

DIRECTORS' REPORT

REMUNERATION REPORT (AUDITED)

This report details the nature and amount of remuneration for each Director of Carbon Energy Limited and for the Executives receiving the highest remuneration.

Remuneration policy

The remuneration policy, which sets the terms and conditions for the Managing Director and other Senior Executives, was developed by the Remuneration Committee after seeking professional advice from independent consultants and was approved by the Board. All Executives receive a base salary, superannuation, fringe benefits and performance incentives. The remuneration committee reviews Executive packages annually by reference to group performance, Executive performance, comparable information from industry sectors and other listed companies and independent advice. The performance of Executives is reviewed bi-annually, in February and August, by the Managing Director and his performance is reviewed by the remuneration committee, with revised remuneration packages generally taking effect from the 1st of July of the new financial year.

Executives are also entitled to participate in the employee option arrangement from time to time, as determined by the Board. Key performance indicators are established for each executive and relate to specific outcomes agreed between the Executive and the Company for the period involved. Furthermore, the Executive needs to be in the employment of the Consolidated Group for the period to successfully meet the performance criterion for the granted options to vest. The amount of remuneration for all

specified Directors and the specified Executives including all monetary and non-monetary components are detailed below. All remuneration paid to Executives is valued at the cost to the Company and expensed. Any options that are issued are valued using the Black-Scholes methodology.

An election has been provided to existing Executives to forfeit the Options under the Executive Service Agreement and to participate in a new scheme to receive Short Term Incentives (STI) and Long Term Incentives (LTI). The STI and LTI components paid to Executive Managers range between 15% and 20% of their fixed annual remuneration package and involve providing shares in Carbon Energy Limited. All new executives will participate in this new scheme.

The scheme involves establishing a maximum STI value and LTI value for each financial year, subject to satisfactorily meeting Key Performance Indicators. These would be allocated as follows:

- At the end of each financial year, the executive would be allocated a number of shares equivalent to the cash value of the STI, based on the 90 day VWAP prior to 30 June of that year, which are redeemable immediately;
- At the end of each financial year the executive will be allocated a number of shares equivalent to the cash value of the LTI, based on the 90 day VWAP prior to 30 June of that year, which would be redeemable in 2 equal tranches. The first tranche is redeemable after 12 months from 1 July, the second after 24 months from 1 July, provided the executive remained employed with the Company at that time; and

- If the Company terminates the Executive's employment, other than for cause, the LTI tranches that have been allocated but not yet redeemed will be issued to the executive.

The Board expects that the remuneration structure implemented will result in the Company being able to attract and retain the best Executives to run the Consolidated Group. It will also provide Executives with the necessary incentives to work to grow long-term shareholder value.

The payment of bonuses, stock options and other incentive payments are reviewed by the remuneration committee annually as part of the review of Executive remuneration and a recommendation is put to the Board for approval. All bonuses, options and incentives must be linked to predetermined performance criteria. The Board can exercise its discretion in relation to approving incentives, bonuses and options and can recommend changes to the Committee's recommendations. Any changes must be justified by reference to measurable performance criteria.

The Company's Remuneration Committee Charter is set out on the Company's website www.carbonenergy.com.au.



Details of remuneration for year ended 30 June 2011

The remuneration for each Director of the Consolidated Group during the year is noted as follows:

PARENT ENTITY DIRECTORS

2011	Salary \$	Directors Fee \$	Other \$	Super Contributions \$	Sub-total \$	Share-based Payments Expense (iii) \$	Total Excluding Forfeited Options \$	Performance related %	Forfeited options \$
Mr K. Robinson	-	60,000	-	5,400	65,400	-	65,400	-	-
Mr A.M. Dash	465,502	-	-	25,000	490,502	847,098	1,337,600	63.3%	(1,086,816)
Dr C.W. Mallett (resigned 30 June 2011)	175,000	-	-	15,750	190,750	59,870	250,620	23.9%	(94,834)
Mr M.D.J Cozijn	-	40,000	-	3,600	43,600	-	43,600	-	-
Mr P.N. Hogan (i)	-	40,000	-	-	40,000	-	40,000	-	-
Mr L. Rozman (ii)	-	40,000	-	-	40,000	-	40,000	-	-
Mr I.W. Walker (resigned 31 Dec '10)	-	20,000	-	1,800	21,800	-	21,800	-	-
Dr H.M. Garnett (appointed 6 Sep '10)	-	40,924	-	3,683	44,607	-	44,607	-	-
TOTALS	640,502	240,924	-	55,233	936,659	906,968	1,843,627	-	(1,181,650)

(i) Amounts paid to Incitec Pivot Limited for Mr Hogan's service.

(ii) Amounts paid to Pacific Road Partnership for Mr Rozman's services.

(iii) Options are valued using the Black Scholes Methodology.

PARENT ENTITY DIRECTORS

2010	Salary \$	Directors Fee \$	Other \$	Super Contributions \$	Sub-total \$	Share-based Payments Expense (iii) \$	Total Excluding Forfeited Options \$	Performance related %	Forfeited options \$
Mr K. Robinson	-	60,000	-	5,400	65,400	-	65,400	-	-
Mr A.M. Dash	299,926	-	1,320	25,000	326,246	1,670,335	1,996,581	83.7%	-
Dr C.W. Mallett	140,750	-	2,640	50,000	193,390	176,411	369,801	47.7%	-
Mr M.D.J Cozijn	-	20,000	-	23,600	43,600	-	43,600	-	-
Mr P.N. Hogan (i)	-	40,000	-	-	40,000	-	40,000	-	-
Mr L. Rozman (ii) (appointed 7 Apr '10)	-	9,341	-	-	9,341	-	9,341	-	-
Mr I.W. Walker	-	-	-	43,600	43,600	-	43,600	-	-
Mr P.T. McIntyre (resigned 12 Feb '10)	-	24,666	-	2,220	26,886	-	26,886	-	-
TOTALS	440,676	154,007	3,960	149,820	748,463	1,846,746	2,595,209	-	-

(i) Amounts paid to Incitec Pivot Limited for Mr Hogan's service.

(ii) Amounts paid to Pacific Road Partnership for Mr Rozman's services.

(iii) Options are valued using the Black Scholes Methodology and calculated at the date of grant. As at the date of this report, the Board has not formally ratified the vesting of these options.

DIRECTORS' REPORT

REMUNERATION REPORT (AUDITED)

The remuneration for each Executive Office of the Consolidated Group during the year is noted as follows:

PARENT ENTITY EXECUTIVES

2011	Salary \$	Termination Costs \$	Other Costs \$	Super Contribution \$	Sub-total \$	Share-based Payments (ii) \$	Total excluding Forfeited Options \$	Performance related %	Forfeited Options \$
Mr J Bidwell	329,357	-	-	29,642	358,999	104,640 (i)	463,639	22.6%	-
Mr A Mifflin (resigned 4 Feb '11)	192,469	-	-	16,974	209,443	218,748	428,191	51.1%	(44,400)
Mr P Nair	206,879	-	-	18,619	225,498	67,650 (i)	293,148	23.1%	(135,919)
Mr P Swaddle	224,488	-	-	20,204	244,692	55,056 (i)	299,748	18.4%	(135,919)
Mr J Hoskin (appointed 24 Jan '11)	138,519	-	-	12,467	150,986	45,780 (i)	196,766	23.3%	-
TOTALS	1,091,712	-	-	97,906	1,189,618	491,874	1,681,492		(316,238)

(i) The amounts have been earned but shares have not been issued as at the date of this report each reflecting 50% as STI and 50% as LTI.

(ii) Options are valued using the Black Scholes Methodology.

PARENT ENTITY EXECUTIVES

2010	Salary \$	Termination Costs \$	Other Costs \$	Super Contributions \$	Sub-total \$	Share-based Payments (i) \$	Total excluding Forfeited Options \$	Performance related %	Forfeited Options \$
Mr J Bidwell (appointed 27 Apr '10)	28,749	-	-	12,501	41,250	-	41,250	-	-
Mr A Mifflin (appointed 18 Jan '10)	99,722	-	605	24,300	124,627	104,332	228,959	45.6%	-
Mr P Nair	148,933	-	20,387	50,000	219,320	122,551	341,871	35.9%	-
Mr P Swaddle	180,000	-	1,320	38,000	219,320	122,551	341,871	35.8%	-
Mr J Wedgwood (resigned 7 May '10) (ii)	160,513	31,559	2,750	25,346	220,168	118,748	338,916	35.0%	(303,964) (ii)
TOTALS	617,917	31,559	25,062	150,147	824,685	468,182	1,292,867	-	(303,964)

(i) Options are valued using the Black Scholes Methodology.

(ii) Upon resignation, \$303,964 worth of options were forfeited.

Performance Bonuses were awarded to Executive Directors and Executive Officers on successful achievement of key performance indicators.

Options Granted as part of Remuneration:

2011 – No options over shares were provided to Key Management Personnel.



KEY MANAGEMENT PERSONNEL

2010	Vested No.	Granted No.	Grant Date	Value per option at Grant Date \$	Exercise Price \$	First Exercise Date	Last Exercise Date
Mr A Mifflin (appointed 18 Jan '10)		1,000,000	22/03/10	\$0.28	\$0.80	30/06/11	22/03/15
		1,000,000	22/03/10	\$0.23	\$1.20	30/06/12	22/03/15
		1,000,000	22/03/10	\$0.20	\$1.60	30/06/13	22/03/15

In 2010, all options issued to Executive Officers were as part of their at-risk remuneration and all options are all performance based. Options were granted for nil consideration.

Shares issued on Exercise of Compensation Options

No options were exercised during the 2011 year that were granted as compensation in prior periods to current Key Management Personnel.

Options exercised during the 2010 year that were granted as compensation in prior periods are as follows:

KEY MANAGEMENT PERSONNEL

2010	No. of ordinary shares issued	Amount paid per share	Amount unpaid per share
Mr I.W. Walker	6,000,000	\$0.20	Nil
Mr M.D.J. Cozijn	3,000,000	\$0.20	Nil
TOTALS	9,000,000		

Options expensed during the 2011 year that were granted as compensation in current and prior periods are as follows:

2011	Options Expensed (i) \$	Total Remuneration Represented by Options %	Options Exercised \$	Options Forfeited (\$)	Total \$
Mr A.M. Dash	847,038	63.3%	-	(1,086,816)	(239,778)
Dr C.W. Mallett	59,870	23.9%	-	(94,834)	(34,964)
Mr A Mifflin	218,748	51.1%	-	(44,400)	174,348
Mr P Nair	-	N/A	-	(135,919)	(135,919)
Mr P Swaddle	-	N/A	-	(135,919)	(135,919)
TOTALS	1,125,656			(1,497,888)	(372,232)

(i) Options are calculated using the Black Scholes Methodology and calculated at the date of grant.

DIRECTORS' REPORT

REMUNERATION REPORT (AUDITED)

Options expensed during the 2010 year that were granted as compensation in current and prior periods are as follows:

2010	Options Expensed \$	Total Remuneration Represented by Options %	Options Exercised \$	Options Forfeited (\$)	Total \$
Mr A.M. Dash	1,670,335	83.7%	-	-	1,670,335
Dr C.W. Mallett	176,411	47.7%	-	-	176,411
Mr A Mifflin	104,332	45.6%	-	-	104,332
Mr P Nair	122,551	35.8%	-	-	122,551
Mr P Swaddle	122,551	35.8%	-	-	122,551
Mr J Wedgwood	118,748	N/A	-	(303,964) #	(185,216)
TOTALS	2,314,928 *		-	(303,964)	2,010,964

Options previously granted forfeited on resignation of employee.

* Options are calculated using the Black Scholes Methodology and calculated at the date of grant.

Service Agreements of Directors and Executives

No new options were issued to Executive Directors during the year.

Mr Dash, Managing Director is employed under a four-year Executive Service Agreement (ESA) which commenced on 30 June 2008 and expires on 30 June 2012.

Dr Mallett, Technical Director is currently employed under a three-year ESA with Carbon Energy Ltd which commenced on 1 July 2008 and expires on 30 June 2011, extended for 1 year, until 30 June 2012.

Mr Nair, CFO and Company Secretary is currently employed under a three-year ESA with Carbon Energy Ltd which commenced on 1 November 2008 and expires on 31 October 2011.

Mr Swaddle, Senior VP Strategy & Business Development is employed on a permanent basis.

Mr Hoskin, Chief Operating Officer commenced on 24 January 2011 and is employed on a permanent basis.

Mr Bidwell, General Manager Commercial and Project Development agreed to take up the role on a permanent basis from 1 May 2011.

Mr Mifflin, resigned on 4 February 2011.

Required notice periods for executives employed under Executive Service Agreements are three months from either party. A payment for termination benefit on early termination by the employer is payable, other than for gross misconduct, and is equal to base salary and superannuation for 6 months.

The remuneration and terms of employment for the Non-Executive Directors (Messrs Robinson, Walker, Cozijn, Hogan and Dr Garnett) are subject to annual review with no fixed term, with one third of the Director's being subject to re-election at each Annual General Meeting of Shareholders.

The aggregate amount of remuneration payable to all non-executive Directors was set by shareholders at \$500,000 per annum. The total amount currently paid inclusive of superannuation is \$43,600 per annum to each Non Executive Director and \$65,400 per annum to the Chair of the Board. The Chair of the Audit Committee is paid an additional \$10,000 per annum plus superannuation. No termination payment provisions are currently in place.



MEETINGS OF DIRECTORS DURING THE YEAR ENDED 2011

Director	BOARD MEETING		AUDIT COMMITTEE MEETING		REMUNERATION COMMITTEE MEETING		NOMINATION COMMITTEE MEETING	
	Number eligible to Attend	Number Attended	Number eligible to attend	Number attended	Number eligible to attend	Number attended	Number eligible to attend	Number attended
K. Robinson	9	8	2	2	1	1	2	2
A. Dash	9	9	NM	NM	NM	NM	2	2
C.W. Mallett	9	9	NM	NM	NM	NM	2	2
M.D.J. Cozijn	9	8	NM	NM	NM	NM	2	2
P.N. Hogan	9	9	2	2	1	1	2	2
L.I. Rozman	8	7	NM	NM	NM	NM	2	2
I.W. Walker (retired 31 Dec '10)	5	4	NM	NM	NM	NM	NM	NM
H. Garnett (appointed 7 Sep '10)	6	6	2	2	NM	NM	1	1

NM – Not a member of the Committee

Share Options

At the date of this report, the total of unissued ordinary shares of Carbon Energy Limited under option is 35,580,000 and is comprised of:

No. of Options	Grant Date	Exercise Price	Vesting Date	Expiry Date
5,000,000	13/11/2008	\$0.25	30/06/2009	10/12/2013
8,000,000	13/11/2008	\$0.70	30/06/2011	10/12/2013
10,000,000	13/11/2008	\$1.00	30/06/2012	10/12/2014
1,400,000	13/11/2008	\$0.35	30/06/2010	10/12/2013
1,750,000	13/11/2008	\$0.80	30/06/2011	10/12/2013
875,000	13/11/2008	\$1.20	30/06/2010	10/12/2013
1,750,000	13/11/2008	\$1.60	30/06/2011	10/12/2013
2,500,000	16/09/2008	\$0.80	30/06/2009	10/12/2013
1,000,000	16/09/2008	\$0.80	30/06/2011	10/12/2013
1,000,000	17/10/2008	\$0.80	31/10/2009	10/12/2013
1,000,000	17/10/2008	\$0.80	31/10/2009	10/12/2013
205,000	31/03/2009	\$0.40	30/06/2010	1/04/2012
100,000	31/03/2009	\$0.25	30/06/2010	1/04/2012
1,000,000	22/03/2010	\$0.80	30/06/2011	22/03/2015

DIRECTORS' REPORT

Unlisted

35,580,000 of these Options are on issue to Directors and employees of Carbon Energy Limited at the date of this report.

Non-audit services

The Board of Directors, in accordance with advice from the Audit Committee, is satisfied that the provision of non-audit services during the year is compatible with the general standard of independence for auditors imposed by the Corporations Act 2001. The Directors are satisfied that the services disclosed below did not compromise the external auditor's independence for the following reasons:

- All non-audit services are reviewed and approved by the Executive Directors prior to commencement to ensure they do not adversely affect the integrity and objectivity of the auditor; and
- The nature of the services provided do not compromise the general principles relating to auditor independence in accordance with APES 110: Code of Ethics for Professional Accountants set by the Accounting Professional and Ethical Standards Board.

Fees for non-audit services were paid to the external auditors Deloitte Touche Tohmatsu during the year ended 30 June 2011.

Indemnifying Officers and Auditors

The Company has continued an insurance policy insuring Directors and officers of the Company against any liability arising from a claim brought by a third party against the Company or its Directors and Officers, and against liabilities for costs and expenses incurred by them in defending any legal proceedings arising from their conduct while acting in their capacity as a Director or Officer of the Company, other than conduct involving a wilful breach of duty in relation to the Company.

In accordance with a confidentiality clause under the insurance policy, the amount of the premium paid to insurers has not been disclosed. This is permitted under S300 (9) of the Corporations Act 2001.

Proceedings on behalf of the Company

On 12 July 2011 DERM advised Carbon Energy of charges laid against the Company in relation to a spillage of process water that occurred during 2009. Proceedings have been adjourned to 20 September 2011.

The Company has also commenced proceedings in the Supreme Court of Queensland against Alexware Consulting Pty Ltd trading as Pangea Partners International ("Pangea") and Mr John Wedgwood, a former Carbon Energy employee. Pangea was the contractor originally engaged to build and commission Carbon Energy's 5MW power station. The legal action brought about by Carbon Energy is in relation to serious irregularities in the performance of the contract and accordingly, Carbon Energy will be seeking damages from the partners named above.

Auditor's independence declaration

The lead auditor's independence declaration for the year ended 30 June 2011 has been received and can be found on page 37 of the Annual Report.

Signed in accordance with a resolution of the Board of Directors made pursuant to s298 (2) of the Corporations Act 2001.

On behalf of the Directors



C. Rawlings
Chairman

Brisbane, Queensland
15 September 2011



A.M. Dash
Managing Director