

Buy, Sell, Trade.

T 03 5027 3588 F 03 5027 2155
E info@waterexchange.com.au
5 Short Street (PO Box 468)
Wentworth NSW 2648
ABN 66 615 100 206
waterexchange.com.au

6 December 2019

Australian Competition and Consumer Commission

By email: waterinquiry@acc.gov.au

Dear Sir / Madam

RESPONSE TO ACCC INQUIRY INTO WATER MARKETS IN THE MURRAY-DARLING BASIN

We refer to the above matter and advise that this correspondence represents the response of WEX Water Pty Ltd (“Waterexchange”) to the water markets issues paper.

By way of background the Waterexchange is a transparent online marketplace and clearing house for water products which was originally established in 1994. The business was previously owned by the National Stock Exchange Ltd (and operated under its Australian market licence) and is now majority owned by Nutrien Ltd, the world’s largest provider of crop inputs, services and solutions for farmers.

Waterexchange operates a live market and clearing house for all water trading zones in the southern connected system. New geographical areas have also been established in recent years including Queensland. Currently there are more than 30,000 registered customers and 65 individual water brokers using the platform from a range of competing companies. Additionally, a number of approval authorities use the platform to approve trades online including SunWater, Murrumbidgee Irrigation, Colleambally Irrigation and others.

Waterexchange has strong governance, trade process, financial management and dispute resolution procedures to protect customers and ensure fair market operation.

In response to the Australian Competition and Consumer Commission (ACCC) water market Issues Paper we submit the following:

Issue 1 – Market trends and drivers

- How water availability and demand are changing over time, the reasons for these changes and the impact they are having on water markets.
- The factors that have been driving movements in prices for water access entitlements and allocations over time.
- Changes to the number, diversity and behaviour of water market participants over time, and how this is affecting water markets.
- Changes to the number, diversity and amount of trading activity of water market products on offer over time, and how this is affecting water markets.

Demand factors – temporary allocation

- 1) Cotton has expanded south throughout the Murrumbidgee Valley and into the Murray Valley over the past 5 years. The gross margins for cotton have been higher than for other established annual crops such as rice and pasture. This shift has resulted in an increase in the total irrigated area as previously dryland grazing properties have been converted for (cotton) irrigation. This factor has resulted in greater demand and a higher price for temporary allocation, particularly in wet or average water availability years as evidenced in 2017/18.
- 2) Higher profitability of permanent plantings crops such as almonds, table grapes and citrus has resulted in a significant expansion of the irrigated area throughout the Murray (below choke) and Murrumbidgee over the past 20 years. A large proportion of this expansion has been carried by operators who have chosen not to purchase additional high security / high reliability permanent entitlements, but secure most of their water needs through the temporary allocation market or other water products such as forwards and leases. This has resulted in greater demand and higher prices for temporary allocation. This additional demand is particularly problematic in low water availability years when the total supply of available allocation is potentially lower than demand from permanent plantings. This results in industry unrest as permanent plantings do not have optionality in respect of annual water requirements (as compared with, for example, annual cropping operations which have the option to forgo production and sell available allocations).
- 3) Recent changes in policies from water authorities in respect of not allowing irrigators to have a negative account balance has shifted demand across the water year. Previously many irrigators would use the full water year to cover a deficit in their water account which often resulted in temporary allocation purchasing spread throughout the full water year. The recent policy changes have resulted in shifting more demand to the peak irrigation period between October and February which in turn has increased prices during this period.

Supply factors – temporary allocation

- 4) Over the past decade annual rainfall across the catchments has been below average which in turn has resulted in lower inflows into the catchments and accordingly lower annual allocations granted to entitlements. This is particularly evident for allocations granted NSW General Security entitlements which are often a key driver in the temporary allocation market supply and price. A significant proportion of General Security entitlements are in the ownership of annual

cropping operations which have the option to forgo production and sell available allocations. The lower average annual allocations over the past 10 years has resulted in less supply into the market and higher temporary allocation prices.

- 5) The Commonwealth Basin Plan has shifted ownership of a significant proportion (approx. 22%) of all permanent entitlements on issue from private irrigators to the Commonwealth Environmental Water Holder (**CEWH**). The annual allocations granted to these entitlements are no longer available to the temporary allocation market (only in limited circumstances can the CEWH sell allocations into the market). This is a step change decrease in supply to the temporary allocation market which is a major contributing factor to higher prices now and moving forward.
- 6) The operation of inter-valley trade (**IVT**) rules has created supply shortages to particular zones at certain times. For example, the 100GL IVT rule from the Murrumbidgee to the Murray is currently reducing supply to the Lower Murray zones which have the greatest demand from permanent plantings. It is noted that during the last drought the NSW Government suspended the Murrumbidgee Water Sharing Plan (which removed the 100GL limit) from 10 November 2006 to 16 September 2011, which increased supply to Sunraysia and the Riverland.
- 7) The increase in the number of permanent entitlements owned by investors since 2007 has added to the supply on the temporary allocation market. Investors include institutional funds, private high net worth individuals and retired farmers who have sold their property but maintained ownership of their entitlements. Most of the entitlements purchased by investors were previously owned by farmers who often used the annual allocations on their property and not for spot market sales. Investors are incentivised to sell their available allocations each year to generate an annual return.

Demand factors – permanent entitlements

- 8) The general increase in the temporary allocation price (from the demand / supply factors identified above) has resulted in stronger demand for permanent entitlements from investors. The higher annual income yields and potential for continued capital growth from entitlements has appeared favourable in comparison to many other asset classes and therefore attracted investment capital. In recent years there has been significant growth in the number of retired farmers owning permanent entitlements as an investment. Such investors understand the water markets and are comfortable with this asset class.
- 9) As identified above, in recent years permanent planting enterprises have been increasingly profitable. At the same time due to recent drought many such operators are seeking additional water security as cover for periods of low allocations. Accordingly, many almond and table grape growers have increased their demand and purchased additional permanent entitlements. Often such purchases have been various types of permanent entitlements (source, class etc) to give diversity and different allocation reliability to the enterprise.

Supply factors – permanent entitlements

- 10) In the past five or so years there has been a significant decrease in the supply (volume) of permanent entitlements coming onto the market for sale. A major factor contributing to this has been the increased profitability of many irrigated crops, which in turn has meant that there are fewer financially distressed sellers in comparison to the period between 2006 and 2014 when commodity prices were low.
- 11) Additionally, the significant capital deployed by the Commonwealth for buybacks associated with the Basin Plan in a relatively short period of time from 2008 to 2012 brought forward many farmers' decisions to sell entitlements and created fewer potential sellers post this period.

Market participant and activity changes

- 12) As identified above there has been an increase in the number of irrigators without sufficient permanent entitlement to cover their annual water requirements. Conversely over the same period there has also been an increase in the number of investors with permanent entitlements but not land. These two factors have combined to result in a general increase in the number of temporary allocation trades conducted annually.
- 13) The above trend has also contributed to development of innovative new water products to the market such as forward allocation agreements, entitlement leases and carryover capacity. Market acceptance and adoption of these products has grown exponentially over the past five or so years.

Issue 2 – Market transparency and information

- Your use of market information, including the types and sources of information you currently access, the information you would like to access and the methods and tools you use to access it (including whether you get information through public sources, such as state water registers, or private sources, such as through water brokers, and the reasons for using your preferred sources).
 - Whether and, if so, how the availability, accessibility, accuracy, consistency and timeliness of water market information affects your trading decisions or markets more generally.
 - Your views on the types of water market information that should and should not be publicly available.
 - How much you rely on the information and knowledge possessed by water market intermediaries, such as brokers, exchanges and advisors.
 - What avenues you are aware of to increase or improve your knowledge of water markets, and any suggestions on additional information and information delivery methods you would like to see made available.
- 14) Our views in respect of this issue have largely been captured in our submission to the recent Victorian Government Water Market Transparency Options Paper. A copy of this submission is attached for reference and review in response to this issue.

Issue 3 – Regulation and institutional settings

- Whether regulation and institutional settings for Murray-Darling Basin water markets are effective and appropriate.
- Whether and how regulatory and policy differences between states, Basin catchments and trading zones impact competition, efficiency and access to water markets.
- The extent to which market settings, such as trading rules and management of constraints, are positively or negatively impacting efficient and equitable water market activity.
- The extent to which regulatory functions, settings and actions are clear and understood.

15) Overall, we believe the regulation and institutional settings are appropriate and are resulting in efficient water markets which are equitably allocating a scarce natural resource to the highest and best use as intended. Importantly any changes to such settings can have significant and unintended market impacts and potential for perverse outcomes such as decreasing permanent entitlement values and affecting temporary allocation demand / supply to different zones.

16) However, there is always room for some improvement and areas we consider could be investigated include:

- a. Improving the SA temporary allocation trade processing time frames and reducing the processing fee for allocations from \$272;
- b. Improving the time frame for registration and completion of dealings at NSW Land and Property Information;
- c. Removing tagged usage accounts to provide all irrigators equitable access to temporary allocation pricing and removing unnecessary complications for IVT calculations;
- d. Improving the State Government water registers to provide a better source of reliable data to the market, by differentiating spot, forward and lease trades. Also including a date of agreement would assist with time lag issues associated with the registers.

17) An area which we consider may warrant additional regulation is in relation to the unchecked expansion of permanent plantings throughout the basin. We believe an investigation into possible measures to better align the total area of permanent plantings to the likely minimum water availability in dry years is worthy of consideration. This would reduce the hardship and associated industry unrest when water availability becomes less than the amount required for permanent plantings in a given water year.

Issue 4 – Market participant practices and behaviours

- How you use water markets, and your understanding and experience of how other market participants use water markets.
- How the practices and behaviours of different water market participants are positively or negatively impacting water market access, transparency, efficiency, and competition.
- Whether and, if so, how large market participants have influenced water markets (for example, by changing water availability or prices) through their trading strategies.
- How you use different water market products (including carryover, leases, options and forward contracts) and services provided by water market intermediaries.

18) Since the Millennium Drought, water markets have continued to develop and innovated to meet the needs of participants. Irrigators have become more sophisticated in their interaction with the market. Secondary water market products, which are predominantly offered to the market by investors, have provided non-capital intensive ways to manage risk over short, medium and longer term horizons. Since 2015 there has been an increase in the uptake of these products, especially:

- Carry-Over Parking
- Forward Allocation (single year and multi-year)
- Long Term Entitlement Lease

In addition to these products we have also noted increased sophistication in the methodologies employed by irrigators in managing their entitlement portfolios, such as diversification via ownership or entitlement lease. Many irrigators now hold interstate entitlement as a hedge against allocation announcements or to access more favourable carry-over characteristics. Much of this diversification of strategy and product has been developed by irrigators in close consultation with their broker.

19) There is an enormous amount of water market information disseminated by water brokers every week, providing weekly education opportunities for market participants. Indeed much of the improved water market literacy of water market participants is thanks to the work of water brokers educating their clients via websites, newsletters, webinars, seminars, meetings and phone calls.

20) Many large allocation buyers may inhibit transparency by insisting on receiving “off-market” offers which they can negotiate on, rather than interacting directly with live allocation markets. When deals are negotiated in this manner, they have often not been made available to other market participants.

21) We are aware of increased activity by parties buying / selling temporary allocation within a given water year with a view to making a profit. This strategy carries inherent risk proportionate to the quantum of the position taken. Whilst this activity brings some benefits to the market in terms of increased liquidity and a tightening of bid / offer spreads, clearly most irrigators (particularly temporary allocation buyers) are not supportive. This activity is of itself within the rules and consistent with the operation of a market functioning as expected. Should there be

impropriety involved in any particular transaction, we trust that market regulators will enforce existing laws.

- 22) We note that the environmental water holders are subject to the same market rules as all other market participants. In most cases their actions are clearly communicated to the market prior to interaction. The state based environmental water holders tend to engage with the market via Australian Water Brokers' Association (**AWBA**) member water brokers. We note that in the case of the CEWH, they choose to act via an open tender process. This process takes more time than direct market interaction and has a greater impact on the market.

- 23) We note the importance of carry over arrangements as an important tool for irrigators to manage their water from year to year, but equally important is the impact that carry over arrangements have on secondary market products such as forward allocation. In times of reduced allocations, forward allocation products between years offer irrigators the opportunity to secure water with the benefit of being able to manage cash flows more efficiently. These products are generally offered by investors who are able to secure the water in the year prior and offer the water in the following year at a fixed price. We have received direct feedback from many investors regarding some of the proposed changes to carry over arrangements, and as a result of the public discussion these clients no longer have the confidence to offer forward allocation into the 2020/21 season. This is going to have a significant impact on the ability for irrigators (particularly small to medium) to manage their water risk and cash flow through this incredibly tough period.

Issue 5 – Competition and market outcomes

- The extent to which the objectives of water markets have been achieved and any unintended consequences that may have resulted.
- Whether and how competition and efficiency in water markets have changed over time.
- The extent to which water markets are currently operating efficiently.
- How the outcomes of water markets vary between different industries, locations and individuals.

24) Water markets are achieving their stated objectives of creating more enterprise flexibility and ensuring water moves to the highest and best end use. They are also a successful method of allocating a scarce natural resource in dry times which would be very difficult for government to achieve without a market.

25) The markets are developing new innovative products and the water broking sector has become increasingly competitive which has resulted in lower costs to customers and increased service levels. Irrigators are becoming more educated in respect of the markets and their engagement.

26) As previously identified the only unintended consequence has been the unchecked expansion of new permanent plantings throughout the basin by operators without permanent entitlements. This is putting excessive pressure on the temporary allocation market in dry years for specific zones.

Waterexchange would like to remain engaged in this process and would welcome the opportunity to meet with the ACCC to discuss these issues in more detail.

Yours sincerely



Todd Oakley

General Manager

Enc: Waterexchange Submission to Victorian Government Water Market Transparency Options Paper

Buy, Sell, Trade.

T 03 5027 3588 F 03 5027 2155
E info@waterexchange.com.au
5 Short Street (PO Box 468)
Wentworth NSW 2648
ABN 66 615 100 206
waterexchange.com.au

6 November 2019

Dept of Environment, Land, Water and Planning
Water Market Transparency

Dear Sir / Madam

RESPONSE TO WATER MARKET TRANSPARENCY OPTIONS PAPER

We refer to the above matter and advise that this correspondence represents the response of Wex Water Pty Ltd (“**Waterexchange**”) to the water market transparency options paper.

By way of background the Waterexchange is a transparent online marketplace and clearing house for water products which was originally established in 1994. The business was previously owned by the National Stock Exchange Pty Ltd (and operated under its Australian Market Licence) and is now majority owned by Nutrien Ltd, the world’s largest provider of crop inputs, services and solutions for farmers.

Waterexchange operates a live market and clearing house for all water trading zones in the southern connected system. New geographical areas have also been established in recent years including Queensland. Currently there are more than 30,000 registered customers and 65 individual Water Brokers using the platform from a range of competing companies. Additionally, a number of Approval Authorities use the platform to approve trades online including SunWater, Murrumbidgee Irrigation, Colleambally Irrigation and others.

Waterexchange has strong governance, trade process, financial management and dispute resolution procedures to protect customers and ensure fair market operation.

In response to the water market transparency options paper we submit the following:

Option 1 – Full Market Transparency

Waterexchange does **NOT** support this option for the following reasons:

- 1) In our opinion, it will expose irrigators to receiving unsolicited marketing calls, emails, direct mail etc from a range of service providers who can identify that an irrigator has been actively purchasing allocation and / or entitlement. These service providers may include agchem / fertilizer resellers, water brokers, grain traders, livestock agents, irrigation companies, finance, insurance sales and so on.
- 2) We note a key objective of the water market is to “*ensure scarce resources are allocated to their most valuable and productive uses*”.

Even though this is a key objective, we note that when the market achieves this objective it can result in structural land use changes which often creates negative market commentary from industry groups, media and other fringe stakeholders who are perceived to be disadvantaged.

Potential examples include:

- A particular industry is buying / selling verses another (e.g. almonds is buying, dairy is selling);
- A particular company is buying / selling (e.g. foreign owned companies or other large agri corporates verses family owned farms);
- A particular geographical area is buying / selling verses another (e.g. net allocation trade going from a particular region into other zones etc).

Full market transparency as proposed will only amplify the negative commentary of these structural shifts which will further undermine confidence.

- 3) By only having this data available for Victorian trades and not in South Australia or New South Wales it will, in our opinion, only show part of the complete market picture. Having only part of the market represented it may lead to incorrect assumptions and conclusions as to what is really going on within the markets.

Option 2 – Publish Information on large water market participants

Waterexchange does **NOT** support this option for the following reasons:

- 4) We believe that implementing this option would not achieve any of the objectives of increased water market transparency. Publishing the large entitlement / allocation holders, whilst interesting, will not assist in establishing clarity of current prices or market depth at a given point in time.
- 5) We believe it will create many of the problems as identified above (per option 1).
- 6) As correctly identified, some large water market participants could create workarounds to prevent appearing on the list. This potentially would result in large participants remaining anonymous and circumstances where mid-tier participants would not be anonymous, which is not the intent of this option.

Option 3 – Improve real-time information on price and amount of water available

Improve existing systems

Waterexchange **supports** the suggestions for improvements to existing systems as presented in the options paper:

- *requiring a reason for trade. This would both capture useful data about different types of allocation trades like forwards and futures, and could well reduce the number of zero dollar trades recorded*
- *requiring brokers to report a conflict of interest when they (or a related-party) hold an account involved in the trade*
- *extending the Broker portal or My Water portal across the southern-connected Murray-Darling Basin to provide consistency across the southern Basin water markets*
- *expanding automated trade rules assessment across the southern-connected Basin water markets to speed up processing times and make transaction and price data more up-to-date*
- *expansion of requirements on brokers who use these automated systems would help achieve an additional degree of broker regulation.*

Other suggestions which may be worth of consideration includes:

- A requirement for brokers to provide the “date of matching” for each trade so as to show a clear picture of prices on a given day and remove anomalies resulting from delays of particular trades being recorded on the Vic Water Register.
- A requirement for brokers using the broker portal to publish the details of their trades (date, volume, price, zone) on their company website which is audited against those submitted. This will eliminate broker misrepresentations to customers in respect of prices achieved and market share / activity.

Central trading platform or exchange

Waterexchange does **NOT** support this option. We believe it is not the role of Government to facilitate or operate a central exchange for the following reasons:

- 7) If there is a genuine market need for a central exchange, the private sector should be allowed to create the solution. In this regard we note that Waterexchange already operates an independent central exchange and in recent years has grown market share across the whole basin and QLD.
- 8) Conversely, a Government exchange which is mandated for use by all brokers for all trades would create a monopoly position which we believe is anti-competitive.

- 9) In our experience as the operator of a central exchange there are many circumstances which require the need for resolution of a commercial nature which would not be possible for Government. For example:
- a. A buyer agrees to purchase allocation but subsequently changes their mind and does not remit the funds;
 - b. A seller enters a trade to sell allocation but subsequently does not have the volume of allocation available;
 - c. Misunderstandings and disputes in respect of terms within forward, leases and carryover agreements.

We acknowledge that some solutions for the above may be possible with IT settings for Vic only trades only but not when interstate buyers and sellers are involved.

- 10) We are not aware of any other market where Government has introduced and / or operated a central exchange successfully and would question how Government would decide which markets to intervene in to such an extent. We note for many irrigators water is only one of many markets in which they operate. Other markets such as fertilizer, electricity, fuel, grain, livestock and milk to a large extent have less transparency than water and are nonetheless able to operate effectively.

- 11) We note the paper states *"Creating a central trading platform or exchange would give a single market price and accurately show how much water is available for sale all in the one spot."*

We dispute this statement as in our experience many sellers do not want to make their water visible on an exchange. They prefer to receive buy offers presented to them which they then decide to transact upon or not. In addition, the price of allocation is often variable on a given day based on other factors such as parcel size, zone and the parties involved.

Furthermore, we note that even the ASX does not achieve this outcome as many equity transactions are negotiated off market and only subsequently recorded through the ASX. The price and availability of the same stock can vary from Broker to Broker.

- 12) We note the paper states *"When people list their water on multiple platforms it can be really hard for this crop irrigator to tell how much water is actually for sale."*

We dispute this statement as the Waterexchange platform is a live matching market and sellers are contractually bound to honour the trade should it be matched at any time by a buyer. As such sellers / brokers using Waterexchange do not list the same parcel on multiple platforms.

General Comments

The current drought is causing angst for many irrigators, particularly those who have previously sold entitlement and/or expanded permanent plantings and are heavily exposed to the allocation market. However, these difficulties in our opinion are the result of their own internal business decisions and should not be regarded as evidence of water market (or information) failure.

Overall, there is an extraordinary amount of water market information and data available to irrigators at present, and there is no clear evidence that additional data is required. We believe most irrigators do not have the time available to research / analyse / interpret all the information currently available for just one particular input. This is the role of brokers to interpret and advise accordingly. We also note that even with additional water market data and transparency, unfortunately it will not assist in forecasting forward looking water price movements which is ultimately determined by the weather.

We believe the silent majority of irrigators across the basin are happy with the operation and evolution of the water markets and the existing transparency (which will continue to improve). We recommend Government consults a wider audience as is our experience water market focus groups and issues papers tend to attract the noisy minority whose views are not necessarily shared by the majority.

In summary, our position in respect of the options paper is that aspects of the existing Broker Portal should be improved which will enhance transparency significantly. However, the proposed creation of a new centralised exchange has huge commercial complexities which are outside of the role of Government. We believe the private sector should provide the required solution without the need for taxpayer expense.

Waterexchange would like to remain engaged in this process and would welcome the opportunity to meet with key decision makers to discuss the issues in more detail.

Yours sincerely

Todd Oakley
General Manager