



SELECT HARVESTS

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BY EMAIL: waterinquiry@accc.gov.au

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Australian Competition and Consumer Commission (ACCC)
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Dear Sir/Madam

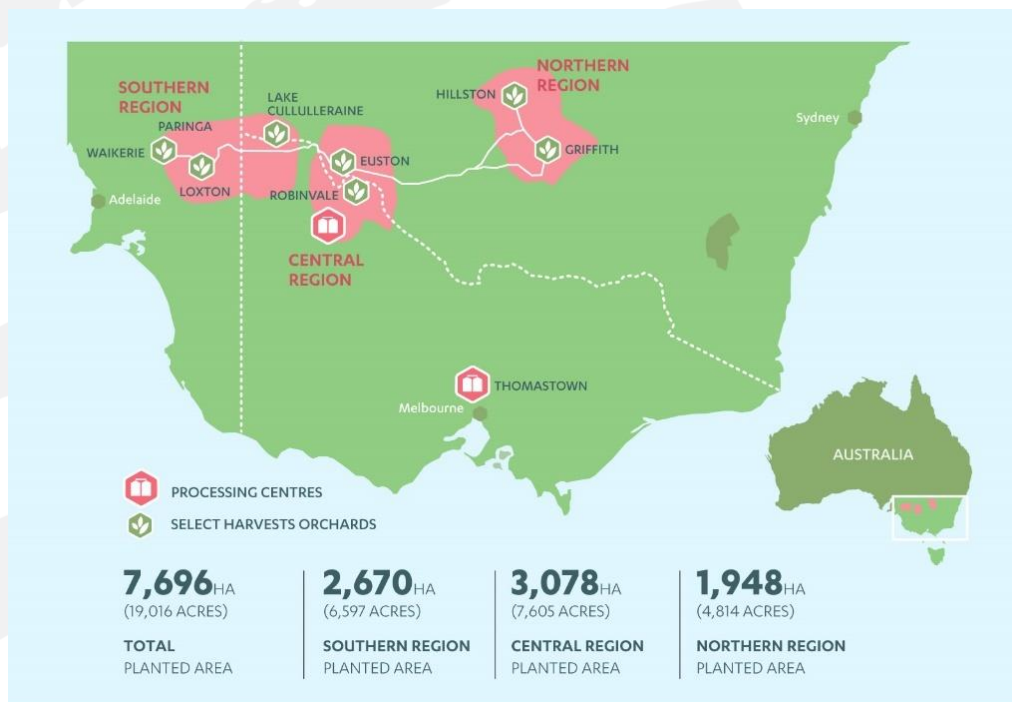
**Inquiry into Water Markets in the Murray-Darling Basin –
Public Submission of Select Harvests Limited**

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1. Thank you for the opportunity to make a submission on the issues raised in the ACCC's Inquiry into Water Markets in the Murray-Darling Basin Issues Paper (**Issues Paper**).
2. Select Harvests is Australia's second largest almond grower with orchards in South Australia, Victoria and New South Wales. The southern and central regions utilise surface water and the northern region utilises both surface water and groundwater. We include in Figure 1 below a map of our orchards.

Figure 1: Map of Select Harvests' Orchards



3. As Australia's second largest almond growers, Select Harvests depends on the effective operation of water markets in the southern Murray-Darling Basin (**sMDB**). It regularly trades in markets for both permanent water entitlements and annual water allocations and has a deep knowledge of how those markets work.
4. Select Harvests' policy is to meet its annual surface water requirements through a mix of 1/3rd ownership of water entitlements, 1/3rd long term leases of water entitlements and 1/3rd purchases of annual allocation water on spot markets. The majority of water entitlements owned or leased by Select Harvests are high security entitlements, which provide the level of certainty of supply necessary for permanent crops such as almonds.
5. Select Harvests supports the sMDB system. Clearly defined tradeable water property rights decoupled from land ownership have significantly improved water use efficiency and agricultural output across the sMDB. However, the water market has evolved significantly since water rights were unbundled from land on 1 July 2007. Increased water demand has been offset by a reduction in water supply. Community expectations, trading platforms, market participants and technologies have all evolved since then. Fundamental elements of an efficient water market, namely timely access to relevant information, effective market participant obligations, monitoring and compliance need to be reviewed and updated.
6. Reliance on highly variable rainfall means the size of various markets (each defined as a specific water trading zone, e.g. Zone 7 – Vic Murray from Barmah Choke to SA Border) will vary considerably from year to year. Water storage and river flow is carefully controlled by the Murray-Darling Basin Authority. Government regulation of the operation of the interconnected hydrological system, and of the conduct of buyers and sellers, will always be required to balance competing societal, economic and environmental demands.
7. The current light-handed regulation and oversight of water markets was not designed to address issues caused by large-scale trading of annual allocation water for the sole purpose of maximising profit for a non-water user during droughts, rather than for purchasing and consuming water for the most productive use or environmental protection. Management of the current water markets has simply not been able to address the growing market power and influence of non-water users, including sophisticated investors (**Sophisticated Investors**).
8. The substantial scale of some Sophisticated Investors, arising from their financial clout, analytical resources and access to global financial markets, combined with the fact they have no physical need to apply water to crops through the season, provides them with unparalleled flexibility and market power. Due to the fragile nature of the current water markets, Sophisticated Investors are able to implement trading strategies that actively raise prices above supply and demand fundamentals, negatively impacting the markets' allocative efficiency.
9. The price of annual allocation water in the 2018/19 and 2019/20 seasons has materially increased far in excess of the prices experienced during previous seasons with similar dry conditions and water storage levels (by around \$100/ML to \$300/ML). The ABARES Water Trade Model is consistent with this view, estimating the 2019/20 season in the VIC Murray Below the Choke (Zone 7) should experience an average price of \$473/ML under a 'Dry Scenario' and factoring in the increased demand in the sMDB, '[...] including the effects of new almond plantings in the Victorian Murray'. The median price for Zone 7 in the first month of the 2019/20 season was in excess of \$600/ML and has continued to rise to more than \$950/ML.
10. Select Harvests has observed conduct by Sophisticated Investors coinciding with these material price increases.
11. Water markets are fragile. The price of water is inevitably impacted by Sophisticated Investors and government intervention. The ability of water markets to achieve efficient outcomes is limited by:
 - (a) thin daily trading volumes;

- (b) multiple discrete trading zones;
 - (c) vulnerability to sharp price movements due to the trading conduct of Sophisticated Investors;
 - (d) variations in Government administration, management and policy across the sMDB;
 - (e) practices such as intervalley trading, intra-season and inter-season water account management;
 - (f) the effect of carryover rights, and
 - (g) inconsistent data collection transparency and timeliness (including variability in water meter reading timeliness and capability).
12. The majority of the water in the sMDB is owned by irrigators who require it for their own use. Their water will rarely – if ever – be available for trading. Thus, the volume of water available for trade (that is, the free float) is significantly smaller, particularly in dry seasons.
13. Water markets are not operating effectively for the benefit of the Australian economy, irrigated agriculture, consumptive users, basin communities or the environment. The ACCC has sought information on a detailed and comprehensive range of issues. We have focussed our submission on six key issues:
- (a) **Growth of Sophisticated Investors** — Sophisticated Investors have a qualitatively different degree of market power and sophistication compared to other market participants. This arises from their scale, strong analytical resources, access to low cost capital and the fact they do not have physical consumptive requirements or regulatory deadlines to use any water themselves. Consequently, they are able 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 those outcomes.

This is in comparison to water users, whose ability to pursue similar trading strategies is limited by the fact that in doing so they will be raising their own cost of production, they have limited financial resources and they must observe physical and regulatory deadlines. The growing significance of Sophisticated Investors has exposed critical deficiencies in the current regulatory regime that require urgent rectification.

There is a role for Sophisticated Investors in the water market. It is important that organisations have the opportunity to invest in water and that industries like agriculture have access to all consumptive funding mechanisms to secure water. However, it is important that their resource advantages do not distort the markets as outlined above.
 - (b) **Data Deficiencies and Information Asymmetry**— A lack of consolidated, accurate, comprehensive and timely data on water rights trading activity gives a significant informational advantage to large, well-resourced and connected Sophisticated Investors and large scale irrigators (like Select Harvests) over smaller market participants. This has led to an overreliance on thinly traded water exchanges for price signals. It means the extent to which price movements are attributable to a genuine change in market sentiment or the actions of one or more related parties is very difficult for ordinary water users, sellers and regulators to determine. We propose that a single regulator be responsible for collecting and publishing high quality trading data, like the Australian Securities Exchange (**ASX**) or the Australian Energy Market Operator currently do.
 - (c) **Market Manipulation Loophole** — Competition and consumer laws have not been an effective means of constraining the behaviour of market participants, in part due to the complexity of the market. We submit that robust market manipulation prohibitions and enforcement mechanisms are required, as currently exist in other product-specific statutory markets such as financial securities and electricity. The behaviour of some water market participants would not be tolerated if it involved trade of securities on the

ASX. This is only possible in the water market because the market is not transparent or regulated, and is fragmented and complex.

- (d) **Annual Water Allocation Market Speculation Moratorium** — Non-water users currently have the ability to purchase annual water allocations as a pure form of short-term market speculation. In this instance, they have no practical use for this water. This is having such a significant adverse influence over market liquidity and annual water allocations that an immediate response to alleviate pressure is required. We propose a moratorium on non-water users from purchasing annual allocations and carrying unused allocation forward into the following season to avoid 'hoarding water' within an irrigation season.
- (e) **Enhanced Water Broker Obligations** — The lack of rules governing the conduct of brokers has undermined trust in the services they provide, and the water industry as a whole. Brokers are strongly incentivised to increase water prices and volumes, as their remuneration is directly linked to transaction size. They are not restricted from using commercially sensitive information or required to disclose any conflict of interest. Many brokers have their own allocation account (ABA) which, if used inappropriately, can be used to trade water in their own right (private book/account) against their clients' interests. To complicate things further, many brokers charge commissions to both the buyer and seller, making it impossible to discern who is the broker's client and primary interest. We propose that water brokers should be licensed and required to comply with basic regulatory obligations, including owing a duty to clients, and disclosing conflicts to clients.

Ethical brokers should have no fear of regulation as this is common practice in most brokerage industries and the cost, which is ultimately borne by the industry, has proven not to be prohibitive.

- (f) **Inconsistent Carryover Rules** — The current carryover rules across the sMDB are inconsistent and potentially destructive to good management of the river. A total rethink is required. The ability to carryover water should be capped in all States at 100% of the entitlement volume, with loss rates depending on the individual characteristics of the water source. Further, we submit that the ability to carryover water should be restricted to water users, preventing non-water users from hoarding water and exacerbating shortages.

Yours faithfully



Paul Thompson
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