

ATTACHMENT 17.6 ANCILLARY NETWORK SERVICES PROPOSAL 2019-24

April 2018

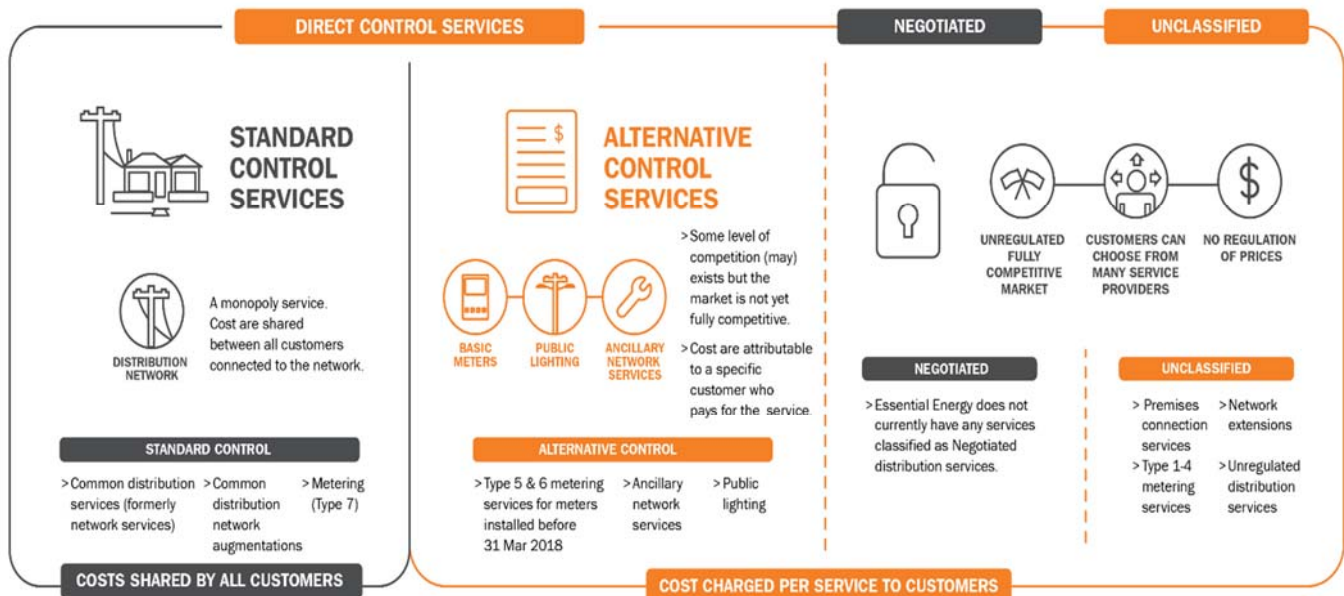


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1. BACKGROUND

The Australian Energy Regulator (AER) determines the form of regulation that will apply to Essential Energy's different service groupings over the period 2019-2024. The form of regulation governs how we can collect revenue from customers for specified classes of services.



Ancillary Network Services (ANS) are provided to individual customers, their retailer or their Accredited Service Provider (ASP) on an as-needs basis. More than 150 of these services are proposed for the 2019-24 regulatory period. Examples include (but are not limited to):

- > Design-related services.
- > Connection-application-related services.
- > Contestable network commissioning and decommissioning.
- > Access permits, oversight and facilitation.
- > Notices of Arrangement and Completion.
- > Network-related property services.
- > Site establishment services.
- > Rectification works to maintain network safety.
- > Inspection services.
- > Authorisation of ASPs.

The AER's final Framework and Approach for Ausgrid, Endeavour Energy and Essential Energy - July 2017 lists all the services grouped under ANS on pages 92 to 98. These form the basis of our ANS Proposal.

Several of our previously Unclassified Network Services have been reclassified for the 2019-24 regulatory period as ANS. This change is driven by the implementation of the AER's Distribution Ring-fencing Guideline and the resulting need for us to separate contestable and monopoly service provision.

In general, we agree with the AER's final service groupings, with a few minor exceptions.

- We have developed cost-effective approaches so regional and remote customers continue to be able to access services captured by the Ring-fencing Guideline where other providers are not available. To do this, we have proposed some changes to our service classification.
- We have proposed to reclassify some services that we deem to be non-contestable due to safety or reliability factors when completing works for large-scale connections. This change will allow us to recover these costs from the specific customers driving them and keep downward pressure on prices for other customers.

For further detail, refer to Attachment 8.1 - Classification of Services.

The AER has classified all ANS as Alternative Control Services.

As they are Alternative Control Services, the AER requires that Essential Energy establish specific service charges for services classified as ANS. These charges are generally capped by the AER and can be of 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 scope of activities cannot be readily defined.

2. OBLIGATIONS AND DRIVERS FOR PROVIDING ANS

Providing an Alternative Control Service incurs costs that are directly attributable to the customer who requires them¹. We provide skilled labour, plant and equipment, materials and contracted services to perform the activities necessary to complete the tasks required to safely and efficiently deliver the service.

To provide cost-reflective ANS network charges, Essential Energy has identified appropriate cost drivers for each service.

We have sought to establish a fixed price for services where the scope and scale are known, with the network charge per service provided to the customer. Where the scope and scale are variable, we will apply a cost per hour for providing the service.

Both approaches are cost-reflective, but services charged on an hourly rate recognise the range and complexity of each customer's needs.

- > **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 into the calculations.
- > **Per hour (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 vary according to the distance and speed it travels. In this case, the driver of the costs will be the number of hours applied to deliver the service, multiplied by the cost per hour. The volumes of these types of services are outside Essential Energy's control and to provide a fixed price per service would penalise some customers and benefit others. The per hour rate will therefore be applied to the time necessary to complete the task.

3. SERVICE COSTS FOR ANS

The costs needed to deliver each ANS are mostly operating costs. No specific capital is invested in these activities. Fleet costs to transport and support the skilled labour are allocated where appropriate, and costs for information technology, rent and other items are incorporated in the overhead allowances in accordance with the approved Cost Allocation Methodology (CAM). We also apply overheads to the base labour, fleet and materials costs in accordance with the approved CAM.

For further detail, refer to Attachment 11.1 – Cost Allocation Method.

¹ Clause 6.2.2 (c) (5) of the NER.

3.1 ANS cost build-up

In calculating the cost build-up for services, we have adopted a straightforward approach to identifying service delivery costs, and the accumulation of these costs (including overheads and financing), to determine a charge that recovers only the costs for that particular service.

Developing the calculation methodology has involved preparing a model that:

- > Details the service descriptions.
- > Systematically builds up labour rates from base pay rates to what Essential Energy terms 'fully-loaded rates', including all labour on-costs and overheads.
- > Calculates overtime rates and loadings to enable charges to be provided for both normal time and overtime services.
- > Calculates finance charges, materials on-costs and other overheads/on-costs that apply throughout the models.
- > Calculates charges for the respective periods, all expressed in \$2018/19.

While we obtained core inputs into the models centrally (e.g. the Enterprise Bargaining Agreement for specific labour rates), the process of refining service descriptions and resourcing levels/durations entailed significant consultation with subject matter experts within our business. This included both a quantitative reconciliation where existing services are provided, and a qualitative assessment where either new services were proposed or there was a significant gap in the coverage of an existing service.

After thorough analysis, we continued to use bottom-up estimates as the most precise predictor of efficient unit costs. In several cases, collecting data relating to historical costs for providing some services showed that the volumes and allocation of some charges were imprecise and inconsistent across the organisation. A key focus when developing this Proposal was to expand internal consultation, with a view to enhancing consistency of application across Essential Energy.

We have a significant technology refresh program underway, including installing a new field works management system. Once this system is implemented (scheduled for 2018), we expect to have access to more reliable time and labour data and associated volumes, assisting with future cost forecasting for ANS and other core distribution services.

3.2 The methodology for developing charges for each ANS

For each ANS, developing a unit price involved collecting expenditures, and quantities of services delivered, to establish the efficient costs for delivering that service.

- > For each relevant employee class, we calculated an hourly rate (\$2018/19) that took into account the base rate plus statutory on-costs.
- > The business units that provide each ANS estimated the time taken to carry out the various tasks involved and indicated the relevant employee positions required, bearing in mind the efficient deployment of various skill sets across Essential Energy. The time estimate included the time taken to travel to a premise to carry out the service. Due to Essential Energy's wide geographical area, travel times are a significant part of the time taken to perform on-premise tasks.
- > To determine the direct labour unit cost for each task, the employee class hourly rates were multiplied by the completion time for each task. The direct labour unit cost of all tasks relevant to the specific service was then totalled to derive the overall direct labour unit rate for each service.
- > Where appropriate, a plant or fleet cost was applied to the estimated hours and applied across all relevant service categories.
- > Additional costs for stores, materials and other costs were applied as appropriate to the task. This ensured cost-reflectivity, in accordance with the NER principles for pricing under an Alternative Control Service methodology.
- > Overheads were applied to the direct costs based on our approved CAM.

- > A financing charge was included to allow for funding a degree of working capital due to timing differences. Our payments (predominantly labour) are made as they are incurred, whereas we collect the invoiced amount from customers after delivering the service.

Following this process provided our forecast unit rate for each service. This was applied to the volumes forecast for the 2019-2024 regulatory period to calculate an estimate for the fully-loaded operating expenditure for each ANS.

We have developed a separate model for each ANS that provides details of cost inputs and forecasts total expenditure.

Refer to Attachment 17.7 - Ancillary Network Services Models.

4. ANS CHARGES

4.1 Key principles

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

- > **Facilitates customer choice:** This means 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.
- > **Cost-reflective:** Developing a cost-reflective charge to ensure customers make fully-informed decisions. We have established each charge robustly by referencing our current direct expenditure for carrying out the tasks involved in providing the service and our CAM, which is approved by the AER.

4.2 Charge inputs

Essential Energy's ANS charges have been determined through a bottom-up assessment of the resources required to deliver a particular service. These costs include:

- > Essential Energy personnel costs. For the purposes of calculating prices for the 2019-24 regulatory period, we used six labour categories, representing the skills mix used to deliver the portfolio of services. We analysed the paypoints for personnel booking time for each rate over the 2016/17 financial year. In the case of administration activities, separate clusters of paypoints were observed. One represented general administration and the other was associated with more experienced or qualified personnel. Following this analysis, we introduced a Paralegal (R1b) Rate in addition to the Administration Rate.
- > Fleet costs, based on calculating the average hourly rate of vehicles commonly used in delivering the portfolio of services.
- > Contract rates, where contractors were used for such services as Traffic Management, Vegetation Management and Meter Reading.
- > Labour on-costs, which recognised costs such as payroll tax, leave entitlements, superannuation etc.
- > Material on-costs, which recognised the costs of storage and logistics.
- > Overhead rates, which attributed a range of operating overheads in accordance with the approved CAM.
- > Non-system costs, which recognised costs such as providing depots, information technology and communications.
- > Financing charges, which recognised the time between delivery of the service and the receipt of payment.
- > A return equivalent to the rate of return detailed in the Rate of Return chapter of the Regulatory Proposal.

As a general principle, no specific capital expenditure is associated with providing an ANS.

Refer to Attachment 17.7 - Ancillary Network Services Models for further detail on inputs.

4.3 Proposed ANS charges

A separate workbook model is provided for every service group. This outlines the current service description or new description, additional service-related information, a description of what is involved in providing the service and the current and proposed fee. The workbooks are part of Attachment 17.7 (Ancillary Network Services Models) of the Regulatory Proposal.

For a new ANS, and for some existing services where we consider the scope of the activity has changed or evolved, we have provided a more detailed task breakdown and the relevant skill level required to perform the activities within each task.

During consultation for Essential Energy's 2014-19 Regulatory Proposal, we received feedback that customers preferred to have disconnection and reconnection fees applied separately. In line with this customer preference, we have proposed separate disconnection and reconnection fees for the 2019-24 regulatory period.

Our proposed ANS charges were developed in accordance with the AER's price cap formula. They are provided as Attachment 2 - Indicative Ancillary Network Services Pricing Schedule of the Tariff Structure Statement.

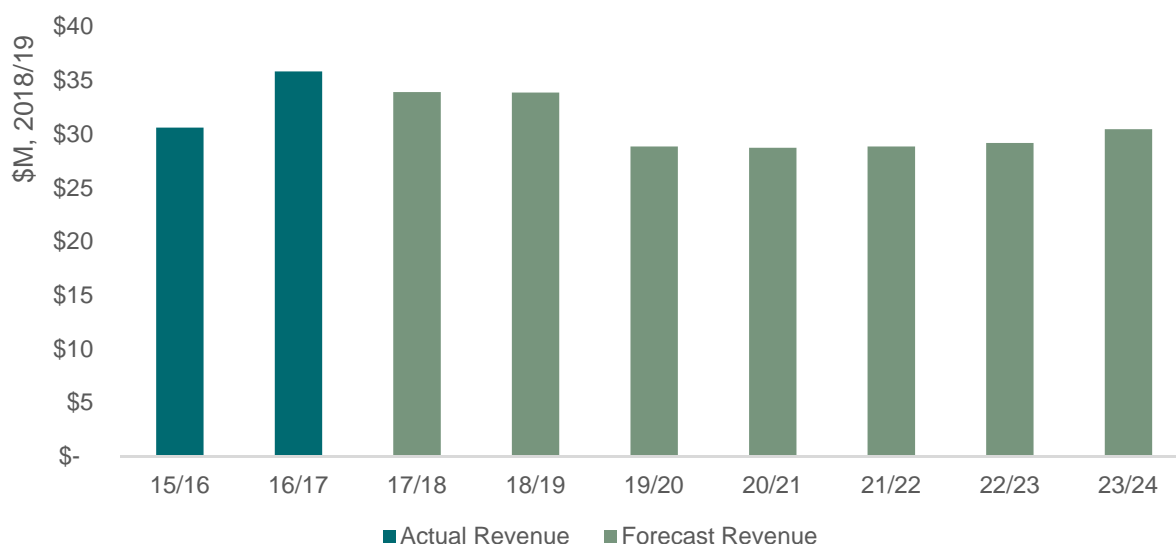
5. ANS REVENUE

In accordance with the AER's Framework and Approach, caps will continue to be applied to Essential Energy's ANS charges during the 2019-24 regulatory period. We have provided our actual and forecast revenue for the current regulatory period (2014-19) and forecast revenue for the future regulatory period (2019-2024) for comparison.

We have introduced new services for the 2019-24 regulatory period, driven by the introduction of Power of Choice and the new Ring-fencing Guideline obligations. While costs for these services have been developed, the associated revenue is a rough estimate, as volumes were not available at the time of preparing this Proposal.

Our revenue for the 2019-24 regulatory period was also impacted by the reduction in costs associated with several existing services, such as Special Meter Reading, with these services now being delivered under an external services contract.

Forecast Ancillary Network Services Revenue (\$M, 2018/19)



Ancillary Network Services Revenue (\$M, 2018/19)								
15/16	16/17	17/18	18/19	19/20	20/21	21/22	22/23	23/24
\$30.62	\$35.84	\$33.92	\$33.88	\$28.86	\$28.74	\$28.86	\$29.18	\$30.47

6. 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 provides us with the flexibility to provide new, unforeseen services to our customers and customers with the protection of a regulated charging mechanism.

7. COMPLIANCE WITH THE CONTROL MECHANISM

The AER has decided to apply price caps to individual service charges for all Alternative Control Services during the 2019-24 regulatory period.

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

When developing charges for our ANS, we adopted a cost build-up approach so we could demonstrate compliance. This approach is comparable to the building block approach prescribed for Standard Control Services.