



Private & Confidential

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Review of AER's methodology of adjusting for differences in occupational health and safety obligations

New South Wales, Queensland, South Australia, the ACT and Tasmania enacted the Work Health and Safety (WHS) Laws (the *Workplace Health and Safety Act 2011* and the *Workplace Health and Safety Regulations 2011*) by 1 January 2013. Victoria did not follow its counterparts in enacting the Model WHS Laws.

The AER has acknowledged that the WHS laws create a material difference in operating expenditure between network service providers in the National Electricity Market (NEM).¹ The AER has also acknowledged that the benchmarking model, on which it has relied in the 2014 Annual benchmarking report, does not account for differences in OHS regulations.²

Subsequently, in its Draft Decision for the three NSW distributors, the AER has made an operating environmental factor adjustment of 0.5 per cent to take into account the material differences in occupational health and safety obligations between Victorian and NSW distributors.

Occupational health and safety is deeply embedded in Ergon Energy's work practices and corporate governance. In its Statement of Corporate Intent, Ergon Energy has committed to ensuring the health and safety of its people and communities.³

The AER's methodology in its Draft Decision

PwC in 2012 found that the potential annualised ongoing cost of the enacting the new WHS laws in Victoria was \$796m.⁴ The AER compared this annual cost to Victoria's Gross State Product (GSP) of \$328,595m. This was extrapolated by the AER to conclude that the impact of complying with the WHS laws was 0.24 per cent of GSP for all jurisdictions.

This figure was then multiplied by 2.5 based on PwC's finding that the annual ongoing cost for power generators was almost two and half times greater than for the 'average business'.

¹ AER, Draft Decision, Endeavour Energy, Attachment 7 – Operating Expenditure page 125.

² AER, Draft Decision, Endeavour Energy, Attachment 7 – Operating Expenditure page 124.

³ Ergon Energy, *Statement of Corporate Intent 2013-14*.

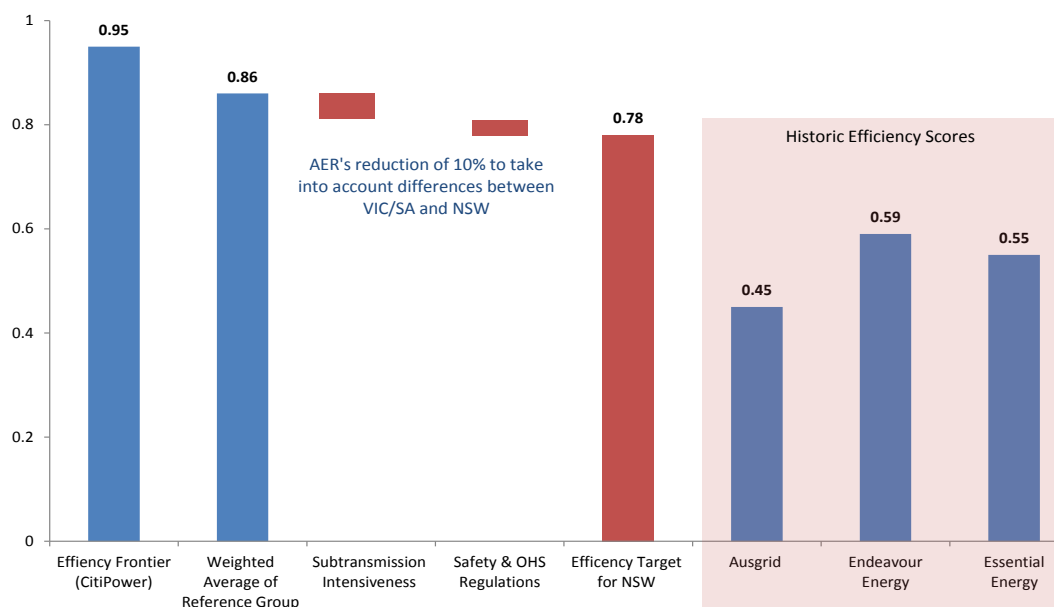
⁴ PwC, *Impact of the Proposed National Model WorkHealth and Safety Laws in Victoria*, April 2012, page 9.

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This led the AER to conclude that relative to their Victorian peers, distributors in other NEM jurisdictions require 0.6 per cent more opex (that is, 2.5 times the average of 0.24 per cent).

A **weighted** operating environmental factor adjustment of positive 0.5 per cent was then applied to the NSW distributors to account for differences in customer numbers.

Figure 1 – AER’s methodology in setting the efficiency target for NSW



Source: *Economic Insights, Economic Benchmarking Assessment of Operating Expenditure for NSW and ACT Electricity DNSPs, Prepared for the AER, 17 November 2014.*

Merit of the adjustment

PwC agrees with the AER that an operating environmental factor adjustment is required to be made in favour of businesses within jurisdictions that have adopted the WHS laws. Further, and as accepted by the AER the adjustment does create a material difference in the businesses’ operating expenditure. However, PwC does raise the following concerns with the methodology used by the AER in reliance to its 2012 findings.

Observations concerning the AER’s methodology

1. PwC’s 2012 report only considered the potential costs borne by Victorian businesses

PwC’s approach was tailored to specifically assess the impacts of the new WHS laws on Victorian businesses. That is, PwC compared the costs of adopting the new WHS laws against existing Victorian legislation – the *Occupational Health and Safety Act 2004* (Vic) and *Occupational Health and Safety Regulations 2007* (Vic). To inform this analysis, PwC only surveyed Victorian businesses during the data collection process. Consequently, the findings of the report do not reflect the costs of implementing or complying with the WHS obligations by Queensland businesses.

2. The total costs of implementing and complying with the new WHS laws was not considered by the AER

PwC’s report found that Victorian businesses would face approximate transition costs of \$999m and an annualised cost of \$796m due to the proposed changes to occupational health and safety obligations in Victoria.⁵

⁵ PwC, *Impact of the Proposed National Model WorkHealth and Safety Laws in Victoria*, April 2012, page 7.

The AER has not considered the costs of transitioning to the new WHS laws when benchmarking the distributors in the NEM. In addition, even if both transition and ongoing costs are accounted for, applying PwC’s estimates for Victorian Businesses does not consider the total cost of WHS laws. PwC’s report only modelled the impact of 20 major changes and acknowledges that there are other costs that have not been quantified that may impose further costs on businesses.

3. PwC’s findings are not reflective of the costs facing network service providers

PwC found that the costs of adopting the new WHS laws are not uniformly distributed across Victorian businesses.⁶ During the data collection process PwC surveyed a targeted cohort of businesses, with no network service providers consulted. The estimated compliance costs for power generators in Victoria may not reflect of the costs facing network service providers in Queensland. There may also be changes that have a specific and significant impact on network service providers that did not form part of the 20 changes modelled in PwC’s report.

4. The annualised cost was normalised using Victoria’s Gross State Product which could be misleading

As outlined above, PwC’s report found that the potential annualised ongoing costs of adopting the new WHS laws across all Victorian businesses was \$796m. The AER has normalised this cost against Victoria’s Gross State Product (GSP).

GSP measures the volume of goods and services produced in each state. The Australian Bureau of Statistics has recognised the data limitations of the GSP measure, highlighting that the accuracy of the estimates will not be as high as that of the corresponding national estimates.⁷

The level of volatility of this measure between jurisdictions can be significant. For example, the average annual compound growth rate in GSP in Queensland was over 50% higher than Victoria during 2001 and 2012 (4.0 per cent and 2.6 per cent respectively) (see Table 1).

Table 1: Average annual compounding growth rate (2001/02 – 2012/13)⁸

State	Average Gross State Product
NSW	2.1
Victoria	2.6
Queensland	4.0
South Australia	2.4
Western Australia	4.9
Tasmania	1.8
NT	4.1
ACT	3.1

It is PwC’s opinion that the use of Victoria’s GSP to extrapolate a cost differential between distributors across the NEM is inappropriate due to the variance in this measure between jurisdictions.

⁶ PwC, *Impact of the Proposed National Model WorkHealth and Safety Laws in Victoria*, April 2012, page 8.

⁷ Australian Bureau of Statistics, *Australian National Accounts – State Accounts*, 2012-13, Category 5220.0 , Explanatory Notes.

⁸ Australian Bureau of Statistics, *Australian National Accounts – State Accounts*, 2012-13, Category 5220.0 .

Conclusion

We agree that the implementation and ongoing costs associated with the WHS laws are material and that an operating environment factor adjustment is required to be made by the AER, particularly as the AER's benchmarking model does not take into account these differences.

PwC's 2012 findings relate to the potential costs for Victorian businesses of adopting the WHS laws. PwC's analysis did not consider the costs faced by businesses in other jurisdictions nor provide a cost differential between jurisdictions. It is PwC's opinion that the AER's methodology for adjusting for differences in occupational health and safety obligations between Victorian distributors and other distributors in the NEM is overly simplistic. The methodology potentially understates the costs faced by Queensland distributors in implementing and complying with the new WHS laws.

The AER's methodology does not therefore provide an accurate representation of the actual cost differential between Victorian distributors and their peers across the NEM.

Yours sincerely



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Director

Yours sincerely



Martin Stokie
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