The Senate Economics Committee

1. About CSR Limited

CSR Limited has been operating in Australia for 153 years. The company is a leading diversified manufacturing company with operations throughout Australia, New Zealand, China and South East Asia and employs over 6000 people. In 2009 trading revenues were $3.4b. The company essentially operates three manufacturing divisions, comprising Building Products, Aluminium smelting, through our shareholding in the Tomago aluminium smelter, and Sugar.

Our Building Products' Division is a leading supplier to the residential and commercial construction industry - supported by a nationwide distribution network. It manufactures well known brands such as Bradford ™ Gold glass wool insulation, Viridian™ flat and energy efficient glass and downstream products, Gyprock™ plasterboard, Cemintel™ cement sheeting, Monier™ and Wunderlich™roof tiles and PGH™bricks through 35 wholly-owned or majority owned manufacturing plants in Australia and operations in New Zealand and Asia.

CSR Sugar is the 6th largest sugar company in the world and the largest raw sugar producer in Australia, operating 7 mills in northern Queensland. Australia exports 85% of the raw sugar production and CSR through its joint venture with Mackay Sugar Limited exports about 30% of our refined sugar production. The company is the sixth largest generator of RECS under MRET. CSR Ethanol is centred on production in Sarina, Queensland and mainly produces fuel grade bio-ethanol for the Australian market.

The Tomago Aluminium smelter, of which CSR has an effective interest of approximately 25%, is the second largest employer in the Hunter Valley with 1200 direct employees and generates $1.5b pa in sales of which 85% are exported. It is the 10th largest smelter in the world. The facility consumes around 900MW of power supplied by Macquarie Generation.

CSR Limited has very broad range of activities impacted by this legislation. As a renewable power and fuel generator we are impacted by the RET Scheme. Our insulation and glass divisions can help provide solutions to improve energy efficiency in the built environment. As manufacturers we consume large quantities of natural gas and electricity, producing many products which are trade exposed.

2. Background to CSR's submission on the Scheme

As noted in our previous submission to this committee, CSR has consistently supported a preference for a broad-based emissions trading scheme, with an early introduction to provide business certainty surrounding future investment decisions. The timing should be set by that which is required to ensure the scheme is workable, effective and efficient. We have also supported the Government's election policy that trade exposed industry's international competitiveness should not be compromised by the introduction of emissions trading. An emissions trading scheme was seen as a method that would encourage the lowest cost way to reduce emissions with appropriate transitionary assistance that did not disadvantage the trade exposed sector. We encourage the Government and opposition parties to move forward with the legislation by resolving the serious outstanding issues and complexities and passing the Bills.

During the time frame that the White Paper and the Draft Bills were released we note the initiatives of the Federal Government which have impacted on our businesses. The Nation Building Packages, with measures to improve the levels of insulation in housing were welcome as a jobs stimulus and as an energy savings measure for householders. Furthermore the recent uplift package for CPRS gives some recognition to the difficult financial climate. It provides more time to get this legislation right, allows more time for companies to prepare, acquire knowledge and skills, and to develop and invest in the systems that will be required to do business in a carbon constrained world. The uplift factors and $10/t carbon tax recognise the overlay of the difficult business environment on top of the transition faced by the trade exposed sector.

3. The major issues still facing CSR Limited in relation to this legislation are:

a. It is not yet clear what the level of transitional assistance will be for CSR's trade exposed businesses at the time of this submission

Draft regulations have not yet been made available for those businesses which have completed assessment and pre-assessments are not complete. Given that the transitional assistance process is not regulated and there are no rights of appeal and combined with the high degree of ministerial discretion in finalising assessments, it is important that these draft regulations be made available at the time the bills are debated, at least for the Senate.

Late changes in activity definitions have meant delays to data submission, again delaying any prospect of seeing draft regulations for certain activities coincident with debate on the bills.

Furthermore those entities seeking to use value add are significantly disadvantaged compared to those using revenue as a determinant for transitional assistance. Once again this is not a regulatory process. However the bills should not be passed until this major issue is resolved and the entities using this process can see whether the outcome as determined in draft regulation is acceptable.

b. The impost of RET upon Aluminium Smelting is disproportionate to other sectors.

The draft regulations for the aluminium smelting sector are also not presently available and so a full assessment of the measure cannot be made. Aluminium is an electricity intensive industry and stands well above any other sector for its power use. The measures proposed in RET for exemption for most industry would be welcomed. Both the CPRS impact and RET must be assessed concurrently to determine the impact on this trade exposed industry. However for Aluminium, the RET obligation is more than double the existing MRET impact. Using a CPRS methodology for Aluminium is not workable for RET. Aluminium faces the prospect of increasing imposts from the CPRS Bill (how much is unknown until the draft regulations are published) and from RET, both in terms of the increased size and cost of the scheme. This will significantly impact the international competitiveness of the Australian industry and limit expansion prospects as this is a cost not yet born by international competitors. The impact of both schemes have to be looked at together as they both drive electricity prices. Initially it is expected that RET will do the heavy lifting, but over time this may shift to the CPRS. Just as the Government has recognised the need for transitional assistance under CPRS, the assistance measures under RET need further consideration. For electricity intensive processes the

treatment under RET needs to be different from that proposed for CPRS. The cost burden under RET is much greater than CPRS.

CSR supports the proposal of the Australian Aluminium Council that the exempt portion of the scheme be extended to cover the full obligation. Thus Aluminium would be exempt from 90% of the obligation across the original target and the new target.

4. Main shortcomings based on assessment of the Bills

a) There is still no prescribed methodology to balance the national allocation of permits between households and industry. Consequently the balance to trade exposed industry on the basis of emission intensity bears no relationship to loss of international competitiveness. The emission intensity hurdles are arbitrary. Segments which are almost 100% trade exposed and just below the arbitrary cut off will receive no assistance. The balance should be re-dressed such that all trade exposed business receives a full allocation of permits.

b) The treatment of trade exposed industry is a critical instrument of this legislation to hold Australian industry competitive, avoiding premature closures and encouraging ongoing investment and modernisation, so keeping jobs in Australia. If Australia is to make the transition successfully, it will require investment by industry to restructure and modernise to reduce emissions. Industry can only do this if it has adequate earnings to generate such investment. An incorrect balance of permits will achieve adjustment by closures, a least preferred outcome in the national interest, especially if no global savings in emissions occur.

c) Elements of the trade exposed treatment, dealing with value add provisions, if carried to regulation are inequitable with those energy intensive trade exposed facilities treated on a revenue basis.

   This gross inequity is caused by having a hurdle determined by one accounting methodology and an assessment against that hurdle driven by a different or proxy accounting methodology.

   The White Paper policy document correctly identified that for some industries, where raw material costs are a very high proportion of finished product prices, the revenue method of determining an administrative allocation of permits was unsuitable. Furthermore the policy also correctly assessed that a value-add method of determination would be suitable. Refined sugar is one such activity.

   Analysis by the Department of Climate Change also correctly concluded that a suitable hurdle for the value-add determination would be to multiply the revenue hurdles of 1000tonnesCO_2/$m revenue and 2000t$CO_2$/$m by three. Thus the hurdles for the value add methodology become 3000tonnesCO_2/$m value add and 6000tonnesCO_2/$m value add. Value add is defined this way as ***Revenue less Operating Costs plus Labour***. This is consistent with the Australian Bureau of Statistics Australian National Accounts: Concepts, Sources and Methods, 2000. Checking against many of CSR's other business activities confirms this three to one ratio is reasonable when based on national accounts methodology.

The White Paper and both pre-assessment and formal assessment papers then change the rules for the assessment process in a way that is inconsistent with the hurdles. ***The assessment criteria are Revenue less Significant Non Capital, Non-labour Input Costs***. This is a poor proxy for the ABS Methodology. The pre-assessment and assessment processes further limit the deductions to the five main raw material and energy inputs, diverging further from the ABS basis. A small change in costs has an enormous impact on entitlement. For instance, a 5% to 6% removal in costs can discount the calculated emissions intensity by 35% to 50% for the activity.

The gross distortion is obvious from this simple example. It is inequitable to persevere with one section of industry being treated at a disadvantage to others.

This does not appear in the Bills, but is a crucial element of the CPRS and must be addressed before the Bills are passed. A full allocation to trade exposed industry without an energy intensity test would overcome the need for a value add measure. Alternatively the proxy method should be replaced by the ABS methodology.

d) The impact on small and regional trade exposed industry has not been investigated. The Climate Change Adjustment Fund is not a solution for these businesses, although it may help re-equip small business in some cases. However it is not an adequate measure to hold companies even on trade exposure. CCAF grants are likely to be taxable and so the full benefit does not flow through to recipients. There are no details in the bills in relation to CCAF and how it might work and the qualification process and what exclusions will be included. This is a key part of the package.

e) The Productivity tax of 1.3% serves no function than a tax transfer to government. Industry is still incentivised to act regardless of the decay factor and it should be removed.

Other issues which require amendment are contained in the appendix.

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Appendix

Other Issues Requiring Amendment

1. Objects of the Act should include other provisions such as:
    i. To impose a price on emissions
    ii. To offset competitive disadvantage for trade exposed industry
    iii. To replace existing measures such as EEO and cross alignment with NGERs

2. The OTN provisions have been improved over the draft bills, however they favour energy suppliers over energy users. This will reduce the effectiveness of the scheme and drive up the costs for large fuel using entities.

   A large non liquid petroleum fuel using entity should be able to opt in voluntarily to its fuel supplier if any **entity** under its operational control has a mandatory obligation. The upstream fuel supplier is providing two prices under the one supply agreement anyway, so there is no burden to the supplier.

   Providing this measure, allows corporate groups, rather than specific facilities to take control of their own emissions and increase participation in the permit market. Corporate groups make contracts, not necessarily facilities. In this case there is no need to specify in regulations a tonnes threshold (clause 56 (1), (c). Reducing the number of players or the participation by controlling corporations to only its large fuel facilities, when in fact the controlling corporation's aggregate demand might be large, increases the power of fuel suppliers in the carbon market. This is undesirable from a market efficacy point of view and in terms of controlling corporations and entities engagement in price discovery and abatement activities.

   It now appears there is no provision at all for the use of OTN for consumers of petroleum fuels for combustion purposes (clause 52(1) (a)). However, small users obtaining fuel for non combustion purposes will need to quote an OTN where it is used for blending etc (clause (58)). Due to this inconsistency, petroleum companies will be required to provide OTN's for some companies, but not large users. It would appear to be straight forward for all parties to have access to OTN's from petroleum fuel suppliers and this is again desirable to broaden and develop the market and have emitters wherever possible taking responsibility for their own emissions. The fundamental premise of CPRS is market discovery and Government should not be inhibiting this through regulation.

   Thus a new clause 66(4) is recommended:

   (4) The regulations made for the purposes of this section must:
   (a) specify objective criteria for the circumstances under which a supplier may reject the quotation of the recipient's OTN in relation to a supply; and
   (b) provide for the recipient to have a right to appeal to the Authority against a rejection of the recipient's OTN in relation to a supply and for the Authority to have the power to make a binding determination on the issue.

3. GST is applicable to these transactions. No government should gain a windfall arising from this scheme and the Federal Government must ensure that permits are GST free, as is the case in the New Zealand scheme.

4. Back dating of avoidance measures is inequitable. There are circumstances where operational control has been determined in a certain way, but which under a CPRS legal framework would have been constructed differently. Entities could be accused of avoidance by altering a fact of history. Sometimes in association with avoidance issues, assets in one entity cause that entity to trip. However those assets may be used solely for the purposes of a third party and had they been associated with the third party the original entity would not have tripped. Entities with these assets now inadvertently have a liability, which if setting up under a CPRS environment would be established differently, and would not have such liability for these emissions. Thus a distortion can be created between competitors. Where the primary emissions cause such an entity to trip, provision should be made for exemption.

5. The Bills offer little incentive to develop a biofuels industry with petrol exemptions for motorists. A new excise policy for petroleum fuels based on energy content and carbon footprint is recommended as a complementary measure.

6. Removal of transitional assistance should not be solely based on the status of our major trading partners, but should be heavily weighted towards those nations which compete with the activities receiving assistance. This may or may not include major trading nations.

7. Requirements for a financial license to deal in permits by liable parties are unduly onerous. Simpler means for liable parties to buy and sell permits must be found.

8. The situation with Liability Transfer Certificates remains unclear despite Government consultation efforts, particularly in relation to unincorporated joint ventures. There is still inadequate time to research this issue fully.