



Fourth Annual Water Symposium

Improving water trading outcomes in the Murray-Darling Basin 20 February 2009, Sydney

ACCC Commissioner Joe Dimasi

Introduction

Good afternoon, it's good to be with you today. When it comes to Australia's largest river system – the Murray-Darling Basin – many are surprised to hear that the ACCC is playing a very important role.

We're responsible for developing and enforcing rules to remove barriers to water trading across the Basin and giving effect to the objectives of the *Water Act 2007(Cth)*. The rules which we've been developing include:

- **water market rules** which relate to properly vesting rights in water;
- **water termination fee rules** which are capped and are only permitted when an irrigator terminates access to water delivery services;
- **water trading rules** that regulate trading up and down the Basin; and
- **water charge rules** that regulate fees and charges related to water in the Basin including:
 - bulk water charges set by an irrigation infrastructure operators for the delivery and storage of water; and
 - water planning and management charges set by State government departments, or water supply authorities.

However some may ask the question about why competition is being introduced into water markets across the Basin and what role does the ACCC have in achieving this? Before I answer this question, I'll first take a snapshot of the Basin's history and government policy relating to it. This will provide some background on the significance of the ACCC's new water functions.

Four rivers and market failure

Although it is one river system, for close to 100 years the Murray-Darling Basin was managed as four separate systems defined by state boundaries. Accordingly, state governments issued water licences with little consideration of the long-term impact on the river system. This was largely due to the lack of established scientific knowledge about sustainable yields and the fact that many licences were distributed during relatively wet periods.

As the nation expanded, so did our thirst for the Basin's resources. It grew from about 2000 GL during the 1920s to 12,000 GL in the late 1990s.

The Basin's water was often not used to its highest value through purely administrative or transaction cost barriers. We are now much more aware that

it is not efficient to grow low value and water intensive crops and that's why some irrigators may be bulldozing and changing their output. Even though trading was possible across the Basin in recent years, high termination fees, limits on the amount of interstate water trading and complex approval processes has meant the potential gains from water trading had not been fully realised. Let me elaborate a little further.

For example, many irrigators have told the ACCC that the current termination fee – a multiple of 15 times the annual access fee paid for water delivery services – is too high and discourages trade.

Another barrier to trade in the MDB is the complexity of rules/regulations that govern trading. Irrigators often find these rules difficult to access and interpret as there are significant differences in terminology. For example, it is not uncommon for different words to have the same meaning or for there to be different meanings for the same word. For example 'water allocation' in Queensland means a perpetual or ongoing right to water, while in New South Wales and Victoria it means the amount of water available to an irrigator in any one year.¹

Furthermore there are the restrictions imposed by the 4 per cent cap on the trade of water entitlements out of irrigation areas in any one year. The initial justification for this was to manage the rate of change by preventing an exodus of farmers and boost irrigation communities struggling in harsh drought conditions. However the reality is this cap has been applied inconsistently throughout the MDB, if at all. There are plans to lift the 4 per cent cap to 6 per cent this year.

The recent National Water Commission *Australian Water Markets Report* also noted that approvals for water trading can take up to 40 days for trades into Victoria and between 5 and 25 days for trades within Victoria. NSW and SA had similarly slow approval times. In contrast, Queensland had much quicker approval times, however very low or no levels of trade existed outside of or between water supply schemes.

So what does all this mean? In short, trading across the Murray-Darling Basin is not working as well as it should. Compounding this problem was the scarcity of water available in the Basin caused by years of low rainfall.

Policy makers and governments realised that the situation was dire and that a new approach to the Basin's water resources must be adopted. This movement was apparent in 1995 when NSW, Victoria, South Australia and Queensland agreed to implement a cap on diversions as part of the MDB Agreement.

¹ Perpetual water rights are specified in megalitres. Annual allocations are specified as a proportion of the perpetual water right. In low rainfall years irrigators typically get an annual allocation of less than 100 per cent. At the moment many irrigators in southern New South Wales are on a zero allocation.

Although the reasoning behind the cap was to prevent further decline in river health, the limits imposed were not necessarily sustainable.

The Agreement capped diversions at the volume of water that would have been diverted under 1993/94 levels of development had the climatic conditions of the present year had occurred back then.²

Although the agreement required states to report annual diversion amounts, allocations and trades, the Murray-Darling Basin Commission was unable to take any enforcement action if caps were exceeded.

The next step in water policy development was COAG's National Water Initiative announced in 2004. Its goals included:

- to recover water for the environment;
- to address over-allocated water systems;
- to promote more confidence in the water industry by providing more secure water entitlements and simpler registry arrangements; and
- to improve the management of water in urban environments.

As part of these reforms, the National Water Commission was established in 2005.

Two years later, the Commonwealth *Water Act 2007* came into force, which included the preparation of a whole-of-basin plan and provided limits on water use. The *Water Act* also assigned new water functions to the ACCC and other agencies.

Closely following this was the COAG intergovernmental Agreement between the Basin states and the Australian Government, signed in July 2008. As part of this agreement, the Murray-Darling Basin Commission merged with the Murray-Darling Basin Authority.

Last year also saw the Australian Government announce it would spend \$3.1 billion to buy back water from willing irrigators to be used as environmental flow for the Basin. It is anticipated that this should reduce diversions by about 15 per cent.

The government also committed to invest \$5.8 billion for infrastructure improvement along the Basin. Much of the water diverted from rivers is lost in transportation through irrigation channels leading to significant losses in evaporation and seepage. The Commonwealth's grants will upgrade infrastructure with the objective of returning savings in water to the environment.

² Water Auditing Monitoring Report on Cap Implementation (WAM) (2003-04).

The ACCC's new water functions

As you have just heard, the Murray-Darling Basin has been subject to a history of over allocation of water resources, difficulties and barriers to water being used at its highest value as well as substantial environmental degradation.

Against this backdrop and as I mentioned earlier, the ACCC has a role in developing four sets of rules to ensure trade across the Basin is functional, efficient and meets the objectives of the *Water Act*. These are the:

- water market rules;
- water termination fee rules;
- water trading rules; and the
- water charge rules.

The reason we need to introduce greater competition across the Basin has been summarised by the National Water Commission:

“Water markets and trade can reveal the value of water to existing and potential users and create incentives for users to seek improved technical productivity, innovate and improve water use efficiency. This leads to more productive and efficient use of water resources over time.”³

But before I examine the development of the water market rules, I'd just like to reiterate that we have conducted and will continue to run extensive consultation with the community from irrigators, operators and governments in the development of all these rules. We've ensured that the rules are robust and comprehensive reflecting the experience and knowledge from as many stakeholders as possible.

Now let me outline the water market rules.

Water market rules

The purpose of the water market rules: *“[is to]... free up the trade of water access rights within the Murray-Darling Basin by ensuring that the policies or administrative requirements of [irrigation] infrastructure operators do not represent a barrier to trade.”⁴*

Irrigation infrastructure operators

It is the irrigation infrastructure operators, not the irrigators, who often hold water entitlements collectively on behalf of their members. This is the case for the most part in NSW and SA.

³ National Water Commission, *2005 National Competition Policy: follow-up assessment of water reform progress*, May 2007, pp. 12 viewed 16 December 2008, www.nwc.gov.au/resources/documents/2005-NCP-followup-water-trading-MDB-0907.pdf

⁴ Explanatory memorandum to the Water Bill 2007, clause 97, paragraph 190, p. 28.

By virtue of holding the statutory rights to water, an operator can prevent or delay their members from fully realising the benefits of their irrigation rights. For example, operators can:

- prohibit trade out of an irrigation district;
- impose restrictions on who can buy water;
- impose exit fees or fees levied once water is traded; and
- require irrigators to terminate their delivery entitlements.

The recommended water market rules will enable irrigators to ‘transform’ the water entitlements held on their behalf by operators into separately held entitlements. Once irrigators directly hold their water entitlements, the operator cannot restrict trade.

These rules will provide more flexibility for irrigators by allowing them to:

- transform, whether or not in association with trade, and retain delivery rights with their existing operator; and
- trade and choose to terminate delivery rights with their operator.

The water market rules do not require operators to transform the irrigation rights of all their customers. Transformation is voluntary and can only be triggered by a request from an irrigator. An irrigator will need to consider a number of issues when deciding whether to transform, and I’ll briefly run through some of them now.

Restrictions on trade

Restrictions in any form are likely to reduce trade and may lead to outcomes inconsistent with the objectives in Schedule 3 of the *Water Act*.

The recommended water market rules prohibit actions of an operator that prevent or delay transformation arrangements unless the rules identify it as a permissible restriction. While some restrictions may be appropriate, it is not feasible to develop and maintain a list of all inappropriate restrictions imposed by operators in the Basin.

Restrictions identified as permissible might be imposed for reasons consistent with the water market and the trading objectives of the Act, such as third party impacts and protection of the environment. However stakeholders have raised concerns regarding the treatment of conveyance losses, protection of stock and domestic entitlements and increased business risks due to decreased security over ongoing fees.

The ACCC has considered these issues and recommends that:

- if operators do not hold a separate conveyance licence, they can withhold a volume of water from transformation that an irrigator is entitled to in order to account for fixed conveyance losses;
- transformation can be restricted if permitted under state law or related instrument, such as in relation to stock and domestic licences;

- security can be required by operators to address the risk of non-payment of water delivery fees. Similarly, operators can reject applications for transformation if outstanding fees are owing to them.

Delivery rights

It is also important to highlight that when collectively held rights by operators are transformed into individually held rights by irrigators, transformation does not extinguish the delivery rights attached to the entitlement. In other words, the operator cannot refuse the irrigator delivery of their rights because of transformation. The irrigator continues to be serviced by the operator unless they choose to trade or dispose of their rights.

Timeframes

As for timeframes, the recommended water market rules allow 20 business days for operators to process applications for transformation. As potential issues of complexity - for example irrigation rights, delivery contracts and conveyance losses - can be dealt with before application, we consider this time limit to be sufficient for all operators to ensure consistent application across the Basin.

Commencement

The water market rules will take effect from the day they are made by the Minister. That is, from that date, operators cannot undertake actions that would conflict with the water market rules. A transitional period to 31 August 2009 applies to existing arrangements, such as contracts.

Enforcement

The ACCC is also responsible for enforcing the water market rules.⁵ We will assist operators to understand and meet their obligations, take enforcement action against operators found in contravention, and provide for preventative or remedial action where necessary.

We consider that conduct that prevents trade would have more serious effects on the efficient operation of water markets and be more likely to be designated as a civil penalty, than conduct that delays trade.

The ACCC has submitted our final advice for the water market rules to the Minister. We anticipate the rules should be in place in March or April of this year.

As discussed earlier, a large disincentive impeding water trading are high termination fees. The ACCC also has a role in developing rules for such fees, which I'll now explain.

⁵ Section 137 of the Water Act.

Water termination fee rules

Irrigation infrastructure operators face ongoing costs for maintaining irrigation infrastructure. As many of these costs are fixed, they are incurred by the operator whether or not an irrigator chooses to terminate access.

Termination fees needed

If irrigators terminate access without paying termination fees then operators may not be able to recover their committed fixed costs. Over time this may compromise the viability of operators, service standards and investment. The prospect of irrigators leaving without paying termination fees creates revenue uncertainty for operators which may undermine investment.

The ACCC has provided advice on termination fee rules to the Minister. In doing so, we recommended:

- termination fees should only be permitted when an irrigator terminates water delivery services;
- operators must not apply termination fees on the sale of water rights – that is no exit fees;
- termination fees should be calculated using actual delivery fees, not shadow access fees; and
- termination fees should be capped.

If termination fees are set too high they act as a barrier to water trade. In cases where irrigators terminate access as well as selling their water access rights, termination fees need to be subtracted from the proceeds gained from selling water access rights to determine the net returns to the irrigator.

Where a termination fee is paid concurrently with selling water access rights, the higher the termination fee, the lower the net returns, and the lower the incentive for the individual to trade water for a given water price.

In the development of the termination fee rules, we balanced the legitimate interests of operators against the objective of facilitating fair and efficient water trade across the Basin. We have come to a conclusion that a cap must be applied to termination fees.

In our extensive consultations, many irrigators told us that termination fees imposed by operators were too high,⁶ while operators largely supported the current practice of using a termination fee with a multiple of 15x.⁷

⁶ D Barclay, draft advice submission, p. 1; D Star, draft advice submission, p. 1; P Leslie & D Ferguson, draft advice submission, p. 1; J R Rorke, position paper submission, p. 3; D Crowhurst, position paper submission, p. 1; G Doherty, position paper submission, p. 1; D W Sehestedt, issues paper submission, p. 1.

⁷ NSWIC, draft advice submission, p. 4; MRFF, draft advice submission, p. 2; TNIS, draft advice submission, p. 4; SRI & RGA, draft advice submission, p. 2; GMW, draft advice submission, p. 1; CI, draft advice submission, p. 4; MI, draft advice submission, p. 6; MIL, draft advice submission, p. 7; CIT, position paper submission, p. 2; RIT, position

10x recommended

After careful consideration, we recommended that a multiple of 10x be adopted as it delivers the operator between 12 to 15 years of access fees. This provides an extended period of revenue stability for operators and fee stability for irrigators. This should be sufficient to give operators time to assess the impact of water trading on demand and to adjust their operations if necessary.

The ACCC has recommended that termination fee rules come into effect for all irrigation infrastructure operators on 1 July 2009. Because of the lack of data and the uncertainty about the impact of water trading and the drought, the ACCC has also recommended that a review of termination fees begins in 2012 and reports back a year after. This will allow up to four years of data to be analysed, including two years of data collected after the expected finalisation of the Basin Plan.⁸

As with the water market rules, the ACCC has submitted our final advice to the Minister. We are anticipating that the rules will become effective either next month or in April.

Let me now move onto the creation of water trading rules.

Water trading rules

The water trading rules relate to the trade or transfer of tradeable water rights across the Basin. These rights include the use of surface water - both regulated and unregulated - and groundwater. The rules also cover 'permanent' and 'temporary' trade and will form part of the Basin plan, being developed by the Murray-Darling Basin Authority.

Unlike the market and termination fee rules, there are no regulatory requirements about the ACCC's consultation process. Nevertheless, we will adopt a similar process as with these earlier rules before providing our advice to the Murray-Darling Basin Authority.

To formally begin our consultation process, the ACCC proposes the release of an issues paper by April this year.

We will allow for a substantial consultation period for the trading rules given the wide scope and the desire to incorporate submissions from a wide range of stakeholders – many of whom have a limited capacity to provide detailed input in a short timeframe.

paper submission, p. 2; TBG, position paper submission, p. 3; NSWIC, position paper submission, p. 2; WMI & CI, position paper submission, pp. 3-4; TNIS, position paper submission, p. 4; MIL, position paper submission, p. 3; MI, position paper submission, p. 6.

⁸ For more information refer to DEWHA website:
<http://www.environment.gov.au/water/publications/mdb/pubs/mdba-transition.pdf>,
accessed on 6 October 2008.

As outlined today, a key aim of the rules will be to promote the operation of efficient water markets and water trading across the Basin. Significant delays occur in processing water trading transactions and it can be difficult for most irrigators to obtain and understand information about water rights from other areas and other states.

If water markets work well, irrigators can weigh up the net returns from using water to grow crops or selling water. For example, if water prices are high and an irrigator produces a relatively low value and water intensive crop, they are more likely to sell the water. Furthermore, water that is priced at its highest value may send signals to irrigators to change the crops they grow – for example, moving away from water intensive summer crops to winter cereals. Currently, the impediments to trade distort market prices which in turn distorts the decisions irrigators make regarding water use.

It is hoped that the release of the Basin Plan's water trading rules will remove many of the current barriers to effective water trading across the Basin.

Before I finish today, I must mention our work with another set of rules - the water charge rules.

Water charge rules

The purpose of water charge rules is to contribute to the sustainable use of water resources and infrastructure as well as ensuring the water market is functioning efficiently.

There are three types of water charge rules (including termination fee rules).

The first two types of rules will apply to:

- Bulk water charges (such as those levied by State Water in NSW and Goulburn-Murray Water in Victoria);
- Fees and charges payable to an irrigation infrastructure operator in relation to access to the operator's irrigation network.

The aim of these water charge rules is to:

- Prevent misuse of monopoly power by infrastructure operators;
- Prevent discrimination against irrigators that transform their water entitlements or trade their water;
- And promote transparency around the pricing and investment decisions of operators.

Already, the ACCC has released two issues papers as well as a position paper about these water charge rules.

We recognise the significant challenge ahead, with more than 600 bulk water and irrigation operators of varying sizes and with different ownership structures.

And in light of this, we have recommended a three-tier approach to regulating water charges:

- Tier 1— provides a basic level of pricing transparency that includes rules prohibiting unfair price discrimination and a requires operators to publish regulated fees and charges;
- Tier 2—includes the rules in tier 1 plus a requirement to produce a network service plan and publish an explanatory statement outlining the basis for the charges;
- Tier 3— adds the use of a building-block model to approve or determine charges.

These tiers have been developed with regard to current governance and charging arrangements and principles of the *Water Act*. The ACCC has also balanced the need for economic regulation against the regulatory compliance costs for different types of water infrastructure operators.

Tier 1 rules will apply to all operators including those covered by tier 2 and tier 3 rules. The basis of the non-discrimination rule is that irrigation infrastructure operators, irrespective of their size, have an incentive to discriminate against non-members who seek to transform and conduct water trade.

Tier 2 rules will apply to large member owned operators such as NSW's Murray Irrigation Limited and SA's Central Irrigation Trust, and similar sized non-member owned operators not regulated under tier 3.

The rationale behind Tier 2 rules is that the benefits of increased transparency and accountability are likely to outweigh compliance and administrative costs.

Most businesses to be regulated under tier 2 already undertake similar types of reporting to that proposed in the rules. Therefore the compliance costs associated with these rules are likely to be minimal.

Tier 3 rules will apply to the following large non-member owned operators:

- State Water, the bulk water service provider which is New South Wales Government owned;
- Goulburn-Murray Water—Victorian Government owned bulk water and irrigation infrastructure operator; and
- Lower Murray Water— also a Victorian Government owned irrigation infrastructure operator.

The other types of water charge rules on which the ACCC must advise the Minister for Water relate to charges levied for water planning and management activities.

Water planning and management activities include water resource planning, administration of entitlements and permits, salinity and flood management and the monitoring and evaluation of water resources. Across the Basin these activities are undertaken by many different types of bodies including

government departments, government owned water businesses, and regional natural resource management bodies.

Currently there is an inconsistent approach to the way these services are charged for across the Basin. The ACCC's proposal is focussed on improving transparency of charges for water planning and water management activities, as well as the costs of all water planning and management activities even if a charge is not imposed.

The proposed approach will ensure those facing water planning and management charges in the Basin can understand the charges they are required to pay, why they are required to pay those charges, and to help facilitate comparability of approaches to cost recovery for these activities and between costs for similar activities across Basin states. This approach will also provide water users and the general public with better information about water planning and management activities funded through general taxation.

Our final advice to the Minister about all types of water charge rules is due in June. Subject to Ministerial approval, it is likely that these rules will come into effect in the latter half of the year.

Conclusion

As you've heard today, there has been a torrent of change concerning the Murray-Darling Basin in recent years.

But we must not get ahead of ourselves as the reforms stemming from the National Water Initiative and the *Water Act* are still relatively new.

The ACCC's water market, water termination fee and water charge rules are still to come into effect. The water trading rules will form part of the Basin Plan, due to begin in 2011. Once in place, the new rules should go a long way to reducing the market failure that currently impedes water trading across the Basin.

However, the ACCC's rules are only one of a number of steps required to provide a comprehensive response to the challenges facing the Basin. Policy makers will have some work to bring together the various elements needed to improve water market outcomes.

There is also a need to monitor the outcomes of these rules and further refinement may be required over time. The ACCC along with the National Water Commission and Murray-Darling Basin Authority will monitor the outcomes and where necessary enforce the rules to uphold the objectives set out in the *Water Act*.

Thank you.