

3 **Bills for Introduction**

Not Relevant

303 MMRD07/01CS

Minister for Mineral Resources Development's Item
(Paul Holloway)
APPROVED

Not Relevant

CABINET COVER SHEET

- | | | |
|----|----------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1. | TITLE | SANTOS SHAREHOLDING CAP |
| 2. | MINISTER | Paul Holloway
Minister for Mineral Resources Development |
| 3. | PURPOSE | To seek Cabinet approval for Parliamentary Counsel to draft legislation repealing the <i>Santos Limited (Regulation of Shareholdings) Act, 1989</i> ; and

To seek Cabinet approval to introduce into Parliament the <i>Santos Limited (Deed of Undertaking) Bill, 2007</i> . |
| 4. | RELEVANT GOVERNMENT POLICY AND/OR SOUTH AUSTRALIA'S STRATEGIC PLAN TARGET | Santos is a major contributor to the State in terms of mining exploration, employment, jobs, investment, aboriginal employment and sponsorship in areas such as the arts and education. Negotiations with Santos have aimed at securing an ongoing commitment by Santos in these areas. |
| 5. | ICT COMPONENT | The submission does not have a material ICT Component. |
| 6. | RESOURCES REQUIRED FOR IMPLEMENTATION | No additional resources are required. |
| 7. | COMMUNITY AND ENVIRONMENTAL IMPACT | Business impact Statement

The government has negotiated commitments from Santos in terms of ongoing corporate presence and community benefits of \$60 million over 10 years.

In a worst case scenario, should the shareholding cap be removed and taken over by a company who moves the head office operations outside of South Australia, the direct loss of contribution to the Gross State Product (GSP) is estimated at \$130 million per annum or 0.2% of GSP.

A potential benefit from the removal of the shareholding cap is that it is estimated that there could be a one-off increase in household wealth to shareholders in South Australia of between \$130 million and \$190 million.

Regional and Environmental Impacts
The removal of the cap is unlikely to create any additional regional development or environment implications. |

8. **RISKS** The key risk associated with the removal of the shareholding cap is the loss of the head office, resulting in the loss of jobs in South Australia.

If the cap is not removed there is a risk that Santos would look to split the company in two without providing any commitments to the State in terms of corporate presence or community benefits.

9. **CONSULTATION** The review of the shareholding cap was undertaken by the Department of Trade and Economic Development, the Department of Primary Industries and Resources South Australia, the Department of Treasury and Finance and the Crown Solicitor's Office. Public submissions were received.

10. **COMMUNICATION STRATEGY** The Premier announced the removal of the cap on Tuesday 16 October 2007.

11. **URGENCY** The Deed of Undertaking entered into with Santos requires that the cap be removed twelve months after Royal assent of the legislation.

There is a strong desire by both Santos and the Government to remove the cap by December 2008, which requires the passage of the legislation through this session of Parliament.

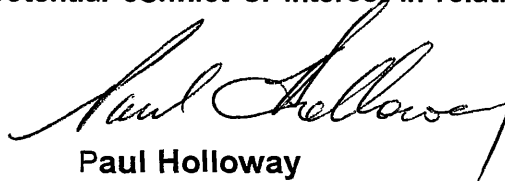
12. **RECOMMENDATIONS** It is recommended that Cabinet:

4.1 Instruct Parliamentary Counsel to draft legislation to repeal the *Santos Limited (Regulation of Shareholdings) Act, 1989*; and

4.2 Approves the introduction into Parliament of the *Santos Limited (Deed of Undertaking) Bill, 2007* as attached.

I declare that I have no actual or potential conflict of interest in relation to the proposals contained in this submission.

SIGNATURE OF MINISTER:



Paul Holloway
Leader of the Government in the Legislative Council
Minister for Police
Minister for Mineral Resources Development
Minister for Urban Development and Planning

DATE: 22 / 10 / 2007

Contact Officer: Raymond Garrand
Telephone: 8303 2280

TO: THE PREMIER FOR CABINET

RE: REVIEW OF *SANTOS LIMITED (REGULATION OF SHAREHOLDINGS) ACT, 1989*

1. PROPOSAL

- 1.1 To seek Cabinet approval for Parliamentary Counsel to draft legislation repealing the *Santos Limited (Regulation of Shareholdings) Act, 1989*; and
- 1.2 To seek Cabinet approval to introduce into Parliament the *Santos Limited (Deed of Undertaking) Bill, 2007*.

2. BACKGROUND

- 2.1 The Santos shareholding restriction was enacted in 1979 to prevent Alan Bond from taking over Santos
- 2.2 The 1979 Act was replaced in 1989 with the Santos Limited (Regulation of Shareholdings) Act 1989. The 1989 Act only applies while Santos Limited produces petroleum in South Australia.
- 2.3 In response to a formal request received from Santos Limited to undertake a review into the shareholding cap Cabinet approved at their meeting on Monday 30 April 2007 a formal review of the Act.
- 2.4 A formal review of the Santos Limited (Regulation of Shareholdings) Act 1989, has been conducted under the direction of the Minister for Mineral Resources Development by the Department of Trade and Economic Development in conjunction with the Department of Primary Industries and Resources South Australia, the Department of Treasury and Finance and the Crown Solicitors Office. Mr Kevin Osborn of the Economic Development Board chaired the Steering Group undertaking the review. A copy of the review is to this submission (attachment A)

3. DISCUSSION

3.1 Key issues

- 3.1.1 It is likely that if the shareholding cap is removed that Santos Limited will become the subject of merger and acquisitions activity. This may include Santos merging with another oil and gas company or alternatively being taken over by another company. The primary reason that Santos is keen to remove the cap is to better utilise its balance sheet for any mergers of acquisitions.
- 3.1.2 There could be significant risks to South Australia should the shareholding cap be removed. In a worst case scenario, in the event of a takeover of Santos by a company who moves the head office operations outside of South Australia, the direct loss of contribution to the Gross State Product (GSP) is estimated at \$130 million per annum or 0.2% of GSP.
- 3.1.3 The shareholding restriction only applied while Santos Limited produces petroleum in South Australia. The legal basis for this restriction is diminishing as South Australia now only accounts for 23% of Santos production and 17% of its reserves. The existing legislation does not require Santos to maintain its head office in South Australia.

- 3.1.4 The market value of Santos has increased by around \$1.6 billion since the announcement of the review and a full takeover of Santos may deliver a further \$0.8 billion premium.
- 3.1.5 If Santos became the subject of a takeover, then the likely premium is estimated to be between 20% and 30%. Based on the current market capitalisation of Santos it is estimated that this would add an additional \$0.8 billion to \$1.6 billion to its market capitalisation.
- 3.1.6 In January 2007 Santos had 14,881 shareholders domiciled in South Australia who would benefit from any increase in the value of Santos.
- 3.1.7 Santos employs, directly and indirectly, 759 people at Moomba and Port Bonython and approximately 740 in the Adelaide head office with total expenditure on wages and salaries of nearly \$170 million in 2006 in South Australia. As the operator of the Cooper Basin joint venture, Santos invested \$368 million in the SA Cooper Basin in 2006.
- 3.1.8 Santos currently spends around \$3 million on sponsorships in South Australia of which \$2.5 million is paid to the Australian School of Petroleum.
- 3.1.9 The removal of the shareholding cap could allow Santos to grow through acquisition which may result in an increase in employment in South Australia.
- 3.2 Conclusions of the Review into Santos Limited (Regulation of Shareholding) Act, 1989**
- 3.2.1 The original basis for the introduction of the legislation in 1979 is no longer valid.
- 3.2.2 The benefits to the State as a whole from the removal of the cap are less clear than the benefits to Santos shareholders given the potential of a downside risk if a hostile takeover and loss of head office jobs occurred.
- 3.2.3 A potential benefit from the removal of the shareholding cap is that it is estimated that there could be a one-off increase in household wealth, to shareholders in South Australia of between \$130 million and \$190 million.
- 3.2.4 The removal of the shareholding cap will deliver significant benefits to Santos and its shareholders. The market value of Santos has increased significantly since the announcement of the review (in part due to the announcement and other announcements made by Santos since 1 May 2007). It is estimated that a full takeover of Santos would add an additional \$0.8 billion to \$1.6 billion.
- 3.3 Recommendation of the review into the Santos Limited (Regulation of Shareholding) Act, 1989**
- 3.3.1 The review recommended that the shareholding cap, imposed by the Santos Limited (Regulation of Shareholdings) Act 1989 be removed. The original basis for the introduction of the legislation in 1979 is no longer valid. The review recommended that the removal of the cap should be conditional upon negotiating the following two conditions:
- Taking a whole of state perspective, a legally binding agreement be entered into with Santos to secure ongoing economic benefits in South Australia including jobs and investment and that negotiations commence with Santos on this agreement; and
 - The legislation is passed during the next six months but that the removal of the cap will not be effective for 12 months following Royal assent and that further discussions occur with Santos prior to any announcement regarding timing.

3.4 **Negotiations with Santos Limited**

- 3.4.1 Negotiations were undertaken with Santos on the basis that, should the shareholding cap be removed, they enter into a legally binding agreement to ensure their substantial commitment to their corporate presence in South Australia is maintained.
- 3.4.2 The Government has negotiated a Deed of Undertaking from Santos which includes:
- Santos guaranteeing effectively 90% of the current South Australian-based roles stay here, which includes 100% of the roles at major South Australian operational sites. This equates currently to approximately 1,700 jobs in South Australia;
 - A Social Responsibility and Community Benefits fund of some \$60 million over 10 years, to be applied to a range of sponsorships, including support for the Royal Institution, indigenous programs and educational scholarships; and
 - These commitments will be supported by a \$100 million legally enforceable compensation mechanism, should there be a significant reduction in corporate presence.
- 3.4.3 A signed copy of the deed is attached for to this submission (attachment B).

3.5 **Timing**

- 3.5.1 The Deed of Undertaking entered into with Santos requires that the cap be removed twelve months after Royal assent of the amended legislation
- 3.5.2 There is a strong desire by both Santos and the Government to have the cap removed by December 2008, which requires the passage of the legislation through this session of Parliament
- 3.5.3 It is proposed that the lifting of the cap not become effective until 12 months after Royal assent this will:
- Allow Santos to manage the transition; and
 - Potentially allow Santos to undertake acquisitions to strengthen the company and make them less vulnerable to takeover.

3.6

3.6.1 **Economic, financial and budgetary implications.**

Should the shareholding cap be removed the potential economic, financial and budgetary implications include:

- The potential loss of the head office in South Australia, in a worst case scenario the potential cost to the South Australian economy is estimated at a direct loss to the GSP estimated at \$130 million per annum or 0.2% of GSP.
- A potential benefit from the removal of the shareholding cap and the resultant increase in the share price is a one off increase in household wealth estimated at between \$130 million and \$190 million.
- The removal of the shareholding cap could allow Santos to grow through acquisition which may result in an increase in employment in South Australia.

3.6.2 **Required resources**

There are no additional resources required.

3.6.3 South Australia's Strategic Plan

South Australia's Strategic Plan has specific targets in relation to mineral exploration, investment, employment and exports. Santos is a major contributor to all of these targets and the removal of the shareholding cap may impact both positively and potentially negatively on a number of these targets. In order to minimise the impacts of the anticipated reduction in the Cooper Basin contribution to South Australia it is important that Santos continue to grow. Santos believes that the removal of the cap will assist in reducing their cost of capital and enable the funding of future expansion through acquisition.

3.6.4 Information and Communication Technology Requirements

There are no additional Information and Technology requirements in relation to the decision to remove/not remove the shareholding cap.

3.6.5 Staffing Implications

There are no staffing implications associated with the decision.

3.6.6 Impact on the Community and the environment

Business Impact Statement

Should the shareholding cap be removed and Santos taken over by a company who moves the head office operations outside of South Australia, there is the potential for a direct loss of contribution to the GSP estimated at \$130 million per annum or 0.2% of GSP.

A potential benefit from the removal of the shareholding cap is that it is estimated that there could be a one-off increase in household wealth, to shareholders in South Australia, of between \$130 million and \$190 million.

Regional and Environmental Impacts

The removal of the cap is unlikely to create any additional regional development implications.

3.6.7 Risk Management Strategy

A risk associated with the removal of the shareholding cap is the potential loss of head office, resulting in the loss of jobs in South Australia.

3.6.8 Consultation

The review of the shareholding cap was undertaken by the Department of Trade and Economic Development, the Department of Primary Industries and Resources South Australia, the Department of Treasury and Finance and the Crown Solicitors Office. Public submissions were received. Parliamentary Counsel have drafted the Bill.

3.6.9 Implementation Plan

Once the legislation is drafted it will be presented to Parliament with an effective date 12 months from Royal assent.

3.6.10 Communication Strategy

The Premier announced the decision on 16 October 2007.

3.6.11 Executive Council

This proposal does not require the approval of His Excellency the Governor in Executive Council.

4. RECOMMENDATIONS

It is recommended that Cabinet:

- 4.1 Instruct Parliamentary Counsel to draft legislation to repeal the *Santos Limited (Regulation of Shareholdings) Act, 1989*; and
- 4.2 Approves the introduction into Parliament of the *Santos Limited (Deed of Undertaking) Bill, 2007* as attached



Paul Holloway

Leader of the Government in the Legislative Council
Minister for Police
Minister for Mineral Resources Development
Minister for Urban Development and Planning

Date: 22/10/2007

In Cabinet

22 OCT 2007



Draft Bill prepared by Parliamentary Counsel

3 pages removed

Exempt clause 10(1) – legal professional privilege

**REPORT INTO THE SHAREHOLDING CAP UNDER THE SANTOS
LIMITED (REGULATION OF SHAREHOLDINGS) ACT, 1989**

27 JULY 2007

ATTACHMENT A

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1. EXECUTIVE SUMMARY

- The bases for the introduction of the legislation in 1979 were concerns over energy security and the economic development benefits to be derived from the Cooper Basin Project.
- With gas imported from Queensland through the Moomba gas pipeline and from Victoria through the SEA Gas pipeline energy security is no longer considered an issue.
- Significant development has occurred in the Cooper Basin since the introduction of the 1979 Act. Further development of the Cooper Basin is likely to be based on the economic viability of the project. Santos is a global company and currently generates 23% of their production from South Australia. The remaining proven reserves in South Australia represent 17% of Santos' global proven reserves.
- Whilst the original basis for the introduction of the shareholding cap imposed under the *Santos Limited (Regulation of Shareholdings) Act 1989*, is no longer valid, there is the potential, if the shareholding cap is removed, of the loss of the head office and employment in South Australia
- The removal of the cap is unlikely to create any additional regional development implications.
- A potential benefit from the removal of the shareholding cap is that it is estimated that there could be a one-off increase in household wealth, to shareholders in South Australia.
- The removal of the shareholders cap will deliver significant benefits to Santos and its shareholders. The market value of Santos has increased by \$1.59 billion since the announcement of the review to 13 July 2007. The increase in the share price would in part be due to the announcement of the review and other announcements made by Santos since 1 May 2007.
- In order to minimise the impacts of the anticipated reduction in the Cooper Basin contribution to South Australia it is important that Santos continue to grow. Santos believes that the removal of the cap will assist in reducing their cost of capital and enable the funding of future expansion through acquisition.
- There has been significant activity in mergers and acquisitions worldwide in the oil and gas sector over the last two and a half years. During this period there have been 375 deals in the oil and gas sector worth in excess of US\$100 million with total deals worth US\$413 billion.
- The benefits to the State as a whole from the removal of the cap are less clear than the benefits to Santos shareholders, given the potential of a downside risk if there is a hostile takeover and the loss of head office jobs occurred.

- It is recommended that the shareholding cap imposed by the Santos Limited (Regulation of Shareholdings) Act 1989 be removed. The original basis for the introduction of the legislation in 1979 is no longer valid. The removal of the cap should be conditional upon negotiating the following two conditions:
 - a) Taking a whole of state perspective, a legally binding agreement be entered into with Santos to secure ongoing economic benefits in South Australia including jobs and investment and that negotiations commence with Santos on this agreement; and
 - b) The legislation is passed during the next six months but that the removal of the cap will not be effected until 30 September 2008 and that further discussions occur with Santos prior to any announcement regarding timing.

2. RECOMMENDATIONS

- 1 It is recommended that the shareholding cap imposed by the Santos Limited (Regulation of Shareholdings) Act 1989 be removed. The original basis for the introduction of the legislation in 1979 is no longer valid. The removal of the cap should be conditional upon negotiating the following two conditions:
 - c) Taking a whole of state perspective, a legally binding agreement be entered into with Santos to secure ongoing economic benefits in South Australia including jobs and investment and that negotiations commence with Santos on this agreement; and
 - d) The legislation is passed during the next six months but the removal of the cap will not be effected until 30 September 2008 and that further discussions occur with Santos prior to any announcement regarding timing.

3. TERMS OF REFERENCE

3.1 The original intent of the legislation and its applicability today

The Santos shareholding restriction was enacted in 1979. The original legislation was introduced by the Honourable Mr Hugh Hudson. In introducing the Bill for its second reading, an extract from Mr Hudson's statement is as follows:

"This is one of the most important pieces of legislation introduced in the history of the state. It has not been introduced lightly. The Government believes that what is involved is the future of energy supplies in South Australia and the future development potential of the State.

Industry in South Australia, and therefore the employment of our people, depends on assured sources of gas and electricity which can be made available at prices comparable with the major industrial markets of Sydney and Melbourne.

The Cooper Basin supplied 34 per cent of South Australia's primary energy requirements in 1978, and Santos's share of those sales was 45.57%. Santos is the operating company in the Cooper Basin, and its financial strength and stability is fundamental to the development of the hydrocarbons of the basin. Any action which destabilises the financial position of Santos, or has the potential so to do, will make serious and harmful impact on the costs of further development in this State and the price that South Australians must pay for natural gas."

There was significant concern about the anticipated takeover of Santos by the Bond Corporation. The Government of the day recognised the importance of the development of the Cooper Basin to South Australia.

Based on the statement made by Mr Hudson there were two major concerns which led to the introduction of the Santos (Regulation of Shareholdings) Act, 1979.

Firstly there was the concern about energy security. South Australia was very dependent on the continued growth and development of the Cooper Basin for gas security.

The issue of energy security will be dealt with in section 3.4.

Secondly there was the issue of the economic development benefits of the Cooper Basin project and the concern that a takeover of Santos would lead to a reduction in the potential economic development benefits.

Over the period since the introduction of the 1979 Act we have seen the stable development of the Cooper Basin. The Cooper Basin joint venture partners have injected over \$8 billion in capital investment which has

established it as a mature and valuable hydrocarbon province. In recent times there has been the \$1 billion Cooper Oil project.

Santos currently generates 23% of their production from South Australia and the remaining reserves represent 17% of its reserves. To the extent that the original Act was intended to ensure the stable development of the Cooper Basin then it appears that the legislation has been successful

The Cooper Basin now supports ongoing incremental investment that can exploit the remaining hydrocarbon resource and the existing infrastructure.

It is likely that whilst the current ownership of Santos remains that the Cooper Basin will continue to be developed. Should Santos become the subject of a takeover bid then the future of the Cooper Basin is less certain. Would a company with their head office outside of South Australia continue the development of the Basin and consider projects such as the Moomba Carbon Storage project.

3.2 The impact of the shareholding cap on the operations and future growth of Santos both globally and in South Australia.

It is a commonly held view that the existence of the shareholding cap imposed under the Santos Limited (Regulation of Shareholdings) Act, 1989 has had an adverse impact on the company's share price.

The Santos share price was \$11.24 on Monday 30 April, 2007. In the three days after the announcement that there would be a review into the shareholding cap the share price increased to \$12.32, an increase of 9.07%. The closing share price on Friday 13 July was \$13.88 an overall increase of 23.5% or an increase in the market capitalisation of the company of \$1.59 billion.

Over the period since the announcement of the review there are other factors which would have influenced the increase in the current share price including:

- The announcement to do an off-market share buy back on terms likely to be attractive to the majority of shareholders
- Increases in the price of oil
- The Energy sector index has increased by 13.8% in the same period and the S & P ASX200 has increased by 3.6%
- The announcement of the Moomba Carbon Storage project demonstration phase. A decision to proceed with the project is dependent on a number of factors including a Federal Government grant application, and
- The announcement of a proposal to construct a liquefied natural gas (LNG) facility in Queensland, which would see coal seam gas processed and sold into export markets

Whilst there have been other factors which have influenced the share price movement during this period, it is reasonable to conclude that the announcement of the review has already had a significant impact on the share price of Santos.

3.3 Any potential risks from removal of the cap to South Australia's economy.

The major potential risks from the removal of the cap to South Australia are as follows:

- Loss of head office
- Reduced development and exploration in the Cooper Basin

The legislation supporting the shareholding cap does not require the Santos Limited head office to be located within South Australia. So far, commercial and geographical considerations in relation to Cooper Basin production have resulted in the head office being maintained in Adelaide, despite the diminishing importance of the South Australian production and reserves in the overall Santos business.

Santos have recently committed to a ten year lease on a new building in South Australia which is a commitment of in excess of \$100 million over the term of the lease.

Despite the commitment of Santos to the new building, should they be taken over, the risk of the loss of the head office in South Australia remains.

A potential benefit from the removal of the shareholding cap and the resultant increase in the share price is that there could be a one-off increase in household wealth to shareholders in South.

Any agreement or covenant that binds Santos to South Australia may reduce the benefits of any removal of the cap by reducing the integration benefits normally associated with a takeover.

Should the shareholding cap be removed and Santos taken over there are three possible scenarios being:

- Takeover by a company intent on using Santos and Adelaide as their base for their Australian operations. Under this scenario it is possible that, whilst there would be the loss of the current board and senior executives, there may be increases in the total number of head office staff. The extent of any increase is unknown and therefore it is not possible to quantify.
- Takeover by a company intent on maintaining the status quo would still result in the current Board and senior executives becoming redundant. The loss of these positions is likely to have a limited.
- Takeover by a company who moves the majority of the head office operation outside of South Australia combined with a focus on achieving greater efficiencies in Cooper Basin production.

3.4 Energy security issues in South Australia.

When the original legislation was introduced a major concern to the Government was gas security.

In the 28 years since the introduction of the legislation there have been significant changes in the source of gas into South Australia. Queensland gas has been imported through Moomba since the early 1990's, due to an initiative of the Bannan Labor Government. Since 2004 South Australia has been importing large volumes of gas from Victoria through the SEA Gas pipeline. A third link which will connect the Moomba-Adelaide pipeline with the Queensland system is currently being planned. When completed this third link will enable South Australia to tap directly into the Queensland coal seam methane (CSM) supplies.

The Moomba to Adelaide gas pipeline is owned by Epic Energy which is controlled by Hastings Fund Management. Hastings Fund Management is controlled by Westpac. The proposed new link directly into the Queensland coal seam methane supplies is proposed to be constructed by Epic Energy.

The SEA Gas pipeline is jointly owned by TRU Energy, Origin Energy and International Power.

The Department of Primary Industry and Resources South Australia have recently prepared a Minute on the Eastern Australia Gas Supply Forecast.

The Minute concluded that:

- *Eastern Australian gas demand is likely to be supplied by "local" basins at least until the middle of the 2020s.*
- *Subsequent supply will highly dependent on the success of CSM development, with "gas from the north" (i.e. PNG, Bonaparte, Browse, Carnarvon) providing an alternative supply option.*
- *Active basin-on-basin competition in the Eastern Australian markets will continue to provide downward pressure on gas prices in the short to medium term. In the longer term prices may rise as competition for supply will be with global LNG markets.*
- *Petroleum exploration licences have recently been granted over Arckaringa Basin in the centre of SA, with coal seam methane being a major focus of the exploration effort. Should this prove successful, the requirement to seek gas supplies from the northern Australian basins will be further delayed.*

The charts below have been extracted from the Minute prepared by Richard McDonough (Manager Engineering and Policy, PIRSA). The charts show the reducing importance of the Cooper Basin to Eastern Australian Gas Supplies. The charts also show that, based on current known reserves and resources, production from the Cooper Basin is projected to remain steady in the short term and fall progressively in the medium to long term.

Based on the above, gas security is no longer an issue and is unlikely to be impacted by any decision to remove or retain the current shareholding cap.

Figure 1

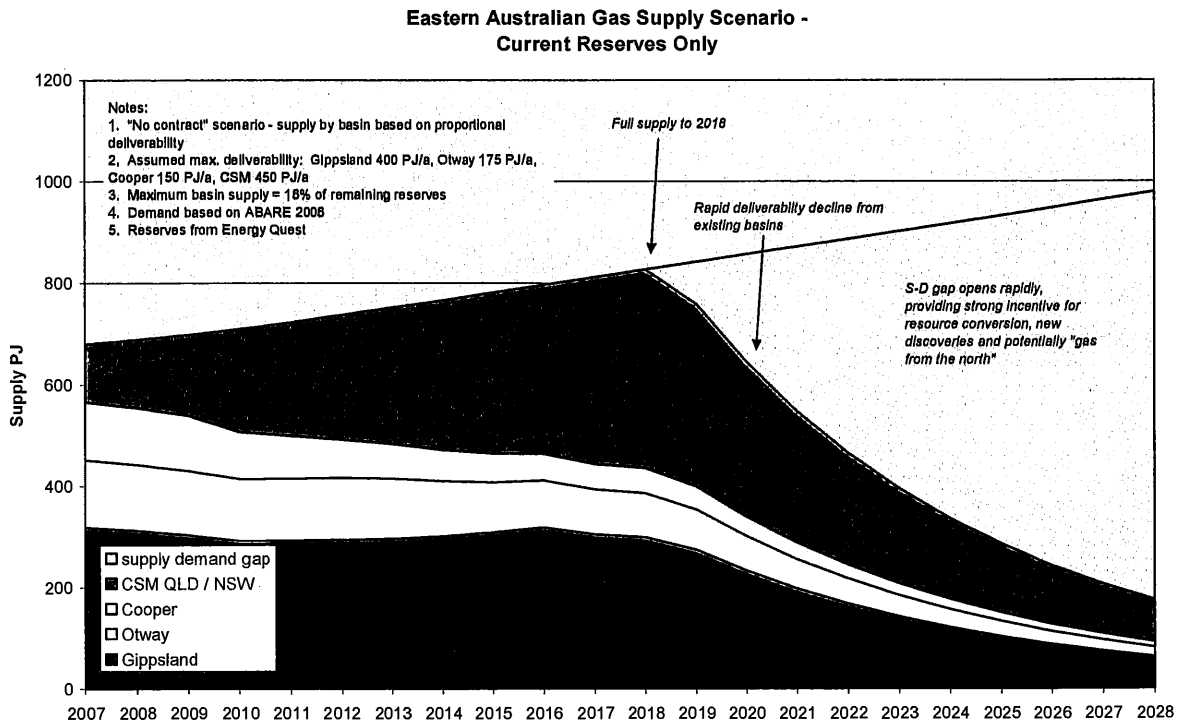


Figure 2

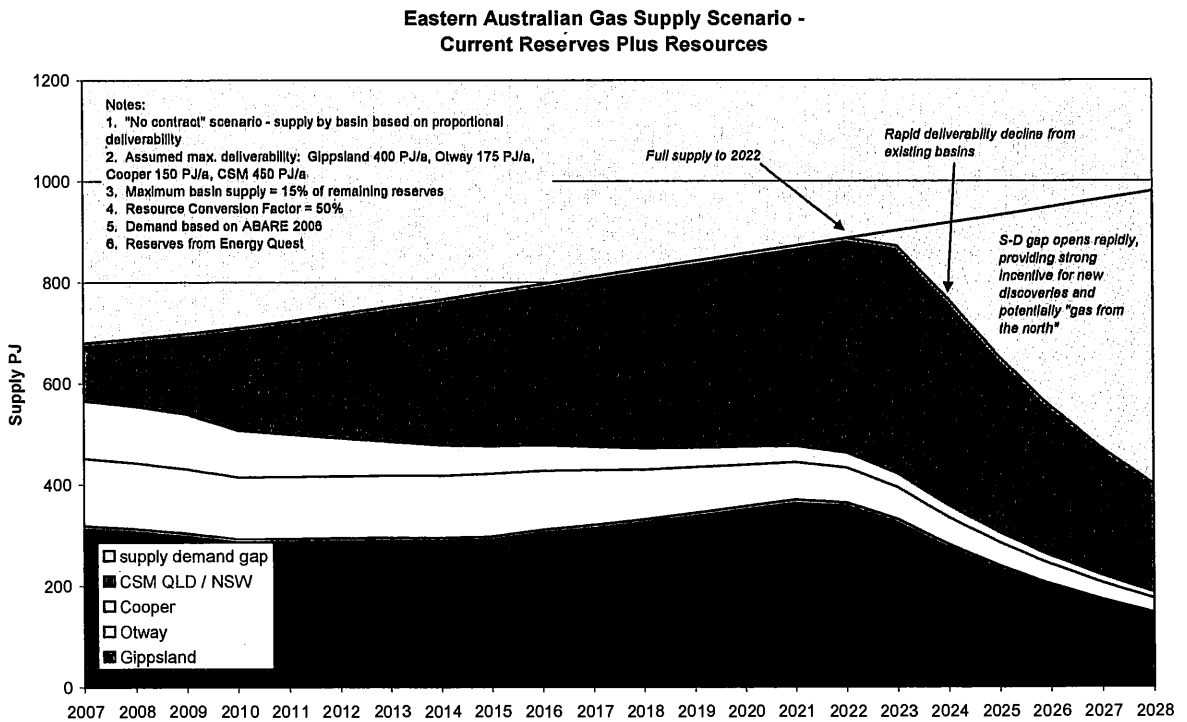
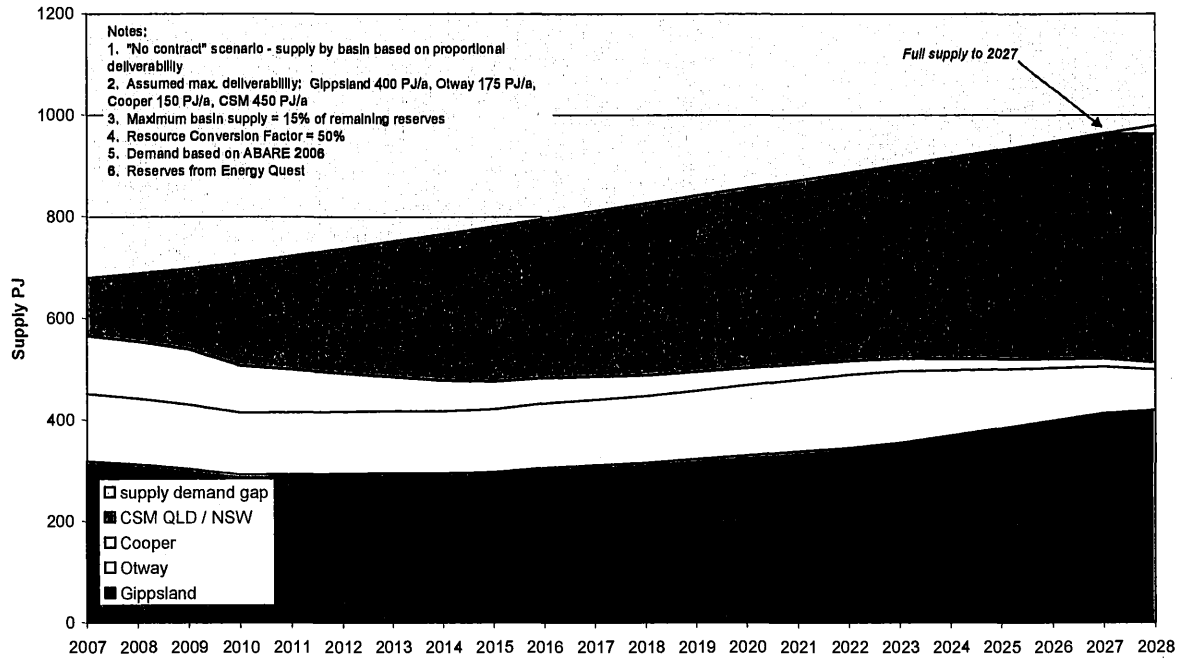


Figure 3

Eastern Australian Gas Supply Scenario -
Current Reserves Plus Resources Plus Discoveries



3.5 Regional development implications.

Over the next phase of the Cooper Basin project there are likely to be significant regional development implications. Based on current projections there are likely to be job losses in Moomba, Whyalla and Port Bonython. This is likely to occur irrespective of the retention or removal of the shareholding cap.

A decision to proceed with the Moomba Carbon Storage Project could have substantial beneficial impacts on regional development, especially if a decision is made to proceed to Phase 2 and Phase 3 of the project. A decision to proceed with Phase 1 is likely to be dependent on Federal Government support and the results of the demonstration phase. A decision to proceed with the Moomba Carbon Storage project is unlikely to be influenced by the ownership of the company and will be made on economic grounds.

3.6 An overall assessment of the current and future benefits of Santos' operations in South Australia.

Background

Santos was founded in 1954. It commenced producing gas in South Australia in 1969. The discovery of oil in the early 1970's led to a liquids recovery plant being built at Moomba along with a fractionation and load-out facility at Port Bonython. Over the past two decades Santos has expanded its oil and gas interests which now include exploration and production activities throughout Eastern and Western Australia and the Darwin LNG project along with Indonesia, Papua New Guinea, Vietnam, India, Krygyzstan and Egypt.

Current Benefits

Cooper Basin production has moved into a relatively mature phase and its importance in the Santos business portfolio is diminishing. Over the past 5 years Santos' global production has increased by almost 10% but oil and gas production out of South Australia has declined by 38%. SA accounts for only 17% of total Santos proven reserves. Santos have recently embarked on a new oil exploration program, the Cooper Oil project, which is a five year \$1 billion investment involving up to 1,000 wells and employing 100. While this could moderately increase Cooper Basin oil output, current company forecasts indicate a short life and by around 2012 production levels would on a "most likely" basis start to fall away significantly again. Developments which can drive extraction costs to the point of an economic return within prevailing resource prices will determine whether the Cooper Basin output will diminish or expand over the coming decade.

Santos activities employ over 1,500 people in South Australia. This includes:

- 1,162 employees – of which 794 are located in the head office and 368 in Moomba/Port Bonython. South Australian based staff account for 72% of Santos' global workforce.
- A further 391 direct contractors and external service provider staff located at Moomba/Port Bonython.

Adjusting out interstate and overseas employees, but including contractors and external service providers at Moomba and Port Bonython, it is estimated that the remuneration base in SA is around \$214 million. Around \$115 million of this is estimated to be in the head office, of which \$78 million is estimated to relate to Cooper Basin activities (Santos argues that 68% of the Adelaide head office staff are working on Cooper Basin projects). These estimates are based on the average wages paid by Santos on employment and subcontractor information provided by Santos.

In 2006 Santos paid \$9.3 million in payroll tax and \$57.4 million in royalties.

Santos currently spends \$3 million per annum on sponsorships in South Australia which includes a 10 year, \$2.5 million per year commitment to the Australian School of Petroleum at the University of Adelaide.

Future Benefits

Irrespective of the decision on the removal of the shareholding cap, it is expected that based on current projections that there will be a significant

reduction in the Cooper Basin operations of Santos over the coming years. It is estimated that the reductions will include:

- Cooper Basin production falling by around 40% or more by the mid 2010's; and
- An associated loss of employment totalling around 360.
- A reduction in the contribution of Cooper Basin production to South Australian annual GSP of about \$206 million or 0.33%.

As a result of the reduced activity there will be a reduction in payroll tax and royalties.

In order to minimise the impact of the anticipated downturn in the projected contribution of Santos to the Gross State Product, it is critical for Santos to continue to grow. Growth from projects around the world will see Santos maintain a strong head office in South Australia and position the company to undertake other projects within South Australia.

One such project could be the recently announced Moomba Carbon Storage Project which has the potential to generate significant economic benefits to South Australia. The first phase, running from 2010 to 2030 would witness a \$700 million investment to demonstrate the long-term economic viability of storing large volumes of CC2 in Moomba's depleted oil and gas reservoirs. Santos is seeking Federal Government support for the first phase.

During the first phase, Santos would sequester its current CO2 emissions, providing a major boost to the State Government's climate change targets as well as generating additional royalty revenue. The second and third phases of the Moomba Carbon Storage Project could commence as early as 2013 and could potentially lead to a multi billion dollar investment in the Cooper Basin.

Santos have advised that, subject to Federal funding decisions they anticipate a Board decision to proceed with phase 1 during 2007. The decision to proceed will be based on economic issues rather than ownership issues.

4. TIMING ISSUES

A commitment has been given that an announcement on the decision will be made by no later than 30 September 2007.

The cabinet submission will be presented to Cabinet as a locked submission.

Santos shares trade on the Australian Stock Exchange (ASX) from approximately 9:30 am (CST) through to 3:30 pm (CST). Santos shares can also be traded through American Depositary Receipts (ADR's), the effect of which is that Santos shares can be traded 24 hours a day

It is recommended that any announcement in relation to the shareholding cap be made at 9 am on a Monday prior to the opening of the Australian Stock Exchange.

If Cabinet agrees to remove the cap then it is advisable that the legislation is passed during the next six months but that the repeal of the cap be made effective from 30 September 2008.

The delay of the removal of the cap until 30 September 2008 will allow sufficient time to progress the legislation through Parliament and allow Santos time to manage the transition.

5. **WORLDWIDE MERGER AND ACQUISITION ACTIVITY**

5.1 **Global Merger and Acquisition Activity**

There has been significant deal activity within the Upstream Global Oil and Gas sector over the last three years. A summary of the Upstream Global Oil and Gas deals greater than US\$100 million in the period January 2005 through to June 2007 is as follows:

Period	Merger and Acquisition Deals	Deal Value Total (US\$ million)	Average Deal Value (US\$ million)
2007 to date	84	87,726	1,044
2006	146	163,269	1,118
2005	145	162,658	1,122
Total	375	413,653	1,103

The current market value of Santos is approximately US\$7.5 billion. Should a takeover bid be made for Santos, then, based on their current market capitalisation, it would rank as the third largest acquisition in 2007. Over the period from January 2005 to June 2007 there have only been 8 mergers and acquisitions, in the oil and gas sector, with a deal value greater than Santos' current market capitalisation.

Of the 10 largest deals, in the oil and gas sector, undertaken in 2007, 5 represent the sale of Oil and Gas assets from the Government of Russia. Of these 3, worth US\$21.796 billion, were to Rosneft headquartered in Moscow. Rosneft is a vertically-integrated Russian oil and gas company with upstream and downstream operations in each of Russia's oil-producing regions.

Of the remaining acquisitions in the Global Oil and Gas sector the other most active company has been Enel SpA. Enel SpA has completed 3 acquisitions worth \$10.508 billion. Enel SpA is Italy's largest power company, and Europe's third-largest listed utility by market capitalization.

5.2 Asia Pacific Merger and Acquisition Activity

Within the Asia Pacific region there has been minimal merger and acquisition activity in the upstream Oil and Gas Sector. A summary of the Upstream Asia Pacific Region Oil and Gas deals greater than US\$100 million in the period January 2005 through to June 2007 is as follows:

Period	Merger and Acquisition Deals	Deal Value Total (US\$ million)	Average Deal Value (US\$ million)
2007 to date	8	5,806	726
2006	13	3,970	305
2005	11	8,704	791
Total	32	18,480	576

The current market capitalisation of Santos is approximately US\$7.5 billion. Should a takeover bid be made for Santos, then, based on their current market capitalisation, it would rank as the largest Acquisition in the Asia Pacific region over the period since January 2005.

The largest acquisition in the period since January 2005 was the \$5 billion acquisition by China National Offshore Oil Corporation from the Government of Iran.

5.3 Private Equity Interest

Private equity firms have been active in acquiring companies seeking to add value to companies over the medium term through acquisitions, privatisation and subsequent restructuring. To date, there has been minimal Private Equity interest in the International Oil and Gas Sector. In the wider resources sector the experience has been similar although the recently announced \$1.15 billion acquisition of Xstrata Pic's aluminium assets by Apollo Management LLP (a private equity and capital markets investor with investments in a diverse range of sectors in the US and internationally), suggests that private equity firms are likely to have a greater impact in the resources sector in the future.

Private Equity generally targets companies with:

- Inefficient balance sheets;
- Inefficient corporate structures; and
- Underperforming businesses.

Barriers to Private Equity interest in the Oil and Gas Sector are as follows:

- The risk of unsustainable debt finance;
- Experience and the capability to operate an Oil and Gas company;
- Long vs mid-short term returns. Private equity generally targets companies with mid term profit growth. In the Oil and Gas sector there are generally long lead times from capital investment to generating a return; and
- The volatility of commodity prices and the unique risk/reward profile of the industry.

6. ANALYSIS OF OIL AND OR GAS UTILITIES THAT MAY HAVE AN INTEREST IN SANTOS LIMITED

6.1 Companies based in Australia

7. RISK AND RISK MANAGEMENT STRATEGIES

7.1

7.2 Controls that could be implemented to preserve employment and head office operations

One of the major risks of the removal of the shareholding cap is the loss of the Santos head office operations should they be taken over. It should be possible for the State and Santos to enter into a legally binding arrangement for the preservation of Santos' head office and certain employment levels in South Australia.

The principal mechanisms identified are a Contract/Deed between Santos and the State Government or a Statutory Indenture

In drafting the deed it will be necessary to clearly define what a "head office" is. The State could require terms which:

- Prevent the shifting of employees, operations;
- Ensure control of the operations remains in South Australia;
- Allow the State to have extensive audit rights; and
- Cover anti-avoidance.

One of the main issues in drafting any deed/agreement/indenture is in determining appropriate sanctions for non-compliance. Some examples of non-compliance include:

- Payment of a substantial fine;
- Refusal of corporate reconstruction ex-gratia stamp duty relief on the transfer of assets by Santos within its group;
- Rights for the State to obtain specific performance requiring Santos to remedy its breach;
- Removal by the State of Santos' legislative approvals and mining permits;

In the recently proposed takeover of Qantas by APA, APA proposed a legally binding Deed capturing the restrictions by which it agreed to be bound. Some of the proposed restrictions included:

- Maintenance of the Qantas and Jetstar brands both domestically and internationally;
- Qantas undertake substantial capital investment;
- Qantas and Jetstar would expand internationally and within Australia to provide a substantial mix of full service and value based offerings;
- Qantas Group would support regional capacity growth and regional network improvement;
- Head office of Qantas to be retained in Australia;
- At all times two-thirds of the directors are to be Australian citizens;
- Facilities located in Australia, when compared with those located in any other country, must represent the principal operational centre for the Qantas group;

- Prohibit any action to become incorporated outside of Australia; and
- Acknowledges the Commonwealth's right to seek remedy in the event of a possible breach, including through an injunction or specific performance.

7.3 Foreign Investment Review Board

Should a takeover bid be launched for Santos by a foreign corporation then it will require approval by the Foreign Investment Review Board (FIRB) under the Foreign Acquisitions and Takeovers Act 1975 (FATA). Under the FATA legislation the FIRB have the power to block certain proposals seen as being "contrary to the national interest".

FIRB is an advisory board that examines proposals and makes recommendations to the Commonwealth Government on whether the proposal satisfies Government policy.

Any foreign corporation proposing to acquire more than 15% of Santos would need to notify FIRB. The Federal Treasurer would, once he has considered the recommendations of FIRB, determine to reject or accept the proposal. The importance of this control was illustrated by the thwarted effort of Shell to acquire Woodside Petroleum in 2001. In announcing the decision on the proposed takeover of Woodside by Shell the Treasurer stated:

"Ladies and gentlemen, after long and careful deliberations, I have today made orders under the Foreign Acquisitions and Takeovers Act prohibiting Shell from acquiring a substantial shareholding in Woodside which would result in a change of control of Woodside. I want to emphasise at the outset that the Government's policy is, and will continue to be, to welcome foreign investment into Australia. Australia operates a very liberal foreign investment regime and less than 3 per cent of applications for approval under foreign investment are refused. I think by value about 0.1 per cent. But the Foreign Acquisitions and Takeovers Act allows the Treasurer in the national interest to prohibit a change in control where that involves a foreign company.

I have determined that this is one of those rare occasions on which that power should be operated. In particular, in assessing the national interest, I had regard to the fact that the North West Shelf is Australia's largest energy resource and has the capacity to be one of our largest export earners.

I believe it is in the national interest of Australia that that resource be developed to its full, and that exports from the North West Shelf are promoted and sold in preference to exports that compete against it from any other part of the world."

In the event of a proposed takeover of Santos by a foreign corporation, FIRB would seek comment from the South Australian Government in relation to the takeover. The South Australian Government would have the opportunity to argue the case for economic development at that time if appropriate.

APPENDIX 1 TERMS OF REFERENCE

Background

The 15% shareholding restriction on shares held in Santos Limited was enacted almost 30 years ago in 1979. The original Act was repealed in 1989 and replaced with the Santos Limited (Regulation of Shareholdings) Act 1989.

The legislation restricts any one party from having a shareholding of greater than 15% in Santos Limited. The restriction remains in place whilst Santos, or a subsidiary of Santos engages in the recovery and production of petroleum within South Australia.

Details of Terms of Reference

The South Australian Government has been requested to undertake a review of the Santos Limited (Regulation of Shareholdings) Act 1989 by Santos.

The Government will undertake a review under the Minister for Mineral Resources Development by 31 July 2007.

The review will assess the benefits and cost of retaining the shareholding cap for both Santos and South Australia, taking into account:

1. the original intent of the 15% shareholding cap and its applicability today;
2. the impact of the shareholding cap on the operations and future growth of Santos both globally and in South Australia;
3. any potential risks from removal of the cap to South Australia's economy;
4. energy security issues in South Australia;
5. regional development implications; and
6. an overall assessment of the current and future benefits of Santos' operations in South Australia.

The review will include the opportunity for public consultation and submissions to the review can be made by 15 June 2007.

The internal review by Government will be completed by 31 July 2007 and the Government will announce its intentions within 2 months of finalising the review.

Deed of Undertaking to
the Premier for and on
behalf of the Crown in
right of the State of South
Australia

Santos Limited

Deed of Undertaking to the Premier for and on behalf of the Crown in right of the State of South Australia

Date ►

This Deed of Undertaking is made by	Santos Limited ("the Company") ACN 007 550 923 of Ground Floor Santos Centre, 60 Flinders Street, Adelaide, South Australia, Australia 5000
In favour of	The Premier for and on behalf of the Crown in right of the State of South Australia ("State") of 200 Victoria Square Adelaide SA 5000
Background	<ol style="list-style-type: none"> 1 In 1979 the South Australian Parliament passed legislation capping the number of voting shares in the Company that a person could have an interest in. This was designed to ensure the security of South Australia's energy supplies and the stable development of the Cooper Basin. 2 The <i>Santos Limited (Regulation of Shareholdings) Act 1989 (SA)</i> (Santos Legislation) continues the restrictions on interests in shares in the Company that were first put in place in 1979. 3 The Company has since developed substantial operations in South Australia and also has significant oil and gas operations elsewhere in Australia and around the world. 4 The Company remains committed to South Australia and the Company has agreed to be bound by the terms of this Deed of Undertaking.

2 Acknowledgements

- (a) This Deed of Undertaking is entered into as a deed poll for the benefit of the State.
- (b) The Company acknowledges that the Premier and the State of South Australia will rely on the terms of this Deed of Undertaking in taking any steps to secure the removal of the Share Cap.
- (c) The Company acknowledges that the South Australian Government cannot seek to fetter the discretion of Parliament and that the Company does not in making this Deed seek to rely on any statement or representation made by the State or the South Australian Government in relation to removal of the Share Cap.

3 Commencement and Termination

3.1 Commencement

- (a) The Company's obligations under clause 4 of this Deed of Undertaking will commence on the date upon which the Repealing Act receives Royal Assent.
- (b) Each of the undertakings by the Company in clause 4 are subject to and conditional upon the Repealing Act receiving Royal Assent on or before 30 June 2008.

3.2 Termination

- (a) Subject to clause 3.2(b), this Deed of Undertaking will terminate automatically when any of the following circumstances apply:
 - (1) a period of ten years has elapsed from the Commencement Date;
 - (2) the South Australian Parliament imposes or authorises the imposition of a new Share Cap or any other restrictions on or in respect of the Company's Board or Senior Management which have an adversely discriminatory effect in their application to the Company relative to other companies domiciled in the State;
or
 - (3) an aggregate amount of at least \$100 million is paid as Deed Expenditure.
- (b) Subject to clause 5(h), the Company remains liable to the State for any obligations accrued or arising before the termination of this Deed of Undertaking but otherwise the Company will cease to be bound by the undertakings in clause 4 on termination of this Deed of Undertaking.

4.2A Warranties

- (a) The Company acknowledges and warrants that the roles covered by clauses 4.1 and 4.2 represent, as at the date of this Deed of Undertaking:
- (1) effectively 100% of roles directly associated with Santos' South Australian activities; and
 - (2) approximately 90% of the Company's South Australian based workforce, which currently equates to approximately 1700 jobs.
- (b) The Company warrants that, as at the Commencement Date, it will have acted in a manner between the date of this Deed of Undertaking and the Commencement Date (provided it is no later than 30 June 2008) which is consistent with the position that would have applied had the Company been bound by clauses 4.1 and 4.2 from the date of this Deed of Undertaking.

4.3 Social Responsibility and Community Benefits

- (a) The Company has a well established program of sponsorships, donations and community benefit projects (Social Responsibility and Community Benefits Program), under which the Company supports communities in which it operates in South Australia and elsewhere. The Company recognises that it has a responsibility to support the social fabric of the communities in which it operates.
- (b) As at the date of this Deed of Undertaking, as part of its Social Responsibility and Community Benefits Program the Company sponsors or donates to organisations and projects within the following categories (Categories):
- (1) scientific endeavour and research;
 - (2) indigenous employment and training;
 - (3) vocational and industry development;
 - (4) environment, sustainability and climate change;
 - (5) health and safety;
 - (6) education and training;
 - (7) youth affairs;
 - (8) arts and culture; and
 - (9) other community benefits.
- (c) The specific organisations and projects and the Categories of organisations and projects in South Australia to which the Company provides support as part of its Social Responsibility and Community Benefits Program may change over time, depending on the particular needs of the Company and South Australian communities and depending on changes in values and priorities of those communities and of the Company. All sponsorships and donations will be subject to the Company's standard philanthropic assessment and ongoing oversight and performance management criteria.

5 Compliance

- (a) The provisions of this Deed of Undertaking constitute legal, valid and binding obligations on the part of the Company and are enforceable by the State, but are not enforceable by any other person other than the Company and its successors or acquirers.
- (b) In the event of a threatened or actual breach of this Deed of Undertaking the State is entitled (without limiting its other rights) to seek an injunction or order for specific performance to restrain or compel the relevant act or omission.
- (c) This Deed remains binding on the Company and its successors and must be complied with by the Company notwithstanding any merger, amalgamation, takeover or change in control which might occur in respect of the Company.
- (d) If the Company is of the opinion that its financial position is such that continuing to make payments which the Company is obliged to make under clause 4.3 would cause the financial position of the Company to be materially adversely affected then the Company may make application to the Premier to suspend its obligations. The Premier must give reasonable and timely consideration to the application and must not unreasonably refuse to agree to the suspension of the Company's obligations.
- (e) In the event of a breach or threatened breach of an undertaking provided by the Company in clause 4.1 or clause 4.2, the Premier may, by notice in writing delivered to the registered office of the Company within 28 days of becoming aware of the breach, require the Company to:
 - (1) rectify that breach or withdraw the threatened breach; or
 - (2) provide a cure plan as set out in a deed poll to the State in a form to the reasonable satisfaction of the State to mitigate the effects of that breach or threatened breach;within 60 days of the Company receiving the notice.
- (f) Subject to clause 5(h), if the Company fails to comply with a notice reasonably issued in accordance with clause 5(e) or the terms of any deed poll provided under clause 5(e)(2) in relation to a material breach (which, for the purposes of this Deed of Undertaking, would mean a breach resulting in loss to South Australia of not less than \$5 million) of an undertaking provided by the Company in clause 4.1 or clause 4.2 (each such non-compliance a **Compensable Event**), the Company will pay to the State by way of compensation such amount as the State shall certify as its loss, which certificate is conclusive in the absence of manifest error provided that, before issuing the certificate, the Premier must discuss and consult with the Chief Executive Officer or the Chairman of the Company, and have regard to their views, regarding the State's loss.
- (g) The amount of the loss which may be claimed by the State under clause 5(f) shall be capped as follows:
 - (1) where the earliest Compensable Event occurs on or before the first anniversary of the Commencement Date, \$100 million;
 - (2) where the earliest Compensable Event occurs after the first, but on or before the second anniversary of the Commencement Date, \$90 million;
 - (3) where the earliest Compensable Event occurs after the second, but on or before the third anniversary of the Commencement Date, \$80 million;

8 Further Assurances

The Company will promptly at its own cost do all things (including executing all documents) necessary or desirable to give full effect to this Deed.

9 Severability

If any part of this Deed is or becomes void or unenforceable, or if this Deed would, if any part were not omitted, be or become void or unenforceable, then that part will be severable without affecting the remainder of this Deed.

10 No Confidentiality

This Deed and its subject matter are not confidential.

11 Governing law and jurisdiction

- (a) This Deed is made in South Australia and is governed by the laws in the State of South Australia.
- (b) The courts of South Australia have exclusive jurisdiction in connection with this Deed.
- (c) Any proceeding brought in the Federal Court in relation to this Deed must be instituted in the Adelaide Registry of the Federal Court and the Company will not apply to transfer that proceeding to any other Registry of the Federal Court.

12 Modification or Revocation

- (a) No addition to or modification of any provision of this Deed shall be binding unless made by written instrument executed by the Company and the State.
- (b) This Deed may be revoked by written instrument executed by the Company and the State but is not otherwise revocable.

13 Waiver

- (a) Any waiver of any provision of this Deed is ineffective unless it is in writing, expressed to be a waiver of that provision of this Deed and signed by the State.
- (b) A waiver by the State in respect of a breach of a provision of this Deed by the Company is not a waiver in respect of any other breach of that or any other provision.

Executed as a deed

Signed sealed and delivered for
Santos Limited in accordance
with section 127 of the Corporations
Act 2001 (Cth) and its Constitution by:


Director

STEPHEN GERLACH


Director/Secretary

JOHN CHARLES ELLICE-FLINT