Market integrity and conduct

This Part includes five chapters relating to the activities and practices of certain water market participants and regulatory solutions to increase confidence in the integrity and fairness of the Murray-Darling Basin water markets.

Chapter 5 examines the role, strategies and trading activities of water investors, with a particular focus on the four large investors and four small investors operating in Basin water markets.

Chapter 6 provides an assessment of the conduct of water investors. The chapter sets out the concerns raised by stakeholders and presents the ACCC’s analysis and findings regarding investors’ conduct in Basin water markets.

Chapter 7 examines the water use, water strategies and allocation trading activities of 11 agribusinesses.

Chapter 8 examines the role, practices and conduct of water market intermediaries, in light of concerns raised by market participants. The chapter assesses how these concerns undermine confidence in Basin water markets and affect perceptions of market integrity and fairness.

Chapter 9 examines the effectiveness of the existing regulatory settings for Basin water markets. The chapter then recommends solutions to improve market conduct and integrity.
5. Investor role, strategies and trading activities

Key points

- Investors provide benefits to water markets. They provide new sources of capital to irrigated agriculture, increase water market liquidity and provide a range of water products which help irrigators to manage water supply risks.

- There are four large investors operating in the Murray–Darling Basin water markets. As at 30 June 2019, they collectively held 7% of all high reliability/security entitlements across the Southern Connected Basin.

- The large investors broadly pursued buy and hold entitlement strategies that aimed to achieve long term capital growth, and generated income by supplying water products.

- Leasing entitlements was a key income stream for the large investors as it provided a predictable source of medium to long-term income.

- Collectively the four large investors were large traders of water allocations. They accounted for around 19% of the volume of allocation trades-out (excluding zero dollar trade) in 2018–19 and 16% in the first half of 2019–20. The ACCC estimated that in 2018–19, they collectively sold around 176 GL of water allocations on the spot market and traded approximately 102 GL for the purpose of fulfilling lease or forward agreements. They received 167 GL of seasonal allocation from their own entitlements and purchased 129 GL of allocation through spot water trade.

- One large investor was a significant purchaser of water allocation in 2018–19. From late 2017 to mid–2019, this investor raised capital and invested that capital in temporary allocation trading until it was able to secure suitable permanent entitlements.

- Irrigators and agribusinesses were the most significant customers of the large investors in 2018–19. Importantly, all large investors had a business model that enabled them to meet demand from customers requiring large parcels of water.

- There is also a number of small investors operating in Basin water markets. The ACCC closely analysed four small investors. Most owned no or very few entitlements but were active traders, frequently buying and selling water allocations. Some bought and sold water allocations more frequently than some large investors.

- Both large and small investors had the time and knowledge needed to analyse the complexities of the Southern Connected Basin water markets. As such, investors are better placed than others, in particular smaller irrigators, to take advantage of trading opportunities in Basin water markets.

- It was not possible to ascertain the investors’ trading activities from a single source of information. The current quality of Basin State and IIO data and data collection arrangements made analysis of trading behaviour difficult, time consuming and resource intensive. The ACCC had to rely on its information gathering powers to obtain additional data and other information and documents from investors. In spite of this extensive data collection exercise, there remained some gaps and limitations to the data. Improving data quality and coordination of data collection across Basin States and IIOs is essential to achieve more effective market oversight.

5.1 Introduction

The inquiry’s terms of reference included consideration of the ‘role and practices of market participants, including water brokers, water exchanges, investment funds and significant traders of water allocations and entitlements’. This chapter examines the role, strategies and trading activities of water investors.
As set out in chapter 4, the ACCC considers water investors to be those holding, trading and/or managing water assets for the purpose of future financial gain, which is unrelated to their use as an input in agricultural, industrial or other production.

There are many different types of water investors operating in the Southern Connected Basin. These include superannuation funds and fund management businesses; retired farmers who have retained their water access entitlements, including in self-managed superannuation funds; farmers who trade water alongside their farming business; and other small firms and individual traders. Some investors do not own permanent entitlements and generate income solely through water allocation trading activities and by purchasing and selling other water products.

Investment in water entitlements provides opportunities for both capital growth (entitlement value) and yield (from the sale of water products such as leases, forwards and spot allocation sales), and allocation trading can also provide pure trading gains.

The ACCC understands that the increased involvement of investors in water trading has been incentivised by the long-term increase in water asset values, the opportunity to diversify their investment portfolios with water assets which share little price correlation with other asset classes, and the fact that variability in water market prices presents significant opportunities for trading returns. Water entitlements offer investors long term capital appreciation due to increasing water demand from high-value permanent horticulture producers, the constraint on water supply due to the impact of climate change, and reduced supply due to government recovery of water entitlements for environmental purposes.

Many stakeholders raised concerns about the conduct of water investors in water markets. The ACCC examined these concerns, as well as other trading activities that appeared unusual or suspicious. This analysis is contained in chapter 6.

5.2 Investors provide benefits to the Murray–Darling Basin water markets

5.2.1 Investors provide new sources of capital to irrigated agriculture

Investors’ participation in water markets has provided new sources of capital for irrigated agriculture. This was acknowledged by a number of stakeholders. The National Irrigators Council (NIC) submitted that the presence of investors in the water market has enabled some irrigators to invest available capital into land or agricultural production rather than owning water entitlements, and manage their business more effectively. This has assisted some irrigators to expand their irrigated production area, without the significant capital outlay that would be required for water entitlement purchases.

Water products supplied by investors provide avenues for irrigators to better structure their finances according to business needs. For example, water acquired through a lease may represent an operating expense, as opposed to the capital cost of a water entitlement. Riparian Capital Partners submitted that water products such as leases and forward contracts allow irrigators to appropriately manage both operational water risks and the structure of their capital and water balance sheets.

Box 5.1: Example: expanding agricultural production

An irrigator has a tree nut orchard. The irrigator has further land adjacent to the orchard that they are considering developing.

To support additional permanent plantings, the irrigator wants to secure access to high reliability water access entitlements. However, the irrigator does not have enough capital to develop the land and purchase additional water entitlements.

The irrigator could lease water entitlements from an investor and invest their available capital in developing the land, planting new trees and investing in irrigation infrastructure. The irrigator would have access to all the benefits associated with owning the entitlements, without the significant upfront capital expenditure required to purchase them.

The lease provides an alternative to obtaining finance or outlaying capital to purchase water access entitlements.

5.2.2 Investors increase water market liquidity

Water market liquidity describes the readiness with which participants are able to buy and sell water assets at predictable prices. Indicators of market liquidity are the presence of many buyers and sellers in the market and a narrow spread between bid and offer (buy and sell) prices with transactions taking place reasonably frequently.

The NSW Farmers’ Association (NSW Farmers) submitted that policy reforms to separate water from land ownership has facilitated the entry of new investors in water markets; 287 Investor participation in water markets has increased the number of potential buyers and sellers of water allocations, improving market liquidity. Increased liquidity makes it easier for market participants to buy and sell water at prices that reflect underlying supply and demand conditions.

NSW Farmers noted that investors provide out-of-cycle investment in the water markets by selling water allocations at a time when irrigators need to buy. Investors do not have water needs linked to agricultural production cycles. As a result, investors are a natural counterparty to irrigators, which increases the liquidity of the water markets.

The National Farmers’ Federation submitted that investors add financial liquidity to markets, enabling producers to hedge risk efficiently, particularly against a variable climate. It submitted that, if appropriately regulated, they provide a valuable service to communities. 288

Increased liquidity in the market may also allow irrigators to better achieve the full market value for their water assets, particularly, for example, if they seek to sell their water entitlements. 289

5.2.3 Investors provide irrigators with a range of water products which help manage water risks

Investors offer a range of products that assist irrigators in managing their businesses, including leases, forward contracts, and carryover parking (as described at subsection 5.4.2).

These products provide irrigators with flexibility in terms of on-farm production decisions, managing water supply risks and forward planning, and the option of reducing their exposure to the allocation market. 290 As noted by the Victorian Farmers Federation Sunraysia Branch, these products allow buyers to spread their risk and ensure adequate water supply at a known price across several years. 291

---

287 NSW Farmers’ Association, Submission to the Murray-Darling Basin inquiry issues paper, 13 February 2020, p. 5.
289 Kilter Rural, Submission to the Murray-Darling Basin inquiry issues paper, 5 March 2020, p. 10.
290 ACCC Murray-Darling Basin inquiry, Renmark public forum.
The NIC noted that investors’ participation in the water market enables many irrigators to more effectively hedge water access or water supply and water price (input cost) risk. Forward water contracts also enable irrigators to secure water allocations for future years, which may allow irrigators to more confidently forward sell their expected production at times when the forward commodity price is relatively high and profitable.292

Riparian Capital Partners submitted that water products allow irrigators to manage the water risks of their operations, and to structure both their capital and water balance sheets appropriately. Further, they stated that these products are likely to have resulted in the smoothing of supply and demand conditions from season to season, as irrigators secure leases and/or forward water allocations at lower prices. This allows them to produce in seasons when in-season supply and pricing conditions may not have allowed (that is, in dry conditions when water allocation prices are higher, and would otherwise make the watering of a particular crop unprofitable).293

Box 5.2: Example: using water products to mitigate risk

ABC Farms has 20,000 ML of high security entitlements, which it partly owns and partly leases from a third party. At 100% allocation the entitlements do not generate enough water to meet ABC Farms’ needs, so it has been purchasing water on the temporary market. The forecast is for below average rainfall in the region. ABC Farms is concerned that temporary market purchases are exposed to significant price volatility. To reduce its water supply risk, ABC Farms enters into a three year forward contract with an investor for supply of 2,500 ML of water each year. Under the forward contract, the investor is required to supply ABC Farms with a fixed amount of water on agreed delivery dates at a fixed price.

While there is some risk that it might rain and the price of water on the temporary market will not increase, the forward contract provides a number of benefits to ABC Farms:

- water supply certainty – the investor is obliged under the contract to supply the agreed volume of water.
- price certainty – water is supplied at the agreed price under the forward contract, regardless of the fluctuation of prices on the temporary market
- no upfront capital outlay – ABC Farms pays for the water at the time it is delivered under the forward contract
- production cost certainty – ABC Farms has a better sense of water costs so may be more confident to forward sell its crop.

5.3 The inquiry examined the position of the four large investors operating in the Murray–Darling Basin

There are four large institutional investors operating in the Murray–Darling Basin. These are Argyle Investment Management and Argyle Capital Partners (together Argyle Group), Kilter Rural, Duxton Water and Aware Water. A reference to the large investors is a reference to these four investors.

The ACCC used its compulsory information gathering powers under the CCA to obtain information and documents on the large investors’ water holdings, transactions and trading strategies. The ACCC used this information together with Basin State and irrigation infrastructure operator (IIO) data to examine their activities in the Murray-Darling Basin water markets.

5.3.1 Methodology for analysing the large investors’ water access entitlements

Unless otherwise indicated, information on the large investors’ permanent water holdings includes both water access entitlements and irrigation rights within IIOs.

There are significant differences between various entitlement classes. In this section we treated Victorian high reliability, South Australian high reliability and New South Wales high security entitlements (collectively referred to as high security entitlements) as analogous because they each provide reliable access to water across multiple water years.

In contrast, New South Wales general security entitlements and Victorian low reliability entitlements serve different purposes reflecting Victoria and New South Wales’ respective approaches to water management. In wet and average years, New South Wales general security entitlements will receive a volume of water against their entitlements. Outside of extreme wet years, Victorian low reliability entitlements in the Murray and Goulburn valleys will not receive any water. Therefore, Victorian low reliability entitlements are held almost exclusively for the purposes of carryover. In this section, the ACCC distinguished between New South Wales general security entitlements and Victorian low reliability entitlements unless otherwise indicated.

5.3.2 Entitlements held for agricultural production

Some large investors had invested in agricultural enterprises in addition to their water market trading operations. These investors dedicated a portion of their water access entitlements to these agricultural operations.

These entitlements and the associated water allocations were rarely, if ever, available to be traded on the water market. Therefore, the ACCC’s analysis sought to exclude these entitlements and associated allocations when analysing investor behaviour in water markets. Unless otherwise indicated, the following analysis of investor water access entitlements excluded entitlements investors reported as being held for agricultural production.

5.3.3 The large investors’ water access entitlements were predominantly in the Southern Connected Basin

The vast majority of the investor entitlement holdings were concentrated in the Southern Connected Basin.

As at 30 June 2019, the large investors collectively held 230 GL of high security entitlements, 81 GL of New South Wales general security entitlements, 56 GL of Victorian low reliability entitlements and 4 GL of supplementary entitlements across the Southern Connected Basin. The investors’ entitlement holdings were more heavily weighted towards high security entitlements, with between 54 and 68% of their respective portfolios consisting of high security entitlements. Collectively, this represented approximately 7% of all high security entitlements on issue across the Southern Connected Basin, 7% of all Victorian low reliability entitlements and 2% of all New South Wales general security entitlements on issue.

Outside the Southern Connected Basin, the investors held a total of 26 GL of water entitlements in various entitlement classes, including high and low security, medium security, groundwater and unsupplemented water entitlements.

---

Figure 5.1 illustrates that the large investors’ entitlement portfolios have grown markedly since 2013, particularly in Victoria and New South Wales. The investors’ holdings of Victorian high reliability entitlements increased from around 69 GL in June 2013 to almost 160 GL in June 2019. Their holdings of New South Wales high security entitlements increased by around 42 GL over the same period. The large investors have not invested in South Australian Murray entitlements to comparable levels, with the investors’ holdings only increasing by approximately 11 GL between June 2013 and June 2019.

The large investors’ low reliability and general security entitlement holdings have also grown considerably. In Victoria, the investors’ low reliability holdings have grown steadily since June 2013, more than doubling by volume. Their investment in New South Wales general security entitlements increased significantly from the end of the 2015-16 water year, with their holdings increasing from approximately 22 GL in June 2016 to over 81 GL in June 2019.

The four large investors commenced their respective investments in the water markets at different times, with some commencing before 2013. The extent of each investor’s contribution to the aggregate entitlement holding growth of investors shown in figure 5.1 varied.

5.3.4 Composition of the large investors’ water entitlement portfolios

The large investors’ entitlement holdings were distributed across the Southern Connected Basin as set out in figure 5.2.
Collectively, the majority of investor-held Victorian high reliability entitlements were concentrated in two trading zones, the Greater Goulburn (zone 1A) and Victoria Murray – Barmah Choke to SA (zone 7). New South Wales high security entitlements were spread evenly between the New South Wales Murray below the Barmah Choke (zone 11) and the Murrumbidgee (zone 13).

Collectively, the four investors’ general security entitlements were concentrated in the New South Wales Murray above the Barmah Choke (zone 10) and Murrumbidgee (zone 13). They also held between 15 to 22 GL of low reliability entitlements in three major Victorian trading zones, those being 1A, 6 and 7.

The investors also held a small volume of supplementary water access entitlements. These entitlements allow water to be extracted during announced periods when flows exceed those required to meet other licensed obligations and environmental needs.

Figures 5.3 and 5.4 respectively set out the proportion of all high and low/general security entitlements held by the large investors across the Southern Connected Basin as at 30 June 2019. The share of high security entitlements held by the investors in any particular zone was generally in the 7 to 8% range. However, in Boort (zone 1B) and the New South Wales Murray below the Choke (zone 11) there was a higher concentration of investor holdings. Figure 5.4 indicates that low reliability investor entitlements were more concentrated in a number of zones in Victoria when compared to New South Wales general security entitlements.

Figures 5.3 and 5.4 include environmental water holdings. This means that the four large investors’ share of high security entitlements in the consumptive pool was higher than these figures indicate.

Source: ACCC analysis based on s. 95ZK responses from the large investors.

For more information, visit the Water NSW website.
5.3.5 Large investors' shares of allocation trading activities

Figures 5.5–5.8 present the large investors' shares and volumes of Southern Connected Basin allocation trades-out and trades-in respectively, excluding zero dollar trades. These charts were prepared by combining Basin-State allocation trade data received from the South Australian, Victorian and New South Wales Governments in response to voluntary information requests.

The ACCC excluded zero dollar trades to better identify commercial trades between distinct buyers and sellers. The ACCC notes that this is an imperfect measure of commercial allocation trading activity, as
it does not reliably distinguish between allocation sales, deliveries on lease and forward contracts, and deliveries for carryover parking purposes.\textsuperscript{296}

Figure 5.5 shows that the four large investors collectively represented 11% of non-zero dollar trades-out in 2017–18, 19% in 2018–19 and 16% in the first 5 months of 2019-20. The extent of the investors’ allocation trades-out in the Southern Connected Basin was significantly greater than their entitlement holdings suggested. This is partly because, unlike investors, a large number of other entitlement holders do not frequently sell water allocations. This is also partly because some investors purchase allocations for resupply.

**Figure 5.5:** Large investors’ share of non-zero dollar allocation trades-out (volume) by year, Southern Connected Basin

![Figure 5.5: Large investors' share of non-zero dollar allocation trades-out (volume) by year, Southern Connected Basin](image)

Source: ACCC analysis based on South Australian, Victorian and New South Wales Governments’ responses to voluntary information requests and s. 95ZK responses from the large investors. The 2019–20 water year only includes data from July to November 2019. The chart excludes zero dollar trades.

**Figure 5.6:** Large investors’ non-zero dollar trades-out by volume by year, Southern Connected Basin

![Figure 5.6: Large investors' non-zero dollar trades-out by volume by year, Southern Connected Basin](image)

Source: ACCC analysis based on South Australian, Victorian and New South Wales Governments’ responses to voluntary information requests and s. 95ZK responses from the large investors. The 2019–20 water year only includes data from July to November 2019. The chart excludes zero dollar trades.

\textsuperscript{296} The ACCC obtained information from the investors on the trade type of their transactions. However, this information could not be used for this analysis, as the ACCC did not have similar information for all market participants.
Figure 5.7 shows that the large investors collectively represented 4% of non-zero dollar trades-in in 2017–18, 10% in 2018–19 and 2% in the first half of 2019–20. The ACCC considers that the investors still comprised a significant proportion of allocation trades-in in 2018–19, when considering investors also had access to seasonal allocations assigned to their entitlement holdings. However, there was considerable variance in the scale of allocation trades-in between different investors, with one of the investors accounting for the majority of investor allocation trades-in in each of the presented water years.

**Figure 5.7: Large investors’ share of non-zero dollar trades-in (volume) by year, Southern Connected Basin**

Source: ACCC analysis based on South Australian, Victorian and New South Wales Governments’ responses to voluntary information requests and s. 95ZK responses from the large investors. The 2019–20 water year only includes data from July to November 2019. The chart excludes zero dollar trades.

This analysis shows that the scale of allocation trading activity of particular investors was not necessarily linked to the size of their entitlement holdings, as some investors purchased (and then sold) more allocations than others.
Figures 5.9A to 5.12B present a more detailed analysis of the four large investors’ shares of allocation trades-in and trades-out in the Lower-Murray as a whole (zones 7, 11 and 12) and zone 7 specifically across the 2018–19 water year. As the Basin State data only recorded the date the trade was submitted for approval and the date the trade was approved, there was a level of uncertainty as to the exact date of each trade. For this reason, the analysis was undertaken on a monthly basis.

Large Investor share of allocation trades-in in the Lower Murray and zone 7

The level of the investors’ engagement with water allocation markets fluctuated throughout the season.

Figures 5.9A and 5.9B respectively set out the volume and proportion of non-zero dollar allocation trades-in by the investors in the Lower Murray (zones 7, 11 and 12) each month for the 2018–19 season. Around three quarters of all allocation trades-in by the investors in 2018-19 were into or within the Lower Murray.

The investors’ share of allocation trades-in fluctuated between 3.5 and 18% of all non-zero dollar allocation trades-in each month. On average, the investors represented around 13% of allocation trades-in per month. The vast majority of these trades-in were conducted by a single investor.

Figure 5.9A: Volume of large investor non-zero dollar trades-in within the Lower Murray (zones 7, 11 and 12), by month, 2018–19

Figure 5.9B: Proportion of large investor non-zero dollar trades-in within the Lower Murray (zones 7, 11 and 12), by month, 2018–19

Source: ACCC analysis based on South Australian, Victorian and New South Wales Governments’ responses to voluntary information requests and s. 95ZK responses from the large investors.

Figures 5.10A and 5.10B respectively set out the volume and proportion of allocation trades-in attributed to the investors in the 2018–19 water year in zone 7 (Murray-Barmah to SA). The proportion of allocation trades-in captured by the investors was amplified slightly when focusing exclusively on zone 7. This was because trades into zone 7 alone accounted for nearly 80% of allocations acquired by the investors in the Lower Murray. Like figures 5.9A and 5.9B above, the vast majority of this water was acquired by a single investor.
Large Investor share of allocation trades-out in the Lower Murray and zone 7

As a group, the large investors were far more active in the trades-out of allocations.

Figures 5.11A and 5.11B set out the monthly volume and proportion of allocation trades-out by the investors in comparison to the rest of the market in the Lower Murray (zones 7, 11 and 12) in the 2018–19 water year.

Similarly to allocation trades-in, around 70% of water allocations sold by the investors were sold into or within the Lower Murray. Zone 7 alone accounted for more than 45% of all the investors’ allocation.
trades-out for the year. As shown in figure 5.11B, in 2018-19, the investors accounted for around 24% of all non-zero dollar trades to the Lower Murray. The proportion of sales captured by the four investors on a monthly basis peaked around 36% in March 2019, when the investors sold a combined 28 GL of allocations.

In the first half of the 2018-19 water year, each of the investors was responsible for a significant proportion of the group’s overall trade out, and no single investor was responsible for a majority of that monthly trade. However, from April to June 2019 one single investor was responsible for most of the trades-out by the group in the Lower Murray.

The volume and proportion of allocations traded-out in zone 7 are set out in figures 5.12A and 5.12B and followed a similar trend to the broader Lower Murray system.

The ACCC examined the implications of the investors’ trading activities for the water markets, and this is discussed in chapter 6, including whether any investor was able to exercise market power.

5.4 The inquiry examined the strategies of the four large investors

The four large investors adopted broadly similar investment and trading strategies, primarily deriving capital growth from investment in entitlements and deriving income by supplying water products.

5.4.1 The large investors had similar buy-and-hold entitlement strategies

The large investors principally pursued buy-and-hold entitlement investment strategies that aimed to achieve long-term capital growth and yield by investing in a diversified portfolio of water entitlements across the Basin. Some investors specifically relied on the interconnectivity of the Southern Connected Basin as part of their investment strategy.

The large investors held greater volumes of high security entitlements than low reliability and general security entitlements, and high security entitlements provided the bulk of the large investors’ seasonal allocations. Some investors saw high security entitlements as providing a superior combination of
capital growth and yield, but some investors also acquired low reliability entitlements to utilise them to carry over water between water years.

The large investors considered a range of factors when deciding which entitlements to acquire, including:

- the concentrations and types of industries comprising the demand for allocations assigned to the entitlement and their capacity to pay for these allocations
- the transferability of allocations from the entitlement trading zone to other trading zones
- the expected income to be generated from the assigned allocations under the entitlement
- other structural factors, including the reliability of allocations under the entitlement, carryover flexibility and the prevalence of buyers and sellers for the entitlement
- mandates or directions by the investor’s own investors.

Some large investors identify target portfolios of specific entitlements or entitlements defined by trading zone, type and/or security class that they aim to acquire in order to deliver optimal long-term capital growth and yield.

Although the large investors primarily adhered to long term buy-and-hold investment strategies, they sold entitlements from time to time. For instance, some large investors were able to extract a premium on large parcels of entitlements, and then sought to progressively reacquire the sold volume of entitlements from the market at a cheaper overall price. Some investors also sold entitlements when they believed specific entitlements were overvalued, or to rebalance their entitlement portfolio against their target portfolio, or to generate cash to pay out redemptions to their clients.

5.4.2 The large investors generated income from their entitlements by supplying water products

The large investors generated income from their underlying entitlements by offering a range of water products to irrigators. These products included entitlement leases, forward contracts, spot allocations and carryover parking.

Entitlement leases

Our enquiries identified two broad forms of entitlement leases:

- A limited term transfer or term transfer lease, which involves the allocations and other rights of an entitlement, or parcel of entitlements, being directly assigned to the lessee’s water accounts. The lessee receives all the benefits and rights of the entitlement and is also liable for its associated costs (like storage fees) during the term of the lease. Such a lease is registered on a state register.

- An allocation transfer lease or entitlement supply agreement which requires the lessor to deliver the seasonal allocation volumes attached to a specified volume of entitlements to the lessee during the term of the lease. Such leases are not registered on a state register. They can reduce counterparty risk for the lessor, as allocation transfers may be withheld until lease payments are received and allocations may be met using seasonal allocations received on entitlements in other zones.

Entitlement leasing was a key income stream for the large investors as it provided a predictable source of medium to long-term income. Some investors targeted an annual lease fee based on a percentage of entitlement value. The investors commonly offered three to five-year lease terms exclusive of renewal options.

As at 1 July 2019, the large investors had between 40 and 80% of the volume of their high reliability entitlements committed to leases for the 2019–20 water year. Some investors had significantly increased their lease commitments in the 2019–20 water year compared to previous water years.

With entitlement leases the investor (as the lessor) does not bear the effects of seasonal allocation variability (allocation risk) as the lease is not tied to a specific volume of water. Instead, the lessee bears allocation risk under a lease.
Forward contracts

In contrast to entitlement leases, forward contracts shift allocation risk to the selling party. Investors can supply water under a forward contract from allocations assigned under their own entitlements and/or by purchasing water allocations. Investors supplying under forward contracts are exposed to the risk of seasonal allocations being below expectations. Investors can also be exposed to an associated price risk if they need to purchase water to meet forward contract commitments, as allocation prices could have increased by the time the water is to be supplied.

Some investors mitigated their allocation and price risks by carrying over allocations or by purchasing allocations beforehand to service forward contract commitments.

The investors charged forward prices at a premium to the prevailing spot price at the time of agreement. In the case of multi-year forward contracts, some investors also required a sufficient premium to the prevailing lease rate, and at times required a premium to annual forward contracts.

Spot allocation sales

The investors adopted different spot allocation selling strategies with respect to the timing of sales. Some adopted a more passive approach of selling down their expected annual allocations in a linear manner, with roughly equal volumes of monthly spot allocation sales during the water year. Some investors timed the market in a general sense by targeting their allocation sales to times of high seasonal demand. In timing the market, some investors specifically accounted for the seasonal water usage profiles of regional agricultural industries. Some investors had occasionally suspended spot allocation sales on the basis that spot allocation prices were likely to increase in the short-term, or to retain flexibility to capitalise on sudden increases in allocation prices. Some investors adopted price and/or volume targets to direct their allocation trade.

Carryover parking

Carryover parking involves the renting of the carryover capacity of an owned entitlement to a counterparty. In practice, this involves receiving a volume of allocations from the counterparty prior to the end of a water year and returning the net allocations to the counterparty after the start of the next water year.297 The provider of carryover capacity receives a fee for this service. Carryover renting fees commonly represented less than 5% of net annual income for some large investors.

5.4.3 The large investors had different approaches to purchasing allocations

The large investors adopted different strategies regarding allocation purchases.

As indicated above, some of the investors purchased allocations to meet their forward contract commitments, either to cover unplanned shortfalls in allocation holdings or as part of a deliberate forward contract strategy. Some had also a strategy to purchase allocations in wet years to carry over into future dry years for sale.

Other investors actively purchased and sold allocations on the spot market to generate income. This involved the buying and selling of allocations to capitalise on opportunities in the fragmented water markets. It also involved the purchasing of allocations before reselling in periods of expected short-term higher demand to derive profit. One investor was a particularly active purchaser of allocations in 2018–19, as set out in the analysis below.

297 In Victoria, 5% of the volume carried over is forfeited to account for evaporation losses. New South Wales and South Australia’s carryover rules do not provide for a similar adjustment of carryover volumes and the transferor will take back the full volume of water transferred to the investor. See section 15.2 for more detail on carryover arrangements.
5.5 The ACCC examined the temporary water allocation trading activities of the large investors

The ACCC undertook a review of the allocation trading activities of the large investors for the 2017-18, 2018-19 and 2019-20 (July to November) water years in the Southern Connected Basin. Over the past three years, all of the investors engaged in temporary allocation trading to some degree. This section details the investors’ trading activities in 2018-19. This water year was selected because significant trading activity took place and many concerns raised by stakeholders related to this water year. The ACCC notes that some unique circumstances arose in 2018-19 and this water year should not be taken as representative of all past and future water years.

5.5.1 The highly fragmented and incomplete nature of trading information in the Murray-Darling Basin makes effective market oversight difficult

Information on trading activity in the Murray-Darling Basin is highly fragmented and incomplete. Each of the Basin States maintains its own register of water trading activity. Each IIO also retains its own record of trades inside its network. Each of these systems and repositories operate in isolation. As water market trading becomes more sophisticated and water market participants increasingly trade water between Basin States or a Basin State and an IIO network, the fragmented nature of the data collection will prohibit effective market oversight.

To review the trading activities of the investors in the Southern Connected Basin, the ACCC compiled state registry data provided by the New South Wales, Victorian and South Australian state governments and further information obtained compulsorily from the investors. The ACCC also sought to examine IIO data where available.

Based on the ACCC’s experience in the inquiry, it is not possible to ascertain the conduct or trading patterns of market participants from a single source of information. The current quality of data and data collection arrangements made analysis of market participants’ trading behaviour difficult, time consuming and resource intensive. To conduct this analysis, the ACCC joined the multiple sources of data together to properly analyse the water allocation trading activities of the large investors across the Southern Connected Basin. In spite of this extensive data collection exercise, there remained some gaps and limitations to the data. Better data collection and coordination across Basin States and IIOs are central to effective market oversight.

Trade categories

The Basin State data did not distinguish between the various sub-categories of trade, such as sales and purchases of allocation, trades under a lease or forward agreement, and trades under a carryover parking arrangement, which can distort interpretation of transaction prices. Without this information, it was difficult to clearly identify spot market activities and therefore analyse the conduct of market participants. To address this issue, the ACCC obtained additional information from the investors in order to identify the different sub-categories of trade. The ACCC notes that New South Wales and Victoria (for electronic trade forms) have recently implemented changes to their trade processes to collect information on allocation trade types. South Australia is currently investigating opportunities to implement similar changes as part of a broader initiative to modernise South Australian water management and registry systems (see subsection 11.2.2).

Price reporting and zero dollar trades

While the Basin State registers provided a relatively accurate record of account and trade volumes, they did not necessarily reflect the actual price paid. This is a result of diverging data collection approaches
between the various states and different practices when reporting the prices of various types of trades by market participants. The ACCC considers there are a number of legitimate reasons for zero dollar trades, such as where a water holder is moving water between zones (either on its own accounts or through a broker’s) or where allocation is traded under a ‘wet’ entitlement sale.

Strike Date

In the period considered by the inquiry, the Basin States did not require market participants to report the date a trade was agreed to on their trade approval forms. Instead, Basin State registers recorded the date a trade was submitted to the trade approval authority and the date the trade was approved. Although exchange platforms had a record of the date and time bids and offers were matched, this information needed to be collected from multiple platforms. In addition, strike date information was not readily available for trades negotiated through other means, and was not collected by Basin States in any event. Without this data, it was not possible to retrospectively know how much water was traded in different trading zones on any given date.

The ACCC notes that New South Wales and Victoria (for electronic trade forms) have recently implemented changes to their trade processes to collect information on strike dates. South Australia is currently investigating opportunities to implement similar changes as part of a broader initiative to modernise South Australian water management and registry systems (see subsection 11.2.2).

Commercial identifiers

In some instances, it can be difficult to identify the true parties conducting a trade if an entitlement has been acquired, disposed of or leased, or the name associated with an account or licence is very different to the name of the overarching commercial entity responsible for the trading activity. From a market oversight perspective, it is important for water market participants to be easily and consistently identifiable in the data. This highlights the need for a unique identifier for each commercial entity to be used for each transaction.

NSW and South Australia IIO trades

The fragmented nature of Basin State allocation trade register data and IIO internal temporary irrigation right trade data makes it difficult to trace the counterparty and the purpose of trades into and out of NSW and South Australian IIO networks.

As described in Chapter 2, trades into or out of an IIO’s network generally entail a water allocation trade to or from the IIO’s licence or account, and a crediting or debiting of the internal customer’s account (see section 2.4). These arrangements mean that the IIO appears as the buyer or seller in the Basin State registry data (rather than the name of the internal trader within the IIO’s network). In addition, IIOs are not required to report temporary irrigation right trades within their networks to the relevant Basin State trade approval authority or register. Information about internal trades is recorded by IIOs for their own internal purposes and for some IIOs to comply with the requirement to report to the Bureau of Meteorology.

Due to these arrangements, the ACCC was unable to create a combined dataset of all water trades by the investors across the Southern Connected Basin including trades within NSW and South Australian IIOs. The ACCC considers that Basin State and IIO data must be consistent and joinable in order to provide regulators with a complete and accurate picture of the water trade occurring within the Basin. The ACCC’s recommended options to improve the consistency of data across the Basin is discussed in subsection 12.4.2.

---

298 The Victorian and South Australian Registers record price on the basis of the total transaction value divided by the quantity traded; the New South Wales Register records price on a per ML basis.
- Victoria: Form 39
- New South Wales: Form 71 for surface water assignment
- South Australia: Form A1.

299 Market participants have indicated that they report the value of certain trade differently to the Register, in particular regarding leases and forwards.
Carryover

It is not possible to identify the true volume of allocation carried over by market participants from a single data source. Basin State registers and IIO water management systems do not distinguish between carryover belonging to the account holder and carryover held under a carryover parking agreement with a third party. Furthermore, any party that utilises carryover parking services will have water stored outside of their own water accounts.

Consequently, at least three data sources were required to determine the volume of carryover by a market participant, including Basin State registers, an IIO’s water management records, and a market participant’s own trading records.

Further discussion of data quality issues is at Appendix G.

5.5.2 The ACCC examined the trading activities of the large investors in the Southern Connected Basin the 2018–19 water year

Methodology

In conducting this review the ACCC analysed the water allocations held by the large investors on their licences or accounts for the purpose of trading water products. Trading activity recorded on a Basin State register was combined with the investors’ internal trading records to allow the ACCC to more accurately classify the various types of trades. The figures aggregate the trading data of the large investors.

The ACCC excluded internal transfers between an investor’s own accounts or licences and zero dollar trades with water brokers for the purposes of trading water between zones from the figures below. These were excluded on the basis that they did not represent a disposal or acquisition of water because ownership of the allocation remained with the investor, and would misrepresent the volume of water actually traded by the investors.

The ACCC classified the various types of trading activities as follows:

- seasonal allocation: temporary allocation received through an investor’s entitlement holdings
- spot water trade: sale or purchase of temporary allocation to or from a third party for consideration
- trade under a lease: a trade pursuant to an arrangement under which the investor passes any water received against its leased entitlements to the lessee
- forward: a trade pursuant to an agreement under which the investor supplies an agreed volume of temporary allocation to the buyer on an agreed date
- ‘internal transfer to/from IIO: a transfer of allocation into or out of an IIO network
- carryover parking: temporary allocation transferred to an investor at the end of a water year to be stored against the investor’s entitlements, which is then returned to the client after the beginning of the following water year
- carryover: unused temporary allocation stored for trade in the following season(s). Note that the carryover volume includes both the investor’s own water as well as water held under a carryover parking arrangement. If an investor used the carryover parking services of third parties, those trades have been categorised as carryover for the purposes of this analysis.
- settlement transfer: temporary allocation associated with the sale or purchase of a ‘wet’ entitlement (an entitlement purchases or sold with its allocation for that water year).

The analysis includes a category called ‘other’. This category includes a small number of trades with irrigators, for which a trade type has not been identified, and some debit errors and corrections.

The analysis in this section of the report is primarily concerned with allocation trading activity. Certain types of trading activity, such as Limited Term Transfers or Term Transfers under which the lessee

300 Water acquired for agricultural purposes is excluded from the analysis.
obtains possession of the underlying entitlement, do not involve a trade of allocation and are not represented in the following analysis.

**Large Investor trades for 2018–19 water year**

Figure 5.13 shows the seasonal allocation, carryover and different types of trading activities on the large investors’ Basin-State trading accounts or licences in 2018-19.

**Figure 5.13:** Seasonal allocations, carryover and types of trading activity undertaken by the large investors, Southern Connected Basin, 2018–19

The investors offered a range of water products in the Southern Connected Basin in 2018-19. They provided approximately 176 GL of water on the spot market and traded approximately 102 GL for the purpose of fulfilling a lease or forward water agreement. The investors collectively received 167 GL of seasonal allocation from their own water access entitlements and purchased 129 GL of allocation through spot water trade. Three of the investors delivered the majority of their water products to the market using their own seasonal allocation.

**Spot Allocation Trading**

Figure 5.14 shows the volume and timing of spot water trade undertaken by the large investors in the 2018–19 water year for the Southern Connected Basin.
A key concern for many stakeholders was the participation of investors in spot allocation purchasing. Approximately 89% of the volume of all large investor spot allocation purchases and 67% of the volume of all large investor spot allocation sales in the Southern Connected Basin in the 2018–19 water year were attributed to one investor. The ACCC observed that this investor was a very active participant in the water market, mainly in Victoria. It purchased a significant number of small parcels of water and sold water back into the market in larger parcels.

This investor’s temporary allocation trading activity was unlike the other three investors. From late 2017 to mid-2019, the investor raised capital and temporarily deployed that capital into the temporary allocation market as it waited for suitable permanent entitlements to become available to purchase. As it secured permanent entitlements, it entered into a large number of lease arrangements with individual irrigators. The ACCC observed that in the first half of the 2019–20 water year, this investor had not been as active in trading water allocations as it was in the previous water year.

**Large investors’ water allocation holdings on a State by State Basis in 2018–19**

The ACCC examined the cumulative volume of the allocation held by the investors on a state by state basis. Figure 5.15 shows the cumulative water allocations held by the investors in Victoria over the course of the 2018–19 water year.
Figure 5.15: Large investors’ cumulative volume of water allocation held, Victoria, 2018–19

Source: ACCC analysis of Victorian Government’s response to a voluntary information request and s. 95ZK responses from the large investors.

Figure 5.15 shows that the investors received a significant portion of their water through seasonal allocations at the start of the water year. The ACCC observed that in 2018–19, some investors began to reduce their overall water allocation holdings in Victoria from September–October 2018, while others began to substantially reduce their overall Victorian water allocation holdings from January 2019.

Figure 5.16 shows the cumulative water allocations held by the investors in New South Wales over the course of the 2018–19 water year.
Figure 5.16: Large investors’ cumulative volume of water allocation held, New South Wales, 2018-19

Figure 5.16 shows that the investors received the majority of their allocation through seasonal allocation and carryover from the 2017-18 water year. Compared to Victoria, the investors undertook limited spot water trading on their New South Wales licences. Instead, most trades were for the purpose of transferring allocation into an IIO network, or to deliver on a lease or forward contract.

Figure 5.17 shows the cumulative water allocations held by the investors in South Australia over the course of the 2018-19 water year.
The investors collectively undertook significantly less trading on their South Australian accounts. The investors received the majority of their water through seasonal allocations, and either provided it back to the market through spot water trades or trades under a lease or forward contract. Two investors collectively transferred approximately 5.5 GL of allocation to their Victorian ABAs.

Examining the investors’ South Australian water accounts does not provide a complete picture of their trading activity in South Australia. The interconnected nature of the Southern Connected Basin allows water market participants to trade water across State boundaries. In addition to water products generated from their South Australian entitlements, the investors also collectively provided approximately 28 GL predominantly to South Australian irrigators and agribusinesses from their Victorian and New South Wales accounts and licences.

**Internal Transfers**

The volume of trade between the investors’ accounts was significant. In 2018−19, the investors transferred approximately 89 GL of water between their Basin State accounts and licences. In addition, the investors also transferred water between their Basin State accounts and licences to their accounts within IIOs. This is discussed further in the next section.

The investors’ collectively transferred approximately 63 GL of water into their zone 7 (Vic Murray–Barmah to SA) accounts from other zones. The majority of this water came from zone 1A (Greater Goulburn – 29 GL) and zone 6 (Vic Murray above the Barmah Choke – 20 GL). The investors relied heavily on water brokers to assist with their transfers of allocation through IVT restrictions and the Barmah-Choke.

---

**Source:** ACCC analysis of the South Australian Government’s response to a voluntary information request and s. 95ZK responses from the large investors.

---

This figure includes interstate and intrastate transfers.
Investors’ trading with IIOs

Each of the large investors traded with customers located within IIO networks. Some investors also held accounts and irrigation rights within a number of the IIO networks.

As indicated in subsection 5.5.1, the ACCC was unable to create a combined dataset of all large investors’ trades across the Southern Connected Basin including trades within NSW and South Australian IIOs. The ACCC therefore examined the large investors’ trading with IIOs separately.

The ACCC used data from the Basin State registers and IIOs, and supplemented this with information compulsorily gathered from the investors themselves.

Figure 5.18 sets out the investors’ allocation trading activities with the large IIOs, Murray Irrigation Limited (MIL), Murrumbidgee Irrigation (MI) and Coleambally Irrigation Cooperative Limited (CICL). The figure includes trades within MIL, MI and CICL, as well as trades between the investors’ Basin state accounts or licences and their accounts within the IIOs.

The different types of trades are separated out as follows:

- seasonal allocation: allocations received against irrigation rights held within an IIO network
- internal transfers into and out of an IIO: allocation trades between an investor’s Basin State account or licence and its own IIO account
- trade into an IIO: allocation purchased into an IIO from a seller outside the IIO
- trade out of an IIO: allocation sold from an investor’s IIO account to a buyer outside the IIO
- trade in (within IIO): allocation acquired by an investor from a seller also located within the same IIO
- trade out (within IIO): allocation sold by an investor to a buyer also located within the same IIO.

A large proportion of the investors’ overall engagement with IIO customers was actively purchasing and selling temporary allocations within an IIO (i.e. where both the buyer and seller were located within the IIO network). In 2018-19 the large investors acquired over 44 GL of water from sellers within MIL, MI and CICL, and sold over 56 GL to buyers in those IIOs from their own IIO accounts. The overwhelming majority of these purchases and a large majority of these sales are attributable to one investor.

The large investors also moved significant volumes of water into and out of IIO networks through internal transfers between their own accounts. In the 2018-19 season, they traded over 29 GL of water from their Basin state accounts and licences into their IIO accounts. Approximately 22.5 GL related to
transfers of allocation from zone 7 into the MIL irrigation network. The investors transferred around 23 GL of water back from their IIO accounts to their zone 7 ABAs or zone 11 water access licences. To a lesser extent, the investors also bought and sold water allocations that were transferred between their and customers’ Basin state accounts and licences and IIO accounts. For example, in 2018–19 the investors sold around 2 GL of water to customers in IIOs from their Basin state accounts and licences, and purchased around 7.5 GL of water from customers outside IIOs into their IIO accounts.\textsuperscript{302}

### Carryover

The ACCC estimated that the large investors collectively carried over approximately 40 GL of water from the 2017–18 water year into the 2018–19 water year in the Southern Connected Basin. At the end of the 2018–19 water year, the large investors carried over approximately 39 GL of water into 2019–20. These figures were derived by calculating the total volume of carryover on the investors’ Basin State and IIO accounts and licences and also incorporated carryover parking undertaken for the investors by third parties.

Carryover was an important part of an investor’s strategy for delivering water products. The large investors collectively carried over approximately 19 GL of water into 2018–19 and approximately 12 GL of water into 2019–20 on behalf of customers through carryover parking services.\textsuperscript{303}

The ACCC estimated that overall, the large investors carried over for themselves around 20 GL into the 2018–19 water year and around 27 GL into the 2019–20 water year. This represented less than 2% of the total volume of water carried over by all market participants. However, not all water carried over into the 2019–20 water year was available for allocation sales.

Some investors used carryover to deliver on forward contracts. In 2019–20, the large investors collectively committed to deliver approximately 33 GL of water through forward contracts. Towards the end of the 2018–19 water year, one investor purchased allocation to carry over in anticipation of low seasonal allocation at the beginning of the following water year. Another investor used carryover to mitigate their delivery risks and lock in a margin for the sale of their forward contracts. One investor also purchased allocations at the end of the 2018–19 water year as water prices softened, to carry over and sell in the following year.

#### 5.5.3 Agribusinesses and irrigators were the large investors’ key customers

The ACCC examined the customer profile of the large investors for spot allocation sales. Figure 5.19 shows the proportion of water allocation sold by the large investors for the 2018–19 water year to different customer type. This chart was prepared using Basin-State data and includes trades with an IIO recorded on a Basin State register, but does not include trades within an IIO.

\textsuperscript{302} Both of these kinds of trades are listed as ‘Trade into IIO’ in figure 5.18.

\textsuperscript{303} This analysis relies on information provided by the large investors in response to s.95ZK notices.
Collectively, irrigators and agribusinesses were the most significant customer types of the investors in the 2018–19 water year, accounting for approximately 63% of the volume of allocation sales. The proportion of sales between irrigators and agribusinesses varied depending on the investor. IIO networks and brokers/exchanges accounted for 13.1 and 7.7% of the volume of the investors’ allocation sales respectively. These parties typically hold water on trust for irrigators and agribusinesses to facilitate trade. The investors traded approximately 10.5% of their water allocations to non-institutional investors.

The large investors sold their water products to customers via direct negotiations with customers, engaging a water broker to sell water on their behalf or an exchange platform. Direct negotiations enable investors to reduce transaction costs, improve their understanding of a customer’s business, build customer relationships and maintain confidentiality with their client. If an investor trades via a water broker or an exchange platform, the investor normally does not know the identity of their customer. For some large investors, direct engagement with customers was an important part of their strategy, while others traded more through intermediaries.

The ACCC observed that the four large investors tended to sell larger parcels of allocation than other sellers. In 2018-19, the average volume of allocation sales by the large investors was 312 ML, the median volume was 200 ML and the maximum volume of allocation sold in a single trade was 3,000 ML. All large investors’ business models enabled them to meet demand from customers requiring large parcels of water, from the allocations received under their entitlements and/or by aggregating small purchases.

5.6 Smaller investors were also active in the Southern Connected Basin

In conducting this inquiry, the ACCC identified a number of small investors that traded water allocations in the Southern Connected Basin.

The ACCC used its compulsory information gathering powers under the CCA to obtain information about the water holdings and trading strategies of four small investors. A reference to the small investors in this section refers to these four investors.

Some of the small investors were individuals while others were small trading companies. Some conducted trading activities alongside their farming activities. Some small investors had been active in water markets for a long period of time, while others had entered the market in recent years.
Generally small investors owned no or very few water entitlements, however some small investors were focused on entitlement ownership. Some small investors received water pursuant to entitlement leases and forward contracts, and some provided water via forward contracts, usually to irrigators.

Most small investors were active traders in the market, frequently buying and selling water allocations. The ACCC observed that some small investors bought and sold water allocations more frequently than some large investors. Most relied upon water brokers and broker exchange platforms, rather than dealing with a customer directly.

Figure 5.20 shows that each month the four small investors generally sold a similar volume of water to the amount they purchased. This reflects frequent buying and selling of water allocation, and avoidance of risks associated with holding water.

**Figure 5.20: Combined volume of spot allocation purchases and sales by the small investors, by month, July 2017–November 2019**

For some small investors, trading across the Southern Connected Basin was an important part of their trading strategy. Most were successful in moving water from zone 6 to zone 7 through the Barmah Choke, and between valleys. Some small investors developed technology which assisted them to trade through the Barmah Choke, while others spent time monitoring public websites. In the 2018–19 water year the small investors moved over 7GL of water from zone 6 to zone 7. During the first five months of the 2019–20 water year the small investors moved almost 4GL from zone 6 to zone 7. Other small investors avoided IVTs and considered them too risky.

Some small investors had specific strategies where they only bought in one zone and sold in another specific zone. Others bought and sold depending on market conditions and prices across the Southern Connected Basin. Most traded allocations year round, but some only participate in the market when specific market conditions arose that suited their trading strategy.

Most small investors spent a significant amount of time monitoring the market, including allocation announcements, IVT openings, the price of water allocations in different zones and/or the types of agriculture in different zones.

During the course of the inquiry, the ACCC identified a number of other trading accounts that may be categorised as small investors. Some trading accounts were linked to irrigators or water brokers, highlighting that some small investors may participate in water markets in multiple capacities. Some accounts appeared to be individuals or small companies who focused solely on trading water allocation. It appeared that some small investors participated in water markets continuously, while others were only active intermittently.
In addition, information provided to the inquiry indicated that retired farmers may retain their water entitlements, including in self-managed superannuation funds, and supply water products from these entitlements (leases or water allocation sales).

5.7 Investors understand the complex market dynamics of the Southern Connected Basin

The large investors had a sophisticated understanding of the market dynamics of the Southern Connected Basin. They were conscious of the seasonal and long-term water needs of different industries in the Basin and how that demand may impact Basin water markets. In addition, three of the large investors had agribusiness arms and were able to leverage knowledge of irrigated agriculture from their groups’ respective agribusiness portfolios.

All four small investors had a high level of knowledge about how the water markets operate, which they obtained through previous employment or their involvement with irrigated agriculture, and could dedicate the time to investigate and pursue trading opportunities.

Generally, the investors considered the Southern Connected Basin holistically and sought to move water to the areas of greatest demand, as permitted by the trading rules at the time. Both large and small investors had a good understanding of the price differentials that could arise between different zones within the Southern Connected Basin. The investors often transferred water between water accounts, including within an IIO, to move some allocations to the trading zones with a higher demand and price prior to sale. They also moved water between zones to take advantage of price differentials for forward contracting and water leases. This involved moving water between different trading zones separated by the Barmah Choke or the Murrumbidgee and Goulburn intervalley trade restrictions. The investors were conscious of the risks associated with restrictions and had adopted strategies to manage these risks.

The ACCC’s observations of small investors suggests that participants in water allocation markets do not need to employ large teams of people or have access to substantial capital in order to trade successfully.
6. Examination of investors’ conduct

Key Points

- During the inquiry, many stakeholders raised concerns about the conduct of investors in water markets. In broad terms, the concerns related to the ability of investors to influence water markets and specific conduct resulting in market distortions and artificially inflated prices.
- The ACCC did not find evidence that investors exercised market power or manipulated prices to increase water prices in the Southern Connected Basin water markets.
- Broadly, price manipulation is conduct that results in a price that does not reflect genuine forces of supply and demand. It generally includes creating or maintaining an artificial price.
- The data suggests that rising prices over the 2018–19 and the first half of the 2019–20 water years was due to limited inflows and increasing water scarcity, and the level of water demand over this period.
- The ACCC undertook extensive analysis to reach this conclusion. The ACCC used its information gathering powers to obtain data from investors and exchange platforms, as well as other information and documents, to complement the Basin State data. The ACCC also conducted private hearings of representatives of a large investor to examine its investment and trading strategy and activities.
- One large investor was the largest trader of water allocation in 2018–19. During the first half of 2018–19 when prices were lower, the large investor was a net buyer, accumulating water allocations but maintaining an active role as a seller. During the second half of 2018–19 when water prices were higher, it was a net seller but it continued to buy water allocations. During this period there were a large number of competing sellers of water allocation. The data suggests that neither the large investor nor any other water sellers exercised market power.
- The ACCC found that there were wide market spreads between buy orders and sell orders. This could result in large price movements in trades. Such trade outcomes may be best attributed to poor liquidity rather than price manipulation.
- The ACCC was only able to conduct its analysis by using its information gathering powers, and obtaining data from a wide range of sources to enable a detailed picture of trade activities. However, the ACCC was unable to examine some allegations due to deficiencies in the available data and the time that had elapsed since the issue occurred.
- The ACCC considers that poor quality public data contributed to misconceptions and misinformation about the conduct of market participants, and harmed confidence in water markets.

Over the course of the inquiry, stakeholders raised concerns about the conduct of investors in the Basin water markets. The ACCC examined these concerns, as well as other trading activities observed in the data that appeared unusual or suspicious.

This chapter sets out the ACCC’s analysis and conclusions regarding investors’ conduct in the water markets.

6.1 Stakeholders raised concerns about the conduct of investors

In public forums, complaints to the ACCC, and submissions in response to the issues paper and the interim report many stakeholders raised concerns about the conduct of investors in water markets. Some stakeholders raised general concerns about the presence of investors in the water markets and
questioned their value. Many alleged that investor behaviour had resulted in materially higher water allocation prices. In broad terms, the concerns related to the investors’ ability to influence Basin water allocation markets and specific conduct resulting in market distortions and artificially inflated prices.

For instance, Robert McGavin, CEO of Boundary Bend, submitted that:

> The conduct of non-water users in water markets is harming not only farmers, but also rural communities and, ultimately consumers by artificially inflating prices in a manner that does not reflect the natural forces of supply and demand. We estimate that during the last 3 irrigation seasons, the conduct of non-irrigators has raised the price of temporary water by $100/ML to $500/ML above the price that would otherwise prevail in the current climate, if irrigators were only competing with each other for the available temporary water.

6.1.1 Stakeholders were concerned about investors’ ability to influence water markets

Stakeholders raised concerns about the competitive dynamics of water markets. Some alleged that investors had market power which they used to influence the market.

Some stakeholders submitted that investors had advantages in analytical resources, financial market access and financial backing, and were unconstrained by the need to apply water for agricultural production. Participants at the Shepparton forum submitted that larger buyers operating in shallow markets may have been able to influence market quantities and prices to their advantage.

6.1.2 Stakeholders alleged investors withhold water to raise prices

Some stakeholders raised concerns that investors were buying water allocations and withholding water from the water markets to artificially drive prices higher.

Some stakeholders alleged that investors bought a large proportion of available allocations early in the water year, when seasonal allocation and trade volumes are low. This cleared lower-priced allocations and forced up the price for allocations. Stakeholders alleged that investors did not supply these purchased allocations for a large part of the season, while also withholding allocations received under their own entitlements. This allegedly restricted market supply sufficiently to artificially raise allocation prices by a material amount. Stakeholders alleged investors then supplied allocations to the market at inflated prices at times of peak demand.

Stakeholders also alleged that investors carried over allocations at the end of the water year to withhold allocations across multiple water years to push prices up. They stated these allocations could otherwise have been used by irrigators in preceding water years at lower prices.

---


305 Murray River Group of Councils, Submission to the Murray-Darling Basin inquiry issues paper, 30 January 2020, p. 4; Select Harvests Limited, Submission to the Murray-Darling Basin inquiry issues paper, 16 April 2020, p. 2; ACCC Murray-Darling Basin inquiry, Southern Basin public forums.


307 Select Harvests Limited, Submission to the Murray-Darling Basin inquiry issues paper, 16 April 2020, p. 2.

308 NSW Farmers’ Association, Submission to the Murray-Darling Basin inquiry issues paper, 13 February 2020, p. 5; ACCC Murray-Darling Basin inquiry, Renmark public forum.

6.1.3 Stakeholders alleged investors conduct allocation transactions to manipulate water markets

Some stakeholders raised concerns that investors, by themselves or jointly with brokers, conducted allocation transactions in such a way as to create or maintain artificially higher allocation prices. In particular, stakeholders made the following allegations:

- investors placed substantial buy orders on allocation announcement days, and around forecasted rain events, to ensure allocation prices were not eroded
- investors paid above market prices on small parcels of allocations to drive up the value of underlying entitlements
- investors placed concurrent buy and sell orders to maintain prices within a narrow predetermined band
- investors manipulated offer prices on exchange platforms to create price spikes
- investors manipulated inter-valley trade to create or maintain a floor price in the destination zone
- investors traded on inside information.

6.1.4 Stakeholders alleged investors distort market information to suit their interests

Stakeholders raised concerns about investors engaging in conduct that distorted market information to suit their interests.

Some stakeholders alleged that investors sometimes conducted trades outside exchange platforms to influence information about market price. They alleged that investors bought allocations on exchange platforms, pushing the reported prices up, but then directly, or through a broker, approached irrigators to offer large parcels of water allocations. As these trades were not transacted on commonly-used exchange platforms, the agreed prices were not publicly reported and were not reflected in quoted platform-traded prices. It was alleged this conduct resulted in information asymmetries between investors and market participants that were reliant on exchange platforms for price information, and maintained artificially high ‘market prices’.

6.2 Methodology

To undertake the analysis of investors’ conduct, the ACCC relied on a number of data sources and other information.

The ACCC relied in part on allocation trade data provided by Basin States in response to voluntary information requests. The advantage of this dataset was that it covered all trades in the Southern Connected Basin, except trades within NSW and SA IIOs. However, as discussed in subsection 5.5.1, this data did not identify the exact date of the transaction nor distinguish allocation trade from other transaction types (such as leases or forwards).

In addition, the ACCC used its information gathering powers to obtain data from the exchange platforms Waterexchange, H2OX, Waterpool and Waterfind. The ACCC also obtained data from Murray Irrigation Limited (MIL)’s Water Exchange and WaterMart under voluntary requests and compulsory notices. The data included all buy orders, sell orders and trades for the period 1 July 2017 to 31 December 2019. In contrast to Basin State data, the platform data included the date and time the transactions occurred.

The platform data is a subset of all allocation transactions in the Southern Connected Basin. In volume terms, the platform data, excluding MIL’s Water Exchange and WaterMart, represented around 60% of
the volume of non-zero dollar transactions in the Basin State data for the Southern Connected Basin. In addition, the platform data included allocation trades within MlL and Coleambally irrigation networks, which are not recorded on Basin State registers.

Not all exchange platforms operated in the same way. Some platforms could facilitate the reporting of negotiated trades to Basin State approval authorities. For some platforms, there was a level of negotiation or manual intervention around some buy or sell orders placed on the platform.

That is, the platform data included:
- on-platform trade (where buy and sell orders are matched on the platform, either automatically or selected by the customers without negotiation)
- off-platform trade (reported trade where the trade was negotiated directly by parties or through a broker and then placed on the platform for processing and settlement, or where there is some manual intervention around buy or sell orders listed on a platform).

One platform could not provide any details to differentiate between on-platform and off-platform transactions. As a result, the ACCC’s analysis relied on assumptions to identify on-platform trades within this platform.312

The ACCC estimated that approximately two thirds of the trades in the platform data were on-platform trades.

The ACCC sought to recreate the order book of each exchange platform; that is, the list of buy orders and sell orders submitted to a platform at any one time. A complete trace of an order’s lifecycle covers submission, amendments and any cancellation or execution. It was not possible to completely recreate the order book for all exchange platforms from the available data.

The ACCC used its information gathering powers to obtain information and documents from the large investors and a broker to assess specific allegations and examine specific transactions. The ACCC also sought additional information on a voluntary basis from certain market participants.

The ACCC also conducted two private hearings of representatives of a large investor to examine its investment and trading strategy and trading activities.

6.3 The water market is opaque which leads to participants misinterpreting market activity

The ACCC obtained information about certain transactions undertaken by the four large investors, reported on Basin State water registers, that the ACCC considered to be unusual. This was also informed by specific concerns raised in submissions. These unusual transactions included zero dollar and priced transactions.

Many transactions that appeared suspicious were explained once the transaction type was known.
- A number of transactions had a reported price per ML that appeared out-of-line with other transactions in the same period. These transactions were in fact a transfer of allocations under a lease reported with the price of the lease payment, or under a forward contract reporting the contract per ML price. However, other allocation transfer under leases were reported as zero dollar transactions.
- There were a number of zero dollar transactions involving a range of volumes in the investors’ accounts. It appeared that the investors were receiving or providing water allocation at no cost. The zero dollar trades were in fact allocation transfers tied to the sale or purchase of a ‘wet’ entitlement (that is, an entitlement traded together with its current allocation), for which the price of the allocation forms part of the total price paid for the entitlement.

312 The ACCC understands that when the platform is used to process trades negotiated off-platform, the buy order, sell order and trade are submitted to the platform quasi simultaneously. The ACCC assumed that off-platform trades were those trades where the buy order, sell order and trade occur within five seconds.
A number of transactions of different sizes recorded for zero dollar or a small dollar value were identified as carryover parking and carryover return to and from investors’ accounts, reflecting both carryover parking services provided by and to the investors.

A large number of zero dollar transactions were movements of water between an investor’s own accounts mostly from one zone to another, including via broker.

Reporting of transaction types on Basin State water registers would assist in dispelling some misunderstanding about allocation trading activities in the Southern Connected Basin.

The large number of trades conducted by one investor on certain days was cited to the ACCC as evidence of the investor exercising market power. These days were identified using information from the Victorian Water Register. The ACCC used its information-gathering powers to obtain the investor’s records of trades conducted on a number of identified days. It was only possible to identify the true date of a trade from invoices and communications at the time the trade was struck.

The ACCC found that less trades were actually concluded on the identified days than the published approval date on a register suggested. ACCC analysis indicated that the length of time between a trade occurring and being approved by the relevant authority can vary significantly (see chapter 10). The variation can be due to a range of factors, including the time taken to pay the invoice.

The ACCC considers that the publication of strike dates (being the date the trade was agreed/occurred) on State Basin registers for all transactions would improve market confidence by assisting stakeholders to assess market activities and avoid misinterpretation. It is also relevant to understanding the volume of water available in the markets on any given day. The ACCC notes that Victoria and NSW have commenced collecting information on trade types and strike dates. South Australia is also currently investigating opportunities to implement similar changes as part of a broader initiative to modernise South Australian water management and registry systems. This is discussed in more detail in chapter 11.

### 6.4 The analysis suggests that investors were not holding water allocations for long periods of time

The ACCC examined whether the investors held the water allocations they purchased or received as seasonal allocation for long periods of time during the year. In particular, the analysis sought to ascertain whether investors had withheld water from the market for long periods of time, before releasing it at times of high prices.

The ACCC used water account data obtained from the Basin States for the period 1 July 2016 to 30 November 2019 to create a consolidated list of all credit and debit entries for all water accounts in the Southern Connected Basin.

The credits took the form of carryover water, seasonal allocation and any allocation traded into the account. The debits included usage and any allocation traded out of the account. All movements of water within an account were considered on a first in – first out basis. That is, older credits were debited first from any account. In this analysis, movements of water between accounts of the same entity (internal transfers) also appeared as credits and debits.

The ACCC examined the holding times and volume of water allocation held by five investors in their accounts. They were the four large investors and one of the highly active, small investors. Overall, these five investors did not tend to keep water in their accounts for long periods of time. The ACCC observed that 60% of all water held in their accounts was held for less than 30 days, with 75% of all water being held for less than 60 days during the analysis period.

The ACCC observed differences between investors reflecting their different trading strategies. The more heavily involved in buying and selling water allocations an investor was, the shorter their holding periods, compared to other investors less engaged in purchasing temporary water allocations. In

---

313 The Basin state account data include positive and negative adjustments which remain in the dataset used for this analysis.
periods when an investor was less actively purchasing water allocations in the temporary market, the average holding period of the water in its account increased.

The ACCC notes that investors only realise their profits (that is, convert ‘book’ profits into cash) by disposing of water allocations held in their accounts. This includes committing water in advance through leases and forwards, and selling uncommitted water.

The ACCC also examined the water holding patterns of the investors when prices were high. This analysis sought to address the concern that investors were withholding water for longer periods to increase prices and only selling once prices were higher.

This analysis considered all water allocation sales conducted on days with a volume weighted average price in the top 10% for each year. The analysis then identified the holding period for each parcel of water that was sold and combined this data.

The analysis showed that at those times of higher prices during a year, 60% of the water traded out by investors had been in their accounts for less than 15 days, 68% for less than 30 days and 80% for less than 60 days.

The analysis suggested that at times of high water prices, the holding times of the water that was traded out by investors tended to be shorter. This suggested that investors turned over water in and out of their accounts more quickly at times of high prices.

6.5 The ACCC did not find evidence of investors exercising market power

Stakeholders raised concerns about the competitive dynamics of water markets and the ability of large investors to influence market prices. The ACCC analysed the 2018-19 Basin State trading data to establish if the investors were capable of exercising market power to influence water market prices.

A firm’s market power comes from a lack of competitive constraint. Such a firm is able to act with a degree of freedom from competitors, potential competitors, suppliers and customers in choosing what they sell, when and for how much. A firm with market power may be able to influence the price it receives in ways that other firms cannot (for example, by changing the volume it trades). In contrast, a firm without market power has no control over the market price for its goods or services (that is, it is a ‘price taker’).

6.5.1 Is there potential for large market participants to exercise market power?

In any market, the potential for market power depends on the characteristics of supply and demand. Putting aside carryover, the total volume of water available to be used each year is largely inelastic. That is, over a very large range of prices the total volume of water available does not increase when water prices increase.

In contrast, the demand for water is more elastic over part of the price range. When the price of water is low, irrigators may find it profitable to plant water-intensive annual crops such as rice. However, as the price of water increases, these farmers would be expected to reduce their plantings or not plant. However, permanent plantations require a similar volume of water each year to sustain and develop the trees. As a result, above a certain price, the demand for water is likely to become particularly inelastic.

This point is set out in a submission from Ricegrowers Limited:

Agribusiness enterprises that involve permanent plantings (such as tree nuts) involve significant upfront capital commitment to establish an orchard, and then require the operator to ensure sustained water supplies for the life of the trees (which may be a 10 to 12-year investment) in order to realise appropriate returns. This means that unlike an annual crop (for which water demand is determined on a year-by-year basis), a tree nut operation
is committed to very similar annual water usage over the life of the plantation, irrespective of the commercial returns available in a given year.\textsuperscript{314}

This analysis is further supported in industry-estimated demand curves. Figure 6.1 below shows a demand curve for water in fruit and nut plantations, as estimated by Aither. Writing in February 2016, Aither notes:

Current and expected future almond prices are sufficiently high that growers are prepared to pay extremely high water prices to ensure the survival of the plantings. At land values in excess of $50,000 per hectare for established almond orchards, growers would be prepared to pay over $3,000 per ML for water allocations.\textsuperscript{315}

Figure 6.1: Estimated annual water demand for fruits and nuts in the Southern Basin, 2013–14

![Image of demand curve for water in fruit and nut plantations]

Source: Reproduced by the ACCC from Aither 2016, Aither estimates

The combination of inelastic demand and inelastic supply at times of tight supply-demand conditions implies that the price may increase substantially with only relatively small changes in water supply. This potentially gives rise to opportunities to exercise market power. At times when the supply-demand balance is tight, a market participant with even a relatively small share of the total water allocation may be able to profitably increase prices by withholding water from the market. Figure 6.2 illustrates how an exercise of market power could increase the price of water in dry or drought years.

\textsuperscript{314} Ricegrowers Ltd, Submission to the ACCC inquiry into water markets in the Murray Darling Basin Issues Paper, 20 December 2019, p. 15–16.

\textsuperscript{315} Aither, Contemporary trends and drivers of irrigation in the southern Murray-Darling Basin, RIRDC Publication No. 16/07, February 2016, p. 43.
Figure 6.2: Impact of market power on the price of water allocations in wet and dry years

In a wet year, the water price is expected to be low and is likely to be largely unresponsive to changes in supply. As a consequence, even very large water suppliers are not likely to have market power at such times and attempts to withhold large amounts of water from the market will not have much effect on water prices. In contrast, in dry or drought years, the water price is expected to be higher and is likely to be sensitive to small changes in water supply. At such times, even water suppliers with a relatively small market share (10% or less) could, in principle, exercise material market power by withholding a volume of water from the market to drive up the price, denoted by the arrow in the chart above.

In principle, a water trader seeking to exercise market power would withhold a volume of water from sale to generate scarcity. This could be profitable for the water trader if the higher price received for the sales of the remainder of the water holding outweighed the loss of revenue from the withholding (and potentially the lower price received when that water is sold at a future time). One of the consequences is that the exercise of market power in the water market is likely to have the effect of increasing the price variation between wet years and dry years.

The ability to store water or carry over water from one year to the next likely diminishes the incentive and ability to exercise market power. Entitlement holders usually have some ability to carryover water from one water year to the next. There are also carryover parking products available for market participants to access carryover space of other entitlement holders. If water allocation holders expect the following year to be a dry year and therefore prices to be higher, they are likely to carry over some water from the current year. This effect is stronger the higher the price is expected to be in the following year. Carryover increases the supply of water in dry years when prices would be higher, thus increasing the elasticity of supply in dry years. Therefore, carryover would have the effect of lowering prices in the dry year (compared to what prices would otherwise be without carryover) and moderating price fluctuation between the years. The effect of carryover is typically to dampen the ability of a water trader to exercise market power.

6.5.2 Have the investors exercised market power?

To look for evidence of market power, the ACCC reviewed the Basin State water allocation trade data for the Southern Connected Basin for the period 1 July 2017 to 30 November 2019. The ACCC concentrated on zone 7 (Vic Murray–Barmah Choke to SA Border) which had been the focus of concern by stakeholders. This zone had seen a large increase in permanent plantings, especially almonds. Over the course of this period, the water price was steadily increasing.

Although many trades clustered in a tight price range, a large number of trades occurred with reported prices outside this range, as shown in figure 6.3. This reflects how the Basin State datasets record a range of different transaction types as explained in section 6.3. However, there is a clear pattern of trades clustered around what appears to be a typical, increasing market price. In order to clean up the
data, all trades that lie outside the upper and lower bounds indicated in figure 6.3 were discarded. The remaining trades formed the dataset for the analysis in this section.

Figure 6.3: Allocation trade prices in zone 7 – July 2017 to November 2019

Source: Victorian Government response to a voluntary information request. Upper and lower bounds chosen by ACCC. Recorded prices are in nominal dollars.

Figure 6.4 shows the total volume of allocation trades and the average price for each month during this period. Traded volumes tended to increase in the second half of the water year, with the peak during this period in the second half of the 2018–19 water year. As noted above, the water price for water in zone 7 was increasing over this period.

Figure 6.4: Monthly allocation trade volumes and average prices

Source: Victorian Government response to a voluntary information request. Average prices are in nominal dollars.

To examine whether or not there was evidence of market power in the Southern Connected Basin, the ACCC carried out two different analyses using the above dataset:

a. The first analysis looked at whether there is any evidence that one large investor who was also a large trader had some impact on the allocation price in its short-term trading activity. This analysis looked at the water trades in each month in isolation, to explore whether, at times of high water demand, one large investor could have some impact on the water price.
b. The second analysis explored whether or not a water seller was able to obtain a dominant position in the market for water in zone 7 during this period — in other words, whether or not throughout this period the largest buyers of water always faced a range of competing sellers.

The ACCC notes that the large investor was both a buyer and seller in all months of the 2018–19 water year. During the first half of the water year when water prices were lower it was a net buyer, accumulating water allocations, but it maintained an active role as a seller. During the second half of the water year when water prices were higher, it was a net seller, but it continued to act as a buyer.

As noted in chapter 5, the data indicates that the large investor consistently pursued a strategy of purchasing a large number of small volume water allocations, aggregating these water holdings and selling them as large parcels. On average, the large investor earned a small margin on these transactions.

In regard to the first analysis, the ACCC estimated the short-term demand curve faced by the large investor each month during the 2018–19 water year by looking at the price-quantity combinations reflected in the trades approved each month. The analysis found that the demand curves faced by the large investor were almost entirely ‘flat’ which suggested that the large investor was a price taker on the volume purchased and sold over short time periods (a month). There is no evidence that the large investor had influence over the water price in the short term.

The ACCC then examined whether a large water seller would be able to affect market price over a year by withholding water. To this end, the ACCC examined the activities of large sellers.

The 20 largest water sellers collectively accounted for 45% of all the water traded in zone 7 over this period. The four large investors and some small investors were among the largest sellers. One large investor was the largest seller by a substantial margin, but still only accounted for a small share of the total water sales in this zone.

Figure 6.5: Largest 20 sellers into or within zone 7 – 1 July 2017 to November 2019

Source: ACCC analysis based on the Victorian Government’s response to a voluntary information request and s. 95ZK responses.

Restricting the analysis to the 2018–19 water year, the large investor was the largest seller by an even greater margin. The other large investors and one small investor were present in the top 20 sellers in 2018–19.
The ACCC further examined the share of water sold by the 10 largest sellers in zone 7 by month over the period 1 July 2017 to 30 November 2019.

Figure 6.7 shows the share of the largest seller relative to the total volume sold by the ten largest sellers into or within zone 7 each month during the period 1 July 2017 to 30 November 2019. The data shows that in the period from February to July 2019, the large investor was more prominent than any other large sellers.

However, as shown in figure 6.8, the large investor still had a relatively low share of the total sales into or within zone 7. At all times during this period, there were many other sellers of water in zone 7. Even though the large investor was a large market participant, it was still competing with many other sellers at all times.
The ACCC also considered the issue from the buyer side to determine whether large buyers of water may have been exposed to a degree of market power because they can only buy water from a limited group of sellers.

The ACCC identified in the dataset the five largest buyers of water in or within zone 7 that were water users. These were all agribusinesses with permanent plantings, four of them being almond growers. During the period February to July 2019, when the large investor was the single biggest seller of water in zone 7, the large investor accounted for no more than 32% of the water allocations sold to these five large buyers, as set out in figure 6.9.

During the second half of the 2018–19 water year, the five largest buyers transacted with many different sellers. For each of these large buyers, the majority of the water purchased came from sellers other than the one large investor. In other words, at all times during the period examined, even the largest buyers had a choice between competing sellers of water. There is no evidence that these large buyers were
ever forced to trade with the one large investor or any one of the other water sellers. One of the large buyers did not purchase any water from the large investor.

Similarly, the data does not suggest that the large investors were withholding water in zone 7 in the second half of 2018–19 to increase prices. While one large investor was a net buyer of water allocations in the first half of the 2018–19 water year, it was a larger net seller in the second half of the year. As indicated in chapter 5, the investors had large net transfers of water into zone 7 from other zones in 2018–19. Overall, this evidence is more consistent with the view that the large investor was responding to market prices across the 2018–19 water year (that is buying when prices were lower and selling when prices were higher) than withholding water in order to push up prices.

At the end of the 2018–19 water year, based on the seasonal determination outlook for the 2019–20 water year\(^{316}\) it was likely that prices would rise further, and prices did continue to rise in the first half of 2019–20. In this circumstance, even a water holder without market power might seek to carry over some water into 2019–20. As indicated in chapter 5, the ACCC estimated that the large investors collectively carried over around 27GL into 2019–20, with some of the water committed to forward contracts in 2019–20. This behaviour is consistent with investors simply responding to market price signals and prior commitments.

One large investor was the largest water trader and did play a major role as a water seller in the second half of 2018–19, however there remained a large number of competing suppliers of water.

Overall, the analysis of trading data in zone 7 did not find evidence that any investor was able to exercise market power, or engage in withholding of water to increase prices. The data is more consistent with the increase in prices being due to limited inflows and increasing water scarcity with more inelastic demand over this period.

6.6 The ACCC examined whether price manipulation and other harmful conduct occurred

The ACCC utilised the framework of common misconduct patterns outlined by the Fixed Income, Currencies and Commodities (FICC) Markets Standards Board (FMSB)\(^{317}\) to analyse trade data for possible signs of misconduct or manipulation. The framework includes seven broad categories of behaviour indicative of:

- price manipulation
- inside information
- circular trading
- transactions meant to influence other assets or prices
- collusion
- improper order handling or failing to act in the best interest of clients
- misleading customers.

These behaviour patterns identify core behaviours which occur most frequently in market misconduct cases. Market misconduct can harm market integrity, efficiency and fairness.

To respond to the concerns raised, the ACCC focused its analysis on price manipulation, inside information and collusion. The analysis mostly used exchange platform data which provides the date and time of trades. This was to respond to stakeholders’ concerns that investors have used exchange platforms to manipulate market prices.


6.6.1 Platform activities

Investors’ participation

Analysis of platform data from the six exchange platforms over the period 1 July 2017 to 31 December 2019 indicated that institutional investors were responsible for 11% of all transactions and 10% of the volume of on-platform trades. Institutional investors comprised the large and small investors examined in chapter 5.

One large investor was the most prevalent trader across all exchange platforms. It tended to buy much more on-platform than it sold (in terms of volume and number of transactions). Conversely, it tended to sell much more off-platform than it bought. Its participation rates also varied across water years. It was a larger buyer on exchange platforms over 2018–19 than it was in 2017–18 or 2019–20. In 2018–19, it purchased a significant volume of the water that was available on exchange platforms in zones 7, 11 and 13.

Other large and small investors were also present on these exchange platforms. They had substantially lower participation rates and did not tend to utilise all exchange platforms. However, the ACCC observed that small investors can be quite active traders. One of the small investors had a higher participation rate across the exchange platforms than three large investors.

Bid-offer spreads on exchange platforms

The ACCC calculated the market spreads, being the difference in price between the buy orders (bids) and sell orders (offers), on the Waterexchange platform over the period 1 July 2017 to 31 December 2019.\[318\]

The market spreads were wide. The ACCC estimated that the average market spread across the major zones on Waterexchange was 23%. In addition, considerable variations existed between zones. Figure 6.10 summarises the time-weighted average spreads for the major trading zones. Zone 11 (NSW Murray below Barmah Choke), zone 12 (SA Murray) and zone 13 (Murrumbidgee) exhibited the smallest spreads of 13 to 20%, while zone 6 (Victoria Murray - above Barmah Choke) and zone 1A (Goulburn) had much wider spreads (31% and 34%).

---

318 All spreads over the period 1 July 2017 to 31 December 2019 were collated and all small volumes (less than 50 ML) were excluded. Market spreads are expressed as a percentage of the prevailing mid-point price. Bids and offers are exclusive of fees. Market spreads for each zone were calculated on a time-weighted basis. Every quoted spread that contributed to a zone average was weighted by its period of observation. For example, if the duration of a particular spread was short then it would be given less weight that a spread that existed for a longer period of time. A single market spread across the zones was then calculated on a volume-weighted basis. Each zone spread that contributed to the market average was weighted by the volume of on-platform trading in that zone.
Figure 6.10: Market Spreads on Waterexchange, by zone, 1 July 2017 to 31 December 2019

Source: ACCC analysis based on s. 95ZK response.

Figure 6.11 shows the cumulative distribution of the observed market spreads on Waterexchange over the period 1 July 2017 to 31 December 2019. The data suggests that 37% of the time, the market spreads on this platform were 10% or less; and 60% of the time, the market spreads were 20% or less. However, at times the bid-offer spreads were much wider. The tail of the distribution in figure 6.11 suggests that 20% of the time, the bid-offer spreads (across all zones, and for buy orders and sell orders exceeding 50 ML) were greater than 38%.

Figure 6.11: Cumulative distribution of market spreads

Source: ACCC analysis based on s. 95ZK response.

Observations were restricted to buy orders and sell orders of at least 50 ML.
The wide bid-offer spreads reflected the poor liquidity of water allocation markets. Large movements in water prices may occur when one trade occurs at the buy order price and the following trade occurs at the sell order price. Argyle Capital Partners noted in its submission that two irrigators that purchase on the same day in the same zone may trade at very different prices, depending on their willingness to ‘cross the spread’ (that is, one buyer purchasing at the sell order price, and the other waiting for a seller to accept the buy order price). Such discrepancies in outcomes may be best attributed to poor liquidity rather than trader misconduct.

### 6.6.2 The ACCC did not find evidence of price manipulation

Broadly, price manipulation is conduct which has resulted in a price that does not reflect genuine forces of supply and demand. It generally includes creating or maintaining an artificial price.

The ACCC examined participant conduct against the FMSB common behavioural patterns of misconduct. This included patterns of price manipulation often referred to as squeezing, ramping and spoofing.

#### Squeezing

Squeezing would involve an investor purchasing water allocations to obtain a sufficient volume with the intention of increasing or maintaining prices, and profiting from those activities as others are forced to purchase from that investor at inflated prices.

As indicated in previous sections, collectively the four large investors purchased and sold water throughout the 2018–19 water year. One large investor was the largest buyer and seller during that year. There is no evidence that it reached a volume sufficient to manipulate prices. In contrast, there is evidence that in months when it was significantly the largest seller, other buyers continued to have a choice of alternate water sellers.

#### Purchasing water allocation on allocation announcement days

More specific concerns were raised by stakeholders that large investors had placed substantial allocation buy orders on key allocation days in order to maintain prices, thus effecting a squeeze.

To examine this concern, the ACCC analysed the allocation buy orders and trades on four exchange platforms. For this analysis, the ACCC focused on buy orders and trades in zones 1A, 6, 7 and 11 during the 2018-19 water year, and on allocation announcement days where there was an increase in water allocation plus the two days before and after the announcement.

In the zones analysed, the ACCC did not find that any market participant routinely placed substantial allocation buy orders on a platform on allocation announcement days, and did not find systematic purchasing of water allocations in the two days prior or following an allocation announcement. Generally, on each of the allocation announcements analysed, there were different market participants placing buy orders to purchase water.

The ACCC did observe that on some allocation announcement days, on one platform in zone 7, one large investor purchased a significant proportion of the total volume traded on that day. However, the total volume of buy orders placed on the platform on these allocation announcement days varied significantly. On other allocation announcement days, the large investor either purchased no, or a very small proportion of the water available in zone 7. Overall, the investor’s purchasing activity around allocation announcements did not appear to be different from its strategy for purchasing water on other days.

---

321 Waterexchange; H2OX; Waterpool and Waterfind.
Spoofing

Spoofing is a form of fictitious trading. It is generally characterised as the placing of orders with the intention to cancel those orders prior to them being filled. The purpose of this manipulation strategy is to seek to induce or influence the buy order or sell order price level.

The ACCC examined order-to-trade ratios across a number of platforms. An order-to-trade ratio measures how many orders are placed on platforms against the resultant number of trades. Orders include all buy order and sell order submissions, amendments and cancellations posted onto a platform.

A high order-to-trade ratio is an indication of possible spoofing. The repetitive submission, amendment and cancellation of orders may influence prices to levels that are not reflective of genuine demand and supply. A high order-to-trade ratio is an indication that an account may attempt to influence prices by creating a false impression of activities.

Platform data shows that order-to-trade ratios for the largest trading accounts were consistently low. These traders had order-to-trade ratios that were consistently below 2:1. Their orders tended to remain on the platform and were static once posted. The platform orders were not removed with any strategic intent to avoid trading.

The platform data shows that there were some accounts with high order-to-trade ratios. In general, accounts with high order-to-trade ratios tended to belong to smaller individual water traders that traded occasionally. These individuals tended to trade in one direction (only buying or only selling) and their order amendments were likely associated with market inexperience or caution. This was not indicative of a purposeful strategy to influence price.

Ramping

Ramping refers to the actions of a market participant designed to artificially increase prices through the impact of its own trading.

The ACCC examined the trading activities of one large investor using data from five exchange platforms.322

As noted in subsection 6.5.2, the data shows a regular pattern of multiple smaller purchases against a small number of larger volume sales. The data also shows occasions of concentrated purchases on a single day.

The ACCC examined whether concentrated purchases by the large investor were driving up prices. The ACCC observed in the data concentrated purchases in a single day when prices were increasing, but also when prices were decreasing or remained level. This suggested that the purchasing behaviour of that investor was not causing prices to increase.

Analysis of anomalous price movements

To seek to identify potential price manipulation, the ACCC also looked for anomalous price movements (or price spikes) in on-platform trade data across the six platforms over the period 1 July 2017 to 31 December 2019.

A price spike would suggest that trading is suddenly moving to a different level. It could be an indication of price manipulation because of the action of a market participant seeking to induce others to trade at a certain level or attempt to force an artificial price.

The ACCC identified the largest 5% of all observed price movements as price spikes. The ACCC then examined the categories of market participants that were responsible for these price spikes. The ACCC also examined the counterparties to these transactions. That is, which category of market participant was selling water when a buyer pushed prices up, and was buying water when a seller pushed prices down.

Institutional investors were responsible for 7% of the price spikes observed in the data, which was below their underlying on-platform participation rate of 11%. However, investors had a greater participation as a counterparty to price spike transactions, with 13% of all observed instances, in particular in transactions where prices spike down.

One large investor was the single largest contributor to price spikes overall. However, its contribution was less than its overall participation rate in on-platform trading.

A large investor and a small investor were the largest counterparties to price spike transactions, much more when price spiked down. These were discretionary traders who can time their purchases opportunistically. The data suggested they were more able to respond to opportunities in the form of low priced offers.

The ACCC examined each price spike a large investor was responsible for in the context of the surrounding transactions to identify whether manipulation concerns were present. The ACCC observed that many price spikes up followed a trade by another party at a low price outside the trading range, and were followed by trades within the trading range. The ACCC did not identify conduct of concern.

Market participants could misinterpret a price spike if they only observe prices on one platform. For instance when the ACCC identified price spikes in the Waterexchange trade data, it found that for 31% of these price spikes there had in fact been trades at intervening pricing points on other platforms.

---

323 A price spike was identified as a move in price that exceeds the 2 standard deviation mark. This would correspond to the largest 5% of all observed price movements. To ensure that changes in the water price over the period did not influence the calculation, the standard deviation was recalculated over a rolling 3 month period.

324 The party responsible for the price spike is the buyer when prices spike up and the seller when prices spike down.
Box 6.1: Case Study

Concern about price spike in zone 7 on 7 September 2020

Concerns were raised with the ACCC regarding an apparent $50 increase in the price of water allocation available to purchase in zone 7 on one exchange platform, between Friday 4 September 2020 and Monday 7 September 2020. The ACCC was advised that water had been available to purchase at around $230–$250 per ML on the Friday, and had risen to $285–$300 per ML on the Monday for no apparent reason.

Figure 6.12 shows that prices for on-platform trades on that platform for zone 7 were between $320–$380 per ML in July 2020, and then started to decrease in August 2020 reaching $220 per ML. In the week beginning 31 August 2020, water was trading at the low end of the range between $220 and $240 per ML, with some isolated trades at close to $280 per ML.

With this context, water for sale priced at $285–$300 per ML on Monday 7 September 2020 may be against the decreasing price trend, but was not outside the recent trading price range.

The ACCC analysed the buy and sell orders on the platform for zone 7. On Friday, 4 September 2020 the price that market participants were offering to buy and sell water in zone 7 remained relatively static. The best (highest) buy orders were at $221 per ML (for 200 ML). The best sell order was for 10 ML at $240 per ML, followed by $245 per ML for 135 ML.

By close of business on 4 September 2020 there were two parcels totalling 45 ML for sale at $245 per ML. The next sell order was at $295 per ML (limited to 30 ML); an increase of $50 per ML. There was more volume offered for sale at around $300 per ML and then $350 per ML and above. By Monday 7 September 2020, the two sell orders at $245 per ML had been removed from the platform, and water subsequently traded at around $300 per ML, in line with the offers that were listed on 4 September.

The analysis does not indicate any misconduct behind the observed price spike on the one platform on 7 September 2020. The data suggests that the large recorded price movement was a result of low liquidity. Any market participant which needed water immediately and was prepared to ‘cross the spread’ and purchase the allocations available at around $300 per ML would trigger a large jump in reported price.

---

325 In the data the ACCC obtained from this exchange platform, the buy order prices were inclusive of fees and the sell orders were exclusive of fees.
Examination of suspicious transactions and trading patterns

The ACCC also observed in the platform data a few transactions and transaction patterns that appeared suspicious. The ACCC obtained information and documents from the traders and was satisfied that the transactions did not raise concerns.

6.6.3 The ACCC examined concerns about inside information

In broad terms, insider trading involves trading in water products based on material information that has not been made generally available to all market participants and which can be expected to affect the price of the water product. Insider trading could be undertaken by a person employed by the organisation that has ownership of the information, but also by an external person who is informed by an insider either intentionally or inadvertently. The Basin Plan trading rules prohibit trading based on information about a water announcement that is not ‘generally available’ (rule 12.51, see subsection 9.10.4).

Allegation of insider trading prior to an announcement regarding trade through the Goulburn IVT

The ACCC examined a specific allegation of insider trading made to the inquiry. This allegation was in regard to an announcement on 20 August 2019 by the Victorian Government that the flow of water out of the Goulburn Valley would be reduced in order to better protect the environment (Goulburn IVT announcement). The Goulburn IVT announcement included an interim operational regime that limited variable summer flows in the Goulburn to levels well below then prevailing levels, to be implemented before the high-risk period began that summer.326

It was alleged that an investor used insider information on the Goulburn IVT announcement to purchase a significant volume of water on an exchange platform immediately prior to it being made public. The complainants considered these purchases by the investor meant allocation prices in the Lower Murray increased rapidly and resulted in a greater price difference between zone 1A and zone 7 or zone 11.

Considering the nature of the policy change, the ACCC would expect the price difference between zone 1A and zones in the Lower Murray to increase as less water would be able to be transferred out of zone 1A.

However, the Goulburn IVT was generally closed from 1 August 2019, so water could not be moved from zone 1A to zone 7 and the Lower Murray. This would have made it difficult for a market participant to benefit from trading on inside information if they purchased water in zone 1A.

If a market participant was trading on inside information then the ACCC would expect to see in the data unusual or large purchases in zone 7 or 11 (where prices would be expected to rise) before the Goulburn IVT announcement.

The ACCC used its information gathering powers to obtain documents relating or referring to the Goulburn IVT in August 2019 from large investors. The ACCC also examined the trading data from exchange platforms to determine whether there was trading activity of concern.

The documents obtained in relation to the Goulburn IVT did not indicate that these large investors had advanced information about the Goulburn IVT announcement. The documents, however, indicated that earlier in August some investors anticipated possible changes to the Goulburn IVT rule following the Victorian Water Minister’s statement on 31 May 2019 that the Goulburn IVT rules would be reviewed by

327 The announcement included three actions. The three actions were summarised as: (1) an interim operational regime that achieves variable summer flows in the Goulburn well below recent volumes, to be implemented before the high-risk period begins in summer; (2) ensuring that from December all trades from the Goulburn system, including water use from tagged accounts, will be treated consistently with Victorian rules for inter-valley trade and in line with the Basin Plan trading rules; (3) the start of public consultation in January next year about long-term options to change the current Goulburn to Murray trade rule to maximise trade opportunities within environmental thresholds.
328 The ACCC analysed data from three platforms – Waterexchange, H2OX and Waterpool.
the end of July 2019. Some investors also considered that entitlement prices would adjust to factor in any new Goulburn IVT restrictions.

Analysis presented in figure 6.13 shows the price of water in zones 7 and 11 increased by almost $200 per ML over the subsequent ten days following the Goulburn IVT announcement, increasing the price differential with zone 1A.

**Figure 6.13: Allocation trade prices on exchange platforms – August–September 2019**

[Graph showing allocation trade prices on exchange platforms from 31-07-19 to 25-09-19 with a vertical line indicating the time of the announcement.]

Source: Trade data from Waterexchange, H2OX and Waterpool. Prices in nominal dollars.

On 20 August 2019, one large investor did purchase a large volume of water via water exchange platforms; however, the purchases occurred after the Goulburn IVT announcement. The large investor purchased a large portion of this volume late in the day at increasing prices, particularly in zones 7 and 11. The large investor did not purchase water allocations in the preceding two days on exchange platforms.

The number of participants purchasing large combined volumes of water in zones 7 and 11 increased in the days following the Goulburn IVT announcement.

The data and documents obtained by the ACCC do not provide evidence that any large market participant traded on inside information in relation to the Goulburn IVT announcement.

**Other concerns about insider trading**

During consultation, the ACCC received a number of general allegations of insider trading involving parties other than investors.

Stakeholders raised concerns about the conduct of some IIO companies or persons associated with IIOs, including insider trading around water allocation or enhancement announcements, and rule or policy changes.

The ACCC considered these concerns, but due to deficiencies in the available data the ACCC was unable to determine whether there was behaviour of concern. Without adequate and complete data, it would not be possible for any regulator to properly investigate allegations of insider trading.

---


6.6.4 The ACCC examined concerns about collusion between a water broker and an investor

Concerns were raised with the ACCC about an investor and a water broker conducting a combination of zero dollar and priced trades between themselves for the purpose of colluding to manipulate market pricing. This allegation was investigated by the ACCC.

The ACCC firstly used Basin State data to examine the identified trades and a broader cluster of trades of the same nature. The ACCC then relied on its compulsory information gathering powers to obtain further information and documents about the cluster from both the investor and the broker. On closer examination of the relevant zero dollar trades, it became evident that the investor engaged the water broker to assist it to navigate the Goulburn IVT as the Victorian Water Register’s Broker Portal enables water brokers to process IVT applications more efficiently than other market participants.

Noting these comparative advantages, the ACCC further examined whether the water broker gave the investor priority access for intervalley transfers. This does not appear to be the case. If the water broker was unable to transfer all of its clients’ allocation through an IVT in aggregate, it gave priority to clients that had a genuine use for the allocation in the destination valley. Examining the specific transactions, the information indicated that not all the volume sought to be transferred by the investor was successfully transferred at each IVT opening. Ongoing IVT openings eventually allowed the broker to transfer the full volume of allocation between zones. The information and explanation were confirmed by Basin State data. The ACCC also established that what appeared to be preferential payment terms were in fact available to other market participants.

The ACCC also examined the specific priced trades and concluded that they did not raise concern. In these trades, the water broker’s account was used to facilitate allocation sales from the trader to different accounts of a buyer, as requested by the buyer.

6.6.5 Conclusion

The ACCC did not find evidence of market manipulation and other market misconduct in Basin water markets over the period 1 July 2017 to 31 December 2019. The extensive analysis undertaken was a difficult, time consuming and resource intensive task in the absence of a single comprehensive, quality dataset of trading activities. The ACCC was only able to conduct its analysis by using its information gathering powers to obtain additional data from investors and exchange platforms to supplement the Basin State data. While there remains limitations in the data, the ACCC is confident in its analysis and findings.

Concerns about the conduct of investors in water markets have reduced irrigators’ confidence in the integrity and fairness of the markets. While the ACCC was able to scrutinise market activities as part of this inquiry, this only provided a snapshot of the markets over a limited period of time.

The analysis has highlighted the need for significant improvements in the consistency and completeness of Murray Darling Basin water market data. This would better enable ongoing surveillance and regular reporting of market activities, with the ability to undertake investigations and take enforcement action if misconduct were identified. It would help to address the underlying concerns of many stakeholders, and restore confidence in water markets.
7. **Agribusinesses’ strategies and activities**

**Key Points**

- The ACCC has examined the strategies and activities of 11 agribusinesses between July 2017 and November 2019. These agribusinesses were Auscott, Australian Food and Agriculture, AustOn, Boundary Bend, Brownport Almonds, Costa, MRA Merrowie, Select Harvests, Public Sector Pension Investment Board, Olam and Webster. These agribusinesses engaged in permanent horticulture, annual broadacre cropping and livestock management.

- The agribusinesses were large water users. In 2018–19, the agribusinesses used a total of 636 GL, with the water used by individual agribusinesses ranging between 21 GL and 174 GL. While the agribusinesses operate in many locations across the Basin, the Lower Murray (zones 7, 11 and 12) and Murrumbidgee (zone 13) accounted for a large proportion of the agribusinesses’ water use.

- The agribusinesses employed diverse strategies to manage their water and financial risk. Among the agribusinesses with permanent horticulture, some owned sufficient entitlements to meet all or most of the water needs of their permanent plantings while others had made a deliberate choice to rely almost entirely on water allocation purchases. A number of agribusinesses employed more complex strategies utilising a diverse combination of water market products. Some of these agribusinesses were among the largest water purchasers in the Southern Connected Basin.

- As at 1 July 2018, the agribusinesses held in total (owned or leased) 197 GL of higher reliability surface water entitlements in the Basin. This included 144 GL in the Lower Murray which represented 9% of the higher reliability entitlements on issue in this area.

- All of the agribusinesses engaged with the water allocation markets. The agribusinesses were significant purchasers of water allocations, but not significant sellers.

- The agribusinesses accounted for 14% of the volume of water allocation trades-in (excluding zero dollar trades) over the period July 2017 to November 2019. During the first five months of 2019–20 when the Basin experienced continued dry seasonal conditions, the agribusinesses accounted for 24% of the volume of allocation trades-in. In November 2019, the agribusinesses accounted for 40% of the volume of allocation trades-in.

- The agribusinesses purchased 132 GL of water allocations in 2017–18, 150 GL in 2018–19 and 79 GL during the period from July to November 2019. One agribusiness purchased almost 23 GL of water allocations in a single month. When the agribusinesses entered the spot allocation markets, they purchased larger parcels than the market average, and even larger parcels from the institutional investors.

7.1 **Introduction**

The inquiry’s terms of reference include consideration of the role and practices of market participants, including water brokers, water exchanges, investment funds and significant traders of water allocations and entitlements. This chapter examines the strategies and activities of agribusinesses in Basin water markets.
As set out in chapter 4, the ACCC has defined agribusinesses as larger agricultural corporations that engage in irrigated farming. As a group, agribusinesses hold large volumes of entitlements and engage extensively with water markets to undertake a mixture of agricultural activities in the Southern and Northern Basin. This includes using irrigated water for:

- permanent horticulture (such as fruits and nuts)
- annual broadacre cropping (such as cotton, cereals and legumes)
- livestock (such as growing pasture).

However, the level and type of entitlements held, engagement with water markets and commodities produced vary widely from business to business. To understand the strategies and activities of agribusinesses, the ACCC focused on the 11 companies (the agribusinesses) set out in table 1.

### Table 7.1: Agribusinesses examined by the ACCC

<table>
<thead>
<tr>
<th>Agribusiness</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auscott</td>
<td>Auscott specialises in growing and processing cotton in the Namoi, Macquarie and Murrumbidgee water systems. Auscott is a subsidiary of the US-based company JG Boswell, although JG Boswell has sought expressions of interests for Auscott.</td>
</tr>
<tr>
<td>Australian Food and</td>
<td>AFA produces a mix of cereal grains, oilseeds, legumes, rice and cotton in the NSW Murray and Murrumbidgee water systems.</td>
</tr>
<tr>
<td>Agriculture (AFA)</td>
<td></td>
</tr>
<tr>
<td>AustOn</td>
<td>AustOn specialises in growing almonds in the Victorian and South Australian Murray water systems. AustOn is a subsidiary of the Canadian-based company Ontario Teacher’s Pension Plan.</td>
</tr>
<tr>
<td>Boundary Bend</td>
<td>Boundary Bend is one of Australia’s largest olive growers and producers of extra virgin olive oil. Boundary Bend owns 2.2 million trees on over 6,200 hectares in the Victorian Murray and Goulburn water systems.</td>
</tr>
<tr>
<td>Brownport Almonds</td>
<td>Brownport Almonds specialises in growing almonds, operating two orchards in the Victorian Murray water system.</td>
</tr>
<tr>
<td>Costa</td>
<td>Costa is one of Australia’s leading growers, packers and marketers of fresh fruit and vegetables, producing a range of products including avocados, citrus and table grapes. Costa operates properties throughout Australia including in the Victorian Murray and South Australian Murray water systems.</td>
</tr>
<tr>
<td>MRA Merrowie</td>
<td>MRA Merrowie produces a mixture of cereal grains, legumes and cotton. MRA Merrowie operates in the Lachlan water system. MRA Merrowie is a subsidiary of the US-based company MERS Global Investments.</td>
</tr>
<tr>
<td>Select Harvests</td>
<td>Select Harvests is one of Australia’s largest almond growers and operates orchards in the Victorian Murray, NSW Murray, Murrumbidgee and Lachlan water systems.</td>
</tr>
</tbody>
</table>

---

PSP Investments is a Canadian pension investment manager. PSP Investments owns or part owns four Australian entities. Two of these entities, Stahmann Farms and Australian Food and Fibre produce pecans and cotton in the Border Rivers, Namoi Valley and Gwydir Valley.

In February 2020, PSP Investments acquired Webster Limited.337 Webster Limited merged with Stahmann Farms to operate as Stahmann Webster, producing walnuts, pecans, macadamias and almonds.338

Olam operates almond orchards in the Victorian Murray, NSW Murray, Murrumbidgee and Lachlan water systems.

In late 2019, PSP Investments purchased Olam’s permanent water entitlements. In a separate transaction, PSP Investments also purchased around 12,000 hectares of almond orchards which were owned by a third-party and leased to Olam.

Both the land and water entitlements purchased by PSP Investments were leased back to Olam as part of a long term lease for 25 years, with an option to renew for another 25 years.339

Webster was one of Australia’s largest producers of walnuts, supplying around 90% of Australia’s walnuts. It also produced annual crops (including cotton, wheat and maize) and livestock (including sheep and cattle), Webster operated in the Murrumbidgee, Lower Darling, Barwon-Darling, Gwydir and Condamine water systems.

In February 2020, PSP Investments acquired Webster. The purchase of Webster included approximately 150 GL of water entitlements.340 Webster now operates as Stahmann Webster.

During the period examined by the ACCC, Webster was a separate entity, and has been considered as such for the purposes of the agribusiness analysis in this chapter.

The ACCC used its compulsory information gathering powers under the CCA to obtain information and documents on the agribusinesses’ water holdings, transactions and strategies. The ACCC combined this information together with Basin State data to examine how these agribusinesses engaged with water markets and the practices they employed. The analysis focused on the period from 1 July 2017 to 30 November 2019.

7.2 The agribusinesses had large water needs in the Basin

Between 2017–18 and 2019–20, the agribusinesses operated properties in the Southern Connected Basin and other parts of the Basin. These agribusinesses used large volumes of water as part of their operations. This water came primarily from surface water but some agribusinesses also used groundwater. The volume of water used by the agribusinesses in response to drier seasonal conditions in 2018–19 and the first half of 2019–20 varied depending on the nature of their operations.

Figure 7.1 shows the total water used by the agribusinesses between 2017–18 and 2019–20. All of the agribusinesses provided actual water use in 2017–18 and 2018–19. However for 2019–20, some provided forecast water use as at around January 2020 while others provided actual water use. For the purposes of this section, the ACCC grouped forecast and actual water use in 2019–20 together.

In 2017–18, a total of 822 GL of water was used by the agribusinesses. The total volume of water used by individual agribusinesses ranged from 13 GL to 158 GL. In 2018–19 water availability was limited due to drier seasonal conditions, the total volume of water used by the agribusinesses decreased to 636 GL (or 23%). The total volume of water used by the individual agribusinesses ranged from 21 GL to 174 GL.

The water use response of each agribusiness under drier seasonal conditions depended on their operations. Compared to 2017–18, the change in water used by individual agribusinesses ranged from one decreasing its usage by 106 GL (or 80%) and another increasing its usage by 30 GL (or 138%). Four of the agribusinesses decreased their water usage, with a collective water use decrease of 275 GL. As would be expected, those agribusinesses focused on annual cropping generally decreased water use, while those focused on permanent horticulture maintained or increased their water use.

In 2019–20, the total volume of water used (or expected to be used) by the agribusinesses decreased to 515 GL or by 19% compared to the previous year. The total volume used by agribusinesses ranged from 12 GL to 183 GL. Compared to 2018–19, the change in water used by individual agribusinesses in 2019–20 ranged from one agribusiness decreasing by 59 GL (or 78%) to another agribusiness increasing by 6 GL (or 4%). Further to this, seven of the agribusinesses decreased water usage, with a collective water use decrease of 134 GL. Similar to 2018–19, those focused on annual cropping decreased water use and those focused on permanent horticulture maintained or increased their water use.

Nearly all of the agribusinesses operated properties in the Southern Connected Basin. Collectively, water use in the Southern Connected Basin accounted for almost 75% of total water use by the agribusinesses between 2017–18 and 2019–20. Figure 7.2 shows that within the Southern Connected Basin, the Lower Murray (combining zones 7, 11 and 12) and Murrumbidgee (zone 13) were two key regions where the agribusinesses used large volumes of water.
The ACCC has examined the agribusinesses’ collective water use in particular zones in terms of volume and share of total water usage in each zone. Total water usage was drawn from the Basin State data and includes water used for any purpose, such as agriculture, environment, industry and urban.

For the Lower Murray, the agribusinesses’ water use increased by 21% from 284 GL to 343 GL between 2017–18 and 2018–19, and then decreased to 324 GL in 2019–20. Across this period, the water used by the agribusinesses accounted for around 7% and 13% of the water used in this zone in 2017–18 and 2018–19. Some of the agribusinesses were among the largest users of water after environmental users.

For the Murrumbidgee, the agribusinesses’ water use decreased by 3% from 156 GL to 151 GL between 2017–18 and 2018–19, and decreased further to 99 GL in 2019–20. During this period, the water used by the agribusinesses accounted for around 11% and 22% of the water used in this zone. As was the case for the Lower Murray, some of the agribusinesses were among the largest users of water after environmental users.

### 7.3 The agribusinesses used diverse strategies to manage water and financial risks

The agribusinesses employed a number of different strategies to meet their water usage requirements and manage water and financial risks. Broadly, these were as follows:

- using a mixture of entitlements and water allocation market products
- leasing entitlements
- holding surface water entitlements with different reliabilities
- using forward contracts
- carrying over water between water years
- accessing groundwater
- using flexible production systems where production and associated water use can be increased or decreased in response to water availability and price changes.
### 7.3.1 Mixture of entitlements and water market products

A major strategic decision facing agribusinesses in managing water and financial risks is determining the mixture of entitlements owned (relative to their water needs) and usage of different water market products. In referring to water market products, the ACCC included entitlement leases, allocation forwards and spot allocation trade. The decisions made by agribusiness can be framed as a choice between up-front capital expenditure with lower ongoing operating expenditure versus less significant up-front capital expenditure and higher ongoing operating expenditure. This choice fundamentally affects the cash flow and financial position of a business.

At one end of the spectrum, one agribusiness owned enough entitlements to meet their water usage requirements through expected seasonal allocation. This agribusiness may purchase allocation water to meet any water shortfall if necessary to finish a crop. A number of other agribusinesses also had sufficient entitlements to meet all or most of the water requirements of their permanent horticulture. The ACCC notes this strategy requires high up-front capital investment to purchase sufficient entitlements. However, it results in lower susceptibility to seasonal allocation price risk as it reduces exposure to drought-related high water prices in the allocation market.

At the other end of the spectrum, some agribusinesses relied almost entirely on water allocation markets to meet their water needs and owned minimal entitlements. These agribusinesses held a few weeks of water in their water accounts and purchased water allocations based on short-term forecast usage.

For example, Boundary Bend indicated in its 2018–19 annual report that it had owned sufficient entitlements to fully cover its average expected water use. However during the millennium drought, Boundary Bend noted it received only 35% of water allocations to its entitlements. This meant it ‘had to purchase two-thirds of its yearly requirements on the open market at great expense’. Boundary Bend stated this led to significant financial costs, where it had the holding cost of the entitlements and the purchase cost for water allocations. Subsequently, Boundary Bend considered that owning entitlements ‘did not give enough available water or financial security in a severe drought and like many other irrigators decided to secure water as needed in the [allocation] water market’. Following this, Boundary Bend sold all of its water entitlements.

The ACCC notes that this strategy exposes a business to fluctuating water prices, which can mean lower water costs in wet years, but significantly higher water costs in dry years.

In between these two broad approaches, some agribusinesses employed more complex strategies that utilised a combination of water market products. For example, Select Harvests submitted that it employed a strategy of:

- owning one-third of their water usage requirements through owned entitlements
- leasing one-third of their water usage requirements through leased entitlement
- purchasing one-third of their water usage on the allocation market.

As at 1 July 2018, the agribusinesses owned in total almost 606 GL of entitlements in the Basin. These owned entitlements included a mixture of reliabilities as well as both surface water and groundwater. The volume of entitlements owned by each agribusinesses ranged between 100 ML and 213 GL. In total, owned entitlements across the Basin accounted for 81% of the volume of entitlements held by the agribusinesses (with the remaining entitlements being leased from third parties).

Around 307 GL, or over 51%, of volume of entitlements owned by the agribusinesses are located in the Southern Connected Basin. Key zones within the Southern Connected Basin were the Lower Murray and Murrumbidgee, accounting for 36% and 55% of entitlements owned by the agribusinesses.

---


7.3.2 Entitlement leases

Some of the agribusinesses used entitlement leases rather than owning entitlements. Leasing an entitlement instead of owning it means a business has ongoing operating expenditure for the lease but avoids the large capital expenditure needed to own the entitlement. This capital expenditure savings can then be directed to other parts of the business.

As at 1 July 2018, over 138 GL of entitlements were leased by six agribusinesses across the Basin. The volumes of those leases ranged between 3 GL and 51 GL or between 15% and 97% of the total volume of entitlements held by the respective agribusinesses.

Chapter 5 examines the role of institutional investors in water markets. It focused on the four large institutional investors; Argyle, Aware, Duxton and Kilter, as well as a number of smaller water investors. As discussed in that chapter, an aspect of an investor's strategy is providing entitlement leases to other users. However, entitlement leases supplied by institutional investors to the agribusinesses comprised only 5% of the total volume of entitlements that were leased by the agribusinesses.

The majority of the volume of entitlements leased by the agribusiness were from parties other than the institutional investors, including agricultural or rural fund managers. This is because most of the leases held by the agribusinesses included both land and water. For example, Rural Funds Management is an agricultural fund manager which owned and leased almond orchards and water entitlements to Select Harvests and Olam. Such leases tended to be for longer terms. Figure 7.3 shows that a large volume of the agribusinesses’ entitlement leases had a lease term greater than 20 years. Some of the leases provided the option to extend their lease term. That is, a leased entitlement could have an agreed initial term of 5 years but also include an option of extent the lease term to 10 years.

![Figure 7.3: Lease terms for entitlement leases held by the agribusinesses as at 1 July 2018](image)

Source: ACCC analysis based on s. 95ZK responses from the agribusinesses.

7.3.3 Reliability of surface water entitlements

Entitlements in the Basin have differing reliabilities. Broadly, the higher the reliability of an entitlement the greater the certainty of allocation volume and the greater the price to purchase the entitlement. In addition, entitlement reliabilities are different among the Basin States. To assist with comparisons in this subsection, the ACCC has categorised entitlements as follows:

- higher reliability entitlements which includes NSW High Security, Victoria High Reliability and SA surface water entitlements

lower reliability entitlements which includes NSW General Security, Victoria Low Reliability and Queensland Medium Priority surface water entitlements.

The mix of entitlements of different reliabilities held by agribusinesses varied. For example, an agribusiness focused on permanent horticulture generally held higher reliability surface water entitlements, while an agribusiness focused on annual broadacre cropping generally held lower reliability surface water entitlements.

As at 1 July 2018, the agribusinesses held (both owned and leased) in total 197 GL of higher reliability entitlements in the Basin (figure 7.4). The volume held by individual agribusinesses ranged between 179 ML and 93 GL. All but two of the agribusinesses held some higher reliability entitlements. Even those agribusinesses that relied almost entirely on water purchased from the allocation markets owned small volumes of higher reliability entitlements.

Figure 7.4: Reliability of entitlements held by the agribusinesses as at 1 July 2018, by selected zone

Source: ACCC analysis based on NSW, Victoria, and SA governments’ responses to voluntary information requests and s. 95ZK responses from the agribusinesses.

The Lower Murray accounted for a large proportion of higher reliability entitlements held by the agribusinesses. As at 1 July 2018, the agribusinesses held 144 GL of higher reliability entitlements in the Lower Murray. This represented almost 9% of the higher reliability entitlements on issue. The largest holding of higher reliability entitlements by an agribusiness was over 78 GL (or almost 5% of all higher reliability water entitlements on issue).

As at 1 July 2018, the agribusinesses held in total almost 319 GL of lower reliability entitlements. The ACCC notes that one of the important features of lower reliability surface water entitlements for some zones in the Southern Connected Basin is that it allows water to be carried over. For example, one agribusiness which primarily focused on permanent horticulture held lower reliability surface water entitlements to facilitate carryover between years.

The Murrumbidgee accounted for a large proportion of lower reliability entitlements held by the agribusinesses. The agribusinesses collectively held over 153 GL, or over 8% of the entitlements on issue in the Murrumbidgee. The largest holding of lower reliability entitlements in the Murrumbidgee by an agribusiness was almost 79 GL.

7.3.4 Carryover

Carryover strategies varied between the agribusinesses, but most agribusinesses stated they utilise carryover in any given water year if they have surplus water available. A smaller proportion of

Entitlements on issue includes entitlement held by all user types, such as agriculture, environmental, industry and urban.
agribusinesses stated they purchase water at the end of a water year for the purposes of carrying over that water into the next water year.

Figure 7.5 shows the volume of water carried over into 2017–18, 2018–19 and 2019–20 by the agribusinesses. The figures are based on the Basin State data. They do not include the agribusinesses’ carryover within the NSW and SA IIOs.

**Figure 7.5: Volume of carryover by agribusinesses, 2017–18 to 2019–20**

Source: ACCC analysis based on NSW, Victoria, and SA governments’ responses to voluntary information requests and s. 95ZK responses from the agribusinesses.

Between 2017–18 and 2019–20, the total volume of water carried over by the agribusinesses decreased from 362 GL to 27 GL. Over this period, the agribusinesses carried over around 29% of their total carryover volume in the Southern Connected Basin, with the remainder carried over by the agribusinesses in other areas of the Basin.

For the Southern Connected Basin, the total volume carried over by the agribusinesses between 2017–18 and 2019–20 decreased from 120 GL to 27 GL (or almost 78%). Given the different types of entitlements held and varied strategies of the agribusinesses, the volume each carried over greatly varied and ranged from:

- 19ML to 84 GL carried over into 2017–18
- 8 ML to 23 GL carried over into 2018–19
- 14 ML to 13 GL carried over into 2019–20.

The Murrumbidgee was a key zone where the agribusinesses carried over water into 2017–18 and 2018–19, totalling around 39 GL in each year. In 2019–20, nearly all of the water carried over was in the Murrumbidgee (11 GL) and Victoria Murray–Barmah to SA (10 GL).

### 7.3.5 Forward contracts

Forward contracts are agreements to provide a set volume of water allocations at an agreed date in the future. They are another means for managing water and financial risk by agribusinesses. Forward contracts allow an agribusiness to secure future water allocations at a fixed price. This agreed price may ultimately be above or below the prevailing market price at the time the water allocation is provided.

In 2018–19, 6 of the agribusinesses received water pursuant to forward contracts, totalling almost 14 GL of water allocation. The volume of allocations received by each of these agribusinesses under forward contracts ranged from 500 ML to 5 GL. Nearly all of the water allocation received by agribusinesses under forward contracts was provided by the large institutional investors examined in chapter 5.
7.3.6 Groundwater

While surface water was most widely used by the agribusinesses to meet their water needs, a number of the agribusinesses also made use of groundwater entitlements. As at 1 July 2018, 7 of the agribusinesses held in total 103 GL of groundwater entitlements. The volume of groundwater entitlements held by each agribusiness varied between 3 GL and 34 GL, accounting for between 6% and 60% of the total volume of entitlements held. These entitlements were held in the following water systems:

- Lower Gwydir
- Lower Lachlan
- Lower Macquarie
- Lower Murrumbidgee Deep
- Lower Namoi.

A number of agribusinesses noted there were several key benefits associated with groundwater entitlements. For example, one agribusiness noted that its groundwater entitlements have been highly reliable. In addition, these groundwater entitlements allow 100% of the volume of the entitlement to be carried over between water years.

It should be noted that the ability to trade groundwater is generally much more limited than is the case for surface water.

7.3.7 Annual croppers responded to prices and water availability

Agribusinesses with annual crops employed flexible strategies and vary production depending on the price and availability of water in any given area in any given year. The area of annual crop planted by these agribusinesses at a particular property may decrease or increase based on the availability and purchase costs of water in the area. Other similarly flexible strategies were employed to ensure maximum return on their water entitlements. For example, if the return available from selling water on the allocation market is higher than the anticipated return from the annual crop, then an agribusiness may decide to sell its seasonal allocation and not plant crops that season. Similarly, if prices for water on the temporary allocation market were low, the agribusiness may purchase water and increase crop areas. These decisions are made year to year, based on a number of factors, including temporary allocation water prices, seasonal allocation quantities and commodity prices for particular crops.

7.4 The ACCC examined the water allocation trading activities of the agribusinesses in the Southern Connected Basin

The ACCC reviewed the allocation trading activities of the agribusinesses for 2017-18, 2018-19 and 2019-20 (July to November) in the Southern Connected Basin. Over this period, all of the agribusinesses engaged in allocation trade to some degree.

Similar to the assessment of investor trading activities in chapter 5, the ACCC’s assessment of the agribusinesses trading activities drew on trading information from Basin States and the agribusinesses themselves. However, trading information for the Southern Connected Basin is highly fragmented and incomplete. Section 5.5 provides further details on the challenges experienced and the methodology used for assessing investors’ trading activities. The same methodology was used for assessing the agribusinesses’ trading activities.
7.4.1 Seasonal allocations, carryover and forwards

Broadly, the extent to which the agribusinesses engaged with water allocation markets in the Southern Connected Basin depended on their expected water needs less water received from:

- seasonal allocations to entitlements held (including allocation transfer leases or entitlement supply agreements)
- carryover water from the previous year
- forward contracts.

Figure 7.6 shows that between 2017–18 and 2018–19, the volume of water the agribusinesses received from seasonal allocations, carryover and forward contracts decreased from 391 GL to 251 GL or by almost 36%. In 2019–20 (July to November), the volume of water allocation in the agribusinesses’ accounts (excluding water allocation purchases) was 163 GL. For each agribusiness, the volume in their individual accounts ranged between:

- 732 ML and 146 GL in 2017–18
- 161 ML and 100 GL in 2018–19

Between 2017–18 and 2018–19, across the agribusinesses the difference between water usage and water received through seasonal allocation, carryover and forward contracts increased from 42 GL to 124 GL (excluding NSW and SA IIOs). The proportion of water usage met by seasonal allocations, carryover and forward contracts decreased from 91% to 67% (excluding NSW and SA IIOs). That is, in 2018–19, the water usage of the agribusinesses exceeded their available water by 124 GL. It is important

---

346 An allocation transfer lease or entitlement supply agreement which requires the lessor to deliver the seasonal allocation volumes attached to a specified volume of entitlements to the lessee during the term of the lease. Such leases are not registered on a state register (see subsection 5.4.2).

347 This does not take into account the dynamic nature of water needs, where an agribusiness may need water but has not received seasonal allocations yet.

348 The calculations in this subsection do not incorporate carryover, allocations, forward contracts and usage within NSW and SA IIOs.
to note that this 124 GL is a conservative figure and additional water allocations were likely needed for carryover into 2019–20, evaporation losses, operations within NSW and SA IIOs and other factors.

Given this gap between usage and availability, the agribusinesses were required to engage with water allocation markets.

The ACCC examined the participation of the agribusinesses in water allocation markets in comparison with total market activities. Figure 7.7 presents the agribusinesses’ shares of volume of trades-in and trades-out in the Southern Connected Basin, excluding zero dollar trades. The ACCC notes that this is an imperfect measure of commercial allocation trading activity, as it does not reliably distinguish between allocation sales, deliveries on lease and forward contracts, and deliveries for carryover parking purposes.\footnote{The ACCC obtained information from the agribusinesses on the trade type of their transactions. However, this information could not be used for this analysis, as the ACCC did not have similar information for all market participants.}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{agribusinesses_share_of_trades.png}
\caption{Agribusinesses’ share of non-zero dollar water allocation trades-in and trades-out, by year}
\end{figure}

Between 2017–18 and 2019–20, the agribusinesses accounted for 14% of the volume of non-zero dollar water allocation trades-in and 1% of the volume of non-zero dollar water allocation trades-out.

Figure 7.7 shows that between July and November in 2019–20, the agribusinesses accounted for 24% of water allocations trades-in. This was higher than the share the agribusinesses accounted for in both 2017–18 (11%) and 2018–19 (14%). The trading activities of the agribusinesses between September and November 2019 explained the higher share (figure 7.8). During November 2019, with continuing dry seasonal conditions, the agribusinesses accounted for 40% of non-zero dollar allocation trades-in. In comparison, the agribusinesses’ shares of non-zero dollar allocation trades-in were 17% in November 2017 and 15% in November 2018.
7.4.2 The agribusinesses were significant purchasers but not sellers on the spot market

Based on information received from the agribusinesses, a large share of the volume of non-zero dollar water allocation trades undertaken by the agribusinesses were spot allocation trades. Figure 7.9 shows that the agribusinesses either purchased or sold water allocation in almost all months from July 2017 to November 2019. The extent to which they engaged with water allocation markets was seasonal, with higher levels of engagement over summer and autumn, and lower levels over winter.

In 2017–18, the agribusinesses purchased 132 GL and sold 26 GL of spot water allocations. In 2018–19, the agribusinesses’ spot water allocation purchases increased to 150 GL (an increase of 14%) and sales decreased to 4 GL (a decrease of 84%). For 2019–20 (July to November), the agribusinesses spot water allocation purchases were 79 GL and sales were 5 GL.

Source: ACCC analysis based on NSW, Victoria, and SA governments’ responses to voluntary information requests and s. 95ZK responses from the agribusinesses.
The agribusinesses represented a significant group of purchasers of spot allocation in the Southern Connected Basin. Between July 2017 and November 2019, the total volume purchased by the agribusinesses on a monthly basis varied between 125 ML in July 2018 and 39 GL in February 2019. A number of the individual agribusinesses were significant purchasers of water allocations. For example, one agribusiness accounted for almost 23 GL of spot water purchases within a single month.

The contribution of individual agribusinesses is amplified when focusing on specific water zones. For example, 204 GL of spot water allocations were purchased by the agribusinesses in the Lower Murray between July 2017 and November 2019. This region accounted for 57% of spot purchases by the agribusinesses. Over this period, the monthly purchases by the agribusinesses ranged from 328 ML to 32 GL. One agribusiness’s spot allocation purchases totalled almost 20 GL in a single month.

When the agribusinesses entered the spot allocation market, the size of the parcels purchased were larger than the market average. Between July 2017 and November 2019, the volume of spot water allocation parcels purchased by the agribusinesses averaged 278 ML per transaction. In comparison, the average non-zero dollar parcel traded over the same period was 97 ML per transaction.

The agribusinesses also purchased larger parcels from the institutional investors (as examined in chapter 5). Over the same period, the average parcel size of spot allocation purchased by the agribusinesses from the institutional investors was 638 ML per transaction, in comparison to 238 ML per transaction from other sellers. The ACCC notes this supports the view that one of the roles of institutional investors is to provide larger parcels of water allocations to large users and so reduce the number of transactions required.

The agribusinesses were not significant or active sellers of spot water allocations. Over the period from July 2017 to November 2019, for a number of months, several of the agribusinesses did not sell any spot water allocations. Further to this, in 2018-19, only three of the agribusinesses sold water allocations.

Some of the agribusinesses stated that they do not seek to actively trade water or profit from the buying and selling of water. Some of the agribusinesses also stated that water is purchased exclusively for their own agricultural use. Therefore, any volumes of surplus water were generally quite small and carried over for use in the following season.

The agribusinesses provided some circumstances in which they would sell water allocations. Some agribusinesses irrigating mostly annual crops indicated they would sell water back to the market where the price for water exceeds the total productive value of their crops. Others indicated that they may sell water in one zone and repurchase in another zone where trade restrictions prevent them from moving the water to the zone required for use. Some of the larger agribusinesses had arrangements in place to sell surplus water to related entities, whether at an agreed price or by reference to the current market price.
8. Water market intermediaries: roles, practices and conduct

Key Points

- Water market intermediaries play an important role in water markets. They assist market participants to trade and provide a diverse range of services.
- Intermediaries are currently subject to limited regulation. A voluntary code of conduct exists that has not been broadly adopted by the industry and is ineffective in addressing the concerns identified.
- Brokers’ roles are often unclear, as contracts will not commonly set out the obligations brokers owe to their clients. While clients may mistakenly believe their broker is acting solely in their best interests, it is uncommon for such fiduciary responsibility (which is normal for brokers operating in most other markets) to arise within this relationship.
- The interests of an intermediary can diverge from those of its client, including when brokers provide services to both parties in a trade or when intermediaries take a personal position in a trade.
- Intermediaries hold significant amounts of client funds and client water rights in intermediary accounts without any trust-accounting obligations. The use of water holding accounts by intermediaries reduces transparency.
- Some brokers have developed strategies to increase the likelihood of their clients’ intervalley trades (IVTs) being approved. This is a competitive service for their clients within the framework of the current IVT approvals processes. Brokers have discretion in allocating successfully transferred IVT volumes among their clients and this process is not transparent.
- There are no record-keeping requirements for intermediaries, which affects the quality of price-reporting audits and enforcement.
- The ACCC’s view is that a robust regulatory framework is required to establish protections for water market intermediaries and their clients, in the form of clear obligations on intermediaries, including irrigation infrastructure operators (IIOs) who provide intermediary services.

8.1 Introduction

The ACCC received feedback from market participants raising concerns about broker conduct and calls for increased regulation of water market intermediaries, including from intermediaries themselves. There has been continued support for regulation following the interim report. The ACCC is of the view that there is a strong basis for these concerns due to the lack of obligations water brokers owe to their clients and inadequate regulatory oversight of brokers and exchange platforms in a variety of contexts.

Without appropriate regulatory safeguards, such as those which apply to intermediaries in other markets including real estate agents, stock brokers and stock and station agents, there are opportunities and incentives for water market intermediaries to exploit their clients with no consequences. This undermines confidence and trust in water market intermediaries and the practices they engage in, which reduces confidence in the market and lowers perceptions of market integrity and fairness, inhibiting full participation by parties that would otherwise have had incentives to engage in trade. If trades that would benefit buyers and sellers of water rights do not occur due to a lack of confidence in intermediaries then water rights are not traded to their highest value use. In these circumstances, incentives for investment to be directed to the most productive industries are distorted and efficient economic outcomes in the water and related markets are not achieved. As a result,

---

350 The Property and Stock Agents Act 2002 (NSW) refers to ‘stock and station agents’ and this phrase will be used throughout this chapter. Terminology differs across states. For example, in Victoria these agents are referred to as ‘livestock agents’.
Australians fail to realise the welfare benefits associated with water resources being used to achieve their highest value.

### 8.2 Intermediaries play an important role in water markets and offer a diverse range of services

The ACCC uses the term ‘water broker’ to refer to a water market intermediary who, for a commission or fee or other form of remuneration or payment, offers one or more of the following services:

- providing advice to clients regarding the trading of water rights
- trading tradeable water rights on behalf of another person
- investigating tradeable water right trading possibilities on behalf of another person
- preparing and submitting documents necessary for the trade of a tradeable water right on behalf of another person.

Brokers assist potential buyers and sellers to assess the market, form price expectations, and make decisions in the market. As discussed in section 8.8 of this chapter, brokers provide this advice to their clients based on their access to information and ongoing analysis of water markets.

Water market participants can trade independently of brokers, for example with their neighbours or through another organisation acting as an intermediary, such as an exchange platform. Trades can also be negotiated and lodged for approval without the involvement of any water market intermediary. While brokers negotiate trading options for their clients off-platform, exchange platforms operate as online intermediary portals facilitating direct trading between sellers and buyers, using algorithms for automated matching, auction style listings or ‘buy-it-now’ listings. Exchange platforms can also offer similar services to brokers such as organising and submitting the necessary paperwork to the relevant trade approval authority. In some cases, an entity will offer both brokerage and exchange platform services. Trades involving intermediaries may be:

- broker-negotiated, outside of platform
- negotiated by a broker or individuals off-platform, lodged via platform (also referred to as an ‘off-platform’ trade), or
- matched on-platform.

By bringing together multiple potential traders including irrigators, intermediaries can contribute to increased market liquidity and depth, reduce searching costs, improve information availability and otherwise reduce transaction costs associated with water trade. In short, competitive and competent water market intermediaries can make a substantial contribution to the development of efficient water markets.

The ACCC’s view is that obligations on water market intermediaries should be tailored to the service the intermediary is providing. Obligations should also be imposed on exchange platforms under the proposed regulation (in addition to water brokers), with obligations tailored to the particular services they are providing. Chapter 10 and appendix B explore the roles and functions of exchange platforms in more depth.

---

351 This definition of ‘water broker’ aligns with sub-clauses a to c of the definition of ‘water market intermediary’ in the Basin Plan 2012, s. 1.07.

352 Some of the larger exchange platforms include H2OX, Waterfind, Murray Irrigation, Waterpool and Waterexchange.

353 These are referred to as principal-negotiated, outside of platform trades.

354 Trades negotiated and lodged via a broker, without the involvement or use of an exchange platform.

355 Trades negotiated via a broker or individuals without the involvement or use of an exchange platform, but lodged for approval via an exchange platform.

356 Trades matched and lodged for approval via an exchange platform. Covers different kinds of on-platform matching, including automated matching via algorithm, ‘buy-it-now’ (i.e. buyer selects advertised parcel), automated exchange pools, and platform-based auctions.

As brokered trades are less common in the Northern Murray-Darling Basin (Northern Basin), this chapter largely refers to the practices of brokers who trade in the Southern Murray-Darling Basin (Southern Basin). However, any recommendations are intended to apply to both Northern Basin and Southern Basin intermediaries. Despite some submissions suggesting regulation for all water brokers nationally, the proposed regulation recommended in chapter 9 is intended to apply to only those intermediaries providing services within the Murray-Darling Basin.

8.2.1 Brokers charge varied fees and commissions

As the market for intermediary services has matured, brokers have diversified their service offerings and perform some or all of the services outlined above.

The diversity in brokerage services is also reflected in the ways brokers charge clients for their services. Refer to appendix C for further details regarding broker and exchange platform fees. Brokers charge parties to the trade (in some instances the broker will charge the buyer and seller) a percentage commission based on the total value of a trade or a flat fee per ML, or a combination of these, and these charges vary according to a range of factors. Brokerage firms may, for example, provide their brokers (employees and contractors) with guidance as to the percentage of commission they can charge their clients (setting a maximum and minimum charge) for temporary and permanent trades. Commission can be tailored depending on the volume of the trade; whether the client is a buyer or seller, and the product and region in which the trade is located. When considering offering a commission outside the standard rate, brokers have regard to the competitive context, the complexity of the trade, the relationships involved and the uniqueness of the trade. Some brokers offer clients a tiered commission rate for large volumes of trade.

Some intermediaries have acknowledged there is potential for a circumstance to arise where their interests are incompatible with that of their clients, where commissions are related to the price of the water right, and have taken steps to shift away from this model towards a flat fee (for example, $2/ML excl. GST).

8.2.2 Approval of trades and intermediaries

With the exception of trades of irrigation rights and water delivery rights that are internal to an IIO’s irrigation network (which require IIO approval), all trades of tradeable water rights require approval (and/or registration) by state government trade approval authorities. Therefore, while an intermediary will match buyers and sellers and provide services for some aspects of the settlement process (for example, submitting trade application forms to the relevant trade approval authority and arranging payments), a trade will still be subject to obtaining the appropriate approvals. Some IIOs also provide brokerage services or operate online exchange platforms. Concerns that have been raised about IIOs providing intermediary services, while acting as a trade approval authority, are discussed at section 8.11 of this chapter.

8.2.3 Brokers compete strongly for clients

It is difficult to establish the exact number of water brokers currently operating in the market as there is no formal registration process, and some water brokers provide water brokerage services as a sideline to other activities, such as real estate. The ACCC identified approximately 80 brokerage firms that operate in the Murray-Darling Basin (Basis) with some firms having multiple employees and/or

---

358 The ACCC was informed by stakeholders at the ACCC Murray-Darling Basin inquiry, St George public forum that there are proportionately less brokered trades in the Northern Basin than the Southern Basin. At the ACCC Murray-Darling Basin inquiry, Narrabri public forum stakeholders noted that there were just a few brokers that provided brokerage services in that area.

359 For example, for temporary trades there can be a high rate (% commission or $/ML (whichever is greater), a standard rate and a low rate.


361 Internal trades of irrigation rights and water delivery rights require the approval of the relevant IIO, and trades of water access rights to or from an IIO’s entitlement require the approval of both the relevant IIO and the relevant Basin State trade approval authorities.
contractors engaged in brokerage services. Currently, some of the larger water brokers operating within the Basin include Elders, Ruralco Water Brokers, Waterfind, Wilks Water, National Water Brokers and Integra Water Services.

It is unclear exactly what proportion of trades conducted in the Basin are facilitated in some way by a broker or other intermediary. A 2009 ACCC report noted that, ‘it has been estimated that between 80 and 90% of trades are facilitated by intermediaries, but this figure can be expected to vary throughout the MDB.’ Data from 2015 indicates that approximately 82% of irrigators within the Basin used an intermediary to facilitate the trade of a water right. The ACCC also understands that in 2018–19 around 76% of trades in Northern Victoria were lodged through the Victorian online Broker Portal, meaning they were facilitated by an intermediary. What is clear is that the use of intermediaries across the Southern Basin is widespread. Table 8.1 shows the share of the top 5 brokers and exchange platforms in Victoria in 2018–19 (by number of allocation trades).

Table 8.1: Derived market share of Victorian total allocation trade, 2018–19 (by number of trades)

<table>
<thead>
<tr>
<th>Broker or Exchange Platform</th>
<th>Derived market share of Victorian total allocation trade, 2018–19 (by No. trades)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>28.1%</td>
</tr>
<tr>
<td>B</td>
<td>9.8%</td>
</tr>
<tr>
<td>C</td>
<td>6.6%</td>
</tr>
<tr>
<td>D</td>
<td>5.9%</td>
</tr>
<tr>
<td>E</td>
<td>4.8%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>55.2%</strong></td>
</tr>
</tbody>
</table>

Source: ACCC analysis based on Victorian Government’s response to voluntary information request. Data has been updated since the interim report.

While there appears to be a moderate level of concentration in the market for brokerage services in Victoria, the ACCC observed water brokers engaging in highly competitive strategies across the Basin and understands that brokers’ shares of trades in water markets varies between regions and products. For example, brokerage firms regularly examine aspects of their businesses to assess their ongoing competitiveness including ongoing analysis of competitors’ pricing strategies and structures to further develop their own strategies and prices. Additionally, brokers employ a range of direct sales methods to seek to win clients, including strategies that involve regular contacts with market participants. The ACCC also found evidence that brokers compete very strongly for large clients in their marketing and pricing strategies.

8.3 Intermediaries are subject to limited regulation

Brokers and exchange platforms are subject to few specific legislative obligations.

---

362 This number does not include exchange platforms, or government agencies, such as Environmental Water Holders.
364 S Wheeler and others, Water market literature review and empirical analysis, Consultant report prepared for the ACCC Water Market inquiry, 2020, p. 116. The data is drawn from table 6.12 of the draft report and is based on the Centre for Global Food and Resources, University of Adelaide, survey data from 2015. However, note that this refers to intermediaries and therefore includes exchanges.
366 There may be certain geographic areas or systems where competition is lower (for example, groundwater systems generally, or surface water systems in the Northern Basin).
Like other businesses, water market intermediaries must comply with the *Competition and Consumer Act 2010* (the CCA), which incorporates the fair trading provisions within the Australian Consumer Law (ACL). Businesses are prohibited by the ACL from:

- engaging in misleading or deceptive conduct, or conduct that is likely to mislead or deceive;
- making particular kinds of false or misleading representations in connection with the supply or acquisition of services, including making false or misleading representations about the quality, value or price of services;
- accepting payment for services where they do not intend to supply the services, intend to supply materially different services or are aware of reasonable grounds for believing that they will not be able to supply the services within the relevant time;
- engaging in conduct in relation to the supply or acquisition of services that is, in all the circumstances, unconscionable;
- using physical force or undue harassment or coercion in connection with the supply of services or the payment for services.

Under the ACL, a term of a standard form ‘small business contract’ is void if the term is ‘unfair’, within the meaning of the ACL.

Services supplied to consumers are also subject to the statutory guarantees set out in the ACL, including that the services will be provided with due care and skill. A person (including a corporation) who pays less than $40,000 for the services will be a ‘consumer’ in this context.

The CCA prohibits anti-competitive conduct, such as contracts, arrangements, understandings or concerted practices that have the purpose, effect or likely effect of substantially lessening competition in a market, creating a cartel, or misusing market power.

The ACCC, as part of its ongoing functions (outlined above), monitors complaints against brokers and other water market intermediaries. In recent years, the ACCC has only received a small number of complaints concerning brokers and other water market intermediaries. Some stakeholders raised concerns regarding the conduct of an intermediary that is part of the Crown. Whether the water trading activities of a Crown entity amounts to carrying on a business must be considered on a case by case basis and involves consideration of the entity’s activities and the context in which the activities of concern have occurred. Relevant sections regarding cartel conduct are s. 92A of the CCA; ss. 45AA; 45AF; s45AG; s45AJ and s. 45AK of the CCA. Relevant sections regarding the misuse of market power and provides that a business with a substantial degree of power in a market is not allowed to engage in conduct that has the purpose, effect or likely effect of substantially lessening competition in a market.

concerns with the inquiry about the extent of action taken by the ACCC to date regarding certain water-broker related complaints.\textsuperscript{381} Most of the concerns raised in recent years and in stakeholders’ submissions to the inquiry relate to broader conduct issues that are not covered by these provisions, or to situations where there has not been sufficient evidence available to take action.

The ACCC in recent years received two complaints alleging a broker engaged in forgery and fraudulent practices. The issue of theft and fraud was also raised in a 2010 ACCC report regarding water market intermediaries. That report noted that while the criminal law would apply to these practices, further measures could be taken to reduce the opportunity for brokers to engage in such practices and to protect their clients, including the introduction of an industry-wide fidelity fund, a requirement for brokers to use audited trust accounts, and to have professional indemnity insurance.\textsuperscript{382} A subsequent report identified that fraud and theft by water brokers should be safeguarded against by the introduction of an industry-led regulation scheme or, where this did not develop, “the Australian Government should regulate water market intermediaries.”\textsuperscript{383} While theft and fraud are regulated by criminal law, the issues set out in this report highlight that without clear obligations on brokers towards their clients, enforcement of those obligations and greater transparency within water markets, there will be opportunity for brokers to engage in fraud and related practices. The management of client funds and professional indemnity insurance for intermediaries are discussed in section 8.7 of this chapter.

Water market intermediaries who offer products or services that are financial products or services, such as advice on water derivatives, have additional obligations under the Australian Securities and Investments Commission Act 2001 (Cth) (the ASIC Act) and the Corporations Act 2001 (Cth) (the Corporations Act). This is discussed further in chapter 9.

8.3.1 The Australian Water Brokers Association’s voluntary code of conduct

The Australian Water Brokers Association (AWBA) is the industry association that represents water brokers. Members agree to comply with the voluntary AWBA industry code of conduct which seeks to establish standards for the conduct of brokers and intermediaries. The code does address some of the client-facing conduct discussed in this chapter, such as the broker’s obligation to disclose a conflict of interest or that a broker’s promotional material must not contain false or misleading statements.\textsuperscript{384} However, its capacity to achieve compliance across the industry is limited given it has only been voluntarily adopted by 29 full members and 10 provisional members.\textsuperscript{385}

Concerns have also been raised by water market intermediaries that there is no confidence in the voluntary code and the AWBA.\textsuperscript{386} It is clear from the concern expressed to the ACCC at public forums\textsuperscript{387} and in submissions that the industry is not satisfied the voluntary code has capacity to effectively manage broker conduct. The AWBA’s own submission highlighted the limitations of the code. It stated, ‘…we are acutely aware that not all entities who act as water market intermediaries are members of the AWBA. As such the AWBA would welcome government regulation that applies to any entity that lodges water trades on behalf of clients.’

\textsuperscript{385} Provisional AWBA members are in training to become water brokers and do not have AWBA voting rights. Of the individual AWBA members, some are employed by brokerage firms who employ multiple brokers and/or engage contractors. Although the AWBA’s constitution does not at the time of writing enable it to offer company-level membership, companies are offered affiliate membership and there are currently five affiliate members. Therefore, ABWA members reflect a small percentage of individual brokers who operate in the market.
\textsuperscript{387} This issue was raised at the Murray–Darling Basin inquiry, Deniliquin public forum.
8.4 Significant concerns have been raised about broker conduct

Stakeholders raised issues of concern relating to the role, practices and conduct of water brokers that are capable of impeding the efficient operation of water markets. These issues were raised in the interim report and feedback on each of these issues was invited. The ACCC analysed this feedback and this chapter considers where intermediary obligations are needed to address these issues. Recommendations related to intermediaries are set out in chapter 9.

8.4.1 Concerns raised about brokers

The concerns raised by stakeholders in response to the inquiry can be grouped into (a) concerns between a broker and their client, such as client fund management and perceived or real conflicts of interest (client-facing issues); and (b) concerns which extend beyond client-facing issues to impact competition in the market more broadly (market-facing issues). While the ACCC acknowledges some of the issues raised as client-facing issues also arise in some of the market-facing issues, these categories are designed to describe the overarching nature of the conduct. Table 8.2 below sets out the key issues raised with the ACCC during this inquiry, and each of these issues are discussed in this chapter.

Table 8.2: Table of client-facing and market-facing concerns discussed in chapter 8

<table>
<thead>
<tr>
<th>Part</th>
<th>Concerns</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>8.5</td>
<td>Unclear role</td>
<td>There is a lack of clarity about the role that brokers play in water transactions and misunderstanding about the obligations they owe to their clients.</td>
</tr>
<tr>
<td>8.6</td>
<td>Incompatible interests</td>
<td>Some intermediaries do not disclose matters that their clients perceive as a conflict of interest, nor seek their client’s consent to proceed with the trade. For example, when brokers act for both buyers and sellers, or an intermediary acts as a principal in a trade.</td>
</tr>
<tr>
<td>8.7</td>
<td>Client funds are not subject to management obligations</td>
<td>There is currently no regulatory framework to require water market intermediaries to establish statutory trust accounts, or to require intermediaries to obtain professional indemnity insurance, as is the case in other markets.</td>
</tr>
<tr>
<td>8.8</td>
<td>Information asymmetries exist between broker and client</td>
<td>Intermediaries could use their access to information, their ability to analyse that information, and the reliance on information provided by intermediaries, to misrepresent the market to their clients to maintain or increase the price and volume of water rights traded.</td>
</tr>
<tr>
<td>8.9</td>
<td>Incomplete or misleading information to state registers</td>
<td>Intermediaries are able to influence the ‘market price’ of a water right by misrepresenting the price on trade approval applications to signal to the market (via the state register) that the price of a water right is different to the agreed price for the transaction.</td>
</tr>
</tbody>
</table>
| 8.10 | Intervalley trade strategies | Some brokers use strategies when transferring water through intervalley trade which raised equality of access and transparency concerns, including:  
- aggregating clients’ water rights onto broker held accounts for transfer in one large trade, which closes intervalley trade openings prematurely in the view of some stakeholders  
- IT strategies for submitting approval applications to improve the likelihood a trade will be approved.  
It is also alleged that price differentials between the valleys can be maintained by brokers who use their accounts for intervalley trading. |
| 8.11 | Perceived conflicts arising from multiple IIO roles | Concerns regarding the potential conflict of interest where an IIO has a dual role in providing intermediary services and approving trades. |
8.5 Brokers’ obligations to their clients are generally unclear

Market participants raised substantial concerns with the ACCC regarding a lack of clarity about the role that brokers play in water transactions and misunderstanding about the obligations they owe to their clients. Stakeholders have called for brokers to be required to comply with clearly articulated obligations regarding their relationship with their clients. The Australian Dairy Industry Council noted a challenge faced by dairy farmers in engaging a broker was not knowing whether they were acting in the farmer’s best interests.

The obligations owed by a broker to their client depend primarily on the terms of their contract, and potentially a range of other circumstances surrounding their dealings. There are no standardised contracts for water brokerage services. It follows that the specific obligations of a broker to their client vary substantially from case to case, causing significant misunderstanding and potential financial detriment to the client where these obligations are not set out in the contract.

8.5.1 Establishing a fiduciary relationship

In general terms, a fiduciary relationship is one where one of the parties stands in a position of trust and confidence in relation to the other such that the fiduciary is bound to place the other’s interests ahead of his or her own personal interests.

The relationship between agent and principal is often regarded as a fiduciary relationship. However, as set out in the following paragraphs, the existence or otherwise of a fiduciary relationship depends on the circumstances of each case. Despite what market participants might generally assume, it appears that the incidence of a fiduciary relationship arising between a water broker and its client are rare.

While there is no single test to identify a relationship as fiduciary, at its simplest, a fiduciary relationship exists where the circumstances establish that a person has undertaken to act for or in the interests of another person, and not in his or her own, or a third party’s interest. Standard categories of relationship have been recognised as fiduciary relationships, including lawyer/client and doctor/patient.

A fiduciary has duties they owe to the other person. A fiduciary may not enter an engagement in which it has or could have a personal interest conflicting with that of his or her principal, nor may a fiduciary gain a profit for him or herself or a third person, without the informed consent of the principal.

The law of fiduciary relationships has developed over time through the courts rather than by legislation. However, most intermediary relationships are subject to industry-specific state and Commonwealth laws, imposing obligations akin to the obligations of a fiduciary.

There is no such regulation for water market intermediaries. Obligations owed by exchange platforms and other online platforms to their potential users are established through their online conditions of use. The ACCC understands there is no expectation that these platforms owe users a fiduciary duty. In contrast, water brokers’ obligations to their clients will generally be established in their contracts and from the conduct of the parties and will vary from case to case. For example, a broker’s authority to act may be enduring, or it may be confined to a specific timeframe or volume and will be established in

389 Waterfind, Submission to Murray–Darling Basin water inquiry issues paper, 30 January 2020, p. 4. Waterfind supports the introduction of regulation or other obligations that would require brokers to enter into clear, written terms that are agreed with their customers that set out the relationship with the intermediary.
391 For example, the Property and Stock Agents Act 2002 (NSW) regulates real estate agents, stock and station agents and strata managing agents. Stock brokers are regulated by the Corporations Act 2001 (Cth) and the ASIC Market Integrity Rules for security markets and futures markets.
392 While a broker’s failure to disclose a contrary interest may have the effect of misleading or deceiving a customer, and may be a breach of the ACL, there is no industry-specific regulation requiring water brokers to disclose where their interests are contrary to their client’s interests; ACCC, Water market intermediaries: industry developments and practices, December 2010, Canberra, p. 40.
their contract. Without more, these cases are likely to be insufficient to establish the requisite intention to create a fiduciary relationship.

It is foreseeable that in these circumstances, the client could have an expectation that the contract establishes a fiduciary relationship between themselves and their broker, and that the broker is acting as their agent and in their best interests, when this is not the case. The ACCC received a complaint that highlights the confusion and mistrust that can arise when a broker’s obligations to the parties engaged in a trade are not clearly set out in the contract and incorrect assumptions are made. Typically the contracts reviewed by the ACCC do not clearly disclose the existence of a fiduciary relationship.

8.5.2 Some intermediaries perform multiple roles

A client’s understanding of the obligations owed to them by a water broker in any particular trade are further complicated by the fact that the water broker could also be their solicitor, stock and station agent or real estate agent. A solicitor, stock and station agent or real estate agent will often owe specific statutory obligations to their clients when performing those roles, which in many cases will not apply when they engage with the same client as a water broker. For example, a client may not appreciate that the obligations their stock and station agent owes them when acting in that capacity, can differ from the obligations that same individual owes them when acting as a water broker. Additionally, a firm offering water brokering services may also be operating an exchange platform.

To address uncertainties around what services are being provided and what obligations are owed to the client, the following obligations should be established to clarify the relationship between intermediaries and their clients:

- An obligation on intermediaries to act in the best interests of a client
- An obligation to provide the following information in writing to a client at the outset of each engagement (rather than a blanket statement by an intermediary) to allow for negotiation on a trade by trade basis:
  - the services being provided
  - the obligations owed to the client
  - the fees/commissions to be charged.

The ACCC considers that any regulation placing obligations on intermediaries, should include:

- an obligation to inform the client in a timely manner of any reasons for a trade approval authority rejecting or delaying the processing of an application
- an obligation to implement a complaints handling process, and to keep records relating to complaints or resolution of complaints
- an obligation to hold written authorities to submit trades for approval on behalf of clients.

The ACCC considers that obligations should be placed on intermediaries, when they are providing certain services which are typically provided only by brokers, to:

- hold written authorities to act as an agent on behalf of clients
- act in accordance with client instructions
- communicate all buy and sell offers to clients in relation to the proposed trade.

When they are providing certain services which are typically provided only by brokers.
8.6 Intermediary interests can be incompatible with their client’s

The interests of water market intermediaries and their client can be incompatible where:

- the broker provides brokerage services, that includes advice regarding price or volume of water rights, and charges a commission/fee to both the buyer and the seller, or
- an intermediary takes a position as a principal in a trade, while providing services to the other party to that trade. For example, a broker may engage as a principal in a trade to or from their own water account, or their firm’s account, while providing brokerage services (beyond any administrative services they provide) to another party to that trade.

There is no express regulatory requirement on brokers to disclose a practice that is incompatible with their client’s interests. As noted above at section 8.5 of this chapter, the circumstances of each broker-client relationship will determine whether the broker stands in the position of a fiduciary, and therefore has a duty to act in their client’s interests ahead of their own. It is currently unclear which individual relationships would be found to have this character, although it seems likely that these would be few in number.

8.6.1 Some brokers provide services to, and receive payment from, both parties in a trade

In some instances, there is a lack of clarity and misunderstanding about the services brokers provide to parties involved in a trade of water rights and to whom they are providing those services. The ACCC is aware that some brokers act, or appear to act to some degree, for both parties to a trade and the services being provided involve some level of broker discretion (beyond administrative services). Where a broker has been engaged to negotiate or provide advice regarding price by both parties, each party to the transaction will have opposing interests (the seller wants the highest price, and the buyer wants the lowest price). The ACCC considers this is problematic, as, in such circumstances, a broker cannot act in the best interests of clients that have competing interests.

Some brokers have sought to address this issue through disclosure to the parties engaging in the trade in their standard form documentation, such as by disclosing they may act for both buyer and seller and may receive a commission from both. However, stakeholders have identified that where brokers charge commissions to both buyer and seller, it is difficult to discern who is the broker’s client and primary interest.

The following case study illustrates how these issues were addressed by the Royal Commission into Misconduct into the Banking, Superannuation and Financial Services Industry.

---

394 Other than trade approval authority fees.
Box 8.1: Case study

Mortgage brokers and the Royal Commission into Misconduct into the Banking, Superannuation and Financial Services Industry

The Royal Commission into Misconduct into the Banking, Superannuation and Financial Services Industry (the Royal Commission) highlighted concerns regarding conflicts of interest in the relationship between mortgage brokers and borrowers, due to brokers receiving payments from lenders.

The Royal Commission reiterated from its interim report, ‘how difficult it may be to decide for whom intermediaries act and to whom a particular intermediary may owe duties and responsibilities.’ The Royal Commission then noted, ‘the general rule that should apply throughout the financial services industry is that an intermediary who is paid to act as intermediary:

- acts for the person who pays the intermediary
- owes the person who pays a duty to act only the interests of that person, and
- ordinarily owed the person who pays a duty to act in the best interests of that person.’

The Royal Commission then went on to find that:

- ‘Value-based commissions paid by lenders to mortgage brokers are a form of conflicted remuneration. That is, value-based commissions are a form of remuneration that can reasonably be expected to influence the choice of mortgage, the amount to be borrowed, and the terms on which the amount is borrowed’
- ‘trail commissions have the effect of aligning the broker’s interests with those of the lender, rather than those of the borrower’
- ‘The law should be amended to provide that, when acting in connection with home lending, mortgage brokers must act in the best interests of the intending borrower’
- ‘…the best interest’s obligations should be enforceable by civil penalty.’

The ACCC acknowledges the differences in scale, scope and nature of harms between the issues dealt with by the Royal Commission set out above, and the issues addressed in this chapter. In particular, they relate to different markets that impact a different number of individuals and businesses. However, the ACCC considers there are clear parallels in that the risk of substantial financial harm are common to both.

The ACCC is less concerned about exchange platforms being engaged by both parties to a trade (and receiving a commission from both parties) because matching processes on exchange platforms are designed to facilitate direct trading between buyers and sellers. However, even when only one party to the trade, most commonly the seller, is paying the commission or fees for the brokerage services, there are instances where the nature of the obligations owed and the services provided by the broker may be misunderstood.

The ACCC acknowledges that such potential conflicts exist for intermediaries across a range of markets. However, in other markets for intermediary services, such as real estate or financial services, a comprehensive regulatory framework exists to establish clear obligations on the intermediary and to manage any conflicts.

399 ibid.
400 ibid., p. 67.
401 ibid., p. 71.
402 ibid., p. 72.
403 ibid., p. 73.
404 However, there may be instances where the buyer in a trade may be the only party responsible for trade approval fees.
The ACCC’s view is that an obligation is required for intermediaries\textsuperscript{405} to disclose to their client when they are receiving multiple commissions/fees in relation to a single trade.

### 8.6.2 Intermediaries are able to engage in water trading as a principal, for profit

Stakeholders raised concerns about instances when brokers or a related party to the broker or brokerage firm, act as a principal (a buyer or seller) in a trade while also providing intermediary services to the other party to the trade. This is problematic, as the interests of the broker and the client can directly conflict, and this leads to mistrust in brokers. For example, this occurs where brokers are trading their own water rights as a principal without disclosing their personal interest in the trade and may be charging commission. Some brokerage firms disclose to their clients that they may trade using their own water holding accounts or licences, although not necessarily in respect of any particular trade. Some brokers disclose their personal interest and receive written consent for entitlement trades, but not necessarily for allocation trades. The AWBA’s view is that:

\begin{quote}
...whilst we are supportive of brokers having the ability to invest in water products at their own discretion, it is entirely inappropriate that a broker enter into a transaction with a water market participant directly.\textsuperscript{406}
\end{quote}

The AWBA’s policy requires member brokers to use a broker from a separate business when engaging as a principal in the water market.\textsuperscript{407}

The ACCC received feedback expressing strong support for introducing conflict management obligations for intermediaries, including disclosure requirements.\textsuperscript{408} Some submissions went further, calling for a ban on brokers having the ability to take an interest in a trade as a principal.\textsuperscript{409}

The ACCC considers that an outright prohibition on intermediaries trading their own water rights is unwarranted. Conflicts can be managed by imposing a fiduciary-like obligation on intermediaries to enter such engagements only with the informed consent of the client. An obligation on intermediaries to disclose a personal (or related entity’s) interest in a trade is required. Intermediaries should have separate broking water accounts (which are used to hold client water rights) and trading water accounts (which are used to hold water rights in which they have a personal interest). The intermediary must also disclose that the water rights they have a personal interest in are to be transferred to/from the intermediary’s or related entity’s trading water account (that is, not the intermediary’s broking water account which is used to hold client water rights). The intermediary must provide an opportunity for the client to get independent advice, and obtain the written consent of the client before proceeding with the trade.

Disclosure of a conflict or potential conflict allows for clients to seek information or advice elsewhere, and, where an intermediary is taking a personal interest, allows the client to consider in all the circumstances whether any advice provided can be trusted, and whether the services provided by the intermediary warrant the payment of a commission, given the potential of the intermediary to profit directly from the trade.

Water market intermediaries benefit from some information asymmetries because of information they receive from clients in the course of providing intermediary services. Intermediaries are able to use this information to gain an advantage in trading their own water rights. For example, a broker may be

informed by a client that they intend to buy or sell a large volume of water rights, which would have an impact on the prevailing market price. The broker could then gain an advantage by trading their personal water rights before this information is public and the price changes. Chapter 9 recommends broadening and strengthening the insider trading prohibition in water markets, to apply to the use of any material information prior to it being made public in order to gain an unfair advantage in the market. This recommendation is discussed in subsection 9.10.4.

### 8.6.3 Brokers’ use of their own accounts to facilitate trade reduces transparency

In the 2018–19 water year, 12% of all approved allocation trades in the Southern Connected Basin listed a broker or exchange platform as a principal in the trade. Presently, a broker’s use of their water accounts when providing brokerage services reduces transparency as:

- the price the seller receives for the water rights is unclear to the buyer
- the price the buyer pays for the water rights is unclear to the seller
- the buyer and seller are not identified to each other when water rights are transferred through the broker’s water account, and
- clients are unable to distinguish broker facilitated trades from those trades where the broker, or a related party, is the counterparty in the trade.

#### Box 8.2: Case study

**Is the broker the principal in the trade?**

The ACCC received an allegation that a broker offered a parcel of water rights for sale on its website, and engaged in negotiations with the prospective buyer without disclosing that the broker owned those water rights and was therefore a principal in the trade.

A broker is currently able to hold water on their own accounts, either to provide a service to their clients or to undertake their own trades. They may provide this service to their clients for a range of reasons including privacy or to aggregate small parcels of water rights from a number of clients and sell as a larger parcel. The practice of brokers facilitating trade through their own accounts means that when water rights are transferred off the broker’s water account to the buyer’s account, this could mean that the broker is either the seller (and a principal in the trade) or the broker has been holding the water rights on their water account on behalf of a client or number of clients.

This lack of transparency makes it easier for a broker to take a position as a principal (and possibly profit from the trade in excess of their fees or commissions) without the buyer’s knowledge.

There are a range of circumstances in which brokers offer the use their firm’s water accounts to facilitate their client’s trade (rather than to act as a principal in a trade) including:

- aggregating small parcels of their client’s water rights to reduce transaction costs including interstate fees and to meet large buy orders. This can include the movement of temporary allocation through inter-valley trades (IVTs). The issue of brokers using their water accounts to facilitate IVTs is discussed more broadly at section 8.10 of this chapter.

---

401 The ACCC found it is more common for brokers to own water holding accounts than exchange platforms.
411 ACCC analysis based on NSW, Victorian and SA governments’ responses to voluntary information requests.
412 H2OX, Submission to Murray–Darling Basin water inquiry issues paper, 13 February 2020, p. 10. This submission notes vendors would be unable to determine the price received for their water right if it was sold off the broker’s account.
413 Fruit Growers Victoria Ltd, Submission to Murray–Darling Basin water inquiry issues paper, 13 February 2020, p. 2. This submission notes that brokers should disclose if they or a related party are the counterparty to any trade they facilitate.
414 H2OX, Submission to Murray–Darling Basin water inquiry issues paper, 13 February 2020, pp. 9–10; Australian Water Brokers Association, Submission to Murray–Darling Basin water inquiry interim report, 13 November 2020, p. 2. The AWBA submission to the interim report highlighted that there is some dissent within the AWBA on the issue of broker water accounts, however, on balance the majority of members are in favour of the use of broker water accounts to assist clients navigate IVT movements, acknowledging the challenges involved in these movements.
facilitating the transfer of their client’s water rights to regions where clients do not hold accounts, and

enabling their clients to trade with privacy.

It is not always necessary for the parties to the transaction to have visibility over all of the details of a trade. However, the list above highlights the reduced transparency that arises from trading water rights held on a broker’s water account, even when it’s held for a client. As clients are unable to determine the actual price in a transaction and/or to whom they are trading, there is also an opportunity for brokers to profit from price differentials (a low sell price or a high buy price) by transacting with each party separately on the broker’s own or the firm’s account.415 The ACCC does not believe that this practice is systemic, however, the reduced transparency from the pooling of water rights in broker accounts and lack of uniform standards for accounting for water rights in these accounts means it is difficult to identify where the practice may be occurring.

The ACCC conducted analysis of ‘broker-mediated trades’ in the trading data from voluntary information requests, to identify potential instances of brokers capturing a price spread, where an identical volume was traded on to a broker’s account and off that broker’s account within a specified timeframe but at different prices, and sought to compare this with data from a broker. Analysis of the results showed that trades were not necessarily linked (for example, there might be transfers on to a broker’s account in one zone and off an account in a different zone), and when compared with data sought from the broker, the trades identified through the analysis could not be reconciled with the accounting systems maintained by that broker. This example highlights the need for accounting standards which link the seller/s and buyer/s for trades through intermediaries’ water accounts.

An additional concern has been expressed by stakeholders about the lack of clarity about legal ownership of the water right when brokers transfer clients’ water rights on to their accounts.416 Stakeholders have called for improved visibility of brokers’ trades and the AWBA has expressed support for statutory water trust accounts for brokers’ water accounts which are used to hold client water allocations (broking water accounts).418 The AWBA has also agreed a policy for their members regarding the use of broker water accounts to facilitate trades for clients. The policy states that no personal water allocation owned by the broker is to be held in such a water account.419

The ACCC’s view is that the lack of transparency that arises from brokers using their own water accounts is problematic, as brokers can take a position in the trade without the other party knowing. This creates mistrust between brokers and irrigators, and reduces the quality of information that irrigators have when making buying decisions. To address this concern, client water rights management and accounting obligations are required for intermediaries with water accounts which are used to hold client water rights (broking water accounts).

Intermediaries’ use of water accounts to facilitate trades can provide a valuable service to clients and client water rights can be protected with the application of a statutory trust accounting framework to these accounts. The ACCC’s view is that any such trust accounting framework should also prohibit the co-mingling of water rights owned by the intermediary or a related entity, in that intermediary’s broking water account which is used to hold client water rights. In addition, the framework should provide for a standard of accounting which is able to link the trade(s) into the account (from the seller/s) with the corresponding trade(s) out of the account (to the buyer/s). An intermediary should also have an obligation to disclose to a client when water rights are to be transferred to or from the intermediary’s broking water account which holds client water rights, to make it clear to the client that the water is not being transferred to/from the counter-party’s account.

417 Kilter Rural, Submission to Murray–Darling Basin water inquiry issues paper, 5 March 2020, p. 10. This submission noted that an area for improvement includes better visibility of all brokers’ trades.
Box 8.3: Case study

How a broker could take a personal interest in a trade under the proposed obligations

A seller wants to sell 100ML of water allocation, but a broker only has a buyer for 80ML and the broker agrees to purchase the remaining 20ML personally. Under the proposed obligations set out in this chapter, the broker would be obliged to:

- Confirm to the seller in writing that the 20ML would be transferred to a trading water account owned by the broker, and disclose their interest as the purchaser of the 20ML.
- Seek written consent from the seller that the 20ML is to be purchased by the broker personally, after giving the client the opportunity to get independent advice.
- If consent is received, confirm to the seller in writing that the 80ML would be transferred to the broker’s broking water account which is used to hold client water rights (if not being transferred directly to the buyer’s water account).
- Arrange for the 20ML to be transferred from the seller’s water account to the broker’s trading water account and not the broker’s broking water account which is used to hold client water rights.
- Ensure that the seller is paid for the 20ML out of the broker’s separate bank account, and the payment for the 80ML is paid for from the broker’s trust account for client funds (after receipt of the funds from the buyer of the 80ML).

The obligations discussed in this section should apply such that the relevant disclosure must be made for each trade, and general disclosures about the practices of the intermediary would be insufficient.

8.7 Client funds are not subject to management obligations

Intermediaries hold a significant percentage of the total value of the trade in escrow until settlement.420 The establishment of a robust industry wide legal framework for water market intermediaries and their clients, in the form of statutory trust accounts and an obligation that intermediaries hold professional indemnity insurance, would foster greater trust and confidence between these parties. The ACCC received submissions proposing audited statutory trust accounts421, fidelity or assurance funds422 and professional indemnity insurance423 for brokers. These issues have also been raised by water market participants in previous reports regarding water market intermediaries in the Basin.424 There was strong


support for the creation of statutory trust accounts and an obligation for intermediaries to hold professional indemnity insurance in submissions in response to the interim report.

8.7.1 Statutory trust accounts for client funds

It is the ACCC’s view that water brokers and exchange platforms should be required to establish audited statutory trust accounts for client funds. This would address stakeholder concerns about the current management of client funds. Kilter Rural submission to the interim report expressed concerns in relation to;

…the lack of statutory requirements for water brokers to maintain and operate audited trust account facilities in a similar way to licensed real estate agents. The transaction deposit amounts held by brokers often involve large sums of money. In addition, for some transactions, brokers may hold deposit monies for up to 5 years. In the absence of proper trust account facilities, the ultimate recipient of these deposits is likely to be treated as an unsecured creditor in the event of broker insolvency. We are of the view that this is an unacceptable situation. Other industries including the legal and real estate professions have been able to establish statutory trust account standards to address these issues. We recommend that the same approach be taken to water brokers.

A trust account is a bank account in which the account holder retains funds on behalf of another person such as a client. The legal frameworks governing certain professions, including solicitors, accountants and real estate agents, require members to establish trust accounts and comply with particular auditing and reporting obligations.

This use of a trust account lessens the risk that client funds will be dispersed to creditors in the event of intermediary insolvency or bankruptcy. A trust account also increases transparency with regard to management of client funds and reduces the opportunity for fraud or misuse of client funds. Trust accounting would provide another avenue for clients to seek redress in relation to the management of their funds, without having to institute legal proceedings.

The trust account framework should include prohibitions on comingling of client funds with any personal funds of the intermediary, for example, from the sale of their own water rights. An

---


429 Examples of other industries where trust accounts are required by legislation: Lawyers (s. 136 of Schedule 1 of the Legal Professional Uniform Law Application Act 2014 (Vic)); Conveyancers (Conveyancers Act 2006 (Vic) s 66); Money paid to a financial services licensee (Corporations Act 2001, Volume 4 (Cth) s 981B).

430 Department of Sustainability, Environment, Water Population and Communities, 2013, Regulation of Water Market Intermediaries—Draft COAG Regulation Impact Statement for consultation, April, p. 11, https://ris.pmc.gov.au/sites/default/files/posts/2013/04/03-Water-Market-Intermediaries.pdf. The Draft COAG RIS for regulating water market intermediaries (brokers) did not proceed to final. There was an independent review in 2014 of the Water Act 2007 which received submissions and made a recommendation (no.9) on an industry led approach to broker regulation.

431 ibid., p. 12.
intermediary should be required to ensure funds are deposited into or paid from a separate bank account for any trade, or part trade, in which the intermediary has a personal interest.

Some brokers have established separate bank accounts to hold client funds. However, the use of the words ‘trust account’ by brokers to describe some of these accounts is likely to mislead or confuse some clients who assume the broker is under the same obligations as professionals subject to statutory trust accounting obligations.

Where a firm’s business engages in both water brokerage services and, say, real estate, the funds relating to water trading are likely to be held in a real estate statutory trust. Market participants have submitted that funds held in statutory trust accounts must relate to funds from the provision of the related industry’s services, for example, the sale of property, and that funds relating to the sale of water rights held in these accounts might not be protected in the event of dispute or insolvency. The ACCC notes that issues related to the use of real estate trust accounts for non-real-estate funds will differ between jurisdictions. In any case, the option to use a statutory trust account is only open to those businesses which are members of the relevant profession, and while some overlap of these services and water brokerage services has been identified, many of the larger brokerage firms solely provide services associated with the water market.

The AWBA’s submission advocates that audited statutory trust accounts should be coupled with the establishment of an assurance fund, administered by the government, that could mirror those that have been established in other intermediary industries. Some submissions also expressed support for an assurance/fidelity fund. One market participant has suggested including a capital adequacy requirement. The ACCC considers that such a requirement may act as a barrier for new entrants and notes that some brokers are competing by offering to ‘make good’ trades if one of the parties withdraws or cannot complete the trade. While the ACCC has not identified widespread support for such a fund or a capital adequacy requirement at this time, the ACCC is of the view that an obligation on intermediaries to comply with a statutory trust accounting framework for client funds is required.

### 8.7.2 Professional indemnity insurance is not mandatory

Submissions in response to the interim report included support for regulation to require intermediaries to hold professional indemnity insurance. Professional indemnity insurance would provide water brokers with some protection when providing advice to their clients that may result in those clients incurring financial or other losses. It would also offer some protection against intermediary insolvency or bankruptcy that can otherwise occur when compensation must be paid. In turn, this insurance can protect the funds of other clients, held by the intermediary, from being distributed among creditors.

It is the ACCC’s view that, given that solicitors, conveyancers and financial planners must obtain professional indemnity insurance, and water market intermediaries have similarly serious levels of responsibility and influence over their client’s finances, water market intermediaries should be required to hold professional indemnity insurance. While it has been noted in previous reports that professional indemnity insurance has to date been difficult for water market intermediaries to obtain, this has in part

---

432 National Water Commission, loc. cit.
433 Australian Water Brokers Association, Submission to Murray–Darling Basin water inquiry issues paper, 30 January 2020, p. 5. An example of an assurance fund that has been established for clients of Real estate agents is established by ss. 79 and 80 of the Estate Agents Act 1980 (Vic).
437 For example, solicitors in Victoria are regulated by sections 211 and 212 of Schedule 1 of the Legal Profession Uniform Law Application Act 2014 (Vic); conveyancers are regulated by section 41 of the Conveyancers Act 2006 (Vic); financial planners are regulated by section 91B of the Corporations Act 2001 (Cth); Department of Sustainability, Environment, Water Population and Communities, op. cit., p. 12.
been due to a lack of targeted regulation that establishes clear standards and obligations. Regulation that provides greater clarity around the role of brokers and exchange platforms, the services they provide and the nature of the risks to be insured, would facilitate the development of appropriate insurance products for water market intermediaries.\textsuperscript{439}

8.8 Information asymmetries exist between brokers and clients

8.8.1 Irrigators rely on brokers for market information

As discussed at subsection 8.2.3 of this chapter, the majority of Southern Basin trades are conducted using a broker. Irrigators and other market participants therefore rely heavily on the information that brokers provide. Brokers play an important role in providing information to the market and aid in the distribution of a scarce resource to its highest value use.

Information asymmetry is a possible cause of market failure that occurs when one side of the transaction has less information about relevant market factors than the other. The presence of information asymmetries can reduce market efficiency, because parties with less information are unable to make fully informed decisions, resulting in market prices that are too high or too low..

Brokers have an information advantage over almost all water market participants. This is due to the complexity of water trading rules, along with the ability of brokers to devote time, resources, and technology to analysing market activities. Brokers are also advantaged by their ability to access information which is not accessible to their clients. For example, brokers have access to the cumulative data arising from their previous and existing clients’ water use, trading histories and proprietary holdings, and often their clients’ short-term trading intentions.\textsuperscript{440}

While information is available from different channels (that is, Waterflow, state registers), a number of participants have highlighted that there is insufficient timely, reliable and objective market price information and stressed their reliance on broker-provided information. For instance, WaterNSW’s submission to the inquiry stated that while more sophisticated market participants are able to understand the complex water market, smaller parties are reliant on third-party information.\textsuperscript{441}

It has also been alleged that buyers and sellers of water rights often simultaneously list their parcels of water rights with multiple intermediaries, making it more difficult for participants to gauge the price and availability of water rights.\textsuperscript{442} A submission to the inquiry, summarising stakeholder concerns regarding the opaqueness of the Southern Basin water market, stated that because there are so many exchanges, participants are left overly reliant on brokers who have a better understanding of true market volume and value, which in turn can be inconsistent with transactions recorded on the three state registers.\textsuperscript{443}

Feedback to date suggests that Basin State register data is not timely, and provides an insufficient level of detail, to meet the information needs of market participants. Accordingly, information provided by brokers cannot always be compared to information on state registers. There are often significant time delays between when an agreement to trade is struck, when trade approvals are finalised, and when the transaction information is released on the public state register, as well as integrity issues between different registers and different values in pricing for transactions made on the same day.\textsuperscript{444} These trade processing delays are examined further in chapter 10 of the report and price reporting is examined further in sections 9.4 and 11.3 of the report.

\begin{footnotes}
\item[440] Civic Ledger, Submission to Murray–Darling Basin water inquiry issues paper, 30 January 2020, p. 1. This submission notes that water broker’s access to proprietary information via their water trading activities causes ‘information asymmetry’ in the market.
\item[443] Ricegrowers’ Association of Australia’s, Submission to Murray–Darling Basin water inquiry issues paper, 30 January 2020, p. 5.
\end{footnotes}
8.8.2 Brokers provide information in a variety of forms

Brokers communicate information to clients directly or present information to the wider market on their websites. Brokers engage in vigorous marketing strategies to promote their services to prospective and current clients. This includes sending regular SMS messages, email messages or making phone calls offering regional specific information and water strategies along with their proposed rates. Some brokers target these messages to potential and existing clients based on their licence volume and value, to assess the potential value of trade each client will engage in. The brokerage firm will then engage with each client based on their assessment as to their likely value of trade.

Individual brokers within some firms are required to meet key performance indicators based on the number of calls made to current or prospective clients, orders placed, number of client’s served, client feedback and commission targets. These pricing and marketing strategies are competitive strategies to encourage clients to engage the broker.

Brokers and exchange platforms will often list recent trades on their websites. Some brokers also list buy and sell offers on their websites (while exchange platforms provide a platform to match buy and sell offers). Water market participants rely on this pricing and market depth information to make trade decisions.

8.8.3 Some irrigators do not trust the information provided by brokers

It has been alleged that some brokers make misrepresentations about the price and availability of water rights, or give misleading advice about predictions or trends, to encourage market participants to pay higher prices and trade higher volumes than they otherwise would. This has led to mistrust in brokers. The Almond Board of Australia’s submission stated that, ‘Many growers rely on water broker pricing information that is not comprehensive and could be seen to be selective in nature for the purpose of sustaining high prices.’

Stakeholders at forums and in submissions also alleged that some brokers make unfounded statements in emails to their clients about the rising price and decreasing availability of a water right in a particular location, to induce clients to enter into a trade. Even so, some market participants consider that the information provided by brokers is the most accessible and trusted information available.

8.8.4 Buy and sell-offers on broker websites

Brokers do not always list all opportunities for buying and selling water rights on their websites or on exchange platforms as buy and sell offers. In these cases, trade approval application forms are lodged directly to the relevant trade approval authority without the parcels being made available for sale or purchase to the public. However, it is also the case that trades not involving intermediaries will also generally not appear on any website or other publicly available place.

There is no obligation on brokers to publish all buy and sell offers on their websites and this practice is not unique to water markets; For example, in other markets including for Australian company shares, a transaction for shares might be settled by two parties without involving a stock market. Although the ACCC notes that market participants often refer to these trades as ‘off-market’ or ‘off-exchange’ trades (including in the submissions cited below), water market trades do not occur ‘off-market’ per se as there is no central exchange through which all trades are conducted in the Basin water markets.

445 Robinvale Table Grape Growers Advocacy Group, Submission to Murray-Darling Basin water inquiry issues paper, 30 January 2020, p. 5
446 Almond Board of Australia, Submission to Murray-Darling Basin water inquiry issues paper, 5 March 2020, p. 16.
448 The Robinvale Table Grape Growers Advocacy Group, Submission to Murray-Darling Basin water inquiry issues paper, 30 January 2020, p. 5.
449 For example, at the Murray-Darling Basin inquiry, Murray Bridge public forum, an irrigator said they got a weekly email from Ruralco and seemed happy to rely on that.
450 In this report, the term ‘off-platform’ is used to describe a trade negotiated via a broker or individuals without the involvement or use of an exchange platform, but lodged for approval via an exchange platform.
There are multiple reasons why a broker may decide not to publish all buy and sell offers, including at their client’s request. For example, where a seller or buyer may be dealing with multiple intermediaries, they may prefer not to list their parcel exclusively with one broker, or the client may request it not be published to maintain their privacy. A broker may not list an offer in the interests of efficiency, such as where they already know of a potential buyer or seller. Additionally, a broker may find that the buy/sell offers on their website do not attract many customers and not prioritise updating these.

Some market participants are concerned that given the incentive to maximise commissions, a broker could decide to exclude a sell offer on their website which is lower than the other offers, to create the impression on that website that the water right is trading at a higher price than would otherwise be the case.

Further, because brokers are able to be selective with the offers they list publicly, it becomes more difficult for market participants to ascertain the actual price and availability of that water right. One submission claimed that most trades in the Southern Basin occur ‘off exchanges’ via brokers and are therefore not reflected accurately to the wider market. Another submission to the inquiry suggested that large allocation buyers insist on negotiating ‘off-market’ offers which inhibit transparency.

### 8.8.5 List of recent trades on broker websites

Brokers often present a list of recent trades on their websites. There are concerns that brokers are selective with the trades they display, which provides an incomplete picture of the trades that broker has conducted. This can give a misleading impression of prevailing market prices and result in incorrect average price derivations. Reliance on information provided by brokers means that brokers have the opportunity to misuse their unique position in the market to keep water right prices and their commissions higher than they otherwise would be, by not reporting lower priced trades on their websites.

Without complete and timely information on the Basin State registers, the lists of recent trades cannot be compared against register data. A submission by Waterexchange suggests regulation to require brokers using the Victorian Broker Portal to publish the details of their trades on their website, which is audited against the trades submitted through the Portal, in order to eliminate broker misrepresentations to customers in respect of prices achieved and market activity.

### 8.8.6 Improved transparency and market oversight would increase confidence in the market

The ACCC has not found specific evidence of brokers making unfounded statements about the price and/or supply of a water right to induce a client to trade, or selectively publishing buy/sell offers or recent trades with the aim of sustaining perceptions of a higher price. However, it is a concern that it is difficult for market participants or regulators to verify the accuracy of statements or information provided by brokers, because the relevant information is not available or is not timely. There is also a perceived incentive for brokers to adopt inappropriate practices to maximise their commissions. When combined with an inability to verify broker provided information, and a lack of oversight of market participant behaviour, these issues have led to mistrust in brokers and a lack of confidence.

Existing prohibitions under the ACL, such as the prohibitions against engaging in misleading and deceptive conduct and making false or misleading representations regarding the quality, value or price of services, could be relevant to the forms of intermediary conduct described in subsections 8.8.3 to 8.8.5 above. However, as set out at section 8.3 of this chapter, the complaints regarding intermediary conduct that have been raised to date with the ACCC have been either outside

---

453 One broker noted that higher prices are detrimental to their business as market participants trade less when prices are high, and brokers receive frustration and anger from customers about high prices.
454 s. 18 of the ACL.
455 s. 29 of the ACL.
the ACCC’s jurisdiction or there has not been sufficient evidence to take action. Further, the current lack of available, reliable data coupled with the significant volume of trade that is conducted ‘off-platform’ means the ACCC’s ability to effectively gather evidence and prosecute such action is limited.

As detailed in chapter 11, the ACCC considers that the availability of more timely and accurate market information would increase transparency, and reduce the reliance on intermediaries as the primary source of up-to-date information.

In addition, the ACCC considers that targeted oversight of the behaviour of market participants, and introduction of prohibitions against market manipulation would address the concern about intermediaries using their discretion when publishing buy and sell offers or recent trades to affect perceptions of the market price. To enable the effective oversight of the behaviour of market participants, exchange platforms should provide details of buy and sell offer data, strike dates and times through a regular data feed to a backbone platform. These recommendations are detailed in chapter 9 and will assist effective oversight of the behaviour of market participants, and the verifiability of information provided by brokers and exchange platforms, and increase confidence in the information provided by intermediaries.

8.9 Accuracy, completeness and timeliness of reporting

Although there is no single exchange platform providing a centralised price index, state registers provide a weighted average price of approved trades. Water market participants rely on this pricing information to make trade decisions.

There is no central regulatory authority that monitors price reporting, so it is difficult to ascertain whether market participants are accurately reporting the price of trades. It has been alleged that brokers seek to influence the price of water rights by inaccurately recording prices on trade approval applications (incorrectly reporting to the state register some of the lower priced water rights traded in the market), including the inappropriate recording of zero dollar trades. Price reporting and zero dollar trades are discussed in detail in sections 9.4, 11.3 and in appendix G and are only briefly discussed in this section in relation to broker conduct.

We also note the following comments in the Murray–Darling Basin Authority’s (MDBA) 2018 media release on this issue:

Access to accurate price information is fundamental to a competitive water market, and under the Basin Plan Water Trading Rules, water trade prices must be made available to authorities, yet a large number of trades are reported at zero value. Some of this is legitimate, but we’ll be undertaking an audit of this issue, to increase accurate price disclosure by water brokers and sellers.

Part of the MDBA’s audit of water trade price reporting for the 2017–18 water year focussed on water traders’ and brokers’ compliance with the requirement to report prices. The audit identified a range of issues including confusion about the requirement to report price, inconsistent approaches to reporting price by different traders and brokers, and not being able to verify price on nearly half of all (sampled) transactions. Deloitte, who conducted this part of the audit, determined it was not able to obtain enough evidence to form a conclusive opinion on the extent to which water traders and brokers were reporting prices accurately. Deloitte noted this was largely due to the inability to contact some of the selected traders or brokers and a lack of adequate supporting evidence for selected transactions.

The ACCC notes that while it is the role of the MDBA to monitor compliance of the price reporting obligations through such audit processes, it is the Basin State registers that include the price as a field in the forms used when submitting a trade for approval. On the issue of enforcement, the MDBA’s audit found that, ‘Mandatory price reporting across all Basin States is a relatively new requirement brought...
under the Basin Plan in 2014, and as a consequence compliance and enforcement was found to be sporadic.

The ACCC notes that 28% of the number of approved water allocation trades in the Southern Connected Basin had a reported price of zero dollar in 2018–19. Based on Victorian data, 14% of the number of all trades lodged through the Victorian Broker Portal in 2018–19 were reported as zero dollar trades. These statistics are 66% and 45% respectively if viewed from the percentage of the volume of approved water allocation trades (rather than percentage by number) for 2018–19.

Some Basin State registers have recently begun requiring information on the reason for a trade, for all trades including zero dollar trades. Some states are yet to capture data on the party that lodges a trade when an application is lodged by a third party on behalf of one of the principal parties. Section 11.2 discusses the recent improvements to data capture and chapter 12 details recommendations to further improve accuracy and transparency of trade information, including trades within IIOs.

In addition, there are no industry-wide obligations on brokers or exchange platforms, including within IIOs, which would require them to keep or provide data to the state registers. The ACCC recognises that the Basin Plan Water Trading Rules at section 12.48 requires a person disposing of a water access right to notify the approval authority in writing of the price of the trade. While this obligation applies to the seller, there is no obligation for an intermediary executing the trade application on behalf of their client to ensure the seller’s obligation is fulfilled.

In the absence of clear recording-keeping obligations, it is not clear whether the information provided to state registers is complete and accurate. The MDBA audit undertaken by Deloitte (discussed above) noted a lack of supporting evidence to be able to verify transactions. These examples indicate broader transparency and integrity issues which exist in the water market, and the lack of appropriate trade data captured by state registers. They also highlight the inability to enforce accurate price reporting without record-keeping.

Chapter 9 recommends broadening and strengthening price reporting obligations, with a regulator having responsibility for oversight and adequate enforcement. To enable the regulator to investigate and enforce accurate trade reporting for intermediaries, an obligation is required by intermediaries to keep records of client details, client instructions, and trade details (including price, volume, parties, and strike date) for the period of time (five years) required under Australian Tax Law.

Chapter 12 details the use of a digital protocol for consistent and structured sharing of information from all water market intermediaries to a backbone platform, which includes a central information repository that will enable effective monitoring of trade reporting, and improve information flows to remove the potential for errors in reporting (for example, linkages should be established so that the purchase price from exchange platforms is directly provided to the trade approval authority). Further detail about the development of Water Market Data Standards for the collection, storage and transmission of water market data is provided at subsection 12.4.2.

As outlined in subsection 8.8.6 above, chapter 9 recommends targeted oversight of the behaviour of market participants, and the introduction of prohibitions against market manipulation. These recommendations would also go towards addressing the concern about intermediaries misreporting the price of trades to trade approval authorities to affect perceptions of the market price.

8.10 Brokers use a range of strategies to facilitate intervalley trades/transfer

Intervalley trade/transfer (IVT) openings offer an opportunity for water market participants to take advantage of price differentials between the origin valley and the destination valley (arbitrage). These

460 ACCC analysis based on NSW, Victorian and SA governments’ responses to voluntary information requests.
461 ACCC analysis based on Victorian Government’s response to voluntary information request.
462 ACCC analysis based on NSW, Victorian and SA governments’ responses to voluntary information requests.
463 ACCC analysis based on Victorian Government’s response to voluntary information request.
opportunities are often strongly contested and when price differentials are significant, trade approval applications must be rapidly submitted to trade approval authorities before the IVT limit is reached and the trading opportunity closes. IVT application processes are discussed in detail in subsection 14.1.6.

Market participants have informed the ACCC about a lack of equal opportunity to participate in IVTs. Equality of access concerns can impact perceptions of market integrity, result in a lack of confidence in the market and inhibit participation in inter-valley trading, leading to inefficient outcomes. Stakeholders have noted concerns about high levels of complexity of IVTs. As discussed above at section 8.8 of this chapter, brokers benefit from information asymmetries and have an advantage in accessing IVTs because of their experience and the time they have to devote to assessing trade rules, trade balances, and anticipating openings. A small number of brokers have recently consistently traded large volumes of water rights between valleys in the Southern Connected Basin, particularly with respect to Murrumbidgee IVTs.

The ACCC examined how market participants access IVT opportunities, and some of the behaviour and strategies of brokers with respect to inter-valley trading. In particular, the ACCC examined the aggregation of water rights on brokers’ accounts prior to IVT openings, IT and automation for faster submission of trade applications and how the use of brokers’ accounts could affect price differentials between valleys.

### 8.10.1 Brokers aggregate multiple parcels of water rights onto brokerage firms’ accounts in anticipation of an IVT opening

As part of their service to facilitate the trade of water rights between valleys, some brokers aggregate large parcels of their client’s water rights onto their firm’s water accounts (in the origin valley) in anticipation of an IVT opening. As discussed in subsection 8.6.3 of this chapter, brokers offer the use of their firm’s water accounts to minimise transaction costs for clients or when facilitating transfers to regions where clients do not hold an account. Additionally, brokers aggregate parcels on their own accounts before an inter-valley trade opening as a strategy to increase the likelihood of a higher percentage of their clients’ trades being approved, before the trade limit is reached.

Commonly, the aggregated parcel of water rights is transferred from a brokerage firm’s account in the origin valley, to the brokerage firm’s account in the destination valley and recorded on state registers as a zero dollar trade.

---

Brokers aggregate parcels of water from clients who wish to transfer their water for use in another valley (for example, client C in the figure above), and from clients who wish to trade their water in another valley and take advantage of the arbitrage opportunity due to the price differential between the valleys (for example, clients A and B above).

Stakeholders raised the concern that transfers of large parcels of aggregated water rights between valleys by a small number of brokers can result in rapid closing of the trading opportunity (when the trade limit is reached). The aggregation of parcels of water rights by brokers provides a valuable service to clients who cannot themselves submit a trade for approval during an IVT opening, or for those who consider that using a broker will result in a higher likelihood of a successful transfer. However, when trading opportunities close rapidly, it limits the ability of other market participants to transfer water between valleys and stakeholders raised concerns about a lack of equal opportunity to participate in IVTs.

In the 2019–20 year to date (to 30 November 2019), brokers’ accounts were the recipients of 57% of the volume transferred out of Murrumbidgee. However, only 20.6% of the volume transferred out of the Murrumbidgee in the same period was transferred off brokers’ accounts. This may be because some of these IVT openings were less competitive and brokers were able to submit multiple trades during the openings such that the water rights were transferred directly from multiple clients’ accounts in the origin valley to the broker’s account in the destination valley.

Analysis conducted by the ACCC on individual’s shares of the Goulburn IVT capacity when the trading opportunity is open for less than 24 hours found that, during these constrained openings, the shares captured by brokers and agribusinesses significantly increased (see subsection 14.1.6 and figure 14.5).

8.10.2 Brokers are developing strategies to get their IVT applications approved

Some brokers have developed trading strategies to improve the likelihood of approval of their trades, through faster submission of their trade applications. Some of these strategies have given rise to concerns about the equality of access to IVTs, transparency of trade approval processes and the design of intervalley trade rules. Additionally, given there are a small number of brokers who have consistently had large volume IVTs approved recently, some market participants consider they must use those brokers to successfully transfer or trade water between valleys.

---

466 Source: ACCC analysis based on NSW, Victorian and SA governments’ responses to voluntary information requests.
Figure 8.2: Recipients of trades (% by volume) out of Murrumbidgee since 2017–2018.

Source: ACCC analysis based on NSW, Victorian and SA governments’ responses to voluntary information requests.

The above figure demonstrates that two brokers have secured the majority of the share of volume traded out of Murrumbidgee in the 2019–20 year to date.467

Victoria and NSW have different systems for the lodgement and approval of trades, as discussed in chapter 10 and appendix D. Market participants are critical of the system for applications for trade approvals in NSW that requires applications to be made by email or fax, suggesting that it is low-tech, flawed, and difficult for irrigators to use in competition with brokers during an IVT opening.

The ACCC is aware that some brokers have developed IT strategies for faster lodgement of applications for inter-valley trade approvals to take advantage of the NSW approvals system. The ACCC is also aware that patterns in trades submitted to the Victorian Broker Portal show increasing use of automation to rapidly submit trades when an IVT opportunity arises.

The development of IVT approval strategies further signifies that the market for water brokerage services in the Southern Basin is highly competitive. Brokers are developing trade approvals strategies that make the most out of the existing approvals system, to the benefit of their clients. Such competition driven innovation can be positive for markets, provided that the market structure itself does not unfairly exclude some participants from using similar innovations; and the amount spent on the efforts is not disproportionate and inefficient (see subsection 14.1.6). Increased investment in IT and automation will affect the range of parties that are successful with their IVT approval applications. Competitive pressures and arbitrage opportunities could result in more brokers and other market participants developing their own strategies for trade approvals over time. While smaller irrigators will not have the capacity to invest in automation technologies themselves, they could engage a broker who does.

The existence of IVT limits means that IVT opportunities will likely remain highly contested when price differentials are significant. The ACCC’s view is that brokers are offering a competitive service to clients which is based on the current design of the IVT approvals process (the ‘fastest finger’ approach). There has been support from stakeholders to change the IVT approvals process to improve equality of access.468 Market architecture recommendations for improving equality of access to IVTs are discussed in subsection 16.2.8. Other recommendations set out in chapter 12 include upgrading trade approval processes to ensure a ‘level-playing field’ for traders in the Southern Connected Basin.

467 The 2019–20 figures are year to date figures to 30 November 2019.
The ACCC identified that intermediaries have discretion in allocating successfully transferred volumes among their clients, where large volumes have been aggregated on the intermediary’s account in anticipation of an IVT opening, and not all has been able to be transferred. This process is not transparent and the ACCC considers intermediaries should be required to disclose which method they are using to allocate successfully transferred volumes amongst their clients following an IVT opening (for example, in chronological order or pro rata).

8.10.3 Concerns brokers affect price differentials between valleys

A concern was raised that price differentials between the valleys can be maintained by brokers who use their own water accounts for IVTs. It is alleged that the practice of brokers using their accounts to transfer water rights between valleys prevents prices in the valleys from responding quickly or equalising when the constraint is removed. It has been suggested that prices would more rapidly respond, or equalise, if water could only be moved directly from a seller’s account to a buyer’s account or between an individual irrigator’s accounts and that IVT opportunities would remain open for longer.

The prices recorded when the water rights are aggregated in the origin valley in some instances are not the same as the prices recorded when the water rights are transferred off the brokers account in the destination valley. For example, the prices will not ‘match’ because a buyer has not been found prior to the IVT opening (when the parcel is aggregated). The use of brokers’ water accounts to facilitate trade also limits transparency, which is discussed above at subsection 8.6.3 of this chapter.

A stakeholder has raised further concern that, following the approval of an IVT, a broker can slowly sell water rights off their account into the destination market, to maintain the price differential between the valleys. Brokers can hold parcels of water rights on their accounts in order to maximise their clients’ gain from selling their water rights in the destination valley. Strategies to maximise the return on sellers’ water assets is in line with the efficient functioning of markets.

Concerns have arisen that brokers may use these strategies to exercise their market power. Some brokers are successfully transferring large amounts of water between valleys, and have demonstrated their ability to capture most or all of the trade limit in one application. This can often be a significant volume of water which in some instances has the potential to equalise prices between the valleys when the constraint is removed. However, this large amount of water consists of aggregated amounts of multiple client’s water, each of whom will have different requirements either for use or for sale in the destination valley. This means it is unlikely to provide brokers with sufficient market power to affect price differentials between valleys.

8.10.4 Brokerage firms taking a personal position in IVTs

The ACCC is also aware of the potential for brokers or brokerage firms to take a position in an IVT through the widespread use of the firm’s own water accounts to facilitate the movement of water rights through an intervalley trade opening. The allegation of brokers or brokerage firms taking a position as a principal in a trade is explored above in subsection 8.6.2 of this chapter.
8.11 IIOs which operate exchange platforms or offer brokerage services are capable of preferencing IIO facilitated trades for approval

Market participants raised concerns with the ACCC about IIOs operating trading platforms or offering brokerage services, while acting as a trade approval authority. A previous report\(^{473}\) and ACCC advice\(^{474}\) have considered the potential for conflicts of interest to arise and made recommendations to address such conflict.

IIOs are capable of prioritising the approval of trades facilitated by their own brokerage service or trading platforms over other trade approval requests. A financial incentive could exist for the organisation to bundle water delivery services with the intermediary service in such a way that it limits clients’ choice of independent intermediary. To the extent that this occurs, it would result in reduced competition in the market for intermediary services, and result in higher costs to water traders.

Financial gain from acting inappropriately can arise directly from the revenue generated from the exchange platform, or from acting in a way that financially benefits the operator’s clients or members at the expense of third parties.

The ACCC received submissions in response to the interim report which recognise this conflict.\(^{475}\) The AWBA has stated that ‘there is a clear conflict of interest with IIO’s being an approval authority, engaging in the market directly, and acting as a water market intermediary.’\(^{476}\) Coleambally Irrigation Co-operative Limited disagreed with the proposition that if an IIO operates an exchange or market platform, other traders or intermediaries could be disadvantaged.

The ACCC requested information and met with IIOs who provide intermediary services to explore why IIOs provide these services and how they manage these potentially competing roles. A common aim among IIOs that provide intermediary services, is to keep the costs of trading low for their customers or members. Some smaller IIOs do not consider the services they provide to be intermediary services (even though they are providing matching services for a fee, and using an IIO bank account for settlement). Some IIOs do not receive enough approval applications at any one time, to have to prioritise approval of one application over another. Some IIOs have a policy or practice that they approve trades in chronological order (the order in which applications for trade approval are received).

While there is incentive for an IIO to prioritise approval of a trade for which it is receiving a fee/commission for brokering/matching that trade, the ACCC has not found evidence that this practice is occurring. The ACCC considers that these IIOs are providing a service to customers to assist them to find potential trading partners, and keeping transaction costs lower for customers is a clear benefit to these users. Therefore the IIO’s ability to provide intermediary services should not be removed given little evidence of harm.

However, there is a potential conflict of interest. Chapter 12 sets out that trade approval processes need to be improved, simplified and standardised and that minimum standards and agreed processes need to be consistent and mandated. As part of that move towards standardisation, there is an opportunity to develop a mandated approach for all trade approval authorities (including IIOs) to approve trades in the order in which they are received by the authority.\(^{477}\)

The ACCC also notes that IIOs providing intermediary services may have similar conflicts to other intermediaries, such as receiving multiple commissions for the one trade, or taking an interest in a trade as a principal. Further, IIOs providing intermediary services may hold client funds or client water rights

---


\(^{474}\) ACCC, 2010, Water trading rules, final advice, Canberra, March.


\(^{477}\) An exception to this approach may be necessary for IVT trades, should an alternative to the ‘fastest finger’ approach be introduced.
and should be subject to the same management and accounting obligations as other intermediaries. Accordingly, IIOs providing intermediary services should be required to comply with the obligations identified for intermediaries in this chapter.

8.12 The ACCC’s view is that substantial additional water market intermediary regulation is required

8.12.1 Intermediaries are regulated across most markets

This chapter has highlighted that brokers and exchange platforms play an important role in the water market. It is therefore crucial that intermediaries are subject to and comply with obligations that are appropriate for a market intermediary and that market participants are clear about what these obligations are, including how they apply within an IIO. In particular, it is imperative that where there is a real or perceived conflict of interest between an intermediary and their client, these circumstances are clearly disclosed to the client. The client must understand what the intermediary’s obligations are and intermediaries must be obliged to act in the client’s best interests.

This chapter also identifies the need for the introduction of a client fund and client water right management framework to protect the interests of intermediaries and their clients. Intermediaries across a range of other industries, including real estate agents and stock brokers are regulated specifically to address the risk of similar conduct. It is the ACCC’s view that there is merit in likewise addressing these risks in the water market context.

The potential for intermediaries to use their position in the market to mislead clients or the market will be constrained by improvements to market data and information and record keeping to enable effective, targeted oversight of market participants.

8.12.2 The ACCC considers the obligations proposed in this chapter will enhance market integrity

The ACCC’s view is that clear obligations for intermediaries are required to address the lack of clarity in the role and obligations of intermediaries, the potential for perceived or real conflicts of interests, and scope for brokers to influence markets without oversight. This regulation would increase the integrity and transparency of water markets, improving their operation for all market participants. The form of the proposed regulation is considered in chapter 9.
9. Regulatory settings and solutions: protecting market integrity and prohibiting harmful conduct

Key Points

- Regulatory settings in Murray–Darling Basin water markets are complex and fragmented between participating jurisdictions. For example, while the Commonwealth Basin Plan Water Trading Rules underpin market regulation, the Basin States each have more specific water trading rules that apply in their jurisdictions.

- For rules such as those dealing with price reporting, the unclear delineation of compliance and enforcement responsibilities between the Commonwealth and Basin States, and the resultant lack of enforcement, means the existing regulation is often ineffectual.

- Notwithstanding the amount of regulation that exists for water markets, much of it relates to water resource management, or state trading rules such as inter-valley trade and carry over rules. There is a lack of a cohesive regulatory framework for market conduct and integrity of the kind that exists for other markets.

- There has been increased participation in water markets by investors and agri-businesses over the last 10 years, and the use of intermediaries to facilitate trade in the Southern Basin is now widespread. The regulatory framework has failed to keep pace with these changes.

- While these market participants provide many benefits to Basin water markets, a lack of trust in them by other market participants is inhibiting market confidence. This is partly due to the fact that water market intermediaries such as brokers and exchange platforms are largely unregulated, and there are scant rules to govern the conduct of market participants more broadly.

- While the ACCC was able to scrutinise market activities under this Inquiry, this only provided a snapshot for a given period of time. Nevertheless, some water market participants do not have confidence in the markets, which discourages their participation. This means that opportunities exist to improve trade and economic activity. This requires a regulatory framework which prohibits misconduct such as market manipulation and enables ongoing market surveillance, which could extend to investigation and associated enforcement action if needed.

- The lack of a centralised Basin-wide regulator to monitor trading conduct and activities makes it difficult for market conduct to be assessed holistically and for harmful conduct to be identified.

- The ACCC considers that new centralised Basin-wide legislation is required to prevent harmful conduct, to strengthen integrity, and to improve confidence and fairness in Basin water markets.

- The legislation would be best established through some form of cooperative legislative scheme, and enforced by a centralised regulator – a proposed Water Markets Agency (see chapter 17).

- The legislation should include statutory conduct prohibitions and integrity protections applicable to all market participants, and an enforceable mandatory code for intermediaries.

- Harmonisation of state legislation would not be adequate because it would not be possible to identify market manipulation by looking only within a single trading zone or Basin State. The proposed Water Markets Agency would need to be able to carry out investigations and enforcement activity across state borders.

---

Water ‘management’ includes, for example: the management of Basin water resources to meet critical human water needs; the Basin Plan, which provides for limits on the quantity of water that may be taken from the Basin water resources; arrangements for sharing water between the Basin States; and management of water quality and salinity.
9.1 Introduction

This chapter examines the extent to which existing regulation is adequate to govern the conduct and integrity of market participants in Murray-Darling Basin water markets. The chapter then makes recommendations for regulatory solutions to prohibit harmful conduct and to improve market integrity.

The chapter includes information about the existing framework of regulation and regulators. It explains some of the challenges that these arrangements create for compliance and enforcement activity. It also notes that despite the volumes of existing regulation, there are scant rules to prohibit harmful conduct and to protect integrity.

The chapter notes that there isn't a cohesive regulatory framework for Basin water markets comparable to those that exists for other markets, such as the financial services and energy markets. It discusses three options that have been considered for addressing this deficiency. It concludes by recommending that new centralised Basin wide legislation be introduced to improve the integrity and fairness of Basin water markets by regulating conduct of market participants. It recommends the legislation should be enforced by the proposed Water Markets Agency (see recommendation 26).

The chapter also explains which water products are financial products regulated by ASIC, and responds to requests from some market participants for restrictions on investors, both domestic and foreign.

9.2 The existing patchwork of regulation and regulators results in the lack of a cohesive framework for Basin water markets

Regulation of water markets in the Murray-Darling Basin is currently subject to a range of regulatory regimes and regulators.

9.2.1 The Murray-Darling Basin Authority and Basin States

As noted above, the MDBA is responsible for enforcement of the Basin Plan Water Trading Rules, in conjunction with the Basin States. Each of the five Basin States maintains responsibility for legislative and administrative arrangements for water rights (water resource management) and for water trading arrangements in their jurisdictions. These rules must be consistent with the Basin Plan. Each Basin State is responsible for enforcing their own trading rules in their jurisdictions.

The ACCC’s role in the Murray-Darling Basin

The ACCC advises the MDBA on the development of Basin Plan Water Trading Rules under the Water Act 2007, and advises the Commonwealth minister responsible for water on development of water market rules and water charge rules. The ACCC also monitors compliance and enforces the water market rules and water charge rules applicable to infrastructure operators. The ACCC refers complaints about possible breaches of the Basin Plan Water Trading Rules to the MDBA which enforces those rules. The Water Market Rules 2009 prohibit actions or omissions by off-river infrastructure operators that prevent or delay an irrigator from transforming an irrigation right into a water access entitlement. The water charge rules include a termination fee cap and requirements for the publication of Irrigation Infrastructure Operators schedule of charges. The water charge and market rules that the ACCC enforces do not address conduct by individual water market participants, such as brokers, investors or irrigators.

However, like other businesses, water market intermediaries must comply with the Competition and Consumer Act 2010 (the CCA), which incorporates the Australian Consumer Law (ACL).
The CCA prohibits anti-competitive conduct and the ACL includes consumer protections, such as prohibitions on misleading and deceptive conduct. Section 8.3 in chapter 8 details these protections.

The provisions of the ACL most relevant to water brokers are discussed more fully in a series of ACCC publications including, Water trading—a guide to your fair trading rights when using brokers and exchanges, Canberra, 2011. 481

The ACL is legislated at the Commonwealth, state and territory levels. It is enforced by the ACCC at the Commonwealth level and by the state and territory Offices of Fair Trading at the state and territory level.

The ACCC’s Water Monitoring Report 2018–19 states:

Through our compliance work, the ACCC is aware of some complaints from irrigators about (alleged) unfair conduct. However none of the conduct was found to be a breach of the Rules or the Competition and Consumer Act 2010. 482

The role of the Australian Securities and Investments Commission

The Australian Securities and Investments Commission (ASIC) is responsible for the regulation of financial services and financial markets under the Corporations Act 2001 (Corporations Act). The regime is limited to financial products and services as defined in the Corporations Act. Financial products includes a broad range of financial instruments including derivatives.

ASIC regulates water market participants who deal in water products that are derivatives and therefore financial products. To be a derivate contract, a water option contract would need to allow for all three prescribed methods of settlement, with the purchaser being given the right to elect the method of settlement at the time of settlement. That is, under the terms of the contract, the purchaser can elect to use either cash-settlement, set-off, or physical-settlement. 483 In contrast, products described as water options contacts that only allow for physical settlements are not financial products. 484 Any water brokers dealing in water options and futures that are financial products would need to hold an Australian financial services licence (AFSL). More detail about financial services regulation is set out in section 9.11 of this chapter.

Role of the Australian Tax Office

Acquiring and disposing of water rights is also subject to general taxation laws administered by the Australian Tax Office (ATO). Foreign acquisitions of water rights are subject to laws for foreign investment administered by the Treasurer, where the acquisition forms part of an agricultural land or agribusiness acquisition that meets the relevant monetary threshold. Foreign acquisitions of water rights must also be registered on the Register of Foreign Owned Water Entitlements, administered by the ATO. More about these arrangements is set out in section 9.13.3 of this chapter.

---

483 Subsection 761(3)(d) of the Corporations Act and subregulation 7.1.04(8) of the Corporations Regulations 2001 provide that an arrangement is not a derivative if it does not permit the seller’s obligations to be wholly settled by cash, or by set off between the seller and the buyer, as an alternative to [physical] transfer of ownership of the tradeable water rights or replacement water rights.
484 Subregulation 7.1.04(8) of the Corporations Regulations 2001 provides that, for paragraph 761D(3)(d) of the Corporations Act, each of the following is declared not to be a derivative for chapter 7 of the Corporations Act: (a) tradeable water rights; and (b) an arrangement: (i) under which a person (the seller) has, or may have, an obligation to sell tradeable water rights at a future date; and (ii) under which another person (the buyer) has, or may have, an obligation to buy the tradeable water rights, or replacement water rights, at a future date; and (iii) that does not permit the seller’s obligations to be wholly settled by cash, or by set off between the seller and the buyer, rather than by transfer of ownership of the tradeable water rights or replacement water rights.
9.3 Unclear delineation of enforcement responsibility results in inadequate enforcement action

Central to the regulatory settings for the water markets in the Murray–Darling Basin are the Basin Plan Water Trading Rules in chapter 12 of the Murray–Darling Basin Plan. These rules were developed to contribute to achieving the Basin water market and trading principles set out in Schedule 3 to the Water Act 2007.

The MDBA has the role of monitoring and enforcing the Basin Plan Water Trading Rules. These rules apply to the Commonwealth (including the MDBA), Basin States, irrigation infrastructure operators, and individuals participating in water markets and address three broad aspects of market operation, namely reducing restrictions on trade, improving transparency and access to information, and maintaining market integrity and confidence.

The Basin Plan Water Trading Rules aim to ensure free trade in surface water, except where there are defined allowable restrictions. The rules define the types of trade restrictions that are and are not permissible in the Basin. The Basin Plan Water Trading Rules also aim to increase the level of information available in the market, as access to information facilitates transparency and increases confidence, allowing participants to make informed decisions.

The rules require that certain information must be made available on water announcements, the characteristics of water access rights, and water trading rules applied by Basin State Governments and IIOs. For example:

- a person (generally a Basin State or Commonwealth agency) who makes a water announcement must ensure it is generally available.
- a person who is aware of a water announcement that could have a material effect on the price of a trade must not enter into the trade informed by that information until the information is communicated to the market through being made generally available.
- the agreed price of each trade of a water access right must be reported to the relevant approval authority by the seller of the water access right, either before, or at, the time the approval or registration is sought.

The inclusion of water trading rules in the Basin Plan was intended to provide a consistent framework for water trading across the states. While these rules prohibit or require certain things, the Basin States develop and enforce more specific rules, and have access to more trade information. This causes a lack of clarity regarding the delineation of responsibilities, causing confusion about where the boundaries lie in relation to enforcement responsibilities.

---

487 ibid. para. 687, p. 122.
489 Division 2 of Part 5 of the Basin Plan Water Trading Rules.
490 Section 12.46 of the Basin Plan Water Trading Rules.
491 Section 12.47 of the Basin Plan Water Trading Rules.
492 See definition of ‘water announcement’ at s. 12.49(2) of the Basin Plan 2012.
493 Section 12.50 of the Basin Plan 2012.
494 Sections 12.49 to 12.52 of the Basin Plan 2012.
495 Section 12.48 of the Basin Plan 2012.
9.4 The objectives of the Basin Plan Water Trading Rules are best met by centralised enforcement

The Water Act 2007 and the Basin Plan 2012 give the MDBA powers to enforce compliance with the Basin Plan Water Trading Rules. Basin States are responsible for regulating water users within their jurisdictions, and enforcing compliance with their own trading rules.\(^{497}\)

Basin Plan compliance and enforcement has received considerable attention in recent years. In 2017, the Australian Government requested the MDBA and an Independent Panel conduct the Murray–Darling Basin Water Compliance Review following allegations of water theft in the Basin.\(^{498}\) The review included the following comments about the Basin Plan Water Trading Rules:

The MDBA regards the successful implementation of Basin Plan Water Trading Rules as a high priority and acknowledges that lack of compliance can compromise both entitlement holders’ and traders’ confidence to invest in water access rights. Priorities for enforcing trade rules are outlined in the MDBA Strategic priorities for Basin Plan Water Trading Rules.\(^{499}\)

As part of the annual statement of assurance process, the MDBA asks Basin States to provide information about how they have managed market sensitive information and how Basin States are meeting relevant obligations under the Basin Plan.\(^{500}\)

The MDBA Strategic priorities for the Basin Plan Water Trading Rules states:

The rules require the price of a trade to be reported (s. 12.48). This obligation rests with the seller, not the approval authority. There are two elements associated with compliance with this rule; firstly that a price is provided, and secondly that the provided price accurately reflects the agreed price for the trade. The MDBA considers that the consequence of any individual not reporting their trade price is minimal. However, it is possible that in a thin market, where trade volumes are large, or the price varies significantly, not reporting a single transaction may have an effect. Furthermore, if there is systemic misreporting or price manipulation then this may represent collusion, or misleading or deceptive conduct. Should the MDBA become aware of individual traders who regularly fail to fulfil their obligations, increased intervention in these cases may be considered. The MDBA intends to work with Basin States to improve our knowledge of current reporting practices.\(^{501}\)

Price reporting requirements are being approached in different and seemingly arbitrary ways by those affected by the rules. For example, some water market participants designate a $0/ML on application forms when reporting the price of forward contracts, in an effort not to skew public data. Other market participants report the price under the forward contract that has been contractually agreed to with the counterparty. There is also trade between related parties, where no monetary consideration is paid. For example, moving water between licences in a water portfolio. Such transfers are not differentiated from trade in terms of regulatory treatment for price reporting and are often reported as zero dollar trades.

In its 2019 Audit of Compliance with s12.48 (‘Price of trade to be reported’) of the Basin Plan, Deloitte found that misreporting of water trade prices in the Murray Darling Basin is pervasive. Deloitte uncovered a number of reasons for this:

Reasons include a lack of understanding about the requirement to report trade prices, poor reporting systems that do little to encourage accurate price reporting, and little or no

\(^{497}\) ibid.


validation of the price data provided. Overall, Deloitte found that no relevant government had fully effective controls in place to ensure complete and accurate price reporting.\textsuperscript{502}

Although the MDBA has statutory enforcement powers under the \textit{Water Act 2007}\textsuperscript{503}, it has considered water compliance and enforcement to be largely a matter for the Basin States:

The MDBA’s role in compliance allegations concerning individual water users is limited. Such a role was never contemplated for the Authority, and it is not resourced to perform this intensive role across the Basin. Rather, it has been assumed that Basin States are enforcing their own laws diligently.\textsuperscript{504}

However, in the course of the 2017 \textit{Murray–Darling Basin Water Compliance Review}, it was made clear that ‘the community does not accept this arrangement’.\textsuperscript{505}

In response to concerns about enforcement of the Basin Plan, the MDBA has established an Office of Compliance, and revised its Compliance and Enforcement Policy, amongst other actions.\textsuperscript{506} In December 2018, the Commonwealth and Basin State Governments agreed to the ‘MDB Compliance Compact’.\textsuperscript{507}

In addition to these ongoing efforts to improve compliance and enforcement activity, the Commonwealth Minister for Resources, Water and Northern Australia has announced plans to improve arrangements for compliance governance in the Murray Darling Basin by separating the operational and compliance responsibilities of the MDBA. Under the proposed arrangements, the responsibilities of the Inspector-General of Water Compliance\textsuperscript{508} and the MDBA’s Office of Compliance would be merged. These arrangements are still being developed.

The ACCC supports a centralised Basin-wide approach to enforcement as this would avoid the unclear delineation of enforcement responsibilities between the Commonwealth and the Basin States described above, enable investigations to cross state boundaries and promote a consistent approach to enforcement.

In addition, to address the enforcement challenges outlined above, existing price reporting obligations\textsuperscript{509} and insider trading prohibitions should be removed from the Basin Plan Water Trading Rules, and incorporated into the proposed new water market conduct and integrity legislation. The new provisions should be broadened and strengthened as set out in recommendation 3.

\section*{9.5 New legislation is needed to provide a cohesive framework for water markets and to address market integrity and conduct}

Despite the regulation described above, there isn’t a cohesive regulatory framework for Basin water markets comparable to those that exist for other markets, such as the financial services, energy, and real estate markets.

While investors, brokers, and exchange platforms provide significant benefits to Basin water markets, a lack of trust in them by other market participants is inhibiting market confidence. Unusual or suspicious transactions and price movements are unable to be formally investigated, making it difficult to rule

\begin{figure}
\centering
\includegraphics[width=\textwidth]{figure}
\caption{Figure}
\end{figure}

\begin{table}
\centering
\begin{tabular}{|c|c|}
\hline
Column 1 & Column 2 \\
\hline
Row 1 & Row 2 \\
\hline
\end{tabular}
\caption{Table}
\end{table}

\textsuperscript{502} ibid.
\textsuperscript{503} Part 8 of the \textit{Water Act 2007}.
\textsuperscript{505} ibid, p. 70.
\textsuperscript{508} https://www.igwc.gov.au/.
\textsuperscript{509} Section 12.48 of the Basin Plan 2012.
out innocuous reasons for transactions and identify real attempts to manipulate prices or mislead the market. Current governance and regulatory arrangements make it difficult for market conduct to be assessed holistically across the Basin, and for harmful conduct to be identified. NSW Farmers submitted, ‘there is insufficient regulatory oversight and associated enforcement and compliance activity, in relation to the practices of some market participants. The perception of misconduct are enough to significantly undermine confidence in water markets’.

The ACCC considers that new regulation is required to improve market integrity. Three options for integrity and conduct regulation for Basin water markets have been considered:

1. A government initiated licence scheme for intermediaries.
2. Applying the financial regulation framework to all water market products.
3. An independent market focused government regulator administering new conduct and integrity legislation.

These options were included in the interim report. Submissions to the interim report have been taken into account in forming recommendations. The following best practice principles, based on principles established by the Office of Best Practice Regulation, have also informed the recommendations:

- Establish a need – are there harms that must be addressed?
- Proportionality – do the benefits outweigh the regulatory burden and other costs?
- Ease of implementation – can the solution be implemented in practice?
- Consistency – does it fit with broader governance and regulatory frameworks?
- Transparency – will the solution lead to enhanced market transparency?
- Flexibility – can the solution evolve with developing water markets?
- Capability and accountability – would it create clear responsibilities and could it be effectively enforced?

In addition, the recommendations in this chapter are informed by the six norms of market conduct, identified in the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne Royal Commission) These are:

1. obey the law
2. do not mislead or deceive
3. act fairly
4. provide services that are fit for purpose
5. deliver services with reasonable care and skill
6. when acting for another, act in the best interest of that other.

Both of the above sets of principles have informed the recommendations made in this chapter regarding the substantive content for the proposed new legislation (see sections 9.9 and 9.10).

9.6 A government initiated licensing scheme for intermediaries would be burdensome for industry

A harmonised Basin State licence scheme and a Commonwealth licence scheme have been considered. While a harmonised Basin State licensing scheme for intermediaries could result in consistency in legislation between the states, there could be inconsistencies in state approaches to compliance and enforcement. In addition, investigations of breaches of licence requirements would not be able to be conducted across state boundaries.

---

A standalone Commonwealth licensing scheme could overcome these deficiencies. However, the conclusion following consultation and analysis is that a licence scheme would impose a disproportionate regulatory burden on intermediaries. Braithwaite’s pyramid (see below) highlights the ‘big stick’ penalty of licence revocation that is available under a licence scheme. Under a licensing scheme, intermediaries would need to apply for a licence in the first instance and those who do not comply with the law could be excluded from the industry through suspension or revocation of their licence. A licence scheme would impose a barrier to entry for new industry participants. Although there was support from some stakeholders for mandatory accreditation or minimum training requirements and a capitalisation threshold, such requirements would be a significant burden for some intermediaries. Industry is, however, encouraged to develop its own accreditation and competency standards, if this is considered to be of benefit.

Figure 9.1:  Braithwaite’s ‘regulatory pyramid’

9.7 The financial services regulation would not be a good fit for basic water products

A noted above at section 9.2 of this chapter, the regulatory framework for financial products, services and markets already applies to certain water products, and some stakeholders were in favour of applying it to all water products by categorising them as derivatives under the Corporations Act. For example, Select Harvest supported ‘a push for transparent and robust water market regulation in the Murray Darling Basin similar to oversight of the ASX, and for water brokers to face the same level of regulation as ASX stockbrokers’.

Although the financial services regulation is an adaptive framework, it would need to be significantly tailored in order to be fit-for-purpose for water products and markets, and even then, there would be significant challenges. In their submission to the ACCC inquiry, ASIC noted that:

The regulation of specialised commodity markets in Australia has generally been undertaken by tailored legislation overseen by specialised regulators, for example in the electricity markets. The nature of water rights and trading in those rights is more analogous to a commodity and this suggests mechanisms to regulate commodity trading may be another avenue to regulate the activity.

ASIC noted that:

ASIC only regulates financial markets. It does not regulate the physical electricity market. The physical market is the responsibility of the AER. ASIC regulates derivatives financial products that are traded over physical electricity such as listed futures and options or swap agreements that relate to the wholesale price of electricity. This separate regulation of the physical electricity market and the financial product market associated with electricity has

---
operated effectively for more than 15 years. It relies on the expertise of a dedicated energy market regulator to engage with the oversight of a very specialised physical market.\textsuperscript{513}

ASIC continued:

The ACCC draft interim report notes on page 256 that the Australian Energy Regulator (AER) is the specialised regulator for the Australian physical electricity market. Also significant in the regulation of the electricity market is the involvement of Australian Energy Market Commission which undertakes rule making and energy market development. The specialised expertise for a unique market is an important aspect of the regulatory framework for electricity. In addition the involvement of the Australian Energy Market Operator (AEMO) as the specialised market operator for physical market highlights the benefit of specialised arrangements for the operation of unique physical markets. AEMO has an exemption from the licensing requirements that apply under the Corporations Act to the operators of clearing and settlement facilities.\textsuperscript{514}

ASIC also noted challenges with the application of the financial regulation disclosure requirements:

The Corporations Act requires disclosure when a financial product is issued, in a product disclosure statement about the details of the financial product.\textsuperscript{515} Each person who is a party to a financial product that is a derivative and that is not entered into or acquired on a financial market will be an issuer of the derivative.\textsuperscript{516} This means that if water rights are derivatives then the person who is issued a water right may be required to prepare a product disclosure statement where the sale of the water right occurs to a retail client, as defined in in s761G of the Corporations Act. As the creation of water rights relies on the Crown granting the water right under the respective legislation it is possible that the Crown, in issuing the water right, may not be subject to the Corporations Act. This is as result of the operation of the s 5A of the Corporations Act. This provision exempts the Crown from the application of, amongst other things, the product disclosure obligations in Part 7.9 of the Corporations Act. One of the key aspects of the regulation of financial products under the financial service regulation are obligations about product disclosure that may not be adequately accommodated if the financial regulation in chapter 7 of the Corporations Act was adopted [for basic water rights].\textsuperscript{517}

ASIC also noted the issue of ‘dual regulation of statutory licences’:

Water licences are created by statute in the respective states and transferred in accordance with the relevant rules applicable to the transfer of those licences. Unlike for other financial products, ASIC does not regulate or oversee the initial issue of that product. The characteristics of a licence are determined by the relevant State government which has created types of water rights and the mechanism for the transfer of such rights is a matter for the relevant State legislation. ASIC would have limited engagement with the oversight of the licences that will be traded and the clearing and settlement arrangements for transactions involving water rights.

In addition, each state within the Murray-Darling Basin has its own legislation that creates the relevant water rights. ASIC under the financial regulation scheme has no control over the nature of those rights and the mechanisms that are used to transfer those rights. ASIC does not currently regulate other forms of statutory licences.\textsuperscript{518}

Noting these concerns, together with concerns expressed by stakeholders that the financial regulation framework would be too burdensome for water market participants, this option is not recommended.

\textsuperscript{513} ibid, p. 2.
\textsuperscript{514} ibid, p. 2.
\textsuperscript{515} Section 1013C Corporations Act.
\textsuperscript{516} Section 761E(5) Corporations Act.
\textsuperscript{517} ASIC, Submission to Murray-Darling Basin water inquiry interim report, 4 December 2020, p. 5.
\textsuperscript{518} ibid.
9.8 New centralised Basin-wide legislation is needed for market integrity and conduct

The ACCC considers that new centralised Basin-wide legislation is required to prevent harmful conduct, to improve the integrity and fairness of Basin water markets. In terms of the form of regulation, rules like the Basin Plan Water Trading Rules, or state-level rules like the IVT rules, would not be suitable. For conduct prohibitions, centralised statutory provisions are needed.

The legislation should be achieved through some form of cooperative legislative scheme. A harmonised scheme would not suffice. To address risks of market manipulation, the proposed Water Markets Agency would need to be able to carry out surveillance, and associated investigation and enforcement activity across state boundaries.

The legislation should include integrity protections. It should require exchange platforms and Basin State approval authorities to keep records of trades and to provide trade data to the proposed Backbone Platform. The data should include information about the water product, price and trade date. Continuous disclosure is critical for market integrity. The proposed Water Market Agency should be given access to this data, stored on the Backbone Platform, for ongoing monitoring of market activities and investigation of potential market misconduct. More detail about the Backbone Platform and Central Information Portal, the enabling technology for data collection, storage and disclosure, is set out in chapter 10.

9.8.1 The proposed Water Markets Agency should enforce the new conduct and integrity legislation

The new conduct and integrity legislation should be administered and enforced by the proposed Water Markets Agency (see chapter 17).

To analyse price movements and suspicious transactions holistically across water exchange platforms, including in different states, a Basin-wide regulator would be needed. Establishing the proposed Water Markets Agency as the centralised regulator would promote consistency in enforcement. It would avoid the kinds of enforcement problems that have arisen under the Basin Plan Water Trading Rules and Basin States’ water trading rules, due to the unclear delineation of enforcement responsibilities between the Commonwealth and the Basin States. It would enable investigations to cross state boundaries and help to ensure that there is a level playing field for all market participants, regardless of their location in the Basin.

The existing governance arrangements for Basin water markets are out of step with those in place for other markets. For example, ASIC is the independent whole of market supervisor for financial services and markets across Australia. It was considered that having a whole of market supervisor for that sector would streamline supervision and enforcement, and enhance confidence in the integrity of the market, thereby increasing stability in the market. Under the Corporations Act, AFSL holders (financial brokers) are subject to surveillance checks by ASIC when ASIC is alerted to potential problems, and to enforcement action when necessary.

---

519 Under the Corporations Act, AFSL holders (financial brokers) are subject to surveillance checks by ASIC and to criminal sanctions for committing offences and civil penalties for contravening certain provisions: section 912E Corporations Act. ASIC does a certain amount of surveillance of AFSL holders when it is alerted to problems.

520 Section 912E Corporations Act.
**Recommendation 1**

**Implement centralised, Basin-wide water market conduct and integrity legislation**

New centralised Basin-wide legislation should be introduced to protect the integrity of Basin water markets by regulating conduct of market participants, to be enforced by the proposed Water Markets Agency (see recommendation 26).

The proposed new legislation should include:

- an enforceable mandatory code for intermediaries, to address the detrimental conduct and practices identified by the inquiry and ensure that intermediaries are subject to the standard safeguards that apply in similar markets
- integrity protections such as broader price reporting requirements, and conduct prohibitions on market manipulation and insider trading
- a requirement for exchange platforms and trade approval authorities to keep records of trades and to provide trade data to the Water Markets Agency through arrangements for the flow of trading data outlined in recommendations 10 and 11
- a role for the proposed Water Markets Agency to conduct surveillance, enforcement and reporting
- compulsory information gathering powers and appropriate enforcement powers for the Agency
- a requirement to issue a unique common identifier to each market participant, to enable trades to be traced and traders to be identified across regions and multiple accounts (see recommendation 4).

9.9 **The new centralised conduct and integrity regulation should include an enforceable mandatory code for intermediaries**

In its submission to the ACCC interim report, H2OX noted, ‘Brokers are able to act in a way that would not be allowed by real estate agents, stockbrokers, solicitors, accountants and any other regulated profession’. The existing voluntary AWBA code has been largely unsuccessful in terms of take-up and therefore industry-wide compliance. Industry itself is supportive of a stronger approach. Mandatory codes are generally stronger than voluntary codes, both in terms of enforceability and the potential for inclusion of substantive obligations to address risks of harmful conduct. Mandatory codes are particularly suitable for providing tailored regulation for a particular occupation, trade or industry. Mandatory codes are often prescribed by regulation, making them easier to modify over time as industry evolves. For example, the ACCC regulates mandatory industry codes that are prescribed under the Competition and Consumer Act 2010, including the Dairy Industry Code of Conduct, the Electricity Retail Code and the Horticulture Code of Conduct.

A mandatory code for intermediaries could be prescribed under the CCA. However, CCA codes focus on consumer protections whereas the code for intermediaries will be broader. A mandatory code for intermediaries could be prescribed under the financial services regulation. However, this would require basic water products to be treated as derivatives. The ACCC does not support this option. The better approach would be for a mandatory code for intermediaries to be included in the new centralised legislation for market integrity and conduct (see recommendation 1).

While mandatory codes are often prescribed by regulation, making them easier to modify over time as industry evolves, they can also be included in primary legislation. The National Consumer

---


Credit Protection Act 2009 includes the National Credit Code as Schedule 1 to the Act. This replaces previous state-based consumer credit codes and the Uniform Consumer Credit Code and applies to the conduct of all Australian credit licence holders. ASIC administers this single national consumer credit regime. The legislative vehicle for the code for water intermediaries should be considered at the implementation stage.

Obligations and requirements for intermediaries could be interspersed in the higher level legislation, together with the more general conduct and integrity provisions that will apply to all market participants. However, having all of the intermediary obligations and requirements set out in one place would assist the industry and avoid legislative complexity.

The recommended substantive content for the enforceable mandatory code is set out in recommendation 2 and in table 9.1 below. Intermediaries should also be subject to the new integrity and conduct provisions that are recommended to apply to all water market participants.

Recommendation 2

Incorporate key obligations as part of an enforceable mandatory code for water market intermediaries

The mandatory code should apply to all parties that provide intermediary services, including irrigation infrastructure operators, and include obligations to:

- act in the best interests of a client, when providing certain services typically provided only by brokers
- provide the following information in writing to a client at the outset of each engagement:
  - the services being provided by the intermediary
  - the obligations owed to the client by the intermediary
  - the fees/commissions to be charged by the intermediary
- inform the client in a timely manner of any reasons for a trade approval authority rejecting or delaying the processing of an application
- implement a complaints handling process, including obligations to keep records relating to complaints or resolution of complaints
- hold written authorities to submit trades for approval on behalf of clients
- hold written authorities to act as an agent on behalf of clients, when providing certain services typically provided only by brokers
- act in accordance with client instructions, when providing certain services typically provided only by brokers
- communicate all buy and sell offers to clients in relation to the proposed trade, when providing certain services typically provided only by brokers
- disclose to the client when receiving multiple fees/commissions in relation to a single trade, when providing certain services typically provided only by brokers, excluding trades matched through an exchange platform
- disclose to the client when an intermediary or a related entity has a personal interest in the trade, and that the water rights they have a personal interest in are to be transferred to/from the intermediary’s or related entity’s trading water account (that is, not the intermediary’s broking water account which is used to hold client water rights). The intermediary must provide an opportunity for the client to get independent advice and the client must return written consent before proceeding with the trade
- disclose to the client when water rights are to be transferred to/from the intermediary’s broking water account which holds client water rights
- comply with client water rights management and accounting obligations (under statutory trust accounting framework for broking water accounts which hold client water rights)
- comply with client funds management and accounting obligations (under statutory trust accounting framework for client funds)
- hold professional indemnity insurance
- keep records of client instructions, trade details (including strike date) and client details for the period of time (five years) required under Australian Tax Law
- disclose which method the intermediary is using to allocate successfully transferred volumes following an intervalley trade opening (for example, in chronological order or pro rata).

Table 9.1 below outlines the services provided by intermediaries, and identifies the recommended obligations on an intermediary based on the services provided by the intermediary, rather than according to a classification into ‘water broker’ or ‘exchange platform’. The ACCC considers this will allow intermediaries to be flexible with the services they provide, and also may remove confusion where intermediaries provide both typical brokerage service and also exchange platform services.

To assist with understanding, the type of intermediary that commonly provides the service is included in the table, but this is intended as a guide only, as it is intended that the type of service (rather than the type of intermediary) corresponds to the particular obligations.
Table 9.1: Table of water market intermediary services and corresponding obligations proposed under the mandatory code.

<table>
<thead>
<tr>
<th>Type of water market intermediary that usually provides these services</th>
<th>Service</th>
<th>Obligation</th>
</tr>
</thead>
</table>
| Brokers and Exchange platforms | Information Services (collecting, cleaning, and aggregating market relevant information and disseminating to market participants) | ▪ Obligation to provide the following information in writing to a client at the outset of each engagement:  
  - the services being provided by the intermediary  
  - the obligations owed to the client by the intermediary  
  - the fees/commissions to be charged by the intermediary.  
  ▪ Obligation to disclose to the client when an intermediary or a related entity has a personal interest in the trade, and that the water rights they have a personal interest in are to be transferred to/from the intermediary's or related entity's trading water account (that is, not the intermediary's broking water account which is used to hold client water rights). The intermediary must provide an opportunity for the client to get independent advice and the client must return written consent before proceeding with the trade.  
  ▪ Obligation to disclose to the client when water rights are to be transferred to/from the intermediary's broking water account which holds client water rights.  
  ▪ Obligation to implement a complaints handling process, including obligations to keep records relating to complaints or resolution of complaints.  
  ▪ Obligation to comply with client funds management and accounting obligations (under statutory trust accounting framework for client funds).  
  ▪ Obligation to comply with client water rights management and accounting obligations (under statutory trust accounting framework for broking water accounts which hold client water rights).  
  ▪ Obligation to disclose which method the intermediary is using to allocate successfully transferred volumes following an IVT opening (for example, in chronological order or pro rata). |
| Preparing and submitting documents for approval of trades of water rights (contracts, and approval authority forms) | ▪ Obligation to hold professional indemnity insurance.  
  ▪ Obligation to inform the client of any reasons for an approval authority rejecting or delaying the processing of an application.  
  ▪ Obligation to hold written authorities to submit trades for approval on behalf of clients.  
  ▪ Obligation to keep records of client instructions, trade details (including strike date) and client details for the period of time (five years) required under Australian Tax Law. |
| Settlement services (Holding client funds or client water rights in the intermediary’s accounts to facilitate transfer of funds or rights between sellers and buyers) | ▪ Obligation to disclose to the client when an intermediary or a related entity has a personal interest in the trade, and that the water rights they have a personal interest in are to be transferred to/from the intermediary's or related entity's trading water account (that is, not the intermediary's broking water account which is used to hold client water rights). The intermediary must provide an opportunity for the client to get independent advice and the client must return written consent before proceeding with the trade.  
  ▪ Obligation to disclose to the client when water rights are to be transferred to/from the intermediary's broking water account which holds client water rights.  
  ▪ Obligation to implement a complaints handling process, including obligations to keep records relating to complaints or resolution of complaints.  
  ▪ Obligation to comply with client funds management and accounting obligations (under statutory trust accounting framework for client funds).  
  ▪ Obligation to comply with client water rights management and accounting obligations (under statutory trust accounting framework for broking water accounts which hold client water rights).  
  ▪ Obligation to disclose which method the intermediary is using to allocate successfully transferred volumes following an IVT opening (for example, in chronological order or pro rata). |
| Brokers | Advisory services (Investigating trading opportunities, assisting potential buyers and sellers to assess the market, form price expectations, and make decisions in the market) Conveying offers on behalf of clients or entering into agreements to trade on behalf of a client | ▪ Obligation to act in the best interests of a client.  
  ▪ Obligation to disclose to the client when receiving multiple fees/commissions in relation to a single trade.  
  ▪ Obligation to communicate all buy and sell offers to clients in relation to the proposed trade.  
  ▪ Obligation to act in accordance with client instructions.  
  ▪ Obligation to hold written authorities to act as an agent on behalf of clients. |
9.10  **Conduct prohibitions that should be included in the proposed new legislation**

To identify what protections are needed, the ACCC analysed several unusual or suspicious market transactions (see chapters 5 to 7).

9.10.1  **Avoid duplicating existing misleading and deceptive conduct prohibitions**

As noted above, the prohibition of misleading and deceptive conduct is generally considered to be a norm for market regulation. However, the proposed new legislation should not duplicate provisions that already exist. For example, section 18 of the ACL already applies to misleading and deceptive conduct. A failure by an intermediary to tell a customer that the intermediary is buying or selling water on their own behalf could amount to misleading or deceptive conduct. In addition, the Criminal Code Act 1995 contains offences of general relevance to Commonwealth administration. Of relevance are offences under section 137.1 – ‘False or misleading information’ and section 137.2 – ‘False or misleading documents’. The Attorney-General’s Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers states that these provisions should be utilised, where possible, instead of creating a new offence. Also, in addition, for water products that are financial products, section 1041H of the Corporations Act provides, ‘A person must not, in this jurisdiction, engage in conduct, in relation to a financial product or a financial service that is misleading or deceptive or is likely to mislead or deceive’. To avoid duplication and complexity on the statute book, the inclusion of a prohibition on misleading or deceptive conduct in the new conduct and integrity regulation is not recommended.

9.10.2  **Prohibit market manipulation**

During the inquiry, many stakeholders alleged that investor behaviour had resulted in materially higher water allocation prices. Some stakeholders raised concerns that investors are buying water allocations and withholding water from the water markets to artificially drive prices higher. Over the course of this inquiry, market data has been analysed and evidence of actual misconduct has not been found (see chapter 7). However, there is a strong perception that market manipulation has occurred, and opportunities for, and risks of, market manipulation do exist. There is a case for the introduction of a prohibition on market manipulation.

Broadly, market manipulation is conduct which has resulted in a price that does not reflect genuine forces of supply and demand. It generally includes creating or maintaining an artificial price. In *Director of Public Prosecutions (Cth) v JM* the High Court held that an ‘artificial price’ for the purposes of s 1041A of the Corporations Act is a ‘price that results from a transaction in which one party has the sole or dominant purpose of setting or maintaining the price at a particular level [and does not reflect] the forces of genuine supply and demand in an open, informed and efficient market.’ Thus, the focus is on the effect of the manipulative conduct in relation to the affected product rather than on the intention.

---


524 These provisions should be utilised, where possible, instead of creating a new offence; see ‘The Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers’ Attorney-General’s Department, p. 14. Of particular relevance are offences under section 137.1 – False or misleading information and Section 137.2 – False or misleading documents and section. These provisions have particular requirements which must be followed for them to be able to be invoked. These include that a warning be given about the operation of the offence [section 137.1(4)].


526 Director of Public Prosecutions (Cth) v JM (2013) 298 ALR 615 is the most recent High Court authority. See also Beach J’s decision in ASIC v Westpac [2018] FCA 751, concerning allegations of cross-market manipulation – i.e. conduct in one market creating an artificial price in another. North v Marra (1981) 148 CLR 42, 59; Fame v Jeffries (1998) 28 ACSR 58, 62.

527 ibid.

528 ibid.
of the trader or the person involved.\textsuperscript{529} Section 1041A of the Corporations Act provides a useful example in the context of financial products and markets.

### Box 9.1: 1041A of the Corporations Act – Market manipulation

A person must not take part in, or carry out (whether directly or indirectly and whether in this jurisdiction or elsewhere):

(a) a transaction that has or is likely to have; or

(b) 2 or more transactions that have or are likely to have;

the effect of:

(c) creating an artificial price for trading in financial products on a financial market operated in this jurisdiction; or

(d) maintaining at a level that is artificial (whether or not it was previously artificial) a price for trading in financial products on a financial market operated in this jurisdiction.

Note 1: Failure to comply with this section is an offence (see subsection 1311(1)).

Note 2: This section is also a civil penalty provision (see section 1317E). For relief from liability to a civil penalty relating to this section, see section 1317S.

The Corporations Act includes additional protections such as s1041B ‘False trading and market rigging—creating a false or misleading appearance of active trading’. Such a provision could be included in the new integrity and conduct regulation, if a need is identified. Regardless of the method, behaviour or intention, the harm that should be prevented by the new regulation is the creation of an artificial price. Various methods of price manipulation, such as squeezing, ramping and spoofing, are discussed in chapter 6. The manipulation provision for the new market and integrity legislation should be tailored for water markets.

As noted earlier in this chapter, in order to identify market misconduct such as manipulation, centralised legislation is needed. It would not be possible to address risks of market manipulation by looking only within a single trading zone or Basin State. The proposed Water Markets Agency would need to be able to carry out investigations and enforcement activity across state borders. There would be no point legislating a prohibition on market manipulation unless it could be enforced.

#### 9.10.3 Broaden existing price reporting obligations

Inaccurate and incomplete price recording on trade forms is perhaps the most significant issue limiting information publication by the registers and by other sources relying on register data (see chapter 11). While sellers of water access rights are subject to trading rule 12.48 of the Basin Plan Water Trading Rules, requiring them to disclose price to the approval authorities, there is no subsequent obligation on the states to collect this information, and enforcement of this rule by MDBA (who is responsible for Basin Plan compliance) has proved challenging. Moreover, rule 12.48 only applies to trade of water access rights, meaning there is no obligation to report prices for trades of irrigation rights or water delivery rights.

Exchange platforms now often facilitate trade within, into, out of, and outside irrigation networks. This means that market participants are often directly comparing buy and sell offers, and historical price data, for temporary irrigation right trades alongside allocation trades. Thus, price information for temporary irrigation right trade should have equal importance as price information for water allocation trades.

\textsuperscript{529} Among the major amendments made to the Corporations Act by the Financial Services Reform Act 2001 was the removal, on the part of the prosecution, of the explicit requirement of proving the existence of intent from the wording of the market manipulation and other related provisions before imputing any liability.
Further, given that trade to or from an IIO’s network involves both irrigation rights and water access rights, a failure to capture price information for irrigation rights may also lead to an absence of price reporting for water access rights. For example, if an IIO aggregates multiple internal parcels of water (temporary irrigation rights) in order to conduct a single larger water allocation trade outside of its network, the IIO may be unable to correctly report the price associated with the allocation trade when applying to the Basin State for approval.

In view of these matters, there is a need to establish a clear and comprehensive trade processing and market reporting framework governing all entities which process trades—including brokers who provide matching services, exchanges, IIOs and Basin State approval authorities, and all transactions of tradeable water rights.

The ACCC considers Basin Plan water trading rule 12.48 should be revised to require prices to be reported for all transactions of tradeable water rights, including irrigation rights and water delivery rights, and not just water access rights. The obligations under rule 12.48 should rest with the individual or entity disposing of the right, or, the individual or entity that submits a trade for approval or registers a trade, on behalf of the person disposing of the right.

The ACCC acknowledges this expansion of price reporting requirements to apply to all tradeable water rights would require irrigation infrastructure operators to routinely collect price information. The ACCC’s analysis of data provided by medium and large IIOs across the Basin indicates that most of these IIOs already have the systems in place to collect price information; although collection rates differ markedly in practice (see Appendix G).

9.10.4 Prohibit insider trading

The Basin Plan Water Trading Rules include restrictions on trade in situations when certain government water announcements are not generally available to market participants. Improvements to policies and practices currently adopted by governments to comply with this water announcement rule should be made. This is needed to address claims that important information, such as allocation policies, are inadequately communicated to the irrigators and traders who rely on these to make business decisions.

The ‘water announcements rule’ in the Basin Plan Water Trading Rules is often referred to as an insider trading rule. However, it is not an insider trading prohibition of the kind that exists for financial markets. Irrigators have broader concerns about insider trading in Basin water markets that are not addressed by the Basin Plan Water Trading Rules. For example, allegations of brokers securing deals for related parties by using other clients’ information, and people with access to information about upcoming amendments to IIO policies, before that information is made public, and using that knowledge to gain an unfair advantage in the market (See chapter 8).

The so-called insider trading prohibition in the Basin Plan Water Trading Rules should be broadened and strengthened to apply not only to ‘water announcements’ (e.g. government announcements about allocations, carryover and trading restrictions) but also to the use of any material information prior to it being made public in order to gain unfair advantage in the market. This strengthened prohibition should be removed from the Basin Plan Water Trading Rules, and incorporated in the new water market conduct and integrity legislation that can be enforced across jurisdictions.

530 Sections 12.49 to12.52 of the Basin Plan 2012.
Recommendation 3

Prohibit price manipulation, broaden price reporting and broaden and strengthen insider trading obligations

Existing price reporting obligations and insider trading prohibitions should be removed from the Basin Plan Water Trading Rules and incorporated into the new water market conduct and integrity legislation.

The price reporting obligations should be broadened to require prices to be reported for all transactions of tradeable water rights, including irrigation rights and water delivery rights – not only water access rights. Trade approval authorities (including irrigation infrastructure operators) should be required to collect, record and transmit this information.

The insider trading prohibition should be broadened and strengthened to apply to the use of any material information prior to it being made public in order to gain an unfair advantage in the market – not only to ‘water announcements’ (for example, government announcements about allocations, carryover and trading restrictions).

The proposed new conduct and integrity legislation should include a prohibition on price manipulation.

The price reporting obligations, insider trading prohibition and market manipulation prohibition should be enforced by a single Basin-wide regulator – recommended to be the Water Markets Agency (see recommendation 26).

Implementing this recommendation will address challenges in enforcing prohibitions against misconduct that arise under current laws, and address regulatory gaps.

9.11 Some concepts from the financial services and markets regulation are not able to be mirrored for water markets

The interim report sought feedback from stakeholders on a range of regulatory provisions that exist in financial services and markets regulation. That feedback has informed consideration of whether similar provisions should be introduced for Basin water markets. While the following provisions were considered as part of this process, they are not recommended.

9.11.1 Best execution obligation and systematic pre-trade transparency

The best execution obligation in rule 3.8.1 of the ASIC Market Integrity Rules (Securities Markets) 2017 requires market participants handling and executing an order for a client to take reasonable steps to obtain the best outcome for their client. Best execution promotes client protection by requiring market participants (including financial brokers) not to place their own interests ahead of those of their clients. This obligation requires market participants (including financial brokers) to transmit orders to the platforms offering the best outcome. Generally, in financial markets, the best execution obligation can be discharged only by trading on a pre-trade transparent order book of a licenced market/exchange. So in financial markets there is a link between the best execution obligation and pre-trade transparency requirements for exchanges.

There is currently no requirement for systematic pre-trade transparency in Basin water markets, nor would it be possible to impose such a requirement because there are many trades negotiated without the use of platforms or brokers. While the use of exchange platforms may increase over time, many traders are family farms who see value in maintaining simpler or less formal entry points into water markets.
A best execution obligation of the kind that is in the ASIC Market Integrity Rules (Securities Markets) 2017 would not be workable and is not recommended for Basin water markets. Instead, obligations for intermediaries to act in their clients’ best interests and to manage conflicts of interest are recommended as a more effective means of protecting clients’ interests.

9.11.2 Compensation/fidelity funds and capitalisation requirements

Mandatory contributions to a compensation fund would be burdensome on intermediaries and a need for such a requirement has not been established. A capitalisation requirement could drive out smaller firms or inhibit their entry into the market, or encourage consolidation of firms in an effort to raise the necessary capital and therefore reduce competition in the market. It could also cause firms to increase their fees and commissions, to raise the necessary capital.

9.11.3 Obligation to maintain competence of staff

A requirement to maintain competence of staff exists for AFS licensees under s. 912A(1)(f) of the Corporations Act. A mandatory requirement to maintain staff competence in water markets would impose a disproportionate burden for intermediaries. However, the ACCC encourages the industry to develop their own accreditation and competency standards, noting that several intermediaries already do this.532 In addition, the new code for intermediaries would promote best practice standards for all practitioners.

9.12 Which water products are financial products regulated by ASIC?

As noted at section 9.2 of this chapter, ASIC is responsible for the regulation of financial services and markets under the Corporations Act 2001. This regime is limited to financial products and services as defined in the Corporations Act. Financial products includes a broad range of financial instruments including derivatives.

The definition of derivative in s 761D of the Corporations Act is very broad. As observed by Giles JA in International Litigation Partners Pte Ltd v Chameleon Mining NL:

533 The definition of ‘derivative’ is extraordinarily wide, one which could catch many arrangements not ordinarily thought of as derivatives … Given this deliberate drafting, there is little warrant for reading down the definition in the exclusory s761D(1). It was intended to be wide, overwidth was to be controlled by subsequent exclusions, including by regulation.

As a result of the breadth of that expression, prior to 2014 there was some uncertainty as to whether tradeable water rights could be categorised as ‘derivatives’534 and therefore be ‘financial products’ for the purposes of the ASIC Act and Corporations Act.535 The application of financial regulation was contemplated as a result of the potential characterisation of water rights as derivatives. That is, the

533 International Litigation Partners Pte Ltd v Chameleon Mining NL: [2011] NSWCA 50 at [66], [72].
534 Under subsection 761D(1) of the Corporations Act, a ‘derivative’ is an arrangement under which at some agreed future time a party to the arrangement must provide consideration of a particular kind to the other party. The amount of consideration must be derived from the value of something else, including for example, an asset, a commodity, an index, or a rate (for example, interest rate). The future time must not be less than 3 business days for a foreign exchange contract (reg 7.1.04(1)(a) of the Corporations Regulations 2001) and one business day for all other arrangements (reg 7.1.04(1)(b) of the Corporations Regulations 2001). The Corporations Act provides that certain arrangements are excluded from the meaning of derivative, such as the obligation to buy or sell tangible property: s. 761D(3)(a).
535 Water rights are unlikely to meet the general definition of a financial product under section 763A of the Corporations Act. However, paragraph 764A(1)(c) of the Corporations Act specifies that a ‘derivative’ is a financial product. It has been noted that, if not excluded from the definition of a derivative, tradeable water rights may be categorised as derivatives and included within the definition of financial product under paragraph 764A(1)(c); see Explanatory Statement at https://treasury.gov.au/consultation/draft-amendments-on-regulation-of-water-market-trading. A ‘derivative’ is one of a wider classes of things that fall within the legislative concept of a ‘financial product’ for the purposes of chapter 7 of the Corporations Act; see Derivatives Report, Corporations and Markets Advisory Committee. Note: If a product falls under the definition of both a security and a derivative, it will be regulated as a security: s. 761D(3)(c) of the Corporations Act.
value of water rights may be derived from the value of some other thing, that being the water that is subject to the water right and that the water rights are intangible property.\textsuperscript{536}

**9.12.1 The 2014 ‘carve out’ for basic tradeable water rights clarified this legal uncertainty**

Regulations made under the Corporations Act and the ASIC Act can declare anything not to be a derivate.\textsuperscript{537} In 2014, the Australian Securities and Investments Commission Regulations 2001 and the Corporations Regulations 2001 were amended by the Corporations Amendment (Water Trading Exemptions) Regulation 2014 to address the legal uncertainty as to whether tradeable water rights could fall within the definition of a derivative.

The Corporations Amendment (Water Trading Exemptions) Regulation 2014 expressly excludes basic tradeable water rights, and certain arrangements to buy and sell them, from the definition of ‘derivative’ under the ASIC Act\textsuperscript{538} and Corporations Act. This means that water entitlements, allocations, delivery rights, irrigation rights, forward contracts and leases are not financial products. As a consequence, the provisions in the Corporations Act and the ASIC Act relating to financial services and markets do not apply to these tradeable water rights.\textsuperscript{539}

The exclusion of basic water rights from the definition of derivative reflects the approach recommended by the Companies and Markets Advisory Committee (CAMAC) in its Derivatives Report. The CAMAC report at para 4.6.4 noted that one way to deal with peripheral areas is through the powers to enact regulations declaring something not to be a derivative. This is the approach adopted in the regulation which currently exempts certain types of water rights from the definition of derivative.\textsuperscript{540}

However, options and futures contracts in respect of tradeable water rights are not included in the carve-out and are considered to be derivatives for the purposes of the Corporations Act and the ASIC Act.\textsuperscript{541} To be a derivate contract, an option contract would need to allow for all three prescribed methods of settlement, with the purchaser being given the right to elect the method at the time of settlement. That is, under the terms of the contract, the purchaser can elect to use either cash-settlement, set-off, or physical-settlement.\textsuperscript{542} That is why some form of water index or contractual method for determining price would be needed. CSIRO is developing a methodology for calculating the spot price (or index) for a particular water trading zone. CSIRO noted that it is conceivable that its methodology could be incorporated into options contracts as the method for calculating the spot price (index) for the options-expiry date, and the difference between the spot price and the options strike price to be used for arranging cash-settlement.

Water option contracts that give the purchaser the right to settle by physical-settlement only are not derivatives. Options of this kind are being traded in the Basin. These physically-settled options help irrigators better manage their water and risk. For example, an irrigator could enter into a contract for an option to buy a certain volume of allocation at a predetermined future time and price, to guard against potential low allocation announcements in the future and/or spot price rises. H2OX has developed contracts and procedures to implement such options in conjunction with potential suppliers and buyers of these products. H2OX is not the supplier or buyer of these options. Rather, it brokers arrangements between counterparties, administers the collateral and manages the delivery of allocation at the

\textsuperscript{536} ASIC, Submission to Murray–Darling Basin water inquiry interim report, 4 December 2020, p. 2.

\textsuperscript{537} Paragraph 12BAA(8)(p) of the ASIC Act provides that the regulations may prescribe that a facility, interest or other thing is not a financial product for the purposes of Part 2, Division 2 of the ASIC Act. Under subsection 761D(2) of the Corporations Act, the regulations may declare anything to be a derivative. Under para 761D(3)(d) of the Corporations Act, the regulations may declare anything not to be a derivative.

\textsuperscript{538} Regulation 2BC of the Australian Securities and Investments Commission Regulations 2001 and subregulation 7.1.04(8) of the Corporations Regulations 2001.

\textsuperscript{539} Explanatory Statement for the Corporations Amendment (Water Trading Exemptions) Regulation 2013.

\textsuperscript{540} ASIC, Submission to Murray–Darling Basin water inquiry interim report, 4 December 2020, p. 2.

\textsuperscript{541} Explanatory Statement for the Corporations Amendment (Water Trading Exemptions) Regulation 2013.

\textsuperscript{542} Subsection 761(3)(d) of the Corporations Act and subregulation 7.1.04(8) of the Corporations Regulations 2001 provide that an arrangement is not a derivative if it does not permit the seller’s obligations to be wholly settled by cash, or by set off between the seller and the buyer, as an alternative to [physical] transfer of ownership of the tradeable water rights or replacement water rights.
The options for water that H2OX has developed are physically-settled and the contract does not allow for them to be wholly cash-settled or set-off.\footnote{543}

### 9.12.2 Some stakeholders are unaware of the implications for bona fide water options and futures under the financial regulation framework

Water options and futures that are derivatives are subject to financial markets and services regulation under the Corporations Act 2001 (Corporations Act)\footnote{545}, and the ASIC Act.\footnote{546} Under chapter 7 of the Corporations Act, ASIC’s regulatory work comprises three main elements: disclosure requirements, market integrity enforcement and licensing powers.

Key aspects of financial markets and services regulation under the Corporations Act are:

- the licensing regimes for financial services\footnote{547} and markets\footnote{548} under the Corporations Act
- the market integrity rules under Corporations Act: ASIC Market Integrity Rules (Securities Markets) 2017 (Securities Markets rules) and the ASIC Market Integrity Rules (Futures Markets) 2017 (Futures Markets rules)\footnote{549}
- the obligations and requirements set out in chapter 7 of the Corporations Act.\footnote{550} For example, Part 7.10 of chapter 7 of the Corporations Act deals with market misconduct relating to financial products and financial services
- the disclosure rules that apply under the Corporations Act when a financial product is issued.\footnote{551}

To the extent that an intermediary advises clients on futures contracts and options contracts that are derivatives, they would require an AFSL.

It is also possible that exchange platforms could potentially operate a ‘financial market’ and therefore be required to hold an ‘Australian market licence’ under section 791A of the Corporations Act. Exchanges that currently hold Australian market licences, such as ASX24 and ChiX, could potentially trade water derivatives, if demand for such products arose in the future.\footnote{552} Water futures are not currently traded on either platform. Futures contracts can also be traded over the counter (OTC). The ACCC is not aware of anyone currently dealing in OTC water futures in the Murray-Darling Basin. The 2009 Survey of the OTC derivatives market in Australia noted that participation in OTC markets is usually limited to more sophisticated counterparties, such as wholesale clients.\footnote{553}

\footnote{543} H2OX, 2018, \url{h2ox.com/water-products/options/}, viewed 5 Feb 2020.
\footnote{544} ibid.
\footnote{545} Section 764A(1)(c) of the Corporations Act provides that a derivative is a ‘financial product’.
\footnote{546} Section 12BAA(7) of the ASIC Act provides that a derivative is a ‘financial product’ for the purposes of Part 2, Div 2 of the ASIC Act (consumer protection provisions). For example, s12DA of the ASIC Act deals with misleading or deceptive conduct in relation to financial services. Section 131A of the Competition and Consumer Act 2010 (CCA) excludes ‘financial products and services’ from the operation of the ACCC’s Australian Consumer Law (ACL).
\footnote{547} Section 911A of the Corporations Act.
\footnote{548} Section 791A of the Corporations Act.
\footnote{549} Part 7.2A of the Corporations Act enables ASIC to make market integrity rules dealing with the activities or conduct of: (a) licensed markets; (b) persons in relation to licensed markets; and (c) persons in relation to financial products traded on licensed markets.
\footnote{550} The obligations for market operators are set out in Pts 7.2 and 7.2A of the Corporations Act.
\footnote{551} Section 1013C Corporations Act, Section 761E(5) Corporations Act.
9.13 Calls for restrictions on investors

At public forums and in submissions, some stakeholders argued for regulatory intervention in the form of restrictions on investment and foreign ownership of water rights.554

9.13.1 Foreign investment—harmful behaviours should be regulated rather than classes of market participants excluded

Under the Foreign Acquisitions and Takeovers Act 1975, the Treasurer is responsible for making decisions on individual foreign investment proposals and is advised by the Foreign Investment Review Board (FIRB). Generally, foreign investment proposals are subject to monetary and control screening threshold tests. If these threshold tests are met, then FIRB examines the foreign investment proposal and advises on national interest implications by applying the ‘national interest test’. ‘The Australian Government’s policy stance on foreign investment recognises that foreign investment brings many benefits. For this reason, foreign investment proposals are assessed against the national interest on a case-by-case basis. This flexible approach is preferred to hard and fast rules. Rigid laws that prohibit a class of investments too often also stop valuable investments’.555

Foreign investment in rural water rights is generally not separately subject to the FIRB screening and assessment processes. However, foreign investment in rural water rights can be considered by the FIRB if the acquisition forms part of an agricultural land or agribusiness acquisition that is subject to FIRB screening. The FIRB may consider a range of factors when examining foreign investment proposals for agricultural land and agribusiness, including the effect of the proposal on the quality and availability of Australia’s agricultural resources (including water), land access and use, agricultural production and productivity, Australia’s capacity to remain a reliable supplier of agricultural production, both to the Australian community and our trading partners, biodiversity, and employment and prosperity in Australia’s local and regional communities.556

In their submission to the interim report, NSW Farmers’ said ‘A gigalitre (GL) or investment ($) threshold would be beneficial to provide an opportunity to review foreign investment in Australian water resources, similar to the threshold test for the acquisition of Australian agricultural land’557. As noted above, the Treasurer is responsible for making decisions on, and changes to, foreign investment policy. In addition, the Senate Economics Committee is currently conducting its Review of foreign investment proposals against the national interest test and thereport is required by 30 June 2021. The terms of reference for this review include consideration of the extent to which the risk that foreign investment proposals are being used for money laundering is examined. The then Interim Inspector-General of Murray-Darling Basin Water Resources asserted that the current rules for foreign investment in water leave the door open to criminal activity, including money laundering.558 Such money laundering risks and foreign investment more generally are matters for the Government and Senate Committees rather than the ACCC.

Register of Foreign Owned Water Entitlements

The Australian Government has legislated for mandatory reporting by foreign entities of water owned and traded, so as to gain a better understanding of the level of foreign ownership and market activity. The Commissioner of Taxation, through the Australian Tax Office, maintains a Register of Foreign Owned Water Entitlements under the Register of Foreign Ownership of Water or Agricultural Land Act 2015 (Cth).

554 ACCC Murray-Darling Basin inquiry, Renmark and Shepparton public forums.
The Treasurer publishes an annual report of data derived from the Register. The Treasurer’s most recent report from the Register, published in March 2019, presents data in aggregate form for the northern Basin and separately in aggregate form for the southern Basin. There are statutory restrictions on the publication of ‘protected information’ collected by the ATO. The Treasurer’s report states:

The ATO is required to report on data from the Register in aggregated format only. Consistent with the principles applied in Australia’s broader foreign investment regime, the details of investors are not made publicly available. The taxation law also restricts the release of information that could identify, or be used to identify, an individual or entity.

No information from the Register is released about individual owners or the water holdings of state-owned enterprises. Nor is data released at a catchment-specific level. Transparency is also hindered by the fact that the requirement to register water acquisitions is a self-reporting requirement. Although there are enforcement provisions in the legislation, no penalties for non-compliance have been issued to date.

The Register of Foreign Owned Water Entitlements is subject to statutory review by the Productivity Commission. On 4 December 2020, the Productivity Commission announced its inquiry into the Register. The inquiry will examine the effectiveness, costs and benefits of the Register. The terms of reference include:

- assess whether the information provided in the Report delivers on the policy objectives of the scheme of increasing transparency of foreign ownership of water entitlements
- identify the direct and indirect costs and benefits associated with maintaining the Register and producing the Report
- identify the direct and indirect costs borne by foreign owners of water entitlements to ensure compliance with the Act.

New Register of Foreign Owned Assets

On 8 December 2020, Parliament passed the Foreign Investment Reform (Protecting Australia’s National Security) Bill 2020. The legislation establishes a new Register of Foreign Owned Assets which incorporates the existing Register of Foreign Ownership of Water Entitlements and Register of Foreign Ownership of Agricultural Land. The new Register of Foreign Ownership of Australian Assets will record all foreign interests acquired in Australian land; water entitlements and contractual water rights; and business acquisitions that require foreign investment approval, including acquisitions reviewed under the new national security test.

Tax treatment of foreign investors

Tax requirements could differentiate between local and foreign owners in a way that produces an unfair competitive advantage for foreign investors. However, while there are certain tax concessions that are available to incentivise foreign investors, new limitations were imposed on these tax concessions for foreign pension funds and sovereign entities by the Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax in Australia and Other Measures) Act 2019 (Cth). This Act is intended to protect the integrity of Australia’s corporate tax system by limiting access to tax concessions for foreign investors who convert active business income into passive income in order to avoid paying tax at the top corporate rate.

560 ibid.
562 Section 34A of the Register of Foreign Ownership of Water or Agricultural Land Act 2015 (Cth).
564 Foreign Investment Reform (Protecting Australia’s National Security) Bill 202, EM, p. 10.
9.13.2 Domestic investment – many of the important benefits of water markets cannot be realised without the participation of investors

The ability to purchase water rights without agricultural land has led to water being purchased for financial investment rather than agricultural production. Retired farmers are also retaining their water entitlements for investment purposes to fund their retirement, rather than selling them on retirement.

Some stakeholders suggested that restrictions on access to the water market by non-irrigators is the appropriate response to deflate water prices, while others advocated that the purchase of water allocations should be limited to those who hold a water use licence or water use registration. In terms of investors’ use of carryover, some stakeholders suggested the appropriate solution is to tie carryover rights to delivery share or water use licences rather than entitlements.566 Another suggestion from stakeholders was a proposal for a ‘single trade rule for temporary water’. This would mean that ‘every megalitre of allocated water is only able to be traded once before it is used for agriculture, environment or critical human needs.’567 These stakeholders advised that this would prevent market participants increasing the price of water by buying and selling water.

Under the Basin Plan Water Trading Rules, restrictions based on classes of water market participants, or the purpose for which the water will be used, are not permitted.568 Even if such restrictions were permitted, the introduction of rigid laws that prohibit a class of market participants, such as investors, from participating in the market would preclude valuable financial investment. Investors provide irrigators with access to capital, increase water market liquidity, and provide a range of water products that help irrigators to manage water supply risks, such as forward contracts and carryover parking.

It has been noted that leases from retired farmers to irrigators can be beneficial to the next generation irrigation community.569 Concerns about the conduct of investors should be addressed through the proposed conduct and integrity legislation, rather than by excluding these participants from the market.

9.13.3 Traders should be required to include on registration forms a unique common identifier.

The ability to identify market participants, and trace and follow transactions, is a foundational issue for market confidence. In the absence of an ability to trace transactions, regulators such as the new WMA, Basin States and the ATO would be very limited in their capacity to enforce regulation. The identifier could be an ABN, ACN, or a new identifier issued by the Water Markets Agency.

The use of a unique identifier could assist the ATO. Revenue from water ownership is derived from temporary allocation trading and capital appreciation. The ATO website states:

- Water rights, such as licences and water allocations, are capital gains tax (CGT) assets. The permanent trade of a water right is a disposal of a CGT asset. A temporary trade of a water right is also a CGT event. Whether there are general income tax consequences as a result of trading a water right depends on your particular circumstances.570

Some irrigators include allocations in their cost of goods purchased for income tax calculations within a particular year. Some brokers keep records of client transactions for several years and provide them to clients’ tax accountants, on request by clients. However, the lack of a requirement to record an ABN or ACN on registration documents inhibits the ability to cross-check the cost base of a CGT asset and the cost of goods purchased for income tax purposes. Illegal tax avoidance is possible if a buyer declares a high price to the ATO and the seller understates the income. Again if the price has not been logged with

---

568 Section 12.07–12.08 of the Basin Plan.
the trade, and an ABN or ACN is not recorded, then there is no way to be sure that the information is accurate. The ACCC analysed data regarding the percentage of water entitlements with either an ABN or ACN listed for the owner. In Victoria, only 4% of entitlements have either an ABN or ACN listed for the owner. In South Australia it is 18%.\textsuperscript{571}

\begin{quote}
Recommendation 4

Require identifiers on trade forms

Traders should be required to include a unique common identifier on trade forms. This could be their ABN, ACN and/or the unique identifier issued to them by the centralised regulator.

The ability to identify market participants, and trace and follow transactions, is a foundational issue for protecting market integrity and maintaining market confidence. This will improve the regulator’s ability to detect misbehaviour and enforce against it.
\end{quote}

\textsuperscript{571} See Data Quality Appendix (DQA) to this report.