

Attachment M

Review of WAMC's pricing framework

30 September 2024



Natural Resources
Access Regulator



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1 Identifying and implementing reforms to WAMC's pricing framework

This attachment presents our consideration of potential changes to the structure of WAMC's water management prices for the 2025 determination period, and our plans to review the structure of WAMC's water management prices in time for the 2030 price determination. We welcome IPART and stakeholder feedback on our proposed approach to this review.

1.1 The current structure of WAMC's water management prices

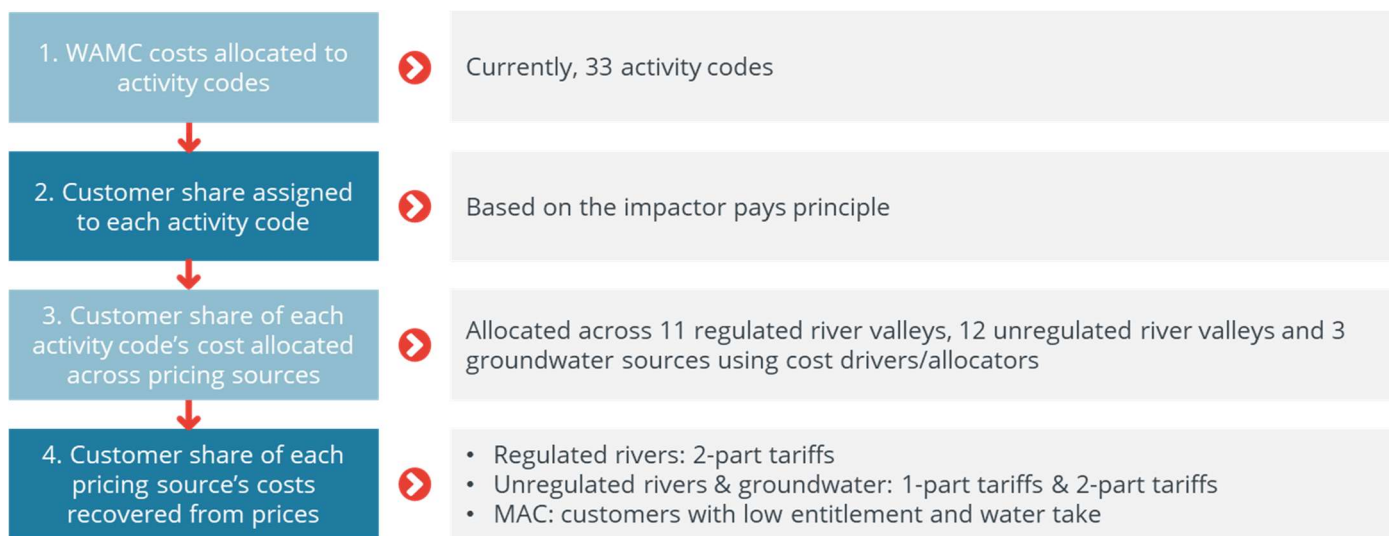
The current WAMC pricing framework involves:

- allocating costs to water management activities (codes)
- applying the impactor pays principle to determine water customers' share of the costs of each activity
- allocating the customer share of each activity across regulated river valleys, unregulated river valleys and groundwater sources using cost allocators to determine the customer share of the 'notional revenue requirement' (i.e., costs to be recovered from water management prices) for each valley/source
- setting water management prices for each valley/source to recover its customer share of notional revenue requirement through:
 - two-part tariffs for regulated river valleys (i.e., \$ per ML of water entitlement and \$ per ML of water take)
 - two-part tariffs (\$ per ML of water entitlement and \$ per ML of water take) for customers with meters on unregulated rivers and groundwater sources
 - one-part tariffs (\$ per ML of water take) for customers without meters on unregulated rivers and groundwater sources
- applying a Minimum Annual Charge (MAC) where a customers' two or one-part tariff would be less than the MAC, with the MAC set at a uniform level across the state.

Currently, about 20% of WAMC's price revenue is tied to water take (80% of revenue is largely fixed, received from MAC and entitlement charges), although this may increase towards 30% as more meters are in place and therefore more customers move from one to two-part tariffs.

There are also one and two-part MDBA and BRC water management charges and separate consent transaction and metering charges.

Figure 1: Key features of the framework for WAMC’s water management charges



1.2 IPART’s comments on the pricing framework at the 2021 determination of WAMC’s prices

At its last determination of WAMC’s prices, IPART observed that:

“WAMC’s cost allocation methodology and price structures are complex. Prices are determined by an indirect cost allocation process (using cost drivers), rather than direct attribution of costs.”

“There are advantages and disadvantages of undertaking this cost allocation methodology. This allocation process could allow prices to be more cost reflective for each water source. However, it may not be materially more cost reflective given the inherent uncertainty associated with the cost allocation methodology. It could also be unnecessarily complex and costly to administer.”¹

IPART encouraged WAMC to consider this issue further over the 2021-2025 pricing period, including whether:

- WAMC can move towards greater direct cost attribution
- the cost drivers used to allocate costs between water sources can be improved

¹ IPART, Review of prices for the Water Administration Ministerial Corporation from 1 October 2021 to 30 June 2025, Final Report, September 2021, p 18-19

- there would be merit in moving towards more aggregated and less complex pricing arrangements.
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1.3 Our consideration of changes to WAMC's pricing framework for the 2025 determination

In response, we have considered a range of potential changes to our pricing framework. We propose new floodplain harvesting charges and changes to the allocation of three activity codes to allow for the more direct attribution of costs (outlined in Chapter 6). However, we do not recommend further changes for this 2025 price determination for several reasons:

- Apart from changes to the way costs are allocated for 3 activity codes, we have not identified any other clear improvements to cost attribution and allocation at this stage. We consider our approach to allocating costs to water sources using cost drivers is transparent and sound.
- Our proposal to manage the transition towards full cost recovery through annual caps on the level of price increases would be ineffective and not transparent to customers if WAMC also simultaneously proposed changes to price structures.
- Changes to our pricing framework and structure have not been identified as a key issue or source of concern for customers during consultation. A higher priority for customers is confidence that the Government is paying its fair share and transparency about what customers are paying for, which is more easily assured and communicated by continuing current structures. For this price proposal, we have therefore instead focused on issues that are most important to customers and stakeholders.
- Given the potentially significant impacts of changes to the pricing framework, we would like to take more time to review our cost structure and to consult extensively with customers and other stakeholders on the range of potential changes, their merits and their impacts.

Changes to price structure would create 'winners' and 'losers' amongst customers, with some customers' prices increasing and other customers' prices decreasing as a result of changes to price structure (all else being equal). Further, all elements of the pricing framework (activity codes, customer shares, cost allocators and the geographic and fixed/variable split of prices) are interrelated. Therefore, changes should be informed by a comprehensive review of the pricing framework, a sound understanding of WAMC's cost structure, extensive customer consultation, and analysis of bill impacts across the customer base.

We therefore plan to undertake a comprehensive review of the structure of WAMC's water management prices over the 2025 determination period, to inform our proposal to IPART's 2030

price determination. Below we outline our consideration to date of the geographic and fixed/variable split of WAMC's water management prices.

Further below we provide an overview of our proposed approach to reviewing WAMC's price structure over the 2025 determination period.

1.3.1 The geographic structure of WAMC's water management prices

IPART has suggested that WAMC considers a move to more aggregated pricing. This could involve, for example:

- setting regional prices for rivers and groundwater (e.g. inland/coastal, northern/southern or by regional water plan area), rather than valley-specific prices, and/or
- amalgamating regulated and unregulated rivers for pricing purposes.

However, this requires careful consideration and justification, as geographic aggregation has been contentious in the past. Geographic aggregation will result in 'winners' and 'losers' in the absence of a price cap and an alternative funding arrangement to absorb the financial risk (on behalf of 'losing' customers) as proposed by WaterNSW in Alternative Scenario 3 of its bulk water pricing proposal.

Further, the geographic structure of WAMC's water management prices is linked to its activity codes (and hence the customer share of costs of these codes) and cost allocators. Therefore, a review of the geographic structure of WAMC's water management prices also requires a review of its activity codes and the approach to attributing/allocating the costs of those codes to relevant geographic areas and/or water sources.

Ideally, WAMC's water management prices should be set at a geographic level that best reflects WAMC's cost structure (i.e. the extent to which WAMC's water management costs vary by geographic region or water source) while readily allowing for robust cost allocation to impactors.

The objectives of the price structure would be to ensure that cost allocation/attribution is:

- accurate, so that price differences between pricing areas/sources reflect genuine differences in the costs of providing water management activities (consistent with objectives of efficiency and equity)
- transparent and easy to explain to customers and other stakeholders, so that WAMC can explain why the costs of supplying water management activities differ between pricing areas/sources.

Key questions to consider in reviewing the geographic structure of WAMC's water management prices include:

- At what geographic level do WAMC’s water management services vary (e.g. valley level, broader regional level, or no variation across the state)?
- Do WAMC’s water management services vary between types of water sources (regulated rivers and unregulated rivers)?
- At what area and source level can WAMC robustly allocate costs to impactors?
- How can WAMC’s costs be best allocated to the area/source that best matches its cost structure?
 - e.g. it may be possible to directly attribute some costs to areas or sources, whereas others may still need to be indirectly allocated using cost drivers (and, if so, what are the best cost drivers for each relevant cost code?).

1.3.2 The fixed/variable structure of WAMC’s water management prices

We considered a range of potential options for the fixed/variable structure of WAMC’s prices for the 2025 determination. This included:

- The status quo
- Remove the MAC, so that all licence holders face the one or two-part tariff
- Apply a two-part tariff to all licence holders on all water sources, comprised of:
 - A ‘fixed charge’ per entitlement holder (\$ per licensee, per annum) to recover WAMC’s fixed costs per licensee (i.e., the costs that WAMC incurs irrespective of a licensee’s volume of entitlements). This would be in place of the current MAC and apply to all entitlement holders.
 - A charge per ML of a licensee’s volume of entitlements (\$ per ML of entitlement, per annum).
- Apply a two-part tariff to all licence holders, on all water sources, comprised of:
 - A ‘fixed charge’ per entitlement holder (\$ per licensee, per annum) to recover WAMC’s fixed costs per licensee (i.e., the costs that WAMC incurs irrespective of a licensee’s volume of entitlements).
 - A charge per ML of a licensee’s water take (\$ per ML of water take, per annum).
- Applying a three-part tariff to all licence holders, on all water sources, comprised of:
 - A ‘fixed charge’ per entitlement holder (\$ per licensee, per annum) to recover WAMC’s fixed costs per licensee (i.e., the costs that WAMC incurs irrespective of a licensee’s volume of entitlements).
 - A charge per ML of a licensee’s volume of entitlements (\$ per ML of entitlement, per annum).

- A charge per ML of a licensee's water take (\$ per ML of water take, per annum).

Relevant considerations in evaluating potential changes to the fixed/variable structure of WAMC's prices include WAMC's fixed/variable cost structure, customer preferences, bill impacts, distribution of risk between WAMC and its customers and simplicity.

Our preliminary assessment of these options is in **Table 1** below. The column on impacts assumes there are no caps on price increases below cost-reflective levels to manage bill shocks (i.e. it outlines indicative impacts under cost-reflective pricing). It also does not take into account any change to the geographic split of prices – which would also have impacts on the prices faced by different customers.

This assessment highlights that there are a range of issues to consider and weigh-up in evaluating potential changes to price structure – which supports a process of comprehensive review and consultation prior to the implementation of any significant changes to price structures.

Key questions to resolve or issues to consider in evaluating potential changes to WAMC's fixed/variable price structure include:

- the relationship between WAMC's water management costs and volumes of water take
- the relationship between WAMC's water management costs and volumes of water entitlement
- customer views on the fixed/variable split of WAMC's water management prices
- the proportion of WAMC's water management costs that are fixed per licence (i.e. independent of water take and entitlement volumes).

Table 1: Preliminary evaluation of potential changes to the fixed/variable structure of WAMC’s water management prices

Option	Logic	Impact relative to status quo option	Pro	Con
Status quo	Some costs are fixed per licence (hence the MAC), other costs are primarily driven by entitlement volumes, with a water take charge provided to tie a portion of bills to water take consistent with customer preferences.	<ul style="list-style-type: none"> • None 	<ul style="list-style-type: none"> • No change required • Any changes are best to occur after a comprehensive review of cost and price structures (i.e., look at fixed/variable & geographic split together) 	<ul style="list-style-type: none"> • Complex • Different pricing to those on the MAC Vs those not on the MAC (for those on the MAC, fixed and variable costs recovered through the MAC; for those not on the MAC fixed and variable costs recovered in proportion to entitlement/usage volumes)
Status quo, but remove the MAC	Entitlement volumes are the primary driver, with a water take charge provided to tie a portion of bills to water take	<ul style="list-style-type: none"> • Lower bills for those previously on the MAC, higher bills for other users 	<ul style="list-style-type: none"> • Simplification • Consistent pricing to all users 	<ul style="list-style-type: none"> • Very small users unlikely to pay the fixed costs of licences

Option	Logic	Impact relative to status quo option	Pro	Con
	(consistent with customer preferences)			
\$ per licence and \$ per ML of entitlement	Some costs are fixed per licence, other costs are driven by entitlement volumes	<ul style="list-style-type: none"> Higher bills for those currently on the MAC, lower bills for other users Higher bills for those with a high entitlement to usage ratio 	<ul style="list-style-type: none"> Simplification Cost-reflective Consistent pricing to all users Revenue stability / certainty for WAMC 	<ul style="list-style-type: none"> Customers generally support some component of their bill tied to water take May be seen as inconsistent with the meter roll-out
\$ per licence and \$ per ML of take (usage)	Some costs are fixed per licence, remaining costs are recovered based on water take (consistent with customer preferences and noting that water take is likely to be positively related to entitlement volumes, which is a key cost driver).	<ul style="list-style-type: none"> Higher bills for those currently on the MAC, lower bills for other users Higher bills for those with a high usage to entitlement ratio 	<ul style="list-style-type: none"> Simplification Consistent pricing to all users Likely to be supported by many customers (i.e. many of those not on the MAC) 	<ul style="list-style-type: none"> Revenue instability/uncertainty for WAMC (overall cost recovery could potentially be managed via a DVAM, but there would still likely be year to year volatility)

Option	Logic	Impact relative to status quo option	Pro	Con
<p>\$ per licence, \$ per ML of entitlement volume, and \$ per ML of water take</p>	<p>Some costs are fixed per licence, other costs are primarily driven by entitlement volumes, with a water take charge provided to tie a portion of bills to water take consistent with customer preferences.</p>	<ul style="list-style-type: none"> Higher bills for those previously on the MAC, lower bills for other users 	<ul style="list-style-type: none"> Reasonably cost-reflective, while still tying a portion of bills to water take (albeit likely a lower portion) likely more revenue stability for WAMC Consistent pricing to all users 	<ul style="list-style-type: none"> Complex The portion of revenue tied to water take would be lower (given 3-part tariff to all customers) – and customers generally support a higher portion of their bill tied to water take

1.4 Our approach to reviewing WAMC's pricing framework for the 2030 determination

Over the 2025 determination period, the WAMC agencies, in consultation with customers and other key stakeholders, plan to review WAMC's pricing framework to inform IPART's 2030 WAMC price determination.

In undertaking this review, we will seek to identify potential changes to simplify the pricing framework, while balancing other price objectives of transparency, cost-reflectivity and stability.

At this stage, we envisage our review will involve:

- Review of WAMC's cost structure, to identify WAMC's geographic and fixed/variable split of costs – as WAMC's cost structure, combined with the level/structure of pricing to which it can readily and accurately allocate costs, will be a key consideration in reviewing price structures
- Review of implications of potential changes to WAMC's price structure for its cost codes (or categories) and consequently its customer shares (per code) and cost allocators
- Engagement with customers and stakeholders (including IPART) to inform decisions on the preferred pricing framework and the transition to that framework. This would likely require several stages: first to inform decisions on the price structure; and then to ultimately test and explain the proposed price structure, including potential impacts.
- Price modelling to assess the potential price and bill impacts of potential changes to price structures, and to inform the transition to any change in price structure and the development of potential measures to mitigate or manage bill impacts.

The objectives of this review will be to that any changes to price structures proposed by WAMC for the 2030 determination reduce complexity, result in prices that are transparent and reasonably cost-reflective, and are informed by customer and stakeholder consultation.