

**Public Submission to Water Trading Rules Issues Paper
by State Water Corporation on 1 May 2009**

State Water supports the development of a mature water market to facilitate the efficient use of water and would welcome the introduction of consistent rules to help overcome some of the many differences in water-entitlement management practices across the different jurisdictions which impact on water trading.

State Water's role in water trading relates solely to processing transactions for temporary allocation assignments under the *Water Management Act 2000 (NSW)* and delivering water that has been traded. State Water's primary concern with respect to water trading relates the inability of State Water to recover usage revenues on water temporarily traded and delivered interstate.

When water is temporarily traded between valleys and States, the fixed charge component is payable by the permanent holder of the water access licence to the NSW State utility, department or authority. The variable (or usage) charge is payable by the purchaser to the utility or authority in the state in which the water is delivered (assuming that that the jurisdiction has a usage charge). As a result, water traded outside the valley reduces revenue earned in that valley. If the water is traded out of the State, that revenue is lost to State Water. This is because an interstate purchaser does not hold a NSW Water Access Licence (WAL), and so State Water has no basis on which to recover this revenue. This is unlike a permanent tagged trade whereby the purchaser *does* also have a WAL against which usage can be charged.

Interstate trading mainly affects the Murray, Lower Darling and Murrumbidgee Valleys where NSW has recently been a net seller of water to Victoria and South Australia. Over the last few years, the volume of water being traded to other states has increased significantly. Combined with the increased ratio of variable to fixed water charges in the 2006 NSW-IPART Bulk Water Price Determination, State Water is now losing increasing amounts of usage revenues, despite incurring all the costs of storing and delivering the water.

It should be noted that the split between fixed and variable charges does not reflect the actual proportion of fixed and variable costs i.e. there is no corresponding reduction in State Water's costs when usage occurs in another jurisdiction. Instead, this pricing structure reflects a requirement of State Water's Operating Licence that prices be based a 60:40 fixed to variable ratio. It also reflects customer preference for lower business costs during poor irrigation seasons.

The recent trend in net trades interstate means that State Water is not fully recovering the costs associated with that water, which is contrary to the National Water Initiative commitments for upper and lower bound cost recovery. In fact, it means that State Water is subsidising these transactions, which means that the water market price is not accurately reflecting the underlying costs of water delivery.

In 2006/07, the net amount of water traded from the Murray and Murrumbidgee Valleys to other States was 50 GL, translating to State Water lost usage revenues of almost \$60,000. In 2007/08 this increased to 157GL and \$278,000. In the financial year to 30 April 2009, State Water has forgone usage revenues of almost \$950,000 due to net trading of over 420 GL to Victoria and South Australia. As trading activity usually accelerates towards the end of the year, State Water expects to lose well over \$1 million in the 2008/09 financial year due to net interstate trading, unless an agreed methodology for invoicing and payment of this account can be determined. There is currently no entity to invoice.

State Water also loses usage revenues when water is temporarily traded from the Murrumbidgee Valley to the NSW Murray Valley. State Water retains only 35% of the revenues collected in the Murray, and passes the rest on to NSW Treasury as cost recovery for the NSW Government's share of Murray Darling Basin Authority costs. State Water has lost over \$45,000 in the financial year to 30 April 2009 due to this type of trade.

In the past the greatest volume of trade out of NSW has occurred at the very time State Water can least afford it - during very dry times in south eastern Australia. However, given the recent maturity in the water market, State Water expects water trading to continue to increase, even when there is a return to greater water availability. State Water will not be financially viable if interstate trading increases and it cannot recover usage charges. Consequently, State Water strongly recommends the ACCC use the opportunity presented by the water trading rules to rectify this situation.

State Water believes that the trading rules must include a mechanism for the recovery of usage revenues by the water utility incurring the cost of storing the water and delivering it (to the border). This could be done in a number of ways. Owners of entitlements could be required to pay variable charges on a "take or pay" basis to most simply and efficiently maintain all legitimate revenues in the Valley, thus reflecting the source of the water. Alternatively a cost could be introduced at the time and point of transaction for all traded water; either the seller or the purchaser would be required to pay the usage revenues at the time of the transaction. This would ensure that the price at which the water is traded will reflect its storage and delivery costs. A third option would be to allocate a nominal WAL to each State to which all water transferred to that state would be credited and usage charged. It would then be up to each State to determine how it recovered that cost from the purchaser.

Responses to Specific Questions

Question 6–A What improvements (if any) could be made to the way in which:

(a) physical constraints

(b) environmental limits

are incorporated into water trading rules?

and

Question 6–B On what basis are water trading zones defined? Are there examples of where trading zones have been set too narrowly? Too broadly?

Currently regulated river systems operate on the basis of full cross subsidy of conveyance losses within regulated rivers. This is because conveyance losses are shared equally between all users in the valley, irrespective of their location within the system. Consequently, there is no market signal to shift water to where it can be delivered more efficiently. This cross subsidy is reinforced by the Water Sharing Plans (WSPs) which require some parts of the system to be operated continuously for stock and domestic purposes.

Existing trading zones only address physical supply constraints and do not address the problems of cross subsidy of conveyance losses. Trading zones could potentially incorporate conveyance losses but this would be difficult to do accurately.

In its current form the trading of a ML of water from the upper reaches of the Murrumbidgee incurs no greater loss-allowance or cost than a ML traded to a farm on the other side of the river. There is obviously a series of State Government interests that will continue to influence any decision to address this issue.

Interestingly a very recent trial transfer of environmental water from Toorale (near Bourke, NSW) on the Darling River to the main stem of the Murray River for the Commonwealth Environmental Water Holder did have estimated actual losses attributed to the trade - as a result only half the water purchased in the upper reaches of the system is now available for delivery in the Murray system in the south of the Murray Darling Basin.

Question 6–C What scope is there to introduce trading zones where there are none already in place?

There is unlimited potential to introduce new trading zones. State Water believes that any new trading zones should aim to remove the cross-subsidisation of conveyance losses. Furthermore trading zones should be based on physical 'chokes' or constraints that may limit the deliverability of traded water allocations rather than parochial boundaries.

Question 6–D What restrictions (if any) relating to carryover should apply to the trade/transfer of water access rights?

State Water does not believe that any restrictions should apply unless there are extenuating circumstances; or the storing of the water for any individual impedes on the existing rights or capacity of another water user. This is because any restrictions to carryover will disadvantage the licence holder who forfeits their allocations at the end of the water year and benefit (other) general security users in the valley in the following year.

Question 6–E What are the advantages and disadvantages of imposing an adjustment for conveyance losses on the trade / transfer of a water access right?

State Water cannot comment on this issue with respect to Irrigation Corporation losses, but it does seem a little anomalous that there are no losses attributed to trades that are carried out along thousands of kilometres of rivers between states.

As outlined above, under the current WSPs, river conveyance losses are grossly cross subsidised. Until these cross subsidies are removed for untraded water, it would appear inequitable to apply them to traded water, unless traded water exacerbates the level of losses incurred.

Question 6–G How could tagging arrangements for 'permanent' trade be improved?

In order for interstate tagged trading to occur, the customer must be able to be set up in two different regulators' systems which currently have no interconnectivity. This process is cumbersome, time consuming and, as a consequence, is often avoided by the customer in favour of annual temporary trades. This could be improved by some simple interoperability between state systems. State Water notes that the cost to develop these systems is not currently being recovered through water charges or transfer (trading) fees.

State Water would welcome trading rules that facilitate such improvements. These future policy enhancements should have input of the operator prior to agreement.

Question 6–K What are the advantages and disadvantages of permitting the trade/transfer of a water allocation:

(a) from a regulated system to a (connected) unregulated system?

(b) from an unregulated system to a (connected) regulated system?

Do these factors differ depending on which system is upstream? What arrangements would be necessary to facilitate these trades/transfers?

In trading between regulated and unregulated systems, rules should be in place to minimise third party impacts. For example, trades from unregulated systems should be expressed in MLs, rather than in shares to ensure that only the water that is actually

traded is transferred between systems. However, there are complex issues relating to the subsequent potential to carry-over unregulated allocations between seasons (when clearly, by definition, they cannot be stored), in particular given the fact that many regulated rivers enjoy significant contributions to allocations from un-regulated flows.

State Water also bulk water charges should be payable if the water passes through the regulated system.

Question 6-L Under what circumstances should a trade/transfer between a ground water system and a surface water system be permitted?

This could happen in systems where the resources are managed jointly and are subject to the same allocation announcement and robust metering, allocation and administration regimes are in place. The hydrological understanding, administration and monitoring of Groundwater systems is non-existent/infantile in the case of most ground-water systems within the Murray Darling basin. There are also potential for serious landscape damage as a result of groundwater quality issues that may be made worse if trade enabled groundwater to be traded, pumped and physically delivered through River systems.

State Water believes that there are very significant opportunities to jointly manage more a interconnected system than is currently the case. State Water understands that this is likely to be addressed in the Basin Plan.

Question 6-M Are there any issues of concern about changes in the location of water access rights within a regulated system?

As outlined above, current systems and rules do not reflect cross subsidy of conveyance losses. The current relocation of groundwater extraction through the issue of "zero Water access licences" and the subsequent transfer of water allocations is a demonstration of how current practice can leapfrog best practice.

Question 7-A What are the advantages and disadvantages of allowing a change in the priority class of a water access right?

In line with the NSW interim embargo on conversions, State Water believes that general security to high security licence conversions should cease until the security of the underlying entitlements is clearly understood and accurate conversion factors can be introduced. This is because licences cannot be converted without impacting allocations to existing licence holders. In the interim (before sustainable yields of various products are clearly determined) if general security licences holders find that they require high security licences, then they should actively manage risk through the judicial use of carry-over or purchase these licences through the water market, as any new market entrant would be required to do.

Question 7-B Does defining a specific purpose for a water access right create a barrier to trade?

Under the Water Sharing Plans, the NSW Minister for Water can 'create' new special purpose licences, such as Stock and Domestic, research, town water supply and Aboriginal Heritage Licences. State Water believes there should be an embargo on the creation of new licences. This is because all the water in the system is fully allocated and as a result the creation of these new licences undermines the security of water for existing licence holders; furthermore the provisions for *basic landholder rights* should be modified to require an volumetric entitlement, allocation-announcements and metering – particularly where infrastructure is in place to allow significant volumes to be used for these needs .

In order for the market to function efficiently, there must be certainty amongst market participants and like entitlements should all be tradeable. However, unless there is an embargo on the creation of these new special purpose licences, the market for existing special purpose licences will be distorted. Therefore, State Water believes tradability of a licence category should only be possible where there is an embargo on granting new licences.

Question 7-C Should there be any restrictions on the trade/transfer of water to urban areas within the MDB?

The creation of new town water supply licences should be 'embargoed' and holders of these licences should be permitted to trade with all other users.

Question 7-D Should it be possible to trade/transfer stock and domestic rights? If so, what conditions should apply?

State Water believes that Stock and Domestic licences should be embargoed, at least on regulated rivers, and then become tradeable licences. While they remain 'un-embargoed' they should not trade. A nominal minimum water entitlement should be maintained on each property; and should not be tradeable. Proponents of subdivisions should source Stock and domestic supplies from the market and secure the infrastructure to provide this water.

Question 7-F What are the advantages and disadvantages of requiring the possession of a relevant water use approval as a condition of approving a trade/transfer?

There are a number of reasons why the purchaser of a water allocation may not hold a water use approval, including the unbundling of licences held by family businesses. As with all markets, expansion of the pool of potential purchasers could assist the irrigation community by increasing financing options. State Water believes there is an important

role for the ACCC to play in preventing any market distortion due to the deliberate manipulation of water prices.

Question 8-C What conditions and restrictions on the trade/transfer of water delivery rights are reasonable?

Delivery rights have been proposed, but not implemented, in NSW for over a decade. Delivery rights should exist where there are supply constraints, and the trading rules should be a logical expression of the constraints. However, this would be extremely complex to achieve effectively because there can be many different supply constraints in the one system, although supply constraints decrease during periods of low water availability.

Question 10-A What are the practical implications of multiple approval authorities involved in the approval of a trade/transfer?

The practical implications customers are that they are required to submit the same paperwork to multiple authorities, often meaning the paperwork arrives at different times or out of order, which can often delay the process. One possible solution may be that the paperwork is filed with the selling state requiring the selling state to submit the paperwork to the buying state ensuring there is still integrity on both sides of the trade. Electronic lodging and processing, and the introduction of compatible trading platforms should assist resolve the issues associated with remote locations, long rivers and paper-based transfers.

Question 10-B What are the advantages and disadvantages of enabling Basin state approval authorities to have direct access to each other's registers and/or accounts for the purposes of determining or giving effect to particular kinds of trade/transfer?

Giving access to each others' systems may aid each state in setting up the transfer (ie validating information) but caution should be taken in determining the transfer for the other state (especially if NSW is buying) as one jurisdiction may not be aware of other transactions pending in the other jurisdiction's systems – or indeed their legislation and processes. This is likely to reduce the efficiency of trade transactions processing, at least initially. Therefore State Water believes it would be more efficient to transfer information electronically between states, rather than permitting direct access.

Question 10-C What considerations are relevant when considering the form and manner of applications to trade/transfer tradeable water rights?

Trade should be facilitated by whatever means to make the process fast for the buyer and seller as it often a time sensitive decision both in terms of needing of the water and the volatility of the market pricing. These transactions should be enabled by electronic means and not require a person to submit originals in mail or person. An electronic version (fax, web) should be acceptable.

Question 10–D Are there other legislative requirements limiting the ability of approval authorities to accept applications electronically?

There are a number of state and federal legislative acts covering electronic transactions that may unnecessarily over-complicate an understanding of how to efficiently do this.

Question 10–E Is there scope to develop application forms relating to the trade/transfer of tradeable water rights that are consistent between states? Would there be merit doing so?

Although different licence systems apply, it should be possible to develop a standard application form for trade. A standard form would aid a customer in completing the form correctly and hence minimise the number of trades rejected or delayed due to customer error, and therefore facilitate annual trade.

Question 11–M What concerns, if any, are there with the current approaches informing water market participants about allocation announcements?

The allocation announcement dates in the southern Murray Darling Basin (15th of each month) have some benefits for market knowledge. However, there seems to be some uncertainty about whether new information which emerges between announcements should be announced to the market. Consequently, not all participants become aware of this information at the same time. State Water supports the adoption of continuous disclosure of any information which might affect the market price where practically sensible.

Question 11–N What are the advantages and disadvantages of water authorities providing forecasts for future water allocation announcements?

This information should be a major factor in the temporary water market. The market will operate better if the market is well informed about the possible range and statistical/climatically weighted chances of improved of water availability later in the irrigation season. State Water already provides operational forecasts for customers, which provide a range of probable water availability.