Transgrid

People. Power. Possibilities.

Preliminary Position Paper Submission

System Strength Project – Revenue Proposal 2026-2031

July 2026

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28 July 2026

Kate Symons
Chair – AER REZ Committee
Australian Energy Regulator
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Dear Kate,

System Strength Revenue Proposal – Submission on Preliminary Position Paper

The need to maintain system strength is emerging as one of the key issues to be managed as part of the energy transition. As coal-fired power stations such as Eraring close, the grid will lose a major source of system strength. Without remedial action, this could expose consumers to an increased risk of voltage instability, blackouts and brownouts.

In December 2022, AEMO forecast a system strength shortfall in New South Wales. This ultimately led to a direction from the NSW Government for the installation of ten synchronous condensers, or syncons, at five key locations under the Priority Network Infrastructure Project Direction (System Strength Project) Order, made on 12 September 2025. In simple terms, the syncons will act as “shock absorbers”, helping to keep the grid stable during disturbances.

This System Strength Project (the Project) will deliver a timely and efficient solution to address the immediate system strength challenges, helping to avoid the economic and social costs associated with widespread outages and disruptions. The Project was originally identified through the Regulatory Investment Test for Transmission (RIT-T), in accordance with the National Electricity Rules (NER). However, given the urgency of the need and the value to consumers of accelerating delivery, it is now proceeding under the NSW regulatory framework.

For this Project, Transgrid is responsible for managing, delivering, integrating, operating, and maintaining the syncons, including project management, engineering oversight, commissioning, and ensuring compliance with regulatory and contractual obligations. Contractors, procured through competitive processes, are responsible for the design, manufacture, delivery, installation, and long-term maintenance of the syncons and associated civil and electrical works at the specified sites. The contestable procurement process and resulting contractual arrangements — including risk allocation and pricing — have been subject to oversight by the Department of Climate Change, Energy, the Environment and Water (DCCEEW) and assessed by the AER as ‘genuine and appropriate’.

The mix of contestable and non-contestable activities makes this Project the first to be assessed in accordance with the AER’s Hybrid Guidelines. As such, Transgrid acknowledges that we are learning how the AER will apply the Guidelines in practice and our Revenue Proposal may not have got everything right.

Transgrid

Against that background, Transgrid welcomes the opportunity to respond to the AER's Position Paper which raises the following key issues:

- Pre-period cost recovery,
- Adjustment mechanisms, including contract-related adjustment mechanism,
- Provisional sums,
- The potential for duplication of costs and risks in Transgrid's Revenue Proposal,
- The capital expenditure sharing scheme (CESS), and
- Stakeholder engagement.

On each of these topics, the AER raises important points which we have sought to address having regard to the long term interests of consumers, and the practical consequences in some cases arising from the AER's preliminary position. For example, Transgrid accepts the AER's view that pre-period RIT-T costs should be apportioned between this Project and other system strength projects identified in the RIT-T on a pro rata basis, according to each project's capital expenditure. However, there is considerable uncertainty regarding which of those projects will actually proceed and, if they do, the expenditure required to deliver them. Transgrid has therefore proposed an alternative cost allocation method that does not depend on forecasts, and is likely to provide a more workable cost recovery arrangement for consumers and Transgrid.

In relation to adjustment mechanisms, Transgrid notes that the AER intends to accept eleven of the proposed twenty adjustment mechanisms substantially as proposed. We acknowledge, with respect to the remainder, the AER's concern that there may be insufficient incentives for Transgrid to minimise payments made to contractors. However, the AER's preliminary position that the proposed contestable adjustment mechanisms should be assessed on a non-contestable basis would be a significant change that warrants careful consideration. Transgrid would therefore welcome further dialogue with the AER to identify whether alternative measures could be introduced to address the AER's concerns and enable the contract-related adjustment mechanisms to be approved as contestable.

In relation to provisional sums, Transgrid accepts the AER's observation that its proposed approach may not have enabled a full assessment of the prudency, efficiency and reasonableness of amounts paid to contractors. This was not Transgrid's intention. The provisional sums were included as placeholder amounts, to be updated so that consumers would only be charged the actual amounts paid to contractors for a series of risks that underpinned adjustment mechanisms. Nevertheless, Transgrid accepts the AER's preliminary position on provisional sums and does not intend to continue advocating for their inclusion in the AER's revenue determination.

We also note that the AER has reserved its position in relation to the application of the CESS to transport costs and the Middle East Conflict. In the attached submission, we explain that the services that underly these adjustment mechanisms are either non-core business for Transgrid or the costs are well beyond our control. As such there is no purpose served in applying incentive mechanisms, such as the CESS, to these costs. We would welcome the AER's confirmation that the actual full costs should be recoverable.

In relation to the AER's potential concerns regarding cost duplication, the attached submission explains the process that Transgrid undertook in developing its Revenue Proposal to ensure that all risks and costs were appropriately identified and allocated to a cost recovery pathway, without duplication. Transgrid looks forward to working with the AER to review our project management and delivery costs and we fully accept that if there has been any inadvertent cost or risk duplication, it should be removed.

On stakeholder engagement, we are listening to our stakeholders, most notably the Consumer Advisory Group (CAG), on how we can improve our approach. The AER's public forum held on 18 July provided a good opportunity to hear directly from stakeholders, and we will be working closely with the CAG to improve our engagement on current and future projects, including the Hunter Transmission Project and Southwest Renewable Energy Zone. We would welcome the AER's guidance on expectations for CAG engagement for NSW EII Act projects, including an approach with the CAG that works for all parties.

In relation to the specific commentary in the Position Paper on our engagement approach for this Project, our view is that the AER's commentary understates the depth and breadth of our engagement, which took place over an extended period, and included:

- **Stakeholder Collaboration**: We worked closely with the NSW Government (DCCEEW), the AER, and the TAC (now CAG), incorporating their feedback into project design, risk allocation, and adjustment mechanisms.
- **Public and Community Consultation**: We conducted public consultation over three years during the RIT - T process (2022-2025), and engaged local councils, landowners, Aboriginal Land Councils, and community groups to inform and address local concerns.
- **Targeted Deep Dives**: We held multiple deep-dive workshops with the TAC to test and refine key aspects of the Revenue Proposal, especially on risk and cost allocation.
- **Ongoing Communication**: We maintained a project webpage, provided regular updates, and established channels for ongoing feedback and information sharing.

We note that some members of the CAG have questioned whether it is best placed to assess complex issues, such as risk allocation. Nevertheless, Transgrid recognises and accepts the AER's general point in its Position Paper that there is scope to improve our engagement approach. We will continue to work with the CAG and the AER to ensure that those improvements are achieved.

In closing, Transgrid appreciates the constructive engagement from the AER Board and staff throughout this Project, including the RFI process. The attached submission provides further details on the revenue setting and framework issues raised by the AER in its Position Paper.

Should you or your team require any further information or clarification on this submission and attachment, please contact Alex McPherson, General Manager of Regulation and Policy at [redacted].

Yours sincerely

[redacted]

Nadine Lennie

Chief Financial Officer

Transgrid

Contents

1. Introduction

This submission responds to the AER's Position Paper on the following issues:

- Section 2 addresses pre-period costs.
- Section 3 responds to the AER's preliminary views on contestable adjustment mechanisms.
- Section 4 discusses the issue of provisional sums.
- Section 5 sets out Transgrid's views on the AER's position on the proposed transport adjustment mechanisms.
- Section 6 responds to the AER's concerns regarding possible cost and risk duplication in Transgrid's Revenue Proposal.
- Section 7 addresses the Middle East Conflict and the application of the Capital Expenditure Sharing Scheme (CESS).

Transgrid welcomes further discussion with the AER on any of the matters raised in this submission.

2. Pre-period costs

Key points

- This section recaps on the pre-period costs included in Transgrid's Revenue Proposal and explains why they were necessary to address system strength challenges. Transgrid welcomes the AER's in-principle acceptance that Transgrid should recover these costs.
- Transgrid accepts the AER's position that the RIT-T costs should be apportioned between this Project and other system strength projects that were identified in the RIT-T. However, we propose a more workable cost recovery arrangement for consumers and Transgrid, given the difficulty in forecasting which projects will proceed and each project's capital expenditure requirements.

Transgrid's Revenue Proposal included pre-period costs for the Project totalling $35.7 million, comprising:

- RIT-T-related costs of $16.9 million, incurred between October 2022 and October 2025. These costs relate to activities associated with the RIT-T process, including network planning, market modelling, commercial and regulatory work, legal advice and stakeholder engagement.
- Project development costs of $18.8 million, incurred between October 2023 and January 2026. These costs relate to early project development, procurement and management activities required to accelerate the Project, including early design work and network studies.

Transgrid incurred these costs so that the system strength issues arising from the energy transition and the planned closure of Eraring power station could be addressed in a timely manner for the benefit of consumers. Otherwise, consumers would be exposed to increased network reliability and quality issues, including increased risk of blackouts, brownouts and voltage fluctuations.

In relation to the RIT-T costs, the AER accepts that Transgrid should be able to recover the total costs incurred, but it does not accept that those costs should be recovered entirely from the System Strength

Project. The AER's principal concern is that the RIT-T identified a portfolio of system strength solutions, some of which may be progressed under the NER. The AER notes that the cost recovery arrangements under the NER differ from the EII framework, which makes the allocation between the EII projects and NER projects important.

Accordingly, the Position Paper considers how the RIT-T costs should be apportioned between this Project and other system strength solutions that were identified in the RIT-T's Project Assessment Conclusions Report (PACR). The AER's preferred approach is to allocate RIT-T costs proportionally across the portfolio solutions identified in the PACR, based on the forecast cost of each project.

Transgrid agrees with the AER's observation that the System Strength Project is part of a broader portfolio of solutions identified in the PACR. From Transgrid's perspective, however, the AER's proposed allocation method raises the following concerns:

- **Future system strength projects remain uncertain.** There is considerable uncertainty regarding which of the system strength projects identified in the PACR will proceed. The AER's cost allocation methodology, however, relies on accurately forecasting which projects will proceed and the costs of those projects. The likelihood is that an allocation based on forecast information will not be accurate or appropriate. Furthermore, the methodology exposes Transgrid to the risk that some RIT-T costs may not be recoverable if a project does not proceed as forecast.

- **Cost recovery would be delayed.** Some projects identified in the PACR are not expected to commence for several years, and may not be completed until 2032/33 or later. As Transgrid's RIT-T costs date back to 2022, it seems unreasonable to delay cost recovery to the extent implied by the AER's methodology. We note that an extended delay will result in consumers paying higher financing costs and create uncertainty for Transgrid as to whether the costs will be recovered.

The majority of RIT-T costs were also incurred to identify the preferred portfolio of solutions and would have been incurred regardless of whether the PACR ultimately recommended the installation of five, eight or ten synchronous condensers. The cost of determining the answer is largely independent of the answer itself. In the first instance, Transgrid therefore proposes these costs should be recovered in full as part of this determination.

In the alternative, Transgrid proposes the following methodology for the AER's consideration:

- **Step 1:** The AER allows initial recovery of the RIT-T costs through this Project, noting that the RIT-T costs are fixed and would be fully attributable to this Project if no other project proceeded.

- **Step 2:** If and when a revenue proposal or CPA is submitted for another project identified in the PACR, a portion of the RIT-T costs would be reallocated from this Project to the new project. The pro rata allocation would be based on the AER's approved allowance for each project. This ensures a fair allocation, based on the AER's assessment of project costs.

- **Step 3:** If and when additional projects arise, Step 2 is repeated so that the RIT-T costs are reallocated from the System Strength Project to the NER projects (and between the NER projects, if desired).

This process is analogous to 'pioneer' schemes that have been adopted in relation to distribution connection charges. Under these schemes, the initial infrastructure costs are borne by the first project and then shared with subsequent projects as they arise. For the purpose of this Project, a simple adjustment to the regulatory asset base would give effect to the reapportionment of the costs, and an adjustment mechanism could be adopted to formalise the arrangement.

Transgrid

As the proposed adjustment to the RAB would be accompanied by an amendment to the revenue determination for this Project, there would be no over-recovery or duplication of Transgrid's RIT-T costs. Specifically:

- In relation to any transfer amount, only the undepreciated component of the RIT-T costs would be subject to a transfer, thereby preventing any double-recovery of RIT-T costs that have already been recovered from consumers.
- At the time of the transfer, there would be an exact match between the amount recognised in the RAB for the NER project and the reduction in the RAB for this Project, which would be made through an adjustment mechanism. In terms of timing, providing that the transfer date (and amount) is the same in the PTRMs for each project, Transgrid's net revenue position will remain the same in present value terms.
- As part of its determination for the NER project, the AER would determine the transfer amount and the date, and may nominate a date that it considered most convenient for calculation purposes. Whichever date is chosen, however, Transgrid's total combined revenue for both projects will be unaffected in present value terms. For this Project, the PTRM will reduce the quarterly payments from the Scheme Financial Vehicle (SFV), in present value terms to account for the amount and timing of the transfer determined by the AER. Similarly, the PTRM for the NER project will provide an equivalent increased revenue allowance to recognise the same transfer amount and timing.

Transgrid's alternative approach has the advantage that it does not require upfront forecasts about which future projects will proceed and their relative costs. Instead, this alternative approach reallocates costs when future projects actually proceed and their efficient costs are known. It is therefore simpler to administer, relies on actual rather than forecast information, and avoids the higher financing and regulatory risk that arise from delayed or uncertain cost recovery.

Transgrid would welcome further engagement with the AER on this alternative approach, noting the advantages described above.

3. Contestable adjustment mechanisms

Key points

- This section responds to the AER's preliminary views on contestable adjustment mechanisms.
- Transgrid acknowledges the AER's focus on ensuring that costs are prudent, efficient and reasonable, and suggests additional safeguards could be adopted to support the classification of these mechanisms as contestable.

Transgrid proposed 20 adjustment mechanisms with 15 of them classified as non-contestable and 5 of them classified as contestable. The AER's preliminary position is to accept 11 of the proposed adjustment mechanisms as submitted by Transgrid – all of these are classified as non-contestable mechanisms. Of the 9 remaining adjustment mechanisms 3 related to major transport works which the AER's preliminary position is to combine into a single adjustment mechanism (discussed in more detail in section 5 below). The 5 adjustment mechanisms that relate to the contestable adjustment mechanisms were no accepted by the AER as part of their preliminary position.

Transgrid notes that the Position Paper provides important insights into the AER's preliminary views on its assessment of proposed contestable adjustment mechanisms. In particular, the Position Paper explains that, for a contract-related adjustment mechanism to be classified as contestable, it must address two core components:

- Triggers — the mechanism must define the events or conditions that establish an entitlement to an adjustment amount, and
- Methods — the mechanism must set out the process for determining the adjustment amount once a trigger is satisfied.

In relation to triggers, the AER accepts that the relevant contract variation clauses generally reflect the outcomes of the competitive assessment process, except for those relating to the Middle East conflict, which were negotiated after the formal tender process had been completed. Accordingly, in relation to triggers, the AER is inclined to accept Transgrid's contract-related adjustment mechanisms as contestable.

In relation to methods, however, the AER considers that the process for determining variation amounts is not sufficiently specified or robust to give it confidence that costs will be prudent, efficient and reasonable. As a result, the AER is inclined not to accept the proposed contract-related adjustment mechanisms as contestable and instead to treat them on a non-contestable basis. This would mean that the AER would undertake its own prudency, efficiency and reasonableness assessment of adjustment amounts when annual submissions are lodged, or alternatively provide Transgrid with a risk cost allowance in relation to some events.

Transgrid accepts the underlying principle that any amounts recovered through a contract-related adjustment mechanism must be prudent, efficient and reasonable. However, the Position Paper appears to clarify the AER's view that, for such a mechanism to be classified as contestable, the contractual method must itself constrain costs to prudent, efficient and reasonable levels. This is reflected in the AER's statement that:[1]

> "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."

Transgrid appreciates that the EII framework is continuing to develop, particularly in relation to hybrid projects. However, where the Position Paper provides further clarification of the AER's expectations, Transgrid considers that it should be given a reasonable opportunity to respond to that clarification, particularly where the AER's proposed approach may significantly impact Transgrid's risk exposure. In particular, Transgrid notes that the Position Paper sets out additional requirements regarding the meaning of 'specific' which were not detailed in the AER's relevant Guideline.[2]

Transgrid is also concerned that the AER's proposed approach may shift the framework towards oversight regulation rather than incentive-based regulation. Specifically, if the AER intends to review the prudency, efficiency and reasonableness of each adjustment amount after it is paid, this will impose a significant administrative burden on both Transgrid and the AER. While all contract variations are recorded and documented, additional resources would be required to prepare materials and evidence for an ex post review. The additional resource requirements and focus on managing regulatory risks would inevitably lead to increased costs, which would be contrary to the interests of consumers. This situation may also be replicated in future EII projects, which would exacerbate the administrative challenges.

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[1] AER, Preliminary Position Paper, System Strength Project, 1 October 2026 – 30 September 2031, June 2026, p.39.

[2] AER, Transmission Efficiency Test and revenue determination guideline for non-contestable network infrastructure projects, May 2026, section 7.2.6, p.41.

Transgrid also notes that the AER may be considering a risk allowance for some risk events, rather than an adjustment mechanism. However, this approach would be a significant change to Transgrid's risk profile, particularly for costs that are either entirely or largely outside Transgrid's control, highly uncertain and difficult to forecast. Transgrid's preference is to ensure that the hybrid regime operates in a way that recognises that Transgrid should be able to recover the contestable costs of delivering the project.

Given these concerns, Transgrid would welcome the AER's reconsideration of its approach to contestable adjustment mechanisms. In particular, Transgrid considers that additional safeguards could be developed to provide the AER with reasonable assurance that contract payments made in accordance with the adjustment mechanisms are prudent, efficient and reasonable, without requiring a detailed ex post review of each payment or a change in Transgrid's risk profile through the risk allowance pathway.

Transgrid would appreciate the opportunity to discuss with the AER the additional information or safeguards that it may require to support classification of the contract-related adjustment mechanisms as contestable.

4. Provisional sums

Key points

- This section discusses the treatment of provisional sums in the Revenue Proposal, noting that the intention was only to recover the actual costs incurred.
- Transgrid accepts the AER's preliminary views in its Position Paper and no longer advocates for the inclusion of provisional sums in the AER's revenue determination.

Transgrid proposed $195.2 million in provisional sums as part of our proposed contestable capex. The provisional sums were intended to cover pre-identified risks associated with design, manufacture and commissioning, with any unused amounts returned to consumers. The provisional sums reflected an estimate of the payments that would be made in accordance with the contract-related adjustment mechanisms. Given the significant uncertainty in estimating the amounts payable, Transgrid proposed that the additional costs incurred would be recovered through the applicable adjustment mechanism, and any lower amounts would be returned to consumers.

Transgrid's proposed approach to provisional sums, therefore, would have no impact on the total amount paid by consumers. The inclusion of provisional sums meant that Transgrid's forecast revenue would more accurately reflect the forecast project costs, rather than providing an initial allowance of zero in relation to the adjustment mechanisms. The benefit to consumers of that approach is that regulated revenues better reflect expected costs, and prices are more cost reflective.

In its Position Paper, the AER explains that provisional sums were not established through a genuine and appropriate competitive assessment process and, therefore, it does not classify provisional sums as contestable capex. The AER further explains that it prefers to assess all adjustment amounts at the time an adjustment proposal is submitted, rather than allowing a provisional sum as part of the revenue determination. A specific concern raised by the AER is that the provisional sum arrangement would limit its prudency, efficiency and reasonableness review to only those costs that exceeded the provisional sum, rather than the full amount.

Similarly, the AER's preliminary position is not to accept Transgrid's proposed opex provisional sums, and instead to allow any such costs to be recovered through the LTSA contract variation adjustment mechanism.

Transgrid recognises the AER's concern that the proposed treatment of provisional sums may have limited its ability to fully assess whether amounts ultimately paid to contractors were prudent, efficient and reasonable. Transgrid did not intend to avoid regulatory scrutiny. Rather, the provisional sums were included to provide an initial estimate of potential adjustment amounts in the Revenue Proposal, recognising that those amounts were highly uncertain but very unlikely to be zero.

Transgrid intended that the provisional sums would be updated once actual costs were known, so that consumers would only fund costs incurred under the relevant contractual arrangements. Transgrid also understood that, because the amounts were proposed to be addressed through contestable adjustment mechanisms, the AER's review would focus on whether the payments had been made consistently with those arrangements. Notwithstanding these points, however, Transgrid accepts the AER's preliminary position and does not propose to pursue the inclusion of provisional sums in the revenue determination.

Transgrid maintains that its first position, which is that additional safeguards can be introduced so that the amounts that were included as provisional sums in our Revenue Proposal can be addressed through our proposed contestable adjustment mechanisms. This would result in the risk cost allowance remaining as proposed by Transgrid in its Revenue Proposal and all risks identified through provisional sums would be addressed through the 5 adjustment mechanisms as originally proposed (with the removal of the provisional sum upfront determination).

However, if the AER is not willing to accept the additional safeguards as an appropriate approach to demonstrate that our expenditure is prudent, efficient and reasonable, in response to the AER's RFI-14 Transgrid has developed an alternative approach to address the risks originally covered by the provisional sums. In particular, Transgrid has undertaken analysis to first assess which risks are outside of Transgrid's control or which have the potential for a large deviation in financial impact. These risks are most appropriately addressed through adjustment mechanisms. Secondly, the remaining risks were assessed to determine if the risk could be controlled by Transgrid and could be reasonably priced. This is an iterative process and the analysis is ongoing. For those risks that can be priced, Transgrid is undertaking a risk assessment process including quantitative analysis through a Monte Carlo model to provide a probabilistic risk cost allowance which will form part of Transgrid's response to RFI-14.

Transgrid is proposing three adjustment mechanisms under this alternative approach. At this time, the proposed adjustment mechanisms include:

- Site conditions differing from those assumed at tenders – it is proposed that this adjustment mechanism incorporates: (a) latent conditions, (b) contamination, (c) errors in reliance information, (d) heritage finds and (e) all associated delay costs;
- Variations due to design progression from tender to final design – it is proposed that this adjustment mechanism incorporates: (a) design, (b) equipment, (c) construction methodology, and (d) all associated delay costs; and
- Third party requirements – it is proposed that this adjustment mechanism incorporates: (a) AEMO cancelled outages, (b) AEMO directed changes to commissioning, (c) land acquisition related delays, (d) essential interface, (e) access road requirements, (f) other third- party requirements and (g) all associated delay costs.

Under the alternative approach proposed above, the three adjustment mechanisms would cover the majority of the risk amounts originally identified as provisional sums (based on preliminary calculations this is approximately 2/3), with the remainder being accounted for as part of an updated risk cost allowance. It should be noted that the proposed adjustment mechanisms are preliminary and will be set out in more detail as part of our response to the AER's information request. Transgrid submits that these three adjustment mechanisms should be contestable mechanisms, with appropriate safeguards. We look forward to continuing to work with the AER on this matter.

5. Transport adjustment mechanisms

Key points

- This section sets out Transgrid's position on transport adjustment mechanisms and the need for appropriate cost recovery arrangements.
- Transgrid does not support the AER's proposed approach and instead recommends a mechanism that provides greater certainty regarding cost recovery.

The AER's preliminary position on transport adjustment mechanisms is to not accept Transgrid's proposed suite of separate adjustment mechanisms for non-contestable major transport works, as the scope of these works is not yet sufficiently defined. Instead, the AER considers it more appropriate to assess these costs at the time when contracts for major transport works and council works have been executed.

Following contract execution, the AER proposes that Transgrid applies for a review and remake of the revenue determination, which would be limited to the AER's reconsideration of transport works. The AER proposes that it would then examine the prudency, efficiency and reasonableness of Transgrid's forecast transport works costs, any associated contract variations and additional adjustment mechanisms required to recover those contract variations.

Transgrid is concerned that the AER's proposed approach to transport adjustment mechanisms would require Transgrid to execute transport contracts prior to the AER determining the cost recovery arrangements. At this stage, Transgrid cannot know with any degree of confidence whether these competitively let contracts will be fixed price or include adjustment mechanisms of some kind. Moreover, as the transport costs are entirely outside Transgrid's control, the AER's proposed approach would expose Transgrid to significant and unacceptable cost recovery risk.

Transgrid considers that it is appropriate to approve an adjustment mechanism that provides assurance confidence that the costs will be recoverable. Transgrid notes that the Contingent Project provisions in the NER provides strong regulatory precedent for arrangements that provide a regulatory allowance prior to a network service provider entering into a contract with a service provider. Transgrid's view is that similar arrangements could apply in relation to the transport adjustment mechanism, so that Transgrid has confidence that the transport costs will be recoverable before entering into contracts with service providers.

Transgrid also draws the AER's attention to the TAC's position on our proposed transport adjustment mechanism. The TAC recognised that transport costs are outside Transgrid's control and should be subject to an adjustment mechanism, noting that it will ensure that consumers only pay the actual costs of undertaking the transport upgrades, rather than a forecast amount that may not be required. Transgrid considers that the AER should have regard to the TAC's support for actual cost recovery in making its final decision on the transport adjustment mechanism.

6. Risk and cost allocation

Key points

- This section explains the structured approach adopted in developing the Revenue Proposal to ensure Transgrid's project delivery management costs are prudent, efficient, and free from duplication.
- Transgrid outlines the steps taken to identify, allocate, and review risks and costs, and welcomes further engagement with the AER to address any outstanding issues.

The Position Paper explains that the AER needs to undertake further work to verify that Transgrid's project delivery management costs are prudent and efficient.

Specifically, the AER is concerned that some costs, especially labour and project delivery management costs, may be duplicated in risk costs or costs recovered through adjustment mechanisms. For example, the AER comments that roles responsible for risk management are included in project delivery management, but similar risks are also covered by some risk allowances. The AER therefore intends to conduct further analysis to better understand the relationship between labour activities and risk recovery approaches, and to verify that costs are not being double-counted across categories.

Transgrid notes that good practice in risk requires holistic consideration of project risk management and cost recovery mechanisms. Transgrid's position is that the cost risk related to this project was allocated appropriately across different mechanisms considering the circumstances.

While acknowledging that the AER's position paper makes valid comments on individual components of our proposal, Transgrid's view is that changes to individual components need to be considered in the context of the project's risk position as a whole. For example, if the Risk Cost Allowance changes, adjustment mechanisms would also need to change, and this would require a rigorous analysis of the project risk position.

Transgrid is confident that our project delivery management costs are prudent and efficient, and that there is no duplication of costs or risks across the labour activities, risk allowances and adjustment mechanisms. In developing the Revenue Proposal, Transgrid adopted a structured approach to risk and cost allocation to address the AER's focus on ensuring project delivery management costs are prudent, efficient, and free from duplication. The process was designed to identify, allocate, and recover all relevant risks and associated costs through a specific regulatory pathway. Transgrid's approach comprised the following steps:

- **Comprehensive risk assessment.** Transgrid's risk managers, project development and management teams, and subject matter experts conducted a detailed risk assessment, resulting in a risk register that captured all material risks relevant to project development and delivery. The risk register was refined throughout the project development phase, particularly in preparation for major tenders, to ensure accuracy and completeness.
- **Allocation to recovery pathways.** Each identified risk was allocated to the most suitable cost recovery mechanism, including contestable adjustment events, base expenditure, insurance, risk cost allowances, or non-contestable adjustment events. Allocation was based on which party was best placed to manage each risk, consistent with contractual and regulatory expectations.
- **Granular risk segmentation.** Where risks could arise at different project stages or under varying circumstances, they were split into distinct components. For example, noise issues from operational synchronous condensers were separated into construction-phase and post-commissioning risks, each

with its own recovery pathway and likelihood assessment. This ensured risks were not double-counted and that cost attribution was as precise as possible in the time available.

- **Final review.** A thorough review was undertaken to confirm that all risks were identified, appropriately allocated, and that no duplication existed across labour activities, risk allowances, or adjustment mechanisms.

Transgrid considers that this process, as applied in the development of the Revenue Proposal, provides a sound basis for the allocation of project management and delivery costs. Transgrid looks forward to working with the AER to address any specific issues or information requests to demonstrate that our project management delivery costs are prudent, efficient and reasonable.

7. Other issues

Key points

- This section addresses the treatment of costs arising from the Middle East Conflict and the application of the CESS.
- Transgrid concurs with the AER's view that the additional costs arising from the Middle East Conflict should be fully recoverable, particularly as these costs are outside Transgrid control.
- Transgrid also explains why CESS should not apply in relation to the costs arising from Middle East Conflict or transport works.

Middle East Conflict

Transgrid's Revenue Proposal explained that the conflict in the Middle East commenced after Best and Final Offer (BAFO) submissions from contractors, but prior to contract execution. As a result, the contractors negotiated an additional contract provision to ensure they have sufficient coverage for additional time and/or costs relating to this conflict. Transgrid is seeking an adjustment mechanism so that it recovers the additional costs negotiated by the contractors.

Transgrid welcomes the AER's recognition that 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, 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, and
- 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.

Transgrid agrees with the AER's assessment that the costs associated with the Middle East Conflict should be fully recoverable, particularly as the payments were the subject of intensive negotiations with the contractors and are entirely outside Transgrid's control.

CESS

In relation to the application of the CESS, the AER explains that it is reserving its position on whether CESS should apply to the costs arising from the Middle East Conflict and transport works. Transgrid notes that the

CESS has no impact if the AER allows the full recovery of the actual costs associated with the Middle East Conflict and transport works. This is because the expenditure allowance will exactly match the actual costs incurred, in present value terms. As the AER has accepted in principle that these full costs should be recovered, it follows that the CESS will not (and should not) apply in relation to these costs.

For completeness, Transgrid notes that section 16.2 of the Revenue Proposal provided detailed reasons for not applying the CESS to these cost categories. While the Middle East Conflict occurred too late to obtain the TAC's views, the TAC strongly supported our position that the CESS should not apply in relation to transport works, as noted below:[3]

> "Members of the TAC considered it neither prudent nor efficient for Transgrid to be responsible for civil engineering transport upgrades. Accordingly, they recognise the rationale for excluding these works from the application of the CESS."

Transgrid concurs with the views expressed by the TAC, which apply equally to the Middle East Conflict. In accordance with the AER's Capital Expenditure Incentive Guideline, further detailed information is provided in section 16.2 of the Revenue Proposal as to why the CESS should not apply to these costs.

[3] Transgrid, System Strength Project 2026-2031 Revenue Proposal Principal Application Document, 10 April 2026, Table 58, p.139.