Australian Government

AUSTRALIAN ENERGY REGULATOR

Preliminary Position paper

System Strength Project (hybrid priority network infrastructure project)

(1 October 2026 – 30 September 2031)

June 2026

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Getting involved

Invitations for submissions

Transgrid and all interested stakeholders are invited to make a submission on our preliminary position paper by **28 July 2026**.

We encourage stakeholders to make submissions relating to any component of Transgrid's revenue proposal including where our preliminary position aligns with Transgrid's revenue proposal. We will consider and respond to submissions received in our final decision.

Submissions should be sent to REZ@aer.gov.au with the subject line: '*Submission on the System Strength Project'*. We prefer that all submissions be sent in an electronic format in Microsoft Word or other text-readable document form and are publicly available, to facilitate an informed, transparent, and robust consultation process. We will treat submissions as public documents unless otherwise requested. For further information regarding our use and disclosure of information, see the ACCC/AER Information Policy.

We request parties wishing to submit confidential information:

- Provide a non-confidential version of the submission in a form suitable for publication.
- Clearly identify the information that is the subject of the confidentiality claim.

All non-confidential submissions will be placed on our website.

Public forum

We will host an online public forum to allow stakeholders the opportunity to ask questions on Transgrid's revenue proposal and the issues we raised in our preliminary position paper before submissions close. The public forum will be held from 10:30 am to 12:00 pm (Australian Eastern Standard Time) on 16 July 2026. If you're interested in attending the public forum, please register to attend the public forum on Eventbrite by 5:00pm on 14 July 2026.

Table 1 Milestones for the revenue determination process

Key dates	Milestone
24 April 2026	Revenue proposal published on our website
18 May 2026	Consultation closed on revenue proposal
30 June 2026	Publication of this preliminary position paper, submissions open
16 July 2026	Public forum to discuss the revenue proposal and the preliminary position paper
28 July 2026	Submissions on preliminary position paper close
21 October 2026	Deadline for AER to make revenue determination

The making of our revenue determination to be made under section 38 of the *Electricity Infrastructure Investment Act 2021 (NSW)* (EII Act) is distinct from its publication on our website. Clause 53(4) of the *Electricity Infrastructure Investment Regulation 2021* (NSW) (EII Regulation) provides that we are required to publish the revenue determination as soon as reasonably practicable but not before the Infrastructure Planner has notified us that, in the Infrastructure Planner's opinion, financial close of the network infrastructure project has been reached.

The New South Wales Department of Climate Change, the Environment, Energy and Water (NSW DCCEEW), as the Infrastructure Planner, anticipates financial close for the System Strength Project will occur shortly following the Australian Energy Regulator (AER) making its revenue determination for the project.

1 Introduction

System Strength Project

Under the National Electricity Rules (NER), Transgrid is the designated System Strength Service Provider for NSW. This means Transgrid is responsible for planning to ensure that there is sufficient system strength available in NSW to meet the standards set by the Australian Energy Market Operator (AEMO). In response to forecast shortfalls in system strength, in 2022 Transgrid commenced work on a Regulatory Investment Test – Transmission (RIT-T) to explore possible solutions.[1] The RIT-T process was completed in 2025 with Transgrid's release of a Project Assessment Conclusions Report (PACR). Transgrid's PACR concluded that the forecast shortfall in system strength could be best addressed via the accelerated procurement, design, manufacture, installation and commissioning of new network synchronous condensers at five locations around NSW.[2] This conclusion forms the basis of System Strength Project.

Under the EII regulatory framework, the NSW Government can direct how and when critical network projects are delivered, providing a pathway to accelerate project delivery. Prompted by the PACR, the NSW Minister for Energy proposed to accelerate the delivery of an initial batch of synchronous condensers at the 5 identified locations by issuing a Priority Network Infrastructure Project (PNIP) Direction Order under the EII Act, in September 2025.[3] The Minister's direction required Transgrid to carry out the System Strength Project and required all synchronous condenser units to be connected and commissioned (except for R2 hold point testing) by September 2028.[4] An amended version of this direction was issued on 27 March 2026 to include transport works required to carrying out the project, and an extension of the timeframe to commission all synchronous condensers until February 2029.[5]

In addition to establishing the scope and timeframes for the System Strength Project, the PNIP Direction also indicated that the System Strength Project should be delivered through a mix of competitively procured (contestable) elements and non-contestable elements. The System Strength Project is the first network infrastructure project to be submitted as a 'hybrid' project, combining contestable and non-contestable project components in a single revenue proposal. Specifically, these components are:[6]

- **Synchronous condenser package** (contestable): The design, manufacture, delivery, installation and maintenance of synchronous condensers at 5 locations in NSW providing a system strength solution of at least 950 MVA at each location. Transgrid

1 Transgrid, *System Strength Project 2026-31 - Revenue Proposal*, April 2026, p. 62.

2 Transgrid, *Meeting system strength requirements in NSW - RIT-T Project Assessment Conclusions Report (PACR)*, July 2025, p. 111.

3 NSW Government Gazette, *Number 376 – Electricity and Water*, 18 September 2025.

4 NSW Government Gazette, *Number 376 – Electricity and Water*, 18 September 2025, p. 7.

5 NSW Government Gazette, *Number 115 – Electricity and Water*, 27 March 2026, pp. 4, 9.

6 NSW Government Gazette, *Number 115 – Electricity and Water*, 27 March 2026, pp. 4–6.

proposes to deploy 2 synchronous condensers at each location (a total of 10 synchronous condensers).[7] The synchronous condenser package involves 2 contracts:

  - The Supply Contract with the original equipment manufacturer (OEM), GE Vernova, to supply the synchronous condensers which runs until early 2029.
  - The Long-Term Service Agreement (LTSA) with GE Vernova to maintain and service the synchronous condensers over a 10-year term, anticipated to commence from 2028.

- **Associated works package** (contestable): Design and construction (D&C) work to integrate the synchronous condensers at each of the 5 locations, such as earthworks foundations, civil work, site infrastructure and substation enabling work. The associated works package involves 2 contracts with 2 individual D&C contractors which are expected to run from 2026 to 2028.
- **Non-contestable elements** (non-contestable): The connection of the synchronous condensers to the network, as well as operation and maintenance of assets not captured under the synchronous condenser package. The non-contestable component also includes costs Transgrid incurs for managing the delivery of the project undertaken by its contracted third parties.

We are appointed as a regulator under the EII Act. Our role is to determine the amount payable to Transgrid based on our assessment of the prudent, efficient and reasonable costs for carrying out the System Strength Project.[8]

Prior to the submission of Transgrid's System Strength Project revenue proposal, we determined whether we were satisfied that the competitive assessment processes undertaken for the two contestable components were 'genuine and appropriate' (genuine and appropriate assessment). These processes were run by Transgrid under the oversight of the Infrastructure Planner (NSW DCCEEW).

Our genuine and appropriate assessment was undertaken based on the information from the competitive assessment process provided to us by the Infrastructure Planner[9] and the criteria contained in our contestable guideline.[10] Under clause 45(6) of the EII Regulation, if we are satisfied that a competitive assessment process was 'genuine and appropriate', we must rely on and adopt the information given to us by the Infrastructure Planner that was obtained from the competitive assessment process in making our revenue determination.[11]

In December 2025 and March 2026, we decided that we were satisfied that the competitive assessment process undertaken by Transgrid for the synchronous condenser and associated works packages were genuine and appropriate. As such, we must rely on and

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7 Transgrid, *System Strength Project 2026–31 - Revenue Proposal*, April 2026, p. 8.

8 EII Act, s.37 and s.38.

9 NSW Government Gazette, *Number 115 – Electricity and Water*, 27 March 2026, p. 5.

10 AER, *Revenue determination guideline for NSW contestable network projects - Final*, 19 August 2022, pp. 9-10.

11 EII Regulation 45(6).

adopt the outcomes of these competitive assessment processes in making our revenue determination (that is, the outcomes are considered to be prudent, efficient and reasonable).

Transgrid has proposed that all elements within its revenue proposal that relate to the contracts from the synchronous condenser and associated works packages be treated as contestable. However, not every element within Transgrid's proposal related to the synchronous condenser and associated works contracts is an outcome of these genuine and appropriate competitive assessment processes. As such, our assessment of the revenue proposal focuses on ensuring that only the outcomes of these genuine and appropriate competitive assessment processes are treated as contestable and therefore not subject to a prudency, efficiency and reasonableness assessment.

Our assessment of the non-contestable components of Transgrid's revenue proposal follows our standard approach, ensuring only the prudent, efficient, and reasonable costs are recovered from NSW consumers.

We do not have a role in the design, planning or timing of projects under the EII Act, as these responsibilities are undertaken by the Infrastructure Planner. Our role as the Regulator is to determine the amount payable to the Network Operator based on our assessment of the prudent, efficient and reasonable costs for carrying out the network infrastructure project.[12] Our *Transmission Efficiency Test and revenue determination guideline for non-contestable network infrastructure projects* (non-contestable Guideline) sets out how we will make hybrid revenue determinations for Network Operators authorised or directed to carry out network infrastructure projects under the EII Act.[13]

Transgrid's revenue proposal

Transgrid began pre-lodgement engagement with us in February 2025. Our discussions primarily focused on the two contestable packages (synchronous condenser and associated works packages) and our genuine and appropriate assessment of these packages. Discussions around non-contestable elements occurred during the development of the hybrid regulatory information notice (RIN)[14] and included whether elements such as transport upgrades adjustment mechanisms were likely to be considered contestable or non-contestable. Transgrid did not provide a draft revenue proposal to us to review, but it did provide some draft adjustment mechanisms for review one month prior to the submission of its hybrid revenue proposal.

Transgrid also engaged with its then Transgrid Advisory Council (TAC), which included consumer, industry and business representatives, on the content of its revenue proposal. We provide further analysis on Transgrid's stakeholder engagement in section 3.1.

As Transgrid did not provide a draft of its revenue proposal, our opportunity to provide material feedback on it was limited. Transgrid initially submitted its revenue proposal to us on 10 April 2026, but we found that this submission did not comply with the requirements of the

12 EII Act, s. 38(1).

13 EII Regulation, cl. 47A; AER, *Revenue determination guideline for NSW non-contestable projects*, May 2026.

14 This was our first hybrid regulatory information notice.

RIN.[15] We worked with Transgrid to resolve the outstanding compliance and non-disclosure issues and received a compliant revenue proposal for the System Strength Project on 22 April 2026.

Transgrid's System Strength Project revenue proposal contains a total capital expenditure (capex) of $1,185.0 million ($September, 2026), a total operating expenditure (opex) of $60.1 million ($September, 2026), and a total maximum allowed revenue of $400.8 million[16] ($ nominal) over the 2026–31 regulatory period.[17] Table 2 summarises Transgrid's proposed building block revenue. We provide a more detailed overview of Transgrid's revenue proposal in section 2 of this paper.

Table 2 Transgrid's System Strength Project revenue proposal – building block revenue for the 2026–31 period ($million, nominal)

Building block	Revenue proposal
Return on capital	339.9
Regulatory depreciation[18]	–5.8
Opex	66.3
Revenue adjustments	–
Cost of corporate income tax	0.4
Annual building block revenue requirement	**400.8**

Source: Transgrid, System Strength Project 2026–31 – Revenue Proposal, April 2026, p. 16.

We published Transgrid's revenue proposal on our website on 24 April 2026. Subsequently, we received and published the 3 stakeholder submissions on Transgrid's proposal. We provide our response to these stakeholder submissions in section 3.2 of this paper.

In this preliminary position paper, we provide a summary of our preliminary view on all components of Transgrid's revenue proposal for the System Strength Project to inform and seek feedback from stakeholders, including the areas of the revenue proposal where:

- We are likely to accept Transgrid's approach, subject to any mechanical updates (changes resulting from updates to numbers or models, or decisions on other components of Transgrid's revenue proposal that act as inputs to that area).
- We do not agree with Transgrid's approach and are likely to adopt a position different to what Transgrid proposed (noting that the most contentious areas of disagreement are presented in the focus issues section of this paper).

15 EII Act, s. 38(7); EII Regulation, cl. 48; EII Chapter 6A, cl. 6A.10.1(c).

16 This is equivalent to $390.8 million ($ nominal) in quarterly payments over the period. The amounts are not equal because the quarterly payments bring forward portions of each annual payment – the Network Operator receives less because we discount the earlier payments at the relevant rate of return.

17 Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, pp. 14–16.

18 Also known as return of capital.

Our overall preliminary position is that we are not currently satisfied Transgrid has sufficiently justified several elements of its revenue proposal, namely its proposed pre-period capex, labour and indirect costs, risk costs and adjustment mechanisms. We have grouped these elements into two broad categories, risk and capex, which are the focus issues of this preliminary position paper (sections 4 and 5 respectively).

We have undertaken our assessment of Transgrid's revenue proposal in accordance with the requirements set out in the EII Act, the EII Regulation and the process set out in our non-contestable Guideline (which includes a section on hybrid revenue determinations). We have 126 business days to make a non-contestable revenue determination under the EII Regulation.[19] More information about our approach to assessing the various components that make up the total revenue is provided in our Guidance note on the AER's EII Assessment Approach for Non-contestable revenue determinations (assessment approach guidance note).

This preliminary position paper provides an indication of which costs we are likely to consider as prudent, efficient, and reasonable non-contestable costs of carrying out the System Strength Project, and which elements of the project we consider are outcomes of a genuine and appropriate competitive assessment process. We consider stakeholder feedback on our preliminary positions allows us to take into consideration of the views of stakeholders and assists us in ensuring that consumers pay no more than necessary for safe and reliable electricity. All preliminary positions presented in this paper are subject to change based on stakeholder submissions and/or receiving additional information from Transgrid in response to this preliminary position paper.

Non-disclosure claims impacting the preliminary position paper

Transgrid's revenue proposal claimed non-disclosure over specific information which we consider requires an open and transparent discussion in this preliminary position paper to allow effective stakeholder consultation.[20] As noted above, we resolved several non-disclosure claims prior to the publication of Transgrid's revenue proposal. Following this, we engaged with Transgrid on its non-disclosure claim for provisional sums in its revenue proposal. Based on the information provided, we were not satisfied that the high-level information was confidential and/or commercially sensitive. As a result of this engagement, Transgrid has withdrawn its non-disclosure claim over the total proposed value of provisional sums, which forms part of its proposed contestable capex (discussed in section 4.1.2). We appreciate the constructive engagement from Transgrid on this matter as it allows stakeholders to better understand Transgrid's proposal and our preliminary positions.

At this point, we have only engaged with Transgrid on its non-disclosure claims where we considered it could impact the text in this preliminary position paper and our ability to consult with stakeholders on key issues. Some additional information, such as the names of the two D&C contractors undertaking the associated works package, may become public shortly. However, we have decided not to delay publication of this paper for this information as we consider it does not materially change stakeholders' ability to engage with our preliminary

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19 EII Regulation, cl. 50(1).

20 Transgrid, *A.8 – System Strength Project 2026–31 Revenue Proposal – Confidentiality (Non-disclosure) Claims*, April 2026.

positions. Consistent with our Non-disclosure Guideline, at the final revenue determination stage, we may reconsider any non-disclosure claims that have previously been accepted.

2 Overview of our preliminary position on Transgrid's revenue proposal

Under section 38(1) of the EII Act, the AER is to determine the amounts payable to a Network Operator for carrying out a network infrastructure project. Clause 47A(2) of the EII Regulation requires the AER to make a non-contestable revenue determination in accordance with the AER's guidelines for non-contestable revenue determinations.

The non-contestable Guideline sets out the AER's approach to making the non-contestable revenue determination.[21] Relevantly, the approach for making a revenue determination includes publication of the revenue proposal submitted by the Network Operator and publication of a preliminary position paper setting out the AER's assessment of the revenue proposal, and its preliminary position on the revenue determination.

A summary of Transgrid's revenue proposal, and an outline of our preliminary position is set out in Table 3. We have also highlighted the most contentious issues from Transgrid's revenue proposal which we believe would benefit from a focused discussion, with feedback and additional material provided either by Transgrid or stakeholders. Our choice of focus issues for each preliminary position paper is identified on a case-by-case basis and is dependent on the issues arising from each specific revenue proposal.

In Table 3, all dollar amounts are provided on a nominal basis except where otherwise indicated.

Table 3 Overview of Transgrid's revenue proposal and AER's preliminary position

Revenue proposal component	Overview of Transgrid's revenue proposal and AER's preliminary position
Total revenue and schedule of payments	
Transgrid revenue proposal	Transgrid proposed a total revenue cap of $400.8 million for the 2026–31 period in its revenue proposal.[22] This is equivalent to $390.7 million in quarterly payments over the 2026–31 period. Transgrid nominated quarterly payment dates (for payment by the Scheme Financial Vehicle (SFV)) as the final day of each quarter. Transgrid initially proposed an earlier payment date than the relevant quarter it relates to. That is, 30 September 2026 as its first quarterly payment date for the October to December quarter, 30 December 2026 as the second payment for the January to March quarter and so on. This timing resulted in the SFV paying Transgrid prior to the proposed commencement of the regulatory control period of 1 October 2026. In response to our request for further information, Transgrid noted this was

21 AER, *Revenue determination guideline for NSW non-contestable projects*, May 2026

22 Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 16.

	a mistake and confirmed a quarterly payment schedule consistent with the final day of each quarter.[23]
AER preliminary position	We are likely to accept Transgrid's approach to calculating its revenues and quarterly schedule of payments. Transgrid used our EII post-tax revenue model (PTRM) (NER PTRM modified for EII non-contestable determinations) to calculate revenues consistent with the requirements of EII Chapter 6A (Appendix A of the Non-contestable Guideline, a modified version of Chapter 6A of the NER that applies to EII projects).[24] The revised payment dates are reasonable, consistent with our previous determinations and align with the payment calculations in the EII PTRM. Any areas of difference in our final decision will likely arise from updates to financial inputs and our assessment of other components of Transgrid's revenue proposal.
Regulatory asset base (RAB)	
Transgrid revenue proposal	Transgrid proposed an opening RAB of $317.1 million as at 1 October 2026.[25] It reflects Transgrid's proposed roll forward of pre-period capex on an 'as incurred' basis (for calculating the return on capital building block) escalated by a nominal weighted average cost of capital (WACC). This includes a half-year WACC escalation as historical capex is assumed to be in mid-year dollar terms. The opening RAB consisted of: • $33.7 million in actual pre-period expenditure incurred before the end of January 2026 related to project development and consultation and RIT-T costs[26] • $271.5 million in estimated contestable and non-contestable pre-period expenditure from February 2026 to September 2026 • $11.9 million in financing costs based on a return on capital for the pre-period costs incurred before the commencement of the regulatory period.[27] Transgrid proposed a forecast closing RAB of $1,251.2 million as at 30 September 2031.[28] This has been calculated by rolling forward the opening RAB and accounting for forecast capex, expected inflation and depreciation (based on forecast capex) over the 2026–31 period.

23 Transgrid's revised payment dates for its proposed regulatory year from 1 October to 30 September are 31 December, 31 March, 30 June and 30 September; Transgrid, *Response to #IR006 – Modelling queries*, May 2026, p. 4.

24 AER, *Guidance note – Amendments to NER PTRM for determinations under the Electricity Infrastructure Investment Act and Regulations*, November 2024; AER, *Non-contestable – EII Sample PTRM template*, November 2024; AER, *Appendix A EII Chapter 6A*, May 2026.

25 Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 95.

26 Transgrid, *GHD – S.6 System Strength Project 2026–31 – Accelerated Syncon Project*, March 2026, p. 29.

27 Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 96.

28 Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 97.

AER preliminary position	We are likely to accept Transgrid's approach to establishing the opening RAB as at 1 October 2026. This is because Transgrid's approach to escalating pre-period expenditure with a nominal WACC is consistent with past determinations and our assumptions around the timing of historical capex being incurred mid-year. We have also confirmed Transgrid's proposed pre-period expenditure has been incurred in the relevant year Transgrid has reported it in. However, we are likely to not accept Transgrid's proposed opening RAB of $317.1 million as at 1 October 2026. Our assessment of the prudency, efficiency and reasonableness of Transgrid's proposed pre-period expenditure is set out in section 5.2.1 as a focus issue. We are likely to accept Transgrid's approach to rolling forward the RAB over the 2026–31 regulatory period using our PTRM. Transgrid has applied our standard approach to rolling forward the RAB over the 2026–31 regulatory period using our PTRM as amended for the EII framework, consistent with our standard approach.
Rate of return	
Transgrid revenue proposal	Transgrid proposed to escalate its pre-period capex from 2023 to 2026 using the nominal WACCs set in its 2018–23 and 2023–28 NER final decisions.[29] To accommodate for the misalignment in regulatory years,[30] Transgrid has proposed to use a weighted geometric mean of the two relevant NER WACC values. These nominal WACCs are then adjusted for actual inflation where the data is available. For the 2026–31 period, Transgrid proposed to apply the binding 2022 Rate of Return Instrument (RoRI) to develop the nominal WACCs used to calculate the return on capital building block. However, Transgrid proposed a minor deviation to our standard approach in forecasting inflation for the 2026–31 period. In response to an information request, Transgrid confirmed it had applied the geometric mean of the two published RBA forecast inflation for June and December to estimate a September forecast.[31]
AER preliminary position	Transgrid has broadly applied our standard methodology to calculate forecast inflation over the 2026–31 regulatory period. However, we are assessing Transgrid's proposal to use the geometric mean of the June and December RBA forecasts in developing a September estimate. We will consider the merits of Transgrid's approach while ensuring consistency with our NER decisions for network businesses with a similar regulatory period.[32] Consequently, while we are likely to accept Transgrid's approach to escalating pre-period capex using a nominal WACC, we are undertaking

29 Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 102.

30 Transgrid's NER determinations are based on a 1 July to 30 June regulatory year. However, Transgrid's proposed regulatory year for the System Strength Project is 1 October to 30 September.

31 Transgrid, *IR006 – SSP 2026–31 Modelling Queries – 20260519 – Public*, May 2026, pp. 3–4.

32 We note that under the NER framework, Ausnet Services (Transmission) is similarly on a 1 April to 31 March regulatory year and therefore face a similar misalignment with the RBA forecasts.

	an assessment of Transgrid's proposed approach to use a weighted average of the approved NER final decision WACCs. We consider the difference in both approaches above is largely mechanical and not controversial. We are also likely to accept Transgrid's proposed risk-free rate and debt averaging periods as they are consistent with the current 2022 RoRI and our final decision will be made prior to the final 2026 RoRI.
Regulatory depreciation	
Transgrid revenue proposal	Transgrid proposed a regulatory depreciation amount of –$5.8 million for the 2026–31 regulatory period.[33] Transgrid also proposed 8 asset classes (including equity raising costs) for the System Strength Project, all of which are consistent with its existing asset classes and corresponding standard asset lives we approved for Transgrid's 2023–28 NER determination.[34] Transgrid has proposed to use standard depreciation approach for transmission businesses per the EII PTRM and consequently an opening 'as commissioned' RAB of zero, reflecting that no assets have been commissioned in the pre-period years. Transgrid has also confirmed it has not applied for a financeability adjustment for the System Strength Project.[35]
AER preliminary position	Our preliminary position is that Transgrid's proposed asset classes and asset lives appear reasonable and are consistent with those approved as part of Transgrid's 2023–28 NER transmission determination. We also consider Transgrid's opening 'as commissioned' RAB of zero is likely to be reasonable and appropriate, reflecting that no assets have been built and commissioned prior to the first year of the regulatory period. Our final decision regulatory depreciation amount will be impacted by our decision on capex and forecast inflation.
Capex	
Transgrid revenue proposal	Transgrid proposed a total of $1,185.0 million ($September, 2026) in capex, which comprises:[36] • $918.1 million in contract-related (contestable) capex – ($216.8 million in pre-period capex and $701.3 million in forecast period capex) • $266.9 million in non-contestable capex

33 Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 94.
This building block is negative as regulatory depreciation is calculated as straight-line depreciation net of inflation on the opening RAB. As our standard approach under the EII framework is to only begin calculating straight-line depreciation when an asset has been commissioned (as commissioned approach), the initial construction years will only reflect a negative inflation component in the revenue building block.

34 Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 94.

35 Transgrid, *System Strength Project 2026-31* - Revenue Proposal, April 2026, p. 39.

36 Transgrid, *System Strength Project 2026-31 - Revenue Proposal*, April 2026, pp. 14-15; All values in this capex section are reported in $September 2026 terms.

	– ($95.7 million in pre-period capex and $171.2 million in forecast period capex). Transgrid's non-contestable capex forecast includes: • $217.2 million in labour and indirect costs (including labour escalation) • $18.4 million in risk costs • $10.3 million in equipment costs • $7.8 million in infrastructure planner fees[37] • $7.1 million in building costs • $0.6 million in fleet acquisition costs • $0.1 million in easement acquisition costs • $5.4 million in equity raising costs.
AER preliminary position	Transgrid's proposed risk costs and provisional sums (part of its proposed contestable capex) are focus issues for this preliminary position paper and are discussed further in section 4. Transgrid's proposed labour and indirect costs are a focus issue for this preliminary position paper and are discussed further in section 5. Specifically, our focus is on Transgrid's proposed project development and project delivery management costs for the project. Our assessment is currently ongoing in relation to Transgrid's proposed capex. At this point of our assessment, we acknowledge that: • Our preliminary position is to accept Transgrid's proposed lump sum payments to contractors ($723.0 million of the proposed $918.1 million of contestable capex) as outcomes of genuine and appropriate competitive assessment processes. • Transgrid's forecast of the remaining non-contestable capex is likely to be prudent, efficient and reasonable. This is because for these categories of capex, Transgrid's forecast is based on either independent advice or competitive market rates.
Opex	
Transgrid revenue proposal	Transgrid proposed a total of $60.1 million ($September, 2026) in opex over the regulatory period, which consists of:[38] • $24.4 million as contestable opex (including provisional sums) relating to LTSA and GPS compliance testing costs. • $35.7 million proposed for non-contestable opex. Transgrid's non-contestable opex forecast includes:

[37] Infrastructure Planner Fees are payable in accordance with the Underwriting Agreement between Transgrid and NSW DCCEEW, and enable NSW DCCEEW to support the Project at a whole of government level.

[38] Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, pp. 14–15.

	• $10.9 million for maintenance costs • $18.9 million for operating costs • $2.8 million for insurance costs • $0.8 million for real labour escalation costs • $2.2 million for debt raising costs. Transgrid indicated its forecast of non-contestable opex has been determined using a bottom-up-build because no base year is available from a preceding regulatory period. Transgrid has not sought to recover any pre-period opex costs in its revenue proposal.
AER preliminary position	Our preliminary position is to accept Transgrid's contract opex as an outcome of a genuine and appropriate competitive assessment process, but not the amount that has been proposed as a provisional sum. We are also likely to accept Transgrid's forecast non-contestable opex for the 2026–31 period, as we consider these costs are likely prudent, efficient, and reasonable. However, our opex assessment is ongoing and changes made to other areas of Transgrid's revenue proposal (e.g. forecast capex or provisional sums) may impact our decision on the appropriateness of its forecast non-contestable opex.
Corporate income tax	
Transgrid revenue proposal	Transgrid forecast a corporate income tax amount of $0.4 million over the regulatory period.[39] Transgrid did not propose an opening tax asset base as at 1 October 2026, consistent with its opening as commissioned RAB detailed in the regulatory depreciation section above. Transgrid has adopted our EII PTRM in calculating tax depreciation on a diminishing value approach, except for Buildings – capital works and equity raising costs. Transgrid did not propose to immediately expense any capex.
AER preliminary position	We are likely to accept Transgrid's approach to calculating its corporate income tax. Transgrid used our EII PTRM and proposed tax asset lives that are consistent with previous AER determinations made under the EII and NER, where applicable. Transgrid's proposal to depreciate all tax asset classes under a diminishing value approach other than Buildings – capital works and equity raising costs is consistent with the ATO rulings. Any area of difference in our final decision will likely arise from updates to financial inputs and our assessment of other components of Transgrid's proposal.

[39] Transgrid, *System Strength Project 2026-31 - Revenue Proposal*, April 2026, p. 105.

Capital Expenditure Sharing Scheme (CESS)	
Transgrid revenue proposal	Transgrid proposed that the CESS is not applied to capex related to transport work upgrades and costs caused by the Middle East conflict.[40] It also proposed related adjustment mechanisms for these events.[41] For transport work upgrades, Transgrid stated that the CESS should not apply because:[42] • The scope, timing and cost of the transport work upgrades has not been fully identified. • There has been insufficient time to complete detailed route surveys, bridge structural assessments and approval processes. • Delivering or managing transport projects is not part of its core business.
AER preliminary position	Our preliminary position is to apply the CESS to non-contestable capex, except in circumstances where expenditure is not within Transgrid's control. We also note that where costs are passed through to consumers (such as via an adjustment mechanism) the incentive impact of the CESS is removed. For transport work upgrades, our preliminary position is to accept an adjustment mechanism but for the mechanism to specify that a review and remake of our decision will occur when the scope of work required is better defined (see section 4.2.3.4). At that point, we will also make a decision on whether the CESS should apply to these costs. For additional costs caused by the Middle East conflict, we are still assessing the appropriateness of Transgrid's proposed approach to determining and recovering these costs (see section 4.2.3.2). As such, our assessment of Transgrid's proposed CESS exclusion for these costs is ongoing.
Efficiency Benefit Sharing Scheme (EBSS)	
Transgrid revenue proposal	Transgrid proposed to defer the decision on whether to apply the EBSS to the end of the first regulatory period due to there being no historical opex data on which to base forecasts and inform this decision.
AER preliminary position	Our preliminary position is to defer our decision to apply the EBSS to the end of the 2026–31 period (at the time of making a revenue determination for the 2031–36 period). At that time, we will consider whether Transgrid has revealed opex that is efficient and whether that base level of opex is at a steady state, such that it could be used to forecast opex for the following regulatory period. This is consistent with our assessment approach guidance note on the application of incentive

40 Transgrid, *System Strength Project 2026-31 - Revenue Proposal*, April 2026, p. 111.

41 Transgrid, *System Strength Project 2026-31 - Revenue Proposal*, April 2026, p. 120.

42 Transgrid, *System Strength Project 2026-31 - Revenue Proposal*, April 2026, pp. 138-139.

	schemes under the EII Act.[43] It is also consistent with our final decision on the non-contestable components for the 2026–31 Enabling Central-West Orana (CWO) Project and 2026-31 Hunter-Central Coast (HCC) Renewable Energy Zone (REZ) Project. [44]
Adjustment mechanisms	
Transgrid revenue proposal	Transgrid proposed 20 adjustment mechanisms,[45] that allow it to apply to adjust certain aspects of our revenue determination. Transgrid's revenue proposal groups these adjustments into 5 broad categories which include: • 5 contract-related variation events • 4 events prescribed under EII Chapter 6A • 4 nominated pass-through events; • 3 routine administrative events • 4 adjustments for events impacting Transgrid's costs, in 2 subcategories: – 3 non-contestable transport works related events – 1 event for Transgrid's costs impacts due to contractual variations. Additionally, 2 of Transgrid's 3 proposed non-contestable transport works adjustment mechanisms have two parts, a forecast (part a) and a true up (part b). Following the submission of its proposal and in response to information requests, Transgrid proposed several additions and clarifications to the adjustment mechanisms for contract-related variation events to fully reflect the contractual arrangements.[46] These are noted in section 4.1.3.1 and reflected in the adjustment mechanism appendix to this preliminary position paper (Appendix A). In its proposal, Transgrid also noted the potential to include an adjustment mechanism to manage impacts under the D&C contracts resulting from the conflict in the Middle East. Following submission of its proposal, Transgrid has provided further information regarding this proposed adjustment mechanism, which involves Transgrid recovering

43 AER, *Guidance note on the AER's EII Assessment Approach for Non-contestable revenue determinations*, September 2025, pp. 51–52.

44 AER, *Final decision – Transgrid – Central-West Orana Enabling REZ non-contestable project 2026–31*, January 2026; AER, *Final decision – Ausgrid – Hunter-Central Coast REZ non-contestable project 2026–31*, December 2025

45 Transgrid's revenue proposal included 19 adjustment mechanisms, but we consider the D&C contractor adjustment should be separated into two adjustments to better reflect the specific contract signed with each party.

46 Transgrid, *Response to information request IR#008*, 29 May 2026.

	amounts for 2 lump sum payments to the D&C contractors (one unconditional and one conditional).[47]
AER preliminary position	Transgrid's proposed adjustment mechanisms for contract-related variation events and adjustment mechanism for non-contestable transport works events are a focus issue for this preliminary position paper and discussed further in section 4 and Appendix A. Specifically, we consider: • What is considered an outcome of the competitive assessment process in relation to contract-related adjustment mechanism triggers and method • Relationship between contract-related adjustment mechanisms and Transgrid's proposed provisional sum allowances • Treatment of the adjustment mechanism to manage cost impacts resulting from the conflict in the Middle East • Simplification and refinement of contract-related adjustment mechanisms to enhance clarity and accuracy • Treatment of transport works adjustment mechanisms. We consider Transgrid's 12 remaining non-contestable adjustment mechanisms are uncontroversial as they: • reflect adjustment events prescribed in EII Chapter 6A and cost pass-through events contained in recent NER determinations • reflect routine administrative events and standard events that are commonly approved • reflect similar types of costs to adjustment events recently approved in other EII determinations.

Source: AER analysis.

[47] Transgrid, *Response to information request IR#008*, 29 May 2026.

3 Stakeholder views on Transgrid's revenue proposal

We consider stakeholder views, gathered from consumer engagement and submissions made to us, to be an important guide in our assessment of revenue proposals. It provides us with helpful insight and evidence of alignment with consumer interests and assists in determining which components of the revenue proposal to focus on in our preliminary position paper.

3.1 Transgrid's stakeholder engagement

Network infrastructure projects under the EII Act may represent a challenge for Network Operators in terms of stakeholder engagement due to confidentiality constraints and the limited discretion that they have over project timing and scope. However, we consider that these limitations increase the importance of effective engagement on those elements of the revenue proposal that consumers are able to influence. Consequently, we expect Network Operators to use their best endeavours to obtain and incorporate stakeholder feedback on their revenue proposals.

Transgrid consulted with the TAC, comprised of consumer, business, and industry stakeholders, on the system strength shortfall and related investment need. Transgrid's TAC consultation:

- was initially undertaken as part of the 'Meeting System Strength Requirements in NSW Regulatory Investment Test for Transmission' process but shifted focus to pre-lodgement engagement for the System Strength Project in August 2025[48]
- featured 7 deep dive sessions on system strength issues from March 2023 until February 2026, with the last 3 deep dives being focused on the System Strength Project[49]
- focused on risk allocation, adjustment mechanisms and incentive design.[50]

AER staff attended some of these TAC meetings as observers and the AER's Consumer Challenge Panel (CCP35) independently met with some of the TAC members to gain insight into their views on Transgrid's engagement.[51] CCP35's role was to provide us feedback on how effective Transgrid's engagement activities were and how its revenue proposal was influenced by this engagement.

We consider that Transgrid's consumer engagement, while limited by confidentiality and scope constraints, requires further improvement. This view is informed by our observations, as well as CCP35's advice to us, which considered that Transgrid's engagement 'fell short of

48 Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, pp. 35, 37.

49 Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 37.

50 Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 10.

51 Consumer Challenge Panel (CCP) Sub-Panel 35, *Submission – System Strength Project – 2026–31 Revenue Proposal*, May 2026, p. 4.

supporting genuine, consumer engagement in accordance with Better Resets Handbook expectations'.[52]

We recognise that Transgrid is taking some positive steps towards better consumer engagement for its EII projects. We, and the CCP35 in its submission, commend Transgrid for taking the following actions in its System Strength Project pre-lodgement engagement:

- establishing and maintaining an informal system strength sub-committee open to all interested TAC members
- preparing and distributing detailed presentation materials and meeting minutes to all participants in a timely manner
- providing clear information as to the potential scope of consumer influence
- ensuring consistent and appropriate Transgrid representation at meetings
- providing a clear plain-English overview of the System Strength Project in its revenue proposal
- undertaking deep dive sessions with its TAC members
- replacing its long-standing stakeholder engagement group (TAC) with the more consumer-focused Consumer Advisory Group, noting that this only occurred shortly before the submission of its revenue proposal. [53]

However, in attending TAC meetings, and as evidenced by the CCP35 submission, we observed that:

- **Transgrid 'informed' but did not 'engage with' consumers:** Transgrid undertook some deep dive sessions with the TAC on key topics such as risk allocation, CESS and adjustment events. However, these sessions were focused on explaining its preferred approach rather than genuinely seeking consumer input to shape aspects of its revenue proposal. The CCP35 commented that while sub-committee members 'were able to ask questions, they had limited capacity to shape substantive elements of the proposal, particularly in relation to risk allocation'.[54] CCP35 also reported that consumer influence over the development of Transgrid's revenue proposal 'was consistently described as minimal'.[55] As such, we consider Transgrid's engagement was more reflective of 'informing' rather than 'engaging' with consumers.
- **No options or trade-offs tested:** Transgrid was open to responding to questions, but less receptive to alternative views, proposals or challenge. The CCP35 submission noted that 'options, trade-offs, or alternative approaches were not tested with consumers in a

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52 Consumer Challenge Panel (CCP) Sub-Panel 35, *Submission – System Strength Project – 2026–31 Revenue Proposal*, May 2026, p. 9.

53 Consumer Challenge Panel (CCP) Sub-Panel 35, *Submission – System Strength Project – 2026–31 Revenue Proposal*, May 2026, p. 8.

54 Consumer Challenge Panel (CCP) Sub-Panel 35, *Submission – System Strength Project – 2026–31 Revenue Proposal*, May 2026, p. 9.

55 Consumer Challenge Panel (CCP) Sub-Panel 35, *Submission – System Strength Project – 2026–31 Revenue Proposal*, May 2026, p. 10.

manner consistent with effective consumer-centred engagement'.[56] We consider that meaningful consumer engagement should provide consumers with the opportunity to directly influence the decisions being made for proposal elements within the scope of consumer influence. Transgrid should seek to provide consumers with the opportunity to influence proposal elements, in the form of different treatment options, cost trade-offs, or alternative approaches. We consider that an example of this type of meaningful engagement was undertaken in Transgrid's risk deep dives as part of its 2026–31 Enabling CWO Project consumer engagement. In that previous process, Transgrid sought consumer preferences on how it treated certain risks, as either adjustment mechanisms (with or without a cap) or risk costs (as part of the capex forecast).[57] Transgrid did not implement the same approach for the System Strength Project.

- **Need to discuss issues holistically:** While Transgrid undertook deep dives into the non-contestable areas of risk and adjustment mechanisms, it did not discuss the provisional sums it intended to propose as part of its contestable expenditure. We consider that provisional sums are closely linked to both risk costs and adjustment mechanisms. As such, they should have been considered alongside these elements so consumers could understand the full extent of Transgrid's proposed approach to recovering risk-related costs. Considering these issues in isolation limits consumers' ability to meaningfully assess or endorse Transgrid's proposed approach. We acknowledge that Transgrid proposed the provisional sums as contestable, and therefore outside of consumers' ability to influence. However, we had indicated to Transgrid prior to the submission of its revenue proposal that we were not convinced provisional sums could be considered an outcome of the contestable process. Additionally, we consider that regardless of whether provisional sums were contestable, the concept should have been disclosed as part of the deep dives with the TAC, including the differences between provisional sums and risk costs.
- **Lack of transparency over costs:** TAC members raised concerns regarding the transparency of key decisions and the lack of availability of information necessary for genuine engagement and scrutiny. The CCP35 submission stated that key negotiations with the NSW Minister for Energy were 'understood to have occurred "behind closed doors", undermining confidence in the integrity of engagement outcomes'.[58] Additionally, the hybrid structure of the proposal, with approximately 80% of total expenditure proposed as contestable, further constrained consumer visibility over the project expenditure. We consider that it may be helpful if NSW DCCEEW consider developing a dedicated consumer panel (or leveraging an EnergyCo consumer panel) to involve consumers in the process of determining the scope and timing of projects under the EII Act.
- **Limited scope for meaningful engagement:** The CCP35 submission noted that the 'movement of evidentiary requirements from the NER into the EII framework further reduced the opportunity for meaningful consumer engagement'. It also noted that the

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56 Consumer Challenge Panel (CCP) Sub-Panel 35, *Submission – System Strength Project – 2026–31 Revenue Proposal*, May 2026, p. 9.

57 Transgrid, *Central West Orana Enabling Project 2026-31 – Revenue Proposal*, 2025, pp. 45-46.

58 Consumer Challenge Panel (CCP) Sub-Panel 35, *Submission – System Strength Project – 2026–31 Revenue Proposal*, May 2026, p. 10.

PNIP designation was 'perceived as weakening the role of consumer input and shifting reliance onto the AER's assessment'.[59] Finally it described the engagement following the project's designation as a PNIP, as 'largely without purpose beyond "informing" as … key decisions had effectively been settled'.[60] We consider that a limited scope places more importance on Transgrid to effectively engage with consumers, allowing consumers to shape the elements of the revenue proposal they can influence.

We expect Network Operators to look at ways to improve pre-lodgement engagement to ensure that, where possible, their proposals reflect consumer preferences. We consider there are actions Transgrid could take to improve stakeholder engagement for future projects. These include:

- engaging with consumers **before decisions have been made** on areas that they can influence, providing them with the information they need to give informed advice. Then allowing consumers to **shape these elements of the revenue proposal** by providing them with choices over different treatment options, cost trade-offs, or alternative approaches
- allowing consumers to **engage with issues holistically** even if they cannot influence all aspects of an issue. We consider that consumer deep dives should discuss all related factors which impact the advice consumers are being asked to provide agreement on (for example, efficient treatment of risks).

The above actions could significantly strengthen consumer confidence in the integrity of Transgrid's revenue proposals.

Overall, Transgrid has demonstrated efforts in some areas to improve its stakeholder engagement following the 2026–31 Enabling CWO Project revenue determination. However, there remain opportunities to further improve engagement, which could improve stakeholder sentiment regarding these non-contestable projects. As outlined in our Better Resets Handbook, we consider that genuine engagement with consumers is likely to result in better quality and well-justified proposals being submitted to the AER.

Proposals that reflect consumer preferences, and meet our expectations, are more likely to be largely or wholly accepted, creating a more effective and efficient regulatory process for all stakeholders.[61] We consider that well-justified, consumer-supported revenue proposals are important, especially given consumers are funding the large capital investments required for the energy transition.

3.2 AER response to stakeholder submissions

We received 3 submissions in response to Transgrid's 2026–31 revenue proposal for the System Strength Project, as presented in Table 4.

59 Consumer Challenge Panel (CCP) Sub-Panel 35, *Submission – System Strength Project – 2026–31 Revenue Proposal*, May 2026, p. 10.

60 Consumer Challenge Panel (CCP) Sub-Panel 35, *Submission – System Strength Project – 2026–31 Revenue Proposal*, May 2026, p. 9.

61 AER, *Better Resets Handbook – Towards Consumer Centric Network Proposals*, July 2024, p. 3.

Table 4 Submissions on Transgrid's revenue proposal

Stakeholder	Date received
The AER's Consumer Challenge Panel (CCP35)	15 May 2026
Centre for Smart Power and Energy Research (CSPER)	15 May 2026
Justice and Equity Centre	18 May 2026

Note: Stakeholders had 15 business days to provide submissions on the revenue proposal between 24 April 2026 and 18 May 2026.

In addition to CCP35's submission on Transgrid's pre-lodgement engagement (covered in section 3.1), stakeholders raised issues with Transgrid's proposed risk elements (adjustment mechanism and risk allowances), and capex (labour and indirect costs).

We have carefully considered all issues and arguments raised in stakeholder submissions. However, some matters are outside the scope of the 2026–31 System Strength Project revenue determination process or are not matters we can address under our functions in the EII framework. Where this was the case, we have not provided a detailed response in this paper but have still considered the merits of the matters raised by these submissions.

We summarise our responses to the matters raised by stakeholders in Table 5. Risk and capex are discussed in further detail in sections 4 and 5 respectively.

Table 5 AER response to matters raised in stakeholder submissions

Stakeholder submission	AER response
CCP35 submission CCP35 considered that we should:[62] • closely scrutinise the revenue proposal, 'particularly given consumers had no influence to ensure appropriate risk sharing' • closely examine Transgrid's risk allocation, adjustment mechanisms and contingency provisions, 'given the extremely limited influence consumers had to influence Transgrid's proposal' • explain, using language that consumers can understand, how our decision-making process and outcomes are in the long-term interests of consumers	One of our focus issues for this preliminary position paper is Transgrid's risk elements, which includes its adjustment mechanisms, risk cost contingencies, and provisional sums (see section 4). We have also identified elements of Transgrid's capex labour and indirect costs forecast (our other focus issue), which are related to risk sharing. We are undertaking a holistic assessment of Transgrid's risk approach, and we encourage stakeholder submissions on this issue to inform our final decision. By identifying Transgrid's risk elements and assessing them in a holistic way, we have made our decision-making process clearer for consumers. Our focus issue discussion details how our assessment seeks to determine outcomes that are in the long-term interests of consumers.

[62] Consumer Challenge Panel (CCP) Sub-Panel 35, *Submission – System Strength Project – 2026–31 Revenue Proposal*, May 2026, p.5.

CSPER submission

CSPER recommended that we should:[63]

- assess the full architecture of consumer risk exposure, not just each element in isolation
- require integrated reporting of all adjustment mechanisms and contingent recovery pathways, including transport adjustments, contract variations and escalation treatments
- require Transgrid provide a risk-to-recovery map showing how each material risk is treated to reduce the risk of double recovery. For example, whether it sits in base expenditure, contractor pricing, risk allowances, insurance, or later adjustments
- require clearer disclosure of assumptions about synchronous condensers, grid-forming technologies, inverter capability, and future system operability
- strengthen transparency around indirect and non-contestable costs, specifically disclosure of allocation logic, capitalisation criteria, shared cost treatment, and corporate support costs
- improve labour-escalation and market-capacity reporting by requiring clearer separation between genuine sector-wide escalation pressures and project-specific inefficiencies or delivery problems
- introduce post-commissioning observability reporting by requiring reporting after delivery on actual system-strength contribution, asset performance, outage behaviour, maintenance burden, commissioning outcomes, and interactions with inverter-based resources
- use this project as a governance precedent to develop stronger long-term principles for transparency, adaptive regulation, and lifecycle observability.

We agree with CSPER that risk elements should be assessed holistically to reduce the risk of recovery overlap. We have taken this approach by selecting risk (as a whole) as a focus issue. In section 4, we examine the pathways Transgrid has proposed to recover certain risks, providing transparency for consumers around how various risks are being treated. We encourage stakeholders to engage with this discussion and provide submissions on this issue to inform our final decision.

Outside of making a determination we do not have formal information gathering and reporting roles under the EII framework, so we cannot require the reporting of specific information on EII projects after making our revenue determinations. However, we intend to consider ways to strengthen information requirements for both revenue proposals (through potential changes to the regulatory information notice) and annual adjustment proposals. We agree with CSPER that requiring Transgrid to submit even a high-level risk-to-recovery pathway map (based on its revenue proposal risk register) would provide consumers and us with greater visibility over its risk allocation. We will consider making this addition to the regulatory information notice.

We recognise the need to scrutinise Transgrid's indirect and non-contestable costs. As part of our capex assessment, we are examining whether Transgrid's indirect costs are being allocated according to its approved cost allocation methodology (CAM). We are also investigating whether any proposed indirect costs overlap with costs to be recovered under its existing revenue determinations, avoiding double recovery of these costs.

Our determination for the 2026–31 System Strength Project will provide the basis for future hybrid revenue proposals. We intend to use this determination to establish strong expectations for cost and risk transparency in hybrid revenue proposals. This determination represents only a starting point for hybrid

63 Centre for Smart Power and Energy Research (CSPER) - Deakin University, *Submission - System Strength Project - 2026-31 Revenue Proposal*, May 2026, pp. 19-21.

	assessments, and we expect that our regulatory process will need to continue to adapt and evolve to better cope with challenges encountered in future processes. The broader discussion on the appropriate regulatory framework design, and increased requirements around lifecycle observability are beyond the remit of the 2026–31 System Strength Project revenue determination.
Justice and Equity Centre submission The Justice and Equity Centre considered that we should:[64] • closely scrutinise Transgrid's proposal to ensure all prudent steps have been taken to minimise project costs and manage risks to NSW consumers • undertake a robust and detailed prudency and efficiency review of Transgrid's actions, given their concerns about its recent project cost management and weak incentives to minimise capital expenditure.	One of our focus issues for this preliminary position paper is Transgrid's non-contestable capex. We are closely scrutinising Transgrid's capex cost build-up, including whether Transgrid has acted prudently to minimise project costs, and whether appropriate incentives apply. Section 5 details how we are undertaking our assessment of these costs and we encourage stakeholder submissions on this issue to inform our final decision. We found that the competitive assessment processes undertaken by Transgrid (under the control and direction of the Infrastructure Planner) for the synchronous condenser and associated works packages were genuine and appropriate (in December 2025 and March 2026, respectively). Under clause 45(6) of the EII Regulation, in making our revenue determination we must rely and adopt the information obtained from a competitive assessment process if we are satisfied the process was genuine and appropriate. Additionally, under clause 47B(1A) of the EII Regulation, our guidelines for non-contestable revenue determinations must provide that the CESS and EBSS do not apply to a contestable component of a non-contestable revenue determination. We consider a hybrid revenue determination is a non-contestable revenue determination with contestable components. As such, we consider that competitively determined procurement costs fall outside of the remit of our standard assessment and cannot be subject to our typical incentive schemes. We also consider that the scope and timing of the project were determined by the Minister's

64 Justice and Equity Centre, *Submission – System Strength Project – 2026–31 Revenue Proposal*, May 2026, pp. 1-3.

direction, and so are also outside the remit of our current assessment.

4 Focus issue 1: Risk

In delivering the System Strength Project, we expect that Transgrid will manage and mitigate risks as efficiently as possible. Key to this is developing appropriate contractual arrangements, whereby risk is allocated to the party that is best placed to manage that risk, and the objectives of the Network Operator and contractor are aligned to the greatest extent possible.

Transgrid's revenue proposal includes the following measures to allocate and recover costs related to project risks:

- **Risk costs (capex)** for specific, pre-identified risk events which Transgrid considers are outside its control and cannot be reasonably mitigated or prevented. These relate to Transgrid's own costs. The EII Act and EII Regulation require that a revenue determination include amounts for other risks for which the Network Operator is not already compensated.[65] As noted in our guidance note, consumers should not bear the cost of risks where a Network Operator has the ability to avoid and/or control these costs. However, there may be significant external factors that can increase the cost of a large infrastructure project, which the Network Operator does not have control over. In these cases, inclusion of a probabilistic risk cost – where they are not already included in forecast expenditure – can be prudent way to account for these risks.[66] We consider risks costs that are non-contestable in nature are subject to incentives under the CESS.
- **Expenditure related to provisional sums**, for cost allowances included in its OEM, LTSA and D&C contracts to manage pre-identified risks in the design, manufacture and commissioning of works for which the contractors are entitled to a contract variation. The provisional sums are proposed alongside adjustment mechanisms for contract variation events.
- **Adjustment mechanisms** for events outside Transgrid's control, which are intended to appropriately allocate risk between Transgrid and consumers. We consider adjustment mechanisms are a suitable approach where risks cannot be forecast with a reasonable degree of certainty. If triggered, these will form part of the potential costs that may be required to be incurred by the Network Operator. Where costs are subject to ex-post adjustment mechanisms, the incentive power of the CESS is removed because costs will be adjusted to reflect actual costs.

In this section we summarise Transgrid's proposed risk costs, provisional sums and adjustment mechanisms, and provide our preliminary position on each. Transgrid's forecast of its labour costs is also relevant to risk management, in that many of the proposed labour activities involve managing and mitigating project risks. We discuss this further in section 5.

65 EII Act, s. 38(2); EII Regulation, cl. 50A.

66 AER, *Guidance note on the AER's EII Assessment Approach for Non-contestable revenue determinations*, September 2025, pp. 22.

4.1 Overview of Transgrid's proposal for risk costs

4.1.1 Risk costs

As part of its non-contestable capex forecast ($266.9 million)[67], Transgrid proposed $18.4 million for risk costs.[68] Transgrid noted that it has taken steps to reduce risk through early geotechnical investigations and environmental activities, interactive procurement, and lessons learned from other synchronous condensers projects.[69]

However, Transgrid also noted that there are residual risks that cannot be fully transferred, avoided or mitigated, which should be covered through the proposed risk costs. The proposed amount is based on P50 estimate for each of the expected residual risk costs.[70]

Broadly, Transgrid's approach to identifying risk cost allowance involved:[71]

- Establishing project context for potential risks
- Identifying expected risks and establishing a risk register
- Analysing and evaluating potential risks and identifying mitigation and management strategies
- Assessing potential cost impacts of risks, to determine the appropriate risk cost allowance.

In estimating its risk cost allowance, Transgrid applied an integrated Cost and Schedule Quantitative Risk Analysis (QCSRA) probabilistic approach.[72] Transgrid developed its QCSRA process inputs through engaging with project team leads and subject matter experts (SMEs) to carry out the initial qualitative risk assessments, cost and time impact quantification, risk allocation and validation of the results.[73] Additionally, Transgrid undertook qualitative workshops, probabilistic schedule and cost modelling, Monte Carlo type simulations and prolongation cost modelling.[74]

Transgrid's QSCRA modelling derived risk cost values for the following categories:[75]

- **Contingent cost risks** - risk costs established through the process of analysing probability and consequence of cost risk events that may or may not happen.

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67 All capex figures in section 4 and 5 of our preliminary position paper are in $September 2026 terms unless otherwise noted.

68 Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 59.

69 Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, pp. 71–72.

70 P50 is the value that has a 50% probability of being exceeded and a 50% probability of not being exceeded, and it is the point at which risks are shared equally between Transgrid and consumers.

71 Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 72.

72 Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, pp. 72–73.

73 Transgrid, *A.5 – System Strength Project 2026–31 – Non-Contestable Risk Cost Allowance Forecasting Methodology*, April 2026, p.12.

74 Transgrid, *A.5 – System Strength Project 2026–31 – Non-Contestable Risk Cost Allowance Forecasting Methodology*, April 2026, p.15.

75 Transgrid, *A.5 – System Strength Project 2026–31 – Non-Contestable Risk Cost Allowance Forecasting Methodology*, April 2026, p.16.

- **Inherent cost uncertainty** - risk costs established through the process of analysing cost uncertainty.
- **Prolongation** - risk costs established through the process of analysing potential additional costs if the project is extended beyond the contractual dates for completion.

Transgrid's used the outputs of its QCSRA modelling process to develop its risk estimates for the 8 risks covered by its proposed risk cost allowance. These 8 risks cost estimates are shown in Table 6.

Table 6 Summary of Transgrid's proposed risk costs

#	Risk Name	Description	Risk Cost ($m, September 2026)
1	Commissioning and integration challenges	The integration and commissioning of the accelerated syncons into the Transgrid network may result in additional uprating or upgrading of equipment being required to deal with issues such as increased fault levels or changes being required to control systems.	6.1
2	Extended inclement weather	Project delays caused by inclement weather such as heavy rainfall or heat (over and above contracted allowance) which prevents the safe and effective completion of works.	2.7
3	Third-party interfaces	Third party interfaces with government departments and utilities result in additional management effort and cost to Transgrid to minimise delays to OEM supplier and D&C contractors.	1.1
4	Additional network modelling	Additional or more complex modelling required for the Project resulting in additional Transgrid resources or consultant support.	2.3
5	Environmental and community engagement works	Additional construction noise and operational noise may result in increased community complaints or the potential to require additional sound mitigation.	1.8
6	Equipment issues	Delays to supply of Transgrid supplied equipment due to unanticipated global supply chain delays and issues with existing equipment within a brownfield environment.	2.5
7	Changes to commissioning approach	Changes to commissioning approach by OEM supplier or D&C contractors result in greater resource requirements for Transgrid to oversee and coordinate, where not covered by proposed adjustment mechanisms.	1.3
8	Contractor industrial action	Additional Transgrid resourcing required as a result of delays arising from contractors or sub-contractors industrial action.	0.6
Total			**18.4**

Source: Transgrid, *A.5 – Non-Contestable Risk Cost Allowance Forecasting Methodology – System Strength Revenue Proposal*, April 2026, p 9.

Transgrid noted that the proposed risk cost allowance was developed before the Middle East conflict commenced, and therefore, it does not include any additional costs that may arise directly from this event.[76] This is discussed further in section 4.2.3.2.

Transgrid also noted that throughout the process, it engaged with the TAC on the appropriate balance between the risk cost allowance and adjustment mechanisms.[77] The proposed risk costs were also reviewed through internal governance and external consultants.

GHD carried out an independent review of the proposed risk costs, including benchmarking, and concluded that the $18.4 million provision was a reasonable residual risk allowance.[78] It stated that the risk allowance was prudent and in line with risk allowance methodologies used on other Integrated System Plan (ISP) projects. GHD considered efficiency was supported by the assessment of the assumptions and inputs used in determining the allowance for residual risk and reasonableness was supported by benchmarking with other ISP and PNIP projects.

Transgrid also stated that it found that some of the risks are unpredictable events that were outside its control and cannot be reasonably mitigated or prevented.[79] For these specific risks, they have proposed adjustment mechanisms which are discussed in section 4.1.3.

4.1.2 Provisional sums

Provisional sums capex

As part of its contestable capex forecast ($918.1 million),[80] Transgrid proposed $195.2 million in provisional sums.[81] The total provisional sum capex comprises separate provisional sums for each of the three contractors, OEM (GE), D&C Contractor 1 and D&C Contractor 2.

Transgrid states that provisional sums are employed on the OEM and D&C contracts to manage pre-identified risks in the design, manufacture and commissioning of the works for which the contractors are entitled to a contract variation.[82] It also states that provisional sums are estimated based on competitively tendered rates and are only used for substantiated contract variations where the contractor has proven entitlement. Transgrid mentioned that any unused provisional sums at project completion will be returned to consumers.

It stated that the provisional sum arrangements would affect its revenue as follows:[83]

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76 Transgrid, *A.5 – System Strength Project 2026–31 – Non-Contestable Risk Cost Allowance Forecasting Methodology*, April 2026, p.16.

77 Transgrid, *A.5 – System Strength Project 2026–31 – Non-Contestable Risk Cost Allowance Forecasting Methodology*, April 2026, p.36.

78 Transgrid, *GHD – S.6 System Strength Project 2026–31 – Accelerated Syncon Project*, March 2026, p. iii.

79 Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 72.

80 Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 14.

81 Transgrid, *Response to information request #007 (Follow up email)*, 17 June 2026.

82 Transgrid, *System Strength Project 2026-31 - Revenue Proposal*, April 2026, pp. 48-49.

83 Transgrid, *System Strength Project 2026-31 - Revenue Proposal*, April 2026, p. 120.

- If the total approved contract variations exceed the provisional sum allowance, then this additional cost will be processed through the relevant adjustment mechanism. If accepted, this would effectively increase its expenditure allowance and maximum allowed revenue.
- If total approved contract variations are less than the provisional sum allowance, then this will be processed as a reduction to project expenditure, leading to a reduction in the revenue entitlement.

We sought further information from Transgrid regarding its proposed approach to true-up the provisional sum allowance. In response, Transgrid suggested that an annual adjustment could be applied to true-up the provisional sum allowance for each contract by comparing its actual approved contract variations against its forecast provisional sum in each regulatory year.[84] This would allow revenue to be adjusted up or down annually depending on whether actual costs were above or below the provisional sum forecast.

As such, a provisional sum allowance operates differently to a risk allowance as Transgrid does not take on the risk of variation costs exceeding its allowance. Rather, it allows Transgrid to include the expected value of future variation claims in its forecast expenditure instead of relying on ex-post adjustment proposals.

The proposed mechanism would cease operating once cumulative contract variations exceed the provisional sum for that contract. Any further cost recovery would occur through the relevant adjustment mechanism.

Provisional sums opex

A component of Transgrid's contestable opex is related to a provisional sum allowance for specific activities to be delivered by GE at Transgrid's direction under the LTSA contract. These activities were originally included in the tendered scope in the competitive assessment process. However, due to uncertainty regarding the extent of work required, the activity was removed from the base scope following proponent's bids being submitted and instead included as a contract variation event to be directed by Transgrid once the scope is known.[85]

4.1.3 Adjustment mechanisms

The following section highlights Transgrid's proposed contract-related adjustment mechanisms and transport-related adjustment mechanisms as focus issues in this paper.

For our preliminary position on all Transgrid's proposed adjustment mechanisms, see Appendix A.

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84 Transgrid, *Response to information request #007 (Part 2)*, 26 May 2026.

85 Transgrid, *A.1 – System Strength Project 2026–31 – Contestable contractual arrangements and risk allocations*, April 2026, p.19. Transgrid, *Response to information request #012 (follow up email),* 23 June 2026.

4.1.3.1 Contract-related adjustment mechanisms

Transgrid proposed 5 'contestable contract-related adjustments'.[86] These are adjustment mechanisms related to potential variations to contracts established through the competitive assessment processes. Specifically:[87]

1. **OEM cost variation event** for an increase or decrease in costs Transgrid is required to pay the OEM (GE) supplying the synchronous condensers, arising from a substantiated variation claim under the OEM contract.
2. **LTSA cost variation event** for an increase or decrease in costs Transgrid is required to pay the OEM (GE) for long term servicing and maintenance of synchronous condensers, arising from a substantiated variation claim under the LTSA contract.
3. **D&C Contractor 1 cost variation event** for an increase or decrease in costs Transgrid is required to pay D&C Contractor 1 for design and construction works, arising from a substantiated variation claim under the relevant D&C contract.
4. **D&C Contractor 2 cost variation event** for an increase or decrease in costs Transgrid is required to pay D&C Contractor 2 for design and construction works, arising from a substantiated variation claim under the relevant D&C contract.
5. **Minor transport works event** for an increase in the costs Transgrid is required to pay a D&C contractor, arising from a variation direction to a D&C contractor for minor works related to transport infrastructure to enable the carriage of the synchronous condensers to their final location (Transport Infrastructure Works and Transport Infrastructure Directable Works).

Following the submission of its revenue proposal and in response to information requests, Transgrid proposed several additions and clarifications to the contract-related adjustment mechanisms to fully reflect the contractual arrangements. The additions and clarifications include:[88]

- addition of an annual true-up to adjust for any discrepancy in the forecast timing of contestable payments and actual payments made each regulatory year[89]
- addition of an annual true-up to adjust for any unspent provisional sums
- clarification that the OEM cost variation event adjustment will include payment of the long service levy by the OEM supplier under the *Building and Construction Industry Long Service Payments Act 1986*[90]

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86 Four contestable adjustment mechanisms were proposed in the revenue proposal but in response to an information request, Transgrid has split the adjustment mechanism for the D&C contracts into two; one for each contractor.

87 Transgrid, *System Strength Project 2026-31 - Revenue Proposal*, April 2026, p. 112; Transgrid, *Response to information request #003*, 4 May 2026.

88 Transgrid, *Response to information request #001*, 5 May 2026. Transgrid, *Response to information request #008,* 29 May 2026. Transgrid, *Response to information request #012*, 22 June 2026.

89 The discrepancy occurs because payments to a contractor are made when the contractor has completed the work linked to specified payment milestones, which may differ from the forecasts which form the basis of the revenue proposal.

90 A building and construction long service levy is a mandatory fee established by state legislation. It funds portable long service leave schemes for eligible workers who frequently change employers within the industry.

- clarification that the D&C cost variation event adjustment mechanisms will apply variations under the D&C contracts related to Middle East conflict, discussed further below.[91]

For the purposes of this paper, we make the following distinctions:

- **Contract variation clause** – clauses within the contracts that entitle a contractor to vary the contract sum owed by Transgrid under stipulated scenarios and events.
- **Contract variation** – agreement between Transgrid and a contractor to vary the contract sum in line with requirements of the relevant contract variation clause.
- **Contract-related adjustment mechanism** – a mechanism set out in our revenue determination to vary the amounts payable to Transgrid by the SFV to reflect changes in costs associated with contract variations.
- **Contract-related adjustment proposal** – a proposal submitted by Transgrid to apply a contract-related adjustment mechanism.

Appendix A, Table 5 provides further details on the specific contract variation clauses that may trigger each contract-related adjustment mechanism.

Contract variation claims must be raised by the contracting party within a defined period of the trigger event occurring. Transgrid has proposed to submit an annual adjustment proposal that captures all finalised contract variations over the previous year. In addition to an annual adjustment proposal, Transgrid has proposed 2 adjustment mechanisms be applied on an ad hoc basis, related to increased D&C contract costs resulting from the conflict in the Middle East.

Method to determine a variation amount for contract-related adjustment mechanisms

The contestable contracts include processes for establishing a variation amount. To support these processes, Transgrid has included in its revenue proposal 2 more detailed processes it will use to assess any variation claims under the contracts.[92] The selected process depends on whether the contract variation is directed by Transgrid. The processes were developed by Transgrid and reviewed by NSW DCCEEW and a third-party consultant, Qubist. The processes expand on the required steps for determining a variation amount included in each contract by:

- Under both processes, establishing a role for the Infrastructure Planner in reviewing variations that:
  - are likely to have a value of more than $5 million, or
  - may impact the project completion date.
- Including additional considerations to be taken into account by Transgrid in assessing a variation amount, such as use of a quantity surveyor for claims over $5 million or where internal expertise is not available. The specific considerations to be taken into account

91 Transgrid, *System Strength Project 2026-31 - Revenue Proposal*, April 2026, p. 120; Transgrid, *Response to information request #008*, 29 May 2026.

92 Transgrid, *System Strength Project 2026-31 - Revenue Proposal*, April 2026, pp. 115, 165.

by Transgrid depends on the process required (that is, if the variation is directed by Transgrid or not).

Transgrid has proposed that all amounts agreed with contractors by following the relevant process should be considered an outcome of the competitive procurement process, therefore satisfying our prudency, efficiency and reasonableness requirement, and be passed through to consumers in full.

Each contract also sets out specific rates and indexation methods that apply for particular cost components when calculating the value of a variation claim.

Increased D&C costs associated with Middle East conflict

Transgrid noted in its proposal that it was negotiating specific provisions with the D&C contractors in relation to the conflict in the Middle East, as this conflict began after proponents submitted their best and final offer for the competitive assessment process but before contracts were executed.[93] Amendments to the contracts were being considered to account for additional costs and time anticipated by the contractors, for example, due to fuel shortages and commodity price increases (such as concrete, steel, copper, aluminium and polyvinyl chloride).[94] While provisions had not yet been drafted, Transgrid incorporated a placeholder trigger for any relevant variation claims as part of the proposed D&C contract adjustment mechanism.[95]

As at 29 June 2026, negotiations on the Middle East Conflict contract amendments had been finalised and the contract with D&C Contractor 1 has been executed. The contract with D&C Contractor 2 is expected to be executed by late June 2026.[96] The contract amendments include:[97]

- a lump sum payment to be made shortly after contract execution
- a second lump sum payment to be paid 4 weeks after contract execution, conditional upon diesel prices exceeding a defined price over a specified period
- time relief consistent with the Force Majeure clauses in the contracts
- time and cost relief associated with a change in law related to the conflict.

The contractors will bear any cost and time risks associated with the Middle East conflict beyond what is provided through these contract amendments.

4.1.3.2 Transport Related Adjustment Mechanisms

The contracted synchronous condensers and associated equipment can weigh up to 250 tonnes each and their transportation from the port to the 5 sites requires oversize and over mass (OSOM) vehicles.[98] Transgrid is responsible for any transport route works to allow

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93 Transgrid, *System Strength Project 2026-31 - Revenue Proposal*, April 2026, p. 120.

94 Transgrid, *Response to information request #012 (following up email)*, 23 June 2026; Note: The inputs included here are for indicative purposes only and we do not consider the adjustment is limited to the commodities/materials listed.

95 Transgrid, *System Strength Project 2026-31 - Revenue Proposal*, April 2026, p. 113.

96 Transgrid, *Response to information request #012 (following up email)*, 23 June 2026.

97 Transgrid, *Response to information request #008*, 29 May 2026.

98 Transgrid, *System Strength Project 2026-31 - Revenue Proposal*, April 2026, p. 121.

for the OSOM journeys. It is likely that some minor transport works will be required on all 5 routes but there is also a significant risk that major upgrades to some roads will be required.

Transgrid proposed the following 4 adjustment mechanisms to reflect any costs of transport work taking place after route notification. These are:[99]

1. **Transport route due diligence and enabling works:** This adjustment mechanism relates to Transgrid's costs for due diligence and enabling works on the viable routes, which is required before the transport works can proceed.
2. **Minor Transport Works:** This adjustment relates to an increase in the costs Transgrid is required to pay a D&C contractor, arising from a direction to a D&C contractor for minor works related to transport infrastructure to enable the carriage of the synchronous condensers to their final location (Transport Infrastructure Works and Transport Infrastructure Directable Works). As this adjustment mechanism relates to cost associated with contract variations, it is also noted under the contract-related adjustment mechanisms in section 4.1.3.1.
3. **Major Transport Works:** This adjustment is split into two parts (3A and 3B) to recover the costs of any Major Transport Works that are not within the D&C contractor capabilities. Adjustment 3A covers the base cost of the work and is triggered by the execution of a contract for Major Transport Works. Adjustment 3B covers the final costs of delivering the work, including Transgrid's costs in managing the works. 3B will be applied as part of the annual true-up process, when final project costs are known.
4. **Transport works undertaken by local council:** Local Council(s) may mandate that any works on their infrastructure, including restoration and maintenance, can only be completed by themselves or by their certified contractors. In this situation, the council(s) would seek payment from Transgrid for the costs of the required works. Similarly to adjustment 3, this adjustment split into two parts (4A and 4B). Adjustment 4A covers the base costs of the work. This adjustment is triggered by the execution of contracts/agreements with local councils or their contractors. Adjustment 4B will be applied as part of the annual true-up process, when final project costs are known.

Transgrid submits that these adjustments mechanisms are necessary because of the route uncertainty for the System Strength Project which prevented it from including any forecast expenditure relating to transport works in its revenue proposal.[100]

4.2 Our assessment and preliminary position on risk costs

4.2.1 Risk costs

We consider that Transgrid's probabilistic risk assessment and estimating approach is appropriate. This approach is consistent with our guidance, which notes that we will not provide a project risk allowance that completely covers the eventuality of all consequential costs being incurred, as this assumes that each of these costs are guaranteed to eventuate and does not recognise their distribution or probability of occurrence.[101] We also agree that

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99 Transgrid, *System Strength Project 2026-31 - Revenue Proposal*, April 2026, pp. 123-129.

100 Transgrid, *System Strength Project 2026-31 - Revenue Proposal*, April 2026, pp. 138-139.

101 AER, *Guidance note on the AER's EII Assessment Approach for Non-contestable revenue determinations*, September 2025, pp. 22.

the P50 value is the appropriate point for forecasting risk costs as it is the point at which risks are shared equally between Transgrid and consumers. This approach is consistent with our recent revenue determinations for contingent projects and REZ infrastructure projects such as HumeLink and Enabling CWO projects.[102]

While we consider Transgrid modelling approach follows our standard expectations, Transgrid's risk modelling is dependent on its inputs and assumptions. For example, risk probabilities were derived from relevant project SME qualitative assessments of the risk consequence being realised after controls have been implemented. We sought further information from Transgrid to understand its inputs and assumptions for its risk cost modelling. In response, Transgrid provided its risk register, which contained all the values of the contingent cost risks, inherent cost uncertainty and prolongation for each risk cost allowance which are the output of the modelling.

Our assessment of Transgrid's proposed risk costs is ongoing, as we are still considering:

- The reasonableness of Transgrid's inputs and assumptions of its risk modelling, including its assumptions relating to the likelihood of each risk event for each site, and
- The extent to which the proposed risk costs relate to the proposed provisional sums and adjustment mechanisms, noting that capex included in the ex-ante allowance as a risk cost will not be subject to a future adjustment.

4.2.2 Provisional sums

Provisional sums capex

Our preliminary position is to not accept the proposed provisional sum capex as a contestable component of the submission. That is, we do not consider the proposed provisional sums are an outcome of the genuine and appropriate competitive assessment processes.

While the provisional sums relate to Transgrid's expectations of the costs it will incur under the competitively established risk allocation, we observed the proponents were not asked to bid on the quantities or the amounts allocated to each risk.[103] Additionally, while a total provisional sum allowance is set out in each contestable contract, the contractors are only entitled to these amounts following substantiation by Transgrid. During the procurement process we observed the total provisional sum allowance was calculated based on:

- contractor rates submitted and evaluated as part of the competitive tender processes, and
- quantities required for particular activities should the risk identified be realised, and the likelihood of the risk occurring, as determined by Transgrid and reviewed by an independent party.

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102 AER, *Determination - Transgrid HumeLink Stage 2 Contingent Project*, August 2024, p.viii; AER, *Final decision – Transgrid – Central-West Orana Enabling REZ non-contestable project 2026–31*, January 2026

103 In one exception, a risk item was bid on by proponents as part of the procurement process but was decided to be managed via a provisional sum and removed from the base contract scope of work.

If we determine the provisional sum allowance to be non-contestable, we are required to assess:

- whether the provisional sum capex allowance is an appropriate mechanism to manage the relevant risks, and if so,
- the prudency, efficiency and reasonableness of the proposed allowance.

Our preliminary position is that we do not consider it appropriate to allow both a provisional sum capex allowance and adjustment mechanism to cover the same risk. While the proposed approach does not necessarily result in over-recovery (as the adjustment would only apply once the provisional sum amount has been exhausted and any unspent amounts would be returned to consumers), we are considering:

- How the approach impacts our ability to assess the prudency, efficiency and reasonableness of contract variation amounts, noting we would expect to assess all adjustment amounts when an adjustment proposal is received, including contract-related adjustments (see section 4.2.3 regarding our approach to assessing adjustment amounts).
- If the provisional sum allowance is used to fund variations Transgrid would not be required to submit an adjustment proposal, which may compromise our ability to conduct our assessment. An alternative approach would be required to enable us to assess contract variation amounts, such as part of our assessment of the annual true up process for any unspent provisional sums.[104]
- The need for an upfront provisional sum capex allowance noting that Transgrid is able to recover prudent, efficiency and reasonable contract variation costs through the relevant adjustment mechanisms. We recognise that an adjustment proposal would occur after a contract variation has been agreed and therefore there is a period between which Transgrid may pay a variation claim and recover the amount through the adjustment process.[105]

As we consider forecast capex for provisional sums to be non-contestable in nature, this capex is subject to the Transmission Efficiency Test and our assessment of prudency, efficiency and reasonableness.

As with Transgrid's proposed risk costs, we sought further information from Transgrid in relation to how these costs were estimated, as well as evidence of Transgrid's risk register for its proposed provisional sums.

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104 As noted in section 4.1.2.1, following its proposal submission and in response to an information request Transgrid submitted an additional adjustment mechanism that would allow an annual true up adjustment to return any unspent provisional sums as a reduction in revenue. The draft adjustment mechanism is provided in section A.5 of Appendix A.

105 Transgrid's proposal also included a statement that its financeability test was done based on the approval of the full provisional sum amount. However, in response to an information request, Transgrid clarified that its financeability modelling did not demonstrate any financeability issue, irrespective of its proposal for a provisional sum amount.

In response, Transgrid provided its provisional sum registers for each contract for which it proposed a capex provisional sum allowance.[106] These contained a description of each risk event and a capex forecast for each of the 5 sites. Transgrid also explained that the amounts calculated for the provisional sums reflect a quantification of each risk based on a combination of likelihood and cost consequences. It also confirmed that the 'most likely' outcome quantity factors in the probability of the event. We also observed that some risk events are also included in Transgrid's risk costs register, as these events are considered to lead to increased owner's costs (to Transgrid) as well as potential payments to the contractors.

The approach described by Transgrid is a 'deterministic' method of risk assessment. This method fixes the characteristics of each risk event and quantifies the impacts of a single hazard. For example, a particular risk event may be assumed to cause 4 weeks of project prolongation, and associated costs of prolongation are then estimated using the contestably derived unit rates. However, as risk events will not occur according to a single, expected scenario, this approach is likely to overstate the efficient level of risk costs.

A probabilistic risk assessment addresses this limitation. Rather than analysing one scenario in isolation, probabilistic approaches (such as the Monte Carlo Analysis Transgrid used to estimate risk costs) analyse thousands of potential risk events and estimate how frequently different costs would be expected. In this way, risk is not seen as a single outcome, but as a distribution of possible outcomes.

We note that while Transgrid consulted with the TAC on its approach to risk allocation, including risk costs and adjustment mechanisms, it did not explicitly distinguish between risk costs and provisional sums. We assume this is because it considered provisional sums to be contestable in nature, and its engagement with the TAC was limited to the non-contestable components of its revenue proposal.

Our preliminary position is that Transgrid should receive either an ex-ante capex allowance (that is, a risk allowance) which may be for all or some of the proposed provisional sum allowance, or its proposed contract-related adjustment mechanisms, but not both.

We consider that Transgrid's approach to estimating provisional sums is not robust enough for these amounts to be included as a risk cost allowance. As we consider the provisional sums to be a non-contestable component of the revenue proposal, Transgrid should have adopted a probabilistic approach (as it used to estimate risk costs) to estimate its proposed provisional sums. We are assessing the potential for some of the risk events included in Transgrid's provisional sums forecast to be estimated with a greater level of certainty and therefore classified as a risk cost allowance. Under this approach, these risk events would not be subject to adjustment mechanisms, and the capex allowance would be subject to the CESS.

Provisional sums opex

Our preliminary position is to not accept Transgrid's proposed provisional sum opex allowance.

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[106] Transgrid, *Response to information request #007 (Part 1)*, 22 May 2026.

We recognise that the proposed provisional sum amount allocated to cover specified activities under the LTSA contract was subject to proponent bids as part of the competitive procurement process. However, while the provisional sum was competitively bid, there is no contractual requirement on Transgrid to pay the provisional sum amount.[107] Rather Transgrid will agree the cost through a contract variation once the scope is known. [108]

Transgrid's proposed adjustment mechanism for LTSA contract variation events would entitle Transgrid to make adjustments for costs related to the scope of work for which the provisional sum allowance has been allocated. As such, Transgrid would have a mechanism to recover its prudent, efficient and reasonable costs should it not receive a provisional sum opex allowance.

An alternative to accepting the provisional sum opex is to replace it with a risk allowance (as considered for provisional sum capex above). However, we note the Efficiency Benefit Sharing Scheme (EBSS) does not apply in the first regulatory period, and therefore the benefits of establishing an opex risk allowance are limited relative to a capex risk allowance.

Our preliminary position is to remove the provisional sum opex allowance, on the basis that Transgrid can recover relevant costs through the LTSA contract variation event adjustment mechanism once the scope is known. The variation amount would be subject to our prudency, efficiency and reasonableness assessment at the time of the adjustment proposal.

4.2.3 Adjustment mechanisms

4.2.3.1 Contract-related adjustment mechanisms

The adjustment mechanism framework is made up of two core components:

- Triggers – events or conditions that establish the entitlement to an adjustment to amounts payable to Transgrid
- Method – the approach to determining the adjustment amount once a trigger is satisfied.

Under our Non-contestable Guideline, if there is an adjustment clause in the contractual arrangements that reflects the outcome of a genuine and appropriate competitive assessment process, the Network Operator is entitled to recover any costs resulting from the application of that adjustment clause.[109]

The following section provides our preliminary assessment of whether these two components, triggers and method, can be accepted as outcomes of the competitive assessment processes.

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107 Transgrid, *A.1 – System Strength Project 2026–31 – Contestable contractual arrangements and risk allocations*, April 2026, p.19. Transgrid, *Response to information request #012 (follow up email),* 23 June 2026.

108 Transgrid, *Response to information request #003*, 4 May 2026.

109 AER, *Revenue determination guideline for NSW non-contestable projects*, May 2026, p. 41.

Contract-related adjustment triggers

In the context of proposed contract-related adjustment mechanisms, the triggers are the contract variation clauses that may give rise to a contract variation, and therefore an adjustment.

To accept the proposed contract variation clauses as a contestable outcome we must be satisfied that the clauses proposed by Transgrid reflect the risk allocation as agreed between parties through the competitive assessment process.

Our preliminary position is to accept all but one contract variation clause as an outcome of the competitive assessment process. The excepted clause is for the Middle East conflict, which is discussed further in section 4.2.3.2.

For contract variation clauses we consider to be contestable, we accept Transgrid's entitlement to recover prudent, efficient and reasonable costs arising from those variation clauses. We also accept that an adjustment mechanism is an appropriate approach to managing these risks. However, we:

- do not consider the contractual arrangements set out a clearly specified approach to ensure the variation amount is limited to a prudent, efficient and reasonable level. We assess the method to determine a variation amount in the following section.
- acknowledge there may be an alternative approach for managing a subset of risks related to contract variations, in the form of a risk cost allowance.

As detailed in section 4.2.2, we are considering an option to accept some of the proposed provisional sums capex allowance as a non-contestable risk cost allowance. Under this approach Transgrid would receive a capex allowance to cover risks related to specified contract variations and would not be eligible to apply for a revenue adjustment should these risks eventuate and costs exceed the allowance. Rather Transgrid would be incentivised to manage this capex efficiently through the application of the CESS. As such, these specified contract variation clauses would be excluded from the list of triggers of the relevant contract-related adjustment mechanism.

Contract-related adjustment method

To be accepted as a contestable component, we must be satisfied that the method to determine a variation amount is an outcome of a genuine and appropriate competitive assessment process. In making this assessment, we consider whether:

- The proposed method reflects the method that was agreed during the competitive assessment process,
- The method to adjust the revenue is clearly specified such that it can be applied through our adjustment process (in line with Criteria 4 of our Contestable Guidelines). We consider 'clearly specified' in this context to be that any variation clause the mechanism relates to must set out a method that constrains costs to those that are prudent, efficient and reasonable.

The contestable contracts include processes for establishing a variation amount that was included in the terms under the competitive assessment process. However, we do not consider these processes are clearly specified to ensure costs are limited to amounts that

are prudent, efficient and reasonable. To support these processes, Transgrid has included in its revenue proposal more detailed processes it will use to assess any variation claims under the contracts. This forms Transgrid's proposed adjustment method under the contract-related adjustment mechanisms.

Our preliminary position is to not accept Transgrid's proposed processes as an outcome of the competitive assessment process. This is on the basis that:

- The processes include elements that were not agreed during the competitive assessment process and are not reflected in the contractual arrangements, and
- While the processes include some elements that would support prudent, efficient and reasonable outcomes (such as the use of rates set through the competitive process and requirements to engage a quantity surveyor or seek Infrastructure Planner approval), the processes are insufficient to ensure that result. The contractual and Transgrid internal processes combined still provide Transgrid significant discretion in how it initiates variation processes and assesses variation claims.

Rather, we consider it appropriate to conduct a prudency, efficiency and reasonableness assessment of all adjustment amounts associated with the contestable contracts at the time of an adjustment proposal. This is on the basis that:

- Transgrid has little incentive to closely scrutinise contractors' variation claims if costs would be fully passed through to consumers.
- Some variations are initiated by Transgrid, such as directions to accelerate works or vary the scope of works.
- Some of the circumstances in which contractors are entitled to a variation relate to cases where Transgrid would be at fault. For example, reinstatement of damage due to a breach of contract, negligent act or omission by Transgrid.
- The contract variation clauses generally allow parties some discretion in determining the variation amount, rather than relying strictly on formulas or pre-determined amounts.

In assessing future adjustment proposals, we would not undertake a prudency, efficiency and reasonableness assessment of elements that were an outcome of the competitive assessment process, including:

- any agreed amounts, rates (fixed or indicative) or quantities that were set through the competitive assessment process that are relied upon
- the wage and material indexation formula contained within the OEM and LTSA contracts
- agreed margins that apply to the assessed costs
- relevant methods specified within the contract to calculate standard costs such as financing costs, insurance costs or third-party preparation costs.

For these contestable elements of the adjustment mechanisms, our review would be limited to confirming entitlement based on the relevant trigger and checking that values match those in the contracts.

In assessing the prudency, efficiency and reasonableness of adjustment proposals we will have regard to our Guidance note on the AER's EII Assessment Approach for Non-

contestable revenue determinations. In reviewing future contract-related adjustment proposals we will also take into account:

- The use of elements in the contracts that we consider an outcome of the competitive assessment process
- Whether the Infrastructure Planner has reviewed and approved the variation claim, and any evidence provided of its assessment
- Any independent expert review of the costs (or underlying price and/or quantities where these are subject to negotiation)
- Whether claims are made on an open book basis
- Whether the proposed costs can be justified with reference to the schedule of rates agreed during the competitive assessment process, where applicable
- Evidence that:
  - The cost does not double count costs already included within the base tender cost or other variation claims, such that it only recovers incremental costs of the event,
  - Reasonable endeavours were taken to mitigate costs,
  - The cost is consistent with supplier quotes where third party or sub-contractor materials or resources are required,
  - The cost is within a reasonable range of comparable external market data.

4.2.3.2 Additional costs related to Middle East conflict

Our preliminary position is that the amendments to the contracts related to the Middle East conflict constitute a change to the risk allocation agreed during the competitive assessment process. At the time of the final tender submissions, the draft D&C contracts included a clause that relieves both parties from delivering on contractual obligations while a Force Majeure event is occurring, including for wars not known about prior to contract execution. Had the contracts been executed prior to the conflict commencing, the contractors would have been eligible for time relief in relation to the Middle East conflict, however the contractor would have borne all cost risk. The new provisions negotiated after the competitive process was completed provide for some cost sharing between parties, in addition to time relief.

Therefore, we will assess Transgrid's adjustment mechanisms to account for the contact variations related the Middle East conflict on a non-contestable basis. In principle, we consider it is reasonable for costs related to higher fuel and commodity prices arising from the Middle East conflict to be reflected in Transgrid's revenue determination. This is on the basis that:

- the change in costs related to the Middle East conflict that affect global fuel and commodity prices is outside the control of both Transgrid and the D&C contractors
- had the conflict commenced while the competitive assessment process was underway, the risks associated with the conflict would have likely been incorporated as an allowance in the proponent's bids.

Therefore, our preliminary position is to accept Transgrid's proposed entitlement to recover additional costs arising from the Middle East conflict. However, we will assess the appropriateness of Transgrid's proposed adjustment mechanisms to agree and recover these costs as part of making the revenue determination.

4.2.3.3 Simplifications and refinements to the contract-related adjustment mechanisms

In response to information requests, Transgrid has provided more detailed descriptions of the contract-related adjustment mechanisms and the contract variation clauses that may trigger an adjustment. We are continuing to work with Transgrid to refine and simplify the description of the contract-related adjustment mechanisms to:

- ensure alignment with the contractual arrangements
- limit cost recovery to prudent, efficient and reasonable costs
- limit duplication and enhance clarity.

A preliminary draft of contract-related adjustment mechanisms is provided in section A.5 of Appendix A.

In developing this preliminary draft, we have made some amendments to the adjustment mechanisms proposed by Transgrid:

- Consolidation of the Minor Transport Works Event adjustment mechanism with the D&C Contract Variation Event adjustment mechanisms, on the basis that minor transport works delivered by a D&C contractor constitutes a contract variation event and is adequately covered by the broader D&C adjustment mechanism.
- Consolidation of the "Pre-agreed Middle East Cost Variation Event" with the D&C Contract Cost Variation Event adjustment mechanisms, on the basis that the middle east cost variation for each D&C contractor constitutes a contract variation event and is adequately covered by the broader D&C adjustment mechanism.
- Consolidation of annual expenditure true-up adjustments to reflect differences between forecast and actual timing of payments, on the basis that the same process is applied to all contracts and therefore a separate mechanism for each contract is not necessary.
- Consolidation of the provisional sums true-up adjustment to return any unspent provisional sums allowance under each contract, on the basis that the same process is applied to all contracts and therefore a separate mechanism for each contract is not necessary. We note that we would not include this adjustment mechanism in the revenue determination if we do not approve the provisional sums allowance (refer to section 4.2.2).

In addition to these amendments, we are considering whether to include an adjustment mechanism that would adjust forecast contestable expenditure for the remaining regulatory period based on a contractor's updated expected delivery of contract payment milestones. Specifically, this would work in conjunction with the already proposed adjustment mechanisms to true up historical expenditure for actuals and ensure that any changes to expenditure timing will be reflected in future revenues (and consequently the schedule of payments). This approach would ensure consistent alignment with the contestably set amount that Transgrid is contractually entitled to recover, rather than delaying this true-up to the end of the regulatory period where the time value of money would also need to be considered.

However, we note that there are certain aspects of the non-contestable framework relating to the interaction between our PTRM and roll forward model between regulatory periods that we would need to explore and ensure it does not interfere with our standard approach to rolling

forward the RAB. We will consider the benefits of and practicality in applying such an adjustment mechanism in making our determination.

Other superficial changes have been made to the description of the contract-related adjustment mechanisms to enhance clarity and align with the contractual arrangements. We welcome any feedback from stakeholders on the drafting of these mechanisms.

4.2.3.4 Non-contestable adjustment mechanisms

Our preliminary position is that we are not likely to accept Transgrid's proposed adjustment mechanisms for non-contestable transport works events, namely: 'Transport route due diligence and enabling works', 'Major Transport Work' (parts a and b), 'Transport works undertaken by local council' (parts a and b). However, we are likely to substitute a single adjustment mechanism for its non-contestable transport works costs in place of its 3 proposed adjustment mechanisms. Additionally, we would require that this adjustment mechanism trigger a review and remake of Transgrid's 2026–31 System Strength Project revenue determination, limited to costs directly related to its non-contestable transport works.

We agree that Transgrid should be able to recover its prudent, efficient and reasonable transport works costs. However, we consider the scope of these works is not yet sufficiently defined. Transgrid has confirmed it has not finished scoping the required works and that finalising them depends on engagement with Transport for NSW and local councils to secure an approved route.[110] Given this uncertainty, we cannot currently determine whether Transgrid's proposed adjustment mechanisms would limit its cost recovery to prudent, efficient and reasonable costs.

Transgrid also clarified that 'part b' of its proposed non-contestable transport works adjustment mechanisms[111] (the annual true-up) would reflect the sum of its annual approved contract variations under its transport works contracts. We do not consider it reasonable to approve adjustment mechanisms for variations under contracts that have not yet been drafted, tendered or negotiated.

Additionally, approving adjustment mechanisms for contractual variations at this stage may reduce the competitiveness of any future tender processes by establishing baseline costs that consumers would bear, weakening their bargaining position. We consider this would be unlikely to result in a prudent, efficient and reasonable outcome for consumers.

We consider our review and remake approach enables our decision on the appropriate structure of this adjustment mechanism to be made at a time when both we and Transgrid have greater certainty over the scope of any future adjustments required under transport works contracts. Under cl. 51(2)(b) of the EII Regulation we may specify whether a particular adjustment requires the revenue determination to be reviewed and remade.

We intend our substituted adjustment mechanism for non-contestable transport works will allow us to consider the same types of costs presented in Transgrid's proposed mechanisms, only via a review and remake of its revenue determination. We consider the review and

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110 Transgrid, *Response to information request IR#010,* 9 June 2026.

111 Specifically, Transgrid's Major Transport Works, and Transport works undertaken by local council adjustment mechanisms

remake process should be triggered once Transgrid has executed contracts for both its major transport works and council works.

At that point, Transgrid could apply for a review and remake of our 2026–31 System Strength Project revenue determination, limited to its transport works costs. We would examine the prudency, efficiency and reasonableness of its forecast transport works costs, any associated contract variations and additional adjustment mechanisms required to recover those contract variations. We would not expect Transgrid to seek any other changes to its 2026–31 revenue determination through that process.

5 Focus issue 2: Labour & indirect costs

Transgrid proposed $217.2 million ($September, 2026) in labour and indirect costs for the project (including labour escalation).[112] This represents 83% of its proposed non-contestable capex and approximately 18% of the total capex forecast for the project (contestable and non-contestable). This figure comprises $79.6 million in pre-period costs and $137.6 million in forecast period costs. Table 7 provides a breakdown of the proposed labour and indirect costs by subcategory.

Table 7 Proposed labour and indirect costs ($million, September 2026)

	Pre-period	2027–28	2028–29	2029–30	Total
Direct labour and labour-related costs					
Project Development	12.3	2.5	0.7	0.1	15.5
Procurement and Transaction Management	0.9	0.3	0.3	-	1.5
Project Delivery Management	18.2	30.0	30.0	7.5	85.7
Regulatory Management	0.8	0.03	-	-	0.9
Land and Environment	1.2	1.2	1.2	0.1	3.7
Community and Stakeholder Engagement	0.1	0.03	-	-	0.2[113]
Other support and corporate roles	4.2	5.0	4.7	2.3	16.1
Total direct labour and labour-related costs	**37.7**	**39.0**	**36.9**	**10.0**	**123.6**
Indirect costs					
Proportion of direct labour and labour-related	16.2	16.7	15.8	4.3	**53.0**
Non-labour costs	25.6	5.8	6.6	2.6	40.6
Total indirect costs	**41.8**	**22.5**	**22.4**	**6.9**	**93.6**
Total labour and indirect costs	**79.6**	**61.6**	**59.2**	**16.8**	**217.2**

Source: Transgrid, *System Strength Project 2026–2031 Revenue Proposal*, April 2026, pp. 73-74.
Note: Includes labour escalation. Totals may not sum due to rounding.

[112] Transgrid, *System Strength Project 2026–2031 Revenue Proposal*, April 2026, pp. 73-74. Note: this amount was mistakenly mentioned as $217.02 million in Transgrid's revenue proposal as the community and stakeholder engagement amount was mistakenly omitted.

[113] This figure was mistakenly omitted from Transgrid's revenue proposal (p. 73) and has been included here for completeness.

We consider labour and indirect costs to be a focus issue because:

- it is the most material category of Transgrid's non-contestable capex forecast, and
- the relationship with, and potential for duplication between, proposed labour costs and risk costs and provisional sums.

Specifically, our focus is on:

- project development costs, which are costs incurred by Transgrid to plan the project, and
- project delivery management costs (refer to sections 5.1.2 and 5.2.2) which are costs to oversee and ensure the timely completion of the project.

These categories capture the largest proportion of the forecast capex for the project.

5.1 Overview of Transgrid's proposal

5.1.1 Project development costs

Transgrid proposed $35.7 million ($September 2026) in historical pre-period capex related to project development. These costs consist of actual expenditure incurred from 1 October 2022 to 31 January 2026.[114] This expenditure can be broken down into the following two categories:[115]

- $16.9 million in relation to the NSW System Strength RIT-T process, and
- $18.8 million in relation to project development works.

In justifying the inclusion of these costs, Transgrid's proposal indicated the RIT-T and early development activities were the foundation for the System Strength Project and the PNIP Direction made by the Minister. Importantly, Transgrid claimed the RIT-T's PACR as a key reason why the PNIP Direction is consistent with the objectives of the EII Act and as such, the proposed project development costs should be recovered as part of this System Strength Project under the EII framework.[116]

Furthermore, Transgrid considered the system strength issues identified by AEMO justified a thorough assessment of the alternative solutions as part of its RIT-T assessment. It claimed that these early project analysis and development activities assisted in arriving at the recommended PACR outcome and enabled Transgrid to provide a detailed assessment of the System Strength Project costs.[117] This process, in turn, directly informed its expenditure forecast for this revenue proposal.

Transgrid confirmed these pre-period costs have not yet been recovered in any other process. Transgrid claimed its 2023–28 NER transmission determination did not include these costs as there was too much uncertainty regarding the need for the project and the potential costs to be included in Transgrid's revenue allowance.

Transgrid provided an initial high-level summary of pre-period development costs in its proposal. However, the initial information provided was not in a format or level of detail we could adequately assess. To address our concerns, we sent Transgrid an information

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114 Transgrid, *System Strength Project 2026–2031 Revenue Proposal*, April 2026, p.60.

115 Transgrid, *GHD – S.6 System Strength Project 2026–31 – Accelerated Syncon Project*, March 2026, p. 31.

116 Transgrid, *System Strength Project 2026-2031 Revenue Proposal*, April 2026, p.62.

117 Transgrid, *System Strength Project 2026-2031 Revenue Proposal*, April 2026, p.62.

request to separate their pre-period activities and costs incurred during the RIT-T process from direct project development works. This also included a request to delineate pre-period expenditure associated with shifting the project from the NER to the EII Framework.

In response to our information request for further clarification on historical pre-period costs, Transgrid provided the following:[118]

- The $16.9 million in RIT-T related costs were incurred between 1 October 2022 to 31 October 2025 and included early project analysis and development workstreams. Transgrid's RIT-T related cost breakdown included:
  - Network planning and market modelling ($7.9 million)
  - Network commercial ($2.3 million)
  - Project development ($1.4 million)
  - Legal ($0.2 million)
  - Regulatory ($0.7 million)
  - RIT-T development and proponent engagement ($4.4 million).
- The $18.8 million in project development costs were specifically related to actual development, procurement and project management of this proposed System Strength Project. These costs were incurred between 1 October 2023 to 31 January 2026 during the RIT-T process due to the risks identified during the Project Assessment Draft Report analysis identifying a need to accelerate the design and procurement of some system strength solutions. These costs were distinct from the RIT-T related costs outlined above.
- RIT-T and other project development costs above are based on different project codes used in its Enterprise Resource Planning system, and hence there was no risk of cost duplication between the activities.
- Lastly, Transgrid confirmed the transition of the project from the NER framework into an EII-directed project occurred progressively from 2023 to 2025, overlapping with the RIT-T assessment and project development activities. As such, there is no discrete date or list of activities relating solely to shifting the System Strength Project from the NER into the EII framework.

5.1.2 Project delivery management costs

Transgrid proposed $117.2 million for Project Delivery Management costs (excluding labour escalation), representing 64% of total proposed labour and indirect costs. This category includes following activities:

- **Project Management** – overseeing delivery of the project, including the co-ordination of the resources required to meet the project's timeframes through to completion and handover to Asset Management.
- **Project Engineering** – reviewing and co-ordinating design stages to ensure the OEM and D&C contractor designs are aligned and managing the integration of the synchronous condensers into Transgrid's network.

[118] Transgrid, *Response to information request #004*, 15 May 2026.

- **Construction Management** – supervising site investigations, coordinating safety, managing outages, including ensuring contractors work safely and comply with design and environmental requirements by resolving on-site issues, engaging with local stakeholders, and coordinating both contractor and internal works to maintain progress to meet the project's timeframes.
- **Commissioning** – co-ordinating and overseeing project specific outage activities, installing and testing telecommunications and SCADA systems and managing onsite testing and protection verification, completion of the handover and closing-out documentation.
- **Commercial Management** – managing all commercial agreements, formal communications, and co-ordinates claims, disputes, and contractual changes, including providing commercial guidance to support project reporting, risk management, and broader stakeholder governance.
- **Project Controls** – co-ordinating planning, financial management, risk, quality, document control, reporting, and administrative coordination to ensure the project remains on schedule and within budget to maintain transparency, accuracy, and effective project execution and meets required standards.

Transgrid's proposed values for these activities are shown in Table 8.

Table 8 Proposed project delivery management costs ($million, September 2026)

	Pre-period	2026–27	2027–28	2028–29	2029–30	2030–31	Total
Project Management	6.6	9.9	9.9	3.9	-	-	**30.4**
Project engineering	0.9	0.8	0.5	0.2	-	-	**2.4**
Construction management	5.1	12.8	12.7	2.2	-	-	**32.9**
Commissioning	2.1	10.7	10.6	1.5	-	-	**25.0**
Commercial Management	2.1	3.1	3.1	0.9	-	-	**9.3**
Project controls	4.0	5.7	5.7	1.9	-	-	**17.3**
Total	**20.8**	**43.0**	**42.5**	**10.6**	**-**	**-**	**117.2**

Source: Transgrid, *A.3 – System Strength Project 2026-31 - Non-Contestable Labour and Indirect Capex Forecasting Methodology*, April 2026, pp. 31, 33, 35, 37, 39, 41.
Note: Excludes labour escalation. Totals may not sum due to rounding.

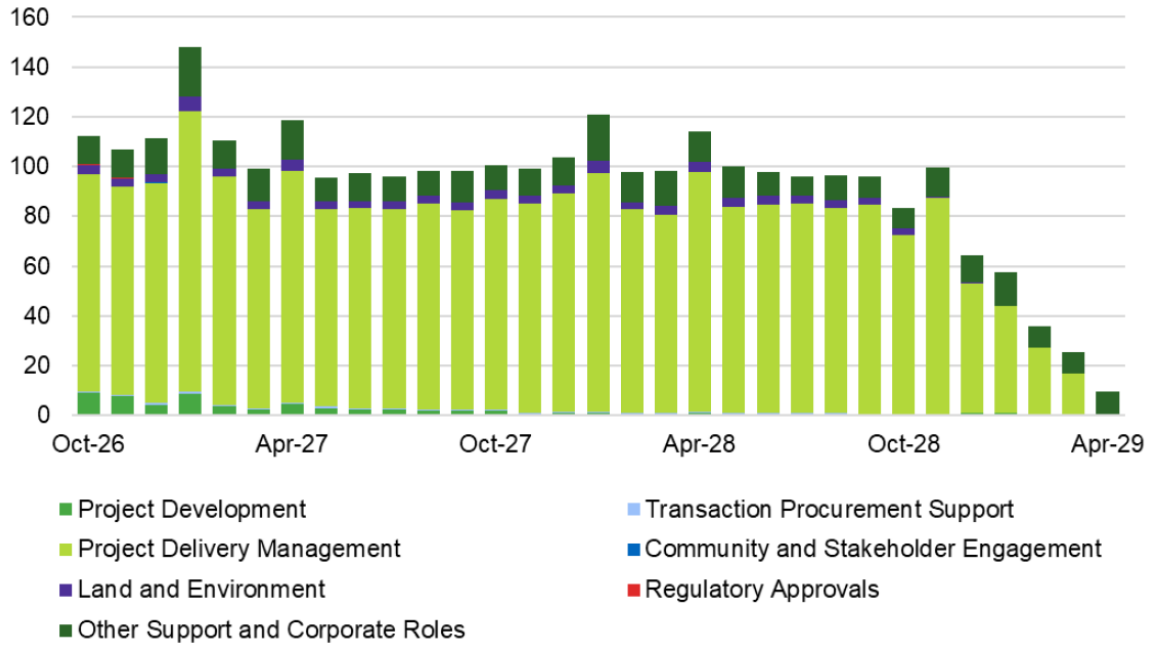
Transgrid has used a bottom-up approach to assess the resources and activities required to complete the project and allocate prudent, efficient and reasonable costs, including those specific to project delivery management as indicated in Figure 1.[119] It submitted these costs are required to manage a fast-tracked, technically complex project across multiple (5)

[119] Transgrid, *A.3 – System Strength Project 2026–31 – Non-Contestable Labour and Indirect Capex Forecasting Methodology*, April 2026, p.13

brownfield sites, while managing contractors, interfaces, risk, commissioning and regulatory obligations. This includes coordinating the OEM supplier, D&C contractors and the associated Long-term Service Agreement (LTSA), while also delivering the non-contestable functions required under the EII framework and ministerial direction.

Transgrid has indicated an average internal labour requirement of 93.4 full time equivalent (FTE) positions for the project, with 76.5[120] of those FTEs allocated to project delivery management. This estimate is based on a bottom-up, month-by-month assessment of role-specific FTE needs to meet the project schedule.[121]

Figure 1 Transgrid's forecast FTE requirements for the project



Source: Transgrid, *A.3 – System Strength Project 2026–31 – Non-Contestable Labour and Indirect Capex Forecasting Methodology*, April 2026, p. 13.

Transgrid sought independent assurance of its forecast capex, including project delivery management costs, and had independent assessments undertaken by GHD and North Projects. These reports only assessed the non-contestable components of Transgrid's revenue proposal. Overall, these assessments supported the resourcing and costs identified by Transgrid and confirmed them as prudent, efficient, and reasonable given the project's complexity, accelerated timelines and NSW labour market conditions.

GHD acknowledged some benchmarking limitations, such as a reliance on Transgrid's past ISP and REZ Network Infrastructure Project submissions and there being limited like-for-like

120 Transgrid, *A.3 – System Strength Project 2026–31 – Non-Contestable Labour and Indirect Capex Forecasting Methodology*, April 2026, p. 21.

121 Transgrid, *A.3 – System Strength Project 2026–31 – Non-Contestable Labour and Indirect Capex Forecasting Methodology*, April 2026, p. 13.

projects for comparison. It did indicate, however, the proposed capex and labour costs were consistent with comparable projects.[122]

5.2 AER assessment and preliminary position

5.2.1 Project development costs

Our Non-contestable Guideline sets out our approach to assessing pre-period expenditure under the EII Act and EII Regulation.[123] We recognise Network Operators may be required to incur costs related to an authorised Network Infrastructure Project prior to the commencement of the first regulatory period. To the extent a Network Operator incurs early development costs which have not been reimbursed through a commercial arrangement, we require evidence to demonstrate these costs are related to the authorised project or Ministerial Direction. The evidence required will vary on a case-by-case basis, however, in general we will examine the following factors (among other considerations):

- the Network Operator demonstrating the activities were required to inform the scoping or development of the project authorisation, with a clear causal link established between the activities undertaken and the information used by relevant parties (e.g. the Infrastructure Planner) in making the authorisation
- confirmation the Network Operator has not recovered the cost through an existing arrangement
- an acknowledgement from the Infrastructure Planner or authorising party that the cost borne by the Network Operator were required and not reimbursed.

Provided a Network Operator can justify the costs are relevant to the authorised project or Ministerial Direction, we may approve pre-period expenditure in our revenue determination if they are assessed to be prudent, efficient and reasonable. Consistency with past regulatory determinations would also be a key factor in our consideration of these costs.

RIT-T related costs

We have reviewed Transgrid's detailed breakdown of RIT-T related activities and costs in its response to our information request.[124] Our preliminary position is to allow partial recovery of the $16.9 million in RIT-T related expenditure. In response to our information request, Transgrid's provided a monthly breakdown of costs and a description of its activities. We expect this new information will allow us to conduct a detailed assessment of the prudency, efficiency and reasonableness of these costs. While this process is still ongoing, our initial assessment that the RIT-T related costs are likely to be prudent, efficient and reasonable. However, we have concerns regarding the linkage of the total RIT-T costs with the PNIP Direction.

Fundamentally, we acknowledge under the NER framework, network businesses are entitled to recover prudent and efficient costs associated with the RIT-T as part of a contingent

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122 Transgrid, *GHD – S.6 – System Strength Project 2026–31 – Accelerated Syncon Project*, March 2026, p.33

123 AER, *TET & revenue determination guideline for non-contestable network infrastructure projects*, May 2026, pp. 27–28.

124 Transgrid, *Response to information request #004,* 15 May 2026.

project application.[125] To the extent we are making a similar decision under the EII framework, we consider it reasonable to apply a similar approach to any prudent, efficient and reasonable RIT-T costs linked to the PNIP Direction.

Transgrid has established a clear causal link between the RIT-T process and the PNIP Direction. In particular, we are satisfied the scope of this System Strength Project, as directed by the Minister, is an outcome of the RIT-T process. While our assessment of the prudency and efficiency of the proposed $16.9 million in RIT-T costs is still ongoing, our preliminary position is that Transgrid has provided reasonable justification for all or most of these costs.

Having established a preliminary position on the prudency, efficiency and reasonableness of these costs, we are required to determine the relevance of this expenditure to the Ministerial Direction. In doing so, we look to address the following:

- The appropriateness of recovering the full amount of RIT-T expenditure if the scope of this proposal is only one portion of the portfolio of solutions identified in the PACR.
- Whether part of the RIT-T related costs have already been recovered through Transgrid's existing opex allowance under the NER framework.

We have reviewed the PACR for Maintaining system strength requirements in NSW, which was published on 14 July 2025.[126] The PACR was prepared as the final step in the RIT-T process and outlined the preferred portfolio of solutions necessary for Transgrid to meet its requirements as a System Strength Service Provider, which included:

- 10 Transgrid network synchronous condenser units,
- 7 New England REZ synchronous condensers units,
- modifications to and redispatch of synchronous generators,
- 5 GW of grid-forming batteries, and
- 4 smaller synchronous condensers or 200 MW of grid-forming batteries for the Hunter-Central Coast REZ (to be determined through a non-network procurement process).

As noted above, Transgrid's System Strength Project proposal only forms one part of the package of solutions identified in the PACR. Specifically, Transgrid's revenue proposal involves the accelerated procurement and delivery of 10 network synchronous condensers, with each unit approximately half the capacity of those originally identified in the PACR (or equivalent to 5 network synchronous condensers). A separate proposal for the remaining Transgrid synchronous condensers associated with the first dot point above is anticipated to proceed as a contingent project application under the NER framework, subject to the outcome of a material change in circumstances application.

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125 AER, *Determination – HumeLink*, August 2022; AER, *Determination – Transgrid VNI West Stage 1 Early Works Contingent Project*, May 2024

126 Transgrid, *Meeting system strength requirements in NSW – RIT-T Project Assessments Conclusions Report (PACR),* 14 July 2025.

As set out in our Non-contestable Guideline, expenditure proposed to be recovered under the EII framework must be consistent with the relevant Ministerial (or PNIP) Direction.[127] As the System Strength Project only forms one part of the broader RIT-T portfolio, we are not likely to consider Transgrid's proposal to include the entire RIT-T cost as appropriate.

Notwithstanding the above, our assessment also explores whether the System Strength Project revenue determination under the EII Act is the most appropriate avenue for the recovery of RIT-T costs. To address this question, we must consider the following:

- Whether part of the labour costs supporting the RIT-T process were included as part of its operating expenditure allocation for ISP preparatory activities in Transgrid's 2023–28 NER determination.
- How this project interacts with the second procurement process for the remaining Transgrid synchronous condensers, which is anticipated to proceed as a contingent project application under the NER framework.[128]
- Feedback from NSW DCCEEW, in response to a request for information,[129] that it does not consider Transgrid's costs to prepare the various reports for the RIT-T as appropriate to recover under the EII Act.
- Costs recovered under the EII framework will be paid by customers connected to the three NSW distribution networks through the contribution determination. This is in contrast to the NER framework, where customers connected directly to Transgrid's transmission network would also be captured. This would allocate the costs across all of Transgrid's customers, including those directly connected to its transmission network who also benefit from system strength initiatives.

Our assessment is ongoing, however our preliminary position, after considering the above factors, is that we will likely not accept the full RIT-T costs of $16.9 million related to pre-period project development capex.

We have explored several possible options, including completely excluding all RIT-T costs from this revenue determination, or to allow a proportionate amount correlated with the scope of this System Strength Project per the Ministerial Direction.

Option 1: Remove the all RIT-T related costs from pre-period capex

We would be inclined not to accept the proposed RIT-T costs if our assessment of Transgrid's proposal reveals that it has already recovered these costs as part of its regular NER opex allowance.

In exploring this option, we would assess Transgrid's claims that it has not recovered this amount elsewhere and reconcile this with the information we have available from the NER determination process. We note that this option would be consistent with NSW DCCEEW's position that it would be inappropriate to recover RIT-T related costs for the initial

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127 AER, *Revenue determination guideline for NSW non-contestable projects*, May 2026, p. 27.

128 Transgrid's procurement of the remaining synchronous condensers will undergo stakeholder consultation for a material change in circumstances, with a final statement identifying the preferred option expected to be published by 24 August 2026.

129 DCCEEW, *Response to AER letter*, June 2026, p. 5.

acceleration of the synchronous condenser procurement under this System Strength Project. This is because there is a separate ongoing process under the NER framework for a second tranche of synchronous condensers that Transgrid can recover these costs under. Further, by transferring the recovery of the RIT-T costs to the NER framework (as is expected for the second synchronous condensers process), this would allow the allocation of the costs across a larger number of consumers, including those directly connected to the transmission network.[130]

However, our key concern with this approach is that it is inconsistent with past NER decisions to allow recovery of RIT-T related costs contained in contingent project applications. While the EII and NER frameworks are governed by different regulations, we consider regulatory consistency to be a key feature of our regulatory framework.

Option 2A: Partial recovery based on a date-based approach

Acknowledging that Transgrid is entitled to recover its RIT-T costs, but only those relating to the scope of the System Strength Project, we could allow a proportion of these costs through a date-based approach.

Under this approach, we would allow partial recovery of RIT-T related costs incurred after a specific date as a way to distinguish costs associated with the Ministerial Direction. Potential dates we are exploring could be the Minister's sign-off on the PNIP Direction (18 September 2025) or when Transgrid published its PACR for Meeting System Strength Requirements in NSW (14 July 2025).

By linking this process to a clear date, we can clearly delineate the costs we approve as part of this System Strength Project. This option reduces the risk of double counting by removing any ambiguity on which costs should be allocated to the System Strength Project under the EII framework and what costs are to be allocated to future regulatory decisions.

One limitation to this approach is that by linking recovery of RIT-T related costs to a date, we would be preventing Transgrid from recovering early assessment and modelling costs that we may potentially assess as relevant to the Ministerial Direction for the System Strength Project. Simultaneously, this approach may also include early project analysis and development costs associated with other system strength solutions contained in the PACR.

Option 2B: Partial recovery proportional to cost

This approach is similar to option 2A, however, we would utilise the total cost estimate for the preferred portfolio solutions presented in the PACR to calculate the proportion of RIT-T costs that relate to the scope of this System Strength Project contained in the Ministerial Direction. The proportion would likely be calculated based on the cost estimates for portfolio option 2, by dividing the cost estimate for 5 network synchronous condensers (half of the capital costs

[130] As noted above, this is due to EII costs being recovered from the NSW distributors (Ausgrid, Endeavour Energy and Essential Energy) through the contribution determination. Larger customers connected directly to Transgrid's transmission network would not be captured under the EII framework.

for Transgrid's network synchronous condensers) by the total cost estimate for the preferred portfolio solutions.[131]

This approach directly addresses our concern that the scope of this System Strength Project is only a part of the overall RIT-T solution and that Transgrid is only entitled under the EII framework to recover costs associated with project contained in the Ministerial Direction. Further, under a cost-proportioning approach the remaining prudent, efficient and reasonable RIT-T expenditure not approved under this decision may be recovered in a future NER contingent project for the procurement of the remaining synchronous condensers. In determining an appropriate proportioning methodology, our final decision would need to consider how many components the total RIT-T costs should be split across.

Our preliminary position is to consider option 2B as the most appropriate approach to recovering RIT-T costs under the EII framework. By proportioning this expenditure through a cost-based approach, we can ensure alignment and consistency with the scope of the System Strength Project as per the Ministerial Direction.

Other project development costs

Alongside the RIT-T costs, Transgrid has proposed another category of project development costs to be recovered in the pre-period years.

Our assessment of the breakdown of these activities and costs is currently ongoing. We understand that the $18.8 million in pre-period capex was incurred to accelerate several project development workstreams during the RIT-T process, such as early design, network studies and procurement of the synchronous condensers which have significant manufacturing and delivery lead times.[132]

Based on our initial assessment, we are satisfied that these activities and costs are likely to be consistent with the Ministerial Direction and appear prudent, efficient and reasonable. Transgrid has provided detailed information and a monthly breakdown (consistent with the reasoning it provided for RIT-T costs above) that supports its claims that these other project development costs are related to the procurement of 10 synchronous condensers as proposed in this System Strength Project.

We will continue our assessment of these other project development costs, to ensure that Transgrid has not recovered these amounts in another process or allowance (such as within the contestable bucket of expenditure).

5.2.2 Project delivery management costs

Our assessment of Transgrid's proposed project delivery management costs is ongoing. At this stage of our assessment, we cannot conclude that the proposed project delivery management costs are prudent, efficient and reasonable. Our concern is the potential for duplication of these costs in risk costs and costs associated with the proposed adjustment mechanisms, in that these either include, or may lead to, additional labour costs.

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131 Transgrid, *Meeting system strength requirements in NSW – RIT-T Project Assessment Conclusions Report (PACR)*, Section 7.5, July 2025, pp. 74–78.

132 Transgrid, Response to information request #004, 15 May 2026.

Transgrid indicated its bottom-up capex build, which includes labour costs, was subject to internal top-down reviews across its project team and executive to both challenge and validate the forecasts made in addition to internal and external reviews.[133] Additionally, Transgrid advised that it used internal benchmarking, noting its consultants recognised the limitations of external benchmarking data to make valid comparisons.

We recognise the complexities associated with the project, and therefore, relative to other projects, a higher level of costs related to project delivery management may be expected. We also acknowledge Transgrid has verified its forecast bottom-up capex by applying a top-down review. However, it is unclear how, and to what degree, the top-down review was applied and whether amendments were made to the final capex forecast.

For example, it is unclear if and how synergies between Transgrid's proposed project delivery management costs, risk costs and provisional sums have been taken into account, or whether any subjectivity in the assumptions to support its bottom-up forecasts were identified and addressed. We note the consultant reports focussed primarily on total capex for the purpose of benchmarking and did not refer to provisional sums, which are included in the contestable capex component of Transgrid's proposal. We assume this is because they did not have knowledge or visibility of this aspect of Transgrid's capex proposal. This means that the benchmarking undertaken could overestimate total project capex and underestimate labour costs as a proportion of total project capex. On this basis, further analysis of the proposed project delivery management costs is required to determine whether they are prudent, efficient and reasonable.

In addition, the consultant reports refer to the use of benchmarking to confirm the capex related labour costs are prudent, efficient and reasonable. However, they noted confidence limitations due to:

- a combination of the unusual nature of the project and labour classifications not being directly comparable with other operators and therefore limiting the strength of any external validation.
- subjectivity through use of judgement, in most cases where Transgrid's stated rates were at, or above, the upper end of the range.
- high level benchmarking confirming only total costs were broadly in range, therefore being unable to verify the detailed FTE build, the split between direct and indirect line items or the potential for overstating or duplicating specific categories.

We also note that a number of proposed roles are responsible for mitigating and managing project risks. For example, the Project Controls function includes a Risk Manager who will oversee and manage the identification, tracking, updating and assessment of risks.[134] However, Transgrid's forecast of provisional sums assumes that all risk events related to potential contract variations will occur and have some cost impact.

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133 Transgrid, *A.3 – Non-contestable Labour and Indirect Capex Forecasting Methodology*, March 2025, p. 19.

134 Transgrid, *A.3 – System Strength Project 2026–31 – Non-Contestable Labour and Indirect Capex Forecasting Methodology*, April 2026, p. 40.

We intend to undertake further analysis on the proposed project development costs, in order to better understand the relationship between these labour activities and Transgrid's proposed approaches to the recovery of risks (discussed in section 4). We will also undertake our own benchmarking to verify the findings of Transgrid's consultants. We welcome stakeholder views on this aspect of Transgrid's revenue proposal and our approach to assessing these costs.

Glossary

Term	Definition
AER	Australian Energy Regulator
AEMO	Australian Energy Market Operator
Assessment approach guidance note	guidance note on the AER's EII Assessment Approach for Non-contestable revenue determinations (September 2025)
CAG	Consumer Advisory Group
Capex	capital expenditure
CCP35	consumer challenge panel, sub-panel 35
CESS	capital expenditure sharing scheme
Confidentiality Guideline	Draft confidentiality guideline - Electricity Infrastructure Investment Act (August 2023)
CSPER	Centre for Smart Power and Energy Research
Enabling CWO project	Enabling Central-West Orana REZ network infrastructure project carried out by Transgrid
D&C contract	design and construct contract
EBSS	efficiency benefit sharing scheme
EII Act	Electricity Infrastructure Investment Act 2020 (NSW)
EII Chapter 6A	Appendix A of the non-contestable Guideline, a modified version of Chapter 6A of the NER applying to EII projects
EII PTRM	refers to a NER PTRM modified for the purposes of making non-contestable revenue determinations under the EII framework (EII Act and EII Regulation)
EII Regulation	Electricity Infrastructure Investment Regulation 2021 (NSW)
non-contestable Guideline	Revenue determination guideline for non-contestable network infrastructure projects
HCC Project	Hunter-Central Coast REZ network infrastructure project
IPF	Infrastructure Planner Fees

ISP	Integrated System Plan is a whole-of-system plan that provides an integrated roadmap for the development of the NEM, published by AEMO.
LTSA	Long Term Service Agreement
NER	National Electricity Rules
Non-contestable Guideline	Revenue determination guideline for non-contestable network infrastructure projects
NSW DCCEEW	NSW Department of Climate Change, Energy, the Environment and Water
OEM	Original Equipment Manufacturer
opex	operating expenditure
OSOM	oversize and over mass
PACR	Project Assessment Conclusions Report
PNIP	Priority Network Infrastructure Project
PTRM	Post-Tax Revenue Model
RAB	Regulatory Asset Base
REZ	Renewable Energy Zone
RIN	Regulatory Information Notice
RIT-T	Regulatory Investment Test for Transmission
RoRI	2022 Rate of Return Instrument
System Strength Project	System Strength Project carried out by Transgrid
TAC	Transgrid Advisory Council
WACC	weighted average cost of capital
WSB Project	Waratah Super Battery non-contestable project carried out by Transgrid