



SELECT HARVESTS

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BY EMAIL: waterinquiry@accg.gov.au

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Dear Sir/Madam,

**Inquiry into Water Markets in the Murray-Darling Basin –
Confidential Submission to the Interim Report by Select Harvests Limited**

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1. Thank you for the opportunity to make a submission to the interim report of the ACCC's Inquiry into Water Markets in the Murray-Darling Basin (**the Basin**).
2. Select Harvests Limited (**SHV**) supports the Basin system. Clearly defined tradable water property rights decoupled from land ownership have significantly improved water use efficiency and agricultural output across the Basin.
3. However, governance of the Basin and the regulatory frameworks for water trading have not evolved significantly since water rights were unbundled from land on 1 July 2007. A significant updating of governance arrangements is now required to harmonise and modernise the regulatory and operational frameworks that support water markets.
4. SHV's preference is for a centralised national approach to water market governance and regulation. Whilst SHV are aware that significant political and jurisdictional obstacles will need to be overcome before such a solution can be implemented, this should not be a reason for change. Therefore, SHV is willing to trade off a 'perfect' centralised solution to current water market issues, for more harmonised and co-ordinated federal government and Basin State solutions that are practical and achievable within reasonable timeframes.

Select Harvests Recommendations

5. The following provides a collation of SHV recommendations from our submission:

- SHV recommends that Basin governments work towards a more harmonised, consistent and coordinated set of rules, regulations and decision-making processes to effectively manage 'whole of basin' water consumption, availability and deliverability, and also investigate water infrastructure options that can increase trade between zones.
- The financial motivations and actions of Sophisticated Investors are potentially in conflict with the Basin Plan's aim. There is a role for these investors in the water markets, however, oversight and market integrity and transparency regulations are urgently required to ensure their activities and actions are not contrary to the Basin Plan's aims.
- In order to improve water market transparency, State Water Registers should disclose transactions associated with Water Authorities, as the Department of Environment, Land, Water and Planning (DEWLP) in Victoria have recently taken steps to do.
- Basin State governments need to have published and consistent rules around IVT decisions and policies.
- All environmental water must be tagged (including private not for profit) and deducted from the free float of available water for irrigators. Generally, these users are treated like any other users and their goal is aligned to the Plan's aim.
- All water brokers should be properly licensed and governed by regulation similar to what has been established for Property, Stock and Business Agents under the Property, Stock and Business Agents Act 2002. All brokers should also be required to hold professional indemnity insurance.
- The Basin is one collective water source and should be managed as such. Trade processes across the basin need to be made more consistent and standardised, including the adoption of a basin wide centralised trading platform and reporting register.
- The current level of information transparency available to both Regulatory/Market Authorities and water market participants is inadequate. Regulatory/Market Authorities need to have enough information to be able to effectively monitor the activities of market participants, and market participants need accurate market analytics to make rational and fully informed decisions.

Chapter 4 – Buyers and sellers: Who trades, where and why?

6. Basin water markets consist of a comprehensive range of buyers and sellers and general market participants. Their activities within these water markets depend on the intended end use of the water. Some acquire water purely for consumptive needs to either grow food crops or to provide critical human needs, while others may use the water for social, environmental, or cultural needs, or even purely for financial gain (Sophisticated Investors).

Consumptive users can sometimes be faced with challenging barriers that can prevent from buying and selling allocations and entitlements, or using leases, carryover parking and forward contracts. These include but are not limited to the tradability of the water, deliverability, and the reliability of the entitlement class. This results in the need for careful navigation to ensure that water can be sourced and delivered when needed. It can also result in higher water costs due to an inability to freely transfer water between trading zones throughout the season.

Sophisticated Investors are not always restricted by these same barriers as the water acquired is often not coupled with the same level or urgency as it is for those who acquire water to meet critical consumptive demand. This can provide them with an unfair advantage and ability to acquire and hold water in any trading zone. It can also provide an ability to release this water back into the market at a premium when trade barriers are lifted.

- a) **Tradability:** The movement of water throughout the Basin is restricted by the relevant trading rules which govern how water can be transferred from one trading zone to another. These rules can vary from season to season depending on conditions at the time and government policy changes. Water delivery through areas such as the Goulburn and Barmah Choke is controlled and restricted to avoid unintended flooding or bank erosion. This affects the volume of water that can be traded from one valley to another (e.g. Goulburn to Murray (Downstream)).

With increasing consumptive demand, especially downstream of restricted trading zones, the respective Basin State governments need to collectively explore additional infrastructure options to provide bypass mechanisms that increase water tradability, deliverability and efficient water transmission, whilst avoiding any potential negative impacts on the environment.

Two examples of potential bypass mechanisms are detailed in Figure 1 below. The red line represents the Mulwala Canal which stretches for approximately 207 kilometres from Lake Mulwala to the Murray River discharge site at ‘Perricoota Escape’. The canal provides water supply to the farming communities and towns within Murray Irrigation Limited’s area of operation. The offtake capacity of the Mulwala Canal is 10,000 megalitres per day. The canal then branches off at a location called the ‘drop’ with 3000 megalitres being diverted to the town of Berrigan and 7000ML diverted to Deniliquin. There are also various other channel discharge sites which are listed in the table below:

| Discharge Site | Outflow Capacity (ML/Day) |
|---|---------------------------|
| Edward River Escape @ Mulwala Canal to Edward River | 2400 |
| Finley Escape regulator to Billabong Creek | 250 |
| Perricoota Escape regulator @ Murray River | 200 |
| Yallakool Creek escape regulator @ Yallakool Creek | 80 |
| Wakool River escape regulator @ Wakool River | 500 |
| Wakool Town Supply regulator @ Wakool River | 70 |
| Niemur Syphon @ Niemur River | 170 |

The blue line represents the Waranga Western Channel, supplied from the Goulburn River through the Cattanach Canal near the Goulburn Weir. It is our understanding that this channel has an off-take at the Campaspe River at Rochester. This off-take has the potential capacity to deliver over 1000

megalitres per day when there are higher flows through the channel system. The system itself largely bypasses the Goulburn River system, avoiding environmental damage to the Goulburn River System, while also increasing flows to meet downstream demand.

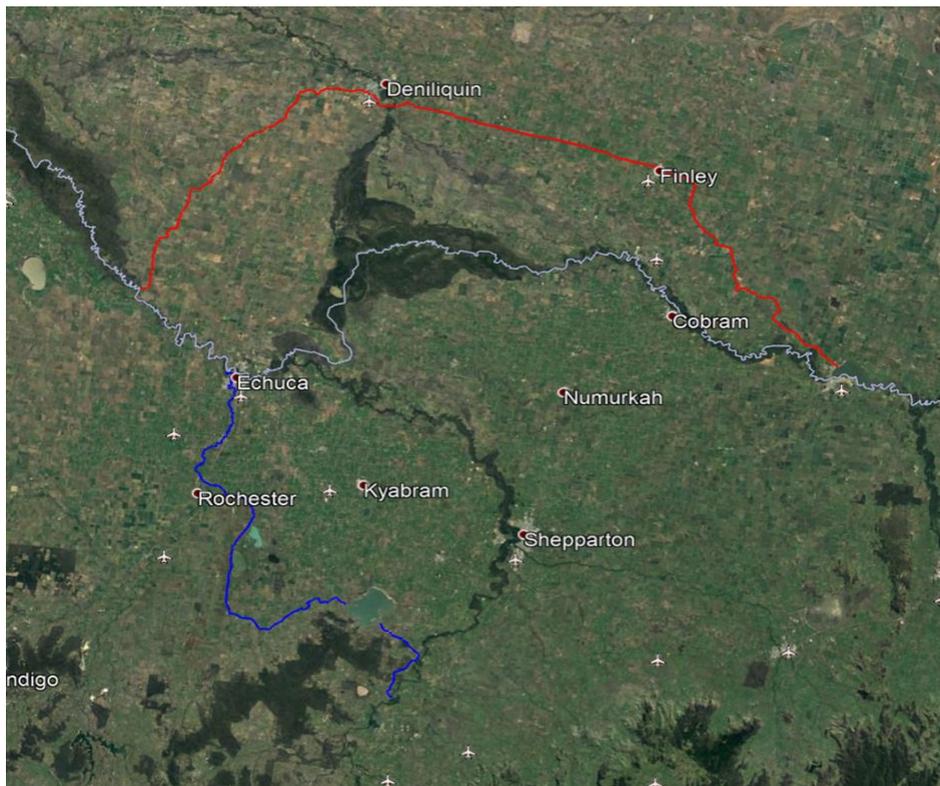


Figure 1: Potential Bypass Mechanisms

As an irrigator, SHV is required to continuously monitor seasonal conditions, trading opportunities and government announcements, to ensure we can trade water to our farms for consumptive use when required.

We are sometimes placed in a position where, a business decision has been made under a certain set of circumstances or rules which subsequently change. Consequently, we cannot access water that we have purchased due to restrictive and changing trade rules increased risk of water not being delivered as planned and significantly increased expense.

The now 'surplus', non-accessible water either needs to be sold at a potential loss or carried forward at cost into the following season. The water carried forward often includes a loss percentage, resulting in a higher 'effective' dollar per megalitre price.

- b) **Deliverability:** Even when trading rules permit trade from one zone to another, there can sometimes be a risk of deliverability shortfalls. This can result from drier seasonal conditions, lower catchment inflows, increased water demand, or a general over estimation of water availability, leading to the inability of Resource Managers to effectively deliver required amounts of water to consumptive users.

As a large consumptive user, SHV must always prioritise water purchasing based on reducing the deliverability risk to our farms for consumptive use when required. Prioritising water purchases based on deliverability risk impacts the types of water we purchase and where this water is sourced from.

- c) **Reliability:** The reliability of an entitlement class determines the type of water that is best suited to a farm location or for a specific purpose. For example, if looking to secure water to support one of SHV's Victorian farms below the Barmah Choke, we would first look at Victorian Murray Zone 7 High Reliability. This entitlement type has a historical high allocation return and allocation is easily transferred to farm by either direct association, a Limited Term Transfer (LTT), or a direct allocation

transfer. It is also not subject to Goulburn IVT trade restrictions, interstate restrictions or additional transfer costs between states.

- d) **Carryover:** Carryover is used by SHV to ensure water availability early in the season, especially during drier seasonal conditions. If looking to acquire entitlement purely for carryover purposes, SHV would focus on Victorian Low Reliability entitlement classes. These entitlement types have historically had little, or no seasonal allocation issued against them, leaving adequate entitlement storage space for carryover purposes.

Our company also holds a volume of General Security entitlement. This entitlement class provides both allocation during average seasonal conditions, and carryover ability up to a percentage of the entitlement class.

A portfolio mix of different entitlement types enables SHV to mitigate against higher water costs, lower allocations, and limits our exposure to a sometimes volatile and reactive allocation market. SHV's water strategy is to hold at least 1/3 entitlement owned, and 1/3 leased, with the balance sourced from the open allocation market.

Recommendation: Restrictive and inconsistent trading rules and a lack of investment in interzone infrastructure have reduced efficient market outcomes by: impeding water tradability between zones; increasing transaction and holding costs; increasing business uncertainty, creating unnecessary deliverability risk; and favouring well-resourced large market participants, who have the resources required to navigate the current system.

SHV recommends that Basin governments work towards a more harmonised, consist and coordinated set of rules, regulations and decision-making processes to effectively manage 'whole of basin' water consumption, availability and deliverability and also investigate water infrastructure options that can increase tradability between trading zones.

Chapter 5 – Investor roles, strategies and conduct

7. The main objective for large non-consumptive sophisticated investors that participate in the water market is to make profits from trading water. With a qualitatively different degree of market power and sophistication compared to other market participants, Sophisticated Investors have the ability to adopt trading strategies that can limit water availability to coincide with announcements by regulators or consumptive peaks and increase price with limited exposure to the risks of these outcomes.

SHV is encouraged by the ACCC's further investigation of the conduct of some investors in the water markets. It is very disappointing that this conduct is not illegal under current regulation (as noted by the ACCC in the interim report). This lack of legality under current regulations provides a clear indication of the urgent need for new regulation/oversight of Sophisticated Investors in the water markets.

Recommendation: The financial incentives and actions of Sophisticated Investors are potentially in conflict with the Basin Plans aim. There is a role for these investors in the water markets, however, oversight and market integrity and transparency regulations are urgently required to ensure that their activities and actions are not contrary to the Basin Plan's aims.

8. In addition to Sophisticated Investors, there are a number of other significant non-consumptive user groups that actively participate in Basin water markets:
- a) **Government & Privately Owned Water Authorities:** From time to time some Water Authorities may have surplus water, through general infrastructure water savings or lower consumptive use. This surplus water is sometimes sold into Basin water markets. There can be situations where Government Water Authorities or Departments are selling water into high priced markets at the same time another

Government Department or Affiliate is allocating water. The sale of water can assist Water Authorities in reducing overall operating costs, with the cost savings delivered to the customer base, or potentially used to fund infrastructure projects within the irrigation district.

There may also be times when Authorities will purchase water against their Bulk Entitlement to enable water delivery to customers when general water availability is low. Alternatively, allocations will be purchased to balance overdrawn accounts of irrigators within the irrigation district.

Recommendation: In order to improve water market transparency, State Water Registers should disclose transactions associated with Water Authorities, as the Department of Environment, Land, Water and Planning (DEWLP) in Victoria have recently taken steps to do.

- b) **Basin State Governments:** Restricted trade through Intervalley Trade Mechanisms (IVT) can significantly distort water pricing. Water prices can vary by more than 100% before IVT trading is opened.

When the IVT does eventually open, the additional allocation assists in diluting the water price in the general market. However, access to this water often occurs later in the season, with larger more sophisticated water market participants and brokers having a distinct advantage in accessing this water due to the internal resources and trading systems they have at their disposal. As a consequence, many smaller consumptive water users avoid IVT trades and acquire water earlier in the season, sometimes at a significantly higher price.

Recommendation: Basin State Governments need to have published and consistent rules around IVT decisions and policies.

- c) **Environmental Water Holders:** Environmental water holders within the Basin invest in entitlements to support environmental watering programs. Entitlement is acquired either through government buy-backs, voluntary relinquishment, or the open market.

Recommendation: All environmental water must be tagged (including private not for profit) and deducted from the free float of available water for irrigators. Generally, these users are treated like any other users and their goal is aligned to the Plan's aim.

Chapter 6 – Water broker roles, practices and conduct

9. A water broker's role is to facilitate water and licensing transactions between sellers and buyers. This role includes:
- sourcing water within the market
 - providing information on water and licensing products available and general market conditions
 - preparing the transaction and contract documentation
 - quoting a price as agreed to by the buyer and seller
 - providing updates on trade opportunities.
10. Brokers roles can become unclear as they charge commission to both the buyer and seller. However, they should only act for one party.
11. There are a number of water brokers that hold their own water accounts. One reason that they do this is to consolidate smaller trade volumes into larger transactions. Another reason is to hold clients trade volume until a trade opening occurs for: carryover parking purposes; trade through IVT's (Goulburn or Murrumbidgee); or through the Barmah Choke.
12. The issue with a broker being able to consolidate smaller trade volumes into their own water account in the current opaque water markets, is that the seller cannot determine when the volume was initially

acquired, what the actual purchase price was, and the number of transactions involved. This opacity in current water markets gives brokers the ability to move beyond a pure 'market-maker' role to actively taking a position in water markets. These ownership structures should be declared and monitored to avoid misuse.

13. SHV has engaged the services of Water Brokers to trade water through IVT's. This process has involved establishing correct authorisations for the broker to trade on our behalf from SHV accounts. Due to better resourcing, including dedicated staff and advanced computer systems, brokers have a greater ability of successfully trading IVT water. Given that a large agribusiness like SHV requires the services of water brokers to trade water thru the IVT, what ability do smaller farmers have to trade water thru the IVT, without the services and cost of a broker?
14. SHV has been misled by water brokers in the past. Examples are provided below:
 - a) **Quoting incorrect market pricing:** There have been instances where brokers have quoted prices well above market trends at the time. In water markets where the majority of trading is 'off exchanges', it is difficult for SHV to determine the 'underlying' market trend price in the absence of the brokers guidance. This deliberate broker misquoting can be avoided with the establishment of a centralised trading platform with up to date market information and the requirement that all water transactions be brought onto the centralised trading platform.
 - b) **Offering water under false pretences:** Offering SHV a parcel of water from an exchange that the broker did not have access to, as they had been banned by the exchange holder from using their trading platform. If the industry was properly regulated and all water brokers licensed, this type of behaviour would be less likely to occur and would at least be reportable.

Recommendation: SHV agrees with the ACCC's preliminary view outlined in the interim report, that substantial additional broker regulation is required. All water brokers should be properly licensed and governed by regulation similar to what has been established for Property, Stock and Business Agents under the Property, Stock and Business Agents Act 2002. All brokers should also be required to hold professional indemnity insurance.

Chapter 7 – Regulatory settings and solutions

15. There is a place for the creation of bona-fide water options and futures in Basin water markets. If options and futures became available and were properly structured, standardised, and sufficiently regulated across the Basin, SHV would consider this as another tool to hedge water costs and to provide more certainty around water availability.

Chapter 8 – Trade Processes – advising, matching, clearing, settlement, regulation and information

16. The Basin is one collective water source and should be managed as such. All dealings in water should be consistent across the Basin, and to achieve this, the following would need to occur:
 - Creation of standard transactional documentation and contracts for all water market participants.
 - Standard transaction costs for all water transactions.
 - Consistent terminology relating to all water and licensing products.
 - Standard national accredited and pattern approved metering for all water users with telemetry capabilities to affectively monitor compliance. Implementation would also provide real time resource management monitoring, which would also potentially mitigate against delivery shortfalls from being able to monitor consumptive demand in real time.

- Standard rules and regulations across all states and jurisdictions.
 - To effectively manage all water dealings, a central trading platform and register needs to be developed and administered by the Commonwealth.
17. There are those that oppose the creation of a centralised register due to the perceived cost and complexity involved. However, if we adopt a piece meal approach and apply a ‘band-aid’ solution to the already fragmented and broken IIO and state based registry systems, the aggregate cost of this piece meal approach is likely to far outweigh the long term benefits from building a new centralised and integrated system. In developing a new centralised system, the better functionality contained within the current state registers could be adopted.
18. A new centralised registry system should be more transparent, with all water dealings categorised by trade purpose, whether it be related to lease activation, settlement allocation, related party transfers, environmental transactions, or general commercial transactions.
19. All commercial transactions should include a mandatory monetary consideration in order to be processed into the system. Any other transaction type should be separated out from commercial transactional data to avoid the potential of distorting market pricing and volume. Zero dollar transactions should only be permissible for proven related party transfers, or settlement allocation transfers.
20. A water use register with account balances would be highly beneficial to all water users and market analysts, as it would provide the scale of water demand within different trading zones throughout the basin, allowing controlled development of the collective resource. In creating a water use register, it would be beneficial to split the use by the following categories:
- Basin
 - Trading Zone
 - Commodity Crop

The development of such a register would require standard metering and compliance across the Basin as outlined in paragraph [15].

Recommendation: The Basin is one collective water source and should be managed as such. Trade processes across the basin need to be made more consistent and standardised, including the adoption of a basin wide centralised trading platform and reporting register.

Chapter 9 – Transaction costs of trade

21. There are currently significant variations in transactional processes, timing and costs across the Basin. These variations affect trade decisions, especially when a market participant, like SHV, manages a diverse water portfolio and supplies water to 16 different farms across 3 states. SHV factors these transaction costs into the price of water we purchase. These costs may include:
- exit taxes: applicable to transferring water from NSW interstate;
 - administration fees: applicable to Water Authorities and some Water Brokers;
 - transfer fees;
 - storage fees; and
 - commissions.
22. Transaction processes can be paper-based or online digital processing, for similar transaction types in different jurisdictions. As a result, processing times can vary from minutes to weeks. This lag time has to be factored into any trade decisions, and water may need to be acquired well in advance to avoid the potential for overdrawing a water account.

23. With the creation of a centralised reporting registry, processes and transaction costs would be standardised and streamlined, reducing transactions costs and time and providing greater certainty to market participants.

Chapter 10 – Information Transparency

24. Regulatory/Market Authorities should have full visibility on market participants water data` including holder types, with this information required to be provided by market participants. However, the level of public disclosure of market participants water data needs to be limited to data that is necessary to minimise information asymmetries, enabling informed decision making by market participant, while not creating an environment that could be unfairly leveraged by a buyer or seller. Such public information should include Buyer and Seller categories (not individual names) that include:

- Non-Water Users (Large)
- Non-Water Users (Small)
- Environment
- Irrigators
- Stock & Domestic Use
- State Government
- Commonwealth Government
- Cultural
- Water Authorities

All transactions should also include a purpose such as:

- Consumptive use
- Investment
- Lease Activation
 - Forward Allocation
 - Entitlement Lease
 - Carryover Parking
- Settlement Activation
- Related Party Transfer
- Environmental Use
 - Environmental Project Description (i.e. Hattah Lakes)
- Miners

This information would enable effective monitoring of market participants by the market regulator and would provide an accurate public database on the scale of use and behaviour of groups of participants in the water market.

25. SHV supports the establishment of a market-focused government regulator to effectively monitor compliance and market integrity, similar to the ASX. One of the key remits of an 'independent market-focused regulator' has to be the provision of overarching market data, analysis and reporting. The regulator should have an independent sub agency responsible for the overarching provision of market data, analysis and reporting for the entire Murray Darling Basin.

26. The fact that the ACCC's interim report had to rely on a private consultancy business as a data source for the value of total water entitlements on issue highlights the current lack of overarching independent water market data. We encourage the ACCC to thoroughly review all 3rd party data presented in its final report.
27. SHV's view is that ownership disclosures of greater than 5% of permanent water entitlements within a specific water market should be required. We also recommend a similar disclosure requirement for temporary allocation trading by all water users.

Recommendation: The current level of information transparency available to both Regulatory/Market Authorities and water market participants is inadequate. Regulatory/Market Authorities need to have enough information to be able to effectively monitor the activities of market participants, and market participants need accurate market analytics to make rational and fully informed decisions.

Chapter 14 – Market architecture reform options

28. SHV supports the inclusion of conveyance losses in the trade of water, as long as this loss is not 'double dipped' and counted twice by authorities and river operators, as this will ensure the effective management of the water source and will also mitigate against any potential water delivery shortfalls.
29. SHV supports the concept of having a continuous accounting system where there is no end of year forfeiture of allocation. However, for this to work there must be limits set on the volume of water that can be held at any one time and usage limits enforced. These limitations would avoid the ability to hoard water.

A continuous accounting system is currently used effectively in the Namoi and Gwydir regulated river systems in New South Wales. This system has enforced limits on water held and what is used.
30. SHV supports the establishment of capacity sharing and the creation of a cap and trade system. The establishment of a cap and trade system would ensure that total water extractions can never exceed the sustainable diversion limits (SDL's) of a water source.

Yours faithfully,



Paul Thompson
Managing Director & CEO