



30 October 2020

Director
Murray-Darling Basin Inquiry
Australian Competition and Consumer Commission
GPO Box 3131
Canberra ACT 2601

Via email: waterinquiry@accc.gov.au

Dear Mr Keogh

Re: ACCC Murray-Darling Basin water markets inquiry Interim report

The National Farmers' Federation (NFF) welcomes the opportunity to provide a submission to the ACCC Murray-Darling Basin water markets inquiry Interim report.

Should you require any further information, please contact Warwick Ragg, General Manager Natural Resource Management, on 02 6269 5666 or wragg@nff.org.au.

Yours sincerely

TONY MAHAR
Chief Executive Officer



**National
Farmers
Federation**

National Farmers' Federation

Submission to the ACCC

Murray-Darling Basin water markets inquiry interim report

30 October 2020

NFF Member Organisations





The National Farmers' Federation (NFF) is the voice of Australian farmers.

The NFF was established in 1979 as the national peak body representing farmers and more broadly, agriculture across Australia. The NFF's membership comprises all of Australia's major agricultural commodities across the breadth and the length of the supply chain.

Operating under a federated structure, individual farmers join their respective state farm organisation and/or national commodity council. These organisations form the NFF.

The NFF represents Australian agriculture on national and foreign policy issues including workplace relations, trade and natural resource management. Our members complement this work through the delivery of direct 'grass roots' member services as well as state-based policy and commodity-specific interests.

Statistics on Australian Agriculture

Australian agriculture makes an important contribution to Australia's social, economic and environmental fabric.

Social >

There are approximately 88,000 farm businesses in Australia, 99 per cent of which are wholly Australian owned and operated.

Economic >

In 2018-19, the agricultural sector, at farm-gate, contributed 1.9 per cent to Australia's total Gross Domestic Product (GDP). The gross value of Australian farm production in 2018-19 is estimated to have reached \$62.2 billion.

Workplace >

The agriculture, forestry and fishing sector employs approximately 318,600 people, including full time (239,100) and part time employees (79,500).

Seasonal conditions affect the sector's capacity to employ. Permanent employment is the main form of employment in the sector, but more than 26 per cent of the employed workforce is casual.

Environmental >

Australian farmers are environmental stewards, owning, managing and caring for 51 per cent of Australia's land mass. Farmers are at the frontline of delivering environmental outcomes on behalf of the Australian community, with 7.4 million hectares of agricultural land set aside by Australian farmers purely for conservation/protection purposes.

In 1989, the National Farmers' Federation together with the Australian Conservation Foundation was pivotal in ensuring that the emerging Landcare movement became a national programme with bipartisan support.

Executive Summary

The National Farmers' Federation (NFF) welcomes the ACCC's interim report. The NFF supports decisive, appropriate and effective reform to address serious problems in the water market, noting four broad reform areas:

- Conduct of market participants;
- Trade processes and market transparency;
- Improving market architecture; and
- Market governance.

The NFF notes from the outset that the Australian water market varies in maturity across the Basin and country. Northern basin irrigators have not noted any major issues with how the market operates in their regions, where trade is limited, and most issues pertain to the southern-connected basin. Given the low volume of trade in the north, the ACCC should be mindful to not propose unnecessarily complex and expensive systems, while recognising that timely and accurate reporting of market is important.

Preliminary comments

The water market should remain a function of state water policies and rules developed to manage a finite water resource consistent with sound water management principles. Any recommendations to amend policies should reflect sound water governance principles, not just to improve the market.

The NFF is concerned about the water market where the market facilitates inefficient economic outcomes or where it exacerbates negative externalities.

The interim report has proposed a significant number of options for consideration. The ACCC has also noted they are currently conducting investigations into various aspects of the water market, including impacts of market architecture and behaviour of market participants.

The interim report does not provide sufficient detail of the impacts of options, nor evidence of poor behaviour, to allow the NFF to make firm recommendations. The comments and recommendations provided have been formed with limited information. The NFF requests that, prior to the Government responding to any recommendations in the final report, it is given the opportunity to review and respond to these recommendations.

The NFF will provide further commentary pending further analysis and consequential findings in the final report.

Principles

The NFF believes that recommended outcomes must:

- Seek to improve trust and confidence in the market;
- Be consistent with the NWI principles;
- Address demonstrated market failure;

- Be cost-effective, guided by cost-benefit analyses of options and minimise the cost burden;
- Reduce duplication, complexity and harmonise existing regulations where appropriate;
- Be proportional to the impact;
- Be considered, fair, equitable, and avoid unintended consequences and other third-party impacts; and
- Be reasonably practicable.

Conduct of market participants

The NFF supports greater regulation of brokers and intermediaries as a priority. Lack of regulation has undermined trust and confidence in the market.

The interim report proposes three options:

1. Government-initiated licensing scheme.
2. Apply the financial regulation framework to all water products.
3. Independent market-focused government regulator.

The NFF recommends the ACCC conduct a cost-benefit analysis to inform stakeholders of the relative costs and benefits of each option. The response must be proportionate to the scale of the issue. The ACCC's investigation into allegations of market misconduct will inform which option would be most appropriate.

The NFF's preliminary view is that options 1 and 2 are preferable. Consideration of option 3 requires understanding the cost to the end user and the scale of the problem. However, any additional costs associated with reform options should not be borne by water users.

There is a discussion to be had about whether better jurisdictional coordination can be a material consideration or whether another model should be considered.

Trade processes & market transparency

The NFF strongly supports greater harmonisation and coordination to improve consistency and transparency across the market. Information transparency must be improved to improve market efficiency and ensure that market participants can make informed decisions.

The NFF recommends improving accessibility to information. Any attempts to collate and disseminate information for public use must be designed in a user-friendly format while protecting commercial-in-confidence information at the individual enterprise level.

The NFF also notes the longer-term solutions proposed in the interim report and prefers options that deliver harmonisation and coordination rather than centralisation. As such, NFF supports the following:

- Short- and medium- term solutions outlined in section 11.2 of the interim report;

- A single water information platform that brings together diverse information sources against a clear standard; and
- An open digital protocol for enhanced interoperability between Basin State registers.

The NFF's preliminary view is that digital solutions that are least complex, improves data collection and interoperability between registers are more practicable and preferable to mandated centralised solutions.

The NFF recommends a cost-benefit analysis of the proposed options to better understand the burden of proposals.

However, the key test would be the ease with which on-ground users can access, learn, engage with and adopt the technology. That is, would irrigators have to understand various rules and regulations in the market to engage with the technology? An extension scheme and ease of interoperability will be important considerations.

The NFF recommends the ACCC minimise the options to be considered for cost-benefit analysis by ruling out:

- A single exchange platform for posting and matching trade offers — the resources required to develop the regulatory frameworks to address issues with monopoly power would be resource intensive, impractical and could be better allocated elsewhere.
- A 'National Electricity Market (NEM) type approach' for water — the NFF does not believe the regulatory reform required, the associated cost, and the additional regulatory burden it would create warrants consideration of this option.

Improving market architecture

The NFF agrees that a fundamental issue is the misalignment between the cost of trade and the physical capacity of the Basin. There is no price signal to reflect the costs of accessing limited storage, the delivery capacity of the system, nor the impact of delivering environmental water, resulting in an inefficient allocation of scarce resources. The risks are subsequently borne by the environment and other water users.

However, states are predominantly responsible for market architecture. Any such reform must be driven by the need to improve water management, not simply to improve the market. Furthermore, any change to underlying market architecture should be led by collaborating state governments, consistent with state policies and NWI principles.

The interim report identifies several reform options including:

- Alternative approaches for allocation and carryover policies;
- Applying transmission loss factors to water deliveries in the southern connected Basin;
- Alternative and more dynamic mechanism to manage inter-valley trade;

- Improving consistency across Basin States' accounting and metering requirements; and
- Removing the exemption for grandfathered tags or removing entitlement tagging altogether.

The NFF is open to considering reforms to improve alignment between the trading system and the physical characteristics of the river system, including market architecture reforms. The NFF will review findings from the ACCC's current investigations before considering reform options.

Improving market governance

The NFF supports improving market governance, with the prioritisation of key regulatory gaps or governance gaps, including the following:

- Regulation of water market intermediaries;
- Regulation to prevent prejudicial conduct in the water market, including the manipulation of water prices;
- The conflicting role of Irrigation Infrastructure Operators (IIOs) has in providing brokerage services and approving trades; and
- The provision of core market data from private exchanges or brokers.

In the longer term, this raises questions about broader basin governance and whether existing arrangements are fit-for-purpose. Ministerial Council (Minco) only meets twice a year, meaning that there may be significant risk of delays to implementation.

The NFF recommends basin governments assess whether existing governance arrangements are appropriate to oversee a functioning water market and address existing, emerging and future challenges.

1. General comments

1.1. Implementation of ACCC reforms

It is clear that market reform options proposed under the interim report are significant, substantial and could have material impacts to operation of the water market.

The NFF suggests that recommended outcomes must:

- Seek to improve trust and confidence in the market;
- Be consistent with the NWI principles;
- Address demonstrated market failure;
- Be cost-effective, guided by cost-benefit analyses of options and minimise the cost burden;
- Reduce duplication, complexity and harmonise existing regulations where possible;
- Be proportional to the impact;

- Be considered, fair, equitable, and not avoid unintended consequences and other third-party impacts; and
- Be reasonably practicable.

The NFF believes that the quantum of change envisaged by the ACCC warrants a clear reform pathway to ensure any transitional uncertainty can be managed.

The ACCC should consider what agencies are most appropriate to lead coordination and implementation of the final report recommendations or if it is a role for the ACCC. This may include creating a new function within an existing body or establishing a new body should there be a material need to do so. However, any newly established body should be independent of government and with coverage outside the Basin to ensure any regulation applied is consistent. While some recommendations can be implemented by respective State agencies, others will require a coordinated approach. Ideally, the body should facilitate a ‘whole-of-basin’ approach.

Once complete, the NFF recommends respective Governments, and the Ministerial Council, assess their capacity to implement ACCC recommendations and develop an implementation package that addresses priority issues initially, followed by more complex reform areas—that is, the ‘low hanging fruit’. Clear and realistic timelines should be developed, and adequate resourcing provided, to implement recommendations.

Clear roles and responsibilities must be assigned to provide visibility, clarity and confidence to basin communities and other market participants. Market participants should understand who is accountable, responsible for decision-making and consider how it aligns with state legislation.

1.2. Meeting NWI commitments

Implementation of basin reforms and recommendations of the final report must be consistent with the National Water Initiative (NWI) principles. The NFF continues to support the NWI objectives. The principles themselves are robust, but it is clear that the implementation of some objectives has been poor. The current water market settings, and the findings within the Interim report, reflect this.

Earlier this year, the NFF responded to the *Productivity Commission National Water Reform Inquiry* Issues Paper, recommending that (in respect of the water market):

- Governments broaden the definition of third-party interests to clarify the needs of the environment within paragraphs 58 (iv) and (v) of the National Water Initiative.
- Governments develop clearer processes to prevent, address and mitigate third-party impacts and environmental impacts caused by the water market.

These recommendations are intended to clarify the principles against which water reform policies are assessed. The NFF agrees with the ACCC that water markets have now evolved beyond the original NWI commitments. They should be recast to be forward-looking. That would be a matter for the current Productivity Commission Water Reform Inquiry.

1.3. Diversity and economic resilience in the Murray-Darling Basin

The NFF supports agricultural diversity and economic resilience in the Murray-Darling Basin. The NFF believes that a diversification of consumptive water uses is likely to lead to a more diversified and hence resilient economy, particularly in regional areas that may have relatively narrow economic bases. Climatic variability, biosecurity incursions, and global demand and supply chain shocks would leave undiversified economies and communities more vulnerable. Economic diversification considerations should be included when considering water reform options.

The NFF supports the idea that a market is the best mechanism to allocate scarce resources, but a market is only as robust as the regulatory settings underpinning it. In NFF's view, the approach to 'higher value' that was envisaged at the time the *Water Act 2007* was drafted was simplistic and largely irrelevant to informing long term sustainable water management in the Basin. Higher value use means different things to different commodities and different communities and change over time.

The NFF suggests it is more likely the case that water policy settings have distorted, or have not considered, the 'true value' of trade. While potentially out of scope for the ACCC, the NFF believes there needs to be consideration of how the water market is facilitating diverse agricultural economies, noting that we would not support quotas or mechanisms to cap the amount of different crop types. The NFF suggests the ACCC assess the extent to which the water market is supporting or inhibiting a diverse and resilient agricultural sector.

2. Response to interim report

2.1. Conduct of market participants

Water brokers

The interim report makes a strong case for the regulation of brokers and intermediaries. The NFF recommends prioritising regulation of brokers and intermediaries as it will likely have the most positive impact on market confidence.

There is scope to reduce market complexity by harmonising rules and regulations where appropriate, creating a single national water information platform and improving accessibility to information. However, the market will remain inherently complex as State Governments are constitutionally responsible for water resource management and have developed different rules and regulations and governance frameworks to reflect their interests.

Water brokers will continue to play an important role in navigating market complexity by providing valuable market information and advice, and facilitating trade. It is more practical that broker behaviour be regulated to ensure brokers have a fiduciary obligation to their clients.

The interim report identifies significant information asymmetry between water brokers and market participants. Water brokers have a greater capacity to devote resources and time, and to invest in technology to assess market trends and information while market participants, especially irrigators who are time poor, cannot do so. As such, they are forced to rely on broker information that they cannot readily verify, and which has facilitated broader scepticism about the integrity of the market.

There is a significant regulatory gap to be addressed that is creating an environment for market participants to be exploited and manipulated. While the report notes potential misconduct, they do not necessarily reflect the conduct of most brokers and intermediaries. However, lack of confidence caused by distrust in third parties is a barrier to participation.

The NFF notes the following findings from the interim report:

- There are few obligations for brokers to act in the best interest of their clients;
- Brokers are subjected to limited government and self-regulation;
- Brokers can have conflicting interests incompatible with their clients;
- Client funds are not subject to management obligations; and
- Information asymmetries between brokers and clients are significant.

The NFF also notes Table 6.2 of the interim report which summarises key client-facing and market-facing issues with brokers.

The NFF supports water brokers being required to hold funds in statutory trust accounts and have professional indemnity insurance.

The interim report proposes three options for consideration:

1. Introduce a government-initiated licensing scheme for intermediaries;
2. Apply the financial regulation framework to all water products, which would be relevant to the activities to a range of market participants; and
3. Establish an independent market-focused government regulator, which would enable the regulation of market participants such as intermediaries, investors and IIOs.

The NFF recommends a cost-benefit analysis of the three proposed options to understand what additional costs may be imposed. While the NFF supports greater regulation, the response must be proportionate and cost-effective to minimise the cost burden to farmers. Where the option harmonises existing regulation, that would be supported. Whichever option is chosen, it should not be overly complex such that it reduces competition by creating a significant

barrier of entry for brokers. The option should also be flexible to respond to emerging issues in the market.

The NFF's preliminary view is that options 1 and 2 are preferable. A government-initiated licensing scheme provides a flexible solution that can be tailored to address existing issues. A Commonwealth-led approach would require agreement between the Commonwealth and States which may be a difficult proposition. If impractical, a State-led approach should be considered.

Applying a financial regulation framework to all water products provides a comprehensive solution that can build on existing 'ready-made' market regulation frameworks. Both a licensing scheme and a financial regulation framework would appear to address key issues identified in the interim report. The NFF envisages that a government-initiated licensing scheme would be slower to implement than the financial regulation framework.

The NFF awaits the outcomes of the ACCC's ongoing investigation into allegations of market misconduct to understand the extent to which it has occurred, as well as the level of ownership that enables an entitlement holder to manipulate the market.

There is also a discussion to be had about whether better jurisdictional coordination can be a material consideration or whether another model should be considered.

Independent water market regulator

The NFF remains cautious about an independent market focused government regulator. On one hand, an independent regulator would provide visibility and allow participants to have greater confidence in the water market, and there are significant benefits with having a regulator that can take a 'whole-of-market' approach to monitor, audit, investigate and enforce actions where necessary.

However, the NFF recognises that this would be the most expensive option. The NFF needs to understand the cost to the end user and the scale of the problem first. Both a cost-benefit analysis and the ACCC's investigation will inform the appropriate solution. However, any additional costs associated with reform options should not be borne by water users.

Speculators

As noted in our initial submission, 'speculators' play a role in adding financial liquidity to markets, enabling producers to hedge risk efficiently, especially in a variable climate. The term itself is ambiguous and can capture investors, non-landowners or retired farmers. Any attempt to regulate classes of participants may unnecessarily result in unintended capture of non-target, possibly legitimate, participants.

The NFF recognises significant community concerns about the behaviour of market participants and awaits the findings of ACCC investigation.

The NFF supports the principle that ‘*harmful behaviours should be regulated rather than classes of market participants excluded*’ and does not believe exclusion of certain classes of participants would be effective in preventing harmful behaviour.

The NFF strongly supports measures to prevent anti-competitive conduct.

In isolation, excluding certain investors would not prevent market manipulation without broader regulatory reform. The NFF suggests that improving the regulatory framework, broader governance and improving transparency will have a greater effect on discouraging anti-competitive behaviour. The case seems yet to be made that participation, by any cohort, is itself distortionary.

2.2. Improving trade processes and market transparency

2.2.1. Short- and medium-term reforms

The NFF strongly supports greater harmonisation and coordination to improve consistency and transparency across the market. Information transparency underpins the proper functioning of efficient markets and allows participants to make informed decisions.

Information must also be accessible. State water registers already contain vast amounts of information but, unless it can be collated and disseminated in a user-friendly format, it is effectively meaningless for most participants who do not have the time, resources nor knowledge to understand relevant information. As noted, water brokers play an important role to address this need.

Any improvements in information in transparency must protect commercial-in-confidence information at the individual enterprise level. The NFF agrees with the ACCC’s preliminary view in section 11.4.2. that publicly disclosing names and other identifying details of entitlement holders is unlikely to materially assist in trading decisions, may be inconsistent with privacy laws, and may have unintended consequences for market participants.

The interim report identifies Victoria as a sound example that basin states could follow to:

- Improve information transparency by mandating an expanded role for trade approval authorities and water registers which better fits with market participants’ needs and expectations;
- Improve trade forms similar to the Victorian Water Portal which collects data on lodging party and lodgement method (for example, whether the trade was lodged via the Broker Portal or API, the MyWater portal, or applications made directly to water corporations), and now publishes names of brokers registered to use the portal; and
- Establish a framework to improve IIO transparency.

Given the interim report’s lauding of the Victorian experience, the Victorian Government could play a role in establishing a workplan to improve information

transparency while the Commonwealth could strategically coordinate states to ensure harmonisation.

The NFF agrees that the immediate task should be to resolve existing issues with trade processing with the long-term aim that market data can be generated and transmitted that provides a clear view of market operations across the basin.

The NFF notes the following practical changes identified by the ACCC:

Option	Commentary
2(a) Basin States to improve trade data validation and quality checking processes before providing data to the BoM	<p>The NFF supports processes to improve data validation and quality checking to ensure there is confidence in market information provided by the BOM.</p> <p>The NFF also supports the need for the BOM to improve metadata to allow users of BOM information to understand where revisions or updates have occurred.</p> <p>The NFF supports updating the Water Regulations 2008 (Cth) to clearly specify these needs.</p> <p>If the BOM is intended to be used as the central market information source, then immediate work must be done to improve the user experience design. The site is not user friendly and there are few participants who use the BOM as their preferred source of water market data.</p> <p>Furthermore, members have indicated that the BOM have done a poor job developing a market portal to date. The final report should consider whether the BOM or another agency would be better placed to provide a platform for market information.</p>
2(b) Update trade application forms to capture the reason for trade or trade type, struck date, lodging party and matching pathway	<p>Supported, but must be consistent with State legislation.</p> <p>Trade should also be digitised, accessible and available outside business hours.</p>
2(c) Remove the ability for zero dollar trades to be approved or recorded unless certain conditions are met and continue to progress to move trade forms online	<p>The NFF agrees that rules for zero-dollar trades should be tightened to ensure they are only used in legitimate circumstances. This has been previously identified by the MDBA's two-part audit of water trade price reporting which recommended that:</p> <ul style="list-style-type: none"> • All state trade application forms include a compulsory trade price field.

	<ul style="list-style-type: none"> • State registry systems be updated such that: <ul style="list-style-type: none"> (i) where a price is submitted as zero, a reason for the zero value must be provided. Where the trade is of environmental water, this should be identified and reported separately from other trades; and (ii) consideration of a trade application should not proceed without this information. (iii) <p>The NFF acknowledges there are legitimate circumstances for zero-dollar trades, noted in section 4.3.1 of the interim report. The required conditions should not interfere with these legitimate instances.</p>
2(d) increasing harmonisation across the Basin States' registers by working towards consistent terminology and data structures	Supported, noting this should be conducted against a standardised template that can be made available to the public.
2(e) Introduce standardised single party identifiers across the Basin, such as using ABNs.	Supported.
2(f) Standards and processes for processing trade applications and recording and disseminating trade data should be mandated and consistent across jurisdictions and apply to all IIOs and Basin State approval authorities. Standardised record-keeping and continuous disclosure rules should also be placed on intermediaries.	Supported — the NFF supports greater harmonisation and transparency. The interim report clearly identifies shortcomings in transparency with IIOs. The NFF strongly supports recommendations for the provision of core market information, trade, and transparency against IIOs, to ensure they are consistent with other market entities.
2(g) Basin States should work towards harmonising allocation trade application fees in the Southern Connected Basin, while recognising the NWI principles for cost recovery.	Supported.
2(h) Basin Plan water trading rules should be revised to require prices to be reported for all tradeable water rights, including irrigation rights and water delivery rights.	Supported — the NFF supports greater harmonisation and transparency.

2.2.2. Longer term digital solutions

The NFF supports the need for a longer-term technological solution to improve transparency and data quality issues. The NFF agrees with the ACCC's preliminary view that, while governance remains distributed between Basin States and other actors, options which deliver harmonisation and co-ordination are more suitable than options which deliver centralisation. Thus, the NFF supports the following:

- a) a digital protocol that enhances interoperability between Basin State approval authorities and registers, IIOs and exchanges, and automates the collection, cleaning and publishing of water market information; and
- b) a water market information platform which brings together (but does not replace) diverse information sources.

A single water information platform aligns with the Commonwealth Government's existing work plan; is consistent with findings from previous reports; and is consistent with the NWI objectives.

The NFF notes that there have been several attempts to develop a single information platform and suggests the ACCC consider the cost, practicality and reasons why previous attempts have failed.

The NFF agrees that the objective of this platform should be to provide a consistent source of core trade data that information service providers can use to provide tailored services.

The NFF also agrees that the information portal should provide:

- Current buy and sell offers (note this would entail linking to existing exchange and broker sites—trade would not be actually conducted in this portal);
- Collated historic trade data (including at least price, volume, category and geography) from the states and from IIOs;
- Information on water market intermediaries and the services offered;
- A simple description and definitions of water terms, policies, operational settings, rules and their implementation and changes or proposed changes to them;
- Information on trade processes, including information on trade application forms, trade, approval fees, and how to make enquiries or complaints (note this could be provided by way of linking to trade approval authority websites); and
- Indicators of supply and demand, including data on storage inflows, river flows, aggregate usage statistics, water availability and climatic forecasts.

Additionally, the information portal should provide information about trades in process which should strive towards real-time publishing of data. Importantly, Governments should work with stakeholders to ensure all relevant market information is included in the platform. The NFF believes it would be more practical to build on an existing portal rather than starting afresh.

Digital solutions

The NFF notes the following long-term technological options proposed:

- a) a spot market and real-time automated matching of buyer and seller offers, similar to the National Electricity Market;
- b) a single exchange platform for posting and matching trade offers by creating a single mandatory online platform for matching buyers and sellers;
- c) an ASX-like approach of a single clearinghouse to administer trade but connecting via interoperability protocols to trading platforms and different Basin State registers;
- d) Distributed Ledger Technology, such as Blockchain, which administers trade through smart contracts and also records all registry information; and/or
- e) a single common register in which all water accounting for both trade and delivery (use) would be accounted for in the same, single system.

The NFF's preliminary view is that the digital solutions that are least complex, improves data collection and interoperability between registers are more practicable and preferable to mandated centralised solutions.

The NFF recommends a cost-benefit analysis of the proposed options to better understand the burden of proposals.

The NFF also recommends the ACCC minimise the options to be considered for cost-benefit analysis by ruling out:

- A single exchange platform for posting and matching trade offers — the NFF believes the regulatory frameworks required to manage the subsequent monopoly would not be worth the effort; and
- A 'NEM type approach' for water — the NFF does not believe the regulatory reform required, the associated cost, and the additional regulatory burden it would create warrants consideration of this option.

The NFF notes competition and cost issues for mandated single platform solutions under Table 11.1. of the interim report.

The key test would be ease with which on-ground users can access, learn, engage with and adopt the technology. That is, would irrigators have to understand various rules and regulations in the market to engage with the technology? An extension scheme and ease of interoperability will be important considerations.

Any options chosen should be developed closely with end users, including farmers, to ensure that any digital product is user friendly.

2.3. Market Architecture

The NFF agrees that a fundamental issue in the market is the misalignment between the cost of trade and the physical capacity of the basin. There is no price signal to reflect the costs of accessing limited storage, the delivery capacity

of the river system, nor the impact of environmental water deliveries, which creates an inefficient allocation of resources. The risk is subsequently borne by other water users and the environment.

However, the NFF notes that states are predominantly responsible for the development of policies to manage their respective water resources. Any reform to market architecture must be driven the need to improve water management, not simply to improve the market. Furthermore, any change to underlying market architecture should be led by state governments, consistent with state policies and NWI principles, and considered under the lens of sound water management.

There is also a need to ensure various state policies cannot be gamed. The ACCC or any other proposed body responsible for market governance may address this gap. The NFF notes that state policies have evolved differently under a range of circumstances and it would be undesirable and impractical to consider a 'one-size fits all' policy.

The interim report identifies several reform options including:

- Alternative approaches for allocation and carryover policies;
- Applying transmission loss factors to water deliveries in the southern connected Basin;
- Alternative and more dynamic mechanism to manage inter-valley trade;
- Improving consistency across Basin States' accounting and metering requirements; and
- Removing the exemption for grandfathered tags or removing entitlement tagging altogether.

The NFF is open to considering reforms to improve alignment between the trading system and the physical characteristics of the river system, including market architecture reforms. The NFF will review findings from the ACCC's current investigations before considering reform options.

Carryover

The NFF strongly supports carryover as a tool to encourage risk management and continues to support the objective of using carryover to improve economic efficiency in the market by providing flexibility of water use across time, especially during drought. Generally, this has served farmers well during the millennium drought in managing a scarce resource and ensuring flexibility in farm production.

The NFF agrees with the ACCC's view that a '*return to no carryover would also likely lead to inefficient usage of water and reduce some entitlements' value.*'

The interim report correctly identifies that different carryover arrangements between states have developed to reflect their respective priorities, hydrological characteristics, entitlements on issue and policy processes.

The NFF agrees that information on carryover arrangements and carryover levels should be improved. This is not controversial, but there is a question about the

extent to which market participants, including irrigators, need to be aware of the breadth of state policy to confidently participate in the market. The NFF suggests that the ACCC consult with relevant stakeholders to ensure carryover information is presented simply and accessibly.

The NFF notes the ACCC's current investigation assessing whether carryover arrangements are likely to promote or undermine the efficient functioning of the water market, including the consideration of:

- The general inter-temporal allocative efficiency considerations of carryover parking;
- Whether prices for carryover parking trades will be able to accurately reflect the true value of storage capacity;
- Whether carryover parking as a mechanism is able to effectively price externalities, given it is a private transaction between two people and the externalities occur at the bulk level;
- Whether the risk of loss because of spill or evaporation are borne by the party obtaining the carryover benefit (through prices that reflect these costs), by the seller or by third parties; and
- Whether the private nature (and lack of disclosure of prices) makes it difficult for the market to establish an efficient, market clearing price.

The NFF will assess the findings from the ACCC's investigation. The NFF notes that, while the report may provide some further information, the crucial point is the degree to which carryover is facilitating sound risk management, not whether it is being used by the market.

Transmission losses

NFF members have raised concerns about how transmission losses are accounted for in the system, particularly in the southern-connected basin. The interim report appears to use the terms conveyance loss and transmission losses interchangeably and this should be clarified in the final report.

One key concern raised is that current rules, reflected in the exchange rates, do not recognise that one megalitre of water upstream is not equal to one megalitre of water downstream. Transmission losses occur during transport and increase with distance, meaning that a large shift in the water is likely to increase transmission losses. However, the loss of water is accounted for by reducing the broader consumptive pool, which then affects water allocation to non-trade parties.

The key concern with how transmission losses are accounted for, and how it's reflected in the water price, is that it does not recognise the cost of delivering water to a particular point on the river. This includes the cost of transmission losses, congestion, and the integrity of the environment which it moves through, leading to potentially suboptimal economic outcomes.

The NFF notes various proposals to address transmission losses including applying loss factors to trade. The NFF agrees that they present significant

administrative, scientific and economic challenges, and may create further unintended consequences, noting section 13.5.7. of the interim report.

This NFF considers that this may be a separate discussion to be had, unrelated to the water market. The issue of transmission losses is a policy issue, not a market issue, and may be more appropriately addressed in other forums such as Ministerial Council. If these provisions are to be considered for change, then any change is likely to be considered as a change to a property right, and therefore compensable.

Removal of grandfathered tags

Members have raised concerns about the existing exemptions of grandfathered tags that enable entitlement holders to circumvent inter-valley trade (IVT) limits. The main concern is the impact on the integrity of the system due to exemptions. The NFF notes the current ACCC investigation to understand the scale of problem with grandfathered tags and looks forward to the findings before considering recommendations.

2.4. Improving market governance

The NFF strongly supports improvements to market governance. The benefits of water trading rely on fair and efficient water markets, underpinned by a healthy river system. A robust governance system that market participants have confidence in, that is consistent with sound water management principles and respects the river system's physical system, will lend itself to this goal.

The NFF supports considering options to improve market governance that seek to:

- a) Establish clear, independent decision-making structures;
- b) Separate market governance roles from broader water management governance;
- c) Consolidate or harmonise fragmented roles;
- d) Reduce regulatory gaps by creating and assigning new roles or functions; and
- e) Address conflicting roles.

The interim report has identified significant problems with existing governance arrangements across the basin that has contributed to regulatory fragmentation, overlapping roles and complexity — arrangements which had not been designed to accommodate water trade of this scale.

In the short term, the NFF agrees that existing regulatory or governance gaps should be addressed in the interim as a matter of priority, including:

- Regulation of water market intermediaries;
- Regulation to prevent prejudicial conduct in the water market, including the manipulation of water prices;
- The dual conflicting role of IIOs has in providing brokerage services and approving trades; and
- The provision of core market data from private exchanges or brokers.

In the longer term, the NFF believes this raises questions about broader basin governance and whether existing arrangements are fit-for-purpose. If regulatory fragmentation is a key feature impeding sound market governance and creating suboptimal outcomes, this demands greater coordination between States. This may require a re-evaluation of whether Ministerial Council is fit-for-purpose given it only meets twice a year.

There is a significant risk that reforms will be delayed under current arrangements. We have seen that key governance recommendations from past reports including the Productivity Commission five-yearly review of the Murray-Darling Basin Plan (Plan) and ‘*review of Murray-Darling Basin joint governance arrangements*’¹ have either been slow to implement or have not been met.

The interim report notes that ‘*where a coordinated approach is required, existing consensus-based decision-making frameworks may not be appropriate to respond to problems in a timely way. This can lead to acknowledged problems remaining unresolved, rather than being proactively addressed from a strategic, whole-of-Basin perspectives... as a result, governments are put in positions where they need to make reactive decisions*’.

Without broader consideration of basin governance, the NFF is not convinced implementation of ACCC recommendations will resolve key issues. Several reports have identified the need for an overarching strategic forum to provide strategic thinking and strategic direction and manage strategic risks.

The NFF recommends basin governments assess whether existing governance arrangements are appropriate to oversee a functioning water market and address existing, emerging and future challenges.

¹<https://www.mdba.gov.au/sites/default/files/pubs/Review-of-MDB-joint-governance-arrangements-final-report.pdf>