

Submission to the
Australian Competition & Consumer Commission
Water market rules issues paper

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Introduction

NSW Irrigators' Council (NSWIC) represents more than 12,000 irrigation farmers across NSW. These irrigators are on regulated, unregulated and groundwater systems. Our members include valley water user associations, food and fibre groups, irrigation corporations and commodity groups from the rice, cotton, dairy and horticultural industries.

In responding to Australian Competition & Consumer Commission's (ACCC) *Water market rules issues paper*, NSWIC is responding with the views of its members. However, each member reserves the right to make independent submissions on issues that directly relate to their areas of operation, or expertise, or any other issues that they may deem relevant. Having said this NSWIC refers the ACCC to comment below regarding timeframes for consultation.

Comments on consultation

NSWIC notes that the timeframes for the consultation currently being undertaken by the ACCC are inconsistent with those being proposed in the draft Water Amendment Regulations 2008.

The *Water market rules issues paper* was publicly released on 4 April 2008 with submissions closing on 9 May 2008, a period of five weeks. This is a significant and important issue with far-reaching implications for the irrigation industry particularly as these new rules will be legislative instruments. NSWIC believes that the current timeframe for consultation is totally inadequate given the complexity and the significance of the subject matter involved. Many NSWIC members are simply not in a position to provide detailed responses in the timeframe they have been given.

It is our very strong view that this and any future consultative processes undertaken by the ACCC (e.g. on water charging and other related matters) must be at least consistent with the eight week timeframe proposed in the current draft regulations.

Statement of key principles and recommendations

- 1) NSWIC supports the introduction of water trade for all systems where it is physically and hydrologically possible to complete the trade.
- 2) NSWIC believes that any new rules must be flexible enough to take into account the probable development of new water products and derivatives.
- 3) NSWIC agrees that it is imperative that any new water charge rules and water market rules are as effective as possible and take into consideration the impacts (both intended and unintended) on irrigators, irrigation corporations and private irrigation districts.

- 4) NSWIC believes that the water trading rules should provide the legislative framework for permanent water trade to occur but should not be designed to deliver specific outcomes in relation to the direction and volume of trade.
- 5) NSWIC supports the concept that the water market rules should apply equally to all participants but the development of these rules must include formal consultation and consideration of the issue of compliance costs.
- 6) NSWIC is of the view that the new water market rules should build on and compliment existing trading agreements and arrangements provided that they are consistent with the *Basin water market trading objectives and principles* as set out in Schedule 3 of the Water Act 2007.
- 7) NSWIC believes that any new water market regime and its monitoring must include an ongoing assessment of the social and economic circumstances that may arise if trade is concentrated out of a specific region.
- 8) NSWIC is of the view that any new standards and operating procedures that are imposed on infrastructure operators should also equally apply to government water utilities (as indicated by the ACCC) and those government utilities be exposed to the discipline of competitive forces in their service delivery.
- 9) NSWIC acknowledges the significant steps taken by infrastructure operators in NSW in response to the ACCC's November 2006 paper (on an inter-jurisdictional regime for the use of exit and access fees) and subsequent amendments to Schedule E of the Murray-Darling Basin Agreement.

Response to specific issues in the paper

Chapter 3 – water market and trading objectives

Are there any other factors that the ACCC should consider when interpreting the water market and trading objectives?

Property Rights

NSWIC believes that the establishment of well defined property rights should be the primary operating condition for efficient markets and should be given the highest priority.

NSWIC supports the real-time metering and accounting of all water extractions including interceptions by plantations. This must be the minimum level of accountability required to ensure accurate compliance with the terms of access associated with water entitlement property rights and the best practice to ensure an integrated system wide approach to water resource management.

Third Party Impacts

It is not sufficient to label the management of third party impacts as a “matter for structural adjustment”. Serious consideration must be given to these issues in the formulation of the water market rules and third party impacts must not be considered a necessary by-product of an efficient permanent water trading market. It is also important to recognise that the benefit of irrigated agriculture to NSW is far wider than that seen on individual farm enterprises.

In many areas, rural and regional communities rely heavily on irrigated agriculture to underpin economic activity and growth. This reliance has been highlighted during the recent drought conditions where whole communities have been impacted because of decreased (or in some cases non-existent) production. If, as a consequence of these new rules, there are unwanted or unintended third party impact on irrigators that result in decreased production then they will have far reaching implications for rural and regional Australia.

NSWIC believes that the definition of ‘third parties’ could be extended to include the wealth impacts on irrigation dependent communities. An extended definition would allow the ACCC to adequately address the adjustment costs for both individuals and communities.

Environmental Water

NSWIC has always supported the provision of water for the environment by way of water efficiency projects first and the purchase of water from willing sellers second. Environmental water entitlements must also be subject to the same standards of public reporting requirements as apply to all other licensed entitlements.

NSWIC supports the provision of environmental water that is predicated on open and transparent management and accountability of all water environmental resources. There is growing concern at the lack of consultation with regards to environmental assets, particularly management and monitoring.

In line with the water market rules being investigated and with an open and transparent market place in mind, NSWIC believes that there must be a recommendation regarding key accountability protocols established for environmental water assets including:

- Recording and disclosure of all purchases;
- Recording and disclosure of all trade transactions;
- Recording and disclosure of all allocations;
- Publication of purchase details;
- Recording of all expenses associated with the purchase, trade and ongoing management of the water balances;
- Details of inter-agency water environmental programs;
- Details of stakeholder consultations and engagement processes;
- Benchmarking of environmental assets and the seasonal or annual measurement of asset conditions; and
- A system-wide environmental water management plan that details:
 - water management plan
 - water balances
 - co-operation plan with other available environmental water resources (both public and privately owned)
 - key environmental objectives

Environmental Externalities

NSWIC believes that it is worth noting that in some instances, irrigation provides positive environmental 'externalities'. For example, the delivery of water to wetlands can be 'piggybacked' with irrigation water during drought to minimise system losses.

NSWIC supports the introduction of water sharing plans as an accountable and transparent process to address environmental externalities on a system-by-system basis.

In addition to the environmental obligations contained in each plan, other land and water management programs have also been introduced by many NSW infrastructure operators to address specific environmental issues within their region. These include activities such as their role in implementing community and government developed and agreed Land and Water Management Plans (LWMPS) that promote the achievement of long term sustainability, water use efficiency, net recharge management and biodiversity enhancement.

NSWIC notes that with recent changes to government programs these LWMPS are no longer guaranteed funding support which is of concern.

Barren Box Storage and Wetland Project

Located 30km north-west of Griffith, NSW, and spanning 3,200 hectares, Barren Box Storage and Wetland (BBSW) project is one of the largest water infrastructure projects in regional Australia specifically instigated to return water to the environment. The major outcomes for this project are:

- reduced water evaporation and forced releases to the lower Mirrool Creek floodway, saving an average annual 20,000 megalitres which will be returned to the Snowy River without impacting on any irrigator's entitlements
- significant benefits for the environment through the restoration of more natural flow regimes to the site and return of flows to the upper reaches of the Snowy River, as well as reducing drainage to the lower Mirrool Creek environment
- improved management and efficiency of the water storage and reduction in downstream flooding
- improved water quality for downstream users (Wah Wah Irrigators)
- preservation and enhancement of local sites of indigenous cultural significance
- the generation of considerable social and economic benefits for the local community by ensuring the continuation of sustainable irrigation in the Murrumbidgee Irrigation Area (MIA)

Murrumbidgee Irrigation funded construction activities for the \$29 million works program. This is a significant investment by the company and clearly demonstrates their commitment to improved environmental management at local, regional and national levels and to improve their level of service to customers and shareholders.

Water for Rivers has purchased the water savings generated and will use it as environmental flows in the Snowy River. *Water for Rivers* is a joint initiative of the Commonwealth, NSW and Victorian Governments established in 2003 to achieve significant improvements in environmental flows, into the Snowy River and the River Murray.

Source: www.mirrigation.com.au

Individuals and commodity groups (such as cotton and rice) have also established their own environmental programs to further develop industry and system wide programs to improve land and water use practices.

In addressing the issue of environmental externalities, NSWIC encourages the consideration of industry, regional and individual efforts to improve environmental outcomes.

If externalities are to be included in pricing, NSWIC believes that both positive and negative externalities must be included. That is, discounts for positive effects as well as costs for negative effects must be addressed. There needs to be further discussion on this issue.

Chapter 4 – restrictions that should be permitted

4.1 – constraints on the parties to whom water can be sold

To what extent, and in what circumstances, is it appropriate for an operator to be able to impose restrictions on the parties to whom water can be sold

In NSW jurisdictions, external water trades (i.e. those that involve a party that is external to the infrastructure operator's license) require State Water (SW) and the Department of Water & Energy (DWE) to manage the delivery, use and environmental impacts of that water. The risk and cost of meeting SW and DWE requirements is met by those parties involved in the trade.

As a direct result of recommendations resulting from the ACCC's 2006 inquiry into the way irrigation companies charge for their fixed costs and other pricing issues (*A regime for the calculation and implementation of exit, access and termination fees*), amendments were made to Schedule E of the Murray Darling Basin Agreement. In order to comply with these requirements, a number of infrastructure operators in NSW have implemented changes which have impacted at an administrative and operational level.

Broadly these changes included:

- The unbundling of water rights and delivery rights and the issuing of tradeable water delivery entitlements to shareholders in proportion to the number of water entitlements they hold.
- The introduction of an access charge to recover fixed operational and maintenance costs (against delivery entitlements).
- The abolition of exit fees on the sale of water entitlements out of an irrigation district
- The introduction of a termination fee to be charged when delivery entitlements are surrendered, in conjunction with the transfer of water entitlements from the operator's license, or to a water entitlement account.

Other changes are also currently under consideration and individual infrastructure operators will have their own views on timing and implementation of these additional changes. NSWIC is of the view that there should be a consistent approach where possible but recognise that administrative capacity may vary considerably.

4.2 – constraints on water exports

To what extent, and in what circumstances, is it appropriate for an operator to be able to impose restrictions on the export of water?

In accordance with NSW legislation (*Schedule 1 of the Water Management Act 2000*) and in line with the National Water Initiative (NWI), the Minister can impose civil penalties on specific operators if they prevent arrangements being made to permanently transfer water outside the district up to an annual threshold of 4%.

NSWIC believes that these operators have taken appropriate steps to comply with their legislative requirements and that in most cases, the 4% limit allows appropriate management of any structural change.

4.3 – other constraints on trade and transformation

To what extent, and in what circumstances, is it appropriate for an operator to be able to impose other constraints such as those imposed for operational and environmental purposes, on trade and transformation?

In some instances water access entitlements will be ‘tagged’ by DWE to specific water sharing plans which means that the entitlement will retain existing rights and responsibilities, including rules governing such things as carryover and annual activation. NSWIC supports the concept that all water traded, irrespective of who is the ultimate purchaser always retains its original characteristics (‘tagged’ trade).

A number of infrastructure operators have identified circumstances where water trades will require special consideration. Approval (or otherwise) of these trades may depend on license conditions. Examples of these special circumstances include, but are not limited to:

- Town water entitlements;
- Stock and domestic water entitlements; and
- Drainage re-use licenses

It should be noted in assessing these examples that all infrastructure operators have obligations to the relevant jurisdictions under their current bulk operating and environmental licenses.

Other constraints that require further consultation and discussion include, but are not limited to:

- The restriction of trade out of specific districts or defined zones when such trade is prevented because of physical or hydrological constraints (as stated in Clause 4 section 3 of the Water Act 2007);
- The need to maintain the hydrological integrity of the system; and
- Overland flow entitlements (that are infrastructure dependent);

4.4 – security for future payment of fees

To what extent, and in what circumstances, is it appropriate for an operator to require security to be offered as a condition on the transformation and/or trade of water rights?

NSWIC supports infrastructure operators putting in place appropriate mechanisms to assess and manage this risk but this will require further consultation with both operators and irrigators.

4.5 – administrative fees and charges

Should the water market rules specify that these be based on cost recovery?

NSWIC is of the view that the ACCC does not have a role in setting prices within private irrigation entities.

4.6 – cut-off dates and trading seasons

To what extent, and in what circumstances, should an operator be able to specify cut-off dates or define trading seasons?

This is matter for the individual infrastructure operators.

NSWIC recommends that cut-off dates for trade be minimised where possible and limited to protecting the integrity of the market. Further consultation may be required on this point.

4.7 – interaction between operators & intermediaries

Do operators recommend specific brokers or exchanges to irrigators seeking to trade and if so on what basis?

NSWIC is of the view that the choice of brokers or exchanges is a matter for the individuals involved in the water trading process.

At present, water brokers, promoters and agents in the trade of water entitlements are not required to maintain any form of licensing, trust account facilities or professional indemnity cover. This current situation could potentially result in the parties trading permanent water access entitlements exposed to risks such as the actions of unscrupulous traders and lack of discipline in the market place.

Whilst the National Water Commission (NWC) has indicated that current consumer protection laws are adequate, NSWIC supports the introduction of a licensing regime for all water brokers (the regime to include trust account facilities and full accountability for all trades and transactions) or at the very least the provision of operating guidelines/standards for market participants.

Chapter 5 – actions that should be required

NSWIC notes that that the issue of transformation is poorly understood and not defined in the Water Act 2007.

5.1 – terms and conditions for transformation and/or trade

Should operator's terms and conditions for transformation/trade be comprehensive and clearly specified as part of the supply agreement?

NSWIC considers that the provision of this information is fundamental to the trade/transformation process but the format is a matter for the individual infrastructure operators.

5.2 – enabling transformation separate to trade

5.2.1: To what extent is it currently possible for an irrigator to transform their irrigation right into a water access entitlement without subsequently trading that entitlement?

A number of infrastructure operators in NSW have taken steps to address the transformation issue but all have recognised that additional steps may need to be taken to ensure compliance with obligations under Schedule E of the MDB Agreement.

Conditions of transformation should not disadvantage the infrastructure operators' capacity to seek payment for services provided.

5.2.2: Should operators be required to establish and clearly specify the minimum terms and conditions on which they will provide delivery services to irrigators who hold a transformed water access entitlement?

NSWIC considers that the provision of this information is fundamental to the trade/transformation process but the format is a matter for the individual infrastructure operators.

5.3 – transformation and/or trade administrative process

5.3.1: What other actions (other than those listed) may be undertaken by an operator to process/approve a transformation or trade?

NSWIC is comfortable that the list as printed on page 26 of the ACCC paper is reasonably comprehensive but further consultation is required on this point.

5.3.3: What is the minimum amount of information required?

This will vary from operator to operator.

5.3.6: What is the rationale for requiring board approval to these transactions?

That is a matter for individual infrastructure operators.

5.4 – timeliness

Timeliness is very important to irrigators for both annual and entitlement trade. As a general principle NSWIC supports improvement in timeliness for both. This applies equally to government water utilities.

5.4.3: To what extent do operators provide information on the time taken to process and give effect to transformation and/or trade approvals? Who gets this information and how often?

NSWIC supports the provision of this information.

5.5 – operators' water registers and accounts

5.5.1: Should requirements be placed on operators in the development of their water registers and water accounts? If so, what should these water registers and water accounts record?

This is a matter for individual operators but NSWIC would expect that most individual operators would develop and maintain appropriate registers as an integral component of their business operations.

5.5.2: Is inter-operability and compatibility between the water registers and accounts of operators and jurisdictions a significant issue?

Consistency is important but NSWIC believes there is merit in exploring the development a national register with a standard format if it can improve market information and contribute to a more efficient trading environment.

5.5.3: Is the timeliness with which operators update their water registers and accounts a significant issue?

There may be isolated cases and as such, if any action is required, then it should be based on guidelines and not rules.

5.5.4: Is it possible to gain direct access to information contained in an operators' registers and/or accounts and who can directly access this info?

NSWIC understands that much of this information is commercial-in-confidence and would therefore be restricted to the parties engaged in the trade or their authorised agents.

5.6 - market information

5.6 (a): Is adequate market information currently available and what are the specifics?

Some infrastructure operators maintain permanent water trade registers as a service to customers but they are not involved in negotiations between parties. In addition, a number of water brokers and exchanges provide market information on their web sites but NSWIC does not have a view about the accuracy and timeliness of this market information other than what is stated below.

5.6 (c): Should operators be required to provide market information and what should it include?

To instill market and consumer confidence in the benefits of water trading, the market must be underpinned by accurate, timely and freely available market information. NSWIC supports the introduction of a market reporting service that requires the compulsory notification of sales data within a specified period (e.g. five working days) after settlement or approval.

Key features of such a system could include:

- Historical records of sales activity (including data on water source, security and license category and basis of trade);
- Details of individual sales including (water source & destination, security of licensed entitlement, license category , volume & price and basis of trade)
- Funded by a flat rate charge on both purchaser and seller.

Further consultation is required on this issue to determine the ability of infrastructure operators to provide the base trade information in a timely manner. Assistance, particularly financial, may be required to meet increased compliance costs.

Chapter 6 – financial implications of water market rules

6.1 - mortgageability of irrigation rights

6.1.1: To what extent are irrigators that do not hold an individual water access entitlement disadvantaged in terms of access to finance as a result of this arrangement?

Feedback from NSWIC members is mixed. Further consultation on this issue is required

6.1.2: How do operators currently identify whether an irrigation right has an encumbrance?

This varies from operator to operator.

6.2 – tax implications of transformation and trade

6.2: What are the possible tax implications in respect of transforming an irrigation right into a water access entitlement for:

- a. Operators?*
- b. Irrigators?*

NSWIC's view is that this is a matter for individual irrigators, infrastructure operators and the Australian Taxation Office. However, this is a serious issue and one which demands a much wider consideration than this paper.

Chapter 7 – application and implementation

7.1 – coverage of the water market rules

7.1.1: To what extent should the water market rules apply to all operators to the same degree?

NSWIC's view:

- 1) Rules should apply equally to all;
- 2) The making of any rule should include formal consideration of, and consultation on, the issue of compliance costs; and
- 3) Funds should be made available over a period of at least three (3) years to assist smaller infrastructure operators deal with increased compliance issues. These funds to be provided by the Australian Government and must not be subject to 'cost recovery' provisions.

7.1.2: Is their merit in a delayed application of the water market rules for specific classes of operators? If so, on what basis should this happen?

Note comments above.

7.2 – transitional arrangements

7.2.2: How could the water market rules account for any pre-existing contract between an operator and irrigator?

Rules must not, under any circumstances, be retrospective.

7.2.3: Are there any other transitional issues that should be considered?

These are matters for individual operators.

7.3 – monitoring compliance with water market rules

7.3.2: Are there any issues the ACCC should be aware of in developing and implementing monitoring arrangements?

Further consultation is required on this point.

NSWIC believes that any new water market regime and any monitoring must also include an ongoing assessment of the social and economic circumstances that may arise if trade is concentrated out of a specific region.

Other factors requiring consideration

Possible application of water market rules outside the Murray-Darling Basin

Notwithstanding the fact that the Water Act 2007 refers mainly to the Murray-Darling Basin, NSWIC is concerned that any rules recommended by the ACCC and/or set by the Minister will be carried over into areas outside the Basin. In many cases these 'external' systems operate in a significantly different manner including most coastal valleys where rivers are only of relatively short length and are often not connected (with few, small tributaries).

NSWIC members that operate in these coastal regions are concerned that the current ACCC investigation into water market rules and their subsequent work on water charging will have unintended consequences on their businesses.

The Hunter Region is a good example where the physical and hydrological constraints of the system mean that the water trading process is potentially more complex. Some of the characteristics of the region include:

- Most streams are fairly short and steep with only short flow times from the head waters to the ocean;
- In the regulated system different storages supply sections of the river and the total allocation for each section needs to be constant to preserve individual users security and property right; and
- Interconnection between streams and valleys is not normally physically possible.
 - Accordingly water trading rules applying in many cases do not allow for trades upstream unless there has been a similar trade downstream.
 - Trading between streams and catchments is not normally available.

Their concerns around water charging also involve complex issues including:

- The high cost of maintenance for smaller dams which has the cost spread over only few users and a relatively small volume of water – if the full cost recovery plus a charge for externalities was imposed on some of these smaller storages it would most likely shut down a number of irrigation industries in the region;
- The large no of nonconsumptive and non chargeable users;
- Correct identification of different security levels and the true costs of higher security storage such as major utility and urban supplies;
- Possible loss of "line in sand" approach for sunk costs; and
- Urban and industrial encroachment on existing supplies.

As a consequence of these concerns and issues:

- 1) NSWIC does not support the application of new water market rules (and the subsequent water charging rules) outside the Murray-Darling Basin; and
- 2) NSWIC believes that there must be a separate, comprehensive and meaningful consultation process with these groups and individuals likely to be impacted and their circumstances must be properly accounted for (i.e. that any demonstrable changes including pricing, be it full cost recovery, externalities or both are met by compensation by the Australian Government.

Private Irrigation Districts – capacity to pay/transitional arrangements

Regardless of the ‘market view’ there are going to be small infrastructure operators who will find it difficult to adjust to a new water market regime that will bring with it increased compliance costs. Many of these operators will struggle both financially and administratively to implement the new rules.

Rather than a delay in implementation NSWIC believes that funds should be made available over a period of at least three (3) years to assist smaller infrastructure operators deal with increased compliance issues. These funds to be provided by the Australian Government and must not be subject to ‘cost recovery’ provisions.

The northern NSW areas of the Murray-Darling Basin

NSWIC members in the northern regions of the MDB have expressed concerns about the perceived focus of the ACCC water market rules paper on irrigation areas in southern parts of the Basin. The interpretation of the ACCC’s definition of an ‘irrigation infrastructure operator’ does not preclude State Water from any new rules (nor should it) and as such raises a number of issues about management and application in those areas of the MDB in northern NSW (for the purpose of the NSWIC response).

These issues include, but are not limited to:

- The need to maintain the hydrological integrity of the systems;
- The need for a discussion about Australian Government funding for hydrological assessments on early trades to ensure competitive neutrality;
- Trading should only be allowed within regulated areas as defined under existing state and inter-state agreements;
- Entitlements need to maintain characteristics of place of origin (i.e. tagged trading);
- Entitlements can’t be transferred out of regulated zones via an unregulated zone to another regulated zone; and
- Metering, measurement and auditing of trades

Conclusion

It has been very clear from the NSWIC efforts in preparing this submission that the consultative timeframes allowed for by the ACCC are totally inadequate. They have not allowed for extensive discussion and they have underestimated the complexity of this very important issue. NSWIC has indicated in a number of areas of our submission that further consultation is required before any draft rules are developed.

There are many factors that will influence the eventual (and necessary) development of a sustainable permanent water market. However, the functioning of an efficient water market cannot be judged on economic principles alone.

The belief that the water market provides individuals with choice implies they will always have alternative options available to them rather than simply selling their water entitlement. As Hancock states, “the notion of choice is viewed as a prerequisite for the efficient reallocation of water entitlements amongst competitive uses in the economy. Increasingly however, individuals are finding their freedom of choice being constrained by their situational context. The combined impact of low water allocations, prolonged drought and declining returns is resulting in irrigators turning to the water market to permanently sell their water entitlement to remain on or leave the land.”¹

Clause 4 of Schedule 3 to the Water Act 2007 is significant in the language it adopts with regards to water trading in that it talks of the evolution of trading mechanisms ‘over time’. Concerns amongst rural and regional communities about the impacts of permanent water traded are legitimate and need to be recognised in the framing of the new water market rules. One cannot overlook either, the role that the temporary water market plays in ensuring an effective and efficient allocation of water resources.

NSWIC believes that there needs to continue to be a cautious and pragmatic approach to this complex issue. NSWIC encourages the ACCC and government(s) to ensure that there is an appropriate mix of good policy, process and practical understanding underpinning the development of the water market rules for permanent water trading.

¹ Hancock B (2008), ‘The permanent water market – a critical discussion’, paper presented to Water Down Under 2008, Adelaide 2008.