

GMID Water Leadership

GMID Water Leadership
E: info@gmid-waterleadership.org

The Australian Competition and Consumer Commission
Murray-Darling Basin Water Markets Inquiry
E: waterinquiry@acc.gov.au

29 November 2019

Dear Sir/Madam,

Re: Murray-Darling Basin water markets inquiry – Issues Paper

GMID Water Leadership welcomes the opportunity to provide further feedback on the ACCC's Issues Paper on the Murray-Darling Basin water market.

One of our members, the Committee for Greater Shepparton CEO Sam Birrell, attended the ACCC public hearing in Shepparton on 13 November. He raised our concerns about the lack of transparency in the southern Basin water market, which we have detailed in our submission to the Victorian water market transparency review. Mr Birrell provided a copy of our submission to your staff. We include a copy here as an addendum, and will focus in this letter on additional issues where we believe action is warranted.

GMID Water Leadership

GMID Water Leadership was established in late 2015 to provide a strong voice on water security for the Goulburn Murray Irrigation District (GMID) in northern Victoria. Its members include leaders in the dairy, horticulture and cropping industries; local government; food processors; natural resource managers; community and business groups.

It is co-chaired by Suzanna Sheed, Independent Member for Shepparton District, and David McKenzie, local agri-valuer and chair of the Goulburn Regional Partnership and the Regional Development Advisory Committee to the Victorian Government.

Carryover

GMID Water Leadership has called on the Victorian Government to review Victoria's carryover rules. While our members strongly support carryover, a great deal has changed since it was first introduced. A review is timely to ensure the settings are working in the best interests of all irrigators.

Carryover of unused allocation was introduced into the Murray, Goulburn and Campaspe systems in 2007. It was initially limited to 30% of entitlement volume, with a 100% cap on accounts combining carryover and new season allocation. The remainder was returned to the collective pool for reallocation. Trade out of the GMID was limited at that time. The policy objective was to give irrigators the capacity to better manage business risks around this essential input from one season to another.

Carryover was later increased to 100% of entitlement volume, with water holders able to accrue their full allocation in the new season as well. This means water holders can now potentially hold up to 200% in their high reliability entitlement account. They can also carryover 100% of low reliability entitlement volume; these accounts are the last to spill, paradoxically making carryover held in low security accounts the most secure water product of all.

The Murray-Darling Basin Plan and water market reforms have changed the way carryover is used. The community has major concerns about the lack of transparency. Many believe speculators are manipulating carryover to limit water for sale and drive up prices, to the detriment of farmers who use water to grow food.

While views are mixed as to what should happen, the impetus for a review is very strong given the very significant changes in water holders' behaviour since carryover was introduced and since the last State review several years ago. The importance of getting carryover right cannot be understated.

Carryover's effect on the likelihood and volume of low reliability allocations appears to have been significant; this must certainly be looked at in the carryover review. Carryover is a tool that must operate efficiently and as was originally intended. Many of the unforeseen consequences do need to be examined and where necessary, the carryover rules and settings changed.

Brokers

While the Australian Water Brokers' Association (AWBA) has a voluntary code of ethics and standards, it carries little weight when most brokers are not AWBA members. The fact that brokers are unlicensed and unregulated is unacceptable when they play a such a significant role in the market for such an essential and limited agricultural input as water.

At it stands, irrigators have little practical recourse if they suspect unconscionable conduct; indeed, there are no rules against insider trading and other water broker behaviours that can potentially influence supply and price on the temporary water market. Brokers are not even required to hold clients' funds in trust accounts.

In this context, it is essential that brokers and associated parties are licensed and registered, to discourage insider trading and provide recourse to their clients – no different to the way that real estate agents and stockbrokers are licensed, registered and bound by regulations.

This includes prohibitions on holding allocation accounts and trading water in their own or associates' right; and, a requirement that they hold clients' water and funds in trust accounts, hold professional indemnity insurance, and disclose conflicts of interest.

River operations

The 2004 National Water Initiative kickstarted the creation of a connected southern Basin water market, but with an important caveat: that entitlement and allocation trading would have no third-party impacts on other entitlement holders. The Basin Plan accelerated market reforms along with environmental water recovery, but with further assurances that neither would change the characteristics or reliability of existing entitlements.

Since then, the water market in practice has facilitated a rapid expansion in permanent plantings taking advantage of cheap 'greenfield' land below the Barmah Choke on the Murray River. These enterprises source their water in large part from irrigation districts upstream such as the GMID and Murray Irrigation in the southern NSW Riverina.

The shift in the location and volume of water demand has led to prolonged high flows through the Barmah Choke and lower Goulburn River. The Murray-Darling Basin Plan has further compounded the problem by creating a large environmental reserve that must also be delivered from the top of the system to improve environmental health in rivers, wetlands, riparian zones and floodplains downstream.

These market- and policy-driven changes are reducing the rivers' carrying capacity by causing banks erosion and slumping, and increased sand and silt deposits. This increases the conveyance losses to meet the new location and volume of consumptive and environmental demand. Those losses must be covered before allocations to NSW Murray general security entitlements and Victorian low reliability entitlements. This is reducing the reliability of these allocations, which in turn reduces the total volume of water available for growing food and fibre.

In any other market, freight costs are factored into the cost of the product. Water should be no different. Conveyance losses must be factored into all allocation trades downstream from their entitlement source zone in the Murray and its tributaries such as the Goulburn River. The conveyance losses for commercial trades should be based on a rigorous analysis of losses through the system.

Inter-Valley Trade (IVT) is another key market-related river operations issue. IVT enables irrigators to better manage their business risks, but limits on this trade are in place for good reasons. It is essential that IVT is driven by transparent river hydrology, and that loopholes to bypass IVT limits, such as tagged accounts, are closed.

Conclusion

It is essential that irrigators and their communities have confidence that the water market is working to support a diverse and prosperous irrigated agriculture sector across the whole southern Basin. The water market was a bold and far-reaching reform, and like all reforms requires constant review to address any unintended and perverse outcomes. We look forward to working with the ACCC over the coming months to address the issues raised.

Yours sincerely,



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Suzanna Sheed, MP
Co-chair, GMID Water Leadership
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ADDENDUM

Goulburn Murray Irrigation District (GMID) Water Leadership

Submission to Victorian Water Market Transparency Options Paper

8 November 2019

GMID Water Leadership was established in late 2015 to provide a strong voice on water security for the Goulburn Murray Irrigation District in northern Victoria. Its members include leaders in the dairy, horticulture and cropping industries; local government; food processors; natural resource managers; community and business groups.

It is co-chaired by Suzanna Sheed, Independent Member for Shepparton District, and David McKenzie, local agri-valuer and chair of the Goulburn Regional Partnership and the Regional Development Advisory Committee to the Victorian Government.

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Recommendations

Recommendation 1: Total transparency on entitlement ownership, with all owners identified by name, entitlement type, volume, trading zone and entitlement trading activity.

Recommendation 2: In principle, total transparency on all allocation accounts, with all owners identified by name, running allocation account balances, and allocation trading activity including names and trading zones of buyers and sellers.

Recommendation 3: Notwithstanding our in-principle support for total transparency on allocation accounts, the Government to provide more information to enable informed stakeholder understanding of implications.

For example, what total allocation account transparency looks like using real data from the water register, but individual accounts de-identified for this exercise.

This information could include how disclosure thresholds might work. For example, what does the list look like if it includes only individual accounts with balances that are one, five or 10 percent of the depth of the water market.

Recommendation 4: Victoria establish a central water trading platform, as the first step to a central trading platform covering the whole southern Murray-Darling Basin. Model platforms include the Murray Irrigation Ltd water exchange and the now defunct GMW Water Move exchange.

Recommendation 5: The Commonwealth fund Victoria to create a central water trade platform from the \$13 billion National Plan for Water Security, and its subsequent expansion across the southern Basin. Project to include modelling of operational cost implications for market participants.

Recommendation 6: Total transparency on carryover ownership and account volumes.

Introduction

GMID Water Leadership welcomes the opportunity to provide feedback on the Victorian Water Market Transparency – Options Paper. We look forward to informing material changes that will instil greater confidence that the market is working first and foremost in the best interests of irrigated agriculture and the communities that depend on this sector.

We have consistently called for an adaptive management approach to water reform, including the 2012 Murray-Darling Basin Plan. Such an approach recognises that much has changed over the last 15 years since the 2004 National Water Initiative. Many assumptions informing the NWI and the Basin Plan, including water market design, operation and trading rules, are no longer relevant, and must be reviewed to avoid emerging perverse and unintended impacts.

The Goulburn Murray Irrigation District (GMID)

The GMID in northern Victoria covers 27,000 km², stretching from Cobram in the east to Cohuna in the west. It is Victoria's food bowl, generating \$5.9 billion¹ worth of dairy, fruit, vegetables, meat and cereals. One in three jobs are on farms, farm services and food processing.² Almost all GMID irrigators are family farmers.

Before the 2004 National Water Initiative ushered in major water reforms, about 1600 GL in high reliability entitlements were held in the GMID; this had almost halved to 886 GL by 2018.³ About half of the reduction is attributable to Commonwealth buybacks and on-farm water efficiency programs. The rest was sold out of the GMID, mostly to irrigators downstream and investors capitalising on the market reforms that unbundled water entitlements from land titles.

At the turn of the century, GMID irrigators owned almost all the entitlements they needed to meet their needs from allocations. In 2016, following the changes described above, 64 per cent of GMID respondents said that they did not own enough water entitlements to meet their irrigation needs. Nearly 37 per cent of respondents said they relied heavily on allocation trade to meet their water needs; 21 per cent said they have some reliance. The trend was highest for dairy farmers.⁴

More than 50 per cent of irrigators said it was part of their long-term plan business plan to use allocation trade to manage through the irrigation season. At that time, a dry season similar to 2018-19, 47 per cent of irrigators said allocation trade was affecting their ability to make a profit (dairy 67 per cent versus 15.1 per cent in 2004/05), and 46.6 per cent said allocation trade was affecting their ability to plan and implement a water budget (dairy 65.1 per cent versus 14.4 per cent in 2004/05).⁵

¹ GMW at a glance. https://www.g-mwater.com.au/downloads/gmw/aboutUs/GMW_at_a_glance_Web.pdf
Accessed 10 April 2018.

² MDBA 2018. Community profiles in the southern Basin. <https://www.mdba.gov.au/publications/mdba-reports/southern-basin-community-profiles>.

³ 'Water Market Trends – Updated Trends in northern Victorian Water Trade 2001-2018'. Department of Environment, Water Land and Planning, March 2019.

⁴ 2015-16 Regional irrigated land and water use mapping in the Goulburn Murray Irrigation District – executive summary. Goulburn Broken Catchment Management Authority.

⁵ *Ibid.*

The information above illustrates the importance of a water market that enables informed decisions. As the market stands, it is near-impossible for water users to get a clear line of sight on how much entitlement and water allocation is available for trade and accurate pricing, and be confident the system is not being gamed through trading behaviour and carryover exploitation. Greater transparency is the first vital step to ensuring the market meets its policy objectives.

Water market objectives

The Water Market Transparency Options Paper describes the water market objectives as follows:

Victoria's water markets were established to allow users to move water in connected systems to where it is most needed. Markets allow farmers, environmental water holders and water corporations to buy and sell water entitlements and allocation so they can manage their own risk.

Water markets that work effectively mean water users and their communities can share the benefits of water security and respond to changes in climate, reduced water availability, increased demands and fluctuating commodity prices.

The Issues Paper for the ACCC inquiry into water markets in the Murray Darling Basin, released on 17 October 2019, describes the water market's objectives as follows:

Water markets in the Murray-Darling Basin are intended to drive an adaptive and productive irrigated agriculture sector, while supporting a sustainable level of water diversion.

By allowing water to move to its most productive or "highest value" use, markets are intended to facilitate the efficient allocation of water over time and across hydrologically connected regions.

Both sets of objectives clearly intend the water market to support irrigated agriculture and the communities that depend on them. Neither set identifies water reaching its highest value as an objective in its own right, i.e., entitlements and allocations trading at the highest prices possible to maximise returns to non-water users.

Rather, market objectives are clearly linked to the use of water, specifically in the ACCC's case, allowing water to be used for its highest value **use** – i.e., the food and fibre that will return the greatest value per megalitre used to grow them.

It is important to keep this distinction in mind when considering water market reforms and greater transparency. The priority is to ensure the water market is working in the best interests of irrigated agriculture, to maximise returns on the water used to grow food and fibre, and to promote water efficiency. The priority should not be the best interests of non-water users or brokers seeking to maximise returns on water trade.

GMID Water Leadership acknowledges that water prices are a function of supply and demand, especially in dry years with extreme scarcity and warm temperatures such as 2015/16, 2018/19 and 2019/20. However, when the allocation water market is shallow, a few large traders are potentially able to

influence allocation supply and therefore allocation prices through their trading behaviour and exploitation of carryover. Greater transparency, particularly in the allocation market and carryover, is required to give all participants confidence that the market is not being gamed.

Options

GMID Water Leadership supports the work already underway to increase transparency in the Victorian water market; in particular, information on who owns water entitlements by type of owner, and the size of allocation holding by type of owner.

Real time reporting

It is unclear from the options paper if information described above will be provided in real time or in reports aggregating the data at the end of each season. It is important that allocation holdings by ownership type are provided in real time, to test if any ownership group can potentially influence the market at key points in time, particularly when market depth is shallow.

Transparency

GMID Water Leadership supports total transparency on the ownership of all entitlements, the volumes held and trading activity. Water entitlements are a property right, no different to land ownership. The same principles should apply whereby it is easy to find out who owns what, where and how much, and the trading history of the entitlement.

Recommendation 1: Total transparency on entitlement ownership, with all owners identified by name, entitlement type, volume, trading zone and entitlement trading activity.

GMID Water Leadership in principle supports total transparency on allocation accounts, including ownership, running account balances, and trading activity. We acknowledge the concerns raised by some stakeholders about the privacy of small players such as retired farmers, the risk of brokers targeting irrigators with low allocation balances, and small farmers being put at a commercial disadvantage compared with larger entities with the time and resources to mine the data.

However, on balance, GMID Water Leadership believes total transparency is the only way to avoid suspicions of gaming the market, or workarounds whereby large entities and brokers may open multiple allocation accounts to remain below disclosure thresholds.

Recommendation 2: In principle, total transparency on all allocation accounts, with all owners identified by name, running allocation account balances, and allocation trading activity including names and trading zones of buyers and sellers.

Thresholds

Allocation

GMID Water Leadership supports total transparency on allocation accounts and trade. The temporary water price in large part determines the return on growing food and fibre, and allocation trade in the market as currently structured is the most vulnerable to anticompetitive behaviour.

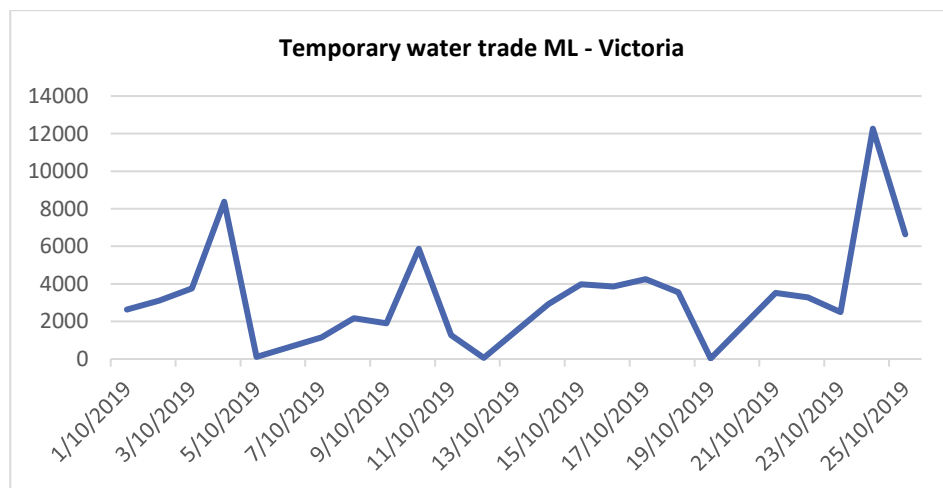
Dairy and grain farmers are being forced out of production under the current extreme dry conditions because they simply cannot afford to buy the water they need, while many horticultural sectors are reaching the limits where water costs more than the anticipated return from their high-value crops.

The allocation market is the most vulnerable to potential supply and price manipulation because allocation can be bought and sold independently of entitlement ownership. How much entitlement one owns is not an indicator of capacity to influence supply and price in the allocation market. What matters is how much allocation is in your account, and your trading behaviour measured against market depth on a given day and on a given exchange.

Using Duxton Water Ltd as an example, as at 31 December 2018, Duxton owned \$20.466 million worth of allocation⁶, equating to an estimated 61-85 GL acquired during 2018⁷. This allocation water was identified as an asset acquired over and above the estimated 26.8 GL volume allocated to the 52 GL of southern Basin entitlements Duxton owned at the time.

The challenge is identifying a meaningful threshold and time boundaries in the allocation market above which traders must disclose their identity, their allocation account volume, and trading details. At a high level, a total of 77,199 ML was traded within, into and out of the Victorian temporary market between 1-25 October 2019. The daily average was 3087 ML, but volumes fluctuated from 0 ML on three days, up to 12,265 ML on 24 October.

At a higher level again, a total of 188,037 ML was traded in the southern Basin from 1-26 October 2019, a daily average of 7232 ML. For context, Duxton Water Ltd held 16,000 ML in its allocation accounts on 14 October 2019,⁸ equating to 8.5 per cent of the total volume traded 1-26 October.



⁶ Duxton Water Ltd, 2018 December Annual Report.

⁷ Volume based on weighted annual average 2018 prices (\$240/ML), and weighted average price in second half of 2018 (\$336/ML),

⁸ Duxton Water Ltd, ASX announcement, 15 October 2019. It is unknown how much of the 16,000 ML may be committed to meet obligations under leased entitlement and other water products offered by Duxton, unrelated to trading on the temporary market.

However, a volume held in an allocation account at a single point in time means little – what matters is how much the allocation account holder trades each day compared with market depth, and their behaviour in undertaking such trades. Brokers, for example, can profiteer using their inside information to purchase allocation in one zone, hold it in their allocation account, then sell it on at a higher price in another zone and pocket the price difference – a practice that is illegal in real estate.

Trader and broker behaviour can potentially influence supply on the allocation market and therefore price. Alleged strategies include large investors purchasing a large proportion of the available water early in the season, when allocation levels and trade volumes are low, effectively clearing lower priced water from targeted exchanges and forcing up the average market price.

During this period, water investors allegedly do not release their own allocation to the market. The combined buying of significant volume and withholding of supply forces the market upwards. Large irrigators have reported being approached by water brokers in person, offering large volumes of water at the recently increased market price. These large volume parcels do not appear on that broker's trading platform. This and other alleged strategies by investors and complicit brokers creates a false impression of market depth and limits the available supply.

As mentioned, the challenge is setting a meaningful threshold above which all details, including the trader's identity, allocation account balance and volumes traded, are made public. An appropriate threshold is hard to judge without an indicative list from the State Government showing, for example, how many and what volumes would be revealed with, say, two per cent versus five or 10 per cent allocation ownership of a system. Similarly, what would be revealed in a list of the top 20, or 50, or 100 allocation owners?

Recommendation 3: Notwithstanding our in-principle support for total transparency on allocation accounts, the Government to provide more information to enable informed stakeholder understanding of implications.

For example, what total allocation account transparency looks like using real data from the water register, but individual accounts de-identified for this exercise. This information could include how disclosure thresholds might work. For example, what does the list look like if it includes only individual accounts with balances that are one, five or 10 percent of the depth of the water market.

Market depth: A central water trade platform

Recommendation 4: Victoria establish a central water trading platform, as the first step to a central trading platform covering the whole southern Murray-Darling Basin. Model platforms include the Murray Irrigation Ltd water exchange and the now defunct GMW Water Move exchange.

It is unacceptable that Basin trade data still has no single point of truth. Errors are compounded in inconsistent systems across 47 different public registers, leaving market participants overly reliant on brokers with a better understanding of true market value, which in turn may be inconsistent with the

public registers.⁹ Market depth is impossible to gauge when allocation parcels can be listed on multiple broker exchanges, creating a false sense of the true volume of water available to users.

We acknowledge that real time price information is provided from the brokers who have registered with Waterflow – but not all brokers are registered so the information on market depth and price remains incomplete.

GMID Water Leadership supports a central trading platform showing all available allocation and entitlement for all trading zones and water systems in real time. All commercial trades would be required to go through the central platform, and all buy and sell offers would be listed to show market depth. People offering their water for sale would be sure they are getting a fair price compared with others, and buyers could be confident the water they buy is priced competitively.

A central trade platform also means a parcel can only be listed once, providing a truer picture of water market depth. It would also be obvious if, for example, any one trader swamps the exchange to buy up all low-priced water; this alleged practice described above can go undetected when conducted across multiple private exchanges and public registers.

GMID Water Leadership supports the following proposals in the Options paper:

- All applications be submitted online to improve timeliness of processing and price reporting.
- All applications include a reason for trade, to capture useful data about different allocation trades such as forwards and futures, and reduce the number of zero-dollar trades recorded.
- Brokers required 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.

The Options paper asks how important is real-time information on price and volume. GMID Water Leadership ranks the suggested options below, but notes the top four are of equal priority:

1. How much water is available to buy.
2. Real time market price.
3. Who is buying and selling.
4. How much water is being traded.
5. Where can I buy from and sell to.
6. How much water is being carried over

While we agree a central platform may change the business models of existing water brokers, this is more than outweighed by the benefits of providing more transparent market price and depth information to water users. We emphasise that the water market's objectives amount to supporting

⁹ MDBA Water Market Audit, May 2019

irrigated agriculture and the communities that depend on the sector as the priority – not supporting the business models of non-water users seeking to maximise their returns.

A central trade platform covering the whole southern Basin is essential, but we realise this agreement among the three southern Basin States. We urge the State Government to expedite the required negotiations. In the meantime, the State Government should begin the work to create a central water trade platform for all entitlement and allocation trade within, into and out of Victoria.

GMID Water Leadership notes that a central trading platform with real time price and availability may increase processing fees. We believe, however, it is premature to ask how much more market participants would be willing to pay. Participants are being asked in a vacuum of information about what realistically the establishment and operation of such a platform would cost.

We also note the \$13 billion 2007 National Plan for Water Security was also intended to accelerate the implementation of the 2004 National Water Initiative, under which the creation of water markets was a priority implemented under the Murray-Darling Basin Plan.

It is not unreasonable to expect the Commonwealth to fund the creation of Victoria's central trade platform, and expand it across the southern Basin from roughly \$4 billion remaining for water reforms, leaving market participants to cover only the operational costs through processing fees.

Recommendation 5: The Commonwealth fund Victoria to create a central water trade platform from the \$13 billion National Plan for Water Security, and its subsequent expansion across the southern Basin. Project to include modelling of operational cost implications for market participants.

Carryover

Carryover is an important risk management tool for irrigators to smooth out peaks and troughs in water supply between wet and dry seasons. However, Victoria's generous carryover provisions on low and high security entitlements are now being exploited by investors and brokers across the southern Basin to manage allocations to maximum commercial advantage. This is an unintended and perverse outcome from the current rules set almost a decade ago.

Carryover is now an important element influencing traders' behaviour on the water market. Transparency on ownership, volumes and purpose of carryover is essential – in the first instance to shine a light on potentially unconscionable conduct to hoard water at the expense of water users, and secondly to provide insights that may inform a comprehensive review of carryover rules. Such a review could consider the implications of options being aired in various community forums, such as:

- Non-water users being banned or limited in carrying over allocation.
- Only those with water use licences being allowed to carry over, and the volume being limited to their WUL licence.
- Changing the spill rules on carryover in low reliability accounts.
- Changing the permitted proportion of entitlement volume that can be carried over.

Recommendation 6: Total transparency on carryover ownership and account volumes.

Conclusion

The southern Basin water market is surprisingly lightly regulated and disturbingly opaque for a mechanism ostensibly intended to ensure fair and efficient distribution of such a scarce and essential resource as water. The risk of market failure is acute, given Australia's highly variable climate, and this risk is exacerbated by the lack of transparency on ownership and transactions.

At stake in market failure is the viability of entire irrigated agricultural sectors, and the communities and service industries that depend on them. GMID Water Leadership sees greater transparency as the first step down a water market review and reform process to ensure the market is genuinely working in the best interests of water users and their communities.