

# ACCC MDB Water Inquiry - Stakeholder feedback form

The ACCC is seeking feedback in response to the issues raised in its [interim report](#), and encourages stakeholders to provide a submission. This form aims to assist more stakeholders to provide feedback. It summarises the ACCC's preliminary conclusions and options for reform, which are available in full on pages 34 to 37 of the interim report.

You can provide a submission or respond using this form, to [waterinquiry@acc.gov.au](mailto:waterinquiry@acc.gov.au). Submissions are requested by 30 October 2020.

The Inquiry is a public process and written submissions will generally be made available on the ACCC website. However if you do not want your personal information (e.g. name and contact details) to be disclosed, please let us know and we can take steps to redact your personal information before placing your submission on the website.

The ACCC can accept a claim of confidentiality from a party if the disclosure of information would damage their competitive position. If you wish to claim confidentiality over all or part of your submission, please identify the relevant parts of your submission and explain why disclosure would damage your competitive position.

## About you

<b>Name</b>	
<b>Occupation</b>	Argyle Capital Partners
<b>Town/region</b>	MDB operations near Hillston (Lachlan), Griffith (Murrumbidgee), Mildura (Murray).
<b>Would you like the ACCC to block out your personal information (e.g. name and contact information) so that it does not appear on the ACCC's website?</b>	Yes

## Conduct of market participants

### **The ACCC considers there is insufficient regulatory oversight, and enforcement and compliance activity, in relation to some practices of some market participants**

The ACCC's preliminary view is that market integrity regulation needs to be improved and that regulation should be introduced in the case of water brokers. Additional regulation could be introduced to cover other market participants such as investors and IIOs.

The ACCC has identified three options for improving market regulation:

- a) Introduce a government-initiated licensing scheme for intermediaries
- b) Apply the financial regulation framework to all water products, which would be relevant to the activities to a range of market participants
- c) Establish an independent market-focused government regulator, which would enable the regulation of market participants such as intermediaries, investors and IIOs.

### **Feedback on options to improve market regulation**

In our view, the option of a government-initiated licencing scheme for intermediaries would be the most preferable approach. We envisage this may be similar to state government licencing of real estate agents – and many water brokers would be familiar with this type of requirement as many

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have emerged from real estate agencies (post the unbundling of water entitlements from land titles).

A government regulator of market intermediaries, investors and IIOs represents a considerable over-reach relative to other agricultural input and produce markets. Water is also not a financial product.

Water markets are conducted by private treaty. All trades (or transfers, except within IIOs) have to be approved by state government water agencies (and titles agencies). There is no necessity or compulsion to use an intermediary - water broker, water broker portal or exchange to conduct a trade.

Increasing the regulation of water brokers – and resulting higher costs execution of trades via intermediaries - may in fact encourage more direct buyer to seller trades (without the involvement of an intermediary) which may result in lesser transparency across various water markets.

Farmers are quite accustomed to selling their produce and purchasing their farming inputs in private treaty markets. They do not seek to have grain/cotton/fertiliser/ag-chem markets regulated. Rather, farmers and their representative organisations have sought progressive deregulation of those markets to encourage greater competition at the farm-gate. In turn this has facilitated greater transparency, greater choice of services, product innovation and we contend has generally lowered execution / supply chain costs.

Farmers are quite capable of determining their best pathways to purchase and sell their produce and inputs and we contend they would largely shun government regulation of those markets.

There is no mandatory licencing / regulation of intermediaries in grain/cotton/fertiliser/milk markets.

Government regulation is costly and adds inefficiency. Those markets are sufficiently developed to self-regulate. Participants are able to rely on the basic principles of caveat emptor / caveat venditor (conduct is regulated by Australian Consumer Law / Corporations Act).

In our view, transacting in water should not be viewed differently. Most farmers are entirely capable of transacting their farm commodities and inputs without regulated intermediaries. Market intermediaries in grains, cotton, sugar, milk, fruit etc are self-regulated by their own design and code of conduct. So too are most water brokers / intermediaries.

Trading in water is not equivalent to dealing in financial markets. Rather it is akin to dealing in other markets for physical goods as described above. Those markets are not regulated by the financial services regulation framework.

Like cotton, grains, sugar etc, the irrigation industry is capable of self-regulation. Rather than a costly government regulated framework, the Australian Water Brokers Association should be encouraged to further develop its code of conduct and standard trade terms and make those well known to prospective water market participants.

Irrigation farmers who choose not to deal via members of the Australian Water Brokers Association should not need to be protected by regulation (likewise, those grain farmers who choose not to deal via affiliates of Grain Trade Australia, or cotton farmers who choose not to deal via affiliates of the Australian Cotton Shippers Association).

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## Improving trade processes and market transparency

### **The ACCC considers practical changes to trade processing are needed to improve the quality and timeliness of core market data**

The ACCC has identified several practical improvements that, in its preliminary view, should be made as soon as practicable. These improvements relate to the validation and quality checking of trade data, including how zero dollar trades should be approved; capturing

additional information in trade forms such as the reason for trade, struck date and intermediaries' details; and increasing harmonisation across Basin States' registers.

### **Feedback on options to improve quality and timeliness of core market data**

The state-based registries record all transfers of water entitlements and water allocations. Many of these transfers are not in fact 'trades' at all; merely a transfer of water allocation (or entitlement) between related parties; including the transfer of water allocations held by environmental water holders.

Victoria, NSW and South Australia have recently commenced the implementation of a number of changes to the reporting of transfers which will better capture the reason for those transfers (trades or not) and a more accurate chronology of those trades (not simply a registration date, but the date the counterparties agreed the transfer). The constraints / shortcomings of transfer application forms have been repeatedly identified since at least 2010. As a regular market participant, we look forward to better quality information being captured and provided via government registries through these latest initiatives.

It should be recognised that this information is 'after the fact'. It is the product of market transactions. Historical price/volume information is a record of previous trading activity, it is not a guide to future price and trade behaviour by market participants. Historical price and volume information is not as useful to inform participants as to whether a proposed transaction is 'fair and reasonable'.

Water allocation markets are very dynamic – historical price information is not so useful to inform daily decisions when competing and changing in-season crop demands, *anticipated* rainfall, evaporation, and anticipated temperatures are impacting actual demand and supply for irrigation water.

We suggest there is greater benefit to market participants through the provision of information in relation to:

- regional water supply including forecast supply (water allocation announcements) under different rainfall conditions; the volume of water allocations announced year to date; the volumes of water allocation used/applied year to date; the volume of supplementary water pumped/taken; the carryover volumes accessed year to date; conveyance volumes and constraints from region to region (zone to zone); and
- regional water demand including the relative returns for various competing crop enterprises; the relative scale (planted area and maturity profile) of various crop enterprises (annual and permanent); their resulting aggregate irrigation requirements year on year etc.

Understanding and assessing those dynamics will better assist market participants to manage risks and identify opportunities. It would allow participants to better adjudicate as to what is a fair and reasonable price for them to transact water allocations (and water entitlements) on any day given their own risk appetite.

In other Australian agricultural commodity markets, there are numerous market analysts / consultants who provide this information on a user pays basis. Commodity brokers (and real estate agents) provide similar information to market participants for commission on sales. Water brokers perform this same role. Over time, those brokers with more accurate, timely and beneficial information will accrue more clients and a greater share of brokered trade. They may have a capacity to charge a higher commission for their role in intermediation. We see no need for government regulation to achieve this outcome; rather it is a function of a market which is continuing to mature.

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## **The ACCC considers practical changes need to be underpinned by clear and comprehensive mandates to provide efficient trade services and high quality information to market participants**

The ACCC has also identified a suite of further changes required to achieve a consistent and comprehensive trade processing and market reporting framework:

- a) Legislative changes to require Basin States to keep registers of entitlement and allocation trades and for Basin State water registers to provide information services with clear publication requirements.
- b) IIOs should be required to establish and maintain registers for temporary and permanent trades, within, out and into their networks.
- c) Update Water Regulations 2008 (Cth) to more clearly specify data reporting requirements for trades of irrigation rights.
- d) Allow for contracts to be registered with or otherwise recorded in water registers such that all allocation trades arising under one contract can be identified together.
- e) Introduce standardised single party identifiers across the Basin, such as using ABNs.
- f) Standards and processes for processing trade applications and recording and disseminating trade data should be mandated and consistent across jurisdictions and apply to all IIOs and Basin State approval authorities. Standardised record-keeping and continuous disclosure rules should also be placed on intermediaries.
- g) Basin States should work towards harmonising allocation trade application fees in the Southern Connected Basin, while recognising the NWI principles for cost recovery.
- h) Basin Plan water trading rules should be revised to require prices to be reported for all tradeable water rights, including irrigation rights and water delivery rights.

### **Feedback on options to provide efficient trade services and data collection**

Basin States already maintain registers of entitlement and allocation trades. In our experience that historical information is readily available via on-line portals (although Queensland's data is not so readily accessed).

As IIOs are bulk water entitlement holders, they can and do facilitate trade within their IIO amongst their own members. The volumes of water allocation trade within the IIO does not have a direct bearing on participants outside the IIOs. All water allocation trades into and out of IIOs are captured by Basin State registries. That information is also available.

IIOs facilitate 'water entitlement' trades within the IIOs, representing their members 'shares'. Those transactions do not necessarily impact water entitlement transactions outside the IIOs.

Members of IIOs who participate in internal transfers of 'water entitlements' and water allocations do need to satisfy themselves as to value relative to transfers to and from the IIO.

We assume IIO members do inform themselves of their ability to trade in and out of the IIO if there is a more competitive bid/offer available from outside the IIO, in which case the market outside the IIO will transact (and price and volume will be captured and registered).

'Contracts' between water allocation buyers and sellers (if they even exist) are not captured in water registers. The registers are only concerned with transfers of water allocations between water allocation accounts within that state jurisdiction; eg moving water 'credits' from one water account

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balance to another water account balance. We see little value and much administrative cost for registers to seek to capture and register 'contracts' between those buyers and sellers.

Not all trades are facilitated by intermediaries. There is no point to regulate intermediaries if transactions between buyers and sellers are conducted by private treaty and without intermediaries.

Water is governed by state jurisdiction. Each Basin State has its own regulatory regime and legal framework. Most are quite harmonised, but they are not interchangeable. History has shown that Basin States are unlikely to implement identical water regulations, including to conform with a specific and consistent trade processing method for water transactions.

Allocation trade processing fees; each Basin State has different volumes of trade, irrigators of different scale, different practical requirements on the movement and supply of water within their MDB systems. This suggestion appears the equivalent seeking to harmonise vehicle registration fees in each state.

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### **The ACCC considers digital technologies offer the opportunity to streamline trade services, at the same time as improving information quality and availability**

The ACCC has identified options for using technological change to make more substantial improvements to improve the integrity of Basin water markets. The ACCC's preliminary view is that while governance remains distributed between Basin States and other actors, options which deliver *harmonisation* and *co-ordination* are more suitable than options which deliver *centralisation*. This approach could be achieved by combining the following options:

- a) a digital protocol that enhances interoperability between Basin State approval authorities and registers, IIOs and exchanges, and automates the collection, cleaning and publishing of water market information
- b) a water market information platform which brings together (but does not replace) diverse information sources.

Other options for using technological change include:

- a) a spot market and real-time automated matching of buyer and seller offers, similar to the National Electricity Market
- b) a single exchange platform for posting and matching trade offers by creating a single mandatory online platform for matching buyers and sellers
- c) an ASX-like approach of a single clearinghouse to administer trade but connecting via interoperability protocols to trading platforms and different Basin State registers
- d) Distributed Ledger Technology, such as Blockchain, which administers trade through smart contracts and also records all registry information
- e) a single common register in which all water accounting for both trade and delivery (use) would be accounted for in the same, single system.

### **Feedback on digital technology options**

We support initiatives to create more efficient mechanisms to process water entitlement and water allocation transfers and transactions within and between Basin States (where there is an ability to transfer water). A centralised 'clearing house' or single common register to assess transfer

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applications may create efficiencies for each state government water agency / registry and enable swift information capture. However, we believe each Basin State is most likely to maintain their own processing capacity given their specific jurisdictional responsibilities for water.

However, the practicalities of the water markets must be considered. There is no one market; there are many regional markets each with their own idiosyncrasies. Furthermore, in the case of water allocations what is being transacted represents water as a physical commodity capable of being delivered from a specific resource. There are many challenges and physical constraints involved in conveying water between different parts of a river, channel or piped irrigation scheme. That challenge is compounded when transferring across rivers in the same State, and even further to transfer between rivers and Basin States. Each application for transfers (trades) has to be considered in light of these constraints. Transacting, clearing and settling water transactions are not as simple as electronically matching buyers and sellers of 'paper' equities for electronic funds transfers via the ASX and its clearing house (which guarantees brokered trades).

Nor are water transfers easily facilitated to the extent of real-time automated matching of buyer/seller offers in the National Electricity Market (with hundreds of very sophisticated, well capitalised energy buyers and generator sellers each with dedicated electricity trading teams monitoring and arbitraging minute by minute opportunities relatively seamlessly). Electricity transmission is comparably instantaneous in the connected national grid (albeit within constraints of transmission line capacities, which are relatively more easily and affordably increased when new demand comes on line in a particular location, as opposed to expensive channel / pipe conveyance for water).

As ACCC's interim report pointed out, we are reminded of earlier failed attempts by government agencies to create a digital solution to harmonize water market information at considerable expense. Several private agencies (usually water brokers) have sought to fulfil this role in water markets since the mid-1990s. In our view there is plenty of information available from a wide range of sources, and this is identified as part of the issue which may cause irrigators to bemoan a lack of transparency. Different broker portals conduct different transactions between buyers and sellers resulting in different daily price ranges. There are many idiosyncrasies to consider.

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## Improving market architecture

### **The ACCC considers the design of the southern connected Basin market architecture has not kept pace with increasing trade activity, and the ACCC is seeking to identify options for reform**

The ACCC considers that market architecture that better integrates trade, operational requirements and the physical characteristics of the system will improve the operation of water markets. This will help achieve a range of benefits, including properly pricing the costs of trade and protecting other water users and the environment.

The ACCC is identifying appropriate market architecture reform options, which might include:

- a) Improvements to policy transparency and consultation processes
- b) Alternative approaches for allocation and carryover policies
- c) Creating formal markets for storage and delivery capacity
- d) Applying transmission loss factors to water deliveries in the southern connected Basin
- e) Removing the exemption for grandfathered tags or removing entitlement tagging altogether

- f) Alternative and more dynamic mechanisms to manage inter-valley trades
- g) Changing all allocation trade to tagged allocation trade
- h) Improving consistency across Basin States' accounting and metering requirements.

### **Feedback on options to improve market architecture**

Specifically for the Murray River there is a pressing need to ensure consistency of Basin State accounting and metering requirements to underpin market integrity and equitable outcomes in that one system.

Most Murray system irrigators are not able to access water allocations to their irrigation farm enterprise unless they have a positive account balance in their water allocation account. However, there are some Murray system irrigators (South Australia) that are permitted to draw on water allocations provided they don't have a negative water account balance at the end of each Quarter.

It seems inequitable in that the same river system an irrigator can access and pump water from 1 January to 31 March and not have had to pay to acquire water allocation 'credits' for their account until 31 March (at the then spot value), while adjacent irrigators in that same river system must acquire water allocations (either via entitlement allocation announcements or allocation purchases) prior to pumping from the system.

We are also aware there has been some recent amendments in relation to grandfathered tags and delivery capacity from the Goulburn to the Murray rivers.

ACCC's proposed list of market architecture reforms would likely require further changes to water regulations in each Basin State. We support progressive changes provided they are in accordance with the principles of the National Water Initiative and the Basin Plan.

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## Changes to market governance

### **The ACCC considers there is a need to reconsider governance frameworks to enable independent and clear decisions on the development of market settings**

The ACCC considers improved governance will help resolve many of the issues identified throughout the inquiry and strengthen the system so fewer problems emerge in the future.

The ACCC is considering options to improve market governance that may seek to:

- a) establish clear, independent decision making structures
- b) separate market governance roles from broader water management governance
- c) consolidate or harmonise fragmented roles
- d) reduce regulatory gaps by creating and assigning new roles or functions
- e) address conflicting roles.

### **Feedback on options to improve market governance**

We support the need to consider governance frameworks to reduced perceived conflicts of interest; and provide greater transparency and delineation between those agencies charged with administering water resource plans / water sharing plans and those who operate water conveyance systems (rivers, channels etc).

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## Other comments

Please provide any other feedback you consider relevant to the ACCC's inquiry.

### **Feedback**

Members of our organisation have been participants in Australia's various water markets since the early 1990s. We have also had considerable experience in cotton, grain, sugar, wool, citrus, wine grape, table grape, electricity and foreign exchange markets.

In our experience the allegations of a 'lack of transparency' are better explained by an examination of the fundamentals and mechanics of those various water markets in practice.

#### *Bid / offer spread*

Broker portals and other exchanges compile and display bids and offers for prospective purchases and sales of water allocations. In almost all daily observations, and by comparison to most other markets, the spread between bids and offers is wide. This is not a failing of the transparency of the markets, rather it is an indication of the illiquidity of the markets.

As an example, yesterday (28 October 2020) one of the more prominent on-line broker exchanges for the market zone with the greatest annual turnover, Victorian Murray Zone 7 quoted buyers' bids from \$180/ML and sellers' offers from \$220/ML. That represented a \$40/ML bid/offer spread; a margin 20% above the bid. Consequently, depending on their willingness to cross that spread, two farmer irrigator as buyers on the same day in the same market zone might get filled at very wide price differentials (purchased water allocation at \$220/ML, or patiently waited for a seller to accept a bid at \$180/ML). It is quite conceivable that later that day one irrigator who paid 20% more might then complain to the other that the markets are 'not transparent'.

This is not a reflection of transparency. It is a reflection of illiquidity.

The illiquidity of the water markets reflects the challenges of conveyance and storage of fresh water (market making, taking delivery, storing and reselling are costly and challenging); the similar motivations of the majority of its participants; and, the nature of water as a *non-substitutable* input for any farming enterprise.

#### *Non-substitutable input*

The vast majority of water market participants are irrigation farmers. Year on year and over various climate cycles water tends to be their most limiting factor of production. In times of severe drought, the cost of acquiring irrigation water can escalate dramatically. A higher water price does not create new sources of supply and there is no substitute for water. No amount of money can make it rain. If all farmers are seeking to buy there may be increasingly fewer sellers as water is offered and used up. In those circumstances bid/offer spreads will widen and spot price volatility will likely increase.

#### *The motivation of market participants*

As the interim report reveals, there are only four major 'investors' in water markets accounting for 6% of water entitlement ownership and up to 20% of water allocation sales by volume.

The vast majority of entitlement holders are irrigators (family farmers to corporate agribusiness).

Many of the corporate agribusinesses manage their water supply via leases, forward contracts, spot purchases and carryover parking with the 'investors' as counterparties.

Within a particular region, irrigators may be involved in the production of similar crops with similar gross margins per megalitre achieved (eg. cotton or rice production). In that case they may have

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similar capacity to pay for water allocations as required. Assuming they have a crop planted, an unexpected heat wave might encourage them all to purchase marginal megalitres of water to meet increased crop water demand. In that situation, there will be a flurry of bids for water allocation in that region and often few willing sellers (as irrigators will all have suffered unexpected water use and 'investors' may have exhausted their inventories with prior sales and leases). In this situation, water allocation prices may increase rapidly until the point where some annual crop irrigators may assess that they could be adequately compensated to abandon their annual crops and sell remaining water allocations they have not yet already applied. This scenario reflects the conditions experienced in the Murray and Murrumbidgee rivers in 2018/19.

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