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Energy White Paper Taskforce
Department of Industry
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Dear Sir/Madam,

CSR LIMITED SUBMISSION:

Energy White Paper; Green Paper 2014

CSR Limited welcomes the opportunity to make a submission in response to the Green Paper 2014.

In reviewing the paper, we believe that there are a number of issues that will have major implications for not just our business but all manufacturing industry and consumers, as it is core to the productivity and growth of production in Australia.

In this submission, CSR have restricted its commentary to specific issues relating to Chapter 3 "Building gas supply and improving market operation".

This represents the greatest energy issue facing CSR's business as a trade exposed manufacturer of building products. If you have any questions regarding this submission, please do not hesitate to contact me.

Yours sincerely,

Marion Johnstone

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Group Treasurer

1. Executive Summary

CSR Limited is an ASX Listed Top 200 company with operations in Australia and New Zealand. The company has over 70 manufacturing and distribution facilities throughout Australia producing high quality innovative building products for use in the construction industry. The company employs approximately 3,000 people in Australia and made a significant contribution to the Australian economy totalling over $2000m in 2014 in the form of taxes and royalties, wages, contractors, suppliers, capital investment and corporate social investment programs.

CSR is both a major consumer of energy and also a contributor to innovative energy efficiency solutions within Australia. The development of Australia's Energy White Paper and subsequent legislation will have a direct impact on our business and confidence to continue to invest in Australia.

The major energy challenge facing CSR's business relates to the supply and pricing of gas. To this end, CSR has commissioned external research and conducted internal research and analysis to understand and quantify the potential impact on its future business should the business as usual situation in the current gas market place be allowed to continue.

Overall CSR believes that Australia can have a successful export LNG industry and a successful manufacturing base. The right regulatory model that will support that objective while ensuring manufacturing does not become a casualty of the LNG expansions is yet to be developed and implemented in Australia. The right model will urgently tackle the substantial and growing uncertainty and insecurity in domestic gas supply, and address the lack of a competitive and transparent domestic gas industry. This submission addresses those issues.

2. Introduction

As a leading manufacturer of building products, the Company is committed to ongoing innovation in the built environment and received 20 patents in the last twelve months and has 48 patents pending. Many of these relate to improvements in energy efficiency in the construction and use of buildings. The company is organized into four divisions:

- Bricks and Roofing, which manufactures PGH™ Bricks and Pavers, Monier™ and Wunderlich™ Roof Tiles.
- Lightweight Systems which manufactures Gyprock™ Plasterboard, Cemintel™ Cement sheeting and Hebel products.
- Viridian™ Glass. This business manufactures float glass and has a downstream business fabricating and heat treating glass and producing integrated glazing units for double glazed windows.
- Bradford which produces Bradford™ Gold glass wool insulation, Edmonds™ Ventilation, and has a growing presence in energy efficiency businesses.

The businesses vary from Bradford™ Insulation and Viridian™ upstream glass being trade exposed and energy intensive, to energy intensive products such as bricks and terracotta tiles which while less directly trade exposed are subject to product substitution. One characteristic of these manufacturing processes is that they are gas dependent and are not easily shutdown. Any kiln based process can take several days to cool down and inevitably requires a significant rebuild before starting up. The glass factory for instance operates 24/7 for 365 days pa for about 15 years before it is shutdown.

Finally there are light weight systems (eg plasterboard and cement sheeting), which while consuming energy, tends to be a smaller component of product cost. Nevertheless increasingly these businesses are becoming more trade exposed and competitiveness in the sector is increasing. These plants are more easily closed and have been closed by the regulator at short notice when gas has been in short supply in the past in New South Wales. Furthermore the New South Wales Government is unable or unwilling to say how this will be handled in the face of future shortages. Gas supply contracts is no guarantee of supply.

CSR's expectation is that from 2015 onwards, gas prices for Australian businesses will double, and that based on the AEMO outlook, there may be insufficient gas to supply the NSW market reliably. The 2014 assessments from AEMO referred to in the Green Paper tends to discount this, but other assessments made available to CSR suggest that outages could be 10 or more days. CSR's direct experience arising from contract negotiations heightens concerns of supply insecurity. Furthermore, private industry analysis commissioned by CSR shows that from 2018 a growing domestic shortfall will emerge against 2P reserves which could be as much as a 30% shortfall by 2025.

3. Green Paper Goals

Bring on new gas supply as quickly as possible.

CSR agrees with this, however under current policy settings this is unlikely to occur in time to solve the imminent shortage or pricing problem. What is more important to a functioning market is to have ***more suppliers***. Under the current market structure, more supply from existing suppliers means more gas for export5. Given that Victoria and New South Wales in particular seem to be unable or unwilling to make this occur, there will be a reliance on other states. It would appear that there is already abundant knowledge and experience from a scientific and technical perspective. The issue is gaining the confidence of communities and this will not happen overnight. The Federal Government should have the responsibility to ensure that domestic users do not run short of gas or bear an exceptional cost burden in a much broader sense than is proposed in the short term. It would be a grim irony indeed if Australia were to suffer critical and economically damaging energy shortages, while becoming one of the largest exporters of gas in the world.

Improve the availability and quality of market information to improve market transparency and competition.

The more information that is made publicly available the better informed the market will be. However while necessary, this is not sufficient for a functioning market where the market is lopsided with multiple buyers and few sellers. The market place asymmetry is compounded by the high degree of integration through the supply and value chain.

Implement other gas market development priorities to expedite gas market reform.

CSR strongly supports measures to have an efficiently operating market and the bulk of our submission deals with our views on how that can be achieved. Work needs to start immediately so that investors and businesses have confidence in making future investment in Australia. COAG processes are slow to deliver and a study by the Productivity Commission or the ACCC could speed up a path to reform.

The Government should assess whether the measures proposed in the Green Paper will solve the problem of affordable available gas for the domestic market. It is our view the measures do not go far enough.

4. CSR views regarding market and regulatory reforms

Context & Background

The Australian market for gas has profoundly changed with the development of the export LNG. This has radically altered the entire market landscape. Export markets could easily consume Australia's entire gas production. In the future, the domestic market will accounts for a small portion of domestic production. The LNG development has opened many end consumers for Australian gas, although the number of suppliers to the domestic market remains very small. These changes have rendered the domestic market dominated by historical structures and regulations unworkable for buy side participants.

A handful of economic interests control almost three quarters of current reserves, while a similarly small group control almost 90% of Australian gas production (CSR commissioned research). At the present time, only a small fraction of available reserves is available to the Australian domestic market. The highly concentrated market has seen a high degree of integration from resource to consumer/ gas user, arguably substantially higher than seen in healthy, functioning markets. Despite the opening of export markets, joint marketing to the domestic market is still permitted.

At the present time, confidence in market outcomes and supply security is low because of the background outlined above. Transparency and opening of the domestic market to competitive functioning is imperative to restoring confidence in the market to deliver.

Objectives:

Open, fair, competitive & transparent markets in all aspects of the gas value chain:

- Facilitate a thriving contestable market in all possible points of the value chain and provide a surrogate for competition where there are natural monopolies or structural barriers to entry
- Reduce historical concentration and barriers to entry at all possible points as a natural and inevitable consequence of the opening of exports
- Transparent pricing set by competitive and contestable markets
- Promote a competitive, transparent market place
- Recognise and mitigate the impact of market power and industry concentration
- Preventing discriminatory or selective service in key areas of infrastructure
- Inhibit the accumulation and exercise of excessive market power
- Protect customers with little choice
- Promote secure, high-quality, environmentally sound energy infrastructure

Themes:

- Because of the presence of natural monopolies and the absence of product substitutes in this type of market, together with the legacy structure from a domestic focus, addressing impediments to competition, transparency, and market development is crucial

Market structure

- Unbundle the value chain from resource ownership/control and production through to consumption, & ensure ownership is diverse, competitive, and separated at each point of the value chain
- Restrict the capacity of any one entity, joint venture, or partnership to control a large or dominating share of reserves, while promoting entry of new competitors from the point of resource control and extraction
- Actively facilitate the entry of new competitors and break down of existing concentration.
- Transparency of information (volume, utilisation) & pricing in markets at each point along the chain
- Simple and competitive access by third parties to infrastructure
- Regulation of all pipelines other than those directly supplying LNG facilities to promote a competitive framework within constraints of the natural monopoly
- Promote competitive and deeper public markets at each point along the chain by:
    - Mandating clear separate ownership of resources, pipelines, distribution, & retailing
    - Resource "owners" should be separated from ownership of storage, pipelines and end market distribution & sales –only transport to designated pipeline hubs via open access arrangements.
        - Resource explorers and owners should be subject to use it or lose it provisions – return of unexplored acreage after 3 years and undeveloped acreage after a further 3 years. Too frequently, permitted entities sit on potential gas fields that others may wish to develop, in many cases because of unique constraints or to prevent the development of a competitive market. The concept is to ensure that gas fields are developed, there are a number of competitive potential suppliers, and that affordable gas is available to the domestic market.
    - Fees for sitting on undeveloped acreage – effectively a storage cost. Australia has been attractive to some parties who can hold their Australian assets while developing those in other economies where there is a risk of losing their acreage
    - Resource "developer" must sell at closest designated hubs – open access markets for buyers to bid, must be non-discriminatory
    - Pipeline transport pricing to be published based off a published benchmark price for the injection and withdrawal points; open access via electronic markets provided to all market participants; participants requiring shipping can price and book transport off the electronic market
    - Pipelines should be designated assets of national importance as a key step to equality of access.
    - Genuine shippers of gas who are holding spare capacity to have full rights to trade pipeline capacity among other shippers

- Gas to be delivered, priced and traded at the designated hub closest to the well head, and must be published against a benchmark price. This will require the establishment of additional hubs, including one at Moomba. As further pipelines and supplies are developed, other hubs can be added to the market place.
- Resource owners or retailers unable to restrict the re-sale of unused / no longer required gas by purchasers.
- Pipeline owners cannot integrate, either back into resources, nor forward into market distribution
- Where gas is sold by a retailer, the transport component must be identified and priced separately, with customers able to negotiate their own pipeline access if preferred
- Gas end-users with sufficient volumes and willingness to invest in the logistics & risk management should be able to price each point in the value chain based on their requirements
- The market is also subject to manipulation by gas owners/producers who "store" gas or fail to produce to game the market.
- Storage facilities to be owned independently (ie not owned by gas developer/ owners or transporters) to prevent gaming of the market by gas owners. Storage capacity market to provide biddable transparent access to avoid 'cornering' or manipulation of the market.
- Transporter pipelines
  - Pricing set via regulated maximums and minimums, for each injection & withdrawal point
  - Open trading market promoted and available – market liquidity improved by facilitating wide access to the pipeline, in standardised marketable parcels
  - No capacity "sitting" – ie no 'buy & hold' capacity purchasing by non-shippers, although broking or short term warehousing may be acceptable if it promotes liquidity
  - End-users / Customers who wish to arrange own access to pipelines should be freely and readily able to do so – pipeline owners should provide open & non-discriminatory access
- Distribution networks
  - As a natural monopoly, retailers should not own distribution networks and pipelines just as the reverse should also apply– full value chain separation is required
  - Retailers & gas users must be able to book capacity via an open access regime as desired.
  - Pricing set via regulated maximums and minimums
- Retail competition – potential new participants must have real options to enter the retail market at every level, from consumer to large commercial
  - The preferred model is to develop an efficient market with many resource owners bidding into a liquid market. Similarly, for consumers to have choice of retail supplier – essentially they organise the logistics of supply, enter into long term contracts for gas, transport, & local distribution, but don't own any local distribution

- Reporting & disclosure requirements, daily/monthly/quarterly/ annual obligations
  - Sales volumes & prices at the hub daily
  - Facilities - quarterly

    - Large contracts – quarterly
    - Reserves – annually

  This would be consistent with the Green Paper recommendations on transparency.

- Full retail choice programme – natural gas customers should be able to purchase their gas from a choice of retailer, which will have open access to the local distribution network. While this occurs in Victoria to some extent, in NSW and Qld the choice is very limited.

Transitional Measures:

Measures as proposed will need to be implemented over time, not overnight even though there is an urgency to deal with the issues.

We propose:

- Establish a National Gas Authority - This could have the characteristics of the Gas Commissioner model recommended by the Victorian Task Force and as implemented in Queensland. The Authority would work towards the development of effective gas markets as outlined and development of a gas industry which balances the export opportunity and domestic requirements. The Authority would have a policy component and an education component to smooth resource development.
- 5 year plan with milestones along the way towards an un-integrated, transparent and competitive market by 2020
- Registering of ‘booked’ volume by destination market immediately
- Export licencing for both gas resource and LNG plants, potentially as an interim measure until domestic markets are fully functioning and ownership concentration issues are dealt with
- “Chinese walls” required immediately between production, transport, & markets functions as a prelude to splitting functions
- To proceed immediately:
    - Removal of all joint marketing arrangements and rights. This was proposed in 2002 in the Parer Report.
    - Reporting & disclosure
    - Mandated transparent hub pricing
    - No preferential allocation to internal marketing arm or affiliates ahead of other bidders. Disclosed bidding and allocation to internal markets and affiliates.
    - Internal markets or affiliates in no way to have an advantage
    - Pipeline and distribution network pricing and ownership regulation
    - Separation of ownership of distribution networks from retail licence and the facilitated entry of new retailers
    - Maximum levels of resource ‘ownership’ and control implemented, with grandfathering of existing permitting only as an interim measure; no further permitting or development approvals in excess of ‘ownership’ limits

In summary

The preferred model is to have many resource owners bidding into a liquid market. Similarly, for consumers to have choice of retail supplier whereby they can if they choose to organise the logistics of supply, enter into long term contracts for gas, transport, & local distribution, but don't need to have any ownership down the chain.

There are many more measures that can be taken within the Federal jurisdiction and in conjunction with the States to reform these broken and oligopolistic markets.