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Tuesday 28 August 2012

LETTER TO SHAREHOLDERS from THE CHAIRMAN OF LAKES OIL NL

You will by now have read that the Victorian Government has declared a moratorium on fracture stimulation of coal bed methane in this State. *Refer attachment 2*

Unfortunately Lakes' tight gas operations in Gippsland will also be subjected to this moratorium as the Government has made no distinction between shallow coal bed methane operations, and Lakes' much deeper oil and gas exploration and development. *Refer attachment 1*

Lakes' tight gas activities have only involved fracing at considerable depths below the water table and without any effect on the important shallow water bearing horizons and reservoirs, which are so vital to the farming and local community.

Sadly, the Government did not seek input from either Lakes or the wider resources industry before it instigated this freeze on fracture stimulation.

Lakes believes the programs it has already carried out, and plans to carry out, are very different from coal bed methane exploration. We would have liked to have made our case on behalf of Lakes' shareholders before this Moratorium was declared.

Under our agreement, our joint venture partner in PRL2, Beach Energy, has to carry out extensive fracture stimulations in two wells (Wombat-4 and Boundary Creek 2) at significant depths, well below the water table. These activities are scheduled to be done prior to Christmas this year.

Beach Energy has contracted expensive equipment to work on these leases and has begun the process of obtaining the approvals before moving ahead.

Procuring the necessary specialised equipment is extremely difficult as it needs to be mobilized from all over Australia, at a time when there is substantial demand for it, particularly in Queensland and WA.

Unfortunately, this move by the Government has come at a time when there are predictions that Victoria could have a shortage of gas within two years and the gas price could double during that time, due to the opening up (to the eastern States' gas producers) of exports of LNG from Gladstone at world market prices.

LAKES HAS ALWAYS BEEN AWARE OF ITS OBLIGATIONS TO THE COMMUNITY AND THE LAND OWNERS.

WE BELIEVE THAT SCIENCE WILL OVERCOME THE OBJECTIONS THAT HAVE NOW ARISEN.

LAKES' FRACTURE OPERATIONS ARE WELL BELOW THE LATROBE COAL SEAMS AND FRESH WATER AQUIFERS.

Australia is still many years behind in both technology and the equipment required to recover unconventional gas.

The Americans have had many delays and objections along the way. However the technology is developing so rapidly that they have been able to increase their reserves from 25 years supply to many times that, with a resulting dramatic fall in gas prices. There is a feeling in the US that cheap gas will be a large contributor to their economic recovery.

Lakes has discovered a major new Victorian deep energy source, which will play a big part in the ongoing development of the State and the region.

The planned development program is designed to prove the commerciality of the Wombat Gas Field and allow us to raise the critical finance to move into production.

It will be challenging financing this project while it is subject to a government moratorium.

BOUNDARY CREEK 2 IS PART OF A MUCH LARGER "PLAY" in the Gippsland Basin

Boundary Creek 2 is located on the eastern end of the 70 km surface Baragwanath Anticline and electric logs run at the time of drilling show the potential to recover gas.

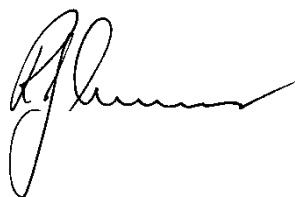
Lakes drilled a well on the western end of the anticline at Loy Yang several years ago within a stone's throw of the power station now owned by AGL. Evaluation of the electric logs of that well by US specialists also showed the presence of gas over a substantial depth.

IN RECENT WEEKS LAKES AND ARMOUR ENERGY LTD, ITS JOINT VENTURE PARTNER, DRILLED A NEW WELL, HOLDGATE-1, POSITIONED MID WAY ALONG THE ANTICLINE.

Specialised analysis of this well also showed gas over a significant section of the well.

All three wells need to be fracture stimulated, and if our interpretations are correct, gas could be present throughout the entire anticline. This could be a giant field with huge potential , making it a very valuable asset for both Lakes Oil and the State of Victoria.

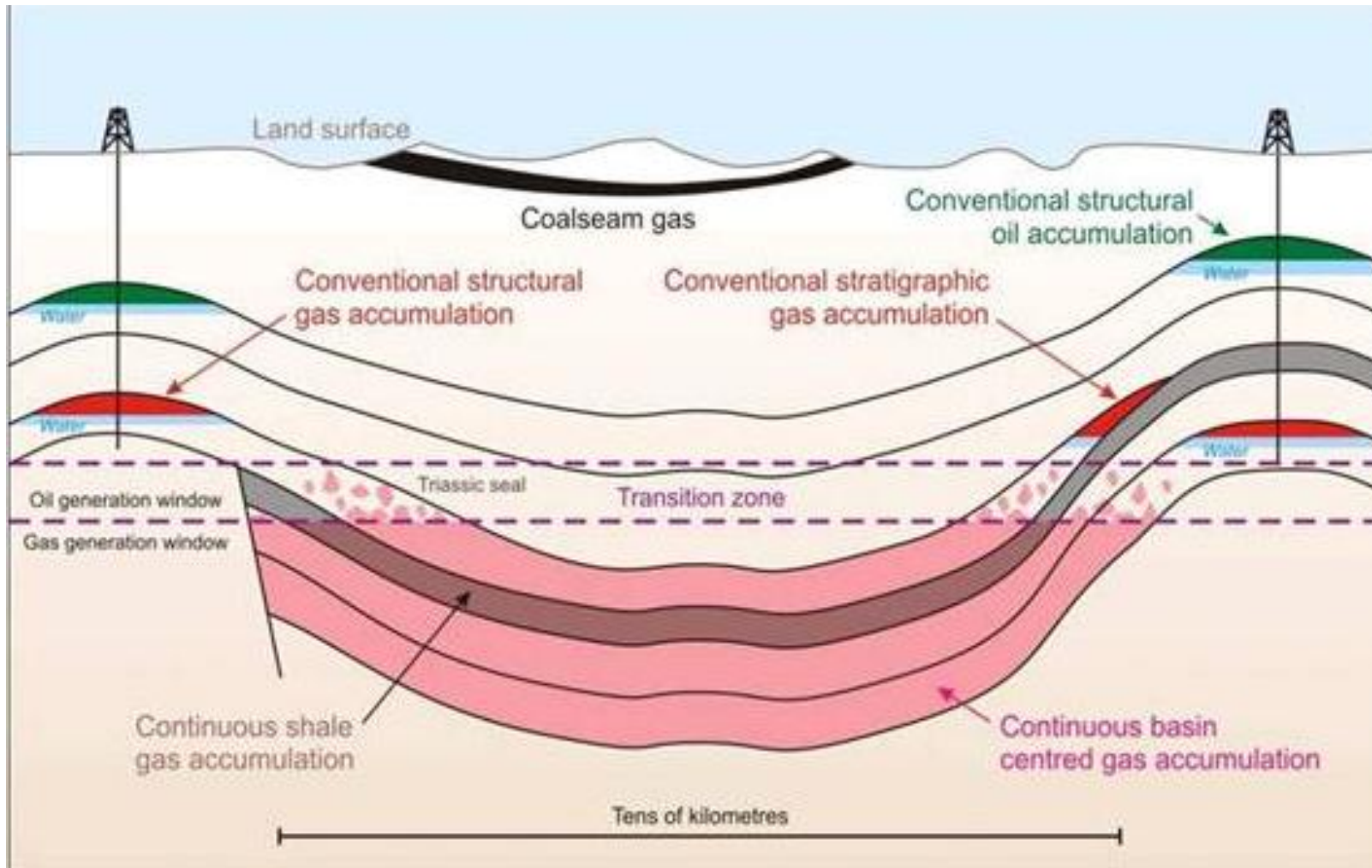
LAKES BELIEVES IT HAS BEEN UNFAIRLY LUMPED IN WITH THE COAL BED METHANE EXPLORERS TO THE DETRIMENT OF LAKES, ITS SHAREHOLDERS AND THE STATE OF VICTORIA.



Robert J Annells.
Chairman Lakes Oil NL.

Attachment 1 – Diagram cited from the website of the Department for Manufacturing, Innovation, Trade , Resources and Energy, Government of South Australia

Attachment 2 – Media Release – The Hon Michael O'Brien MP Minister for Gaming, Minister for Consumer Affairs, Minister for Energy Resources , "Reforms to strengthen Victoria's coal seam gas regulation and protect communities" Friday 24 August 2012



Attachment 1: Schematic diagram cited from the website for the department of Manufacturing, Innovation Trade, Resources and Energy, Government of South Australia showing conventional and unconventional oil and gas accumulation types (Source: Beach Energy Limited, AGM Presentation, November 2011. Amended from Schenk and Pallastro, 2002).



Media release

The Hon Michael O'Brien MP

Minister for Gaming
Minister for Consumer Affairs
Minister for Energy and Resources
Friday 24 August 2012

Reforms to strengthen Victoria's coal seam gas regulation and protect communities

The Victorian Coalition Government has announced reforms that will provide greater certainty for regional communities and industries in the lead up to the national reform process for coal seam gas, Minister for Energy and Resources Michael O'Brien said today.

The reforms which come into effect immediately are:

- A hold on approvals to undertake hydraulic fracturing ('fracking') as part of onshore gas exploration and a hold on the issuing of new exploration licenses for coal seam gas until the upcoming national framework proposals have been considered; and
- A ban on the use of BTEX chemicals (benzene, toluene, ethylbenzene and xylene) in hydraulic fracturing in Victoria.

The Victorian Coalition Government will also:

- Seek to strengthen resource policy and legislation to ensure better consideration of mixed land use issues during the application process for coal seam gas exploration activity; and
- Use impact statements at the exploration stage in circumstances where there will be a significant material impact on the environment, to better manage mixed land use issues for all minerals exploration, not just coal seam gas. This power currently exists under section 41A of the *Mineral Resources (Sustainable Development) Act 1990*.

Work by the States and Commonwealth on the creation of the *National Harmonised Framework* for coal seam gas is progressing and will include a national consultation process. State and Federal Energy and Resources Ministers are expected to consider the framework in December 2012.

The national framework process is considering leading practice approaches to the regulation of the coal seam gas industry, including water management and monitoring, well design and integrity, hydraulic fracturing, chemical use, and industry and community engagement.

Mr O'Brien said that the actions announced today would provide greater certainty for the community in the lead up to the anticipated reforms to industry practice.

"In anticipation of new standards being considered through this reform process, the Coalition Government has decided to place a hold on approvals to undertake hydraulic fracturing as part of onshore gas exploration," Mr O'Brien said.

“This hold will remain in place until the national framework proposals have been presented, and then considered and responded to by the Coalition Government.

“This approach will help to avoid a situation where applications for hydraulic fracturing works might be approved now, only to be inconsistent with new standards to be set in the near future.

“It will ensure that Victorians can have confidence the strongest protections will apply to the regulation of onshore gas exploration while giving industry regulatory certainty,” Mr O’Brien said.

These measures do not affect exploration activity approved under existing licences that does not involve fracking, such as surveying or drilling for core samples.

These reforms follow the announcement in June this year that Victoria had signed a National Partnership Agreement with the Commonwealth on coal seam gas and large coal mining development.

Work is underway to determine the Victorian based scientific studies that will be funded by the National Partnership Agreement. This work will be supplemented by a Gippsland regional scale study by the Commonwealth Government’s Independent Expert Scientific Committee into the impact of mining activity on water resources.

Mr O’Brien said that alternative sources of natural gas present potential economic benefits for local communities and new jobs; however, the Coalition Government will not allow new industries to threaten local livability, the environment or food production.

“Industry development relies on the quality of the engagement between exploration companies and the local communities where this activity takes place, and it relies on the community having the confidence that government regulation keeps pace with an evolving industry,” Mr O’Brien said.

“The reform process will help to ensure that Victoria’s regulation of onshore gas operations remains strong, and continues to protect our environment and our agricultural industries.

“The Coalition Government supports regional jobs and investment in the minerals and resources sector and exploration for onshore gas will make an important contribution in efforts to keep energy affordable for all Victorian households and businesses,” Mr O’Brien said.

These new reforms are in addition to Victoria’s already tough regulatory framework that includes Victoria’s Environmental Protection Policy under the *Environment Protection Act 1970* which does not allow discharge from exploration and mining activities that will pollute groundwater.

Exploration for coal seam gas in Victoria is at a very early stage. There is currently no coal seam gas production in Victoria. While the location of Victoria’s coal resources is well known, the amount of any associated gas and the feasibility of extraction are uncertain.

Hydraulic fracturing was last approved and conducted in Victoria in 2009, under the former Labor Government. No adverse impacts have been recorded.

There are currently no hydraulic fracturing works approved in Victoria.

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