



Strategic Priorities

Basin Plan Water Trading Rules

Purpose

The purpose of this document is to assess the relative importance that each rule under the Basin Plan water trading rules (Chapter 12) has on the achievement of the water market and trading objectives set out in Schedule 3 of the *Water Act 2007* (the Act). This, along with the MDBA *Compliance Strategy* and *MDBA Compliance Risk Management Framework*, will be used by the MDBA to prioritise its regulatory and compliance activities.

Introduction

The Murray-Darling Basin Authority (MDBA) has assessed the key requirements for the successful implementation of the Basin Plan water trading rules with regard to the objectives outlined in Schedule 3 of the Act and the Basin Plan. This document identifies the strategic priorities for the operation of the rules as a result of this assessment.

The MDBA is currently working with Basin States (and approval authorities), Irrigation Infrastructure Operators (IIOs), Commonwealth agencies and water market participants to implement the water trading rules. A key principle is to focus on areas of the water trading rules that have the greatest potential impact on the water market. The strategic priorities inform the MDBA's risk-based approach to compliance, and where we will use our resources to address the most significant compliance risks. Priorities may be adjusted over time, and the MDBA will endeavour to review these on a bi-annual basis.

The MDBA has identified two areas of the water trading rules which present the potential to significantly compromise the objectives of the rules:

- trade restrictions (sections 12.06 to 12.14 and 12.16 to 12.18)
- disclosure of water announcements (section 12.51)

These areas are primarily associated with the activities of Basin States, reflecting that they undertake the majority of activities associated with water trade. Individuals and agencies that operate in the water market may also present compliance risks, but on a more limited basis.

The MDBA intends to focus its work program on these areas of high priority. However, this does not indicate that non-compliance is acceptable outside these areas, or that the MDBA will not be undertaking work on other matters. It reflects that the MDBA intends to devote more resources to these priorities, and anticipates that Basin States will do the same.

Compliance risks and areas of priority identified by the MDBA are not the same as actual instances or allegations of non-compliance. Importantly, just because we identify a compliance risk or a high strategic priority does not mean we think the risk will definitely eventuate, or that we think a certain entity is non-compliant.

Method

The MDBA has assessed the 52 provisions under the water trading rules against the objectives outlined in Schedule 3 of the *Water Act 2007* (the Act) and the Basin Plan. The Schedule 3 water market and trading objectives include:

- a. to facilitate the operation of efficient water markets and the opportunities for trading
- b. to minimise transaction cost, including through good information flows and compatible arrangements across jurisdictions
- c. to enable the appropriate mix of water products to develop
- d. to recognise and protect the needs of the environment and
- e. to provide appropriate protection of third-party interests.

Rules were considered with reference to their impact on:

- f. market transparency
- g. market efficiency
- h. market stability (e.g. lack of volatility)
- i. discrimination in the market.

Consideration was given to:

- j. the potential for the rule to affect a significant volume of market or trading activity (e.g. where an action affects trade from one state to another)
- k. its potential to significantly impact on the value or price of water being traded via peoples decision making process
- l. the potential for third party impacts.

Rules were allocated into three categories: high, moderate or low depending on the scale and nature of their potential impact.

Strategic priorities – criteria

MAGNITUDE		
High Priority	Moderate Priority	Low Priority
<ul style="list-style-type: none"> Occurs in significant water market areas or between different water market areas Occurs across whole State or between States People are prevented from trading or decide to stop trading High potential for third party impacts 	<ul style="list-style-type: none"> Occurs within a river system/water resource plan area/ catchment/ irrigation network People continue trading but do not make optimal decisions Moderate potential for third party impacts 	<ul style="list-style-type: none"> Limited potential to impact on water markets or individual's decision making Limited individuals affected Occurs in a limited set of circumstances Limited likelihood of third party impacts

Note that in undertaking this assessment, the MDBA has considered whether the water access rights are tradable under state water management law, and therefore captured by the water trading rules. For more information about the application of the water trading rules see the [Guidelines to the water trading rules](#).

High priority

This section discusses areas that have been identified as high priority to ensure the successful implementation of the water trading rules.

Trade restrictions

Restrictions on trade can compromise the efficiency of the water market by preventing water moving to its most productive use. They have the potential to stop trade at a state or large river system scale, or impact on a significant proportion of entitlement holders. The efficiency of the water market objective appears prominently in Section 20(e) of the Act and Chapter 5 of the Basin Plan (section 5.07(2)(a)). Schedule 3 of the Act refers to the objective of efficient water markets and opportunities for trading.

Trade allows individuals to realise the full value of their water and make decisions about how to best manage water for their businesses. While the water trading rules permit restrictions for a range of reasons, ensuring there are no inconsistent restrictions is a high priority as it has the potential to significantly impact on achieving the water trading rules objectives.

Restrictions are most evident when a trade is not permitted at all, however, restrictions can also include preventing, deterring, delaying or imposing a barrier or condition on trade.

Rights to trade free of certain restrictions

Sections 12.06 to 12.15 contain a number of rules aimed at ensuring discrimination does not occur through trade. Discrimination is counter to the principles of an efficient market and may also impact on market efficiency and stability. It could prevent water from moving to its most productive use.

The rules limit the ability for discrimination to manifest. These include discriminating based on the purpose for which a person intends to use water, who the person is, use after trade, whether they can carry water over or whether they are trading water from interstate.

Typically discrimination would manifest as a State policy for all trades, or for trades within a defined area such as a Water Resource Plan area or valley (e.g. legislation which restricts a particular type of interstate trade) and therefore occur at a large scale.

The MDBA considers that discriminating against a class of persons (section 12.07) may have a particularly significant impact as it could affect a large proportion of water access right holders. It could also impact on market confidence and stability, especially if discrimination exists between consumptive and environmental users as classes of persons.

- Note: Where a Basin State has not fully unbundled its water access rights, the MDBA considers greater potential exists for inconsistencies with the non-discrimination rules. This is because delivery and use conditions may not be separated from water, which presents more complexity in administering trades.
- Note: section 12.15 applies to water delivery rights which exist within the networks of Irrigation Infrastructure Operators (IIOs). This rule therefore has the potential to impact at the network scale, rather than for river systems or at the state scale. As a result, this is the only non-discrimination rule which is assessed as a moderate priority.

Allowable restrictions on trade

The rules permit a person to trade within a regulated system, between regulated systems or within an unregulated system free of restrictions (section 12.16) including any volumetric limits (section 12.17).

A Basin State is permitted to restrict trade for physical or environmental reasons under section 12.18. As this rule provides the facility to stop trade altogether, if administered incorrectly it could significantly prejudice the operation of the water market.

Basin States are required to notify the MDBA of all relevant restrictions, and the reasons for the restriction (section 12.19). The MDBA may subsequently request additional information if it considers information provided is insufficient or unclear. The MDBA has advised States that the level of information provided should be commensurate with the scale or significance of the restriction. For example, a clearly identifiable physical constraint is unlikely to require substantial explanation of the reasons for the decision.

The MDBA will be examining selected restrictions on trade with reference to the impact of the restriction on the water market, trading activity, and other water market participants. This will include the costs and benefits of the removal of a restriction, such as whether it could cause a perverse outcome or be inconsistent with the objectives of the Basin Plan.

Disclosure and management of water announcements

Transparent information is a key principle of well-functioning markets. Information helps water market participants understand their rights. Asymmetric information can produce inefficient outcomes and increase transaction costs.

Improper management and disclosure of water market sensitive information by government agencies has the potential to damage confidence in the water market. This could manifest through the external entities forming the view that governments are improperly performing their functions or providing advantages to some water access right holders over others.

A number of Basin Plan water trading rules aim to improve access to information in the water market. Chapter 5 of the Basin Plan and Schedule 3 of the Act refer to 'minimising transaction costs on water trades, including through good information flows in the market'.

Water announcements to be made public

The water trading rules (section 12.50) require that a person who makes a water announcement must make it in a manner that is generally available. Information is generally available if it has been published in a manner that will, or will be likely to, bring it to the attention of interested members of the public (section 1.07).

Allocation and carryover announcements made by Basin State governments may influence whether a person decides to purchase more water, sell the water they currently have or transfer water between licences. Allocation and carryover announcements are typically made at the valley scale, but could also occur at the State scale. They are assessed as having the potential to significantly prejudice the successful implementation of the water trading rules.

For State governments, other types of announcements covered by the water trading rules may include trading strategies by environmental water holders, tender processes or amending legislation or regulatory instruments. For the Commonwealth government, types of announcements may include changing the Government's buyback policy, amending the Water Act, tender processes or adjusting the Sustainable Diversion Limit (SDL) under the Basin Plan.

These types of decisions may occur at the whole of Basin Scale, or affect large areas of the Basin. Therefore, improper disclosure of information on these types of decisions has the potential to significantly prejudice the successful implementation of the water trading rules.

Trading with knowledge of water announcements that are not generally available

The water trading rules (section 12.51) restrict persons from trading if they have knowledge of a water announcement until that information is made generally available.

Trading activities based on 'inside information' have the ability to gain a clear material advantage. If this was to occur on a large scale it could impact on a large proportion of a market. Experience of insider trading in financial markets has shown that a lack of trust can damage a market and takes time to recover.

The rules provide a recommendation for a best practice approach in the form of a 'Chinese wall' provision (section 12.52) which allows an agency to appropriately manage information where they make/are aware of water announcements and conduct trading activities.

Moderate priority

This section discusses areas that have been identified as moderate priority to ensure the successful implementation of the water trading rules.

Irrigation Infrastructure Operator requirements

Irrigation Infrastructure Operators (IIOs) operate within a defined area of a state. As each IIO is responsible for a relatively small volume of water within a state, the MDBA considers that their activities do not present the same level of potential impact as Basin States. However, at a local scale they may have a significant number of customers and could cause distortions or restrict trade within that area. Rules associated with IIOs are considered a moderate priority.

Note: section 12.15 of the water trading rules applies to water delivery rights which exist within the networks of IIOs. This rule therefore has the potential to impact at the network scale, rather than for river system or state scale. As a result, this is the only non-discrimination rule which is rated as moderate priority.

The ten largest IIOs by volumes (holdings) are outlined below.

Irrigation Infrastructure Operator	Volumes (GL) 2012-13	Number of Customers 2013-14
Goulburn Murray Water	1,245	14,792
Murrumbidgee Irrigation	995	3,191
Murray Irrigation Limited	959	2,125
Coleambally Irrigation Cooperative Limited	434	473
Lower Murray Water	132	2,785
Central Irrigation Trust	129	1,268
Trangie-Nevetire Irrigation Scheme	67	43
West Cororgan Private irrigation District	62	250
Western Murray Irrigation	55	431
Renmark Irrigation Trust	41	551

This list is indicative only. Sources: For holdings (GL): ACCC, 2012-13. For number of customers: IIO websites, 2013-14.

The water trading rules prevent IIOs from unreasonably restricting the trade of water delivery rights within their networks. Section 12.29 sets out a range of reasons which may be reasonable, although this list is not exhaustive. Where the trade is restricted, the IIO must set out the reasons for the restriction.

Restrictions on the trade of delivery rights may lead to the inefficient allocation of delivery rights within an IIO network. If trade of delivery rights is inappropriately refused, it may leave an individual with no alternative but to pay substantial termination fees. As trade of delivery rights within IIO networks is currently variable, and operates under a range of different constructs, the MDBA

anticipates that further consideration of reasonable restrictions on these types of trades may be required.

The water trading rules (sections 12.32 to 12.35 and 12.47) require IIOs to provide their members with notice of their irrigation and delivery rights and to make their trading rules available (in various forms). If the information is not provided, or is incorrect or outdated, a customer may opt not to trade, or make a trading decision which is suboptimal.

Information and reporting requirements for Basin States

A number of Basin Plan water trading rules aim to improve access to information in the water market. Chapter 5 of the Basin Plan and Schedule 3 of the Act refer specifically to ‘minimising transaction costs on water trades, including through good information flows’.

Much of the information required by the rules is available already, but in a less robust or consistent way than the rules require. Rules of this type are therefore unlikely to significantly change trading behaviour in the water market, although in some instances a lack of information could result in a water access right holder making an incorrect or suboptimal decision.

The water trading rules require Basin States to supply the MDBA with a copy of their trading rules (section 12.46), and information on selected classes of water access rights (section 12.43). The MDBA is required to publish this information (section 12.42).

Section 12.19 requires Basin States to notify the MDBA of all restrictions on trade imposed under section 12.18 and the reasons for the decisions (e.g. restrictions for physical, hydrologic or environmental reasons).

Information on price

The rules (section 12.48) require the price of a trade to be reported. This obligation rests with the seller, not the approval or registration authority (i.e. the Basin State). There are two elements associated with compliance with this rule; firstly that a price is provided, and secondly that the provided price accurately reflects the agreed price for the trade.

The MDBA considers that the consequence of any individual not reporting their trade price is minimal. However, it is possible that in a thin market, where trade volumes are large, or the price varies significantly, not reporting a single transaction may have an effect. Furthermore, if there is systemic misreporting or price manipulation then this may represent collusion or misleading or deceptive conduct.

Should MDBA become aware of individual traders who regularly fail to fulfil their obligations, increased intervention in these cases may be considered. The MDBA intends to work with Basin States to improve our knowledge of current reporting practices.

While price reporting does not present as a high priority using this framework, the MDBA considers that better price reporting (including through information management systems) has the potential to improve the operation of the water market. We therefore intend to pursue work on better price reporting through wider parts of our work program. This will include education activities for water market participants.

Exchange rates

Trading activities that are not managed correctly can compromise the efficiency of the water market by creating distortions or negative third party impacts. Chapter 5 of the Basin Plan and Schedule 3 of the Act specifically refers to 'provide appropriate protection of third party interests'.

The rules (section 12.21) restrict the use of exchange rates in regulated systems, except where the MDBA declares them valid (section 12.22). The MDBA is only permitted to declare an exchange rate valid to address transmission losses or redress previous exchange rate trades.

Exchange rates were used historically for interstate trade adjustments but proved an ineffective way to manage third party impacts. Exchange rates may be set for a river system scale, or occur across a state border. As a result, they could have a high or moderate impact on the water market. However, the MDBA considers their priority is mitigated by the move away from the use of exchange rates in recent years, particularly for interstate trades. The MDBA therefore considers that use of exchange rates should be monitored carefully, but is unlikely to form a substantial component of the MDBA's work program.

Restrictions on tagging

Section 12.23 of the rules prevents different restrictions from being applied to allocation trades versus water ordered under a tagged arrangement. This ensures that loopholes are not created which give some individuals better access conditions than others. This rule applies to both interstate and intrastate tags.

Low priority

This section discusses areas that have been identified as low priority to ensure the successful implementation of the water trading rules.

Declaration provisions

Section 12.20 allows a Basin State to request that the MDBA declare an allowable trade restriction valid. The MDBA must assess the request and declare whether the restriction is valid. Section 12.22 permits the MDBA to declare an exchange rate valid according to certain criteria.

The MDBA anticipates that the presence or absence of a declaration is unlikely to have a noticeable impact on the water market, although it may improve clarity. Further, the MDBA does not anticipate that it will be unable to fulfil these obligations.

Approval authorities to disclose interests

Sections 12.37 and 12.38 require approval authorities to disclose where they have an interest in a trade, and publish this information on their website.

The MDBA considers that this rule may add clarity for users but is unlikely to significantly change trading behaviour in the water market. Further, we understand that there are limited instances where this rule is likely to manifest, so the consequences are minimal.

Approval authorities to give reasons for restricting trade

The rules require all approval authorities to set out the reasons why a trade is restricted (section 12.39). The MDBA considers that this rule may add clarity for users but is unlikely to significantly change trading behaviour in the water market.

MDBA to publish certain information provided by Basin States

The MDBA has published information on our website on classes of water access rights from Basin States.

Establishment of Chinese walls

The establishment of Chinese walls is contemplated as optional under the water trading rules in order for an agency to manage inappropriate exchanges of information. The MDBA considers this to be an important control relating to the management of information within organisations. As such, higher priority will be given to the disclosure and management of water market sensitive information where Chinese walls are not in place.

Exemptions

Section 12.02 contains an exemption from compliance with certain obligations arising under later provisions in Subdivision A of the water trading rules. The exemption allows certain environmental trades that would otherwise not be permitted, if they are the subject of an intergovernmental agreement.

Section 12.02(5) requires the MDBA to review the exemption provision by 2020. The MDBA intends to fully comply with this requirement, and does not expect that it will take more than six months to complete.

Enabling/interpretation provisions

The water trading rules contain a number of rules which contain minor obligations or enable the rules to occur in the most efficient way, e.g. stating that the MDBA determine the central point for information to be provided. They typically aid the interpretation or operation of the Chapter. The rules also contain provisions which provide definition or context only (e.g. objectives), and do not introduce compliance obligations.

Groundwater trade provisions

Unlike the surface water trade provisions of the water trading rules, the groundwater trade provisions (sections 12.24, 12.25 and 12.26) do not require free trade. They restrict trade unless certain conditions are met. For groundwater trade to occur, Basin States are required to meet the conditions set out in sections 12.24, 12.25 and 12.26 in WRPs - the only trading rules that have direct accreditation requirements.

There is currently one Water Resource Plan area in South Australia which allows groundwater trade that must comply with these requirements. All other Water Resource Plans have interim or transitional status and will be progressively developed over time until 2019. The MDBA is currently finalising a detailed technical guideline for groundwater trading rules. Some of the work on groundwater provisions will occur over the longer term and as it forms part of the WRP accreditation process, it is a current low priority for the MDBA's regulatory role under the water trading rules.

Strategic priorities – assessment of all rules

High Priority	Moderate Priority	Low Priority
12.06	12.15	12.01
12.07	12.21	12.02
12.08	12.23	12.03
12.09	12.28	12.04
12.10	12.32	12.05
12.11	12.33	12.19
12.12	12.34	12.20
12.13	12.35	12.22
12.14	12.43	12.24
12.16	12.44	12.25
12.17	12.46	12.26
12.18	12.47	12.27
12.50	12.48	12.29
12.51		12.30
		12.31
		12.36
		12.37
		12.38
		12.39
		12.40
		12.41
		12.42
		12.45
		12.49
		12.52

Enabling or interpretation provisions are identified in grey