

Water Reform – Creating Water Markets: the role of the Water Market Rules and the Water Charge Rules¹

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Introduction

The release of the proposed Murray-Darling Basin Plan (Basin Plan) by the Murray-Darling Basin Authority (MDBA) on 28 May 2012 put water reform at the forefront of public debate once again. The Basin Plan is the most widely-known and controversial component of the reforms introduced by the *Water Act 2007* (Cth) (Water Act) but the Water Act also implements other components of the water reform agenda: in particular, rules to help open up water markets, regulate charging and facilitate trade in water. Practitioners should be aware of these rules to assist them in properly advising clients on their rights and obligations in dealings with rights to water.

In 2009, Senator the Hon Penny Wong, then Minister for Climate Change and Water, made the *Water Market Rules* (WMR) and *Water Charge (Termination Fees) Rules* (WCTFR).² In 2010, the Hon Tony Burke MP, Minister for Sustainability, Environment, Water, Population and Communities, made the *Water Charge (Infrastructure) Rules* (WCIR) and the *Water Charge (Planning and Management Information) Rules* (WCPMIR) (collectively, the Rules).³ Compliance with the rules is monitored and enforced by the Australian Competition and Consumer Commission (ACCC). Minister Burke made minor amendments to the WCTFR in February 2011 and further amendments to the WCTFR and the WMR in October 2012.

This article is intended to assist practitioners to understand the purpose and operation of the Rules (including the recent amendments) and how they relate to the broader water reform agenda.

Water Reform - the background

Water reform has been a constant feature of the regulatory landscape over the past 20 years. In 1994, the Council of Australian Governments (COAG) agreed to the *Water Reform Framework* (Framework). The Framework sought to create water markets through the development of tradeable water rights (by clarifying property rights and separating title to water from land) in order to allow water to flow to higher value uses. The Framework also sought to reform pricing for water and associated services, to make its use more sustainable, by encouraging:

- consumption-based pricing and full cost-recovery
- the reduction or elimination of cross subsidies
- the allocation of water to the environment; and

¹ This article is published by the ACCC for guidance and information purposes only. It is not intended to be taken as legal advice.

² The WMR were made under s. 97 and the WCTFR were made under s. 92 of the Water Act.

³ The WCIR and the WCPMIR were made under s. 92 of the Water Act.

- the adoption of trading arrangements.⁴

In 1995, the Framework was incorporated into the National Competition Policy (NCP) with each state and territory being responsible for implementing it. Consistent with the NCP, a temporary cap was placed on water extraction from the Murray River. This cap was made permanent in 1997.

In 2004, the COAG announced the National Water Initiative (NWI), an agreement between the states and the Commonwealth to implement further water reforms designed to achieve a number of inter-related policy objectives, including to:⁵

- return over-allocated water systems to environmentally sustainable levels of extraction
- expand the permanent trade of water through the progressive removal of barriers to trade, subject to an annual cap of 4% on the volume of water that could be traded out of an irrigation area
- create nationally compatible and secure water access entitlements, separate to land
- cap termination fees at 15%.⁶

On 25 January 2007, in the midst of a severe drought, then Prime Minister John Howard announced the National Plan for Water Security. In September 2007, the Commonwealth Government passed the Water Act, designed to deliver key elements of that plan, including modernising irrigation and addressing the over-allocation and overuse of water resources within the Basin.⁷ The Water Act went beyond the NWI and sought to implement an integrated and consistent approach to the management of the water resources in the Basin. For this purpose, the Water Act:

- created the MDBA
- required the MDBA to prepare the Basin Plan
- established the Commonwealth Environmental Water Holder
- enabled the Minister to make the Rules; and
- conferred on the ACCC the function of monitoring compliance with and enforcing the Rules.⁸

Reform to overcome obstacles to the efficient operation of water markets

Historically, water supplied for the purposes of irrigation had been tied to land ownership ('bundled'), with rights not clearly defined and with no formal capacity to trade water. Over several decades, consistent with the reform commitments described above, states have acted to 'unbundle' entitlements to water from land, creating separate property rights in the form of statutory rights to water.

⁴ COAG communiqué, 25 February 1994, Water Resource Policy:

<http://www.coag.gov.au/coag_meeting_outcomes/1994-02-25/index.cfm#water>

⁵ NWI, paragraph 24.

⁶ Murray Darling Basin Agreement, former Schedule E Protocol on access, exit and termination fees.

⁷ A National Plan for Water Security, 25 January 2007.

⁸ Water Bill 2007, Second Reading Speech, 8 August 2007.

<http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;adv=yes;orderBy=customrank;page=1;query=%22water%20bill%202007%22%20%20%22second%20reading%22%20Dataset%3Ahansardr,hansardr80;rec=12;resCount=Default> and Water Bill, Explanatory Memorandum, paragraph 4.

However, different jurisdictions took different approaches to unbundling and, in some states, the unbundled right was often held by the irrigation water supplier, with irrigators within a network holding a contractual right to water against their supplier. This meant that, despite unbundling, a supplier could still impose contractual restrictions on their irrigators' ability to transfer or trade water within and beyond the supplier's area of operation, limiting the efficient functioning of the water market.

The Water Act provided the Minister with the power to make the Rules to ensure that water markets in the Basin operated efficiently without inappropriate barriers to trade.⁹

Definitions

Before discussing what the Rules do, it is helpful to briefly explain some of the terminology they use (taken from the Water Act). Under state water management legislation, different classes of rights to water can be held and, while rights to water are generally similar in each Basin state, the Water Act and state legislation often use different terminology. When providing advice, practitioners should take care to ensure the terminology used is correct and consistent with the definitions in the Water Act, the legislation of the relevant Basin state and common usage within the industry.¹⁰

The WMR, WCTFR and WCIR operate by regulating key activities of the entities that own or operate water infrastructure. Such entities are defined in s. 7 of the Water Act as *Infrastructure Operators* and *Irrigation Infrastructure Operators*.

An infrastructure operator (IO) is:

- a person
- who owns or operates water service infrastructure
- for the purpose of providing a service to another person.

An irrigation infrastructure operator (IIO) is

- an IO, and
- operates the infrastructure for the purposes of delivering water for the primary purpose of being used for irrigation.

The Water Act defines four main classes of right that relate to water and its delivery: *water access entitlements*, *water access rights* and *irrigation rights* (each of which give the holder some form of entitlement or right to receive water) and *water delivery rights*.¹¹

Water Access Right

- A right conferred under a law of a state to hold or take water from a water resource
- Includes a *water access entitlement* and stock and domestic rights granted under statute

⁹ Water Bill 2007, Second Reading Speech, 27 August 2008. The Water Act also provides for the MDBA to make water trading rules as part of the Basin Plan: see item 12 in s. 22 and s. 26 of the Water Act.

¹⁰ The potential for confusion to arise and mistakes to occur is illustrated by reference to an example: the term *water allocation* is defined in s. 4 of the Water Act as 'a specific volume of water allocated to water access entitlements in a given water accounting period'; however, the term *allocation* is widely used within the industry to refer to the volume of water allocated against an irrigation right in a given irrigation year; further, the *Water Act 2000* (QLD) uses the term to refer to a statutory water right equivalent to a *water access entitlement* under the Water Act.

¹¹ Water Act, s4.

Water Access Entitlement (WAE)

- A perpetual or ongoing entitlement, by or under a law of a state, to exclusive access to a share of the water resources of a water resource plan area.
- E.g. Water Access Licence (NSW), Water Share (Vic), Water Access Entitlement (SA), Water Allocation (QLD)

Irrigation Right

- A right that a person has against an IIO to receive water that is not a *water access right* or a *water delivery right*.
- Generally, but not always, contractual.¹²

Water Delivery Right

- A right to have water delivered by an IO.

Water Market Rules

The WMR are designed to help free up the trade of irrigation water within the Basin by ensuring that policies or administrative requirements of IIOs do not represent a barrier to trade.¹³ State legislation contains mechanisms for irrigators to convert their irrigation rights into a WAE.¹⁴ Under the Water Act, this conversion process is referred to as *transformation arrangements*, meaning:

- arrangements that would reduce the share component of a water access entitlement of an IIO to allow:
- a person's entitlement to water under an irrigation right against the IIO;
 - or
 - a part of that entitlement;
- to be permanently transformed into a water access entitlement held by someone other than the IIO.¹⁵

The transformation of an irrigation right into a WAE reduces the IIO's WAE by an amount generally commensurate with the volume of the former irrigation right.¹⁶ The effect of transformation is depicted in the following diagram.

¹² In NSW there are a number of different IIO structures. In the majority of cases irrigators' irrigation rights are contractual. However, in limited circumstances they may arise on some other ground, generally statute. For instance, s190A and s237A of the *Water Management Act 2000* (NSW) require private irrigation districts and private water trusts, respectively, to determine a "landholder's water entitlement" (which is analogous to an irrigation right) when requested in writing to do so. In SA irrigation rights generally arise under statute following a fixing pursuant to s29 of the *Irrigation Act 2009* (SA).

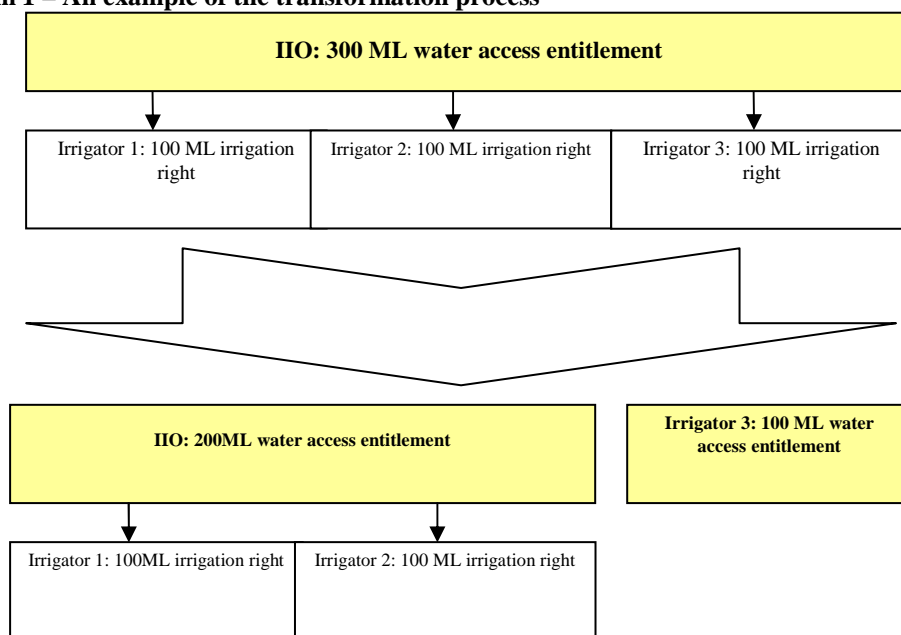
¹³ Water Bill 2007, Explanatory Memorandum.

¹⁴ In 2009 South Australia passed the *Irrigation Act 2009* (SA) which required irrigation trusts (IIOs) to fix irrigators' irrigation rights. The Irrigation Act then provides that irrigation rights may be transformed. See also the *Water Management Act 2000* (NSW) Ch 3, Part 2 Div 4.

¹⁵ Water Act, s97. The WAE (onto which the entitlement to water under the irrigation right has been transformed) can be either a new WAE or an existing WAE and can be held by the irrigator or a third party (so long as it is a person other than the IIO). Transformation will often occur as part of a sale of the right to water and so the irrigation right will be transformed onto a WAE held by or issued to the purchaser.

¹⁶ The delivery of water necessarily involves water loss through evaporation, seepage etc, especially when delivered via open irrigation channels. This loss is referred to as conveyance loss and is generally socialised across an irrigation network. In some cases, the IIO holds a separate licence to account for conveyance loss; however, where this is not the case, irrigators' contribute to conveyance losses from their irrigation rights, such that each irrigator will not receive the full volume of water covered by their irrigation right. The WMR provide a formula for IIOs that do not hold a separate conveyance licence to

Diagram 1 – An example of the transformation process



The WMR apply across the Basin to IIOs that are capable of giving effect to transformation arrangements;¹⁷ however, at a practical level, transformation has already largely taken place in Victoria and Queensland, so the WMR primarily affect IIOs in New South Wales and South Australia.

As transformation involves a reduction of the share component of an IIO's WAE, the IIO has to apply for¹⁸ or consent to such a reduction.¹⁹ In the absence of the WMR, it would be open to an IIO to refuse to give its consent. The WMR provide that an IIO that receives a request in writing for transformation must not do or fail to do an act in a way that prevents or unreasonably delays transformation or the trade of a WAE obtained as a result of transformation arrangements.²⁰

The WMR permit an IIO to specify the information required in order to approve an application for transformation, such as details of the irrigator's entitlement and account with the IIO, but not to mandate the form in which a written application is given.²¹ The WMR also permit an IIO to require payment from a transforming irrigator of all outstanding fees prior to giving its approval for transformation.

An IIO that receives an application must process it within a period of 20 business days and inform the applicant of the outcome within a further 5 business days.²² There is provision for this timeframe to be extended in certain circumstances.²³

reduce the volume of irrigation rights available to an irrigator for transformation to account for fixed conveyance loss: WMR 7(2).

¹⁷ That is, the entity must meet the definition of an IIO, hold a WAE and supply customers who hold irrigation rights against it. There are some entities operating that do not meet the definition of an IIO and are therefore not subject to the WMR. There are also a limited number of IIOs that do not hold a WAE and therefore cannot give effect to transformation arrangements.

¹⁸ For example, section 71Q of the *Water Management Act 2000* (NSW).

¹⁹ Section 150(12) of the *Natural Resources Management Act 2004* (SA).

²⁰ WMR, Rules 16 & 17.

²¹ *ibid*, Rules 11 & 12.

²² *ibid*, Rule 14.

²³ *ibid*, Rule 14(1) provides for an IIO to notify an applicant in writing if the application is not complete or not in accordance with the rules, is not accompanied with the relevant application fee or if there are

An IIO must notify the applicant when approval is given. An IIO may be “unable to approve” an application for transformation where:

- a person who holds a legal or equitable interest in the irrigation right has refused to give approval
- a requirement under a law of a state cannot be satisfied; or
- the applicant has not provided information requested by the IIO necessary to approve the application or paid outstanding fees or charges.²⁴

Failure or refusal to approve an application for some other reason may result in the IIO being considered to have prevented or unreasonably delayed transformation.

Once an IIO has approved an application, the relevant forms must be lodged with the state agency responsible for approving and processing dealings with WAEs. A failure or delay by an IIO in lodging these forms (or facilitating their lodging by providing its WAE to the irrigator) may amount to a prevention or unreasonable delay of the transformation.

An irrigator may decide to continue to have water delivered by the IIO after the transformation by not terminating their access to the IIO's irrigation network. This may necessitate some changes to the delivery contract between the parties. The WMR only permit IIOs to make contractual variations that are necessary as a consequence of the transformation, unless additional changes are agreed in writing by the parties.²⁵ The WMR also prohibit an IIO from requiring termination of a water delivery right as a condition of approving an application for transformation.²⁶

The WMR permit an IIO to request security from a transforming irrigator in certain circumstances to guarantee the future payment of access fees (for an amount not exceeding the applicable termination fee).²⁷ Security must not be refused by an IIO if it is provided by the irrigator in one or more of the forms specified in the WMR.

Water Charge (Termination Fees) Rules

While transformation results in an irrigator gaining control of their water, it does not discharge the irrigator's obligation to continue to pay access fees to the IIO. An irrigator may decide to continue to have water delivered by the IIO after the transformation by not terminating their access to the IIO's irrigation network. If an irrigator does not wish to continue to maintain water delivery and pay access fees, the irrigator must seek termination or surrender of their right of access²⁸ to the IIO's network by giving written notice to the IIO.

any outstanding fees or charges. Rule 14(3) provides that where this additional information or fees/charges is requested, the 20 day period commences once the information or fees/charges are received by the IIO. Also, where an irrigator has requested details of their irrigation right or required the continuation of their water delivery right under Rules 7 or 8, the period prior to the agreement of those details is not included in the 20 day period. Where appropriate steps have been taken to obtain the approval of a person holding a legal or equitable interest in the irrigation right or to satisfy a requirement under a law of a state, the period before approval is given or refused or the requirement is satisfied (or advice received that it can't be satisfied) is not included in the 20 day period.

²⁴ *ibid*, Rule 14(2).

²⁵ *ibid*, Rule 8.

²⁶ *ibid*, Rule 19.

²⁷ *ibid*, Rules 18 & 10.

²⁸ *Right of access* is defined in Rule 3 of the WCTFR to include a right to the delivery of water and a right to the drainage of water through an IIO's irrigation network.

IIOs typically charge a termination fee from terminating irrigators as a contribution towards the future payment of fixed costs²⁹ to minimise the impact of termination on remaining customers.

The WCTFR regulate when a termination fee may be imposed and the calculation of the maximum permissible fee that an IIO may charge a terminating irrigator. Under the WCTFR, an IIO may impose a termination fee when:

- an irrigator elects to terminate or surrender their right of access by giving written notice of termination to the IIO; or
- an irrigator fails to meet their contractual obligations and the IIO gives written notice of termination to the irrigator (except where breach of contract relates to trade of a water access right by an irrigator).³⁰

A termination fee must not exceed the lesser of:

- 10 times the applicable total network access charge (TNAC); or
- a fee specified in a contract or arrangement.³¹

The TNAC is the total amount payable to an IIO by the irrigator in the relevant financial year, subject to specified exclusions.³² Generally, the TNAC is a sum of fixed access charges relating to the provision of access payable in the financial year in which written notice of termination is given.

The WCTFR allow IIOs to add GST to the maximum termination fee.

The WCTFR provide for IIOs to apply to the ACCC for authorisation of an additional termination fee, in limited circumstances.³³

Amendments to the Water Market Rules and the Water Charge (Termination Fees) Rules

In February 2011, the WCTFR were amended to allow IIOs to add GST to the maximum termination fee. In October 2012, the Minister made further amendments to the WCTFR and the WMR to address some minor concerns with the rules that were identified in early stages of implementation.

Water Charge (Infrastructure) Rules and Water Charge (Planning and Management) Rules

The Minister has made two further sets of rules which are designed to facilitate efficient and open markets by providing for transparent water pricing.

²⁹ Fixed costs are costs incurred by an IIO that do not vary with the volume of water delivered

³⁰ WCTFR, Rule 6.

³¹ *ibid*, Rule 7.

³² *ibid*, Rule 3.

³³ *ibid*, Rule 8.

The WCIR regulate charges for infrastructure services and apply to IOs as well as IIOs. The basic transparency requirements apply to all IOs and require them to provide copies of schedules of charges to their customers and, if they manage more than 10GL of water, to publish pricing information.³⁴ The WCIR also prohibit unfair price discrimination by member owned operators between transformed and untransformed customers.³⁵

Member owned operators that provide services in relation to more than 125 GL of entitlement and non-member owned IOs that provide services for between 125 GL and 250 GL of entitlement ('Part 5 operators') are required to develop and consult on a network consultancy paper and provide to customers a network services plan (NSP) which details major capital works and expenditure to be undertaken by the IO and estimates of charges over a five year period.³⁶ Part 5 operators recently completed the first round of NSPs, which will last for five years, with the next round of NSPs to be prepared by 1 July 2017.

Non-member owned IOs that provide services in relation to more than 250 GL of entitlement ('Part 6 operators') are required to seek regulatory approval for their charges.³⁷ The ACCC is the default regulator; however, the Essential Services Commission of Victoria (ESCV) has been accredited under the WCIR to undertake determinations for Goulburn Murray Water Corporation and Lower Murray Water Corporation.³⁸

The WCPMIR regulate charges for water planning and water management activities imposed by, or on behalf of, Basin state governments and require the publication of detailed information about the charge, and disclosure of the process and basis for setting the charge.³⁹

Monitoring and enforcement of compliance with the Rules - practical considerations

The ACCC is the regulatory agency responsible for enforcing compliance with the Rules,⁴⁰ and has the power to seek remedies for contraventions of the Rules including infringement notices, civil penalty orders, injunction and declarations and enforceable undertakings.⁴¹ The ACCC has published guidelines setting out its approach to monitoring and enforcing compliance.⁴²

Since 2009, the ACCC has taken a number of actions to enforce compliance with the Rules. The ACCC has accepted court enforceable undertakings from two IIOs, and has issued one IIO with infringement notices. A further number of investigations have been resolved administratively following agreement by the IIO to take steps to rectify the ACCC's concerns. Actions taken to address concerns have included the payment of refunds to affected irrigators and the review and amendment of applicable charges, policies and procedures.

³⁴ WCIR, parts 2 & 4.

³⁵ *ibid*, Rule 10.

³⁶ *ibid*, Part 5.

³⁷ *ibid*, Part 6.

³⁸ *ibid*, Part 9.

³⁹ WCPMIR, Rule 5.

⁴⁰ Water Act, s. 137.

⁴¹ Water Act, Part 8.

⁴² ACCC Enforcement Guide – Water Market and Water Charge Rules, April 2011.
<http://www.accc.gov.au/content/index.phtml/itemId/890596>

There is also a private right of action for any person that suffers loss or damage as a result of conduct in contravention of the WMR and the WCIR.⁴³

The recent reforms (including the development of the Rules) require practitioners to be alert to the issues that might arise in advising clients on dealings with land, water and associated rights. The differentiation of rights to water from the delivery of water means that the two forms of rights can exist without the other;⁴⁴ practitioners need to be aware of these separate rights and their divisible nature when advising clients with respect to due diligence for the purchase of land, the advertising of land for sale or in conducting the conveyance.

In conveyancing situations, it is usual that water rights will be transferred as well as the land. However, the rights being transferred need to be clearly specified. It is important to make sure that the seller is clear about what rights they intend to sell with the land, that this is correctly advertised and that a purchaser understands what rights they are purchasing. In particular, where a person is purchasing land and a water delivery right but no irrigation right or WAE, it is vital to ensure that they are aware that what they are purchasing does not entitle them to water, it merely gives them the right to have water delivered if they purchase water separately; and that although they do not have a right to water they have an obligation to pay access fees for the water delivery right. If the purchaser is purchasing land and a WAE but no water delivery right, they must be aware that although they are purchasing a share of water, they will not have a right to have it delivered. If they wish to have the water delivered they will need to arrange a water delivery right separately with the IIO or pay casual user fees.

Conclusion

Reforms to the regulation and management of rights to water have had the effect of addressing a number of market failures that enabled IIOs to prevent, delay or obstruct trade and have resulted in more clearly specified rights to water and to delivery. Consequently, irrigators now have a variety of options to deal with what is often a valuable asset. Recent amendments to the WMR and the WCTFR will ensure that the rules operate to give full effect to the underlying policy objectives.

Irrigators, IOs, IIOs and their advisors need to be aware of the rights and obligations created by the Rules so as to avoid breaches and, where breaches have occurred, to identify the avenues of redress that exist. For practitioners, it is of particular importance in conveyancing situations to be aware of the different rights to water and to delivery that may apply and to make sure that clients are clear about the assets (and liabilities) they are selling and purchasing.

⁴³ WMR, Rule 22 and WCIR, Rule 57.

⁴⁴ For instance, it is possible for a person to hold both a WAE and a water delivery right, or just a WAE, or just a water delivery right. An irrigator who sells their WAE may retain the water delivery right because they intend to purchase water intermittently either as seasonal allocation or a WAE and will need a water delivery right to have that water delivered. Conversely, a person may hold a WAE without a water delivery right. This person does not even need to own a farm or, indeed, any land (noting that in Victoria there is a 10% cap on the volume of water shares (WAE) that can be held by non-landowners) however, without a water delivery right, they may not be able to have the water available under their WAE delivered (Some IIOs are willing to offer non-water delivery right holders the ability to access delivery services via the payment of casual user fees).