



**Public Submission to ACCC
Water Market Rules Issues
Paper**

By

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1. Introduction

The NFF welcomes the opportunity to provide comments on the ACCC's *Water Market Rules Issues Paper*.

Since 1994, when the first COAG water reform agenda was developed, a high priority was placed on the development of a water market that would assist in ensuring water is used for its highest value use.

Creating the market conditions that assist in ensuring that the water market operates in an efficient and sustainable manner continues to be an aspiration of Governments being enshrined in the National Water Initiative (NWI) and further linked to investment under the Water for the Future plan.

NFF supports the basic principle that water property rights should be tradeable and that any barriers to trade tend to diminish those property rights. However, it must be acknowledged that trade from group schemes can create unintended consequences such as third party impacts and increased costs on the remaining irrigators.

NFF generally supports providing water access entitlement owners with the trade conditions that enhance their water property right allowing by them to maximise business opportunities and financial returns.

A fully efficient and functioning water market is also dependent on market information. This point is noted by the ACCC in the issues paper, i.e. market information contributes to "well informed decision making on the part of market participants". NFF has concerns that the operation of the current market is being undermined by a lack of transparency and market information, particularly relating to the participation of Governments in the purchase of water.

2. Water market rules

The NFF notes that this issues paper deals with those market rules affecting "collective" water access entitlements¹, such as the irrigation corporations, private irrigation districts (PIDs) or schemes and trusts – and referred to by the ACCC as "infrastructure operators". These organisations hold a water access entitlement(s) on behalf of their shareholders, members or beneficiaries.

Individual irrigators generally hold formal linkages to the water access entitlement of larger infrastructure operators through such mechanisms shares or supply contracts. Irrigators within smaller infrastructure operators may not have formal linkages with the infrastructure operator's water access entitlement. The rights of these irrigators, in particular, are most at risk.

Most of the trade water reforms has been concentrated on the large infrastructure operators, and include such things as tagged entitlements, a 4%

¹ The term collective license (such as private and semi-government irrigation corporations, private irrigation districts and trusts) will be used in this submission to describe a license held on behalf of the constituent individual irrigators.

cap on the external trade of water and the implementation of access termination fees.

Generally, smaller infrastructure operators have not been required to implement trade reforms. Smaller infrastructure operators generally permit annual and permanent trade into the group scheme and frequently prohibit permanent trade out while conditions may be imposed for external annual trade, e.g. the approval of all licence holders.

In some case the issues face by smaller operators may be regulatory, such as the requirement to be an incorporated organisation and the lengthy delays and high cost of any legal complications.

NFF believes that regardless of the operator's size, consistent market rules should apply and for buyers and sellers to have equal opportunity to trade in or out of a group scheme. However, as in the larger infrastructure operators, small infrastructure operators must be provided with the time frames and tools to assist adaption. For example, smaller infrastructure operators must be able to provide a 4% cap on external permanent trades out and the ability to impose access termination fees. There is also a strong case for government assistance for smaller operators to help them reach the required standard of compliance.

The NFF notes that the majority of water owned and used across the Basin is held by large infrastructure operators. In the NSW Murray for example, 80% of the surface water is owned and used by Western Murray Irrigation and Murray Irrigation. The situation is similar in Victoria with Goulburn Murray Water and in South Australia where the larger trusts such as Central Irrigation "hold" the majority of the water.

As a result, there has been a concentration of water reform activities (e.g. access termination fees, tagged entitlements and the 4% permanent trade rule) on these larger water access entitlements in an attempt to free up the trade of water.

These larger infrastructure operators also have more resources (both human and financial) at their disposal to put in place the necessary changes to facilitate trade. Unfortunately, however, there is not an equal weighting of the application of water reforms across state boundaries and across all infrastructure operators.

3. Water market and trading objectives

Transaction Costs

Transaction costs are a legitimate activity to provide an agreed and efficient standard of service. The basic services should include:

- The cost effective and efficient transfer of water;
- Up to date and readily available market information (i.e. on a well publicised and publicly available website) and with possibly user accessible and friendly calculators (e.g. similar to financial websites that provide a calculation of the principle and interest over the lifetime of a home loan);

- Standardisation of Government and operator charges across all states in Australia; and
- Users should be able to track the progress of trade approvals via the internet.

Unfortunately, many of the activities of the service providers in undertaking the trade of water are costly, ineffective and antiquated. Water users should not be paying for the cost of an inefficient service. As an example, temporary trades still require original hardcopy documentation and it is quicker to drive a car from say Deniliquin to Adelaide to complete the trade approval process. This is not trade in the 21st century and nor should the owners of water accept this standard of service.

NFF supports the ability for irrigators to hold a number of water access entitlement products (e.g. NSW general security, Victorian water right or SA Australian entitlement). However, at present there is no ability for these water access entitlements to be linked to a single delivery point to enable single billing for water charges. Furthermore, each delivery operator should be required to facilitate the delivery of water allocations against these different water access entitlements.

Externalities

Resolution of environmental third party impacts by use of a separate externality is not and should not be the role of the water market. The water trading market should reflect the price that the buyer and seller are willing to agree upon for the asset being purchased. The cost of environmental externalities are already accounted for in the price that irrigators pay (noting that not all states have implemented this) for the delivery of water, i.e. fixed and or variable water delivery charges. In NSW for example, IPART noted in its 2006 water pricing determination that "in its assessment of NSW's compliance with the National Competition Policy the National Water Commission has stated:

For rural systems, New South Wales has reported on the extent to which governments are identifying and recovering environmental costs through their pricing regimes. It is noted that in rural systems, externalities are addressed through resource management costs incurred by the Department of Natural Resources, excluding those related to policy development and ministerial and parliamentary services and passed on to water users through bulk water prices.

Based on the above information, the Commission considers that New South Wales has met its COAG commitment with regard to reporting that the recovery of costs by rural water businesses includes the recovery of environmental externality costs."²

Therefore, it is unnecessary for governments to implement trade rules to provide for externalities. Any issues that may arise from the use of water at a particular site (e.g. salinity) must be dealt with through the water use license that remains attached to the land.

Governments have considered the appropriate actions for providing water for the environment. Any adjustment to the sharing of the available resource will be

² 2006, Independent Pricing and Regulatory Tribunal, Bulk Water Prices for State Water and Water Administration Ministerial Corporation from 1 October 2006 to 30 June 2010, Water Report Nos 4 and 5, September 2006, Sydney.

undertaken by the purchase of water entitlements from willing sellers or through investment in infrastructure efficiencies. Governments should **not** impose further unnecessary and inappropriate policy and regulatory burden on water trade through new specifications of water property rights to resolve this issue.

4. Restrictions that should be permitted

Use of water

Constraints placed upon trade of water based on the use to which the water would be put are not acceptable. NFF accepts that the use to which water will be put should form part of the assessment for land use (i.e. the water use licence) and conditions established that will attenuate any possible environment impacts. NFF does **not** accept that land use assessment is part of the assessment for the trade of water on either a permanent or annual basis.

As an example, an owner of water should be able to hold an indeterminate volume of water. However, in establishing the licence that allows the application of water to a particular parcel of land (i.e. the water use licence), environmental considerations are appropriate, such as deleterious impacts on water tables or salinity. Mechanisms that attenuate these impacts must form part of the water use licence assessment for that parcel of land, e.g. maximum hydrologic loadings per hectare, high technology irrigation systems on farm such as laser levelling, farms dams and full reticulation of water.

Restrictions on to whom the water can be sold

According to a well established water broker in South Australia, up to 30% of his clients want to veto where their water can be sold, e.g. the water cannot be sold interstate. This is an unnecessary constraint of trade by individuals let alone those established by infrastructure operators to prevent speculative behaviour or concerns about the loss of water from an area.

Actions by sellers to control who purchases the water access entitlement are flawed. One purchaser may be acceptable, but that person may on sell the water access entitlement to a second person who may represent the original seller's prohibition list.

Furthermore, loss of control of the purchase is irrelevant in a society where it is standard practice to have bids place and accepted via phone or anonymously via agents (this is common with real estate auctions). In some situations, the buyer may not even be aware until or after contracts are exchanged.

Water Exports

NFF's earlier comments regarding tools, timeframes and assistance for small operators to adjust to implement water market reform should be noted.

Access termination fees and or exit fees

Access termination fees (ATF) are a legitimate fee, endorsed by the ACCC, to address the concerns of the remaining members of a group scheme. However, the calculation of these fees should be standardised to prevent their use as trade barrier.

For private corporations whose water delivery clients are the same group as shareholders, there are clear obligations to provide water delivery for least cost. In many situations, although 80% fixed cost businesses, in some cases a large proportion of the costs of the business are recovered from variable charges. This directly influences the fixed charge and the calculation of the ATF, as can the provision of funds for replacement of assets. The wide variation on the level of ATF across state borders raises a number of concerns about how the ATF calculation could be better aligned so as not to present a barrier to trade.

NFF suggests that the MDBA should have a role in standardising the calculation of the ATF across Australia.

Minimum water holdings

In some situations, the trade of all water from a particular landholding can be limited by the requirement for a minimum volume of water to be retained.

With declining terms of trade in many irrigation areas, multiple farms are often owned by one business. There may be no real requirement to leave a minimum provision of water attached to any particular farm.

NFF supports the assessment of these situations on a case by case basis rather than a blanket rule for all irrigation farms.

Other export barriers

NFF does not support the concept that all classes of water should be tradeable. The ACCC issues paper notes some examples such as town water supplies, stock and domestic, dam fills and so on. This water is essential water for life – human, stock and native fauna. This water is not licensed nor is it a property right. This water is provided prior to any water being made available to tradeable water access entitlements (used for commercial purposes). In some cases, the trade in this water may put at risk the very uses to which the water is made. As an example, the sale of town water supplies could put at risk the availability of water for human consumption. However, the sale of surplus town water supplies may be acceptable, providing an appropriate plan is in place should the town use all the remaining water.

Within a group scheme, provision of water (e.g. dam fills) to member and or non-members may be at the discretion of the infrastructure operator and would rightly require the payment on a fee for service basis.

NFF supports the removal of barriers to trade. In some cases, infrastructure operators and Governments are concerned about the loss of water from the water source or area. However, actions would be better targeted to education of irrigators to enable them to act in the market with confidence and for these regions to develop opportunities to attract water. This latter outcome was recently agreed at Griffith in NSW where organisations met to discuss this issue.

Delivery capacity shares

Whilst the ACCC issues paper discusses the water market rules for water trade, there is no consideration for the trade in delivery capacity shares. Instead of the

withdrawal of services to a particular irrigation farm, that farm could instead chose to sell to another irrigator, all or part of the delivery rights.

This has distinct advantages to both irrigators and infrastructure operators. For the operator, the continued payment of fixed charges will alleviate the issues surrounding stranded assets.

Irrigators could gain the ability to access higher volumes of water at critical peak delivery times when water delivery is constrained by channel capacity. Retention and or sale of delivery capacity shares also provides flexibility for irrigators, particularly young farmers and new entrants.

Bad Debtors

However, the downside for infrastructure operators, and the driver for the payment of access termination fees is the risk or increased exposure of infrastructure operators to bad debtors. This is of concern in times of economic downturn such as is being experienced now, for example, irrigators won't pay their water charges until water is required on farm (in most instances water is unavailable if the account is not settled). Drought over the past six years has exacerbated the situation and increased the exposure of the operators, culminating with Murray Irrigation's recent announcement to mandatorily require payment of the ATF on the sale of each access entitlement.

NFF suggests that this exposure may be attenuated by the establishment of a body similar to the Export Finance Insurance Corporation to underwrite bad debts for a period of say five years. The scheme could be administered by the MDBA and establish agreed credit standards with the operators. Compliant Infrastructure operators would be indemnified and irrigators would be provided with the flexibility urgently needed. This reform may also negate most of the issues in 4.4.2 of the issues paper.

Administrative fees and charges

As a general principle, all administrative fees and charges should be based on the recovery of the costs of an efficient service, whether this is government or infrastructure operator.

In many situations, Governments in particular claim that the fees and charges do not recover the costs of providing the service. NFF suggests that irrigators should not be required to pay for antiquated systems that are labour intensive or require hardcopy approvals of trades. In the electronic era, where ASX shares are traded electronically, so should water.

In relation to particularly annual trades, irrigators are required to pay several different charges in order to effect the trade as well as a commission to the broker for the service, whilst there remains little requirement to transact the dealing in a timely efficient manner.

Cut off dates and trading seasons

All cut off dates and trading seasons should be scrutinised on a regular basis by the MDBA, including the operational reason for the cut off date or trading season and to determine if there is another way of achieving the objective. As an example, State Water in NSW has shut the irrigation season down one month

early for the last two years in an endeavour to balance the end of season water accounts. This objective would be better achieved by improving the systems that provide the information required, e.g. use of telemetry to remote read irrigation meters and record water usage³.

A similar issue is the time required at the end of the season to finalise particularly annual water trades. This inevitably comes down to a resourcing issue (both human and systems), i.e. those organisations approving the trades require time to complete this process each year. Again, investment in appropriate systems would alleviate the need for an end-of-year cut off date.

It should be noted that the season can change rapidly in May and early cut offs impede the ability for irrigators to maximise the use of water, e.g. acquiring carry over water for risk management or the sale of water no longer required.

5. Actions that should be required

Terms & conditions for transformation and/or trade

The rate of change faced by irrigators over the last five years has left the majority of them confused and overwhelmed. This can lead to unintended consequences, particularly when the change is not well developed.

Within the irrigation corporations, the change to access and delivery entitlements has created unforeseen challenges for irrigators and infrastructure operators alike. Constant changes in the rules by both governments and operators are a major problem for long term planning, business continuity and sustainability.

In the case of smaller infrastructure operators, there may be no clear contractual arrangements between the member and infrastructure operator leading to a situation where the roles and responsibilities of each may not be properly understood. This also leaves irrigators both within and outside the group scheme confused with different rules applying to different group schemes and confusion in the operation of the water market.

Again, as previously noted in this submission, assistance should be provided to small operators to aid implementation of change.

Where an operator has monopoly powers in the supply of water to irrigators, there should be an obligation on the operator to supply water on reasonable commercial terms to those irrigators even if they are not members. In some situations, it may be appropriate for different contractual arrangements (including the agreed price of the service) for delivery of water to non members from those that apply to members. Such contracts would include clear roles, responsibilities, obligations and costs of both the infrastructure operator and the non-member seeking delivery of water. Additionally, water delivered to non members through infrastructure operators may assist to attenuate the impacts and concerns of stranded assets through the external trade of water.

³ Any reference to metering in this example is done so in the context of demonstrating the use of technology. NFF does not support metering of basic landholder rights.

As a general principle irrigators should be able transform their irrigation right into a water access entitlement (i.e. remove it from the collective licence to a separate licence). This should not enable the irrigator to avoid the charges that face the other irrigators that remain in the scheme. A "transformed" irrigator may hold delivery entitlements with the operator and may be required to pay opportunistic water access charges if they don't.

Irrigators that acquire access entitlements from outside the scheme should not be required to transform those entitlements back into the scheme in order to access the water through the infrastructure operators' delivery system. There should be clear contractual arrangements (the rules relating the water delivery service and the costs to be applied) provided by the infrastructure operator to deliver the annual allocations from these access entitlements that parallel closely the charges paid by members.. Any variation must be justifiable in terms of the delivery of service.

Administration

Both permanent and annual trade processes can be an administrative nightmare for many irrigators. There are a multitude of different application forms, approval processes and procedures, along with varying costs at each step of the way.

From this perspective, there is merit in having standardised administration, particularly forms, across jurisdictions and infrastructure operators resulting in a more streamlined and efficient service.

For many irrigators, the time taken for transformation and or trade can be a trade barrier in itself; but more importantly, it can place the seller and buyer in a situation of disadvantage. For example, a sale that takes several weeks or months to complete may see the sale price change markedly over that time.

If the sale does not proceed on some administrative grounds, then the buyer may lose money (as the price for water has decreased) or alternatively, the seller may be forced to pay a higher price than should have been incurred. A good example occurred when the NSW Government resumed water in October and December of 2006. Annual trades were deliberately held over on anticipation of the decision and then withheld from the approvals process.

Consequently, NFF supports the establishment of time limits for these transactions and should apply to jurisdictions as well as all infrastructure operators. This average, longest and shortest trade statistics should be made publicly available to assist irrigators make informed business decisions. This is of major importance for the annual trade of allocations which is where the vast majority of water trade transactions occur.

Operators' registers and accounts

Irrigators, for many years, have called upon Governments to implement full electronic trades and this would be facilitated by the interoperability and/or compatibility of the various registers (for permanent trades) and accounts (for water assignments/trade of annual allocations). The current situation is a multitude of systems, registers and accounts that can only ensure that

transformation and/or trades (both annual and permanent) are time consuming, inefficient and costly.

To take the situation further, irrigators should be able to access a system where they can retrieve and track their own details electronically or to track their transformation or trade. The latter would provide them with valuable information about where the transaction is, who may be holding up the approvals process and allow the irrigator to make enquiry directly to the person/organisation responsible. This does not necessarily mean that all the information be accessible for a transformation/trade, such as names and addresses. In particular, what is available generally to the public should also be limited.

Market Information

A successful water market cannot operate without market intelligence (information). All participants require some information on which to base a business decision. Past and current programs to purchase water directly from the market (through brokers or tenders) have highlighted the deplorable lack of information. With the Federal Government poised to enter the market with \$3.1 billion, it is essential for information to be provided to market participants.

NFF calls upon all Governments to establish an internet based information service that lists their activities in the market. Information that would assist informing the market includes total water required, prices paid (minimum, maximum, average) on a daily basis. This facility could be developed and administered by the MDB Authority or the NWC. All agencies and statutory authorities must be required to submit its activities for listing.

Brokers, agents, and to some extent infrastructure operators should be required to supply trade information to this central register. The Australian Stock Exchange could be used as a template to provide water market information.

The current information void has the potential to discredit the whole Australian water trade industry.

6. Financial implications of water market rules

Mortgageability of irrigation rights

Water rights held by irrigators within group schemes have been well regarded by financial institutions as security for lending arrangements. Financial institutions have dealt with this situation for a long period of time. There is little to suggest, anecdotally, that this situation has changed.

Financial institutions are more likely to be concerned that the water received by an individual is eroded over time as a result on ongoing and continual water reforms. This situation is likely to lead to an individual business having a reduced ability to maintain and improve productivity on farm, leading to concerns about the businesses ability to meet its ongoing financial commitments.

Tax Implications

There are a number of likely taxation implications. For annual allocation assignments, while there is no tax on the water itself, there may be GST on any service charges applied to the trade.

For permanent water trades and particularly for transformation, there are a number of taxation issues that arise. Of particular concern would be the loss of FBT exemptions for pre-1986 water assets when “transformed” to a “new” water access entitlement.

Additionally, with infrastructure investment, there is a number of differing taxation implications depending on the treatment of the transaction.

7. Application and implementation

Implementation of water reform to the water market has focused on the larger infrastructure operators to date with small operators being quarantined from the requirements to implement the National Water Initiative reforms.

Achieving reform of the water market as a whole must allow irrigators within all group schemes the same opportunities for trading water in or out of the group scheme. However, for smaller operators, there remain significant challenges including resources to implement change.

Smaller operators must be given the same opportunities as the larger infrastructure operators, including the 4% trade cap, access termination fees, as well as the time and resources to implement change.

8. Other issues

Irrigation licences (as opposed to water access entitlements)

Where an infrastructure operator holds water licences on behalf of its members, shareholders or beneficiaries, there must be mechanism or process to consult with and to seek the approval on the disposal of the water access entitlements (or licences) that essentially are held on behalf of individual irrigators.

Brokers

Irrigators have called for the establishment of a licensing system for water brokers. The National Water Commission recently released a report that stopped short of making this mandatory.

It is unfortunate that with the licensing and protocols established for real estate agents, Accountants and Solicitors are not applied to water brokers.

If water brokers were licensed and required to comply with set standards, this would provide confidence to market participants.

If full transparency is required by the remainder of the water market, then this must be extended and applied to the behaviour and actions of water brokers.

9. Conclusion

NFF notes that the ACCC water market rules issues paper concerns the trade and transformation of water held by infrastructure operators on behalf of its members. As a general principle, all buyers and sellers must be afforded the same opportunities for the trade of water.

In many situations, the current rules of infrastructure operators are intended to reduce third party impacts on the business, its members and community. Hence, there must be a requirement for a socio-economic analysis of these impacts as well as targeted assistance for small operators to assist the transition process.

Water market trade rules are first step, with development of water trade rules to follow. NFF looks forward to providing consider responses to the issues to be raised in the development of water trade rules.