

**ATTACHMENT 9.8**  
**ANCILLARY NETWORK SERVICES REVISED**  
**PROPOSAL**

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## 1. PURPOSE

The purpose of this paper is to present to the Australian Energy Regulator (AER) Essential Energy's response to the issues raised by the AER in the *Draft decision Essential Energy distribution determination (2015-16 to 2018-19) – Attachment 16: Alternate control services, in particular those issues related to ancillary network services*. This report does not respond in detail to the following issues identified by the AER:

- > Efficiency of labour costs (Attachment 7.5)
- > Overhead allocation as provided for within the CAM (Attachment 6.5)

## 2. SUMMARY

Issues raised by the AER regarding Essential Energy's ancillary network services proposal and Essential Energy's response are highlighted in table 2-1 below:

**Table 2-1: AER issues and Essential Energy's response**

AER issue	Summary of AERs reasons and findings	Essential Energy's response
Labour costs	The AER has applied reductions to base labour costs to align to benchmarking outcomes.	Essential Energy maintains it cannot obtain the rates described in the Marsden Jacob analysis based on local labour rates for the qualifications required by each ancillary network service. Following further analysis of the average labour rate applied to ANS, Essential Energy has applied a reduction to the administration rate (R1)
Overheads	The AER has applied implied overhead rates as calculated by Marsden Jacob, resulting in a different percentage being applied to each labour category.	Essential Energy rejects these implied overhead rates and continue to use overheads as calculated in accordance with our AER approved CAM.
Labour on-costs	The AER has applied a cap on labour on-costs as proposed by Marsden Jacob to 52.23%	Essential Energy's on-cost methodology is to only apply on-costs to productive hours, ie hours worked by an employee excluding leave. The result is a higher on-cost percentage than if on-costs were applied to all paid hours. Essential Energy rejects the AER's draft decision and proposes to retain the original on-cost percentage to enable full cost recovery of labour related entitlements.
Non-labour costs	The AER has excluded non-labour direct costs from ASP related fees. No explanation has been provided on why this action has been taken.	Essential Energy does not accept the exclusion of non-direct costs from proposed fees as these costs should form part of the cost reflective charge.
Fee inconsistencies	There are a number of inconsistencies between draft decision and ANS pricing models	Essential Energy recommends these be corrected to ensure consistent application across all ANS fees.
Network tariff change	The AER has not approved 'network tariff change – invalid request' as this fee was not supported in submissions from energy retailers as they are unable to tell when a change would be invalid. However, the AER has retained the 'network tariff change' fee within the table of fees for the draft decision.	Essential Energy has revised its definition of 'network tariff change' to only apply to a valid tariff change request made outside the annual pricing process. A revised fee has been provided for 'network tariff change' reflecting this change in definition.

### 3. BACKGROUND

Essential Energy has proposed cost reflective charges for ancillary network services provided to specific customers, as required by the AER. These services include new services identified during the framework and approach process and re-classified services (from standard control) formerly known as 'Miscellaneous and Monopoly' fees as defined in the AER's Framework & Approach – March 2013 paper. The re-classified services had been set historically by IPART, typically at cost and carried forward over the past regulatory periods. The charges proposed by Essential Energy for the 2014-19 regulatory control period were intended to eliminate the cross-subsidisation of these specific activities by standard control services customers.

The AER draft determination approved Essential Energy's proposal for the following specified services:

- > Rate based:
  - ASP Inspection L1 – UG urban
  - ASP Inspection L1 – OH rural
  - ASP Inspection L1 – UG urban C&I or rural
- > Fee based:
  - Reconnection/disconnection – out of business hours
  - Office fees – debt collection costs – dishonoured transactions
  - Office fees – ROLR services.

The AER approved Essential Energy's proposed fees for these ancillary network services because it was considered that the underlying labour rates and overheads fell within the benchmark total labour rates developed by Marsden Jacob.

All other proposed fees have been rejected. The AER's decision to reject was based on analysis of the methodologies Essential Energy used to calculate the fees, particularly the cost inputs:

*We reviewed Essential Energy's proposed fees for all other ancillary network services and the methodologies Essential Energy used to calculate these fees. Based on our analysis of Essential Energy's proposed methodologies we consider the main concern is the cost inputs into the methodologies. Where there are inefficiencies in actual historical costs these will be carried through in the derivation of proposed fees.<sup>1</sup>*

Essential Energy has not revised the proposed ancillary network services charges to adopt the AER's benchmark approach. We do not consider revisions are required to address the matters raised by the AER in its draft decision. Specifically:

- > Essential Energy's labour rates are substantiated by actual information and it is considered they represent a cost-reflective and efficient charge; and
- > Essential Energy's overheads were calculated and applied in accordance with Essential Energy's Cost Allocation Methodology (CAM) approved by the AER in May 2014.

These issues are discussed in further detail in the following sections.

Essential Energy has reviewed its charges to ensure they reflect the latest information available and represent a cost-reflective and efficient outcome. Ancillary network services overhead rates have been updated to reflect efficiency outcomes consistent within standard control services and Essential Energy's AER approved CAM. The ancillary network services cost models are provided as attachment 9.9 to the revised regulatory proposal. The revised charges are provided as attachment 9.10.

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<sup>1</sup> AER, Draft decision Essential Energy distribution determination 2015-16 to 2018-19 Attachment 16: Alternative control services, November 2014, pg 20

## 4. DISCUSSION

In this section the specific issues raised by the AER are discussed, as well as items identified within the ancillary network services models:

- > Labour costs;
- > Fee inconsistencies; and
- > Revised fees and other information.

### 4.1. Labour costs

Essential Energy has built up charges for ancillary network services based on estimated time to complete tasks, allocated labour rates and additional material costs where appropriate.

The AER has made reductions to proposed ancillary network services fees using labour benchmarking analysis from Marsden Jacob.

While Essential Energy acknowledges benchmarking is an available assessment tool, it is considered to be of limited value in forecasting practical and efficient service delivery. It is not considered the techniques are sufficiently refined to be relied upon to such a degree. It is inappropriate to use benchmarking in a deterministic manner for revenue and charge setting. Instead, the benchmarking results should be used to guide a more detailed assessment of proposed charges.

**Table 4-1: Labour rates including on-costs and overheads (\$2013-14)**

Labour Category	Essential Energy Proposed Rate	Marsden Jacob Max Rate <sup>2</sup>	Percentage Variation	AER Draft Decision Max <sup>3</sup>
Administration (R1)	113.22	85.81	24%	82.85
Design (R2a)	143.59	137.60	4%	125.32
Inspector (R2b)	171.03	161.84	5%	149.30
Engineer (R3)	192.38	171.05	11%	170.93
Field Worker (R4)	130.01	128.92	1%	126.10

Essential Energy notes there are inconsistencies with the rates published within the draft decision and those rates applied by the AER in the ancillary network services models and thus the derived draft decision charges. The ancillary network services models use the Marsden Jacob maximum labour rate, whereas the draft decision uses the Essential Energy-specific 'revised administration rate' calculated by Marsden Jacob.

Essential Energy does not accept either benchmarked labour rate as being a cost reflective efficient labour rate for Essential Energy. This is discussed further in the following sections.

#### **Base labour rates**

The AER requested Marsden Jacob to provide advice on the efficiency of the labour rates and overheads applied by the businesses to determine ancillary network service charges.

*Marsden Jacob has used professional judgement to propose a maximum rate that should be applied for each labour category based on consideration of the rates applied across the businesses and a comparison against the Hays benchmark salary rates.<sup>4</sup>*

Essential Energy acknowledges that Marsden Jacob has set the maximum raw labour rate at the upper quadrant of the Hays benchmark, however this analysis ignores the fact that Essential Energy cannot access a national or international labour market. It is not clear if the results are driven by lower labour rates in other states, countries or industries.

<sup>2</sup> Marsden Jacob Associates, Provision of advice in relation to Alternate Control Services, 20 October 2014, Table 4 \$13/14. This is the same labour rates utilised in the AER draft decision ancillary network service models

<sup>3</sup> AER, Draft decision Essential Energy distribution determination 2015-16 to 2018-19 Attachment 16: Alternative control services, November 2014, Table 16-2 indexed to \$13/14

<sup>4</sup> Marsden Jacob Associates, Provision of advice in relation to Alternate Control Services, 20 October 2014, pg 2

Essential Energy maintains it cannot obtain the rates as described in the Marsden Jacob analysis, based on the local labour rates for the qualifications required by each ancillary network service, with labour rates locked in via the enterprise agreement. Essential Energy has historically used a competency based classification system to determine appropriate pay ranges for roles within the business. While there are a number of entry level positions that fall at a lower competency level, the vast majority of tasks completed within the ancillary network service space require a higher level of competency.

In line with the AER draft decision, Essential Energy has further reviewed the proposed pay ranges included within its substantive regulatory proposal and compared these against the tasks provided within ancillary network services. Essential Energy accepts the Administration pay rate (R1) used was not reflective of the average of all tasks being completed; as such, Essential Energy has revised downwards the administration (R1) rate for the revised regulatory proposal. All other proposed labour rates are considered cost reflective.

The AER has generally accepted the times taken to perform services proposed by Essential Energy. Essential Energy considers both the time and labour rate inputs in the revised regulatory proposal represent realistic and efficient costs of providing these services.

Refer to Attachment 7.5 for further details on labour cost analysis.

### **Labour on-costs**

The AER has accepted the Marsden Jacob's recommended efficient benchmark labour rates, overhead and times taken to perform services, in forming its draft decision.

Marsden Jacob applied two types of on-costs to raw labour rates to complete its benchmarking:

- > Basic leave entitlements including annual leave, sick leave and public holidays; and
- > Standard on-costs such as superannuation, workers' compensation, payroll tax, annual leave loading and long service leave.

Marsden Jacob, following a bottom up estimate, recommended that a maximum on-cost of 52.2 per cent should be applied. Essential Energy's proposed labour on-costs vary slightly from the bottom up analysis performed by Marsden Jacob, however the biggest difference comes from the application of productive hours. Essential Energy applies on-costs to worked time only, not periods of annual leave, as such on-costs are only applied to productive time. Essential Energy historical data indicates that productive time is generally around 42.6 weeks per annum (82 per cent productive time). For example, while superannuation equates to 15 per cent of employee salary, as the on-cost is only applied to productive time, the result is an 18.4 per cent on-cost contribution.

Essential Energy's on-cost methodology is to only apply on-costs to productive hours, ie hours worked by an employee excluding leave. The result is a higher on-cost percentage than if on-costs were applied to all paid hours. Essential Energy recommends the AER retain Essential Energy's on-cost percentage to enable full cost recovery of labour related entitlements.

### **Overhead allocation**

Essential Energy's charge build-up for ancillary network services includes both direct and indirect costs to provide a cost reflective charge for customers. A detailed review of the AER draft determination and the Marsden Jacob report has identified some inconsistencies in overhead treatment.

Marsden Jacob calculated implied overheads to assist with benchmarking:

*In order to benchmark overhead rates on a comparable basis, Marsden Jacob calculated an 'implied overhead rate' for each of the businesses by taking the ratio between the total labour rate proposed by the distribution business (including all on-costs and overheads) and the standard labour rate (including on-costs but not overheads).<sup>5</sup>*

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<sup>5</sup> Marsden Jacob Associates, Provision of advice in relation to Alternate Control Services, 20 October 2014, pg 4

The result of this calculation of implied overhead rates for Essential Energy is a different overhead rate for each labour category. This is inconsistent with Essential Energy's overhead allocation method; where overheads are applied on a percentage basis consistent with Essential Energy's CAM approved by the AER in May 2014. A constant overhead rate is applied to all labour categories.

Essential Energy notes the AER has used Marsden Jacob's implied overhead rates in determining labour rates (including on-costs and overheads) to apply within the draft determination. This is inconsistent with the CAM, and results in over recovery of overheads on most labour categories.

Marsden Jacob, in its analysis of overheads, confirmed Essential Energy's overheads were below the recommended benchmark. It is noted, however, that Marsden Jacob iterated in its report that while it considered the overhead rates for ancillary network services in isolation, capping the overhead rate may have unintended consequences for the broader CAM. It recommended the appropriate method of addressing the overhead allocation should be tested with the AER staff responsible for developing and enforcing the CAM<sup>6</sup>.

Essential Energy has consistently applied indirect costs to all ancillary network services fees included within the revised regulatory proposal, consistent with the CAM. We have reviewed our overhead allocation rate of 41.74 per cent and substituted a rate of 36.05 per cent (average over 5 years). This review has generally led to decreased charges for ancillary services from those submitted in our substantive proposal. Further details on corporate and divisional overheads are included in Attachment 6.4 which unbundles the overheads and explains their application.

### *Design or engineering labour rates applicable*

Essential Energy proposed a number of design and certification services where the labour applicable may vary depending on the nature of the service provided. Essential Energy's proposal included the use of design (R2a) or engineering (R3) labour for the rate based charges. Essential Energy notes the AER has generally only provided for the use of design (R2a) labour within the draft determination.

Essential Energy proposes to apply the labour rate (R2a or R3) based on assessment of the level of skill required to perform the service. This assessment will be based on the nature and complexity of the requested service; with an engineering resource (R3) utilised for more complex enquiries.

This level of flexibility is required to enable cost reflective pricing; ensuring that charges are reflective of the complexity and the level of skill required to perform the service.

## **4.2. Fee inconsistencies**

In reviewing the AER's draft decision for Alternate Control Services and the various ancillary network services models, Essential Energy found a number of inconsistencies in the AER's treatment of fees proposed by Essential Energy; these are highlighted in the following section:

### *Draft decision charge inconsistent with model*

Following a review of ancillary network services models provided by the AER, Essential Energy has identified an inconsistency in the charge applied within Table 16-25 Ancillary network services – Essential Energy – draft determination and AER Attachment 8.9\_07 Disconnection – Reconnection Fees.

**Table 4-2: Disconnection charges inconsistent between draft decision and model**

Service	AER Draft Determination Table 16-25 (\$14/15)	AER Draft Determination (\$13/14)	Attachment 8.9_07 (\$13/14)
Disconnection / Reconnect – Disconnection Complete	124.32	119.79	120.42
Disconnection / Reconnect – Technical disconnect	124.32	119.79	120.42
Disconnection / Reconnect – Pillar / Pole	460.24	443.47	444.12

<sup>6</sup> Marsden Jacob Associates, Provision of advice in relation to Alternate Control Services, 20 October 2014, pg 5



It would appear the draft determination rate included within table 16-25 of the AER's draft determination is based on the Marsden Jacob maximum labour rate (including on-costs and overheads), not the revised technical rate (by DNSP) as used within the models.

While Essential Energy does not endorse the use of the Marsden Jacob benchmarking rate in either the draft decision or the ancillary network services models, the business does endorse the consistent treatment of labour rates between all ancillary network services fees.

### **Non-labour direct costs**

Essential Energy's charge build-up for ancillary network services includes both direct labour and non-labour costs, such as stores and materials, as well as overheads to provide a cost reflective charge for customers. A detailed review of the AER draft determination models for ancillary network services has identified inconsistencies in the ASP fees model where proposed non-labour costs have been excluded.

ASP fees include ASP authorisation – initial and renewal, ASP training, and remedial action of ASPs. Additional non-labour direct costs were included in the proposed model for all ASP fees except remediation of ASPs. It is noted the AER has updated formula source references within the model to include only labour costs, thus excluding the proposed non-labour components of the fees from the draft determination.

**Table 4-3: Draft decision fees excluding non-labour direct costs (\$2013-14)**

Service	Unit	Proposed Charge	AER Draft Decision	% variation	Non-labour direct cost	Non-labour cost loaded
ASP Authorisation - Initial	/ authorisation	\$798.08	\$541.05	-32.0%	\$93.96	\$136.03
ASP Authorisation - Renewal	/ authorisation	\$386.36	\$274.59	-28.9%	\$16.64	\$24.10
ASP Training	/ authorisation	\$299.69	\$114.65	-61.8%	\$102.80	\$148.86
Remediation of ASPs	/ hour	\$171.03	\$161.84	-5.4%	-	-

Non-labour direct costs for ASP authorisations include printing, stationery and distribution costs associated with the preparation of Essential Energy's ASP induction pack, and the issuing of an ASP authorisation ID card. The induction pack is provided to new ASPs obtaining authorisation to work on Essential Energy's distribution network. ASPs seeking renewal of their authorisation will be provided with updates to relevant material and a new ID card; as such the non-labour costs are much lower than for the initial authorisation fee.

ASP training includes non-labour costs associated with training venue hire and printing and stationery for training and assessment materials.

Essential Energy does not accept the AER's exclusion of non-labour direct costs from proposed fees as these costs are considered a true cost in providing these services and as such should form part of the cost reflective charge.

### **Partial approval of fees**

In reviewing the detailed draft decision for alternate control services, it appears the rate based fee for ASP Inspections has been approved, however a 5.4% reduction has been applied to inspections of Class B ASPs. This may have been an omission by the AER in the draft determination.

It is not clear to Essential Energy why the AER has determined Class A and Class C ASP inspections fall within Marsden Jacob benchmarking, yet Class B falls outside of benchmarking, as all ASP inspection fees are based on the same labour category of R2b – inspector / outdoor technical officer.

While there is a variation in proposed fees that applies to class A, B and C ASP inspections, this variation is associated with the estimated labour hours for inspections for that class, driven by the volume of inspections required. Refer to below table for details of inspection rates required:



**Table 4-4: Inspection rate**

Grade	Number of inspections
A	1 inspection per 25 jobs
B	1 inspection per 5 jobs
C	Each job to be inspected

**Quoted services**

Essential Energy proposed a number of quoted ancillary network services in its substantive regulatory proposal, as detailed in table 4-5 below:

**Table 4-5: Services to be provided by quotation**

Customer related service – quotation based charges	\$	AER draft decision
High load escorts	per job	/ hour
Retailer of last resort	per event	/ application
CT meter install	per install	/ application
Rectification works - general		/ hour <sup>7</sup>
Rectification works – rectification of illegal connection	per service	
Rectification works – provision of additional crew	per hour	
Rectification works – fitting of tiger tails	per hour + rental	

These services will be quoted on a per job, event, installation, service or hourly basis as detailed in the above table, with the basis of quotation (eg applicable hourly rate) prescribed within the ancillary network service models.

The AER draft decision has provided for some of these charges to apply on an hourly (quote) basis, however, for charges listed as per application it is not clear if the AER’s draft determination has allowed for a quoted service. Essential Energy suggests the AER more clearly identify items within the draft decision that are quoted services.

**Fee based unit changed in draft decision**

Essential Energy has also noted the fee structure for Design Certification – Underground commercial and industrial or rural subdivisions (vacant lots – no development) has changed from the original proposal.

Essential Energy’s proposal was for this fee to be applied on a per lot basis, however in the AER’s draft determination the fee has been applied on a per pole basis. Essential Energy expects this is an error in populating the table within the draft determination and asks that this be corrected within the final determination. To change the application of this fee to apply on a per pole basis would result in significant charge increases for customers seeking design certification services.

**4.3. Revised fees and further information**

**Network tariff change**

The AER has not approved Essential Energy’s proposed ‘network tariff change – invalid request’ charge<sup>8</sup>. Essential Energy notes, however, that a ‘network tariff change’ fee was included within the AER’s draft decision<sup>9</sup>. Essential Energy proposed the network tariff change fee in accordance with the AER’s Stage 1 F&A paper, which classified network tariff change request as an alternate control service. The AER draft decision continues to provide for inclusion of a network tariff change request as an alternate control service<sup>10</sup>:

<sup>7</sup> ‘Rectification works – general’ provided within the AER draft decision. No reference is made to the sub categories of rectification works, assumed an hourly rate is approved for each sub category.

<sup>8</sup> AER, Draft decision Essential Energy distribution determination 2015-16 to 2018-19 Attachment 16: Alternative control services, November 2014, pg 26

<sup>9</sup> AER, Draft decision Essential Energy distribution determination 2015-16 to 2018-19 Attachment 16: Alternative control services, November 2014, Appendix A, Table 16-25

<sup>10</sup> AER, Draft decision Essential Energy distribution determination 2015-16 to 2018-19 Attachment 13: Classification of Services, p22

Table 4-6: Classification of network services

Service Group	Further Description	AER's draft decision on classification 2014-19	Current classification 2009-14
Network tariff change request	When a retailer's customer or retailer requests an alteration to an existing network tariff (for example, a change from an Inclining Block Tariff to a Time of Use tariff), the NSW distributors conduct tariff and load analysis to determine whether the customer meets the relevant tariff criteria. The NSW distributors also process changes in their IT systems to reflect the tariff change.	Alternate Control	Standard Control

In response to the AER's draft decision, Essential Energy has revised its definition for this service so that the fee will only apply to a valid network tariff change request outside the annual pricing process. The network tariff change fee will not be applied where a retailer requests a tariff change that cannot be applied or where Essential Energy had previously incorrectly applied a tariff to the account.

To align with this change in definition, Essential Energy has reviewed and updated the pricing methodology to reflect the change in application of this fee. Essential Energy's revised regulatory proposal includes updated volumes and pricing for network tariff changes.

**Site establishment fee**

Essential Energy notes that it did not submit in its substantive regulatory proposal that the site establishment fee be levied against the ASP. While that is currently the method of charging, the business is considering whether that approach should change.

Currently, Essential Energy charges the ASP a site establishment fee and this fee is then passed onto the customer by the ASP. In the past, retailers could not be charged this fee as the local retailer defaulted as the retailer for the new installations. This occurred where a retailer was not nominated at the application stage; this retailer may not necessarily be the retailer once the customer moves into the premise.

An MSATS system change was implemented in May 2014, with NMIs not published to MSATS until approved by the retailer. Essential Energy proposes that as the retailer must submit an 'Allocate NMI B2B service order', the site establishment fee should be levied against the retailer, subject to Essential Energy's business processes. This potential change will be considered further, including consultation with stakeholders, before a final decision is made.