant, which was $0.79. All of these options must be exercised within 3 months of termination, but in no event longer than the original expiration date of the option.

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Employment Agreements and other Arrangements

Management Services Agreement between CanArgo Energy Corporation and Vazon Energy Limited in relation to the provision of services by Dr. David Robson

Dr. David Robson serves as Chairman, President and Chief Executive Officer of the Company pursuant to an agreement with Vazon Energy Limited (Vazon) of which Dr. Robson is the sole owner, Chairman and Managing Director. Dr. Robson through Vazon has signed a comprehensive Management Services Agreement with a rolling six-month termination notice period and a two-year non-competition clause effective from the date of termination of the agreement.

Under the terms of the Management Services Agreement, Dr. Robson received during 2005 a base salary of £225,000 which was payable on a monthly basis. Dr. Robson is further entitled to a cash bonus payable at the discretion of the Compensation Committee (or failing that the Company s Board) upon the occurrence of certain specified events reflecting the value to the Company of such an event. The Management Services Agreement does not contain any provisions in relation to stock options.

The Management Services Agreement became effective on June 30, 2000 and may be terminated by either party upon 6 months written notice. Other grounds for termination are the liquidation or dissolution of the Company, mutual agreement of the parties to terminate and the occurrence of an Event of Default as defined in the Management Services Agreement. In the event of a change of control of the Company, the Company must give Dr. Robson not less than 12 months written notice to terminate the Management Services Agreement. The Management Services Agreement contains a covenant, under which Dr. Robson will not, for a period of two years following the termination of the agreement, directly or indirectly induce any consultant of the Company to terminate their employment, hire by direct approach any consultant of the Company, or in any way interfere with the relationship of the Company and any consultant, agent or representative. Furthermore, for a period of two years from the date of termination of the Management Services Agreement, Dr. Robson is prohibited from directly or indirectly soliciting, diverting or attempting to divert from the Company any Business or related business which is being conducted by the Company pursuant to any contract or extension to any contract being conducted by the Company at that time.

Under the terms of the agreement, Dr. Robson has a duty not to disclose any confidential information of the Company and he must use such information solely for the benefit of the Company. Dr. Robson has a contractual obligation under this agreement to disclose and deliver to the Company for its exclusive use and benefit any inventions as a direct result of work performed for the Company.

In terms of benefits, the Company makes a monthly contribution of 9% of base salary to Dr. Robson s pension requirements. Dr. Robson is also provided with life assurance with death coverage of four times his base salary (excluding any bonus), permanent health insurance and comprehensive BUPA Travel Insurance.

The Management Services Agreement does not contain any gross-up provisions for excess parachute payments, severance provisions o provisions requiring Dr. Robson s nomination to the Board of the Company.

Service Agreement between CanArgo Energy Corporation and Vincent McDonnell

Vincent McDonnell serves as Chief Operating Officer of the Company pursuant to a Service Agreement dated December 1, 2000. The Service Agreement became effective on December 1, 2000 and may be terminated by either party upon 6 months written notice. The Company is entitled to make a payment to Mr. McDonnell in lieu of notice. The Service Agreement contains garden leave provisions.

Under the terms of the Service Agreement, Mr. McDonnell received during 2005 a base salary of £162,500 which was payable on a monthly basis. The Service Agreement does not contain any provisions in relation to bonus payments and entitled Mr. McDonnell to a one-time grant of 100,000 share options when it when it was originally signed in 2000.

The Service Agreement contains a restrictive covenant, under which Mr. McDonnell will not during his employment or for a period of 12 months following the termination of his employment (without the prior written consent of the Company) directly or indirectly compete with the Company in the Restricted Area (as defined in

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the Service Agreement), solicit or induce any critical employee of the Company to terminate their employment, employ or otherwise engage any critical employee in any competing business with the Company or solicit or induce any government body or agency or any third party in the Restricted Area to cease to deal with the Company.

Under the terms of the Service Agreement, Mr. McDonnell has a duty not to disclose any confidential information of the Company and must use such information solely for the benefit of the Company. Mr. McDonnell has a contractual obligation under his Service Agreement to disclose and deliver to the Company for its exclusive use and benefit any inventions as a direct result of work performed for the Company.

In terms of benefits, the Company will contribute 9% of Mr. McDonnell s basic salary into a personal pension. Mr. McDonnell is also provided with life assurance with death coverage of four times his annual salary, permanent health insurance and family health care insurance.

The Service Agreement does not contain any gross-up provisions for excess parachute payments, severance payments or provisions requiring Mr. McDonnell s nomination to the Board of the Company.

Management Services Agreement between Vazon Energy Limited and CanArgo Energy Corporation in relation to the provision of services by Richard Battey

Richard Battey provides all of his services to the Company as Chief Financial Officer through Vazon, of which he is an employee pursuant to a Service Agreement dated May 6, 2005 between Mr. Battey and Vazon. Vazon provides management services to the Company in accordance with an evergreen Management Services Agreement dated February 18, 2004. Mr. Battey s Service Agreement is terminable upon three months prior notice unless sooner terminated for cause. Pursuant to the Service Agreement, Mr. Battey is entitled to receive a base salary of £120,000 per year and the Company will make a monthly contribution of 9% of base salary to Mr. Battey s pension requirements. The Service Agreement does not contain any contractual bonus provisions, although Mr. Battey will be eligible for bonuses at the discretion of the Compensation Committee (or failing that the Company s Board of Directors). Mr. Battey will be provided with life assurance with death coverage of four times his base annual salary (excluding any bonus), permanent health insurance, PPP Healthcare coverage and comprehensive BUPA Travel Insurance.

The Management Services Agreement contains customary confidentiality provisions. The Agreement does not contain any gross-up provisions for excess parachute payments, severance provisions or provisions requiring Mr. Battey s nomination to the Board of the Company.

Management Services Agreement between CanArgo Energy Corporation and Vazon Energy Limited in relation to the provision of services by Liz Landles.

Liz Landles provides all of her services to the Company as Corporate Secretary through Vazon, of which she is an employee pursuant to a Service Agreement dated February 18, 2004 between Mrs. Landles and Vazon. Vazon provides management services to the Company in accordance with an evergreen Management Services Agreement dated February 18, 2004. Mrs. Landles Service Agreement is terminable upon three months prior notice unless sooner terminated for cause. Pursuant to the Service Agreement, Mrs. Landles receives a base salary of £105,000 per year and the Company will make a monthly contribution of 9% of base salary to Mrs. Landles pension requirements. The Service Agreement does not contain any contractual bonus provisions although Mrs. Landles will be eligible for bonuses at the discretion of the Compensation Committee. Mrs. Landles will be provided with life assurance with death coverage of four times her annual salary, permanent health insurance and PPP Healthcare coverage.

The Agreement contains customary confidentiality provisions. The Agreement does not contain any gross-up provisions for excess parachute payments, severance provisions or provisions requiring Mrs. Landles nomination to the Board of the Company.

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Equity Compensation Plans

The following is a brief summary of our four existing equity compensation plans and arrangements: the 1995 Long-Term Incentive Plan, the CEI Plan, the Special Stock Options and Warrants, and the 2004 Long Term Stock Incentive Plan. The Special Stock Options and Warrants Plan is the only equity compensation plan of the Company that has not been approved by the Company s stockholders.

1995 Long-Term Incentive Plan (the 1995 Plan). The 1995 Plan was approved by the Company s stockholders at the annual meeting of stockholders held on February 6, 1996. This Plan allows for up to 7,500,000 shares of the Company s Common Stock to be issued to officers, directors, employees, consultants and advisors pursuant to the grant of stock based awards, including qualified and non-qualified stock options, restricted stock, stock appreciation rights and other stock based performance awards. As of December 31, 2005, options to acquire an aggregate of 1,454,000 shares of Common Stock had been granted under the 1995 Plan and were outstanding of which 1,214,000 shares are currently vested. The 1995 Plan expired on November 13, 2005.

The Amended and Restated CanArgo Energy Inc. Plan (the CEI Plan). The CEI Plan (also known as the CAOG Plan) was adopted by the Company s Board of Directors on September 29, 1998. All options outstanding under the Plan as of July 15, 1998 were assumed by the Company pursuant to the terms of an Amended and Restated Combination Agreement between the Company and CanArgo Energy Inc. dated February 2, 1998, which was approved by the Company s stockholders on July 8, 1998. This Plan allowed for up to 1,250,000 shares (of which 988,000 shares were registered) of the Company s Common Stock to be issued to any director or full-time employee of the Company or a subsidiary of the Company.

The Company s Compensation Committee has the authority to determine the number of shares subject to each option, the option price, the expiration date of each option, the extent to which each option is exercisable during the term of the option and the other terms and conditions relating to each such option. As of December 31, 2005, five-year options to acquire an aggregate of 220,000 shares of Common Stock had been granted under the CEI Plan and were outstanding, of which 145,000 shares are currently 100% vested.

Special Stock Options and Warrants. This plan was created to allow the Company to retain and provide incentives to existing executive officers and directors and to allow retirement of new officers and directors following the Company s decision to relocate finance and administration functions from Calgary, Canada, to London, England. As of December 31, 2005, special stock options and warrants issued under this plan exercisable for an aggregate of 535,000 shares of Common Stock were outstanding, subject to customary anti-dilution adjustments.

The Special Stock Options were granted on September 1, 2000 at an exercise price of $1.437 per share. They expired on September 1, 2005 and vested 1/2 on or after March 1, 2001, 1/4 on or after March 1, 2002 and 1/4 on or after March 1, 2003. The exercise period has been extended for serving directors and personnel by the Company s Board of Directors.

The Special Stock Purchase Warrants were granted on September 1, 2000 at an exercise price of $1.27. They expired on September 1, 2005 and vested 100% on March 1, 2001. Under the terms of the plan the expiration date of the plan has been extended for serving directors by the Company s Board of Directors.

Neither the Special Stock Options nor the Special Stock Purchase Warrants qualify as Incentive Stock Options within the meaning of the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder. Accordingly, upon exercise, the holders of such options and warrants would be taxed on the same basis as holders of non-qualified stock options.

2004 Long Term Stock Incentive Plan (the 2004 Plan). The 2004 Plan was approved by the Company s stockholders at the annual meeting of stockholders held on May 18, 2004. The 2004 Plan allows for up to 10,000,000 shares of the Company s Common Stock to be issued to officers, directors, employees, consultants and advisors pursuant to the grant of stock based awards, including qualified and non-qualified stock options, restricted stock, stock appreciation rights and other stock based performance awards. As of December 31, 2005, seven-year options to acquire an aggregate of 7,836,000 shares of Common Stock had been granted under this

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2004 Plan and were outstanding, of which 4,044,000 shares were vested at that date. The 2004 Plan will expire on May 17, 2014, although the Board of Directors may terminate the 2004 Plan at any time prior to that date.

Option Grants during the Year Ended December 31, 2005

The following table sets forth information concerning options granted to the Named Officers who were employed during the year ended December 31, 2005.

Name	Number of Securities Underlying Options Granted	% of Total Options Granted to Employees in 2005	Exercise Price ($)	Expiration Date	Grant Date Present Value(2) Per Share ($)	Grant Date Present Value(2) Total ($)
Richard Battey(1)	510,000	16%	0.88	May 5, 2012	0.68	348,078
David Robson(1) 300,000 10% 1.00 July 27, 2012 0.86 258,000						
Vincent McDonnell(1) 210,000 7% 1.00 July 27, 2012 0.86 180,600						
Liz Landles(1) 90,000 3% 1.00 July 27, 2012 0.86 77,400						
Richard Battey(1) 45,000 1% 1.00 July 27, 2012 0.86 38,700						
Vincent McDonnell(1) 300,000 10% 1.42 Nov 30, 2012 0.73 219,000						

(1) All the options vest over two years from the date of issue, 1/3 vesting immediately, 1/3 after 1 year and 1/3 after 2 years.

(2) The hypothetical value of the options as of their date of grant has been calculated using the Black-Scholes option pricing model, as permitted by SEC rules, based upon a set of assumptions set forth in the following table. It should be noted that this model is only one method of valuing options, and the Company s use of the model should not be interpreted as an endorsement of its accuracy. The actual value of the options may be significantly different, and the value actually realized, if any, will depend upon the excess of the market value of the Common Stock over the option exercise price at the time of exercise.

Exercise Price	Dividend Yield	Volatility	Risk-Free Interest Rate	Expected Term
$0.88	0.00%	109%	4.09%	7 Years
$1.00 0.00% 119% 4.16% 7 Years				
$1.42 0.00% 92% 4.47% 7 Years				

The approach used in developing the assumptions upon which the Black-Scholes valuations were calculated is consistent with the requirements of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation.*

Pursuant to the terms of the Company s various stock option plans, the Compensation Committee may, subject to each plan s limits, modify the terms of outstanding options, including the exercise price and vesting schedule thereof. These values are not intended to forecast future appreciation of the Company s stock price. The actual value which an executive officer may realize from his options (assuming that they are exercised) will depend solely on the increase in the market price of the shares acquired through option exercises over the exercise price measured when the shares are sold.

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Aggregate Option Exercise and Option Values at December 31, 2005

The following table sets forth information concerning option exercises and the number and hypothetical value of stock options held by the Named Officers as at December 31, 2005.

Name	Number of Shares Acquired on Exercise	Value Realized ($)	Number of Unexercised Options at Fiscal Year End(1)		Va Une In-th Op Fiscal Y
			Exercisable	Unexercisable	Exercisa
David Robson	1,000,000	1,137,517	2,100,000	700,000	2,100,0
Vincent McDonnell					
300,000	341,255	770,000	640,000	670,000	440,000
Liz Landles					
470,000	230,000	470,000	230,000		
Richard Battey					
185,000	370,000	185,000	370,000		

(1) The exercise of stock options is not dependent on performance criteria and may be exercised in full when vested.

The following table sets forth information concerning equity compensation plans adopted by the Company as of December 31, 2005.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights	Number of securities that remain available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	9,510,000	$ 0.75	1,783,667
Equity compensation plans not approved by security holders	535,000	$0.10	
Total	10,045,000	$0.72	1,783,667

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SECURITY OWNERSHIP BY CERTAIN BENEFICIAL HOLDERS

The following table sets forth information regarding ownership of the Common Stock as of the most recent practicable date or earlier date for information based on filings with the Securities and Exchange Commission by (a) each person known to the Company to beneficially own more than 5% of the outstanding shares of the Common Stock of the Company, (b) each director of the Company, (c) the Company s Chief Executive Officer and each other executive officer named in the compensation tables appearing later in this Proxy Statement and (d) all directors and executive officers as a group. The information in this table is based solely on statements in filings with the Securities and Exchange Commission or other reliable information. Unless otherwise indicated, each of these shareholders has sole voting and investment power with respect to the shares beneficially owned.

Security Ownership of Certain Beneficial Owners

Name of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percentage of Class
Non-Employee Directors		
Nils N. Trulsvik	422,450(1)	*
Russ Hammond	430,000(2)	*
Michael Ayre	670,000(3)	*
Named Executive Officers		
David Robson	3,257,760(4)	1.1%
Vincent McDonnell	1,620,000(5)	*
Liz Landles	700,000(6)	*
Richard Battey	555,000(7)	*
All Directors and Executive Officers as a Group (7 persons)	**7,645,210**(8)	2.2%
5% Holders		
Black Rock Advisors, Inc 100 Bellevue Parkway Wilmington, DE 19809	17,292,200(9)	7.76%
Ingalls & Snyder LLC 61 Broadway New York, NY 10006	22,734,745(10)	9.4%

Ingalls & Snyder Value Partners, L.P. c/o Ingalls & Snyder LLC 61 Broadway New York, NY 10006	15,555,556(11)	6.5%
Robert L. Gibson c/o Ingalls & Snyder LLC 61 Broadway New York, NY 10006	14,614,708(12)	6.4%
Thomas L. Gibson c/o Ingalls & Snyder LLC 61 Broadway New York, NY 10006	16,653,041(13)	7.1%

* Less 1%

(1) Includes 195,000 shares underlying presently exercisable options.

(2) Includes 195,000 shares underlying presently exercisable options. Does not include 290,000 shares subject to unexercised stock options awarded to Mr. Julian Hammond, an employee of the Company and Mr. Russ Hammond s son. Mr. Hammond disclaims ownership of his son s shares.

(3) Includes 445,000 shares underlying presently exercisable options.

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(4) Includes 2,100,000 shares underlying presently exercisable options.

(5) Includes 770,000 shares underlying presently exercisable options.

(6) Includes 470,000 shares underlying presently exercisable options.

(7) Includes 185,000 shares underlying presently exercisable options.

(8) Includes 4,360,000 shares underlying presently exercisable options held by directors and executive officers as a group.

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(9) Security ownership information for the beneficial owner is taken from the Forms 13G dated February 10, 2006.

(10) Security ownership information for the beneficial owner is taken from the Form 13G/A filed on January 19, 2006. Figure includes 15,555,556 shares held by Ingalls & Snyder Value Partners, LP, an investment partnership managed under an investment advisory contract by Ingalls & Snyder LLC.

(11) Security ownership information for the beneficial owner is taken from the Form 13G/A file in January 18, 2006.

(12) Security ownership information for the beneficial owner is taken from the Form 13G filed in March 7, 2006.

(13) Security ownership information for the beneficial owner is taken from the Form 13G filed in March 8, 2006.

COMPENSATION COMMITTEE REPORT ON EXECUTIVE COMPENSATION

The following Report of the Compensation Committee and the performance graph included elsewhere in this Proxy Statement do not constitute soliciting material and should not be deemed filed or incorporated by reference into any other Company filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent the Company specifically incorporates this Report or the performance graphs by reference therein.

The Compensation Committee of the Board has furnished the following report on executive compensation for fiscal 2005.

The Committee s Responsibilities

The Compensation Committee of the Board of Directors is composed entirely of non-employee directors. The Compensation Committee is responsible for setting and administering policies which govern the Company s executive compensation programs. The purpose of this report is to summarize the compensation philosophy and policies that the Compensation Committee applied in making executive compensation decisions in 2005.

Compensation Philosophy

The Compensation Committee has approved compensation programs intended to:

Attract and retain talented executive officers and key employees by providing total compensation competitive with that of executives employed by companies of similar size, complexity and lines of business;

Motivate executives and key employees to achieve strong financial and operational performance;

Emphasize performance-based compensation, which balances rewards for short-term and long-term results;

Reward individual performance;

Link the interest of executives with the interest of stockholders by providing a significant portion of total pay in the form of stock incentives; and

Encourage long-term commitment to the Company.

The Compensation Committee held four meetings during fiscal 2005.

Stock Based Compensation Plans

At December 31, 2005, stock options and warrants had been issued from the following stock based compensation plans:

1995 Long-Term Incentive Plan. Adopted by the Company in February 1996, this plan allows for up to 7,500,000 shares of the Company s Common Stock to be issued to officers, directors, employees, consultants and advisors. As of December 31, 2005, 1,454,000 options issued under this plan were outstanding;

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The Amended and Restated CanArgo Energy Inc Plan. Adopted by the Company following the acquisition by the Company of CanArgo Oil & Gas Inc. in 1998, this plan allowed for 1,250,000 shares

25.1

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(of which 988,000 were registered) of the Company s Common Stock to be issued to employees, consultants and advisors. As of December 31, 2005, 220,000 options issued under this plan were outstanding;

Special Stock Options and Warrants. Adopted by the Company in September 2000, this plan was created to allow the Company to retain and provide incentives to existing executive officers and directors and to allow recruitment of new officers and directors following the Company s decision to relocate finance and administrative functions from Calgary, Canada, to London, England. As of December 31, 2005, 535,000 special stock options and warrants issued under this plan were outstanding; and

2004 Long Term Stock Incentive Plan. Adopted by the Company in May 2004, this plan allows for up to 10,000,000 shares of the Company s common stock to be issued to officers, directors, employees, consultants and advisors. As of December 31, 2005, 7,836,000 options issued under this plan were outstanding.

Compensation Methodology

Each year the Compensation Committee reviews data from market surveys, proxy statements issued by competitors and independent consultants to assess the Company s competitive position with respect to the following three components of executive compensation:

base salary;

annual incentives; and

long-term incentives.

The Compensation Committee also considers individual performance, level of responsibility, and skills and experience in making compensation decisions for each executive.

Components of Compensation

Base Salary: Base salaries for executives are determined based upon job responsibilities, level of experience, individual performance, comparisons to the salaries of executives in similar positions obtained from market surveys, and competitive data obtained from consultants and staff research. The goal for the base pay component is to compensate executives at a level which approximates the median salaries of individuals in comparable positions with comparable companies in the oil and gas industry. The Compensation Committee approves all salary increases for executive officers.

Long-Term Incentive Compensation: The Compensation Committee has structured long-term incentive compensation to provide for an appropriate balance between rewarding performance and encouraging employee retention. Long-term incentives are granted primarily in the form of stock options. The purpose of stock options is to align compensation directly with increases in shareholder value. The number of options granted is determined by reviewing survey data to determine the compensation made to other executives and management employees in comparable positions with comparable companies in the oil and gas sector. In determining the number of options to be awarded, the Compensation Committee also considers the grant recipient s qualitative and quantitative performance, the size of stock option awards in the past, and expectations of the grant recipient s future performance.

In 2005, the Compensation Committee approved the grant of a series of new stock options to a broad range of employees and officers. The stock option awards were granted under the various available Company plans.

Compliance with Section 162(m) of the Internal Revenue Code

Under Section 162(m) of the Internal Revenue Code, the Company may not deduct annual compensation in excess of $1 million paid to certain employees; generally its Chief Executive Officer and its four other most highly compensated executive officers, unless that compensation qualifies as performance-based compensation. While the Compensation Committee intends to structure performance-related awards in a way that will preserve

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the maximum deductibility of compensation awards, the Compensation Committee may from time to time approve awards which would vest upon the passage of time or other compensation which would not result in qualification of those awards as performance-based compensation. It is not anticipated that compensation realized by any executive officer under the Company s plans and programs now in effect will result in a material loss of tax deductions.

Compensation of the Chief Executive Officer

The Compensation Committee annually reviews the compensation of the Chief Executive Officer. The Chief Executive Officer participates in the same programs and receives compensation under the same programs as other executives. However, the Chief Executive Officer s compensation reflects the greater policy and decision-making authority that the Chief Executive Officer holds and the higher level of responsibility he has with respect to the strategic direction of the Company and its financial and operating results. For 2005, the components of Dr. Robson s compensation were:

Base Salary: After considering the Company s overall performance and competitive practices, and the signing of a new contract, the Compensation Committee approved a base salary of £225,000 for Dr. Robson, effective April 1, 2005.

Performance Bonus: There is no defined Short-Term Incentive scheme for the Chief Executive Officer, and any bonus is at the discretion of the Compensation Committee. Under Dr. Robson s previous contract a quarterly Short-Term Incentive scheme was in place. This was replaced by a discretionary scheme in his new contract.

It is the Compensation Committee s intention that, when taken together, the components of Dr. Robson s pay, including base salary, performance, annual incentives, short-term incentive opportunity and long-term incentives, will result in compensation which approximates compensation paid by companies of similar size in the same industry.

This report has been provided by the Compensation Committee.

Nils N. Trulsvik, Chairman.
Russ Hammond

REPORT OF THE AUDIT COMMITTEE

The following Report of the Audit Committee does not constitute soliciting material and should not be deemed filed or incorporated by reference into any other Company filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent the Company specifically incorporates this Report by reference therein.

The Audit Committee of the Board of Directors is responsible for the review and oversight of the Company s performance with respect to its financial responsibilities and the integrity of the Company s accounting and reporting practices. The Audit Committee, in its capacity as a Committee of the Board of Directors, is also responsible for the appointment, compensation, retention and oversight of the work of any registered public accounting firm engaged for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the Company (including resolution of disagreements between management and the auditor regarding financial reporting), and each such registered public accounting firm must report directly to the Audit Committee. The Board of Directors has determined that the members of the Audit Committee are independent in accordance with American Stock Exchange listing standards and are financially literate, as required by such requirements, as such qualification is interpreted by the Board of Directors in its business judgment. The Audit Committee is composed of three non-employee directors and operates under a written charter, a copy of which is attached as Annex I.

The Company, not the Audit Committee or the independent auditors, is responsible for the preparation of its financial statements and its operating results and for the appropriate safekeeping of the Company s assets. The

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independent auditor s responsibility is to attest to the fair presentation of the financial statements. The role of the Audit Committee is to be satisfied that both the Company and the independent auditors discharge their respective responsibilities effectively. However, no member of the Audit Committee is professionally engaged in the practice of accounting or auditing of the Company s accounts, including with respect to auditor independence. The Audit Committee relies, without independent verification, on the information provided to it and on the representations made by management and the independent auditors.

The Audit Committee held five meetings during the fiscal year 2005. The meetings were designed, among other things, to facilitate and encourage communication among the Audit Committee, the Company, and the Company s independent auditors, L J Soldinger Associates LLC. The Audit Committee discussed with L J Soldinger Associates LLC the overall scope and plan for their audit, and met with L J Soldinger Associates LLC, with management present. The Audit Committee has reviewed and discussed the audited financial statements with management.

The Audit Committee has discussed with the independent auditors matters required to be discussed with audit committees under generally accepted auditing standards, including, among other things, matters related to the conduct of the audit of the Company s consolidated financial statements, the Company s internal accounting controls and the matters required to be discussed by Statement on Auditing Standards No. 61, as amended, *Communication with Audit Committees* .

The Company s independent auditors have also provided to the Audit Committee the written disclosures and the letter required by Independence Standards Board Standard No. 1, *Independence Discussions with Audit Committee* , and discussed their independence from the Company. The Audit Committee has reviewed, among other things, the amount of fees paid to L J Soldinger Associates LLC for audit and non-audit services.

In accordance with the rules of the SEC, the following chart outlines fees pertaining to the years ended December 31, 2005 and December 31, 2004 by L J Soldinger Associates LLC:

Services Performed	**2005**	**2004**
Audit Fees(1)	$ 1,107,000	$ 942,000
Audit-Related Fees(2)	$68,000	$132,000
Tax Fees(3)	$36,000	$36,000
All Other Fees(4)		
Total Fees	$1,211,000	$1,111,000

NOTES TO PRECEDING TABLE

(1) Audit fees represent fees billed for professional services provided in connection with the audit of our annual financial statements, reviews of our quarterly financial statements and audit services provided in connection with statutory and regulatory filings for those years.

(2) Audit-related fees represent fees billed primarily for assurance and related services reasonably related to the performance of the audit or reviews of our financial statements or registration statements.

(3) Tax fees principally represent fees billed for tax preparation, tax advice and tax planning services.

(4) All other fees principally would include fees billed for products and services provided by the accountant, other than the services reported under the three captions above.

The Audit Committee has concluded that the provision of the non-audit services listed above is compatible with maintaining the independence of L J Soldinger Associates LLC.

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Based on its review and these meetings, discussions and reports, and subject to the limitations on its role and responsibilities referred to above and in the Audit Committee Charter, the Audit Committee recommended to the Board of Directors and the Board approved, that the Company s audited consolidated financial statements for the fiscal year ended December 31, 2005 be included in the Company s Annual Report on Form 10-K, for filing with the SEC.

Michael Ayre, Chairman
Russ Hammond
Nils N. Trulsvik

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PERFORMANCE GRAPH

The chart set forth below shows the value of an investment of $100 on December 31, 2000 in each of the Company s Common Stock, the American Stock Exchange Index and a peer group of certain oil and gas exploration and development companies. The peer group consists of the following independent oil and gas exploration companies: Aminex plc, Bow Valley Energy Ltd., EuroGas, JKX Oil & Gas plc, Centurion Energy International Inc., Lundin Oil AB, Ramco Energy plc and Soco International plc. As the Company is listed on the American Stock Exchange, the AMEX Index of listed stocks has been included in the comparison table and corresponding NASDAQ Index comparison has been removed.

All values assume reinvestment of the pre-tax value of dividends paid by companies included in these indices and are calculated as of December 31 of each year. The share price performance is weighted based on market capitalisation using the number of outstanding shares at the beginning of each period. The historical stock price performance of the Common Stock shown in the performance graph below is not necessarily indicative of future stock price performance.

	Year End					
	2000	**2001**	**2002**	**2003**	**2004**	**2005**
CNR	100	40	7	79	317	373
Peer Index	100	103	187	421	669	1,108
AMEX	100	94	92	89	127	156

The Audit Committee Report, the Compensation Committee Report on Executive Compensation and the Stock Price Performance Graph shall not be deemed to be soliciting material or to be filed with the Securities and Exchange Commission or subject to Regulation 14A or 14C under the Securities Exchange Act of 1934 and shall not be deemed incorporated by reference into any filing made by the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, notwithstanding any general statement contained in any such filing incorporating this proxy statement by reference, except to the extent the Company incorporates that Report or the Graph by specific reference.

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SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Under Section 16(a) of the Securities Exchange Act of 1934 and SEC Rules, the Company s directors, executive officers and beneficial owners of more than 10% of any class of equity security are required to file periodic reports of their initial ownership, and changes in that ownership, with the Securities and Exchange Commission. Reporting persons are required by SEC Regulations to furnish the Company with copies of all forms they file pursuant to Section 16(a). Based solely on its review of copies of such reports received by the Company and written representations of such reporting persons, the Company believes that during fiscal year 2005, all of our directors and executive officers complied with such SEC filing requirements.

OTHER MATTERS

As of the time of preparation of this Proxy Statement, neither the Board of Directors nor management intends to bring before the meeting any business other than the matters referred to in the Notice of Annual Meeting and this Proxy Statement. If any other business should properly come before the meeting, or any adjournment or postponement thereof, the persons named in the proxy will vote on such matters according to their best judgment.

STOCKHOLDERS SHARING THE SAME ADDRESS

Householding of Proxy Materials. The Securities and Exchange Commission has adopted rules that permit companies and intermediaries such as brokers to satisfy delivery requirements for proxy statements with respect to two or more stockholders sharing the same address by delivering a single proxy statement addressed to those stockholders. This process, which is commonly referred to as householding, potentially provides extra convenience for stockholders and cost savings for companies. The Company and some brokers household proxy materials, delivering a single proxy statement to multiple stockholders sharing an address unless contrary instructions have been received from the affected stockholders. Once you have received notice from your broker or us that they or we will be householding materials to your address, householding will continue until you are notified otherwise or until you revoke your consent. If, at any time, you no longer wish to participate in householding and would prefer to receive a separate proxy statement, or if you are receiving multiple copies of the proxy statement and wish to receive only one, please notify your broker if your shares are held in a brokerage account or us if you hold registered shares. You can notify us by sending a written request to the Corporate Secretary, CanArgo Energy Corporation, P.O Box 291, St. Peter Port, Guernsey, GY1 3RR, British Isles or by facsimile to +44 1481 729 982.

FORM 10-K ANNUAL REPORT

A copy of the Company s Annual Report on Form 10-K as filed with the Securities and Exchange Commission (excluding exhibits) is being mailed together with this Proxy Statement. **A copy of the Exhibits may be requested by any person in writing by addressing the request to the Corporate Secretary, CanArgo Energy Corporation, P.O Box 291, St. Peter Port, Guernsey, GY1 3RR, British Isles and stating that such person is a beneficial owner of Common Stock of the Company. A charge equal to the reproduction cost of the exhibit will be made.** We are subject to the information and reporting requirements of the Securities Exchange Act of 1934 under which we file periodic reports, proxy statements and other information with the SEC. Copies of the reports, proxy statements and other information may be examined without charge at the Public Reference Section of the SEC, 100 F Street, NE., Room 1580, Washington, D.C. 20549, or on the Internet at www.sec.gov. A copy of the Annual Report on Form 10-K is also accessible by following the links to Investor Relations/ Financial Statements on the Company s website at http://www.canargo.com.

The Company s Code of Business Conduct and Ethics, the Audit Committee s Charter and the Resolutions adopted by the Board of Directors regarding the nomination process are also all accessible by following the links to Corporate Governance on the Company s website. The Company will furnish copies of such documents without charge to any person requesting such documents in writing addressed to the Corporate Secretary,

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CanArgo Energy Corporation, P.O Box 291, St. Peter Port, Guernsey, GY1 3RR, British Isles and stating that such person is a beneficial owner of Common Stock of the Company.

STOCKHOLDER PROPOSALS FOR 2007 ANNUAL MEETING

Any stockholder intending to submit to the Company a proposal for inclusion in the Company s Proxy Statement and proxy for the 2007 annual meeting must submit such proposal so that it is received by the Company no later than October 31, 2006, and such proposal must otherwise comply with Rule 14a-8 under the Exchange Act. Proposals should be sent to the Corporate Secretary, CanArgo Energy Corporation, P.O. Box 291, St. Peter Port, Guernsey, GY1 3RR, British Isles. If a stockholder intends to submit a proposal at next year s Annual Meeting, which proposal is not intended to be included in the Company s Proxy Statement and form of proxy relating to that meeting, the stockholder must give appropriate notice to the Company not later than December 31, 2006. As to all such matters which the Company does not have notice on or prior to December 31, 2006, discretionary authority shall be granted to the persons designated in the Company s proxy related to 2007 Annual Meeting to vote on such proposal.

By Order of the Board of Directors

Liz Landles
Corporate Secretary

St. Peter Port
Guernsey
British Isles
March 17, 2006

IMPORTANT: WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING, PLEASE COMPLETE, SIGN, DATE AND MAIL PROMPTLY THE ACCOMPANYING PROXY CARD IN THE ENCLOSED RETURN ENVELOPE, WHICH REQUIRES NO POSTAGE IF MAILED IN THE UNITED STATES. THIS WILL ENSURE THE PRESENCE OF A QUORUM AT THE MEETING. IF YOU ATTEND THE MEETING, YOU MAY VOTE IN PERSON IF YOU WISH TO DO SO EVEN IF YOU HAVE PREVIOUSLY SENT IN YOUR PROXY CARD.

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CANARGO ENERGY CORPORATION
PO BOX 291 ST. PETER PORT
GUERNSEY, GY1 3RR
BRITISH ISLES

VOTE BY INTERNET www.proxyvote.com
Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form.

ELECTRONIC DELIVERY OF FUTURE SHAREHOLDER COMMUNICATIONS
If you would like to reduce the costs incurred by CanArgo Energy Corporation in mailing proxy materials, you can consent to receiving all future proxy statements, proxy cards and annual reports electronically via e-mail or the Internet. To sign up for electronic delivery, please follow the instructions above to vote using the Internet and, when prompted, indicate that you agree to receive or access shareholder communications electronically in future years.

VOTE BY PHONE 1-800-690-6903
Use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you call and then follow the instructions.

VOTE BY MAIL
Mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to CanArgo Energy Corporation, c/o ADP, 51 Mercedes Way, Edgewood, NY 11717.

TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS FOLLOWS: CANAG1 KEEP THIS PORTION FOR YOUR RECORDS
---------- DETACH AND RETURN THIS PORTION ONLY

THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED.

CANARGO ENERGY CORPORATION

(1) ELECTION OF DIRECTORS

	For	Withhold For All	For All Except
1. Michael Ayre			
2.			

To withhold authority to vote for any individual nominee, mark For All Except and write the

Russ Hammond nominee s name on the line below. 3. Vincent McDonnell 4. David Robson o o o

5. Nils N. Trulsvik

	For	Against	Abstain
(2) TO APPROVE AN AMENDMENT TO THE CERTIFICATE OF INCORPORATION TO INCREASE THE AUTHORIZED COMMON SHARE CAPITAL FROM 300,000,000 SHARES OF COMMON STOCK TO 375,000,000 SHARES OF COMMON STOCK	o	o	o
(3) TO APPROVE THE AMENDMENT OF THE COMPANY S 2004 LONG TERM STOCK INCENTIVE PLAN TO INCREASE THE NUMBER OF SHARES OF COMMON STOCK ISSUABLE UNDER THE PLAN BY AN ADDITIONAL 7,500,000 SHARES.	o	o	o

IMPORTANT: please sign exactly as your name or names appear(s) on this proxy, and when signing as an attorney, executor, administrator, trustee or guardian, give your full title as such. If the signatory is a corporation, sign the full corporate name by duly authorized officer, or if a partnership, sign in partnership name by authorized person. **IMPORTANT: WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING, PLEASE COMPLETE, SIGN, DATE AND MAIL PROMPTLY THE ACCOMPANYING PROXY CARD IN THE ENCLOSED RETURN ENVELOPE, WHICH REQUIRES NO POSTAGE IF MAILED IN THE UNITED STATES. THIS WILL ENSURE THE PRESENCE OF A QUORUM AT THE MEETING. IF YOU ATTEND THE MEETING, YOU MAY VOTE IN PERSON IF YOU WISH TO DO SO EVEN IF YOU HAVE PREVIOUSLY SENT IN YOUR PROXY CARD.**

	Yes	No
Please indicate if you plan to attend this meeting	o	o

HOUSEHOLDING ELECTION - Please indicate if you consent to receive certain future investor communications in a single package per household o o

Signature [PLEASE SIGN WITHIN BOX] Date Signature (Joint Owners) Date

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CanArgo Energy Corporation, P.O Box 291, St. Peter Port, Guernsey, GY1 3RR, British Isles and stating that such person is a beneficial owner of Common Stock of the Company.

STOCKHOLDER PROPOSALS FOR 2007 ANNUAL MEETING

Any stockholder intending to submit to the Company a proposal for inclusion in the Company s Proxy Statement and proxy for the 2007 annual meeting must submit such proposal so that it is received by the Company no later than October 31, 2006, and such proposal must otherwise comply with Rule 14a-8 under the Exchange Act. Proposals should be sent to the Corporate Secretary, CanArgo Energy Corporation, P.O. Box 291, St. Peter Port, Guernsey, GY1 3RR, British Isles. If a stockholder intends to submit a proposal at next year s Annual Meeting, which proposal is not intended to be included in the Company s Proxy Statement and form of proxy relating to that meeting, the stockholder must give appropriate notice to the Company not later than December 31, 2006. As to all such matters which the Company does not have notice on or prior to December 31, 2006, discretionary authority shall be granted to the persons designated in the Company s proxy related to 2007 Annual Meeting to vote on such proposal.

By Order of the Board of Directors

Liz Landles
Corporate Secretary

St. Peter Port
Guernsey
British Isles

CANARGO ENERGY CORPORATION
PROXY SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS
OF CANARGO ENERGY CORPORATION FOR ANNUAL MEETING
OF STOCKHOLDERS ON MAY 9, 2006

The undersigned hereby constitutes and appoints David Robson and Liz Landles, and each of them, the attorneys and proxies of the undersigned with full power of substitution to appear and to vote all of the shares of the Common Stock of CanArgo Energy Corporation held of record by the undersigned on March 15, 2006 as if personally present at the Annual Meeting of stockholders to be held on May 9, 2006 and any adjournment or postponement thereof, as designated on the reverse.

THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS OF CANARGO ENERGY CORPORATION. IF NO VOTE IS INDICATED, THIS PROXY WILL BE VOTED FOR EACH OF THE PROPOSALS LISTED ON THE REVERSE AND ACCORDING TO THE DISCRETION OF THE PROXY HOLDERS ON ANY OTHER MATTERS THAT MAY PROPERLY COME BEFORE THE MEETING.

YOU ARE URGED TO DATE, SIGN AND RETURN PROMPTLY THIS PROXY IN THE ENVELOPE PROVIDED. IT IS IMPORTANT FOR YOU TO BE REPRESENTED AT THE ANNUAL MEETING. THIS PROXY IS TO BE RECEIVED BY MAIL IN THE POSTAGE-PAID ENVELOPE PROVIDED TO CANARGO ENERGY CORPORATION, C/ O ADP, 51 MERCEDES WAY, EDGEWOOD, NY 11717 TO BE RECEIVED ON OR PRIOR TO MAY 8, 2006, 15:00 HOURS EASTERN DAYLIGHT SAVING TIME OR ELECTRONICALLY VIA THE INTERNET AT www.proxyvote.com OR BY PHONE AT +1 800 690 6903 PRIOR TO 11.59 PM EASTERN DAYLIGHT SAVING TIME ON MAY 8, 2006.

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CANARGO ENERGY CORPORATION
PROXY SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS
OF CANARGO ENERGY CORPORATION FOR ANNUAL MEETING
OF STOCKHOLDERS ON MAY 9, 2006

The undersigned hereby authorise Den norske Bank ASA to constitute and appoint David Robson and Liz Landles, and each of them, the attorneys and proxies of the undersigned with full power of substitution to appear and to vote all of the shares of the Voting Securities of CanArgo Energy Corporation held of record by the undersigned on 15th March 2006 at the Annual Meeting of stockholders to be held on 9th May 2006, or any adjournment of postponement thereof, as designated below:

(1) ELECTION OF DIRECTORS:

o FOR all nominees listed below (except as indicated to the contrary below)

o WITHHOLD AUTHORITY to vote for all nominees listed below

Michael Ayre Russ Hammond Vincent McDonnell David Robson Nils N. Trulsvik,

(INSTRUCTION: To withhold authority to vote for any nominee, draw a line through his name above)

(2) TO APPROVE AN AMENDMENT TO THE CERTIFICATE OF INCORPORATION TO INCREASE THE AUTHORIZED COMMON SHARE CAPITAL FROM 300,000,000 SHARES OF COMMON STOCK TO 375,000,000 SHARES OF COMMON STOCK.

o FOR o AGAINST o ABSTAIN

(3) TO APPROVE THE AMENDMENT OF THE COMPANY S 2004 LONG TERM STOCK INCENTIVE PLAN TO INCREASE THE NUMBER OF SHARES OF COMMON STOCK ISSUABLE UNDER THE PLAN BY AN ADDITIONAL 7,500,000 SHARES.

o FOR o AGAINST o ABSTAIN

THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS OF CANARGO ENERGY CORPORATION. IF NO VOTE IS INDICATED, THIS PROXY WILL BE VOTED FOR EACH OF THE ABOVE PROPOSALS AND ACCORDING TO THE DISCRETION OF THE PROXY HOLDERS ON ANY OTHER MATTERS THAT MAY PROPERLY COME BEFORE THE MEETING.

YOU ARE URGED TO DATE, SIGN AND RETURN PROMPTLY THIS PROXY IN THE ENVELOPE PROVIDED. IT IS IMPORTANT FOR YOU TO BE REPRESENTED AT THE ANNUAL MEETING. THIS PROXY IS TO BE RECEIVED BY DEN NORSKE BANK, REGISTRARS DEPARTMENT, DEN NORSKE BANK ASA, VERDIPAPIRSERVICE, STRANDEN 21, 0021 OSLO, NORWAY. FAX NUMBER: +47 22 48 11 71 ON OR PRIOR TO 3rd May 2006 13:00 HOURS CENTRAL EUROPEAN TIME.

Dated: ---------- , 2006

Signature(s)

Print Name

IMPORTANT: please sign exactly as your name or names appear on this proxy, and when signing as an attorney, executor, administrator, trustee or guardian, give your full title as such. If the signatory is a corporation, sign the full corporate name by duly authorized officer, or if a partnership, sign in partnership name by authorized person.

Please indicate whether you intend to attend this meeting: o Yes o No **Householding Election:**
Please indicate if you consent to receive certain future investor communications in a single package per household: o Yes o No

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Annex I

CanArgo Energy Corporation
AUDIT COMMITTEE CHARTER

The Audit Committee of CanArgo Energy Corporation (the Company) is a standing committee of the Board of Directors whose primary function is to carry out a detailed and thorough review of audit matters, to be responsible for the appointment, compensation, retention and oversight of the work of any registered public accounting firm engaged for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the Company (including resolution of disagreements between management and the auditor regarding financial reporting), to consider and approve related party transactions and to offer the Company s auditors, stockholders and employees a direct link to the non-executive Directors. This Committee will assist the Board in fulfilling its oversight responsibilities by reviewing the financial information which will be provided to the stockholders and others, the internal control structure, the audit process, and adherence to applicable laws and regulations. Given the growing size and complexity of the Company, the Committee will apply reasonable materiality standards to all of its activities.

The Committee shall be solely comprised of independent members of the Board of Directors. The Board shall appoint Committee members and the Committee Chairman. There shall be not less than three members of the Committee. For purposes hereof, independent shall mean a director who both meets the American Stock Exchange and the Securities and Exchange Commission s definition of independence as determined by the Board in its business judgment. Each member of the Audit Committee shall be financially literate and at least one member of the Audit committee shall have accounting or related financial management expertise, both as the Board interprets such qualifications in its business judgment. Also, at least one member of the Audit Committee shall meet the Securities and Exchange Commission s definition of an audit committee financial expert , as determined by the Board in its business judgment. One member may satisfy both qualifications.

The Committee shall meet at least quarterly. No meeting shall be held unless a quorum of members is present. A majority of the members shall constitute a quorum. The Committee may ask members of management or others to attend meetings and provide pertinent information as necessary. The meetings may be in person or telephonically.

The Committee shall have the power to conduct or authorize investigations into any matters within the Committee s scope of responsibilities. The resources of the Company shall be available to the Committee to carry out its duties and, if needs be, the Committee may (at the Company s cost) take external professional advice and invite outsiders with relevant experience to attend if necessary.

Specifically, the Committee shall:

1. Retain and terminate the Company s independent accountants, evaluate the performance and qualifications of the independent auditors and be directly responsible for the appointment, compensation and oversight of the work of any independent registered public accounting firm engaged by the Company. The Committee will also periodically consider the independence of the independent accountants, including an annual review of non-audit services provided and related fees received. This evaluation and review should include the evaluation and review of the lead partner of the independent registered public accounting firm including such partner s regular rotation as required by law. In making its evaluations, the Audit Committee should take into account the opinions of management and the Company s internal auditors (or other personnel responsible for the internal audit function) and shall present its conclusions to the Board.

2. Pre-approve all permissible non-audit services and all audit, review or attest engagements, and the compensation, fees and terms for such services provided by the independent auditors. By approving the audit engagement, an audit service within the scope of the engagement shall be deemed to have been pre-approved. Establish policies and procedures as warranted for the pre-approval of services by the independent auditors and review such proposed services on a periodic basis. The Audit Committee shall also consider whether the independent auditor s performance of permissible non-audit services is compatible with the

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auditor s independence. The Audit Committee shall also review with the independent auditor the written statement from the auditor, required by the Independence Standards Board, concerning any relationships between the auditor and the Company or any other relationships that may adversely affect the independence of the auditor.

3. Discuss with the external auditors before the annual audit commences the nature, scope and timing of the audit and ensure co-ordination where more than one audit firm is involved.

4. Enquire of management, the independent accountants, the Chief Financial Officer and the Chief Executive Officer about significant risks or exposures to loss or liability facing the Company and enquire as to the steps management has taken to minimize such risks.

5. Consider, in consultation with the independent accountants and the Chief Financial Officer, the combined audit scope and budget to ensure completeness of coverage, reduction in redundant efforts, and the effective use of audit resources.

6. Review with management and the independent accountants:

The Company s quarterly and annual financial statements and related footnotes and the independent accountants report thereon, as applicable, including the Company s specific disclosures under Management s Discussion and Analysis of Financial Condition and Results of Operations , the adequacy of the Company s internal controls, including management s evaluation of and report on the Company s disclosure controls and procedures and internal controls, any significant recommendations they may offer to improve disclosure controls and procedures and internal controls, major judgmental areas and significant adjustments resulting from the audit;

Any significant reserves, accruals or estimates which may have a material impact on the financial statements, including engineering reserves;

Any difficulties or disputes with management encountered by the independent accountants during the course of the audit and any instances of second opinions sought by management;

Management letters to the auditors;

Other matters related to the conduct of the audit and financial reviews which are communicated to the Committee under generally accepted auditing standards;

Review and approve any related party transactions; and

Review the performance of the Company s Internal Audit Department and provide a direct line of communication between the Internal Audit Department, the independent accountants and the Board of Directors.

7. Review and recommend approval to the Board of Directors of the inclusion of the Company s financial statements in the Company s Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and in other public filing documents that require approval of the Board of Directors.

8. Consider and review with the independent accountants, management and the CFO:

The adequacy of the Company s internal controls and any significant findings during the year and management s responses thereto; and

Any difficulties encountered in the course of the independent accountants audits, including any restrictions on the scope of their work or access to required information.

9. Consider with management and the independent accountants the possible impact on any pending changes in accounting standards or rules or any significant changes in the Company s accounting policies.

10. Meet periodically with the Company s legal advisor (and other lawyers as required) to review legal and regulatory matters, including any material pending legal proceedings involving the Company and any

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reports received from regulators that may have a material impact on the Company s financial statements, environmental compliance and financial liabilities or reserves.

11. Meet periodically with the independent accountants in separate executive sessions without any member of the executive management present to discuss any matters that they or the Committee believe should be discussed privately with the Committee.

12. Report Committee actions to the Board of Directors with such recommendations as the Committee may deem appropriate. Minutes will be taken for each Committee meeting which will then be approved at the next meeting.

13. Review with the Chief Financial Officer, legal advisors, and the independent accountants, as appropriate, the results of their review of the Company s monitoring compliance with the Company s Code of Conduct.

14. If appropriate, review any letter to be included in the annual report that describes the Committee composition and responsibilities and how they were discharged.

15. Review the annual expense reports of the Chairman, Chief Executive and other key officers.

16. Other Responsibilities:

Review the appointment and termination by the Chief Executive Officer of the Chief Financial Officer;

Review the adequacy of the Audit Committee Charter annually and evaluate the performance of the Audit Committee every two years and recommend such changes in the Charter as the Audit Committee may determine from time to time are appropriate.

Education and training for members of the Committee;

Periodic local visits to meet local managers on site;

Review with management and the auditors the potential risks facing the Company, the steps management is taking to mitigate such risks, and the adequacy of public disclosure of these risks; and

Receive, retain and consider complaints received by the Company regarding questionable accounting or auditing matters and internal accounting controls and in that connection:

- Provide for the confidential, anonymous submission by employees and others of concerns regarding questionable accounting or auditing matters or internal accounting controls;
- If warranted conduct investigations of management and others to determine the merits of any such concerns;
- Retain independent counsel and other advisors if warranted to assist the Committee in connection with any such investigation;
- Make recommendations for any remedial actions to be taken by the Company, if warranted, to correct any questionable accounting or auditing matter; and
- If material, recommend the disclosure both to the public and to appropriate regulatory agencies of the results of any such investigation and any remedial actions to be taken by the Company in response thereto.

17. Perform such other duties and responsibilities as may be assigned to the Audit Committee, from time to time, by the Board and/or the Chairman and Chief Executive Officer.

18. Approved Minutes of Committee meetings shall be circulated to all members of the Board.

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Annex II

CanArgo Energy Corporation
2004 LONG TERM STOCK INCENTIVE PLAN

Section 1. *Purpose of the Plan.* The purpose of the 2004 Long Term Stock Incentive Plan (the Plan) is to aid CanArgo Energy Corporation (the Corporation) and its subsidiaries in securing and retaining directors, consultants, officers and other key employees of outstanding ability and to motivate such employees to exert their best efforts on behalf of the Corporation and its subsidiaries. In addition, the Corporation expects that it will benefit from the added interest which the respective optionees and AWARDEES will have in the welfare of the Corporation as a result of their ownership or increased ownership of the Common Stock of the Corporation (the Stock).

Section 2. *Administration.* (a) the Board of Directors of the Corporation (the Board) shall designate the Compensation Committee of the Board or another Committee, which may be a sub-committee of the Compensation Committee, to be composed of not less than two (2) Directors (such Committee being referred to herein as the Committee) who shall serve at the pleasure of the Board. Each member of the Committee shall be a non-employee director within the meaning of Rule 16b-3(b)(3)(i) under the Securities Exchange Act of 1934, as amended (the Exchange Act), as such Rule or any other comparable rule may be in effect from time to time, while serving on the Committee. The Board shall fill any vacancies on the Committee and may remove any member of the Committee at any time with or without cause. The Committee shall select its chairman and hold its meetings at such times and places as it may determine. A majority of the whole Committee present at a meeting at which a quorum is present, or an act approved in writing by all members of the Committee, shall be an act of the Committee. The Committee shall have full power and authority, subject to such resolutions not inconsistent with the provisions of the Plan as may from time to time be issued or adopted by the Board (provided the entire Board acting on the matter are disinterested persons), to grant to Eligible Persons (as defined herein) pursuant to the provisions of the Plan (i) stock options to purchase shares, (ii) stock appreciation rights, (iii) restricted stock, (iv) deferred stock, or (v) other Stock-based awards permitted hereunder (each of the foregoing being an AWARD and collectively, the AWARDS and the recipients of such Awards being sometimes referred to herein as AWARDEES). The Committee shall also interpret the provisions of the Plan and any AWARD issued under the Plan (and any agreements relating thereto) and supervise the administration of the Plan.

(b) The Committee shall: (i) select the directors, consultants, officers and other key employees of the Corporation and its subsidiaries to whom AWARDS may from time to time be granted hereunder; (ii) determine whether incentive stock options (QSOs) under Section 422 of the Internal Revenue Code of 1986, as the same may be amended from time to time (hereinafter referred to as the Code), nonqualified stock options (NQSOs), stock appreciation rights, restricted stock, deferred stock, or other Stock-based awards, or a combination of the foregoing, are to be granted hereunder; (iii) determine the number of shares to be covered by each AWARD granted hereunder; (iv) determine the terms and conditions, not inconsistent with the provisions of the Plan, of any AWARD granted hereunder (including but not limited to any restriction and forfeiture condition on such AWARD and/or the shares of Stock relating thereto); (v) determine whether, to what extent and under what circumstances AWARDS may be settled in cash; (vi) determine whether, to what extent, and under what circumstances Stock and other amounts payable with respect to an AWARD under this Plan shall be deferred either automatically or at the election of the AWARDEE; and (vii) determine whether, to what extent, and under what circumstances option grants and/or other AWARDS under the Plan are to be made, and operate, on a tandem basis.

(c) All decisions made by the Committee pursuant to the provisions of the Plan and related orders or resolutions of the Board (as and to the extent permitted hereunder) shall be final, conclusive and binding on all persons, including the Corporation, its shareholders, employees and Plan AWARDEES.

(d) No member of the Committee shall be liable for any action or determination made in good faith with respect to the Plan or any AWARD thereunder.

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Section 3. *Stock Subject to the Plan.* Except as otherwise provided by this Section 3, the total number of shares of Stock available for distribution under the Plan is ten million (10,000,000). The total number of shares of stock with respect to which AWARDS may be granted to any AWARDEE in any year is 5,000,000 shares. Such shares may consist, in whole or in part, of authorized and unissued shares or treasury shares. If any shares that have been optioned cease to be subject to option because the option has expired or has been deemed to have expired or has been surrendered pursuant to the Plan, or if any shares of restricted stock are forfeited or such AWARD otherwise terminates without the actual or deemed delivery of such shares, such shares shall be added back into the total number of shares of Stock available for grant and distribution under the Plan and again be subject to grant as an AWARD under the Plan.

In the event of any merger, reorganization, consolidation, recapitalization, stock dividend, extraordinary cash dividend, or other change in corporate structure affecting the Stock, such adjustment shall be made in the aggregate number of shares which may be delivered under the Plan, in the number and/or option price of shares subject to outstanding options granted under the Plan, and/or in the number of shares subject to restricted stock, deferred stock, or other Stock-based awards granted under the Plan as may be determined to be appropriate by the Committee, in its sole discretion; provided that the number of shares subject to any AWARDS shall always be a whole number; and provided further that, with respect to QSOs, no such adjustment shall be authorized to the extent that such adjustment would constitute a modification as defined in Section 424(h)(3) of the Code or cause the Plan to violate Section 422(b)(1) of the Code or any successor provision thereto. Such adjusted option price shall also be used to determine the amount payable by the Corporation upon the exercise of any stock appreciation right associated with any option. In addition, subject to the limitations provided in Section 11, the Committee is authorized to make adjustments in the terms and conditions of, and performance criteria relating to, AWARDS in recognition of unusual or nonrecurring events (including, without limitation, events described in this paragraph) affecting the Corporation or the financial statements of the Corporation, or in response to changes in applicable laws, regulations or accounting principles.

Section 4. *Eligibility.* Directors, consultants, officers and other key employees of the Corporation and its subsidiaries who are responsible for the management, growth, profitability and protection of the business of the Corporation and its subsidiaries are eligible to be granted AWARDS under the Plan (each an Eligible Person and collectively Eligible Persons). The AWARDEES under the Plan shall be selected from time to time by the Committee, in its sole discretion, from among those eligible, and the Committee shall determine, in its sole discretion, the number of shares covered by each stock option, the number of stock appreciation rights (if any) granted to each optionee, and the number of shares (if any) subject to restricted stock, deferred stock or other Stock-based awards granted to each AWARDEE.

For purposes of the Plan, a Subsidiary of the Corporation shall be any corporation which at the time qualifies as a subsidiary thereof under the definition of subsidiary corporation in Section 424(f) of the Code.

Section 5. *Stock Options.* Any stock option granted under the Plan shall be in such form as the Committee may from time to time approve. Any such option shall be subject to the following terms and conditions and shall contain such additional terms and conditions, not inconsistent with the provisions of the Plan, as the Committee shall deem desirable.

(a) *Option Price.* The purchase price per share of the Stock purchasable under a stock option shall be determined by the Committee, but will be not less than 100% of the fair market value of the Stock on the date of the grant of the option, as determined in accordance with procedures established by the Committee. Notwithstanding the foregoing, the purchase price per share of the Stock purchasable under any QSO granted to any person who is the beneficial owner of more than 10% of the Corporation s issued and outstanding Stock (a 10% owner) shall not be less then 110% of the fair market value of the Stock on the date of the grant of the option, as determined in accordance with procedures established by the Committee.

(b) *Option Period.* The term of each stock option shall be fixed by the Committee, but no QSO shall be exercisable after the expiration of five (5) years from the date the option is granted unless otherwise determined by the Committee, but in no event longer than ten (10) years. Notwithstanding the foregoing, no QSO granted to a 10% owner shall be exercisable after the expiration of five years from the date the option is granted.

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(c) *Exercisability.* (1) Stock options shall be exercisable at such time or times as determined by the Committee at or subsequent to the date of grant; provided, however, that notwithstanding the foregoing from and after a Change of Control (as hereinafter defined) all stock options shall become immediately exercisable to the full extent of the AWARD.

(2) Solely for Federal income tax purposes, to the extent that the aggregate fair market value of Stock with respect to which QSOs are exercisable for the first time by a AWARDEE during any calendar year exceeds $100,000.00 (as of the date of grant), such options shall be treated as options which are not QSOs. For purposes of this rule, options shall be taken into account in the order in which they were granted.

(3) As used herein, Change of Control shall mean any of the following events:

(A) The acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended (the Exchange Act)) (a Person) of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 15% or more of either (i) the then outstanding shares of common stock of the Corporation (the Outstanding Common Stock) or (ii) the combined voting power of the then outstanding voting securities of the Corporation entitled to vote generally in the election of directors (the Outstanding Voting Securities); provided, however, that for purposes of this subsection (A), the following acquisitions of stock shall not constitute a Change of Control: (i) any acquisition directly from the Corporation, (ii) any acquisition by the Corporation, (iii) any acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Corporation or any corporation controlled by the Corporation or (iv) any acquisition by any corporation pursuant to a transaction which complies with clauses (i), (ii) and (iii) of subsection (C) of this Section 5(c)(3); or

(B) Individuals who, as of the date hereof, constitute the Board (the Incumbent Board) cease for any reason to constitute at least a majority of the Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Corporation s shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board shall be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial assumption of office occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board; or

(C) Consummation of a reorganization, merger or consolidation or sale or other disposition of all or substantially all of the assets of the Corporation (a Business Combination), in each case, unless, following such Business Combination, (i) all or substantially all of the individuals and entities who were the beneficial owners, respectively, of the Outstanding Common Stock and Outstanding Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 60% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation which as a result of such transaction owns the Corporation or all or substantially all of the Corporation s assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Common Stock and Outstanding Voting Securities, as the case may be, (ii) no Person (excluding any employee benefit plan (or related trust) sponsored or maintained by the Corporation or any corporation controlled by the Corporation or such corporation resulting from such Business Combination) beneficially owns, directly or indirectly, 15% or more of, respectively, the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership existed prior to the Business Combination, and (iii) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were

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members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or

(D) Approval by the shareholders of the Corporation of a complete liquidation or dissolution of the Corporation.

(d) *Method of Exercise.* Stock options may be exercised, in whole or in part, by giving written notice of exercise to the Corporation specifying the number of shares to be purchased. Such notice shall be accompanied by payment in full of the purchase price in cash, either by certified or bank check; provided, however, that after a Change of Control (x) an optionee (other than an optionee who initiated a Change of Control in a capacity other than as an officer or director of the Corporation) who is an officer or director of the Corporation (within the meaning of Section 16 of the Exchange Act and the rules and regulations promulgated thereunder), during the 60-day period after six (6) months after a Change of Control, with respect to an option that is unaccompanied by a stock appreciation right and (y) any other optionee, during the six month (6) period from and after a Change of Control, who at the time of exercise is not an officer or director with respect to an option that is unaccompanied by a stock appreciation right shall, unless the Committee shall determine otherwise at the time of grant, have the right, in lieu of the payment of the full purchase price of the shares of the Stock being purchased under the stock option and by giving written notice to the Corporation, to elect (within such respective periods) to surrender all or part of the stock option to the Corporation and to receive in cash an amount equal to the amount by which the fair market value per share of the Stock on the date of exercise shall exceed the purchase price per share under the stock option multiplied by the number of shares of the Stock granted under the stock option as to which the right granted by this proviso shall have been exercised. However, any officer, director or 10% owner (collectively, Insider) may only settle the right granted by this proviso pursuant to an irrevocable election to settle the right no earlier than six (6) months after the date of such election, provided that the transaction giving rise to the award of the right is approved by the Company s shareholders (excluding Insider shareholders).

The written notice provided by the optionee shall specify the optionee s election to purchase shares subject to the stock option or to receive the cash payment herein provided.

Notwithstanding the foregoing, the Committee may, in its sole discretion, authorize payment in whole or in part of the purchase price (i) to be made in unrestricted stock already owned by the optionee, (ii) in the case of the nonqualified stock option, restricted stock, (iii) deferred stock subject to an AWARD hereunder (based upon the fair market value of the Stock on the date the option is exercised as determined by the Committee) or (iv) such other method of exercise as the Committee may determine at or after grant, consistent (a) in the case of a QSO, with all applicable requirements of the Code and the Treasury Regulations promulgated thereunder, and (b) in the case of option grants to an Insider, with Section 16 of the Exchange Act and rules and regulations promulgated thereunder. The Committee may authorize such payment at or after grant, except that in the case of a QSO, any right to make payment in unrestricted stock already owned must be included in the option at the time of grant. No shares of Stock shall be issued until full payment therefor has been made. Subject to paragraph (i) of this Section 5, an optionee shall have the rights to dividends or other rights of a stockholder with respect to shares subject to the option when the optionee has given written notice of exercise, has paid in full for such shares, and, if requested, has given the representation described in paragraph (a) of Section 14.

As used in this paragraph (d) of Section 5, the fair market value of the Stock on the date of exercise shall mean:

(i) with respect to an election by an optionee to receive cash in respect of a stock option which is not a QSO, the Change of Control Fair Market Value , as defined below; and

(ii) with respect to an election by an optionee to receive cash in respect of a stock option which is a QSO, the fair market value of the Stock on the date of exercise, determined in the same manner as the fair market value of the Stock on the date of grant of a stock option is determined pursuant to paragraph (a) of Section 5 of the Plan.

(e) *Restrictions on Transferability.* The Committee, in its sole discretion, may impose such restrictions on the transferability of stock options granted hereunder as it deems appropriate. Any such restrictions shall be set

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forth in the stock option agreement with respect to such stock options. QSOs may not be transferred by an optionee other than by will or by the laws of descent and distribution.

(f) *Termination by Death.* Except to the extent otherwise provided by the Committee at or after the time of grant, if an optionee s relationship with or employment by the Corporation and/or any of its subsidiaries terminates by reason of death, the stock option may thereafter be immediately exercised in full by the legal representative of the estate or by the legatee of the optionee under the will of the optionee, for a period of eighteen (18) months from the date of such death or until the expiration of the stated period of the option whichever period is the shorter.

(g) *Termination by Reason of Retirement or Permanent Disability.* Except to the extent otherwise provided by the Committee at or after the time of grant, if an optionee s relationship with or employment by the Corporation and/or any of its subsidiaries terminates by reason of Retirement or permanent disability, any stock option held by such optionee may thereafter be exercised in full, but may not be exercised after twelve (12) months from the date of such termination or the expiration of the stated period of the option, whichever period is the shorter; provided, however, that if the optionee dies within such twelve (12) month period, any unexercised stock option held by such optionee shall thereafter be exercisable to the extent to which it was exercisable at the time of death for a period of eighteen (18) months from the date of the optionee s death or for the stated period of the option, whichever period is the shorter. As used herein, Retirement means, in the case of an AWARDEE employed by the Corporation or any of its affiliates, attainment of age 68 or such later date as the Committee may determine at or after grant. An AWARDEE must, however, voluntarily terminate his or her employment in order for his or her termination of employment to be for Retirement.

(h) *Other Termination.* Unless otherwise determined by the Committee at or after grant, if an optionee s relationship with or employment by the Corporation terminates for any reason other than death, permanent disability or Retirement, the stock option shall thereupon terminate; provided, however, that if such termination is by action of the Corporation and other than discharge for reason of willful violation of the rules of the Corporation or by voluntary resignation of the optionee, in either case within six (6) months following a Change of Control, any stock options held by the optionee may be exercised by the optionee until the earlier of three (3) months and one day after such termination or the expiration of such options in accordance with their terms.

(i) *Option Buyout.* The Committee may at any time offer to repurchase an option (other than an option which has been held for less than six months by an Insider) based on such terms and conditions as the Committee shall establish and communicate to the optionee at the time that such offer is made.

(j) *Form of Settlement.* In its sole discretion, the Committee may provide, at the time of grant, that the shares to be issued upon an option s exercise shall be in the form of restricted stock or deferred stock, or may reserve other than with respect to QSOs the right to so provide after the time of grant.

Section 6. *Stock Appreciation Rights.* (a) Grant and Exercise. Stock appreciation rights may be granted in conjunction with (or in accordance with Section 9, separated from) all or part of any stock option granted under the Plan, as follows: (i) in the case of a NQSO, such rights may be granted either at the time of the grant of such option or at any subsequent time during the term of the option; and (ii) in the case of an QSO, such rights may be granted only at the time of the grant of the option. A stock appreciation right is a right to receive cash or Stock, as provided in this Section 6, in lieu of the purchase of a share under a related option. A stock appreciation right, or applicable portion thereof, shall terminate and no longer be exercisable upon the termination or exercise of the related stock option, except that a stock appreciation right granted with respect to less than the full number of shares covered by a related stock option shall not be reduced until the exercise or termination of the related stock option exceeds the number of shares not covered by the stock appreciation right. A stock appreciation right may be exercised by an optionee, in accordance with paragraph (b) of this Section 6, by surrendering the applicable portion of the related stock option. Upon such exercise and surrender, the optionee shall be entitled to receive an amount determined in the manner prescribed in paragraph (b) of this Section 6. Options which have been so surrendered, in whole or in part, shall no longer be exercisable to the extent the related stock appreciation rights have been exercised.

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(b) *Terms and Conditions.* Stock appreciation rights shall be subject to such terms and conditions, not inconsistent with the provisions of the Plan, as shall be determined from time to time by the Committee, including the following:

(i) Stock appreciation rights shall be exercisable only at such time or times and to the extent that the stock options to which they relate shall be exercisable. Except as otherwise provided in Section 5, an Insider (as previously defined in Section 5(d)) may only settle a stock appreciation right by satisfying either of the following conditions:

(A) the stock appreciation right is settled at least six (6) months after its date of grant; or else

(B) the settlement of the stock appreciation right is made pursuant to an irrevocable election to settle the right no earlier than six (6) months after the date of such election.

None of the conditions of this Section 6(b)(i) shall be applicable in the event of death or permanent disability of the optionee.

(ii) Upon the exercise of a stock appreciation right, an optionee shall be entitled to receive up to, but no more than, an amount in cash or whole shares of the Stock as determined by the Committee in its sole discretion equal to the excess of the fair market value of one share of Stock over the option price per share specified in the related stock option multiplied by the number of shares in respect of which the stock appreciation right shall have been exercised; provided, however, that the payment in settlement of stock appreciation rights during the period from and after a Change of Control shall be entirely in cash. Each stock appreciation right may be exercised only at the time and so long as a related option, if any, would be exercisable or as otherwise permitted by applicable law; provided however, that no stock appreciation right granted under the Plan to an Insider then subject to Section 16 of the Exchange Act shall be exercised during the first six months of its term. The fair market value of the Stock on the date of exercise of a stock appreciation right shall be determined in the same manner as the fair market value of the Stock on the date of grant of a stock option is determined pursuant to paragraph (a) of Section 5 of the Plan; provided, however, that during the 60-day period from and after a Change of Control, the fair market value of the Stock on the date of exercise shall mean, with respect to the exercise of a stock appreciation right accompanying an option which is not an QSO, the Change of Control Fair Market Value.

For purposes of this Plan, the Change of Control Fair Market Value shall mean the higher of (x) the highest reported sale price, regular way, of a share of the Stock on the Composite Tape for American Stock Exchange Listed Stock during the 60-day period prior to the date of the Change of Control or, if such security is not listed or admitted to trading on the American Stock Exchange, on the principal national securities exchange on which such security is listed or admitted to trading or, if not listed or admitted to trading on any national securities exchange, on the Nasdaq National Market or, if such security is not quoted on such Nasdaq National Market, the average of the closing bid and asked prices during such 60-day period in the over-the-counter market as reported by the National Association of Securities Dealers Automated Quotation (NASDAQ) system or, if bid and asked prices for such security during such period shall not have been reported through NASDAQ, the average of the bid and asked prices for such period as furnished by any American Stock Exchange member firm regularly making a market in such security selected for such purpose by the Board of Directors of the Corporation or a committee thereof or, if such security is not publicly traded, the fair market value thereof as determined by an independent investment banking or appraisal firm experienced in the valuation of such securities selected in good faith by the Board of Directors of the Corporation or a committee thereof or, if no such investment banking or appraisal firm is in the good faith judgment of the Board of Directors or such committee available to make such determination, as determined in good faith by the Board of Directors of the Corporation or such committee and (y) if the Change of Control is the result of a transaction or series of transactions described in paragraph (i) or (iii) of the definition of Change of Control set forth in Section 5(c), the highest price per share of the Stock paid in such transaction or series of transactions (in the case of a Change of Control described in such paragraph (i) of Section 5(c), as reflected in any Schedule 13D filed by the person having made the acquisition).

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(iii) The Committee, in its sole discretion, may impose such restrictions on the transferability of stock appreciation rights as it deems appropriate. Any such restrictions shall be set forth in the written agreement between the Corporation and the optionee with respect to such rights.

(iv) Upon the exercise of a stock appreciation right, the stock option or part thereof to which such stock appreciation right is related shall be deemed to have been exercised for the purpose of the limitation of the number of shares of the Stock to be issued under the Plan, as set forth in Section 3 of the Plan.

(v) Stock appreciation rights granted in connection with QSOs may be exercised only when the market price of the Stock subject to the QSO exceeds the option price of the QSO.

Section 7. *Restricted Stock.* (a) Stock and Administration. Shares of restricted stock may be issued either alone or in addition to stock options, stock appreciation rights, deferred stock or other Stock-based awards granted under the Plan. The Committee shall determine the directors, consultants, officers and key employees of the Corporation and its subsidiaries to whom, and the time or times at which, grants of restricted stock will be made, the number of shares to be awarded, the time or times within which such AWARDS may be subject to forfeiture, and all other conditions of the AWARDS. The provisions of restricted stock AWARDS need not be the same with respect to each recipient.

(b) Awards and Certificates. The prospective AWARDEE of shares of restricted stock shall not, with respect to such AWARD, be deemed to have become an AWARDEE, or to have any rights with respect to such AWARD, until and unless such AWARDEE shall have executed an agreement or other instrument evidencing the AWARD and delivered a fully executed copy thereof to the Corporation and otherwise complied with the then applicable terms and conditions.

(i) Each AWARDEE shall be issued a stock certificate in respect of vested shares of restricted stock awarded under the Plan. Such certificate shall be registered in the name of the AWARDEE, and, in addition to any legends required under applicable law, shall, unless determined otherwise by the Committee, bear an appropriate legend referring to the terms, conditions, and restrictions applicable to such AWARD, substantially in the following form:

The transferability of this certificate and the shares of stock of CanArgo Energy Corporation (the Corporation) represented hereby are subject to the terms and conditions (including forfeiture) of the Corporation s 2004 Long Term Incentive Stock Option Plan and Agreement. Copies of such Plan are on file in the offices of the Corporation, P.O Box 291, St. Peter Port, Guernsey GY1 3RR, British Isles and may be inspected upon written request to the Secretary of the Corporation.

(ii) The Committee may require that the stock certificates evidencing such shares be held in custody by the Corporation until the restrictions thereon shall have lapsed, and may require, as a condition of any restricted stock AWARD, that the AWARDEE shall have delivered a stock power, endorsed in blank, relating to the Stock covered by such AWARD.

(c) *Restrictions and Conditions.* The shares of restricted stock awarded pursuant to the Plan may, subject to the determination made by the Committee, be subject to the following restrictions and conditions:

(i) Subject to the provisions of this Plan during a period set by the Committee commencing with the date of such AWARD (the restriction period), the AWARDEE shall not be permitted to sell, transfer, pledge, or assign shares of restricted stock awarded under the Plan. Within these limits the Committee may provide for the lapse of such restrictions (other than those set forth in the Corporation s bylaws) in installments where deemed appropriate.

(ii) Except as provided in paragraph (c) of this Section 7, the AWARDEES shall have, with respect to the awarded shares of restricted stock, all of the rights of a stockholder of the Corporation, including the right to vote the restricted stock and the right to receive any cash dividends both for vested shares only. The Committee, in its sole discretion, may permit or require the payment of cash dividends to be deferred and, if the Committee so determines, reinvested in additional restricted stock or otherwise reinvested. Certificates for shares of unrestricted stock shall be delivered to the AWARDEE promptly after, and only after, any period of forfeiture shall expire without forfeiture in respect of such shares of restricted stock.

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(iii) Subject to the provisions of paragraph (c)(iv) of this Section 7, upon termination of employment of any reason during the restriction period, all shares still subject to restriction shall be forfeited by the AWARDEE and reacquired by the Corporation.

(iv) In the event of an AWARDEE s Retirement, permanent disability, or death, or in cases of special circumstances, the Committee may, in its sole discretion, when it finds that a waiver would be in the best interests of the Corporation, waive in whole or in part any or all restrictions with respect to such AWARDEE s shares of restricted stock.

(v) Notwithstanding anything in the foregoing to the contrary, upon a Change of Control any and all restrictions on restricted stock shall lapse regardless of the restriction period established by the Committee and all such restricted stock shall become fully vested and nonforfeitable.

Section 8. *Deferred Stock Awards.* (a) Stock and Administration. AWARDS of the right to receive Stock that is not to be distributed to the AWARDEE until after a specified deferral period (such AWARD and the deferred stock delivered thereunder hereinafter as the context shall require, referred to as the deferred stock) may be made either alone or in addition to stock options, stock appreciation rights, or restricted stock, or other Stock-based awards granted under the Plan. The Committee shall determine the directors, consultants, officers and key employees of the Corporation and its subsidiaries to whom and the time or times at which deferred stock shall be awarded, the number of shares of deferred stock to be awarded to any AWARDEE, the duration of the period (the Deferral Period) during which, and the conditions under which, receipt of the Stock will be deferred, and the terms and conditions of the AWARD in addition to those contained in paragraph (b) of this Section 8. In its sole discretion, the Committee may provide for a minimum payment at the beginning or end of the applicable Deferral Period based on a stated percentage of the fair market value on the date of grant of the number of shares covered by a deferred stock AWARD. Such payment may include an election to defer receipt of a bonus or other compensation payable by the Corporation and to receive a deferred stock AWARD in lieu of such compensation. The Committee may also provide for the grant of deferred stock upon the completion of a specified performance period. The provisions of deferred stock AWARDS need not be the same with respect to each recipient.

(b) *Terms and Conditions.* Deferred stock AWARDS made pursuant to this Section 8 shall be subject to the following terms and conditions:

(i) Subject to the provisions of the Plan, the shares to be issued pursuant to a deferred stock AWARD may not be sold, assigned, transferred, pledged or otherwise encumbered during the Deferral Period or Elective Deferral Period (defined below), where applicable, and may be subject to a risk of forfeiture during all or such portion of the Deferral Period as shall be specified by the Committee. At the expiration of the Deferral Period and Elective Deferral Period, share certificates shall be delivered to the AWARDEE, or the AWARDEE s legal representative, in a number equal to the number of shares covered by the deferred stock AWARD.

(ii) Amounts equal to any dividends declared during the Deferral Period with respect to the number of shares covered by a deferred stock AWARD will be paid to the AWARDEE currently, or deferred and deemed to be reinvested in additional deferred stock or otherwise reinvested, as determined at the time of the AWARD by the Committee, in its sole discretion.

(iii) Subject to the provisions of paragraph (b)(iv) of this Section 8, upon termination of the relationship with or employment by the Corporation for any reason during the Deferral Period for a given deferred stock AWARD, the deferred stock in question shall be forfeited by the AWARDEE.

(iv) In the event of the AWARDEE s Retirement, permanent disability or death during the Deferral Period (or Elective Deferral Period, where applicable), or in cases of special circumstances, the Committee may, in its sole discretion, when it finds that a waiver would be in the best interests of the Corporation, waive in whole or in part any or all of the deferral limitations imposed hereunder with respect to any or all of the AWARDEE s deferred stock. Anything in the Plan to the contrary notwithstanding, upon the occurrence of a Change of Control, the Deferral Period and the Elective Deferral Period with respect to each deferred

stock AWARD shall expire immediately and all share certificates relating to such deferred stock AWARDS shall be delivered to each AWARDEE or the AWARDEE s legal representative.

(v) Prior to completion of the Deferral Period, an AWARDEE may elect to defer further the receipt of the deferred stock AWARD for a specified period or until a specified event (the Elective Deferred Period), subject in each case to the approval of the Committee and under such terms as are determined by the Committee, all in its sole discretion.

(vi) Each deferred stock AWARD shall be confirmed by a deferred stock agreement or other instrument executed by the Corporation, acting under the authority of the Committee, and by the AWARDEE.

Section 9. *Other Stock-Based Awards.* (a) Stock and Administration. Other AWARDS of the Stock and other AWARDS that are valued in whole or in part by reference to, or are otherwise based on the Stock (Other Stock-based AWARDS), including (without limitation) performance shares and convertible debentures, may be granted either alone or in addition to other AWARDS granted under the Plan. Subject to the provisions of the Plan, the Committee shall have sole and complete authority to determine the directors, consultants, officers and key employees of the Corporation and/or any of its subsidiaries to whom and the time or times at which such Other Stock-based AWARDS shall be made, the number of shares of the Stock to be awarded pursuant to such Other Stock-based AWARDS and all other conditions of the Other Stock-based AWARDS. The Committee may also provide for the grant of the Stock upon the completion of a specified performance period. The provisions of Other Stock-based AWARDS need not be the same with respect to each recipient.

(b) *Terms and Conditions.* Other Stock-based AWARDS made pursuant to this Section 9 shall be subject to the following terms and conditions:

(i) Subject to the provisions of this Plan, shares or interests in shares subject to Other Stock-based AWARDS made under this Section 9 may not be sold, assigned, transferred, pledged or otherwise encumbered prior to the date on which the shares are issued, or, if later, the date on which any applicable restriction, performance or deferral period lapses.

(ii) Subject to the provisions of this Plan and the Other Stock-based AWARD agreement, the AWARDEES of Other Stock-based AWARDS under this Section 9 shall be entitled to receive, currently or on a deferred basis, interest or dividends or interest or dividend equivalents with respect to the number of shares or interests therein covered by the Other Stock-based AWARDS, as determined at the time of the Other Stock-based AWARDS by the Committee, in its sole discretion, and the Committee may provide that such amounts (if any) shall be deemed to have been reinvested in additional Stock or otherwise reinvested.

(iii) Any Other Stock-based AWARDS under this Section 9 and any Stock covered by any such Other Stock-based AWARD may be forfeited to the extent so provided in the Other Stock-based AWARD agreement, as determined by the Committee, in its sole discretion.

(iv) In the event of the AWARDEE s Retirement, permanent disability or death, or in cases of special circumstances, the Committee may, in its sole discretion, when it finds that a waiver would be in the best interests of the Corporation, waive in whole or in part any or all of the limitations imposed hereunder (if any) with respect to any or all Other Stock-based AWARDS under this Section 9. Anything in the Plan to the contrary notwithstanding, any limitations imposed with respect to any Other Stock-based AWARD under this Section 9, including any provision providing for the forfeiture of any Other Stock-based AWARD under any circumstance, shall terminate immediately upon a Change of Control and the number of shares of or interests in the Stock subject to such Other Stock-based AWARD shall be delivered to the AWARDEE (or, in the case of an Other Stock-based AWARD with respect to which such number is not determinable, such number of shares of or interests in the Stock as is determined by the Committee and set forth in the terms of such Other Stock-based AWARD).

(v) Each Other Stock-based AWARD under this Section 9 shall be confirmed by an agreement or other instrument executed by the Corporation and by the AWARDEE.

(vi) The Stock or interests therein (including securities convertible into the Stock) paid or awarded on a bonus basis under this Section 9 shall be issued for no cash consideration; the Stock or interests therein

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(including securities convertible into the Stock) purchased pursuant to a purchase right awarded under this Section 9 shall be priced at least 50% of the fair market value of the Stock on the date of grant.

(vii) The Committee, in its sole discretion, may impose such restrictions on the transferability of Other Stock-based Awards as it deems appropriate. Any such restrictions shall be set forth in the written agreement between the Corporation and the AWARDEE with respect to such Award.

(viii) Each Other Stock-based AWARD to an Insider under this Section 9 shall be subject to all of the limitations and qualifications that may be required by Section 16 of the Exchange Act and all of the rules and regulations promulgated thereunder.

Section 10. *Transfer, Leave of Absence, etc.* For purposes of the Plan: (a) a transfer of an employee from the Corporation to a Subsidiary, or vice versa, or from one Subsidiary to another; (b) a leave of absence, duly authorized in writing by the Corporation, for military service or sickness, or for any other purposes approved by the Corporation if the period of such leave does not exceed 90 days; and (c) a leave of absence in excess of 90 days, duly authorized in writing by the Corporation, shall not be deemed a termination of employment.

Section 11. *Amendments and Termination.* The Board may amend, alter, or discontinue the Plan, but no amendment, alteration, or discontinuation shall be made which would impair the rights of an AWARDEE under any AWARD theretofore granted, without the AWARDEE s consent, or which without the approval of the shareholders would:

(a) except as is provided in Section 3 of the Plan, increase the total number of shares available for the purpose of the Plan;

(b) subsequent to the date of grant decrease the option price of any stock option to less than 100% (110% in the case of a 10% owner of an QSO) of the fair market value on the date of the granting of the option;

(c) extend the maximum option period under Section 5(b) of the Plan; or

(d) otherwise materially increase the benefits accruing to AWARDEES under, or materially modify the requirements as to eligibility for participation in, the Plan.

The Committee may amend the terms of any AWARD theretofore granted, prospectively or retroactively, but no such amendment shall impair the rights of any holder without such holder s consent. Notwithstanding the foregoing, the Board or the Committee may, in its discretion, amend the Plan or terms of any outstanding AWARD held by a person then subject to Section 16 of the Exchange Act without the consent of any holder in order to preserve exemptions under said Section 16 which are or become available from time to time under rules of the Securities and Exchange Commission. The Committee may also substitute new stock options for previously granted options, including previously granted options having higher option prices.

Section 12. *Unfunded Status of the Plan.* The Plan is intended to constitute an unfunded plan for incentive and deferred compensation. With respect to any payments not yet made to an AWARDEE by the Corporation, nothing contained herein shall give any such AWARDEE any rights that are greater than those of a general creditor of the Corporation. In its sole discretion, the Committee may authorize the creation of trusts or other arrangements to meet the obligations created under the Plan to deliver the Stock; provided, however, that the existence of such trusts or other arrangements is consistent with the unfunded status of the Plan.

Section 13. *Employment at Will.* Nothing contained in the Plan, or in any option granted pursuant to the Plan, nor in any agreement made pursuant to the Plan, shall confer upon any AWARDEE any right with respect to continuance of employment by the Company or its subsidiaries, nor interfere in any way with the right of the Company or its subsidiaries to terminate the AWARDEE s employment at will or change the AWARDEE s compensation at any time.

Section 14. *General Provisions.* (a) The Committee may require each AWARDEE purchasing shares pursuant to an AWARD under the Plan to represent to and agree with the Corporation in writing that such AWARDEE is acquiring the shares without a view to distribution thereof. The certificates for such shares may include any legend which the Committee deems appropriate to reflect any restrictions on transfer.

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(b) All certificates for shares of the Stock delivered under the Plan pursuant to any AWARD shall be subject to such stock-transfer orders and other restrictions as the Committee may deem advisable under the rules, regulations, and other requirements of the Securities and Exchange Commission, any stock exchange upon which the Stock is then listed, and any applicable Federal or state securities law, and the Committee may cause a legend or legends to be put on any such certificates to make appropriate reference to such restrictions.

(c) Recipients of shares of restricted stock, deferred stock and other Stock-based awards under the Plan (other than options) shall not be required to make any payment or provide consideration other than the rendering of services.

(d) AWARDS granted under the Plan may, in the discretion of the Committee, be granted either alone or in addition to, in tandem with, or in substitution for, any other AWARDS granted under the Plan. If AWARDS are granted in substitution for other AWARDS, the Committee shall require the surrender of such other AWARDS in consideration for the grant of the new AWARDS. AWARDS granted in addition to or in tandem with other AWARDS may be granted either at the same time as or at a different time from the grant of such other AWARDS. The exercise price of any option or the purchase price of any Other Stock-based AWARD in the nature of a purchase right:

(i) granted in substitution for outstanding AWARDS or in lieu of any other right to payment by the Corporation shall be the fair market value of shares at the date such substitute AWARDS are granted or shall be such fair market value at that date reduced to reflect the fair market value of the AWARDS or other right to payment required to be surrendered by the AWARDEE as a condition to receipt of the substitute AWARD; or

(ii) retroactively granted in tandem with outstanding AWARDS shall be either the fair market value of shares at the date of grant of later AWARDS or the fair market value of shares at the date of grant of earlier AWARDS.

(e) Nothing contained in this Plan shall prevent the Board of Directors from adopting other or additional compensation arrangements, subject to shareholder approval if such approval is required; and such arrangements may be either generally applicable or applicable only in specific cases.

Section 15. *Taxes.* (a) AWARDEES shall make arrangements satisfactory to the Committee regarding payment of any Federal, state, or local taxes of any kind required by law to be withheld with respect to any income which the AWARDEE is required, or elects, to include in his or her gross income and the Corporation and its subsidiaries shall, to the extent permitted by law, have the right to deduct any such taxes from any payment of any kind otherwise due to the AWARDEE. Anything contained herein to the contrary notwithstanding, the Committee may, in its sole discretion, authorize acceptance of Stock received in connection with the grant or exercise of an AWARD or otherwise previously acquired in satisfaction of withholding requirements.

(b) Notwithstanding any provisions to the contrary in this Section 15, an Insider may only satisfy tax withholding requirements with the settlement of a stock appreciation right or with shares of the Company s Common Stock if he or she has held such stock or stock appreciation right for at least six (6) months or the cash settlement of the tax obligation occurs no earlier than six (6) months after the date of an irrevocable election made by an Insider.

Section 16. *Effective Date of the Plan.* The Plan shall be effective on the date it is approved by a majority of the votes cast at a duly convened meeting of shareholders.

Section 17. *Term of the Plan.* No AWARD shall be granted pursuant to the Plan after May 18, 2014, but AWARDS theretofore granted may extend beyond that date.