

Essential Energy

13.01 Ancillary Network Services explanatory document 2024–29

January 2023



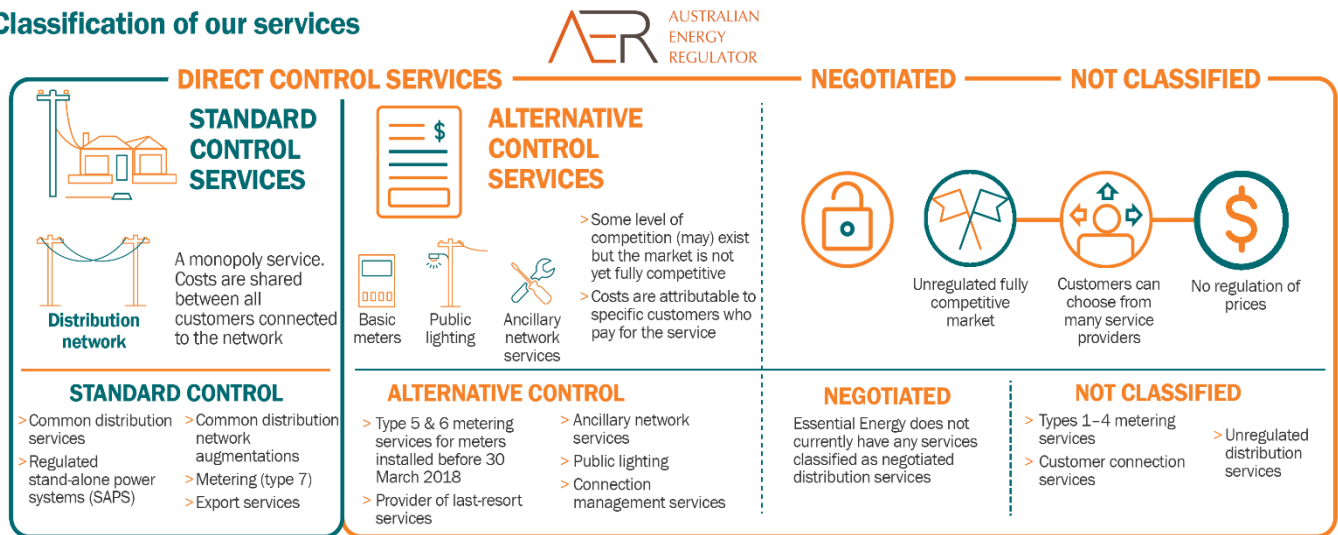
Table of Contents

Background	3
Obligations and drivers for providing ANS	3
Service costs for ANS	4
Service cost classification	4
The method for developing charges for each ANS	4
ANS charges	5
Key principles	5
Charge inputs	5
Proposed ANS charges	6
Margin and corporate tax	6
New services identified within a regulatory period	6
Compliance with the control mechanism	7

Background

The Australian Energy Regulator (AER) determines the form of regulation that will apply to Essential Energy's different service groupings over the 2024–29 regulatory period. This governs how Essential Energy can collect revenue from customers for specified classes of services.

Classification of our services



Ancillary network services (ANS) are provided to individual customers, their retailer or their Accredited Service Provider on an as-needs basis. More than 150 of these services are proposed for the 2024–29 regulatory period.

The AER's *Framework and approach: Ausgrid, Endeavour Energy and Essential Energy (New South Wales) – July 2022* lists the services grouped under ANS on pages 60 to 70. These form the basis of Essential Energy's ANS proposal.

The AER has classified all ANS as alternative control services (ACS). As they are ACS, the AER requires that Essential Energy establish specific charges for services classified as ANS. These charges are generally capped by the AER and can be in one of two forms:

- > a fixed fee for a specific ANS, where the extent of activities can be readily defined
- > hourly rates for providing a specific ANS, where the individual customer can be charged actual labour hours.

Obligations and drivers for providing ANS

Providing an ACS incurs costs that are directly attributable to the person receiving the service. Essential Energy provides skilled labour, plant and equipment, and materials and contracted services when completing tasks required to safely and efficiently deliver the service.

To provide cost-reflective ANS network charges, we have identified appropriate cost drivers for each service. We sought to establish a fixed fee for services where the scope and scale are known, with the network charge per service provided to the customer. Where the scope and scale is variable, an hourly rate is applied:

- > **Fixed fee (per service)** – costs are closely correlated to the number of services delivered and the average effort required by the particular service. For example, a special meter read incurs costs for attending a customer's premises (including travel time) to read the meter and enter the data into a system for an out-of-cycle meter read. The average time to read and enter the data is used as an input in the calculations.
- > **Per hour rate (quoted)** – costs depend on the request for service, with the number of hours it takes varying more widely. For example, escorting a high load incurs costs that differ according to the distance and speed it

travels. In this case, the cost driver will be the number of hours taken to deliver the service, multiplied by the cost per hour. The volume of these types of services are outside our control and to provide a fixed price per service would penalise some customers while benefitting others. The per-hour rate will therefore be applied to the time necessary to complete the task.

Service costs for ANS

Service cost classification

ANS costs are classified as either operating expenses or customer-funded capital. Transport fleet costs to support the skilled labour is allocated to outdoor technical specialists and field worker rates. Costs for information technology, rent and other items are incorporated into the overhead allowances as per the approved cost allocation method (CAM). Overheads are applied to labour, contractor and material costs in accordance with the approved CAM.

For further details, refer to **Attachment 9.01 – Cost allocation methodology (CAM)**.

The method for developing charges for each ANS

The process for defining the service delivery costs used in the AER's standardised ANS model included collaborating with internal subject matter experts to review service descriptions, service tasks, resources needed (for example, skills mix) and task durations.

The review included the following:

- > Each service fee type (fixed fee versus the quoted fee) was reviewed to ensure the most cost-reflective fee type was applied.
- > For each relevant employee class (skills mix), an hourly rate (\$2024–25) was calculated, considering the base rate plus statutory on costs.
- > For fixed fees, the applicable hourly rates were multiplied by the completion time (as provided by the ANS business units) to determine the direct labour unit cost for each task. The unit costs of all tasks relevant to the specific service were then added up to derive the overall direct labour unit rate for each service.
- > Where travel is required to carry out a service, travel times were standardised. Due to the wide geographical area we cover, travel times are a significant proportion of the time needed to perform on-premise tasks.
- > Where appropriate, a plant or fleet cost was applied to the estimated hours and used across all relevant service categories.
- > Where appropriate, costs for stores, materials and other costs were applied to the task.
- > Contractor rates are applied to services such as traffic management, vegetation management and meter reading.
- > Licence costs which are entirely attributable to ANS systems and applications are included as a direct cost and not included in overheads.
- > Overheads were applied to the direct costs based on Essential Energy's approved CAM.
- > Non-system costs, such as those for depots, buildings, information technology systems and in-house software, are allocated according to CAM.
- > A financing charge was included to allow for working capital. This takes into account the lag between when we incur costs (mainly for labour) and when we have delivered the service and are paid by the customer.
- > A tax allowance to recover the tax payable based on revenue less expenses.
- > To ensure cost reflective pricing we will continue to review and update items where we receive more data or other information; for example, fleet rates could be updated in the revised proposal based on the latest cost inputs available.

ANS charges

Key principles

We have developed charges for each ANS in accordance with the following principles:

- > It facilitates customer choice: it does this by providing cost-reflective pricing signals to customers at their decision points. To the extent that customers can make these choices, it is important to provide these signals early in their decision-making process.
- > It is cost reflective: this ensures customers make informed decisions.

Charge inputs

Labour categories: for the purposes of calculating prices for the 2024–29 regulatory period, Essential Energy proposes to use seven labour categories, representing the skills mix used to deliver the portfolio of services.

Relative to the categories used in 2019–24, we propose two additional engineering labour categories:

- > Senior Engineer
- > Engineering Manager.

These categories enable us to recover costs associated with the level of expertise required to facilitate specific services. In particular, large-scale non-contestable and contestable connections.

Under the 2019–24 AER final decision, the same rate was applied for both Administration and Paralegal. We accept the consolidation of these labour categories and haven't included the Paralegal rate in our 2024–29 proposal.

The AER incorporated recommendations from the Review of Alternative Control Services by Marsden Jacob, particularly, the assessment of the ACS labour rates for NSW electricity distributors in the April 2019 final regulatory determination.¹ Therefore, we believe it is reasonable to follow the same method to calculate our labour rates (it is a generally accepted approach for assessing the efficiency of proposed ACS-related labour rates).

We have based our labour rates on an internal review of historical ANS information as well as extensive business consultation, identifying labour classes, skill sets and effort required to provide these services.

For each labour category, our proposed labour rates comprise of the following components.

Charge input	Description
Labour base rate	Based on Essential Energy's Enterprise Agreement 2021 (\$FY22)
Non-system cost	Non-system costs, such as those for depots, buildings, information technology systems and in-house software, are allocated according to CAM. To recover these costs, we apply the proportion allocated to ANS (expressed as a percentage) to the standard labour rates.
On-cost	Standard on-costs such as superannuation, workers compensation, payroll tax, annual leave loading, and long service leave based on federal and state law requirements. For field workers, we have added an allowance, consistent with the Enterprise Agreement.
Overheads	Overheads encompass support costs that are shared across multiple business areas and services. To recover these costs, we apply the proportion of overheads for direct costs (expressed as a percentage) to the standard labour rates. The overheads applied to the raw labour rates do not include any margins. These costs are allocated on a causal basis in proportion to direct costs for each service classification, consistent with our approved CAM.
Vehicle allowance	Vehicle allowance for field workers and outdoor technical specialist categories only. The allowance is based on calculating the average hourly rate of vehicles commonly used in delivering the portfolio of services.

¹ Marsden Jacob Associates, *Review of Alternative Control Services, Prepared for Australian Energy Regulator*, September 2018.

Proposed ANS charges

ANS billing processes and applications, implemented as part of Essential Energy's Transformation Program, enable accurate and upfront cost recovery for services. Our changes have allowed us to simplify the ANS fee structure (in particular, but not limited to, Service Groupings – Design Related Services; Inspection and Auditing Services; and Connection Services), moving it from a per service (fixed) to a per hour (quoted) structure. For several fee types, customers will be quoted based on the time and skill set required to provide specific services per their individual requests. This enables us to pass on process efficiency savings. We propose to streamline and consolidate the list of ANS charges by reducing the number of charge line items from 192 to 157.

We have introduced new charges under both existing and new service groupings. New charges under existing service groupings will enable us to address identified cost-recovery gaps. For example, we have added an outdoor technical specialist rate to complete field inspections on early notice of arrangement requests. Also, we have separated high-load permit requests and high-load escorts, enabling us to recover costs associated with high-load permit requests that do not eventuate in an escort.

We have introduced several new services for the 2024–29 regulatory period, driven by the Framework and Approach service classifications – service groupings. New services will enable cost recovery associated with:

- > connections – large-scale complex connections and connection point management services
- > public lighting – customer-requested lighting services, such as for adding to an existing overhead network, minor capital works.
- > the provider of last resort (Essential Energy only) – provided under a set of controls to ensure that the provision of contestable services does not impinge on existing competition.

We developed our proposed ANS charges in accordance with the AER's price cap formula. They are provided as **Supporting documents 13.01.01 – ANS service schedules** and **13.01.02 – ANS Standardised model** and **Attachment 12.06 ANS pricing schedule**.

Margin and corporate tax

We propose to adopt AER's price cap control formula, which is,

$$\text{Price} = \text{labour} + \text{contractor services} + \text{materials} + \text{margin} + \text{tax}$$

The following table outlines what the elements of the formula represent.

Variable	Represents
Labour	Labour consists of all labour costs directly incurred in the provision of the service, including labour on-costs and overheads, consistent with our CAM. The overheads applied to the labour rates do not include any margins.
Contractor services	Contractor services costs reflect all costs associated with the use of external labour, including overheads and any direct costs incurred. Direct costs are passed on to the customer.
Materials	Materials costs reflect the cost of materials directly incurred in the provision of the service, material storage and logistics on-costs and overheads.
Margin	Margin is an amount equal to our nominal vanilla weighted average cost of capital approved by the AER for standard control services and metering services. The margin is applied to the total cost of labour, contractor services and materials.
Tax	Tax allowance reflects the tax Essential Energy incurs on revenue less expenses.

New services identified within a regulatory period

Where a new service was identified that falls within an existing service group classification, but for which no charge has been approved, we propose to develop charges in the same way as for other services in the same grouping.

We propose to create new charges using the AER-approved ANS models, adding inputs as required to produce charging outcomes. This gives us the flexibility to deliver new, unforeseen services to our customers, and the protection of a regulated charging mechanism.

Compliance with the control mechanism

The AER applies price caps to individual service charges for all ACS.

The AER has also set out its proposed ACS formulas through the AER standardised ANS model. We have adopted the AER's approach to the formulas and will demonstrate our compliance with this control mechanism through the published lists of charges we produce as part of the annual pricing proposal process.

When developing charges for our ANS, we adopted a cost build-up approach to demonstrate compliance. This approach is comparable to the building block approach prescribed for standard control services.