Santos' summary of new proposal in relation to QGC
7 February 2007

FOR PUBLICATION

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New proposal by Santos in respect of QGC: major improvements and significant additional subject matter

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Executive Summary

- Santos announced a new proposal in respect of QGC on 30 January 2007, based on the establishment of a New QGC
- Amendments made since then have developed more detail which:
  - ✓ enhances New QGC's capability to supply gas
  - ✓ adds value to shareholders of New QGC
- This results in more gas being developed and brought sooner to market, than the AGL/QGC proposal
- Both Santos and New QGC will be developing their respective separate interests across all of QGC's tenements
  - ✓ Santos will develop gas to supply QGC's existing contracts, as well as compete for new market opportunities against New QGC and other gas producers
  - ✓ At the same time, New QGC will be developing the potential of more than 9,000 PJ gas in place in its tenements
- Through the proposal and associated agreements, New QGC will be competitive in the market place based on:
  - ✓ continuation of the competitive QGC team in an independent entity
  - ✓ access to additional funding, necessary for competitive growth
  - ✓ infrastructure access and support, including gas processing, pipeline access, drilling and other operational support
  - ✓ rights over highly prospective and familiar acreage
  - ✓ market support and access to new markets including access to North West Queensland and tightly contracted pipeline

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Events since Santos' announcement on 30 January 2007

Since announcing its new proposal on 30th January 2007, Santos has not only made a number of significant major improvements to the terms underpinning its new proposal, but also has offered major new arrangements to QGC over additional subject matter for the commercial and competitive benefit of "New QGC". The result will be to give even greater certainty for QGC's board, QGC's shareholders, its customers, other relevant gas industry stakeholders, and the ACCC, as to the competitive outcomes. Upon implementation of the proposed de-merger transaction, "New QGC" will be both capable and certain of being operated, as soon as possible, with substantial tangible and intangible resources for sustainable, profitable, vigorous, independent and effective competition, as contemplated by QGC's plans.

Overall details of the new proposal, incorporating these changes, and their economic effect on Santos, QGC and "New QGC" are outlined below.

ACCC's Inquiry Process

This document may be published by the ACCC, to its contact list of energy industry participants, under the market inquiry process announced on 30th January 2007. Industry participants will be able to review the essential features of the overall proposal from the outline provided below. Given the beneficial nature of these changes for "New QGC", the publication of this document should not adversely affect the ability of any firm to comply with the ACCC's market inquiry deadline of 13 February 2007 and may resolve concerns.

The relevant supporting documents have been provided to the ACCC in confidence, and may not, at this time, form part of the public record.

Reasons for the changes

The details announced by Santos on 30th January 2007 stated a ***minimum*** set of business arrangements ("*the 30th January arrangements*"). It is Santos' view that its arrangements will meet their requirements for business certainty for a "New QGC".

Santos has done two further things to enhance the 30th January arrangements, as follows-

First, Santos has formulated further enhancements to the scope and scale of the minimum terms, for example, by providing for a 70% increase in the volume of gas (from 60PJ to 100PJ) to be made available to New QGC for its business purposes under the ATP 648P Agreement. The substantial contribution this ATP648P Agreement, as now amended, will make towards the successful early establishment and operation of New QGC, is outlined below. Further amendments have been made to each of the other 30th January arrangements, and these are described below.

Second, Santos on its own initiative has proposed to QGC a wider set of deal terms which will give "New QGC" substantial funding support, and the ability to use some of Santos' Roma to Brisbane Pipeline (RBP) contracted transportation capacity to sell gas in southern Queensland, and a gas swap agreement which will enable it to sell gas to customers located in north west Queensland. The proposal is described below in the commentary about the Transportation and Swap Agreement.

These proposals by Santos are made for the express purposes of:

(1) enhancing "New QGC's" capability to supply gas to a wider geographic customer base, in accordance with QGC's general plans and aspirations, *albeit as a more capable and well-resourced competitor of Santos in vying to win customers*, and

(2) adding value to the investment made by all shareholders in "New QGC", including Santos.

Santos' entry into joint venture-like commercial arrangements for the advancement of the production and supply capability of 'New QGC', as a better resourced and better placed downstream rival of Santos' other business interests, is similar to the investments Santos makes in other production joint ventures. Santos accepts that the direct commercial and legal consequence of its contributions of funds, and use of its assets to contribute to the success of these joint ventures, must improve the independent downstream competitive capability of other parties, such as "New QGC".

Economic Effect of the Arrangements

The overall economic effect of the implementation of Santos' new proposal, as amended and expanded, is summarised as follows:

1. **Santos** will acquire from QGC its interest[1] in "gas in place" at a number of tenements in the Undulla Nose. These tenements will still require substantial time, money and work to be undertaken by Santos (as QGC was planning to do) in order to be able to supply QGC's existing customers, and to enable Santos to use the resources to compete to win new business projects, and in due course, compete to win customers whose long-standing contracts using Cooper Basin gas will end in the next few years.

   A large part of QGC's gas is already spoken for under QGC's contracts and commitments with CS Energy, Incitec-Pivot, Braemar Power Station and Condamine Power Station projects. Santos will inherit and perform, as competently and capably as possible, its obligations under the terms of QGC's contracts and commitments. Santos has assured these customers about these matters.

   Santos has previously provided information to the ACCC about the decline in output gas volumes from the Cooper Basin.

2. **"New QGC"** will be able to focus its operations to accelerate the development of its tenements considerably sooner than would have happened under QGC's stand alone plans, or even under the AGL proposal. In doing so, QGC will be armed with the following substantial tangible and intangible attributes and resources-

[1] Three cases at 90%, six cases at around 58 - 60%, one at 50%, one at 25% and one at 15%.

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(1) Continuation of the competitive QGC team in an independent entity:

(a) the fundamental knowledge and awareness that "New QGC" will enable it to be at least as potent a competitor as the 'old QGC', in imposing competitive tension across the marketplace in competition with Santos and others,

(b) the same fully independent board, without any customer directors as per the AGL proposal (and without any Santos appointees),

(c) the same experienced, qualified and successful chief executive, Mr Cottee, with his demonstrated track record for the development, management and marketing of CSG by "QGC",

(d) the same senior management team: refer to page 37 of Deloitte's Independent Expert's Report, 25 January 2007 "IER"[2].

(e) the same technical team,

(f) the same corporate name, branding and inherited reputation and goodwill,

(g) the same physical offices and services as provided for under the Transitional Services Agreement,

(h) a clear understanding of the likely costs and expenses to undertake all of its business activities,

(i) a clear understanding of the planning processes and likely timetable to undertake all activities to be able to become a credible high volume long term supplier,

(j) a clear understanding of the methods and means to achieve a low cost base as referred to on pages 28 and 29 of the IER, by keeping finding costs low, by implementing gas techniques without pumping compression, by strategically locating its assets, achieving low development costs through controlling the proportion of equity and project finance, controlling the operation of project development, developing a multi-option sales model by establishing long term contracts, providing flexibility through put options and aiming to deliver gas into the spot market,

(k) the same exploration and development know-how and databases, including innovative engineering capabilities and methods which have been used to locate and develop gas at high rates,

(l) the exploration benefit of tenements identified for 80% of old QGC's exploration budget ($7m), as also set out on page 30 of the IER,

(m) tenements which are not contiguous with Santos, and in which Santos has no participatory interest,

[2] We note that the IER will have relied extensively on QGC management briefings on key factual matters.

(n) tenements in which " New QGC" holds higher levels of equity than old QGC's tenements, being 100% interests in four cases, substantial majority interests in two cases, and only one tenement the same selling and marketing capability and connections, with a 50% farm out interest to a third party Origin – this is the only tenement in which a rival has an interest,

(2) **Access to additional funding necessary for competitive growth:**

(a) capitalised immediately as to $40 million under the Subscription Agreement, but not impeded by Santos' shareholding to raise more capital if needed, and

(b) with sufficient working capital funding, but with the ability should it so wish, to call upon Santos for an interim loan facility on commercial arm's length terms of $ million as outlined under the proposed under the Interim Financing Agreement below,

(3) **Infrastructure access and support:**

(a) access to drilling rigs from Santos on advantageous terms, and

(b) access to gas processing infrastructure for " New QGC's" gas under the Infrastructure Access Agreement on attractive terms which avoids delays, or enables "New QGC" to forward plan for any capital investment of its own in such infrastructure,

(4) **Rights over highly prospective and familiar acreage:**

(a) rights over tenements which have already been identified by QGC to have massive quantities of Walloon Coal and to be the "next Undulla Nose". N.B. section 8.2.3 on page 54 of the IER assumes reserves greater than current QGC 3P reserves, and the two resource models on page 55 of the IER for the period 2006 to 2046 necessarily include substantial resource expectations from these tenements,

(b) a high degree of confidence that its tenements have the quantity of the gas in place of over 9,000 PJ, following upon the results of the 2006-2007 gas acceleration strategy referred to in QGC's ASX releases and summarised on page 30 of the IER,

(c) high degree of confidence that PJ of 2P gas at ATP648 P is 'very close' to being proved up, with up to PJ of 2P gas being proved up by the middle of 2007,

(d) advance knowledge of the physical characteristics of the tenements and possession of a range of drilling techniques which might be applied to extract large volumes of gas at the best possible low cost, and

(e) high degree of confidence that ATPs 621P and 651P have potential for development,

(5) **Market support and access to new markets**

(a) the ability under the ATP 648P Agreement to discover 100PJ of gas, and the right to either sell that gas to its customers as part of its program to establish customer relationships and credibility as a gas supplier, or to put 100PJ of gas to Santos at a guaranteed price with a potential net incremental value of the proceeds to 'New QGC' of up to $ million, (with the ability to raise working capital against this arrangement),

(b) the possible opening up of customer opportunities in other regions as new pipelines are built (subject to being price competitive after incurring long run transportation tariffs not incurred by rival suppliers with locational advantages) at future dates corresponding with its development cycles,

(c) but the nearer at hand ability for 'New QGC in the first five years of its operation to supply customers located in south east Queensland and north west Queensland, pursuant to the gas it may have available to sell to them under the ATP 648P Agreement, which it will be able to transport under the RBP transportation arrangements, and to swap that gas out with Santos for sale by 'New QGC' to customers located in north west Queensland (compared to the future, limited, qualified and highly uncertain possibilities to do so under the AGL proposal, and as postulated as future possibilities commencing 2010 or 2013 to 2026 in the IER page 49)[3], and

(d) no supply or marketing tie-ups with a dominant customer/dominant customer-competitor over most of its output, as per the AGL proposal, but with the potential (but not the funding dependency) to sell some or all of its gas to AGL, and/or other aggregators and/or direct to customers,

(e) a potentially large customer base with a demonstrated history of supporting new and expanding entrants by engaging in direct dealing (and not through aggregators) and/or by portfolio buying and/or by engaging in sponsored entry strategies,

(f) a large number of wholesale and industrial and mining customers coming off long term contracts in 2010, 2011 and 2012, and

(g) the growth in demand for CSG as the Queensland economy develops,

Overall, 'New QGC' will have a complete suite of head start advantages, compared with other start-up fields and producers, which addresses each of the five entry barriers referred to on page 22 of the IER- (i) secured land access, (ii) capital resources and services agreements to fund exploratory wells, production wells and necessary equipment, (iii) non-exposure to needing sales(foundation) contracts to underpin the construction of any

[3] We note at pages 49 and 50 of the IER the projections of possible additional gas quantities for sale by QGC. There are references to an "East Coast market" and future pipeline developments. Santos expects that over the longer time horizons referred to in the IER there will be many competing CSG suppliers established as close rivals of QGC, Santos and othes.

infrastructure, (iv) government approval, and (v) the requisite expertise to convert OGIP into 1P reserves and to produce saleable gas.

Relevant Documents

Forwarded with this submission are the following documents (and marked up copies of documents forwarded on 30th January tracking the amendments):-

(1) **Proforma Merger Implementation Agreement.** An incomplete working draft has been provided solely to assist the ACCC to interpret cross-references to defined terms in the documents summarised below.

(2) **Demerger Schedule** describes the division of QGC into "New" QGC and "old" QGC. It achieves this separation by providing that the relevant non-Undulla Nose tenements (and associated assets and contracts) will be transferred into Newco, leaving the Undulla Nose tenements and associated assets and contracts in QGC and its remaining subsidiaries. The legal content, that is, drafting and terminology, is essentially agreed. The schedule remains subject to QGC doing due diligence to check that all appropriate assets will be moved across to New QGC. QGC is currently undertaking that process.

(3) **Transitional Services Agreement** assists New QGC to establish and effectively operate its business. New QGC and old QGC will enter into a transitional services agreement which:

(a) provides for old QGC to provide New QGC with access, , to IT and employee support and such other forms of transitional support agreed by old QGC and new QGC;

(b) grants New QGC a option to call for the transfer to it, of certain additional assets of old QGC which it may require to operate effectively; and

(c) provides a basis for old QGC and New QGC to negotiate the equitable reallocation of any other asset which, following the de-merger, it becomes apparent should be owned by, or shared with, the other.

(4) **ATP 648P Agreement** provides for New QGC to be appointed operator, or otherwise be placed in a position where it can conduct the operations, under the ATP 648P joint venture. This will provide New QGC with the opportunity to develop up to 100PJ of reserves over a period of three years. The intention of this arrangement is to provide a stable source of reserves from which New QGC can derive a guaranteed minimum income.

New QGC can require old QGC to pay for these reserves and/or sell to New QGC a quantity of sales gas equal to these reserves (up to 100PJ). These rights are described in the ATP 648P Agreement as the Payment Option and the Purchase Option.

Reserves discovered by New QGC in excess of 100PJ are not subject to the options, but old QGC will reimburse New QGC its costs of discovering these reserves.

The increase in the volume of reserves which New QGC is entitled to discover , and either sell or put to Santos for payment in accordance with a formula has been increased from 60 PJ to 100PJ.

(5) **Infrastructure Access Agreement** will facilitate the development of New QGC by providing it with access, at cost, to spare capacity in upstream plant and pipeline infrastructure owned or controlled by old QGC (and its related bodies corporate) for the processing of its gas to enable New QGC to have its own gas processed.

New QGC and its subsidiaries are entitled to make requests to use the spare capacity of that infrastructure from time to time.

(6) **Pipeline Consent Agreement** enables New QGC to construct and operate a pipeline connecting ATP 621P to the Roma to Brisbane pipeline. The agreement provides for a commitment by old QGC, and its related bodies corporate, to provide consent on reasonable terms should New QGC wish to construct and operate a pipeline across land owned by old QGC and its related bodies corporate-essentially any member of the Santos group of companies- or across tenements they hold.

(7) **Drilling Rig Access Agreement** provides for old QGC and its related bodies corporate to provide New QGC with use, at cost, of drilling rigs contracted by old QGC and its related bodies corporate when those rigs are not being used by Old QGC/its related bodies corporate. This agreement has been amended to apply not just to rigs contracted by Old QGC but also to rigs contracted by Old QGC and any of its related bodies corporate – again essentially any member of the Santos group of companies.

The scope of the Agreement has also been expanded in that it applies to any rigs contracted by the Santos group which are capable of being used in the Undulla Nose area, rather than the previous scope under which the agreement applied to rigs usually used for exploration around the Undulla Nose.

(8) **Subscription Agreement** with a view to ensuring that New QGC's operations commence on a sound financial footing, Santos will subscribe $40 million in cash to take its shareholding in New QGC to 30 percent. The Subscription Agreement sets out the terms of this investment. Santos' investment has been structured to provide New QGC with maximum independence in developing its gas assets.

Santos has no contractual right to appoint directors to the Board of New QGC. In addition, Santos will agree that, in the first two years after the transaction, it will not exercise its shareholding to appoint or remove directors from the Board of New QGC, unless it is a proposal recommended by the majority of the board , or in other limited circumstances. These circumstances are confined to New QGC making a substantial change to its activities or disposing of its main undertaking, the chief executive officer of New QGC being removed, a majority of the directors of New QGC changing or the occurrence of an insolvency event in relation to New QGC.

As set out in its proposal of 30th January, Santos will undertake to the ACCC that until it is released from its obligation to do so, it will not, without first obtaining the ACCC's prior written consent, appoint any director representing it to the board of New QGC, or remove any director from the board of New QGC unless it is a proposal recommended by a majority of the board.

Santos has agreed that its 30% shareholding in Newco may be diluted by scrip issues by Newco to fund the acquisition of gas-related assets. This is intended to give New QGC flexibility in growing its business.

Santos will agree to a "standstill" to limit its shareholding in New QGC to 30% for two years following the transaction. The standstill will not prevent Santos from acquiring shares under any pro rata capital raising or in the event that New QGC or a third party proposes a control transaction in relation to New QGC.

New QGC will agree not to dilute Santos' 30% shareholding by any non pro-rata share issue without first offering Santos the opportunity to participate in order to maintain its percentage shareholding. Importantly, in order to give QGC flexibility in growing its business, Santos' anti-dilution right will not apply in circumstances where QGC wishes to issue shares to fund an acquisition of gas-related assets. It also will not apply to issues of shares made by New QGC under any employee incentive plan.

Santos will also undertake to the ACCC not to vote against any resolution put to a vote of shareholders at a general meeting of QGC to raise capital for any proper purpose of QGC.

(9) **Reserves Summary Position** which depicts the 1P, 2P, 3P and OGIP reserves positions, and the extent to which they are committed to firm contracts and under the AGL proposal, and the position for New QGC and QGC/Santos under the new proposal.

Current QGC has supply commitments for 1P, 2P and part of 3P reserves, which means it has limited ability to contract additional gas into the market place without reserves upgrades

New QGC focuses primarily on non-Undulla Nose and exploitation of the 9,364 PJ of OGIP

Balance of QGC/Santos utilises capital and operational backing to meet existing QGC contracts and to contract balance of 2P and other uncontracted reserves

(10) **Interim Funding Agreement** has yet to be settled, but will provide for Santos to make available $million to QGC to assist it in meeting its financial commitments and continuing with its capital expenditure program. Santos is also prepared to make additional finance of up to $ million available to QGC if it is deemed appropriate to restructure certain of QGC's existing debt finance arrangements.

Funding is to be made available in the event that the AGL proposal is rejected, and will cover QGC's expected funding requirements for the period from March to June 2006. Funding will be conditional on QGC and Santos first entering into a merger implementation agreement.

Interest and fees payable in respect of the Santos facilities would be on commercial arms length terms, having regard to the exposure assumed by Santos and Santos' costs in providing the facilities.

(11) **Transportation and Swap Agreement** has yet to be settled but will provide for access to the RBP and a gas swap agreement for north west Queensland as follows:

(a) **RBP:** New QGC would be able to utilise up to 10 TJ/d of Santos' existing South West Queensland firm forward haul RBP transportation capacity.

(12) **North West Queensland Gas Swap**

(a) Santos agrees to receipt up to 8 TJ/d of "New QGC's" gas at Windibri and re-deliver the same quality of gas to Mica Creek power station delivery point in North West Queensland.

(b) The above arrangement is subject to the owners of the RBP agreeing to include Windibri as an additional receipt point under the SWQ/RBP gas transportation agreement at no additional cost.

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Attachment 9

Reserves Summary Position

	Current QGC with AGL Proposal [1]				**New QGC** [2]				**Balance of QGC – Santos** [3]			
	1P	2P	3P	OGIP	1P	2P	3P	OGIP	1P	2P	3P	OGIP
Total (PJ)	228	695 (755)	2,556	17,801	0	5 (60)	100	9,364	228	690	2,456	8,437
Contract volumes (PJ)	1,138	1,138	1,138	1,138	100	100	100	100	369	369	369	369
% Contract	500%	164% (151%)	45%	6%	n/a	2000% (167%)	100%	1%	160%	53%	15%	4%
Notes	% Contracted is based on total contracts of 1,138 PJ, viz: • Incitec Pivot 44 PJ (QGC share); • Condamine 180 PJ; • CS Energy 90 PJ; • Braemar 54.7 PJ (incl tranches I,II,III); • AGL 769 PJ (incl 29 PJ gas development) Principal focus of capital on Undulla Nose				1) New QGC has a put option to Santos, or an ability to supply other customers of up to 100 PJ from 648P. 2) As part of QGC's 1000 PJ reserve upgrade plan, it is likely to result in a substantial reserve upgrade to 648P, if this target is achieved. Substantial capital spend and funding available for non-Undulla Nose				% Contracted is based on total contracts of 369 PJ, viz: • Incitec Pivot 44 PJ (QGC share); • Condamine 180 PJ; • CS Energy 90PJ; • Braemar 54.7 PJ (incl tranches I,II,III) Focus on implementation of Undulla Nose development and exploitation programs			

Source: QGC public data; Santos estimates for allocations to New QGC and Balance.

General Notes:

a. Reserves figures do not include Sentient reserves
b. Contract volumes include firm contracts and options for gas supply
c. OGIP = Original Gas in Place
d. 2P brackets in Current QGC and New OGC indicate 2P reserves after estimated imminent reserves upgrade

Comments:

1. **Current QGC has supply commitments for 1P, 2P and part of 3P reserves, which means it has limited ability to contract additional gas into the market place without reserves upgrades**
2. **New QGC focuses primarily on non-Undulla Nose and exploitation of the 9,364 PJ of OGIP**
3. **Balance of QGC/Santos utilises capital and operational backing to meet existing QGC contracts and to contract balance of 2P and other uncontracted reserves**