

UNBUNDLING UNBUNDLING

MAJOR CHANGES TO THE WATER ENTITLEMENTS SYSTEM IN VICTORIA HAVE CREATED PROBLEMS FOR PRACTITIONERS AND CLIENTS THAT ARE STILL TO BE RESOLVED. BY DANNY BARLOW AND HAYLEY COATES

Irrigated agriculture production forms a significant proportion of Victoria's overall economic activity. Products such as milk, fruit, wine and vegetables, valued at in excess of \$9 billion per year, are produced using water from Victoria's irrigation systems. Not surprisingly, those responsible for this production, the farmers, take their entitlement to access water very seriously.

On 1 July 2007 major changes to the way water entitlements are regulated took effect in northern Victoria, the region responsible for the majority of irrigated production in this state. This new system or framework is generally referred to as "unbundling".

This article does not provide a detailed description of the new framework. Instead, it provides an introduction to the new system of unbundling with a few examples of the problems practitioners and their clients have met along the way.

What is unbundling?

To understand unbundling, one must first be aware that historically the right to water in Victoria was regarded by many as being "linked" to the land that the farmer owned. In essence, the right to the water and the land were one. The amount of water that a farmer could draw from the irrigation system (known as a water right) was expressed in volume (megalitres) and each year the farmer would get a percentage of that water right. The level of that percentage would vary, depending on how much water was in the storage dams in that particular year.

The water right could be traded to other land owners and was often of very significant value – sometimes more than the land to which it had been attached. If it was sold, it would then "re-attach" to the purchaser's land.

Given that the water right was at least to some degree linked to the land, the water was often affected by dealings with the land. For example, a mortgage over the land was effectively a

mortgage over the water. A caveat over the land was effectively a caveat over the water.

This water right was a curious legal thing and there has been debate among lawyers as to what, from a legal point of view, it actually was. Was it a proprietary right? (it acted like one), was it a licence?, or was it merely a statutory entitlement that could be taken away at the whim of any government?

In 2004, the Victorian government released an action plan titled *Our Water Our Future*. Unbundling formed part of that action plan.

In 2005, the government passed the *Water (Resource Management) Act* which, together with the *Water (Governance) Act* 2006, made significant changes to the *Water Act* 1989 and paved the way for unbundling. Unbundling involves the splitting of the water right into its distinct components or, in other words, unbundling it.

The major components into which the water right has been split are:

- **A water share** – This is a legally recognised, secure share of water available to the farmer to irrigate his or her crops or pasture;
- **A delivery share** – This is an entitlement to have water delivered via infrastructure to the farmer's property; and
- **A water use licence** – An authority to use water for irrigation on a particular property.

One of the major effects of unbundling has been that the water right (or more correctly now, bundle of rights) is now clearly distinct from the land itself. This has certain consequences which are explored further below.

Why unbundling?

The government argued that unbundling would free up the water market and provide greater flexibility to farmers in how they conducted their enterprises. More specifically, it was said that the following benefits, among others, would flow to farmers:



- Farmers could free up capital by selling their valuable water rights and leasing them back from the purchaser. This would allow access to capital which could be used, for example, to reduce debt and therefore operating costs, or to invest in more efficient farming practices.
- Mortgages could now be granted directly over water shares in contrast to the past when the mortgage would be over the land itself. This, it was said, would allow greater flexibility to farmers in their borrowing arrangements. In addition, it was anticipated that financiers and water brokers would offer irrigators financial products specifically tailored to the farmer's needs.
- Farmers could adjust either the reliability of their water supplies (that is, how likely they were to get a certain amount of water in a given year) or the timeliness of the delivery of the water, depending on their needs. For example, with some produce such as tomatoes, the actual timing of the delivery of the water is just as vital as the amount of water applied over a season. It is said that unbundling makes it possible to ensure that water will be available to the farmer at just the right time.
- By allowing water shares to be bought without owning land, an irrigator could buy water without having to make a significant investment in land. This is said to be particularly useful for sharefarmers (farmers who work on land owned by someone else in return for a share of the revenue).

The Victorian Water Register

In order to record ownership of water rights in Victoria, a new water register has been established. The register is a public document and is to water what the land titles system is to land. The register records who owns what water rights at a particular time and also whether any other party holds an interest in relation to the water, such as a mortgage or lease. It also includes information such as:

- the tenure and holding in megalitres for each water share;
- how much water has been allocated against water shares, how much has been used, and where it was used; and
- summary reports on the volume of water shares in each water system, annual allocation, use and the trading history, including average prices for each water system.

The Victorian Water Registrar is responsible for recording share transactions in the register. Extracts of water shares from the register can be obtained online at www.dse.vic.gov.au or via Anstat. They can also be inspected together with water use licences and extracts of delivery shares in person at relevant water authorities.

Not all smooth sailing

Regardless of one's views as to unbundling in principle, it is clear that the implementation of the new system, at least from a legal practitioner's point of view, has been anything but smooth. In fact, the view of almost all practitioners whose practice is affected by unbundling is that the system was implemented before sufficient consideration had been given to how it would work in practice. Three of the most common areas of concern raised by practitioners are:

Impracticable time frames

Under the new system, a vendor of water (who is often simultaneously a vendor of land) must obtain ministerial consent to the water share transfer taking place. In practice, this occurs by way of the vendor's solicitor lodging with the relevant water authority (Goulburn Murray Water, for example) various paperwork, including material to allow a vendor to satisfy a 100-point identification check.

Assuming the transaction is approved, a transfer document is sent directly to the vendor with a letter of approval. Letters are also sent to the purchaser and the vendor's solicitor. The transfer is only valid for 60 days which, in reality, can cause practical

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issues – for example, the transfer obviously needs to be obtained some time in advance of settlement to ensure that settlement can proceed. If a vendor is for any reason unable to get the transfer to their solicitor promptly, significant delays can occur. This means that by the time settlement has occurred a substantial part of the 60 days has already expired. The purchaser's solicitor or bank may have only a very small amount of time to have the transfer lodged after settlement. Failing to do so means it will lapse, and without cooperation from the vendor (who already has their money) in applying for another transfer, the water will not be transferred. This problem is compounded when delays in settlement occur due to other factors.

Practitioners need to be very conscious of these particular issues in drafting contracts which in any way relate to a transfer of a water share under the new system.

Inability to lodge caveats

Under the old system the lodging of a caveat over land had the practical effect of placing a caveat over any water right which might be attached to the land. This was because, while the transfer of water rights was possible under the old system, it was not permitted where a caveat existed over the land unless the caveator consented to the transaction.

Remembering that one of the effects of unbundling has been to largely remove the nexus between the water right and the land, this protection no longer applies. A farmer may own a farm which, allowing for both land and water, is worth one million dollars. The value of the water might be in excess of half that amount. The ability of an interested party to caveat is now limited to the value of the land, whereas previously it would have been for the full value of the land and water.

This should be of particular interest to those practitioners practising in litigation where an irrigation farm is involved. A common example might be a family dispute where a party claims an equitable interest in the farm and wishes to protect the interest by way of a caveat, pending the outcome of litigation. The level of

protection provided by that caveat may be significantly less than it would have been under the old system.

Wills involving water

Another issue causing concern relates to the fact that unbundling may have the effect of changing the distribution of assets in many wills made before unbundling. Many wills were previously made on the assumption that the leaving of land to a particular party would also leave the water right to that party. Since unbundling, that position has changed as the land and water rights are separate. Unless the will is changed, the land will go to the named party and the water right will form part of the residuary of the estate.

One can see that the results are potentially disastrous and it is therefore vital that, where possible, practitioners alert clients to this potential problem and encourage them to revise the contents of their wills so that the real intention is put into effect.

It should be noted that the Department of Sustainability and Environment is apparently of the view that earlier amendments to legislation which had paved the way for water trading were of themselves sufficient to render water rights personal property rather than part of the land for the purpose of wills.

Whatever the correct position, it is clear that scope for confusion exists as to the status of wills made prior to the unbundling legislation.

Conclusion

The LIV and others have been lobbying to have these and other issues concerning the unbundling legislation to be addressed. While it is hoped that these efforts will result in legislative reform, in the meantime practitioners must be conscious of significant changes that have taken place to the water entitlement system in Victoria and the impact that those changes may have on their clients and the transactions they undertake. ●

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