T R A N S C R I P T

STANDING COMMITTEE ON THE ENVIRONMENT AND PLANNING

Inquiry into unconventional gas in Victoria

Melbourne — 2 September 2015

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Mr Martin Jones (sworn), General Manager, Government Relations, CSR Limited.

The CHAIR — I welcome Martin Jones, general manager, government relations, CSR, to the table. Martin, I ask you to step through a short submission, and then we will ask you questions.

Mr JONES — Thank you for the opportunity to speak to you tonight. I should point out that I am a consultant to CSR. I manage government relations on their behalf. My apologies from the company that they were unable to provide a staff member tonight, but any questions that I am unable to answer, I will be pleased to take back to them for a full response.

CSR has significant and modern assets in Victoria, with high-paying jobs. In some cases these businesses are highly trade exposed, and they are dependent on gas for their energy source. In particular the Viridian float glass factory at Dandenong and the Wunderlich terracotta tile factory at Vermont are competitively impacted by gas prices. Gas price is critical to their future. The plasterboard business and the bricks, which is now in a joint venture with Boral, may be able to pass the costs of higher gas prices through to consumers, but the higher the cost of those products, the more likely there are to be substitutes entering the market or higher costs to build houses.

The former arrangements that CSR used for many years to source gas were simply to send out requests for quotations to the retail sector, assess the quotes and run with who had the best overall offer. Those days are well past, and the procurement people now need to have quite a high level of expertise in terms of gas and gas markets. CSR, to secure its future, has had to consider all its options in relation to gas supply, which could include retail, buying wholesale or even upstream participation.

In the current context of the Victorian market, there are essentially only two suppliers at the wholesale level — they are Esso/BHP and Origin. They are the only two currently supplying the market. It is important for market operation that additional sources come on board. We hear the gas industry say, 'We need more supplies'. CSR would say, 'We need more suppliers to make a market'. It is a very lopsided market today.

The key concerns for CSR arise from significant increases in contracted prices seen in the market, the lack of competition and the ability to obtain supply arrangements on a long-term basis that meet the needs of the business. Future investment by the company in Victoria will be dependent on how this market unfolds. I would remind the committee that the great success in the US followed deregulation of the market over there at all stages through the supply chain.

I will conclude my remarks with that and leave you with as much time as you need for questions.

The CHAIR — I want to draw your attention to a couple of points. On page 2 under point 2, part way down the page, it says:

> CSR's expectation is that from 2015 onwards gas prices for Australian businesses will more than double —

and I am interested in over what period —

> and there may be critical gas shortages and outages of 10 or more days. The most immediate impact on businesses and households is from the steep rise in the wholesale price of gas. Households and businesses are likely to respond to higher gas charges by substituting electricity driven equipment and appliances thus fundamentally changing the pattern of gas usage. Of significant concern is the potential for significantly higher network charges if gas demand falls away …

That sounds to me, and tell me if I am wrong, like a negative spiral or an upward spiral of costs.

> Ensuring adequate gas supplies are available in Victoria and on the east coast more generally will be critical to the ongoing competitiveness of manufacturing in the state.

What are the time period over which you are referring to and the likelihood of that occurring?

Mr JONES — In relation to gas prices, they are varying all the time. Because the oil price has fallen, the offers that are in the market today are somewhat less than they were even when this paper was produced. But we have seen significant cost increases already. You cannot contract long term today. It is quite difficult to contract long term. If you are talking two years in Victoria it would not be a doubling of price, but over three to five years in New South Wales, for instance, we would have seen that. Victoria is not appearing to be quite as severe as New South Wales, but we are expecting a 50 per cent increase from where we are now.

The CHAIR — Over what period?

Mr JONES — Looking out to 2020, if we can in fact contract that far out. In relation to outages, that particularly applies to New South Wales. Some work was done early on that suggested that was the case. Then AEMO revised their forecasts. But to get to the point where they said there were no shortages, you had to have demand destruction. They are assuming factories will close to reach that position. Our understanding is that it is not as critical in Victoria, but it certainly is critical in New South Wales, and we are already starting to see South Australian gas will be pulled away from Victoria. If there is demand destruction by industry, then you will start to see a lot less throughput on the network, and the network is essentially a fixed-cost operation, so the unit charges for the remaining producers will go up. You get a double whammy: you get the gas price going up and you get the fixed charges going up.

The CHAIR — To continue on over the page, you make the point:

> The development of further gas resources in Victoria will have a highly material and favourable impact on the availability and price of gas, and therefore on the viability of many of our businesses.

So you regard this as critical, the security of supply and the price?

Mr JONES — In terms of negotiating contracts, everyone thinks about price and everyone talks about the price of gas going up. That is important, but the other terms of the contract are just as important, and that relates to security of supply, so how reliable is the supplier. If that supplier fails, then what provisions has that supplier got or do you have to make — or can you make — in the market to cover it? The glass factory runs for 15 years, 365 days a year, 24 hours a day. It does not stop. If you stop it, you have to rebuild it. A rebuild is $80 million. You can see that the consequences of unreliable or insufficient backup in the marketplace to cover an outage where you have only got two producers are critical.

Mr LEANE — Just taking up David’s last question, you said at the end of your verbal submission around the viability of some of the enterprises depending on the future gas — and I cannot remember if you said market or something similar. Taking into account our inquiry around unconventional gas, and taking into account the evidence that we have been given is that there is no real certainty whether there are any viable bodies of gas that can be tapped into commercially, is that something that, when forecasting future business cases, you just cannot factor in?

Mr JONES — You cannot, no.

Mr LEANE — You cannot factor it in?

Mr JONES — You cannot factor in the unknown. The industry works on different probabilities — 2P, 3P and so on and so forth. That is a sort of a macro thing. We closed the glass factory in Sydney on a gas arbitrage, and some other market issues, but part of it was gas in Sydney was too expensive and we could close that production. We closed it ahead of when that factory was scheduled for a rebuild and brought it down to Melbourne. We have been able to drive our deviser higher in Melbourne and the business is on a much better footing. But every 15 years or so that factory has to be rebuilt. That rebuild is $80 million. The board will have to decide at some time not too far away on whether they are going to rebuild that factory in Melbourne. Should they rebuild it, there are new technology, advanced manufacturing opportunities for that factory as well, which will be additional investment and more jobs. The board will look at a number of things. But in 2013 we analysed the percentage of the gas cost to total production cost and it was 15 per cent with the gas price as it was then. It would be higher today. Gas is a very big input. That will be one of the prime considerations — what kind of contracts can we enter into that take us through the next 15 years?

Mr LEANE — As you said, you cannot factor in the unknown, and your board making those decisions cannot factor in the unknown of any potential unconventional commercial gas enterprises that we do not know.

Mr JONES — Not today, no.

Mr DALLA-RIVA — Thanks, Martin. Good to see you again. Did you ever meet him?

Mr SOMYUREK — We have met, yes.

Mr DALLA-RIVA — You have got two former industry ministers here in some form.

Mr JONES — That is right.

Mr DALLA-RIVA — That is why I was over with Adem before. I was looking at page 3 thinking, 'This is like a submission to a ministerial brief'. You have made an ambit claim for $80 million, otherwise you are going to leave.

Mr JONES — No, we have not done that. I am just pointing out the facts.

Mr DALLA-RIVA — I am sure you are, sir. Because we are looking at unconventional gas, so all jokes aside — —

The CHAIR — Onshore gas; it could be also conventional.

Mr DALLA-RIVA — Offshore, unconventional gas. I am concerned by some of the terminology in here, that your concerns in the report are about gas supply, but not necessarily supply per se but about the lack of suppliers that are available. On page 3, in the fourth paragraph, you state that:

> CSR is agnostic to the supply and development of gas resources by type of field or technology.

Then you go on to say:

> Suffice to say that whatever source or method used …

Further on, under 'Issues and concerns', 'Bring on new gas supply from a multiplicity of suppliers as quickly as possible', you state:

> Bringing on new gas supplies is vital — however, while highly necessary it is insufficient. We have no confidence that development of resources under current policy settings, in the absence of market opening and development reforms, will resolve the crisis in domestic supply.

I am reading between the lines that it is less about gas supply per se and from where it comes and more about gas supply in the marketplace to CSR, and that is part of your decision-making process. As you said, you are agnostic as to the supply and development of gas resources. It is more about the market dynamics. You mentioned that in Sydney. You said that while the gas supply was high, there were also some market forces around as well. You may just want to expand a bit more on CSR's concern around not necessarily gas supply per se — conventional or unconventional — but more about experience in the supply chain network once it is extracted out.

Mr JONES — A lot of the submission dealt with shortcomings in the Australian market. It is a market that is characterised by many buyers and very few sellers. It is a lopsided market. That is the setting. In relation to that market, it is not an informed market, so prices are not transparent. If you take a fully functioning market, you would expect to see spot prices, you would expect to see volumes traded by all sorts of parties, you would expect to be able to see a forward price, you would expect to see over-the-counter, perhaps, participation, and you would expect to see hedging. None of that exists in the market today.

Furthermore, if you go through the supply chain in the market, there are vertical connections, so the pipeline market does not operate as a transparent market with ready access. The players can go into the market and book capacity and not use it. They are not forced to trade it, they are not forced to put it on the market. If CSR wanted to buy wholesale and get into the market, that is a whole other complex set of equations. That is where they are at really, but that is not a transparent or readily accessible market. There is storage in the market that should be disentangled from retailers, from pipelines and from producers. The market needs to be broken up into separate functioning areas with their own buyers and sellers and rules, and the rules need to be set to allow that to happen.

The CHAIR — And information.

Mr JONES — Yes.

Mr DALLA-RIVA — 'Storage in the market' — could you just clarify what that means?

Mr JONES — There are some storage facilities in the market.

Mr DALLA-RIVA — As in?

Mr JONES — Tanks.

Mr DALLA-RIVA — Tanks. So there is excess gas held?

Mr JONES — Yes, not a lot, but there is. But in principle.

Mr DALLA-RIVA — That is to keep the market where they want it to be? Pardon my ignorance. I am trying to get — —

Mr JONES — I would not go that far, but you would not want it to get to the point where they were able to influence the market by withholding gas.

Mr DALLA-RIVA — You have mentioned here 'critical gas shortages' — which the Chair mentioned — 'and outages of 10 or more days'. Is that because of the supply market? I am trying to differentiate for the committee — —

Mr JONES — That is an issue that really relates to New South Wales. The issue in New South Wales is that they do not have any gas to speak of, so they are reliant on imports. All the gas they might have imported is going to go out through the LNG terminals. They have to import gas. On the coldest days there is the prospect that there will not be enough gas. We have had a situation in New South Wales where they cocked up the forecasts, and you get a phone call and 2 hours notice to shut your plant down. That has happened.

Mr DALLA-RIVA — Here?

Mr JONES — In New South Wales.

Mr DALLA-RIVA — Right.

Mr JONES — It happened here too, but that was a major event.

Mr DALLA-RIVA — That is not about supply of gas, is it? That is more about the market.

Mr JONES — At the time that was about forecasting gas, but the concern is that in New South Wales, on the coldest days they cannot get enough gas out of the system into New South Wales to supply all their needs.

The CHAIR — Victoria is a bit different to that, though, because we have a large pipeline system.

Mr JONES — We understand that Victoria is in a better place.

Mr DALLA-RIVA — So it is true in New South Wales, but Victoria does not have those issues about cold days?

Mr JONES — We believe not.

Mr DALLA-RIVA — If they need to ramp up the offshore gas supply — —

Mr JONES — Of course they have to forecast. It takes a long time to come through, to understand it.

Mr SOMYUREK — Just in terms of competitiveness, at what price do you say it is too expensive — the inputs are too expensive because of the manufacturing process?

Mr JONES — Well — —

Mr SOMYUREK — I know it is like, 'How long is a piece of string?'.

Mr JONES — Exactly.

Mr SOMYUREK — Just ballpark.

Mr JONES — The main competition for the Australian plant is China. If you look at the bare economics of China, you would say they probably could not compete. The fellow who runs the glass factory out at Dandenong worked in China in their glass industry, and they can make most things cheaper than we can make them here. So we have some clever supply chain elements that they do not have access to. Again you can put that in the advance manufacturing ballpark if you like, but they design trucks. When you make float glass it is as long as that wall.

Mr SOMYUREK — I have been to Dandenong. I am sure you have too, Chair.

Mr JONES — It is stacked on frames, and they developed these trucks that do not have axles. They back over the frames, they kneel down, they pick up the glass and they deliver it to the customer or to their own processing factories and so on and so forth. They are things it has been difficult for the importers to replicate, and so we build competitive advantage in other ways. In China they make glass from coal or oil. That would not be feasible here at all. With coal it is actually town gas, so they have like a little town gas unit on the back of their glass plants. With oil they just have oil-fired burners. We are not even competing as if they are using gas. They are using other fuels. I do not know. That is a decision the board will make at the time, and it will not just be the price. It will be how confident they feel about supply, supply interruption and what interruption would mean for the business and so on. It is not just about price.

Mr SOMYUREK — Security of supply.

Mr JONES — That is important as well.

Ms BATH — Just an easy one for clarity, Martin. With respect to gas, is it used as a fuel source? So it is not used in feedstock — —

Mr JONES — No, we do not — —

Ms BATH — It is pure fuel.

Mr JONES — Yes. It is a very clean-burning fuel. One of the issues, we believe, for instance, with the glass coming from China, is that the one that is made from coal, there are fine particles that get embedded in the glass and that is the glass that may tend to shatter.

The CHAIR — It is a quality issue.

Mr JONES — It is a quality issue, and it is the same with bricks. You get a much better brick burning gas. The very old brick kilns still have the coalscuttles in them, but you get a much better brick with gas.

Ms DUNN — Thank you, Martin, for your submission tonight. My question is going to be very similar to the question I asked earlier, which is really around the fact that we have heard evidence in this committee that gas demand has already peaked in Victoria. There is a high range of potential risks attached to unconventional gas. There are potential risks to agricultural land, agricultural jobs, waters and groundwater aquifers, and there are health risks. There is a substantial number of elements that have been presented to us as part of the evidence in this inquiry. We do not know even if there are commercial quantities of unconventional gas in Victoria. In your submission it talked about you being agnostic to the supply. My question is: in terms of what we have heard so far about this particular industry of unconventional gas, do you believe that is the best way for you to secure CSR supplies into the future?

Mr JONES — CSR has not really made any judgements about that. If the community was satisfied with those methods of production, if the appropriate safeguards are in place and it was viable to bring on those supplies, and they are economic and attractive and whatever, then CSR's view would be that that would add to the mix and add to a more competitive market.

Ms DUNN — Thank you. I just wanted to pick up on a matter that was raised by Mr Dalla-Riva. Talking about the storage of gas physically in tanks, I am just wondering if you are aware of why that is? Is that about energy security or are there other things at play?

Mr JONES — It is probably partly about maintaining supply to the system. I think in New South Wales there was one built; I think that was about a retailer and its position perhaps.

Ms DUNN — Thank you.

Mr JONES — It is something to watch. We do not think there should be vertical integration all the way through because it allows gaming.

Mr RAMSAY — I just wanted to ask you your view — and the Chair has raised it at a couple of hearings — about the fact that prices might double post-2015, and then potentially you have got a critical gas shortage. Now if my gas bill in the last quarter was any indication, it has tripled already in the last two years comparative to fossil fuel, electrical power. The cost of living will become a real significant issue if the price does what you are foreshadowing.

Mr JONES — Absolutely.

Mr RAMSAY — So is there any option of preserving a domestic price and supply for the market to try and contain the cost-of-living prices for gas. I am assuming the consumer will move away from gas into something else if the price gets to a certain level, and that will create problems associated with the infrastructure. What is your view about that?

Mr JONES — CSR has considered reservation as a possibility but does not support reservation. What CSR supports is getting to the place where the market works, where we have an effective marketplace in Australia. People say, 'Well, you should just take the price that Japan pays'. That is a whole different model up there. Their alternative is to burn crude oil, or fuel oil, or nuclear or something else. If the Australian marketplace was an export and an import market, that might be a functioning market. But it is not. We are not going to import gas. So what you need to have is a functioning domestic market. I know COAG is looking at that and they have asked for a pricing hub to be established and all the rest of it.

The Henry Hub in America was set up by the industry. That was delivered by a need the industry had. But if you only have got two suppliers, they do not need that. What we need more than anything is a functional market. You might want to have some transitional steps for new development, so that maybe new development has to go into the Victorian market until such time as it is a fully functioning market. Perhaps there are some concessions by the government on royalties during that period. There are some options that government could consider.

The CHAIR — Thank you for your presentation. The secretariat may well be in contact. I want to make sure that an invitation is extended to Jeremy Sutcliffe, your chair.

Mr JONES — Yes.

The CHAIR — And to your CEO, Rob Sindel. We are very happy that you were here, but I am also conscious that some of these comments may be things that they may wish to add to either verbally or in writing. It was a very good presentation. Thank you very much.

Committee adjourned.