



Australian Government



# Final decision

## System Strength Project (hybrid priority network infrastructure project)

(1 October 2026 – 30 September 2031)

September 2026

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## Note

This is the main document for the final decision on Transgrid's 2026–31 System Strength Project (hybrid priority network infrastructure project). It should be read with all other parts of the final decision.

The final decision includes the following documents:

- **Final decision (main document)**
- Appendix A – Quarterly service payments
- Appendix B – Adjustment mechanisms
- Appendix C – Rate of return averaging periods (Confidential)

## Overview

The Australian Energy Regulator (AER) is responsible for the economic regulation of electricity distribution and transmission systems in all states and territories except Western Australia. We exist to ensure energy consumers are better off, now and in the future. Consumers are at the heart of our work, and we focus on ensuring a secure, reliable, and affordable energy future for Australia as we transition to net zero emissions.

In 2021 the NSW Government appointed us to be the Regulator of infrastructure projects under the *Electricity Infrastructure Investment Act 2020* (NSW) (EII Act). Under the EII framework, a Network Operator is required to submit a proposal to us setting out the amount of revenue it seeks to recover from consumers to carry out a network infrastructure project. We must review the proposal and determine an amount payable to the Network Operator that reflects the prudent, efficient and reasonable costs of undertaking the project. A Network Operator must periodically apply to us to determine the maximum allowed revenue it can recover from consumers for the continued operation of its project.

The System Strength Project involves the supply, installation and connection of 10 synchronous condensers at 5 sites and is aimed at addressing a potential future shortfall in system strength in NSW. The NSW Minister for Energy (Minister) appointed the Secretary of the NSW Department of Climate Change, Energy, the Environment and Water (NSW DCCEEW) as the Infrastructure Planner for the System Strength Project and issued a Priority Network Infrastructure Project (PNIP) Direction Order in relation to the project in September 2025. Transgrid has been appointed the Network Operator for the project.

The System Strength Project is the first time under the EII framework that we are required to make a revenue determination for an infrastructure project that includes both contestable and non-contestable components. We refer to these as hybrid revenue determinations.

Our hybrid revenue determination sets out our assessment of the Network Operator's (in this case, Transgrid's) forecast costs to ensure it only recovers from NSW electricity consumers an amount that is prudent, efficient and reasonable for carrying out the project. Under the hybrid approach our revenue determination reflects the outcomes of 'genuine and appropriate' competitive assessment processes and, for those elements of the project not competitively procured, a detailed assessment of the costs of the project.<sup>1</sup> We do not decide the scope or timing of network infrastructure projects. For PNIPs, the Infrastructure Planner recommends the project scope and timing for decision by the Minister.

In December 2025 and March 2026, we found the competitive assessment processes undertaken for the contestable components of the System Strength Project (the Synchronous Condenser and Associated Works packages) were genuine and appropriate.<sup>2</sup> On this basis,

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<sup>1</sup> A Network Operator's hybrid revenue proposal combines the contestable components with project elements that have not been contestably determined, because only the Network Operator, as the monopoly network service provider, can deliver those non-contestable services.

<sup>2</sup> AER, Letter to NSW DCCEEW, *Re: AER review of the procurement process for the synchronous condenser component of the System Strength Acceleration Project*, December 2025; AER, Letter to NSW DCCEEW, *Re: AER review of the procurement process for the associated works component of the System Strength Acceleration Project*, March 2026.

we have accepted the outcomes from these competitive assessment processes as prudent, efficient and reasonable in our revenue determination.

We received a hybrid revenue proposal from Transgrid in April 2026 which incorporated the outcomes of the competitive assessment processes as well as non-contestable components. We have assessed Transgrid's revenue proposal in line with the requirements set out in the EII Act, the *Electricity Infrastructure Investment Regulation 2021* (NSW) (EII Regulation) and the process set out in our *Transmission Efficiency Test and revenue determination guideline for non-contestable network infrastructure projects* (Non-contestable Guideline).<sup>3</sup> Our assessment has been informed by submissions from Transgrid as well as from other stakeholders and the AER's Consumer Challenge Panel (CCP35).

Our final decision allows Transgrid to recover \$385.6 million (\$ nominal) in revenue from NSW electricity consumers over the 2026–31 period. This is \$15.2 million (3.8%) less than Transgrid's revenue proposal and represents what we consider to be the prudent, efficient, and reasonable costs of delivering the System Strength Project. The lower revenue requirement primarily reflects our assessment of capital expenditure, where we did not accept Transgrid's proposed \$195.2 million in provisional sums for specified risk events and partially substituted them with a risk allowance.

We do not consider the provisional sums are an outcome of the genuine and appropriate competitive assessment processes or that it is appropriate to allow Transgrid's proposed approach of both a provisional sum and adjustment mechanism to cover the same risk. Our final decision includes an ex-ante risk cost allowance of \$93.7 million (\$ September, 2026), an increase of \$75.2 million from that proposed by Transgrid to reflect that some risk events proposed to be covered by the provisional sums and adjustment mechanisms will now be managed by Transgrid. Proposed risk events that are not covered by the risk cost allowance may be recovered through adjustment mechanisms, subject to a prudence, efficiency and reasonableness assessment.

Other components of our final decision that differ from Transgrid's revenue proposal are:

- a reduction in operating expenditure (opex) by \$1.4 million to \$58.6 million (\$ September, 2026)
- a lower forecast inflation than proposed by Transgrid (reflecting the latest RBA Statement of Monetary Policy)
- a higher rate of return of 7.37% (reflecting the latest market data)
- a higher opening regulatory asset base (RAB) of \$323.8 million (\$ nominal, an increase of \$6.7 million or 2.1%).

Our determination also includes incentives for Transgrid to carry out the project efficiently and allows for the adjustment of Transgrid's allowed revenue under certain pre-specified circumstances.

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<sup>3</sup> This Guideline was recently updated. See: AER, *Revenue determination guideline for NSW non-contestable projects*, August 2026.

# 1 Background

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, Transgrid commenced work in 2022 on a Regulatory Investment Test – Transmission (RIT-T) to explore possible solutions.<sup>4</sup>

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 (amongst other things) the accelerated procurement, design, manufacture, installation and commissioning of new network synchronous condensers at 5 locations around NSW.<sup>5</sup> This conclusion forms the basis of the System Strength Project.

## 1.1 Regulatory framework and project scope

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 Minister proposed to accelerate the delivery of an initial batch of synchronous condensers at 5 identified locations in NSW. The Minister appointed the Secretary of the NSW DCCEEW as the Infrastructure Planner for the System Strength Project and issued a PNIP Direction Order under the EII Act in September 2025.<sup>6</sup>

The Minister's PNIP Direction required Transgrid to carry out the System Strength Project and that all synchronous condenser units be connected and commissioned (except for R2 hold point testing) by September 2028.<sup>7</sup> An amended version of this PNIP Direction was issued on 27 March 2026 to include transport works required to carry out the project, and an extension of the timeframe to commission all synchronous condensers until February 2029.<sup>8</sup>

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 'hybrid' network infrastructure project under the EII regulatory framework, combining contestable and non-contestable project components in a single revenue proposal. Specifically, these components are:<sup>9</sup>

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<sup>4</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 62.

<sup>5</sup> Transgrid, *Meeting system strength requirements in NSW – RIT-T Project Assessment Conclusions Report (PACR)*, July 2025, p. 111.

<sup>6</sup> NSW Government Gazette, *Number 376 – Electricity and Water*, 18 September 2025.

<sup>7</sup> NSW Government Gazette, *Number 376 – Electricity and Water*, 18 September 2025, p. 7.

<sup>8</sup> NSW Government Gazette, *Number 115 – Electricity and Water*, 27 March 2026, pp. 4, 9.

<sup>9</sup> NSW Government Gazette, *Number 115 – Electricity and Water*, 27 March 2026, pp. 4–8; Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 47; Transgrid, *Accelerated Synchronous Condensers – Procurement Report – Syncons Package*, October 2025, p. 2.

- **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 proposed installing 2 synchronous condensers at each location (a total of 10 synchronous condensers).<sup>10</sup> The synchronous condenser package involves 2 contracts:
  - The Supply Contract with the original equipment manufacturer (OEM), GE Vernova (GE), to supply the synchronous condensers.
  - The Long-Term Service Agreement (LTSA) with GE to maintain and service the synchronous condensers over a 10-year term.
- **Associated works package** (contestable): Design and construct (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 contracts with 2 separate D&C contractors.
- **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 element includes costs Transgrid incurs for managing the delivery of the project undertaken by the contestably contracted third parties.

Our role as a regulator under the EII Act is to determine the revenue that Transgrid may recover for carrying out the System Strength Project.<sup>11</sup> We do not have a role in deciding the appropriate scope or timing of priority network infrastructure projects under the EII Act, as these decisions are made by the Minister based on a recommendation from the Infrastructure Planner. Our 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.<sup>12</sup>

In making our revenue determination, we must rely on and adopt information if the information given by the Infrastructure Planner or Network Operator was obtained from a competitive assessment process that we are satisfied is 'genuine and appropriate'.<sup>13</sup> The EII Regulation prescribes the principle that a genuine and appropriate competitive assessment process results in costs of carrying out an infrastructure project being prudent, efficient and reasonable.<sup>14</sup> Our assessment of the revenue proposal focuses on ensuring that only outcomes of these 'genuine and appropriate' competitive assessment processes are treated as contestable.

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

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<sup>10</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 8.

<sup>11</sup> EII Act, s.38.

<sup>12</sup> EII Regulation, cl. 47A; AER, *Revenue determination guideline for NSW non-contestable projects*, August 2026.

<sup>13</sup> EII Regulation, cl. 45(6).

<sup>14</sup> EII Regulation, cl. 46(1)(a)(i).

information about our standard approach is available in our Non-contestable Guideline, as well as our guidance note on AER's EII assessment approach for non-contestable revenue determinations (assessment approach guidance note).<sup>15</sup>

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<sup>15</sup> AER, *Guidance note on the AER's EII assessment approach for non-contestable revenue determinations*, August 2026.

## 2 Assessment of contestable packages

The Secretary of NSW DCCEE, as the Infrastructure Planner, arranged for Transgrid to run the competitive assessment processes for the contestable packages of the System Strength Project: one for the synchronous condenser package and one for the associated works package.<sup>16</sup> The Infrastructure Planner maintained oversight and control of the processes, including approval of key documents and decisions.

The competitive assessment process for the synchronous condenser package formally commenced in February 2025 with the issuing of the request for tender (RFT) documentation to the tenderers. The process concluded in October 2025 when GE was notified that they were the preferred tenderer to supply synchronous condensers to all 5 sites.<sup>17</sup>

The competitive assessment process for the associated works package was undertaken in parallel, commencing in May 2025 and concluding in February 2026 with works across the 5 sites being allocated to 2 successful tenderers. Specifically, associated works at the Newcastle, Kemps Creek and Armidale sites were assigned to Consolidated Power Projects Australia (CPP), and associated works at the Wellington and Darlington Point sites were assigned to UGL Engineering (UGL).<sup>18</sup>

Transgrid undertook market sounding and received external advice to identify parties with the capability and interest in delivering the required synchronous condensers.<sup>19</sup> This process also identified a market preference to separate out associated works from the synchronous condenser package. Following the market sounding process, Transgrid shortlisted organisations on its Construction Services Panel that it assessed as capable of carrying out the associated works.<sup>20</sup>

The market sounding informed the development of the procurement strategy for the competitive assessment processes, which was reviewed and approved by the Infrastructure Planner before being provided to the AER in February 2025. While we suggested improvements to some aspects of the strategy, we were satisfied that it was likely to result in genuine and appropriate competitive assessment processes.

The three key stages of each procurement process were the RFT stage, the initial evaluation and negotiation stage. During the RFT stages, Transgrid held tenderer briefings, site tours and interactive sessions and received bids from the tenderers. The evaluation stages involved a tender evaluation committee scoring the bids and making recommendations on the tenderers that offered the best value-for-money solution. A tender review panel endorsed the findings of the evaluation committee. The negotiation phases included: notifying a subset

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<sup>16</sup> Transgrid, *Accelerated Synchronous Condensers – Procurement Strategy*, February 2025, p. 29.

<sup>17</sup> Transgrid, *Accelerated Synchronous Condensers – Procurement Report – Syncons Package*, October 2025, p. 78.

<sup>18</sup> Transgrid, *Accelerated Synchronous Condensers – Procurement Report – Associated Works Package*, February 2026, pp. 89–90.

<sup>19</sup> Transgrid, *Accelerated Synchronous Condensers – Procurement Report – Syncons Package*, October 2025, pp. 16–17.

<sup>20</sup> Transgrid, *Accelerated Synchronous Condensers – Procurement Report – Associated Works Package*, February 2026, p. 15.

of tenderers that they would proceed to tender negotiations, negotiating on their material departures from the RFT requirements, requesting a ‘best and final offer’ from shortlisted tenderers, and finalising the evaluation through an assessment of the revised offers.<sup>21</sup>

After the evaluation was finalised, negotiations on the agreed contract terms with the preferred tenderers continued until contracts were executed. Transgrid set out in its revenue proposal the changes that had been made to the contracts after the competitive assessment process had been completed.<sup>22</sup> We have taken material changes to risk allocation that occurred after the selection of the preferred tenderers into account by assessing these elements on a non-contestable basis.

## 2.1 Assessment approach

Our genuine and appropriate assessments were undertaken based on our observation of the competitive assessment processes and the information from the processes provided to us by the Infrastructure Planner. In assessing whether a competitive assessment process was genuine and appropriate, we followed the approach set out in our *Revenue determination guideline for NSW contestable network projects* (Contestable Guideline).<sup>23</sup> Under this approach, we consider whether the competitive assessment process:

- was undertaken in accordance with the EII Act and EII Regulation;
- was undertaken consistent with the Infrastructure Planner’s procurement strategy; and
- reflected our competitive assessment evaluation criteria.

If, following our assessment, we are satisfied the competitive process was genuine and appropriate, we will make our revenue determination for the Network Operator consistent with the outcome of that process as reflected in the contractual arrangement.

We closely observed the procurement processes, attending numerous interactive sessions between Transgrid and the proponents and all evaluation meetings. We also reviewed and commented on key tender documentation, including evaluation and negotiation plans. At the end of each procurement process we received a procurement report from the Infrastructure Planner. We also engaged an expert consultant (Procurement Professionals) to provide us advice on the procurements.

## 2.2 Assessment outcome

In December 2025 and March 2026, we determined that we were satisfied that the competitive assessment processes for the synchronous condenser and associated works packages, respectively, were genuine and appropriate.

These decisions were consistent with the findings of our expert consultant. Based on a review of procurement documents, Procurement Professionals found that the process for procuring the synchronous condensers was conducted appropriately, consistent with industry

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<sup>21</sup> Transgrid, *Accelerated Synchronous Condensers – Procurement Report – Syncons Package*, October 2025; Transgrid, *Accelerated Synchronous Condensers – Procurement Report – Associated Works Package*, February 2026.

<sup>22</sup> Transgrid, *A.1 Contestable contractual arrangements and risk allocations*, April 2026, Confidential.

<sup>23</sup> AER, *Revenue determination guideline for NSW contestable network projects*, August 2022, pp.14–15.

practice, and compliant with the AER's contestability requirements. In reviewing the procurement report for the associated works, Procurement Professionals' view was that the procurement process could be considered genuine and appropriate.<sup>24</sup>

Table 2.1 below summarises our assessment of the 2 competitive assessment processes against the criteria in section 2.1.

Our genuine and appropriate decisions focused on the competitive processes undertaken. Our revenue determination includes decisions on whether the components of Transgrid's revenue proposal that Transgrid claimed to be contestable can be considered outcomes of the competitive assessment processes. For example, our assessments of whether provisional sums and the contractual process for varying the scope or price of the agreed terms could be adopted as competitive outcomes are detailed in sections 10 and 14 respectively.

**Table 2.1 Summary of our assessment of the competitive assessment processes**

| Criteria                                                                                                                   | Assessment                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
|----------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>A. Consistency with the EII Act and EII Regulation</b>                                                                  |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| A request from the Infrastructure Planner for a binding bid from 2 or more persons. <sup>25</sup>                          | The Infrastructure Planner authorised Transgrid to call for binding bids from 2 or more proponents for each package on its behalf. For the synchronous condenser package, 5 binding bids were received in response to the request for tender (RFT), with 2 proponents submitting a 'best and final offer' following negotiations. For the associated works package, 4 binding bids were received, with 2 proponents submitting a 'best and final offer' following negotiations. |
| Eligibility criteria and selection process are developed by the Infrastructure Planner. <sup>26</sup>                      | At the request of the Infrastructure Planner, Transgrid established the evaluation criteria and the evaluation process for the shortlisting and selection of tenders for each package, which was then reviewed and approved by the Infrastructure Planner. These criteria were set out in the procurement strategy and evaluation plans prior to the evaluation of tenders.                                                                                                     |
| Infrastructure Planner consults with the AER and provides information about, and obtained from, the process. <sup>27</sup> | Transgrid and NSW DCCEEW project teams met with AER staff regularly, enabling us to ask any questions and raise any issues during the procurement processes. The Infrastructure Planner sought our comment on the drafts of the procurement strategy and the RFT documentation, evaluation plans and negotiation plans for each package.                                                                                                                                        |

<sup>24</sup> Procurement Professionals, *Letter of advice – accelerated synchronous condensers RFT process*, December 2025; Procurement Professionals, *Advice on the procurement report – associated works for the System Strength Acceleration Project*, March 2026.

<sup>25</sup> EII Regulation, cl. 45(2)(b).

<sup>26</sup> EII Regulation, cl. 45(3).

<sup>27</sup> EII Regulation, cl. 45(4).

| Criteria                                                                                           | Assessment                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
|----------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>B. Consistency with the procurement strategy</b>                                                |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
| Consistency with the Infrastructure Planner's procurement strategy.                                | <p>We consider the competitive assessment processes were undertaken consistent with the procurement strategy in respect of all major elements. There was largely consistency with the planned process, with roles and responsibilities, and with the protocols for probity, information provision, correspondence and interaction between Transgrid and proponents. Deviations were documented and did not impact the outcome of the process.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
| <b>C. Consistency with the competitive assessment evaluation criteria</b>                          |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
| 1. Sufficient competitive tension exists such that a competitive outcome is likely to be achieved. | <p>We are satisfied that each competitive assessment process met this criterion. Tenderers were invited to participate in the processes based on a demonstrated ability and willingness to undertake the roles. All invited tenderers actively participated in the RFT phases and submitted bids, and 2 proponents remained active until the end of each process.</p> <p>For the synchronous condenser package, the evaluation team commenced negotiations with the top 3 ranked tenderers before agreeing to shortlist the top 2 tenderers for further negotiations. The best and final offers demonstrated that both tenderers could effectively undertake the project. While negotiations on the long-term service agreement continued after the selection of the preferred tenderer, a term sheet for key terms of the contract was agreed under competitive tension. The only material difference between the term sheet and the contract was to move certain requirements from the base contract sum to a provisional sum due to uncertainty in the required scope of work.</p> <p>For the associated works package, the evaluation team shortlisted the top 2 ranked tenderers for the negotiation phase and both submitted a best and final offer. Although both shortlisted proponents were awarded contracts, competitive tension was maintained during negotiations as site allocations were undecided and it was possible that one proponent could have been awarded all 5 sites. Engagement by both parties during negotiations and their willingness to consider adjusting positions on departures indicated they recognised ongoing competitive tension.</p> |
| 2. The assessment process supports detailed, credible, and compliant submissions from proponents.  | <p>We consider that the tenderers in each competitive assessment process were provided with sufficient information to make detailed, credible and compliant submissions.</p> <p>The RFT documentation provided to tenderers clearly set out processes and the project scope and included returnable schedules that linked directly to the evaluation criteria. Proponents were provided opportunities to seek clarifications from Transgrid in a fair and transparent manner, including via a Q&amp;A platform, interim submissions and interactive workshops.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |

| Criteria                                                                                                  | Assessment                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
|-----------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|                                                                                                           | <p>Timeframes for the process allowed participants to develop compliant submissions. The Infrastructure Planner granted extensions of time for bid submissions, where appropriate, including where changes to project requirements or scope were introduced. All major non-conformances with the submissions were addressed and all tenderers were deemed sufficiently compliant for evaluation.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
| <p>3. The decision-making, governance and probity arrangements ensure a fair and rigorous process.</p>    | <p>Decision-making processes and governance processes were clear and carried out in accordance with the RFT documentation, procurement strategy, evaluation plans and negotiation plans. For example, bids were assessed in detail by subject matter experts and the risks associated with bid departures were incorporated into the evaluation to allow for like-for-like comparisons.</p> <p>The tender evaluation committee and tender review panel comprised personnel from both Transgrid and NSW DCCEE. NSW DCCEE appointed an independent observer (Procurement Co) to provide additional oversight of the process. The independent observer did not identify any compliance concerns in relation to adherence with our Contestable Guideline.</p> <p>Transgrid appointed an independent probity advisor (RSM Australia), who observed all evaluation and negotiation meetings and provided advice on probity issues. The probity advisor reported that there were no material probity risks that had not been addressed and they were not aware of any non-compliance with their probity advice.</p> |
| <p>4. The outcomes of the competitive assessment process can be reflected in a revenue determination.</p> | <p>We were satisfied that the outcomes from the competitive assessment processes could be reflected in a revenue determination as they included:</p> <ul style="list-style-type: none"> <li>• a total contractual sum and milestone payments to be made by Transgrid to the successful tenderers, which could be reflected in a capital cost profile for our revenue model, and</li> <li>• a defined risk allocation, which was set out in contractual variation clauses.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |

## 3 Revenue determination process

### 3.1 Revenue proposal

On 22 April 2026, Transgrid submitted a compliant revenue proposal for the System Strength Project with total capital expenditure (capex) of \$1,185.0 million (\$ September, 2026) and proposed total revenue of \$400.8 million (\$ nominal) over the 2026–31 period with regulatory years starting on 1 October and ending on 30 September.<sup>28</sup> Table 3.1 below summarises the building block revenue proposed by Transgrid.

**Table 3.1 Transgrid’s proposed building block revenue (\$ million, nominal) for the System Strength Project over the 2026–31 period**

| Building block                 | Revenue proposal |
|--------------------------------|------------------|
| Return on capital              | 339.9            |
| Regulatory depreciation        | –5.8             |
| Opex                           | 66.3             |
| Revenue adjustments            | -                |
| Cost of corporate income tax   | 0.4              |
| <b>Maximum allowed revenue</b> | <b>400.8</b>     |

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. We commenced the first round of consultation on the proposal to help us identify the most material and/or contentious issues for the preliminary position paper. Submissions were open for 15 business days and closed on 18 May 2026. We received three submissions on the revenue proposal which were also published on our website.

### 3.2 Preliminary position paper

The preliminary position paper is designed to focus on identifying and discussing key issues arising from a Network Operator’s revenue proposal. Our Non-contestable Guideline states that we aim to publish the preliminary position paper approximately 55 business days after receiving a compliant revenue proposal.<sup>29</sup>

<sup>28</sup> The quarterly payments, which sum to \$390.8 million (\$ nominal), are less than the proposed revenue because the quarterly payments bring forward portions of each annual payment which are discounted at the relevant rate of return. See: Transgrid, *M.6 – System Strength Project 2026– 31 – EII Post Tax Revenue Model (PTRM)*, April 2026.

<sup>29</sup> AER, *Revenue determination guideline for NSW non-contestable projects*, August 2026, p. 47.

On 30 June 2026, we published a preliminary position paper for the System Strength Project and sought submissions by 28 July 2026.<sup>30</sup> Stakeholders also had the opportunity to ask questions at our public forum on 16 July 2026.

In our preliminary position paper, we focused on two focus issues: risk, and labour and indirect costs.<sup>31</sup> For these focus issues, our preliminary position was that we:

- Risk
  - were continuing to assess the inputs and assumptions for non-contestable capex risk costs and how they were linked to provisional sums and adjustment mechanisms.
  - did not accept that the proposed provisional sums (capex and opex) and contractual adjustment mechanisms were an outcome of the genuine and appropriate competitive assessment process, and therefore should be subject to a non-contestable assessment.
  - were continuing to assess the Middle East contractual adjustment mechanisms.
  - proposed to replace the 3 proposed non-contestable transport works adjustment mechanisms with a single mechanism that would trigger a review and remake of the determination.
- Labour and indirect costs
  - were likely to allow a partial recovery of Transgrid's RIT-T costs as part of Transgrid's pre-period project development capex.
  - were continuing to assess project delivery management costs and whether there were overlaps with risk costs, provisional sums and adjustment mechanisms.

On other areas of Transgrid's proposal, our preliminary position was that we:

- were likely to accept Transgrid's approach to calculating total revenue, schedule of payments (including its revised end of the quarter payment dates), closing regulatory asset base, regulatory depreciation, corporate income tax, and the 12 remaining standard non-contestable adjustment mechanisms.
- were likely to find Transgrid's remaining non-contestable capex and opex proposals to be prudent, efficient and reasonable.
- accepted that all capex and opex proposed by Transgrid as contestable (other than provisional sums) were the outcome of a genuine and appropriate competitive assessment process.
- were likely to decide on applying the efficiency benefit sharing scheme (EBSS) to non-contestable opex at the end of the 2026–31 regulatory period.
- were continuing to assess Transgrid's approach to calculating forecast inflation and its pre-period weighted average cost of capital (WACC)s.

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<sup>30</sup> Our Non-contestable Guideline sets out a consultation period of minimum 20 business days on our preliminary position paper. See: AER, *Revenue determination guideline for NSW non-contestable projects*, August 2026, p. 47.

<sup>31</sup> AER, *Preliminary position paper – Transgrid – System Strength Project 2026–31*, June 2026.

- were continuing to assess the application of the CESS to the costs arising from the Middle East Conflict and transport works, but were likely to apply the CESS to the remaining non-contestable capex.

### 3.2.1 Transgrid submission on the preliminary position paper

On 28 July 2026, Transgrid made a submission on our preliminary position paper.

Transgrid's submission stated that it accepted our preliminary positions except for:

- **RIT-T-related pre-period costs:**<sup>32</sup> Transgrid did not agree with our preliminary position of allowing only a portion of these RIT-T costs to be recovered as part of the System Strength Project's pre-period costs, due to concerns with cost recovery delays and the recoverability of any costs excluded from the System Strength Project if future NER based revenue proposals related to system strength do not proceed as planned.
- **Contractual adjustment mechanisms:**<sup>33</sup> Transgrid was concerned with our preliminary position that the process for determining contract variation amounts was not sufficiently specified or robust to give confidence that costs will be prudent, efficient and reasonable. Transgrid specifically noted that:
  - it should be given a reasonable opportunity to respond, particularly where the AER's proposed approach may significantly impact Transgrid's risk exposure
  - our preliminary position may shift the framework towards oversight regulation rather than incentive-based regulation, imposing a significant administrative burden on both Transgrid and the AER
  - 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
  - if we approve a risk allowance for some risk events, rather than an adjustment mechanism, it 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.
- **Provisional sums:**<sup>34</sup> Transgrid accepted our preliminary position to not accept provisional sums (capex and opex) were an outcome of the genuine and appropriate competitive assessment process. However, it proposed that with the inclusion of additional safeguards the provisional sums should be addressed through its contestable adjustment mechanisms. Alternatively, it proposed recovering the risks originally covered by the provisional sums via either adjustment mechanism or risk cost allowance, depending on their nature. Under this alternative approach, it proposed 3 new adjustment mechanisms (for site conditions, design changes, and third-party requirements) to replace the 5 contractual adjustment mechanisms in its revenue proposal.

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<sup>32</sup> Transgrid, *Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, p. 6.

<sup>33</sup> Transgrid, *Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, pp. 8–9.

<sup>34</sup> Transgrid, *Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, pp. 9–11.

- **Transport adjustment mechanisms:**<sup>35</sup> Transgrid was concerned with our preliminary position to review and remake the determination after the major and council-related transport works contracts were executed. It considered this would result in unacceptable uncertainty and cost-recovery risk. Transgrid instead sought an adjustment mechanism that would provide upfront assurance of actual cost recovery, referring to the Transgrid Advisory Council's (TAC) support for this approach and the NER contingent project provisions as a precedent (Non-network options arrangements). It also considered that CESS should not be applied to these costs as they are not related to its core business or are beyond its control.<sup>36</sup>
- **Risk and cost allocation:**<sup>37</sup> Transgrid noted our preliminary position that we were continuing to assess the inputs and assumptions for non-contestable capex risk costs and project delivery management costs. Transgrid also confirmed that there was no duplication between risks costs, project delivery management costs and the proposed adjustment mechanisms. Transgrid maintained its position that the risk costs were appropriately allocated, given the circumstances, and with no duplication of costs.
- **Middle East Conflict and CESS:**<sup>38</sup> Transgrid noted our preliminary position that it is reasonable for costs arising from the Middle East Conflict to be reflected in Transgrid's revenue determination, but that we were continuing to assess a CESS exclusion for these costs. Transgrid observed that these costs were fixed costs so would have no CESS impact.

Transgrid's submission also provided comments in relation to its stakeholder engagement which we discuss in section 5.

### 3.2.2 AER consultation requirements under the EII Framework

We are required to consult with the Infrastructure Planner before making our revenue determination.<sup>39</sup> We met with NSW DCCEEW on a fortnightly basis in the lead up to and during our assessment of Transgrid's 2026–31 System Strength Project revenue proposal. During these meetings we discussed and considered NSW DCCEEW's comments or concerns regarding various aspects of the System Strength Project. Topics of discussion included pre-period project development costs, treatment of provisional sums, transport works upgrades, adjustments related to the contracts from the contestable packages, and the timing of financial close and the proposed regulatory period start date.

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<sup>35</sup> Transgrid, *Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, p. 11.

<sup>36</sup> Transgrid, *Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, p. 2.

<sup>37</sup> Transgrid, *Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, p. 12.

<sup>38</sup> Transgrid, *Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, pp. 13–14.

<sup>39</sup> EII Regulation, cl. 49(1).

## 4 Our final decision

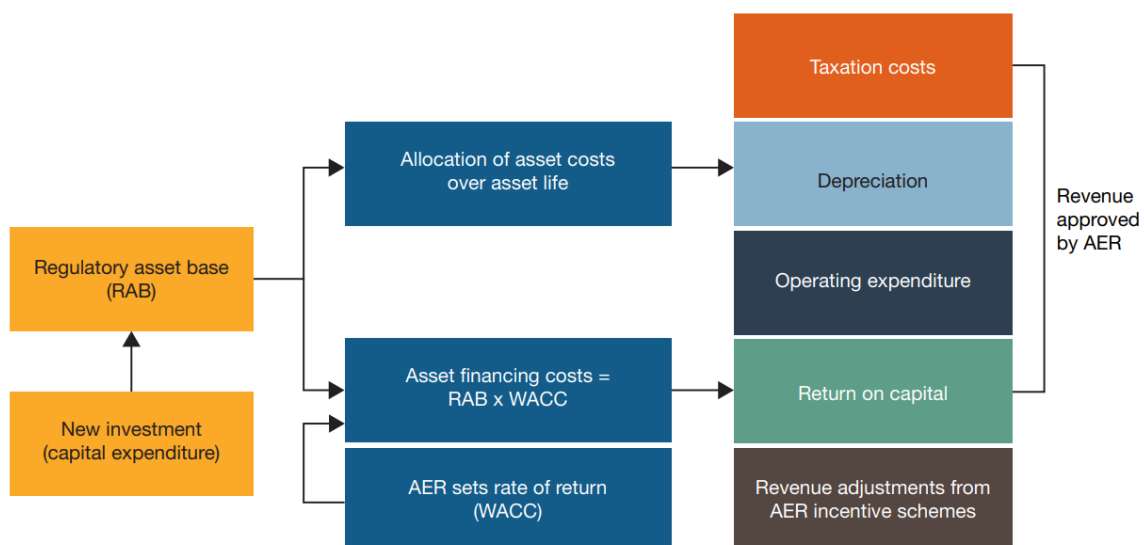
### 4.1 Key components of our final decision

The foundation of our regulatory approach is a benchmark incentive framework for setting maximum allowed revenues: once regulated revenues are set for the 5-year period, a network that keeps its actual costs below the regulatory forecast of costs retains part of the benefit. This provides an incentive for service providers to become more efficient over time. It delivers benefits to consumers as efficient costs are revealed over time and drives lower cost benchmarks in subsequent regulatory periods. By only allowing efficient costs in our approved revenues, we ensure consumers pay no more than necessary for the safe and reliable delivery of electricity.

Transgrid's proposed revenue reflects its forecast of the efficient cost of providing regulated network services over the 2026–31 period. The revenue proposal, and our assessment of it under the EII Act, are based on a 'building block' approach which looks at five cost components (Figure 4.1):

1. return on the regulatory asset base (RAB) – or return *on* capital, to compensate investors for the opportunity cost of funds invested in this business
2. depreciation of the RAB – or return *of* capital, to return the initial investment to investors over time
3. forecast opex – the operating, maintenance, and other non-capital expenses, incurred in the provision of network services
4. revenue increments/decrements – results from the application of incentive schemes in previous periods, such as the EBSS or the CESS. As this is our first determination for the System Strength Project, there are no revenue increments or decrements
5. estimated cost of corporate income tax.

**Figure 4.1 The building block model to forecast network revenue**



As flagged in our preliminary position paper, we have undertaken further assessment of Transgrid's remaining non-disclosure claims in the publication of our final decision. Pursuant to clause 53(6) of the EII Regulation, we have exercised our discretion not to publish part of the revenue determination and reasons subject to the claims as we are satisfied that it is not appropriate to do so, taking into account the following three factors:

- the public interest
- the extent to which publishing the part of the revenue determination would disclose information that is confidential or commercially sensitive
- the effect of publishing the part of the revenue determination on future competitive assessment processes.

Transgrid has constructively engaged with us on its non-disclosure claims throughout our determination process. This allowed us to minimise the scope of non-disclosure claims, thereby enabling stakeholders to engage effectively with the relevant components of the proposal and our preliminary position.

We expect Network Operators to ensure all non-disclosure claims are made in accordance with our Non-disclosure Guideline.<sup>40</sup> This guideline sets out comprehensive guidance on how we will make and assess non-disclosure claims under the EII Act. We also detail our expectations on how Network Operators should engage with us, both prior to submission as well as throughout the revenue determination process.

## 4.2 Key differences between our final decision and Transgrid's proposal

Over the 2026–31 period, the key differences between our final decision and Transgrid's proposal for the System Strength Project relate to our:

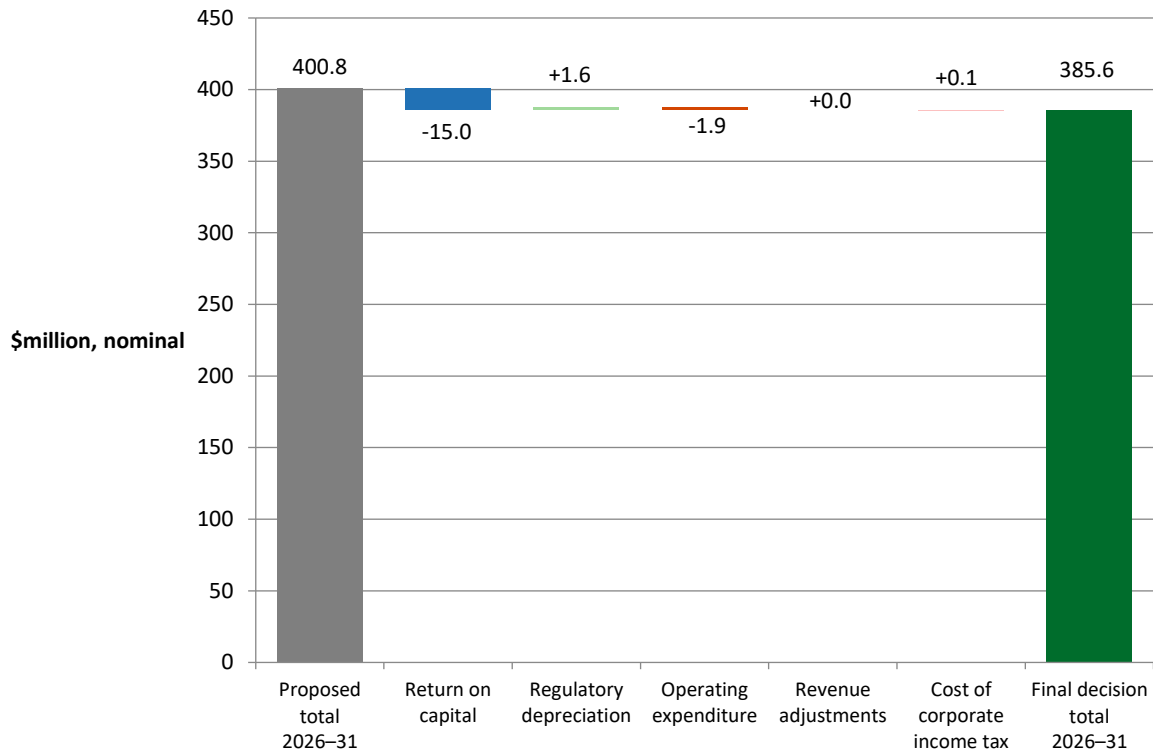
- lower return on capital, which is a result of several aspects of our decision:
  - lower capex, due to our decision to remove provisional sums and replace this with a risk cost allowance for a subset of the identified risks (section 10)
  - higher rate of return, driven by a higher forecast rate of return of 7.37% compared to Transgrid's proposed forecast rate of return of 7.05% (section 8).
- marginally higher return of capital (depreciation), resulting from lower indexation on the RAB which reduces regulatory depreciation (section 9)

Figure 4.2 below compares our final decision blocks with Transgrid's proposal.

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<sup>40</sup> AER, *Non-disclosure Guideline – Electricity Infrastructure Investment Act 2020 (NSW)*, July 2026.

**Figure 4.2 Comparison of building blocks between proposal and final decision (\$ million, nominal)**



Source: AER analysis; Transgrid, *M.6 – System Strength Project 2026–31 – EII Post Tax Revenue Model (PTRM)*, April 2026.

## 5 Stakeholder engagement

We expect that a Network Operator will use its best endeavours to engage with stakeholders ahead of submitting its revenue proposal to us. This engagement may include, but is not limited to, consulting stakeholders on the nature of the project through to the costs it proposes to incur to meet the requirements of the Consumer Trustee’s authorisation or the Minister’s authorisation or Direction.

We also expect that a Network Operator, where it is relevant and appropriate, will demonstrate it has incorporated the findings of its pre-lodgement stakeholder engagement into its revenue proposal. We consider the outcomes of the consumer engagement process and stakeholder submissions when making our decisions.

Further guidance on our expectations for consumer engagement is in our Non-contestable Guideline.<sup>41</sup>

### 5.1 Transgrid’s consumer engagement

The Transgrid Advisory Council (TAC) was Transgrid’s primary forum for engagement on all regulatory issues, comprising consumer, business and industry stakeholders. The TAC was replaced by the Consumer Advisory Group (CAG), in February 2026. The TAC met 11 times between March 2023 and February 2026.

The first 8 TAC meetings, up until August 2025, covered Transgrid’s broader system strength strategy. The last 3 TAC meetings were focused on the System Strength Project and included deep dive sessions on key aspects of Transgrid’s proposal, including engagement approach, allocation of risk, adjustment events and revenue proposal elements.<sup>42</sup> AER staff attended some of these TAC meetings as observers and the AER’s CCP35 independently met with some of the TAC members to gain insight into their views on Transgrid’s consumer engagement.<sup>43</sup> 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.

In our preliminary position paper, we recognised Transgrid had demonstrated efforts to improve its consumer engagement following the 2026–31 Enabling CWO Project revenue determination. This included establishing an informal system strength sub-committee supported by deep dive sessions, providing clear and timely engagement materials, and improving the focus of its engagement (e.g. moving towards a more consumer-focused CAG). However, we were of the view Transgrid’s engagement could be further improved.

At the System Strength Project public forum and in her written submission to our preliminary position paper, CCP35 member Helen Bartley raised concerns that the CCP had not been engaged early enough in the process. This limited the effectiveness of the advice she could

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<sup>41</sup> AER, *Transmission Efficiency Test and revenue determination guideline for non-contestable network infrastructure projects*, August 2026, pp. 17–18.

<sup>42</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, pp. 37–39.

<sup>43</sup> Consumer Challenge Panel (CCP) Sub-Panel 35, *Submission – System Strength Project – 2026–31 Revenue Proposal*, May 2026, p. 4.

provide because she was unable to directly observe all of Transgrid’s earlier engagement. CAG members Louise Benjamin and Gavin Dufty raised a similar issue in their submission on our preliminary position paper.<sup>44</sup> We agree that for this process, the CCP’s late appointment was not ideal and limited the advice it could provide on Transgrid’s consumer engagement.

Following a recent review, we have revised our CCP terms of reference. The revised approach places greater emphasis on the CCP ensuring AER determinations reflect long-term interests of consumers. We expect the CCP to achieve this by providing targeted independent expert advice on key issues affecting consumers in regulatory proposals and whether consumer views are appropriately reflected in the solutions proposed by the Network Operator. Should we engage the CCP for future network projects under the EII framework, we will ensure that it is able to perform its role within the framework provided by these revised terms of reference.

Louise Benjamin and Gavin Dufty also questioned the extent to which the CAG could engage on certain issues, citing the provisional sums in Transgrid’s proposal as an example. They submitted that the CAG was not advised prior to lodgement of the revenue proposal that these provisional sums were likely to be treated as non-contestable expenditure by the AER, which limited its ability to examine Transgrid’s approach. They also queried how the CAG could have meaningfully contributed to the AER’s technical assessment of these costs, even if the issue had been raised.

We note the issues raised around the consideration of provisional sums. Our general expectation is that Transgrid should, as part of its early stakeholder engagement, present related issues holistically (such as provisional sums alongside its risk allowance and adjustment mechanisms) and give consumers meaningful opportunities to test and influence a revenue proposal, including to comment on new or novel approaches.

We acknowledge the improvements Transgrid has made to its stakeholder engagement since its last revenue determination for the CWO Enabling Project, as set out in its submission highlighting the depth and breadth of its engagement. We also recognise that engagement in relation to EII projects operates within a more constrained environment compared to NER projects, involving predefined project scopes, tight timeframes, and a higher proportion of commercially sensitive information. Therefore, expectations around stakeholder engagement should differ from those applying under the national framework.

Transgrid’s submission stated that it was working closely with the CAG to improve engagement on current and future EII projects. Both CCP35 and Louise Benjamin and Gavin Dufty’s submissions also commented on the CAG’s role in future EII projects, with Louise Benjamin and Gavin Dufty proposing principles to guide future engagement. We note Transgrid’s ongoing development of its engagement approach with its CAG members (for example, its willingness to work with the CAG on principles to guide consultation on future EII projects). This demonstrates a commitment to the CAG and a proactive approach to addressing issues identified by stakeholders in the context of the EII framework. We will

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<sup>44</sup> Louise Benjamin and Gavin Dufty, *Late Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, p. 4.

continue to attend CAG meetings for future EII projects, where our role is primarily as an independent observer to Transgrid’s pre-lodgement engagement activities as part of developing its revenue proposal.

## 5.2 Stakeholder submissions

We received three submissions in May 2026 in response to Transgrid’s revenue proposal. We considered these submissions in our preliminary position paper, which was published on 30 June 2026.<sup>45</sup>

We also received three submissions on our preliminary position paper (including one from Transgrid). Stakeholders were also given the opportunity to attend and present on Transgrid’s proposal and our preliminary position paper at a 16 July 2026 public forum.

Table 5.1 below lists the submissions we received for both Transgrid’s proposal and our preliminary position paper.

**Table 5.1 Submissions on Transgrid’s proposal and our preliminary position paper**

| Submission on Transgrid’s proposal <sup>46</sup> | Submission on our preliminary position paper <sup>47</sup> |
|--------------------------------------------------|------------------------------------------------------------|
| Consumer Challenge Panel (CCP35)                 | Consumer Challenge Panel (CCP35)                           |
| Centre for Smart Power and Energy Research       | Louise Benjamin and Gavin Dufty                            |
| Justice and Equity Centre                        | Transgrid                                                  |

Note: Louise Benjamin and Gavin Dufty are members of Transgrid’s CAG.

We appreciate stakeholders providing submissions on Transgrid’s proposal and our preliminary position paper. Stakeholder perspectives are critical to good decision making and ensuring a transparent and balanced approach in our revenue determination process.

### 5.2.1 Specific issues relating to components of our final decision

The submissions from CCP35 and from Louise Benjamin and Gavin Dufty on our preliminary position paper raised a number of issues specific to the System Strength Project, including:

- Transgrid’s stakeholder engagement process (see discussion in section 5.1 above).
- Risk and risk allocation including risk allowances, CESS and adjustment mechanisms (see discussion in sections 10, 13 and 14).

We have considered stakeholder feedback on the preliminary position paper, including a submission from Transgrid, in coming to our final decision. Our consideration of specific

<sup>45</sup> AER, *Preliminary position paper – Transgrid – System Strength Project 2026–31*, June 2026, pp. 21–25.

<sup>46</sup> Stakeholders had 15 business days to provide submissions on the revenue proposal between 24 April 2026 and 18 May 2026.

<sup>47</sup> Stakeholders had 20 business days to provide submissions on the preliminary position paper between 30 June 2026 and 28 July 2026.

stakeholder feedback on each individual component of our decision is reflected in the relevant sections of this final decision.

## 5.2.2 Matters omitted from our preliminary position paper

CCP35 and Louise Benjamin and Gavin Dufty submitted that our preliminary position paper did not address some key concerns raised by the CAG during pre-lodgement engagement on the System Strength Project.<sup>48</sup> These concerns related to noise impacts and the inclusion of transport works in Transgrid's revenue proposal.

We acknowledge these concerns and set out our response to the issues raised in relation to noise impacts and the inclusion of transport works in Transgrid's revenue proposal below.

### 5.2.2.1 Noise impacts

CCP35's submission on Transgrid's revenue proposal highlighted potential noise impacts in the five communities hosting synchronous condensers and insufficient detail on proposed environmental and community engagement risk costs. Similarly, Louise Benjamin and Gavin Dufty's submission on Transgrid's revenue proposal stated that the AER should acknowledge and respond to consumer concerns, such as noise impacts, raised during pre-lodgement engagement.<sup>49</sup>

We acknowledge TAC members raised potential noise impacts during TAC meetings and understand that Transgrid's proposal included additional capex associated with noise mitigation in response to these concerns. Our preliminary position paper did not explicitly identify this as a focus issue due to the relative materiality of the matter. However, our final decision has considered whether expenditure associated with noise impacts was prudent, efficient and reasonable as part of our broader assessment of total capex (section 10).

### 5.2.2.2 Inclusion of transport works in Transgrid's proposal

Both the CCP35 and Louise Benjamin and Gavin Dufty submissions questioned why Transgrid would manage road widening and bridge works when these activities are not part of its core business. They also raised the cost risk for consumers and held concerns on whether the AER had the specialist expertise to assess this expenditure.<sup>50</sup> Louise Benjamin and Gavin Dufty further submitted that including these works could create a precedent for expanding the scope of future Roadmap projects.<sup>51</sup>

TAC members discussed transport works during TAC meetings, questioning why the NSW Government would not fund the required road and bridge works and raising concerns about

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<sup>48</sup> Consumer Challenge Panel 35, *Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, pp. 5 & 16, Louise Benjamin and Gavin Dufty, *Late Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, pp. 4–6.

<sup>49</sup> Consumer Challenge Panel 35, *Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, p. 16, Louise Benjamin and Gavin Dufty, *Late Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, pp. 6.

<sup>50</sup> Consumer Challenge Panel 35, *Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, p. 16, Louise Benjamin and Gavin Dufty, *Late Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, pp. 10–11.

<sup>51</sup> Louise Benjamin and Gavin Dufty, *Late Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, p. 11.

ownership and ongoing maintenance of the upgraded assets. Transgrid noted the TAC's position in its revenue proposal.<sup>52</sup>

The PNIP Direction was specifically amended in March 2026 to extend the scope of the System Strength Project to include transport works. Our preliminary position paper, while addressing transport works, did not expressly refer to this change to the PNIP Direction. We took this approach on the basis that under the EII framework we do not have a role in deciding on the project scope in the PNIP Direction, rather it was a matter for the NSW Government.

As set out in section 14 of this final decision, if Transgrid seeks to recover transport works costs, the AER's role under the EII framework is to determine whether the works are consistent with the PNIP Direction and that the proposed costs are prudent, efficient and reasonable. To support our assessment of any future adjustment related to transport works, we have encouraged Transgrid to provide us with independent expert advice justifying its proposed works and associated costs. We may also engage our own expert consultant to assist us in our assessment of major transport works where we consider it necessary.

### **5.2.3 Consumer engagement in future EII framework projects**

Both the CCP35 and Louise Benjamin and Gavin Dufty submissions included discussion on the approach to consumer engagement for future EII projects, emphasising the need to focus on matters consumers can influence, acknowledging the constraints of the EII framework, and calling for the roles of the AER, Transgrid, the CCP and the CAG to be more clearly defined.

These are important matters which need to be carefully considered. We believe it is critical that electricity consumers, where possible, be informed, and are able to participate in the revenue determination process for the projects that they ultimately pay for. This supports transparency in the costs and benefits associated with projects and promotes confidence in the EII framework. As noted in section 5.1, we acknowledge that features of the EII framework such as predefined project scopes, tight timeframes and a higher proportion of commercially sensitive information may affect effective consumer engagement. As the EII framework matures and we conduct more revenue determinations, we will continue to develop our expectations around what constitutes effective engagement, including the CCP's role in that framework.

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<sup>52</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 39.

## 6 Total revenue and schedule of payments

This section sets out our final decision on the total revenue to be recovered by Transgrid for the System Strength Project over the 2026–31 regulatory control period.

We determine Transgrid's total revenue cap for the period as the sum of its annual building block revenue requirements, using a building block approach.<sup>53</sup> The quarterly schedule of payments is derived from the annual building block revenue requirement, in accordance with the EII Regulation and our Non-contestable Guideline.<sup>54</sup> Our final decision determines the total revenue Transgrid is entitled to recover for the ongoing ownership, control and operation of the System Strength Project, commensurate with the regulatory and commercial risks.<sup>55</sup>

Our assessment approach to determining total revenue and the schedule of payments is detailed in section 2 of our assessment approach guidance note.<sup>56</sup>

### 6.1 Transgrid's proposal

Transgrid's revenue proposal included a total revenue of \$400.8 million (\$ nominal) for the 2026–31 period. Transgrid used the EII post-tax revenue model (PTRM), which is the NER PTRM modified for EII non-contestable determinations, to calculate its total revenue.

Table 6.1 and Table 6.2 respectively set out Transgrid's proposed total revenue cap and quarterly schedule of payments and the dates on which it is to be paid for the System Strength Project.<sup>57</sup>

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53 EII Chapter 6A, cl. 6A.4.2(a)(1) to (2), 6A.14.1(1)(i) to (ii) and 6A.5.4(a).

54 EII Regulation, cl. 52(1) to (2); AER, *Revenue determination guideline for NSW non-contestable projects*, August 2026, p. 19.

55 EII Act, s. 37(1)(c).

56 AER, *Guidance note the on AER's EII assessment approach for non-contestable revenue determinations*, August 2026, pp. 3–5.

57 Transgrid, *M.6 – System Strength Project 2026–31 – EII Post Tax Revenue Model (PTRM)*, April 2026.

**Table 6.1 Transgrid’s proposed annual building block revenue requirement and estimated total revenue cap (\$ million, nominal)**

|                                                  | 2026–27     | 2027–28     | 2028–29     | 2029–30      | 2030–31      | Total                    |
|--------------------------------------------------|-------------|-------------|-------------|--------------|--------------|--------------------------|
| Return on capital                                | 22.4        | 56.5        | 83.3        | 89.1         | 88.7         | 339.9                    |
| Regulatory depreciation <sup>a</sup>             | –8.4        | –7.7        | –2.2        | 5.6          | 6.8          | –5.8                     |
| Operating expenditure <sup>b</sup>               | 0.7         | 7.6         | 17.1        | 19.4         | 21.6         | 66.3                     |
| Revenue adjustments                              | -           | -           | -           | -            | -            | -                        |
| Net tax allowance                                | 0.4         | -           | -           | -            | -            | 0.4                      |
| <b>Annual building block revenue requirement</b> | <b>15.0</b> | <b>56.4</b> | <b>98.3</b> | <b>114.1</b> | <b>117.1</b> | <b>400.8<sup>c</sup></b> |

Source: Transgrid, M.6 – System Strength Project 2026–31 – EII Post Tax Revenue Model (PTRM), April 2026.

Note: Totals may not sum due to rounding.

a) Regulatory depreciation is straight-line depreciation net of the inflation indexation on the opening RAB.

b) Includes debt raising costs.

c) The estimated total revenue cap is equal to the total annual building block revenue requirement.

**Table 6.2 Transgrid’s proposed schedule of payments (\$ nominal)**

|         | Quarter 1<br>(31 December) | Quarter 2<br>(31 March) | Quarter 3<br>(30 June) | Quarter 4<br>(30 September) | Total              |
|---------|----------------------------|-------------------------|------------------------|-----------------------------|--------------------|
| 2026–27 | 3,557,618                  | 3,618,720               | 3,680,872              | 3,744,090                   | <b>14,601,300</b>  |
| 2027–28 | 13,407,132                 | 13,639,399              | 13,871,621             | 14,109,866                  | <b>55,026,017</b>  |
| 2028–29 | 23,339,677                 | 23,740,536              | 24,148,279             | 24,563,025                  | <b>95,791,518</b>  |
| 2029–30 | 27,101,774                 | 27,567,247              | 28,040,713             | 28,522,312                  | <b>111,232,046</b> |
| 2030–31 | 27,810,119                 | 28,287,758              | 28,773,599             | 29,267,785                  | <b>114,139,261</b> |

Source: Transgrid, M.6 – System Strength Project 2026–31 – EII Post Tax Revenue Model (PTRM), April 2026; Transgrid, System Strength Project 2026–31 – Revenue Proposal, April 2026, p. 144.

Note: Totals may not sum due to rounding.

## 6.2 AER final decision

### 6.2.1 Total amounts and components

We determine a total revenue of \$385.6 million (\$ nominal) for Transgrid for the 2026–31 period which is set out in Table 6.3 below. This is a decrease of \$15.2 million (3.8%) from Transgrid’s proposed total revenue of \$400.8 million for this period. This decrease reflects the net impact of our final decision on the various building block costs.

**Table 6.3 AER final decision on Transgrid’s annual building block revenue requirement and estimated total revenue cap (\$ million, nominal)**

|                                           | 2026–27     | 2027–28     | 2028–29     | 2029–30      | 2030–31      | Total                    |
|-------------------------------------------|-------------|-------------|-------------|--------------|--------------|--------------------------|
| Return on capital                         | 23.9        | 56.7        | 78.6        | 83.1         | 82.6         | 324.9                    |
| Regulatory depreciation <sup>a</sup>      | –8.2        | –8.1        | –1.5        | 6.3          | 7.3          | –4.1                     |
| Operating expenditure <sup>b</sup>        | 0.7         | 7.7         | 17.1        | 19.4         | 19.4         | 64.4                     |
| Revenue adjustments                       | -           | -           | -           | -            | -            | -                        |
| Net tax allowance                         | 0.5         | -           | -           | -            | -            | 0.5                      |
| Annual building block revenue requirement | <b>16.9</b> | <b>56.3</b> | <b>94.3</b> | <b>108.8</b> | <b>109.4</b> | <b>385.6<sup>c</sup></b> |

Source: AER analysis.

Note: Totals may not sum due to rounding.

a) Regulatory depreciation is straight-line depreciation net of the inflation indexation on the opening RAB.

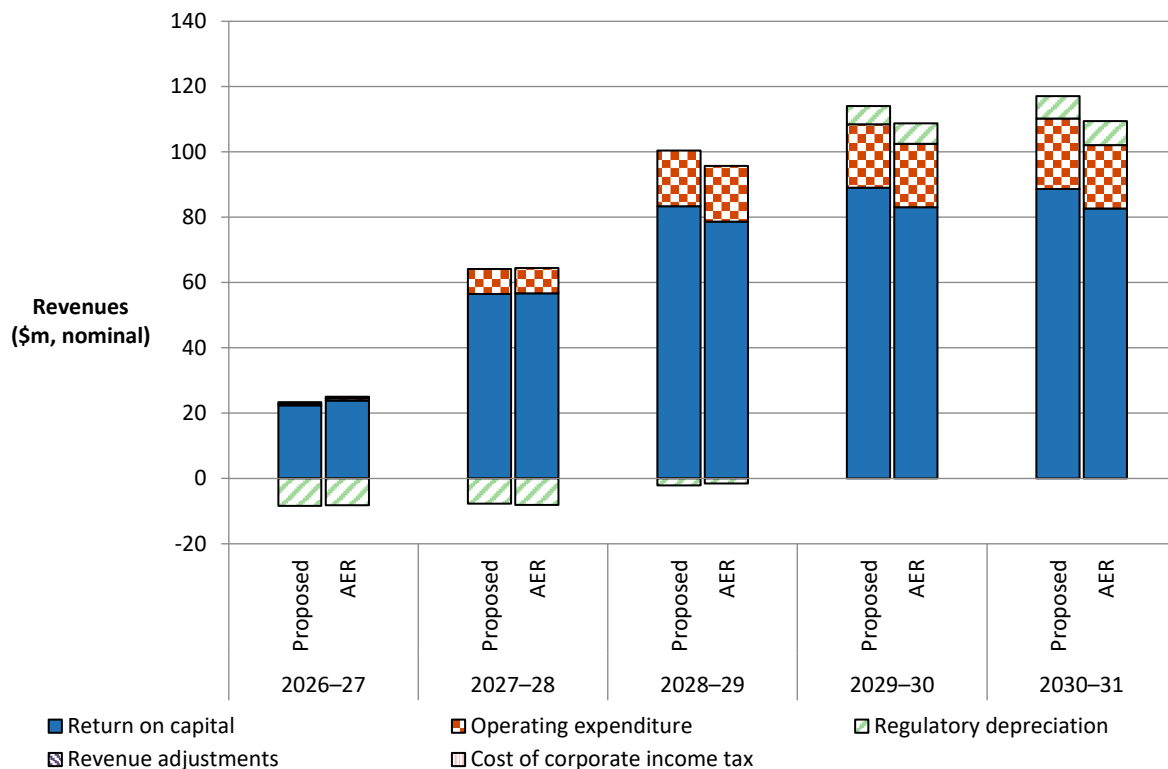
b) Includes debt raising costs.

c) The estimated total revenue cap is equal to the total annual building block revenue requirement.

Figure 6.1 compares the annual building block components from our determination with those from Transgrid’s proposal.

We have made the following changes to Transgrid’s proposed building blocks (\$ nominal):

- a decrease in return on capital of \$15.0 million (–4.4%) (sections 7, 8, 9, and 10)
- an increase of \$1.6 million (28.4%) in regulatory depreciation (sections 8 and 9)
- a decrease of \$1.9 million (–2.9%) in operating expenditure (sections 8 and 11)
- an increase of \$0.1 million in the cost of corporate income tax (section 12).

**Figure 6.1 Comparison of AER’s final decision and Transgrid’s proposed annual building block revenue requirement (\$ million, nominal)**

Source: AER analysis; Transgrid, M.6 – *System Strength Project 2026–31 – EII Post Tax Revenue Model (PTRM)*, April 2026.

Note: There are no revenue allowances associated with revenue adjustments for the System Strength Project for the 2026–31 period. Opex includes debt raising costs.

The primary driver of the overall decrease in revenues is the reduction in the return on capital building block, reflecting our final decision to not accept Transgrid’s provisional sums and substitute it with a risk allowance for a subset of the identified risks, resulting in us approving a lower forecast capex for the 2026–31 period (section 10.2). This building block is responsible for a \$15.0 million decrease in revenues (or 98.8% of the overall \$15.2 million decrease).

## 6.2.2 Schedule of payments and payment dates

Our final decision is to determine a quarterly schedule of payments totalling \$381.2 million (\$ nominal) over the 5 years of the 2026–31 period.<sup>58</sup> This is \$9.6 million (2.4%) lower than Transgrid’s proposal of \$390.8 million. The difference reflects our decision on the various components that make up the annual building block revenue requirement, as discussed in section 6.2.1 above.

<sup>58</sup> This is lower than our final decision for the total revenue because the quarterly schedule of payments is progressively recovered by the Network Operator throughout the year, as opposed to the annual building block revenue requirement which is a single annual amount. To ensure equality we determine a quarterly schedule of payments that is equal to revenues in net present value terms.

We accept Transgrid’s approach to calculating the schedule of payments. Transgrid has used the EII PTRM to calculate the schedule of payments, consistent with the requirements of the EII Regulation as well as what is set out in our assessment approach guidance note.<sup>59</sup>

We also accept Transgrid’s proposed dates on which the quarterly schedule of payments is to be paid, as they align with the payment calculations in the EII PTRM (that is, end of quarter payments).<sup>60</sup> We note that Transgrid’s revenue proposal contained two inconsistent dates for the quarterly schedule of payments between its Regulatory Information Notice response and its revenue proposal. In response to an information request, Transgrid acknowledged the error and confirmed that its proposal was for a quarterly payment schedule consistent with the final day of each quarter.<sup>61</sup> This is consistent with the payment calculations in the EII PTRM, which assumes end of quarter payments.

Table 6.4 sets out our final decision on the schedule of payments and the timing of each quarterly payment for the System Strength Project.

**Table 6.4 AER’s final decision schedule of payments and timing (\$ nominal)**

|         | Quarter 1<br>(31 December) | Quarter 2<br>(31 March) | Quarter 3<br>(30 June) | Quarter 4<br>(30 September) | Total              |
|---------|----------------------------|-------------------------|------------------------|-----------------------------|--------------------|
| 2026–27 | 4,017,251                  | 4,104,886               | 4,194,432              | 4,285,932                   | <b>16,602,501</b>  |
| 2027–28 | 13,540,836                 | 13,783,612              | 14,030,741             | 14,282,300                  | <b>55,637,489</b>  |
| 2028–29 | 22,683,863                 | 23,090,566              | 23,504,561             | 23,925,978                  | <b>93,204,968</b>  |
| 2029–30 | 26,182,520                 | 26,651,951              | 27,129,798             | 27,616,213                  | <b>107,580,482</b> |
| 2030–31 | 26,332,683                 | 26,804,806              | 27,285,394             | 27,774,599                  | <b>108,197,483</b> |

Source: AER analysis.

Note: Totals may not sum due to rounding.

<sup>59</sup> EII Regulation, cl. 52(2); AER, *Guidance note on the AER’s EII assessment approach for non-contestable revenue determinations*, August 2026, pp. 4–5.

<sup>60</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 144.

<sup>61</sup> 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.

## 7 Regulatory asset base

The regulatory asset base (RAB) is the value of the assets used by Transgrid to provide regulated network services.<sup>62</sup> Our revenue determination specifies the RAB as at the commencement of the regulatory period and the appropriate method for the indexation of the RAB throughout the period.<sup>63</sup>

The indexation of the RAB is one of the building blocks that form the annual building block revenue requirement for each year of the 2026–31 period.<sup>64</sup> We set the RAB as the foundation for determining a Network Operator's revenue requirements and use the opening RAB for each regulatory year to determine the return on capital and return of capital (regulatory depreciation) building blocks.<sup>65</sup>

This section presents our final decision on the opening RAB value as at 1 October 2026 for Transgrid and our forecast of its RAB values over the 2026–31 period. It also presents our final decision for establishing the RAB as at the commencement of the 2031–36 period using depreciation that is based on forecast capex.<sup>66</sup>

Our assessment approach for the RAB is detailed in section 3 of our assessment approach guidance note.<sup>67</sup>

### 7.1 Transgrid's proposal

Transgrid proposed an opening RAB of \$317.1 million as at 1 October 2026 (\$ nominal).<sup>68</sup> It is not required to use our roll forward model to determine an opening RAB for this revenue determination as this expenditure occurred prior to the first regulatory period (2026–31).

Transgrid's proposed opening RAB consists of:

- pre-period actual capex of \$33.7 million (\$ nominal) for costs incurred from December 2022 to January 2026 related to project development, consultation and RIT-T costs.
- pre-period forecast capex of \$271.5 million for costs incurred between February 2026 to September 2026 related to estimated contestable and non-contestable pre-period expenditure as well as \$2.0 million in Infrastructure Planner Fees (IPFs)<sup>69</sup>.

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<sup>62</sup> EII Chapter 6A, cl. 6A.6.1(a).

<sup>63</sup> EII Chapter 6A, cl. 6A.4.2(a)(3A) to (4) and 6A.14.1(5D).

<sup>64</sup> EII Chapter 6A, cl. 6A.5.4(a)(1) and (b)(1).

<sup>65</sup> EII Chapter 6A, cl. 6A.5.4(a)(2) to (3).

<sup>66</sup> EII Chapter 6A cl. S6A.2.2B(a).

<sup>67</sup> AER, *Guidance note on the AER's EII assessment approach for non-contestable revenue determinations*, August 2026, pp. 6–9.

<sup>68</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 95.

<sup>69</sup> This represents a portion of the total IPFs contained in Transgrid's proposal, discussed in more detail in section 10.2.3.

- financing costs of \$11.9 million to account for the timing difference between when Transgrid incurred its pre-period expenditures and when it rolls those expenditures into the opening RAB as at 1 October 2026.

Transgrid proposed a forecast closing RAB as at 30 September 2031 of \$1,251.2 million (\$ nominal). This value reflects its proposed opening RAB, expected inflation and rate of return, forecast net capex and straight-line depreciation over the 2026–31 period. Table 7.1 shows Transgrid's proposed projected RAB over the 2026–31 period.

**Table 7.1 Transgrid's proposed RAB for the 2026–31 regulatory period for the System Strength Project (\$ million, nominal)**

|                                               | 2026–27      | 2027–28        | 2028–29        | 2029–30        | 2030–31        |
|-----------------------------------------------|--------------|----------------|----------------|----------------|----------------|
| Opening RAB                                   | 317.1        | 801.6          | 1,182.1        | 1,263.7        | 1,258.1        |
| Capital expenditure <sup>a</sup>              | 476.0        | 372.8          | 79.5           | –              | –              |
| Inflation indexation on opening RAB           | 8.4          | 21.2           | 31.3           | 33.5           | 33.3           |
| Less: straight-line depreciation <sup>b</sup> | –            | 13.5           | 29.2           | 39.1           | 40.2           |
| <b>Closing RAB</b>                            | <b>801.6</b> | <b>1,182.1</b> | <b>1,263.7</b> | <b>1,258.1</b> | <b>1,251.2</b> |

Source: Transgrid, *M.6 – System Strength Project 2026–31 – EII Post Tax Revenue Model (PTRM)*, April 2026.

Note: Totals may not sum due to rounding.

a) As incurred, and net of forecast disposals. In accordance with the timing assumptions of the PTRM, the capex includes a half-year WACC allowance to compensate for the six-month period before capex is added to the RAB for revenue modelling. Includes equity raising costs.

b) Based on as commissioned capex.

## 7.2 AER final decision

We determine an opening RAB value for Transgrid of \$323.8 million (\$ nominal) as at 1 October 2026, an increase of \$6.7 million (2.1%) from the value proposed by Transgrid. We also forecast a closing RAB value of \$1,114.6 million by 30 September 2031. This represents a decrease of \$136.7 million (–10.9%) compared with Transgrid's proposal. The reasons for our final decision are discussed below.

### 7.2.1 Opening RAB as at 1 October 2026

This decision represents our first determination for Transgrid's System Strength Project as a new hybrid network infrastructure project under the EII Act. Ordinarily, new projects do not have an opening asset base, as there is no prior revenue determination with approved capex to establish an opening RAB.

However, Transgrid is required to incur capex prior to the start date of the first regulatory period of 1 October 2026 to meet the contracted commissioning dates for the System Strength Project, as set out in the Minister's PNIP Direction. To the extent that Transgrid is obligated to incur capex prior to our revenue determination, subject to our assessment of the

prudence, efficiency and reasonableness of that expenditure (section 10), an opening RAB needs to be established to account for this capex.<sup>70</sup>

To establish an opening RAB, we must decide on the prudent, efficient and reasonable capex incurred up to 1 October 2026, the start of the regulatory period. We determine an opening RAB value of \$323.8 million (\$ nominal) as at 1 October 2026, which is an increase of \$6.7 million (2.1%) from Transgrid's proposal. This difference relates to our decision to:

- not approve the entirety of Transgrid's RIT-T related costs, reducing pre-period actual capex by \$8.5 million (\$ nominal) (section 10)
- substitute provisional sums capex with a risk allowance for a subset of the identified risks, and to include the negotiated cost impacts of the Middle East conflict, which results in an increase in the pre-period capex by \$15.5 million (\$ nominal) (section 10).

We also provide a return on capital in rolling forward this capex, consistent with our Non-contestable Guideline, to compensate Transgrid for the period between it incurring these costs until an opening RAB is established whereupon it can start recovering revenue associated with this capex.<sup>71</sup> We have corrected for an error in the nominal WACCs proposed by Transgrid to roll forward pre-period capex over the period from 2022–23 to 2025–26. This is discussed in section 7.2.2 below.

## 7.2.2 Forecast closing RAB as at 30 September 2031

We forecast a closing RAB value of \$1,114.6 million (\$ nominal) by 30 September 2031 for Transgrid, which represents a decrease of \$136.7 million (10.9%) relative to Transgrid's proposal. The decrease reflects our final decision on the inputs for determining the forecast closing RAB in the PTRM. Our final decision uses the EII PTRM to forecast the closing RAB as at 30 September 2031.

Table 7.2 sets out our final decision on the forecast closing RAB values for Transgrid over the 2026–31 period.

**Table 7.2 AER's final decision on Transgrid's closing RAB for the 2026–31 regulatory period (\$ million, nominal)**

|                                               | 2026–27      | 2027–28        | 2028–29        | 2029–30        | 2030–31        |
|-----------------------------------------------|--------------|----------------|----------------|----------------|----------------|
| Opening RAB                                   | 323.8        | 769.3          | 1,067.3        | 1,128.2        | 1,121.9        |
| Capital expenditure <sup>a</sup>              | 437.3        | 289.9          | 59.4           | –              | –              |
| Inflation indexation on opening RAB           | 8.2          | 19.4           | 26.9           | 28.4           | 28.3           |
| Less: straight-line depreciation <sup>b</sup> | –            | 11.3           | 25.4           | 34.7           | 35.6           |
| <b>Closing RAB</b>                            | <b>769.3</b> | <b>1,067.3</b> | <b>1,128.2</b> | <b>1,121.9</b> | <b>1,114.6</b> |

Source: AER analysis

Note: Totals may not sum due to rounding.

<sup>70</sup> AER, *Revenue determination guideline for NSW non-contestable projects*, August 2026, pp. 27–28.

<sup>71</sup> AER, *Revenue determination guideline for NSW non-contestable projects*, August 2026, p. 27.

- a) As incurred, and net of forecast disposals. In accordance with the timing assumptions of the PTRM, the capex includes a half-year WACC allowance to compensate for the six-month period before capex is added to the RAB for revenue modelling. Includes equity raising costs.
- b) Based on as commissioned capex.

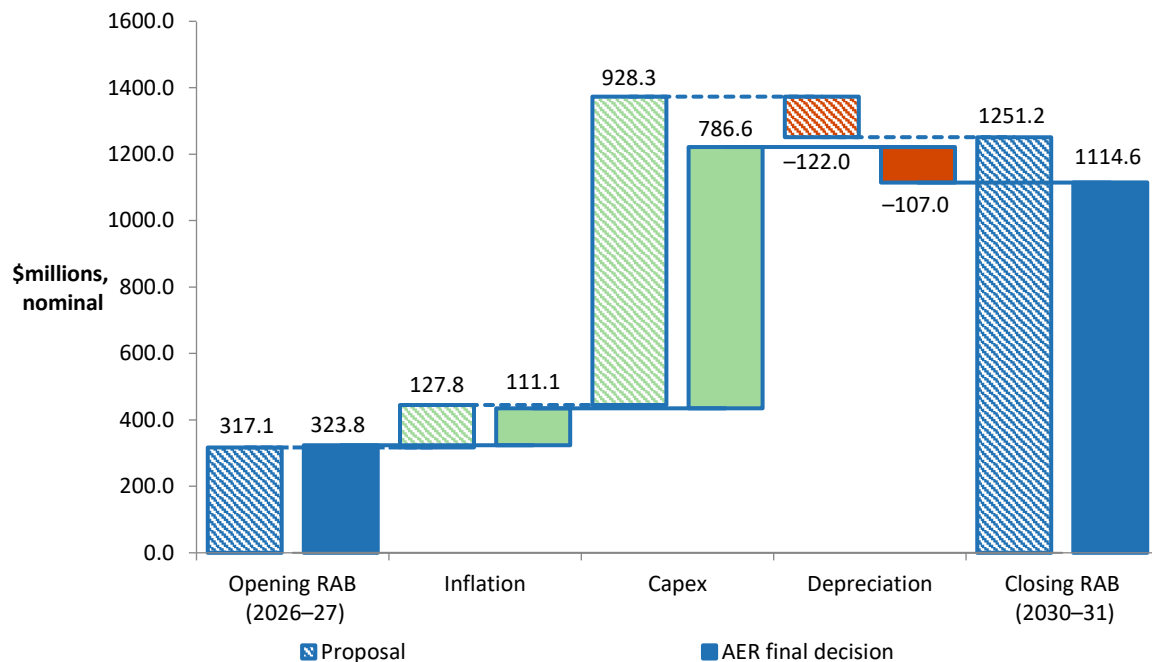
The change in the RAB over the 2026–31 period depends on our assessment of the RAB's various components including forecast capex (section 10), expected inflation (section 8) and forecast depreciation (section 9). Inflation and capex increase the RAB, while depreciation and asset disposals reduce it.

To determine the forecast closing RAB value for Transgrid, we amended a number of the PTRM inputs. Specifically, we:

- increased Transgrid's proposed opening RAB as at 1 October 2026 by \$6.7 million (\$ nominal) or 2.1% (section 7.2.1)
- reduced Transgrid's proposed forecast capex for the 2026–31 period by \$141.7 million (\$ nominal) or 15.3% (section 10.2)
- updated Transgrid's proposed expected inflation rate from 2.65% per annum to 2.52% per annum over the 2026–31 period (section 8.2.3), resulting in a decrease to the indexation of the RAB component for the 2026–31 period by \$16.7 million (\$ nominal) or 13.0%
- reduced Transgrid's proposed forecast straight-line depreciation for the 2026–31 period by \$15.0 million (\$ nominal) or 12.3% (section 9.2). As straight-line depreciation is deducted from the RAB, this has the effect of increasing the closing RAB.

Figure 7.1 shows the key drivers of the change in Transgrid's RAB over the 2026–31 period for this final decision. Overall, our final decision closing RAB at the end of the regulatory period is forecast to be \$790.7 million higher than the opening RAB at the start of the period, in nominal terms. The approved forecast net capex is the largest factor behind the increase, reflecting that the System Strength Project is a new asset being built by Transgrid under the EII framework, with the build-up in the RAB over the period a result of the initial construction phase.

**Figure 7.1 Key drivers of change in RAB over the 2026–31 period – Proposal compared to final decision (\$ million, nominal)**



Source: AER analysis; Transgrid, *M.6 – System Strength Project 2026–31 – EII Post Tax Revenue Model (PTRM)*, April 2026.  
 Note: Capex is net of forecast disposals. It is inclusive of the half-year WACC to account for timing assumptions in the PTRM.

### 7.2.3 Application of depreciation approach in RAB roll forward for next reset

We determine that the depreciation approach to be applied to calculate Transgrid’s opening RAB at the commencement of the 2031–36 period will be based on the depreciation schedules (straight-line) using forecast capex at the asset class level approved for the 2026–31 period. We consider this approach will provide sufficient incentives for Transgrid to achieve capex efficiency gains over the 2026–31 period.<sup>72</sup>

This is consistent with Transgrid’s proposal to use forecast depreciation in rolling forward the RAB for the commencement of the 2031–36 period.<sup>73</sup>

As discussed in section 13.2.1, we will apply the CESS as set out in version 4 of the Capital Expenditure Incentive Guidelines to Transgrid over the 2026–31 period. We consider that the CESS will provide sufficient incentives for Transgrid to achieve capex efficiency gains over that period. We are satisfied that the use of a forecast depreciation approach in combination with the application of the CESS and our other ex-post capex measures are sufficient to achieve the capex incentive objective.<sup>74</sup>

<sup>72</sup> EII Chapter 6A, cll. 6A.14.1(5E) and S6A.2.2B.

<sup>73</sup> Transgrid, *System Strength Project 2026–31 Revenue proposal*, April 2026, p. 99.

<sup>74</sup> Our ex-post capex measures are set out in the capex incentives guideline, AER, *Capital expenditure incentive guidelines*, August 2025, pp. 17–25. The guideline also sets out how our capex incentive measures are consistent with the capex incentive objective. The application of the CESS is also consistent with section 37(1)(b) of the EII Act to promote economic efficiency.

## 8 Rate of return

The return each business is to receive on its RAB, known as the ‘return on capital’, is a key driver of proposed revenues. We calculate the regulated return on capital by applying a rate of return to the value of the RAB.<sup>75</sup>

We estimate the rate of return by combining the returns of the two sources of funds for investment: equity and debt. The allowed rate of return provides the business with a return on capital to service the interest on its loans and a return on equity to investors.

We also make an estimate of expected inflation over the next 5 years. Alongside our nominal estimate of the rate of return, these determine the effective real return that will be provided to investors over time.

Our assessment approach for the rate of return is detailed in section 4 of our assessment approach guidance note.<sup>76</sup>

### 8.1 Transgrid’s proposal

Transgrid’s proposal applied the 2022 Rate of Return Instrument (2022 Instrument).<sup>77</sup> It proposed the following inputs for the rate of return, expected inflation, and debt and equity raising costs for the 2026–31 period:<sup>78</sup>

- a nominal vanilla weighted average cost of capital (WACC) of 7.05%
- a value of imputation credits (gamma) of 0.57
- an expected inflation rate of 2.65%
- equity raising costs of \$5.4 million (\$ September, 2026)
- debt raising costs of 8.3 basis points per annum or a total of \$2.2 million over the 2026–31 period (\$ September, 2026).

The nominal vanilla WACC of 7.05% was calculated using market data from placeholder averaging periods. Transgrid has proposed to use its confidentially nominated averaging periods to estimate its final revenue.<sup>79</sup> This included one risk-free rate averaging period (used to calculate the return on equity) and five averaging periods for the return on debt, so that the latter could be updated annually across the 2026–31 period.

<sup>75</sup> EII Chapter 6A, cl. 6A.6.2.

<sup>76</sup> AER, *Guidance note on the AER’s EII assessment approach for non-contestable revenue determinations*, August 2026, pp. 10–12.

<sup>77</sup> AER, *Rate of return instrument*, February 2023. The specific inputs that Transgrid proposed are in Table 7.2.

<sup>78</sup> Transgrid, *System Strength Project 2026–31 Revenue proposal*, April 2026, pp. 100–104.

<sup>79</sup> Transgrid, *System Strength Project 2026–31 Revenue proposal*, April 2026, p. 102.

Transgrid's proposal includes an expected inflation rate of 2.65%, calculated using the geometric mean of the June and December RBA's Statement of Monetary Policy forecasts to estimate a proxy for a September period.<sup>80</sup>

In addition to the inputs for the 2026–31 period, Transgrid proposed nominal vanilla WACCs for the purpose of capitalising its pre-period capex incurred between December 2022 to September 2026. These are shown in Table 8.1 below:

**Table 8.1 Transgrid's proposed nominal vanilla WACCs for pre-period costs**

|                      | 2022–23 | 2023–24 | 2024–25 | 2025–26 |
|----------------------|---------|---------|---------|---------|
| Nominal vanilla WACC | 6.87%   | 5.59%   | 6.57%   | 6.27%   |

Source: Transgrid, *M.6 – System Strength Project 2026–31 – EII Post Tax Revenue Model (PTRM)*, April 2026.

Transgrid proposed to calculate its pre-period nominal vanilla WACCs using a weighted average of those WACCs determined in the 2023–28 NER decision, proportioned to ensure alignment to the System Strength Project's regulatory year.<sup>81</sup>

## 8.2 AER final decision

For this final decision, we apply the current 2022 Instrument, consistent with the requirements of the EII Regulation and Transgrid's proposal.<sup>82</sup> The 2022 Instrument specifies how we will estimate:

- the return on debt
- the return on equity
- the overall rate of return
- the value of imputation credits

Our final decision estimates an allowed rate of return of 7.37% (nominal vanilla) for the 2026–31 period.

We will update the return on debt component of the rate of return each year, in accordance with the 2022 Instrument.<sup>83</sup> As such, our calculated rate of return would apply to the first year of the 2026–31 period. Our final decision on the rate of return for the 2026–31 period is summarised in Table 8.2.

<sup>80</sup> Transgrid, *System Strength Project 2026–31 Revenue proposal*, April 2026, p. 103.

<sup>81</sup> Transgrid, *System Strength Project 2026–31 Revenue proposal*, April 2026, p. 102.

<sup>82</sup> AER, *Rate of return instrument*, February 2023; EII Regulation, cl. 47D(4).

<sup>83</sup> Further details are set out in section 8.2.1.

**Table 8.2 AER's final decision on Transgrid's rate of return for the 2026–31 period**

|                                     | Transgrid proposal | AER final decision | Allowed return over period          |
|-------------------------------------|--------------------|--------------------|-------------------------------------|
| Nominal risk-free rate              | 4.82% <sup>a</sup> | 5.04% <sup>a</sup> |                                     |
| Market risk premium                 | 6.20%              | 6.20%              |                                     |
| Equity beta                         | 0.6                | 0.6                |                                     |
| Return on equity (nominal post-tax) | 8.54% <sup>a</sup> | 8.76%              | Constant (%)                        |
| Return on debt (nominal pre-tax)    | 6.06% <sup>a</sup> | 6.44%              | Updated annually                    |
| Gearing                             | 60%                | 60%                | Constant (%)                        |
| Nominal vanilla WACC                | 7.05% <sup>a</sup> | 7.37% <sup>b</sup> | Updated annually for return on debt |
| Expected inflation                  | 2.65%              | 2.52%              | Constant (%)                        |

Source: AER analysis; Transgrid, *M.5 – Transgrid – Accelerated Syncons – Rate of Return Model*, April 2026.

a) Placeholders calculated using the averaging periods for Transgrid's 2026–27 return on debt updated PTRM.

b) Calculated using the approved averaging periods. This rate will only apply for the System Strength Project for the first regulatory year (2026–27), as the return on debt component will be updated each year in accordance with the 2022 Instrument (see section 8.2.1).

Our final decision is also to:

- accept Transgrid's proposed risk-free rate averaging period and debt averaging periods because they comply with the conditions set out in the 2022 Instrument.<sup>84</sup> We specify these averaging periods in confidential Appendix C. These averaging periods will be used, alongside the adjustment mechanism set out in Appendix B, to update the rate of return on an annual basis.
- apply a value of imputation credits (gamma) of 0.57 as specified in the 2022 Instrument.<sup>85</sup>
- not accept Transgrid's proposed approach to estimating forecast inflation and instead determine an expected inflation of 2.52%. Our reasoning is set out in section 8.2.3 below.

Table 8.3 sets out our final decision on the pre-period rate of return used to escalate capex incurred between 2022–26 to the start of the regulatory control period consistent with our Non-contestable Guideline.<sup>86</sup>

<sup>84</sup> Transgrid, *System Strength Revenue Proposal – Nominated Averaging Period – CONFIDENTIAL*, March 2026.

<sup>85</sup> AER, *Rate of return Instrument, Explanatory Statement*, February 2023, pp. 240–250.

<sup>86</sup> AER, *Revenue determination guideline for NSW non-contestable projects*, August 2026, pp. 27–28.

**Table 8.3 AER's final decision nominal vanilla WACCs for pre-period costs**

|                      | 2022–23             | 2023–24 | 2024–25 | 2025–26 |
|----------------------|---------------------|---------|---------|---------|
| Nominal vanilla WACC | 10.20% <sup>a</sup> | 6.50%   | 5.54%   | 6.33%   |

Source: AER analysis.

a) Our final decision WACC for 2022–23 is materially different to Transgrid's proposal due to updating for actual inflation and correcting for a timing error in Transgrid's proposal.

### 8.2.1 Transition to the trailing average portfolio return on debt

The 2022 Instrument provides for a gradual transition into the 10-year trailing average portfolio return on debt.<sup>87</sup> This transition period commences in the first regulatory year for which the return on debt is calculated using a trailing average for the first time for the relevant regulated service. The transition takes 10 years to complete.

In the first year, there is only one return on debt estimate, so it is given 100% weight. In each subsequent year, a new estimate is added to the portfolio and given 10% weight, while the weight on the earliest year reduces by 10%. Eventually, after 10 years, a rolling 10-year window is established.

For Transgrid across the 2026–31 period, this means the weights are as follows:

- 2026–27: 100% on 2026–27
- 2027–28: 90% on 2026–27, 10% on 2027–28
- 2028–29: 80% on 2026–27, 10% on 2027–28, 10% on 2028–29
- 2029–30: 70% on 2026–27, 10% on 2027–28, 10% on 2028–29, 10% on 2029–30
- 2030–31: 60% on 2026–27, 10% on 2027–28, 10% on 2028–29, 10% on 2029–30, 10% on 2030–31

This pattern continues until the full 10-year rolling window is established in 2035–36.

### 8.2.2 Pre-period rate of return

The pre-period WACCs are used to capitalise Transgrid's pre-period expenditure to form an opening RAB at the start of its regulatory control period.

Under the EII framework, a Network Operator may be required to incur expenditure prior to the first regulatory determination. For non-contestable and hybrid processes, a Network Operator can only recover its investments through our revenue determinations. As such, we consider it reasonable for a Network Operator to capitalise its efficient, prudent and reasonable pre-period expenditure to form an opening RAB as at the start of the relevant regulatory control period.<sup>88</sup> We typically apply a nominal WACC when capitalising these costs to compensate the Network Operator for the delay in revenue recovery. However, while we are bound by the 2022 Instrument in determining an overall rate of return when making a

<sup>87</sup> AER, *2022 Rate of return instrument (version 1.2)*, March 2024, cl. 9.

<sup>88</sup> AER, *Revenue determination guideline for NSW non-contestable projects*, August 2026, pp. 27–28.

revenue determination, it does not address the specific situation where there is expenditure in advance of the first regulatory period.

We expect financing costs during the pre-period years to be reflective of the broader business' rate of return, reflecting the opportunity cost of obtaining financing in these years. As such, we consider using the rate of return determined in a Network Operator's NER determination for the relevant year is an approach that aligns with the 2022 Instrument.

Transgrid proposed a methodology consistent with this principle for the System Strength Project.<sup>89</sup> However, due to the misalignment in regulatory years between the System Strength Project (1 October to 30 September) and its NER determination (1 July to 30 June), Transgrid indicated that it had applied a weighted average of its NER nominal WACCs.

We consider Transgrid's proposed weighted average approach to be reasonable and consistent with how we escalate capex in our regulatory models. However, following our assessment of Transgrid's revenue proposal, we consider Transgrid has not correctly implemented its methodology in the PTRM and we were unable to reconcile the nominal WACC values.

Our final decision, set out in Table 8.3, is to amend the pre-period WACCs proposed by Transgrid for the four regulatory years from 2022–23 to 2025–26 used to roll forward the pre-period capex and determine an opening RAB as at 1 October 2026 for the System Strength Project. The updated nominal WACCs reflect:

- The approved nominal WACC for 2022–23 per our roll forward model for the 2023–28 final decision for Transgrid's NER determination.
- The approved forecast nominal WACC for 2023–24 to 2025–26 per our 2026–27 return on debt updated PTRM for the 2023–28 final decision for Transgrid's NER determination, which we have subsequently updated for actual inflation.
- The approved forecast nominal WACC for 2026–27 per our 2026–27 return on debt updated PTRM for the 2023–27 final decision for Transgrid's NER determination.<sup>90</sup>
- In response to an information request, Transgrid confirmed it had no concerns with our amendments to the pre-period WACCs.

### 8.2.3 Expected inflation rate

Our estimate of expected inflation included in this final decision is 2.52% (Table 8.4) and is based on the approach adopted in our final position paper from our 2020 Inflation Review.<sup>91</sup>

Transgrid partially adopted our current approach for estimating expected inflation, however proposed to use a geometric mean of the June and December RBA forecast of CPI.<sup>92</sup> In

<sup>89</sup> Transgrid, *System Strength Project 2026–31 Revenue proposal*, April 2026, p. 102.

<sup>90</sup> The NER nominal WACC for 2026–27 forms a part of the 2025–26 pre-period WACC for the System Strength Project. This will be updated for actual inflation, once this input becomes available, through an adjustment mechanism (section 14), consistent with our final decisions for the 2024–29 Waratah Super Battery non-contestable project and the 2026–31 Hunter Central Coast non-contestable project.

<sup>91</sup> AER, *Final position – Regulatory treatment of inflation*, December 2020.

<sup>92</sup> Transgrid, *System Strength Project 2026–31 Revenue proposal*, April 2026, p. 103.

response to an information request, Transgrid stated that this was to reflect the discrepancy between the RBA’s inflation forecasts (published only every 6 months for the June and December period) with its regulatory period (covering 1 October to 30 September). Furthermore, Transgrid reasoned that using a geometric mean, as opposed to an arithmetic mean, reflects that inflation is a compounding process, mirroring the cumulative effect of compounding over a period and is consistent with how the PTRM applies inflation.

We do not agree with Transgrid’s approach to using the geometric mean of two overlapping RBA forecasts. The RBA’s forecast of inflation for each June and December period are distinct annual forecasts, covering different overlapping years. Overlapping annual inflation forecasts do not reflect forecasts of inflation that will compound through time and a geometric average in this case would appear, on average, to be a downward biased estimate of the year to the end of September inflation forecast.

Transgrid’s proposal to average two inflation forecasts to calculate a proxy September CPI is also inconsistent with past NER determinations. In particular, we note that for AusNet transmission, whose regulatory year covers the period 1 April to 31 March, we have historically used a December RBA forecast to estimate forecast inflation.<sup>93</sup> Further, AusNet’s 2027–32 revenue proposal applied an arithmetic average of the December and June RBA forecasts to form a proxy for a March inflation forecast. However, our draft decision stated we will use the December RBA forecast to estimate forecast inflation for a 1 April to 31 March regulatory year.<sup>94</sup>

As such, given our concerns with the proposed approach and to ensure regulatory consistency, our final decision will apply the same approach as our determinations for AusNet transmission, which is to use the June 2027 and 2028 forecasts for years 1 and 2 of the 2026–31 regulatory period, followed by a linear glide path to the RBA’s target band mid-point of 2.5%. This is set out in Table 8.4 below.

**Table 8.4 AER’s final decision on Transgrid’s forecast inflation (%)**

|                    | 2026–27 | 2027–28 | 2028–29 | 2029–30 | 2030–31 | Geometric average |
|--------------------|---------|---------|---------|---------|---------|-------------------|
| Expected inflation | 2.80    | 2.40    | 2.43    | 2.47    | 2.50    | <b>2.52</b>       |

Source: AER analysis: RBA, *Statement on Monetary Policy*, August 2026, Table: Output Growth, Unemployment and Inflation Forecasts. See <https://www.rba.gov.au/publications/smp/2026/aug/overview.html>.

## 8.2.4 Imputation credits

Our final decision applies a value of imputation credits (gamma) of 0.57 as set out in the 2022 Instrument.<sup>95</sup> This is consistent with the value included in Transgrid’s proposal.<sup>96</sup>

<sup>93</sup> AER, *Final decision – AusNet Services transmission 2022–27 – Attachment 3 – Rate of return*, January 2022.

<sup>94</sup> AER, *Draft decision – AusNet Services transmission determination 2027–32 – Overview*, June 2026.

<sup>95</sup> AER, *Rate of return Instrument, Explanatory Statement*, February 2023, pp. 240–250.

<sup>96</sup> Transgrid, *System Strength Project 2026–31 Revenue proposal*, April 2026, p. 106.

## 8.2.5 Capital raising costs

In addition to compensating for the required rate of return on debt and equity, we provide an allowance for the transaction costs associated with raising debt and equity. Our final decision forecasts for debt and equity raising costs are included in the PTRM.

### Equity raising costs

Equity raising costs are transaction costs incurred when a service provider raises new equity. We provide an allowance to recover an efficient amount of equity raising costs. We include equity raising costs in the capex forecast because these costs are only incurred once and are associated with funding the capital investments. Equity raising costs are calculated in our PTRM as part of our approved capex for the first year of the regulatory period.

Transgrid forecast \$5.4 million (\$ September, 2026) in equity raising costs in the PTRM, using the approach set out in the model. We have updated our estimate for the 2026–31 period based on the benchmark approach using updated inputs. This results in equity raising costs of \$4.2 million (\$ September, 2026). This reduction is primarily a consequence of our decision on Transgrid's capex, particularly our decision not to accept provisional sums in relation to risk costs.

### Debt raising costs

Debt raising costs are the transaction costs incurred each time debt is raised or refinanced, as well as the costs for maintaining the debt facility. These costs may include underwriting fees, legal fees, company credit rating fees and other transaction costs. We include debt raising costs in the opex forecast because these are regular and ongoing costs which are likely to be incurred each time service providers refinance their debt.

Transgrid proposed debt raising costs of 8.3 basis points per annum, consistent with our decision for Transgrid's most recent determination under the NER.<sup>97</sup> Our final decision on the System Strength Project has updated the debt raising costs unit rate to 10.6 basis points per annum, resulting in a final decision on total debt raising costs of \$2.6 million (\$ September, 2026) for the 2026–31 period. This is \$0.4 million higher than Transgrid's proposal of \$2.2 million (\$ September, 2026).

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<sup>97</sup> Transgrid, *System Strength Project 2026–31 Revenue proposal*, April 2026, p. 104.

## 9 Regulatory depreciation

Depreciation is the amount provided to capital investors so that they recover their investment over the economic life of the asset (return of capital). In deciding whether to approve the depreciation schedules submitted by Transgrid, we make determinations on:

- The indexation of the RAB and depreciation building blocks for the regulatory period.<sup>98</sup> The regulatory depreciation amount is then calculated as the net total of the straight-line depreciation less the indexation of the RAB.<sup>99</sup>
- The capability for the Network Operator to efficiently obtain finance to carry out the network infrastructure project, known as financeability.<sup>100</sup> Where our assessment is that there is a financeability issue with a particular project, we will determine the necessary adjustment to the depreciation profile to resolve the financeability issue.<sup>101</sup>

This section sets out our final decision on Transgrid's regulatory depreciation amount, proposed depreciation schedules, asset lives used for calculating the straight-line depreciation and financeability. Our assessment approach for depreciation is detailed in section 5 of our assessment approach guidance note.<sup>102</sup>

### 9.1 Transgrid's proposal

For the 2026–31 period, Transgrid proposed a total forecast regulatory depreciation amount of –\$5.8 million (\$ nominal).<sup>103</sup> To calculate the depreciation amount, Transgrid proposed to use:<sup>104</sup>

- the straight-line depreciation method employed in our EII PTRM for all standard asset classes
- the same asset classes and standard asset lives for depreciating its forecast capex for the 2026–31 period as those approved in its 2023–28 NER final decision
- the as commissioned method of depreciation for all asset classes
- the proposed forecast as commissioned capex for the 2026–31 period
- an expected inflation rate of 2.65% per annum for the 2026–31 period.

<sup>98</sup> EII Chapter 6A, cl. 6A.5.4(a)(1) & (3).

<sup>99</sup> EII Chapter 6A, cl. 6A.2.4(c).

<sup>100</sup> EII Regulation cl. 47D(3); EII Chapter 6A, cl. 6A.6.3(d).

<sup>101</sup> EII Chapter 6A, 6A.6.3A(k); EII Chapter 6A, 6A.6.3A(n).

<sup>102</sup> AER, *Guidance note on the AER's EII assessment approach for non-contestable revenue determinations*, August 2026, pp. 13–18.

<sup>103</sup> Regulatory depreciation is defined as straight-line depreciation less indexation on the RAB. A negative regulatory depreciation therefore represents instances where the depreciation schedule is insufficient to offset the growth in the RAB.

<sup>104</sup> Transgrid, *System Strength Project 2026–31 Revenue proposal*, April 2026, pp. 94–99.

Transgrid did not propose a financeability adjustment for the System Strength Project as its assessment indicated there is no material deterioration in financeability over the 2026–31 regulatory period due to the additional forecast expenditure for this project.<sup>105</sup>

Transgrid's proposal included a total capex of \$8 million (\$ nominal) related to IPFs, which are contractual costs that Transgrid is required to repay NSW DCCEEW as part of its Underwriting Agreement. Transgrid proposed to depreciate these costs as part of the Synchronous Condensers asset class.

Table 9.1 sets out Transgrid's proposed annual depreciation amounts for the 2026–31 period.

**Table 9.1 Transgrid's proposed regulatory depreciation for the 2026–31 regulatory period (\$ million, nominal)**

|                                           | 2026–27     | 2027–28     | 2028–29     | 2029–30    | 2030–31    | Total       |
|-------------------------------------------|-------------|-------------|-------------|------------|------------|-------------|
| Straight-line depreciation                | -           | 13.5        | 29.2        | 39.1       | 40.2       | 122.0       |
| Less: inflation indexation on opening RAB | 8.4         | 21.2        | 31.3        | 33.5       | 33.3       | 127.8       |
| <b>Regulatory depreciation</b>            | <b>-8.4</b> | <b>-7.7</b> | <b>-2.2</b> | <b>5.6</b> | <b>6.8</b> | <b>-5.8</b> |

Source: Transgrid, *M.6 – System Strength Project 2026–31 – EII Post Tax Revenue Model (PTRM)*, April 2026.

Note: Totals may not sum due to rounding.

## 9.2 AER final decision

Our final decision determines a regulatory depreciation amount of -\$4.1 million (\$ nominal) for Transgrid over the 2026–31 period for the System Strength Project.<sup>106</sup> Our final decision represents an increase of \$1.6 million compared to Transgrid's proposed regulatory depreciation amount of -\$5.8 million.

In calculating the straight-line depreciation amount in our final decision, we:

- accept Transgrid's proposed straight-line depreciation method for calculating the regulatory depreciation amount as set out in the EII PTRM, including its as commissioned capex profile<sup>107</sup>, as it is consistent with the provisions of clause 6A.6.3 in EII Chapter 6A and the EII Regulations.<sup>108</sup>

<sup>105</sup> Transgrid, *System Strength Project 2026–31 – Revenue proposal*, April 2026, p. 98.

<sup>106</sup> As this is a negative amount, its effect is to reduce the total revenue calculated.

<sup>107</sup> On top of updates arising from our capex decision, we have also modified the forecast as commissioned capex profile to include capitalised financing costs for the pre-period years. This is to ensure consistency between the as incurred capex values and the as commissioned capex in the PTRM in the years where Transgrid is not subject to an existing revenue determination.

<sup>108</sup> EII Regulation, cl. 47D(2).

- accept Transgrid’s proposed asset classes and associated standard asset lives as they are equivalent to those approved in our most recent NER revenue determination for Transgrid.<sup>109</sup>
- accept Transgrid’s approach to depreciating IPF costs within Synchronous Condensers asset classes as this approach calculates a depreciation schedule that reflects the activities that this expenditure relates to.<sup>110</sup>
- Consistent with Transgrid’s proposal to not propose a financeability request, we have not modified the depreciation schedules for financeability as we consider that Transgrid is capable of efficiently obtaining finance for the System Strength Project.<sup>111</sup>

Regulatory depreciation is also affected by the indexation of the RAB, which has an offsetting relationship to straight-line depreciation. We have determined a lower RAB indexation compared to the proposal largely due to applying a lower expected inflation rate of 2.52% per annum in this final decision compared to Transgrid’s proposal of 2.65% per annum. This more than offsets the reduction in straight-line depreciation as a result of our capex decision to not accept provisional sums and replace this with a lower forecast risk allowance.

Table 9.2 sets out our final decision on the forecast regulatory depreciation amount for Transgrid’s 2026–31 period for the System Strength Project.

**Table 9.2 AER’s final decision for the 2026–31 regulatory control period (\$ million, nominal)**

|                                           | 2026–27     | 2027–28     | 2028–29     | 2029–30    | 2030–31    | Total       |
|-------------------------------------------|-------------|-------------|-------------|------------|------------|-------------|
| Straight-line depreciation                | -           | 11.3        | 25.4        | 34.7       | 35.6       | 107.0       |
| Less: inflation indexation on opening RAB | 8.2         | 19.4        | 26.9        | 28.4       | 28.3       | 111.1       |
| <b>Regulatory depreciation</b>            | <b>-8.2</b> | <b>-8.1</b> | <b>-1.5</b> | <b>6.3</b> | <b>7.3</b> | <b>-4.1</b> |

Source: AER analysis.

Note: Totals may not sum due to rounding.

## 9.2.1 Standard and remaining asset lives

Transgrid proposed the same asset classes and standard asset lives as those we approved in our 2023–28 NER final decision for Transgrid.<sup>112</sup> We accept the proposed asset classes and asset lives as they are identical to those determined for Transgrid under the NER, which we have assessed to be reflective of the economic life of the assets.<sup>113</sup> Therefore, we consider Transgrid’s proposed asset lives and depreciation schedule results in a profile that

<sup>109</sup> AER, *Transgrid 2023–28 – Final Decision – Attachment 4 Regulatory depreciation*, April 2023.

<sup>110</sup> For further discussion on IPFs, see section 10.2.3.

<sup>111</sup> EII Regulation cl. 47D(3); EII Chapter 6A, cl. 6A.6.3A(i).

<sup>112</sup> AER, *Transgrid 2023–28 – Final Decision – Attachment 4 Regulatory depreciation*, April 2023.

<sup>113</sup> EII Chapter 6A, cl. 6A.6.3(b)(1).

reflects the nature of the asset over the economic life of the asset. The proposed standard asset lives are also broadly comparable with those approved by us for other network service providers under the NER.

Consistent with Transgrid’s proposal, we have approved a zero ‘as commissioned’ opening RAB and therefore we are not required to make a decision on the remaining lives for these asset classes. This reflects Transgrid only beginning commissioning of its capex in the first year of the 2026–31 regulatory period. We have also removed several asset classes that do not have any forecast capex allocated to them.<sup>114</sup>

Table 9.3 sets out our final decision on the standard asset lives for the 2026–31 period for Transgrid’s System Strength Project.

**Table 9.3 AER’s final decision on Transgrid’s standard asset lives for the 2026–31 periods (years)**

| Asset class                                  | Standard asset life |
|----------------------------------------------|---------------------|
| Transmission lines                           | 50.0                |
| Substations                                  | 40.0                |
| Secondary systems                            | 15.0                |
| Minor plant, motor vehicles and mobile plant | 8.0                 |
| Land and easements <sup>a</sup>              | n/a                 |
| Synchronous condensers                       | 40.0                |
| Building – capital works                     | 40.0                |
| Equity raising costs <sup>b</sup>            | 37.9                |

Source: AER analysis.

- a) Not applicable. We have not assigned a standard or remaining life to the Land & easements asset class because the assets are not subject to depreciation.
- b) Calculated using the weighted average of the standard asset lives for all depreciating assets associated with the project.

<sup>114</sup> The unused asset classes we removed are placeholder asset classes that were pre-filled in our EII PTRM template for in-house software, a spare straight-line tax asset class and several asset classes relating to financeability.

## 10 Capital expenditure

Capital expenditure (capex) refers to investment in the development and construction of network infrastructure. This investment mostly relates to assets with long asset lives (30–50 years), the costs of which are recovered over several regulatory periods.

Under the regulatory framework, Transgrid’s revenue proposal must include the total forecast capex it considers is required to comply with all regulatory requirements in providing regulated network services and maintaining the safety of the network infrastructure project through the supply of regulated network services (the capex objectives).<sup>115</sup> We must determine whether we are satisfied the total of Transgrid’s forecast capex (including pre-period capex) for the regulatory period reasonably reflects the capex criteria with regard to the capex factors specified in EII Chapter 6A.<sup>116</sup> If we are not satisfied, we must set out the reasons for this decision and an estimate of the total capex we are satisfied reasonably reflects the capex criteria, taking into account the capex factors.<sup>117</sup>

Our assessment approach for capex is detailed in section 6 of our assessment approach guidance note.<sup>118</sup>

### 10.1 Transgrid’s proposal

Transgrid proposed \$1,185.0 million (\$ September, 2026) in forecast capex for the System Strength Project. This is summarised in Table 10.1 below. This includes:

- \$918.1 million for the contestable component of the project, comprising \$723.0 million in tendered works (lump sum payments to contractors) and \$195.2 million in provisional sums to manage pre-identified risks in the design, manufacture and commissioning of the works for which the contractors are entitled to a contract variation should those risks occur.
- \$261.5 million for the non-contestable component of the project (a breakdown of this amount is shown in Table 10.1)
- \$5.4 million in equity raising costs (see section 8)

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<sup>115</sup> EII Chapter 6A, cl. 6A.6.7(a).

<sup>116</sup> The capex criteria include: (1) the efficient costs of achieving the capex objectives; (2) the costs a prudent operator would require to achieve the capex objectives; and (3) a realistic expectation of the cost inputs required to achieve the capex objectives. See: EII Chapter 6A, cl. 6A.6.7(c); EII Chapter 6A, cl. 6A.6.7(e).

<sup>117</sup> EII Chapter 6A, cl. 6A.14.1(2).

<sup>118</sup> AER, *Guidance note on the AER’s EII Assessment Approach for Non-contestable revenue determinations*, August 2026.

**Table 10.1 Transgrid’s total capex forecast (\$ million, September 2026)<sup>119</sup>**

| Capex category                                             | Pre-period   | 2026–27      | 2027–28      | 2028–29     | Total          |
|------------------------------------------------------------|--------------|--------------|--------------|-------------|----------------|
| Contestable components                                     | 216.8        | 376.7        | 279.6        | 45.1        | 918.1          |
| Labour and indirect costs<br>(including labour escalation) | 79.6         | 61.6         | 59.2         | 16.8        | 217.2          |
| IPFs                                                       | 2.0          | 2.0          | 1.9          | 1.9         | 7.8            |
| Risk costs                                                 | 4.5          | 7.4          | 5.5          | 1.0         | 18.4           |
| Easement acquisition                                       | 0.0          | -            | -            | -           | 0.0            |
| Equipment                                                  | 9.1          | 1.0          | 0.3          | -           | 10.3           |
| Fleet acquisition                                          | 0.6          | -            | -            | -           | 0.6            |
| Buildings                                                  | -            | -            | -            | 7.1         | 7.1            |
| <b>Total capex (excluding<br/>equity raising costs)</b>    | <b>312.5</b> | <b>448.7</b> | <b>346.5</b> | <b>71.9</b> | <b>1,179.6</b> |
| Equity raising costs                                       | -            | 5.4          | -            | -           | 5.4            |
| <b>Total capex</b>                                         | <b>312.5</b> | <b>454.1</b> | <b>346.5</b> | <b>71.9</b> | <b>1,185.0</b> |

Source: Transgrid, *M.1 – System Strength Project 2026–31 – Capex Forecast Model*, April 2026.

Note: Totals may not sum due to rounding.

Transgrid submitted that its proposed capex is prudent, efficient and reasonable, and reflects a delivery approach focused on managing the unique and complex challenges of System Strength Project, to optimise outcomes and meet the accelerated delivery timeframes.<sup>120</sup>

Transgrid stated that its capex forecasting approach is informed by a compressed schedule, efficient delivery and procurement strategies, lessons from recent synchronous condenser projects, and utilising existing substation footprints to reduce costs, approvals risks and delivery complexity.<sup>121</sup> Independent assurance was provided by Transgrid’s external adviser, GHD, to validate the technical scope of System Strength Project in accordance with the requirements set out in the PNIP Direction. In addition, Transgrid engaged GHD and North Projects to review and verify the capex forecast for System Strength Project.<sup>122</sup>

<sup>119</sup> Only three years of the regulatory period shown as capex is not intended to be incurred beyond 2028–29.

<sup>120</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 64.

<sup>121</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, pp. 64–65.

<sup>122</sup> Transgrid, *GHD – S.6 – System Strength Project 2026–31 – Accelerated Syncon Project*, March 2026; Transgrid, *North Projects – S.1 – System Strength Project 2026–31 – Project Owner’s Cost Assessment Report*, March 2026.

Our preliminary position paper noted that our assessment of forecast capex was ongoing.<sup>123</sup> For contestable capex, our preliminary position was not to accept the proposed provisional sums capex, as we did not consider it to be an outcome of the genuine and appropriate competitive assessment processes. For non-contestable capex, we noted that our assessment would focus on project development (pre-period costs) and project delivery management costs, which are components of the proposed labour and indirect costs.

## 10.2 AER final decision

Our final decision is to provide an alternative capex estimate of \$1,059.9 million (\$ September, 2026). We consider this forecast to reflect prudent, efficient and reasonable costs to meet the capex objectives. Our alternative estimate reflects our decisions to:

- exclude the provisional sums capex from the contestable components, resulting in contestable capex of \$726.6 million<sup>124</sup>
- exclude \$8.5 million of pre-period project development costs associated with its System Strength RIT-T, which recommended projects such as the System Strength Project to address system strength shortfalls in NSW
- substitute an alternative estimate of \$93.7 million for risk costs, based on our decision to exclude risk events we consider are within Transgrid's control from the proposed adjustment mechanisms, and instead quantify these events in the capex allowance. Our alternative estimate for risk costs also includes additional contractual costs due to the Middle East conflict.<sup>125</sup>
- update forecast inflation (labelled in the below Table 10.2 as a modelling adjustment) and equity raising costs (further information in section 8).

Table 10.2 sets out our final decision on Transgrid's forecast capex by year and category.

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<sup>123</sup> AER, *Preliminary position paper – Transgrid – System Strength Project 2026–31*, June 2026, p. 13.

<sup>124</sup> This amount differs from the \$723.0 million proposed by Transgrid because of our updates to inflation and consequential changes to capex profiling and timing due to our decision to remove provisional sums capex.

<sup>125</sup> Also includes consequential changes to capex profiling resulting from our decision to include Middle East conflict costs.

**Table 10.2 AER's final decision capex forecast (\$ million, September 2026)** <sup>126</sup>

| Capex category                                                               | Pre-period   | 2026–27      | 2027–28      | 2028–29     | Total          |
|------------------------------------------------------------------------------|--------------|--------------|--------------|-------------|----------------|
| Contestable components                                                       | 198.9        | 314.9        | 188.2        | 24.6        | 726.6          |
| Labour and indirect costs (including labour escalation)                      | 71.1         | 61.6         | 59.2         | 16.8        | 208.7          |
| IPFs                                                                         | 2.0          | 2.0          | 1.9          | 1.9         | 7.8            |
| Risk costs (including Middle East conflict costs)                            | 37.9         | 32.9         | 19.6         | 3.3         | 93.7           |
| Easement acquisition                                                         | 0.0          | -            | -            | -           | 0.0            |
| Equipment                                                                    | 9.1          | 1.0          | 0.3          | -           | 10.3           |
| Fleet acquisition                                                            | 0.6          | -            | -            | -           | 0.6            |
| Buildings                                                                    | -            | -            | -            | 7.1         | 7.1            |
| <b>Total capex (excluding equity raising costs and modelling adjustment)</b> | <b>319.5</b> | <b>412.4</b> | <b>269.1</b> | <b>53.8</b> | <b>1,054.9</b> |
| Modelling adjustment                                                         | 0.1          | 0.2          | 0.4          | 0.1         | 0.8            |
| Equity raising costs                                                         | -            | 4.2          | -            | -           | 4.2            |
| <b>Total capex</b>                                                           | <b>319.7</b> | <b>416.8</b> | <b>269.5</b> | <b>53.9</b> | <b>1,059.9</b> |

Source: AER analysis

Note: Totals may not sum due to rounding.

### 10.2.1 Contestable capital expenditure

Our final decision is to accept Transgrid's proposed tendered capex (lump sum payments to contractors) of \$726.6 million (\$ September, 2026) as the amount is consistent with the outcomes of the genuine and appropriate competitive assessment processes. Our assessment of the competitive assessment processes for the System Strength Project as genuine and appropriate is set out in section 2.

Our final decision is to not accept Transgrid's proposed \$195.2 million (\$ September, 2026) in provisional sums capex. Consistent with our preliminary position, we do not accept that the provisional sums were outcomes of the genuine and appropriate competitive assessment processes. The provisional sums were based on risk events, and while the tender

<sup>126</sup> Only three years of the regulatory period shown, as capex is not intended to be incurred beyond 2028–29.

proponents bid the rates for activities related to the risks, they did not bid on the activity quantities.<sup>127</sup>

Our decision is that contract variation risks will be addressed through a combination of risk costs included in the ex-ante capex allowance (section 10.2.4) and adjustment mechanisms (section 14.2.2).

## 10.2.2 Labour and indirect costs

Our final decision is to include \$208.7 million (including \$1.7 million in labour escalation) for labour and indirect costs in our alternative capex estimate.<sup>128</sup>

Transgrid proposed \$217.2 million (\$ September, 2026) for its labour and indirect costs.<sup>129</sup> This total includes \$123.6 million for direct labour and labour related costs and \$93.6 million for indirect costs. Indirect costs include non-labour costs (\$40.6 million) and Transgrid's proportionate allocation of its labour and labour-related costs (\$53.0 million) based on its approved cost allocation method (CAM).<sup>130</sup> Transgrid's proposed costs are based on a bottom-up build, with the project's scope and timing determining the labour resources required for delivery.

Within the proposed direct labour and labour-related costs, project development and project delivery management costs account for \$15.5 million and \$85.7 million, respectively. Project development costs are incurred by Transgrid to plan the project, and project delivery management costs are to manage and ensure the timely completion of System Strength Project. These categories of labour and indirect costs were focus issues in our preliminary position paper. Our detailed assessment of these categories is provided below.

Other proposed direct labour and labour-related costs include support and corporate functions (\$16.1 million), land and environment (\$3.7 million), procurement and transaction management (\$1.5 million), regulatory management (\$0.9 million), and community and stakeholder engagement (\$0.2 million). Having regard to the information provided in Transgrid's proposal, including its forecast full-time equivalent requirements and unit rates, we are satisfied the proposed capex for these activities is prudent, efficient and reasonable.

### 10.2.2.1 Project development costs (pre-period)

Our final decision is to approve \$27.2 million (\$ September, 2026) in actual pre-period capex related to the RIT-T process and project development activities.<sup>131</sup> This is a reduction of \$8.5 million (or 23.8%) compared to Transgrid's proposal of \$35.7 million. We do not consider Transgrid has adequately demonstrated the entirety of the RIT-T pre-period costs are related to the scope of the PNIP Direction for the System Strength Project.

<sup>127</sup> Transgrid, *Accelerated Synchronous Condensers – Procurement Report – Syncons Package*, October 2025; Transgrid, *Accelerated Synchronous Condensers – Procurement Report – Associated Works Package*, February 2026.

<sup>128</sup> Further details about our decision on labour escalation, including the inputs used in its calculation, are set out in section 11.2.2.

<sup>129</sup> Transgrid, *System Strength Project 2026-31 - Revenue Proposal*, April 2026, pp. 73–74.

<sup>130</sup> Under which 30% of forecast costs are allocated to indirect costs.

<sup>131</sup> These costs consist of actual expenditure incurred from 1 October 2022 to 31 January 2026.

Transgrid's proposal justified the inclusion of RIT-T and early development activities on the basis that they were the foundation for the System Strength Project and the PNIP Direction made by the Minister, with the early project analysis and development activities conducted directly informing its expenditure forecast for this revenue proposal.<sup>132</sup> Transgrid set out that it had not yet recovered these costs (for example in its 2023–28 NER determination) and as such it is entitled to recover the full amount through the System Strength Project.

Our Non-contestable Guideline sets out our approach to assessing pre-period expenditure under the EII Act and EII Regulation.<sup>133</sup> We recognise Network Operators may be required to incur costs related to an authorised Network Infrastructure Project prior to the commencement of the initial 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 PNIP Direction.

Of the actual pre-period costs proposed by Transgrid,<sup>134</sup> \$16.9 million reflects capex associated with the RIT-T process and \$18.8 million for other early project development and analysis and pre-period activities. To assist with our assessment of these costs, we issued an information request for a detailed breakdown of RIT-T related activities and costs.<sup>135</sup> Transgrid's response provided a detailed breakdown of the costs by workstreams and labour hours as well as a description of activities undertaken. We reviewed Transgrid's detailed breakdown and our preliminary position paper's assessment of its proposal was that:

- \$16.9 million of RIT-T related costs should be proportioned to ensure alignment and consistency with the PNIP Direction for the System Strength Project whose scope only included half of the Transgrid network synchronous condensers originally identified in the Meeting System Strength in NSW RIT-T Project Assessment Conclusions Report (PACR).<sup>136</sup>
- \$18.8 million for early project development costs was considered consistent with the PNIP Direction, and prudent, efficient and reasonable for works to accelerate the development and procurement of the System Strength Project.

Specifically, our preliminary position paper set out our initial thinking and early assessment of Transgrid's proposal to recover RIT-T related costs through this System Strength Project:

- As set out in our Non-contestable Guideline<sup>137</sup>, we will assess whether expenditure proposed to be recovered is consistent with the relevant PNIP Direction.
- The PACR identified 10 Transgrid network synchronous condensers, but the PNIP Direction and revenue proposal included the equivalent of 5 network synchronous

<sup>132</sup> Transgrid, *System Strength Project 2026-31 - Revenue Proposal*, April 2026, pp. 60–62.

<sup>133</sup> AER, *Revenue determination guideline for NSW non-contestable projects*, August 2026, pp. 27–28.

<sup>134</sup> These costs consist of actual expenditure incurred from 1 October 2022 to 31 January 2026.

<sup>135</sup> Transgrid, *Response to information request #004*, May 2026.

<sup>136</sup> Transgrid, *Meeting system strength requirements in NSW – RIT-T Project Assessment Conclusions Report (PACR)*, July 2025.

<sup>137</sup> AER, *Revenue determination guideline for NSW non-contestable projects*, August 2026, p. 24.

condensers.<sup>138</sup> As the System Strength Project only forms one part of the preferred solution identified in the RIT-T process, we were unlikely to consider Transgrid’s proposal to recover the entire RIT-T cost as appropriate.

- We were satisfied that Transgrid had not recovered the relevant costs through any other processes under the NER framework and assessed these costs to be prudent, efficient and reasonable.
- We 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 the System Strength Project per the PNIP Direction.
- Our preferred approach was to allow a proportion of costs to be recovered in this decision which aligns with previous decisions that allow recovery of RIT-T expenditure through contingent project applications under the NER framework and is consistent with the principle under section 37(1)(a) of the EII Act that a Network Operator is entitled to recover the prudent, efficient and reasonable costs for carrying out the authorised project.

In response to the preliminary position paper, Transgrid acknowledged the RIT-T costs related to a broader portfolio of proposed system strength solutions beyond the scope of this System Strength Project.<sup>139</sup> However, Transgrid contended that the full RIT-T expenditure amount of \$16.9 million should be recoverable in the final decision due to uncertainty regarding future system strength projects and delay in cost recovery. It proposed to include an additional adjustment mechanism that would reallocate a prorated proportion of this cost to other system strength projects following subsequent system strength project determinations.

We reviewed the additional material Transgrid provided subsequent to our preliminary position paper, however, our assessment is that this has not changed our view on the matter. That is, while we consider a proportion of the RIT-T costs to be related to the System Strength Project, Transgrid has not provided sufficient evidence to justify recovering the entire pre-period RIT-T costs under the EII framework.<sup>140</sup>

Given the proposed RIT-T costs cover 10 proposed Transgrid synchronous condensers and the PNIP Direction authorised accelerated procurement of 5, we consider it reasonable to allow 50% of the RIT-T costs in this determination, or \$8.5 million.

Stakeholder submissions from CCP35 and Louise Benjamin and Gavin Dufty raised concerns around ensuring Transgrid does not double-count any system strength-related expenditure in future revenue determinations. We consider these concerns to be valid and

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<sup>138</sup> The RIT-T also identified other network and non-network options as well as synchronous condensers required within the New England Renewable Energy Zone. However, to the extent that there is no regulatory process for recovery of non-network costs and Transgrid is not expected to have responsibility for system strength within the New England REZ, we have decided to not include these in the discussion on proportioning.

<sup>139</sup> Transgrid, *Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, p. 5.

<sup>140</sup> AER, *Revenue determination guideline for NSW non-contestable projects*, August 2026, p. 27.

that any future claims for system strength planning and modelling will need to be considered in the following context:

- There is unlikely to be a need in future revenue proposals for significant recurrent capex for system strength modelling tools and workstations, as this has been set up and recovered as part of the system strength RIT-T process.
- We consider the initial resources funded through the RIT-T process have established the models, analysis techniques and staff capability for network planning and market modelling. Moving forward the internal resourcing required to maintain the models and run recurrent studies is expected to be reduced in comparison to the Full-Time Equivalent resourcing figures observed during the RIT-T process. Any increase in technical staff for system strength requires a high bar for change with substantial justification and supporting material to support a step change.
- We anticipate future system strength studies are unlikely to require the same level of external consultant support as seen during the RIT-T process and we would similarly apply a high bar to justifying significant consultant costs, taking into account the capability developed internally for system strength modelling through this process.

#### **10.2.2.2 Project delivery management**

Transgrid proposed \$117.2 million for its project delivery management costs (excluding labour escalation), including \$85.7 million of direct labour and labour related costs. We consider these costs to be prudent, efficient and reasonable. The proposed costs include:

- \$30.4 million for project management, which includes the oversight and coordination of contractors at each site and managing interfaces between contractors.
- \$32.9 million for construction management, which includes design reviews and site support during commissioning.
- \$2.4 million for project engineering management, which includes design reviews and site support during commissioning.
- \$25.0 million for commissioning, which includes planning outage, commissioning and energisation activities for synchronous condensers, reactive plant panel support and coordination, telecommunications equipment installation, upgrade and commissioning, and coordination with AEMO for modelling and compliance testing.
- \$9.3 million for commercial management, which includes managing the upstream contract (with NSW DCCEEW) and downstream contracts (with the OEM and D&C contractors and third-party suppliers).
- \$17.3 million for project controls, including risk management, cost control and quality management.

Transgrid stated that the delivery of the project involves complex brownfield works, and having a suitable site presence on these high-risk brownfield sites is critical to ensure the project is delivered safely, in accordance with the contract and required timelines. It also

noted that recent substation brownfield projects have demonstrated that allocating the appropriate level of internal resourcing ensures an efficient outcome over the long term.<sup>141</sup>

Transgrid's forecast for the project delivery management functions reflects an average internal labour requirement of 76.5 full-time equivalent (FTE) positions over the 2026–31 regulatory period.<sup>142</sup> Transgrid's bottom-up forecast was validated through an internal top-down review and external reviews from GHD and North Projects. At a high level, North Projects found Transgrid's labour costs as a proportion of the construction cost to be slightly above the median of other comparator projects but considered this reasonable given the geographically dispersed nature of the sites and multiple complex contractual interfaces. At a more granular level, North Projects found that the design cost ratio was slightly higher, but the project management cost ratio lower, when compared to the median of the comparator projects.<sup>143</sup>

In our preliminary position paper, we acknowledged that Transgrid had verified its bottom-up capex forecast through a top-down review. However, we considered that further analysis was necessary to determine whether the proposed project delivery management costs duplicated risk costs or costs associated with the proposed adjustment mechanisms in that these either include, or may lead to, additional labour costs.

The submissions from Louise Benjamin and Gavin Dufty, and CCP35, on our preliminary position paper supported further assessment of the proposed project delivery management costs to test prudence, efficiency and reasonableness of Transgrid's proposal.<sup>144</sup> The submissions also stated that there should be no duplication or overlap in labour and indirect costs for managing risk across the base allowance, risk costs, provisional sums and adjustment events.

Transgrid's submission on our preliminary position paper noted our concerns that some costs, particularly labour and project delivery management costs, may duplicate risk costs or costs recovered through adjustment mechanisms. It maintained that its forecast project delivery management costs are prudent, efficient and reasonable, and are not duplicated across labour activities, risk allowances or adjustment mechanisms.<sup>145</sup>

In response to our information request, Transgrid acknowledged that the perception of double counting may have resulted from similar or identical risk descriptions in its risk costs and provisional sums, which should have been distinguished more clearly. Transgrid's response and our further analysis of Transgrid's risk register (see section 10.2.4) adequately addressed our concerns about duplication with other capex categories.

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<sup>141</sup> Transgrid, *A.3 – System Strength Project 2026–31 – Non-Contestable Labour and Indirect Capex Forecasting Methodology*, April 2026, p. 20.

<sup>142</sup> Transgrid, *A.3 – System Strength Project 2026–31 – Non-Contestable Labour and Indirect Capex Forecasting Methodology*, April 2026, p. 21.

<sup>143</sup> North Projects, *S.1 – System Strength Project 2026–31 – Project Owner's Cost Assessment Report*, March 2026.

<sup>144</sup> Louise Benjamin and Gavin Dufty, *Submission on System Strength Project 2026–31 Revenue Proposal*, July 2026, p. 8; Consumer Challenge Panel 35, *Submission on System Strength Project 2026–31 Revenue Proposal*, July 2026, p. 17.

<sup>145</sup> Transgrid, *Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, p. 2.

We undertook further analysis and sought to verify Transgrid's benchmarking results. We validated North Projects' high-level benchmarking of labour costs and found that Transgrid's proposed project delivery management costs (as a proportion of total capex) are broadly comparable with other recent large electricity transmission projects. These comparator projects include Ausgrid's Hunter-Central Coast Project, TasNetworks' North West Transmission Developments Stage 1 Project, and its own CWO Enabling Project.<sup>146</sup>

We reviewed Transgrid's assumptions on the nature of work, role descriptors, number of roles, and time and cost allocations. We are satisfied that:

- The forecast number of roles is reasonable, having regard to the scope of work required to oversee and coordinate the project and Transgrid's recent experience in delivering other brownfield substation projects. We note that Transgrid's labour forecast also appropriately includes overtime requirements to meet the accelerated delivery timeframe of the project.
- The internal labour rates applicable to each role are consistent with those included in Transgrid's recent projects. The contractor and non-labour rates are also consistent with existing supplier agreements and market conditions.

Based on our benchmarking (including our review of Transgrid's benchmarking), review of Transgrid's bottom-up forecast, and our concurrent assessment of risk costs, we are satisfied the proposed project delivery management costs are prudent, efficient and reasonable.

### 10.2.3 Infrastructure Planner Fees

Transgrid's capex forecast includes \$7.8 million (\$ September, 2026) in IPFs for the System Strength Project.<sup>147</sup> These costs are subject to an annual cap of \$2 million (\$ nominal). Our final decision is to accept the approach Transgrid has taken in modelling its IPFs in the EII PTRM, as its revenue proposal seeks an amount that reflects what it is contractually required to pay NSW DCCEEW. We will exclude these costs from CESS as they are a contractual payment and should not form part of the incentive arrangement (see section 13.2.1).

We are required to take into account the principle that Transgrid is entitled to recover payments it is required to pay the Infrastructure Planner, where the requirement is contained in the contractual arrangements entered under the authorisation.<sup>148</sup> To the extent that the Infrastructure Planner Fees (IPFs) set out in the contractual arrangements conform with the EII Regulation, we are not required to assess the prudence, efficiency, and reasonableness of these costs.

Our assessment of Transgrid's proposal and the further supporting information provided by NSW DCCEEW is that Transgrid is required to pay the IPFs to NSW DCCEEW under

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<sup>146</sup> AER, *Final decision – Ausgrid – Hunter-Central Coast REZ non-contestable project 2026–31*, December 2025; TasNetworks, *NWTD Stage 1 Contingent Project Application – Construction – A.1 Principal Application*, October 2025; AER, *Final decision – Transgrid – Central-West Orana Enabling REZ non-contestable project 2026–31*, January 2026.

<sup>147</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 82.

<sup>148</sup> EII Regulation, cl. 46(1)(b)(ii).

clause 7.2 of the Underwriting Agreement. The Underwriting Agreement is a contractual arrangement that Transgrid is required to enter into under the PNIP Direction.<sup>149</sup>

Although we are not required to assess the prudence, efficiency, and reasonableness of IPFs, we sought further transparency over the costs underpinning the IPFs and the governance arrangements in place to ensure prudence, efficiency and reasonableness of costs. On 20 May 2026, we sent a letter to DCCEEW requesting information on the IPFs for the System Strength Project, including the nature of the underlying contractual costs and governance arrangements for the approval and oversight of these costs.

On 4 June 2026, NSW DCCEEW responded to our questions, which included a breakdown of the IPFs as well as details on the governance arrangements for the IPFs. NSW DCCEEW advised that the IPFs related to its performance of statutory functions and contractual arrangements. It included the following completed and planned activities:

- Preparing a report recommending the Minister direct Transgrid to carry out the System Strength Project.
- Preparing contractual arrangements with Transgrid that govern how it performs its Network Operator functions.
- Overseeing the competitive processes for the contestable components of the System Strength Project.
- Providing advice to the Minister and the Regulator on Transgrid's delivery against the PNIP Direction for the System Strength Project.
- Managing the contractual arrangements with Transgrid, including monitoring Transgrid's management of the contracts it has executed with GE Vernova, CPP and UGL.
- Coordinating with other NSW Government agencies to secure permits for activities relating to the construction of the System Strength Project, for example Over Sized Over Mass truck movements.

#### 10.2.4 Risk costs

Our final decision is to include \$93.7 million (\$ September, 2026) for risk costs in our alternative capex estimate. This comprises:

- costs proposed by Transgrid as part of its non-contestable capex forecast;
- costs associated with a subset of risk events related to the OEM and D&C contracts, which were proposed within the provisional sums and subsequently re-estimated by Transgrid;<sup>150</sup> and
- additional D&C contract costs due to the Middle East conflict (with associated expenditure not subject to the CESS).

Our decision accepts Transgrid's alternative approach to the allocation of risks between provisional sums and the risk cost allowance as set out in its submission to our preliminary

<sup>149</sup> NSW Government Gazette, *Number 115 – Electricity and Water*, 27 March 2026, Schedule 1, cl. 2(a).

<sup>150</sup> The remaining contract-related risks previously included in Transgrid's provisional sums capex forecast will be subject to adjustment mechanisms (discussed in section 14).

position paper. This decision resulted in approximately one third of the total provisional sum value transferring into an updated risk cost allowance.

A breakdown of risk costs included in our alternative capex estimate is provided in Table 10.3.

**Table 10.3 Risk costs included in capex allowance (\$ million, September 2026)**

| Risk category                         | Description of risks                                                                                                                                                                                                       | Amount      |
|---------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------|
| Commissioning challenges              | Changes to commissioning approach requiring additional upgrading of equipment or additional Transgrid oversight.                                                                                                           | 17.5        |
| Equipment issues                      | Includes delays associated with Transgrid-supplied equipment such as defects and risks arising from global supply chain constraints (includes Middle East conflict costs). <sup>151</sup>                                  | 23.3        |
| Construction and interface challenges | Includes but is not limited to inclement weather (where this is not covered by the contracts), additional protections associated with working in a brownfield environment, and misalignment between contract requirements. | 10.2        |
| Resourcing                            | Additional network modelling due to complexity or additional Transgrid supervision due to concurrent projects at the sites.                                                                                                | 4.0         |
| Environment and community             | Unanticipated noise requiring additional sound mitigation measures to those included in technical specifications.                                                                                                          | 6.7         |
| Prolongation                          | Prolongation of resources related to the risk events listed in this table.                                                                                                                                                 | 32.0        |
| <b>Total</b>                          |                                                                                                                                                                                                                            | <b>93.7</b> |

Source: AER analysis.

We are required to include in our revenue determination amounts for other risks for which the Network Operator is not already compensated.<sup>152</sup> This includes risk costs which account for external factors that the Network Operator does not have complete control over, such as contract variations with its contractors, but can nonetheless increase the cost of a large infrastructure project.

One of the principles we must consider is that incentives should be given to Network Operators to promote economic efficiency.<sup>153</sup> Risk costs are subject to the CESS.<sup>154</sup> This provides better incentives to Transgrid to control costs compared to adjustment mechanisms, which do not incentivise efficiency as effectively (that is, the management and mitigation of risks during the project). However, including risk costs in the ex-ante capex allowance is only

<sup>151</sup> Specific contract amounts associated with the Middle East conflict are commercially sensitive and are combined with Transgrid's revised calculation of risk costs for equipment issues. Further discussion of these costs is in section 10.2.5.

<sup>152</sup> EII Act, s. 38(2); EII Regulation, cl. 50A.

<sup>153</sup> EII Act, s. 37(1)(b).

<sup>154</sup> Excluding Middle East conflict costs, as discussed in the following section.

appropriate where Transgrid has a sufficient degree of control over the relevant risk events. We also consider the modelling assumptions made by Transgrid, including the probability of each risk event occurring and its estimated cost impact. Where risk events are unlikely to occur and/or the expected cost impact of the risk event is highly variable, they should instead be subject to adjustment mechanisms.

Our assessment approach for risk costs is detailed in section 6.3 of our assessment approach guidance note.<sup>155</sup> This approach is analogous to our approach for project risks for actionable ISP projects.<sup>156</sup>

### Transgrid's proposal and our preliminary position

Transgrid proposed \$195.2 million in capex for provisional sums for contract-related risks under the OEM contract and D&C contracts. The provisional sums were intended to manage identified risks for which the contestable procured contractors are entitled to a contract variation (should they occur). Transgrid considered that these were an outcome of its competitive assessment processes and therefore prudent, efficient and reasonable. If the total approved (by Transgrid) contract variations differed from the provisional sum, then Transgrid would true-up the provisional sum via an adjustment mechanism. Transgrid used a deterministic approach (modelling isolated scenarios based on the contractor's bid unit costs) to estimate provisional sums. Transgrid also proposed provisional sums for opex (discussed in section 11).

Transgrid also proposed \$18.4 million for risk costs covering non-contestable risks. It adopted a probabilistic approach (i.e. Monte Carlo analysis) with costs and probabilities attached to different scenarios, and selected P50 values for its cost forecasts.<sup>157</sup> This approach is consistent with our recent revenue determinations.<sup>158</sup>

Transgrid's approach to risk was a focus issue in our preliminary position paper. Given our preliminary position to remove provisional sums capex, our preliminary position was that for each contract variation risk, Transgrid should instead receive either an ex-ante risk cost allowance subject to the CESS or an adjustment mechanism, but not both.

### Subsequent information request and Transgrid's response

After the release of our preliminary position paper, we reviewed Transgrid's risk register (the basis of its non-contestable capex forecast) and its cost estimates for risk events associated with the proposed provisional sums, and identified the following issues:

- risk events in the risk register were not all modelled on a site-specific basis
- prolongation costs were attributed to individual risk events rather than quantified separately

<sup>155</sup> AER, *Guidance note on the AER's EII Assessment Approach for Non-contestable revenue determinations*, August 2026.

<sup>156</sup> AER, *Guidance note: Regulation of actionable ISP projects*, March 2021, pp. 16–20.

<sup>157</sup> A P50 estimate means there is a 50% (equal) probability that the costs will be greater or less than the estimate.

<sup>158</sup> See for example: AER, *Determination – Transgrid HumeLink Stage 2 Contingent Project*, August 2024, pp. 35–38.

- probability and cost assumptions for provisional sums were not transparent and capable of review.

We requested that Transgrid undertake its Monte Carlo analysis for all risk events, including those previously estimated as provisional sums, and update its risk cost forecast. We also asked Transgrid to provide a status update for each risk event, including whether and how the probability of occurrence and expected cost impacts had changed, or if they had expired.

Transgrid's response to our preliminary position paper reiterated its preference for all contract-related risks to be addressed through adjustment mechanisms and not included in the capex allowance.

However, it also suggested an alternative approach, which was to move approximately one third of the total provisional sum value into an updated risk cost allowance based on an updated assessment of the identified risk events. Transgrid considered the remaining risk events should be included in adjustment mechanisms instead of a risk cost allowance as they relate to 3 issues that are outside its effective control:

- scope growth after finalisation of design
- site conditions differing from those assumed at tenders
- third party interface requirements.

In response to our information request, Transgrid updated its risk cost modelling. As part of this update, it retired 9 risk events and added 17 new risk events to reflect updates since the development of the initial December 2025 risk register. This resulted in 105 total risk events. Transgrid considered that 39 out of the 105 risk events fell into one of the 3 proposed risk categories above, whereas the remaining 66 risk events were within its control and were able to be valued reasonably, and therefore could be recovered through the ex-ante capex allowance.

Transgrid's updated risk cost modelling addressed our concerns by estimating contract-related risks on a probabilistic basis, quantifying site-specific risk costs and estimating prolongation costs for the 66 risk events combined.

Transgrid also engaged Aurecon to provide an independent assessment of its updated risk position. Aurecon concluded that Transgrid's revised risk cost forecast addressed our concerns and the analysis undertaken was consistent with industry standards.

### Other preliminary position paper submissions

The submissions from Louise Benjamin and Gavin Dufty and CCP35 on our preliminary position paper noted that it is in consumers' interests that the AER is satisfied that risk costs are prudent, efficient, and reasonable, and do not overlap with other cost recovery mechanisms.<sup>159</sup> These two submissions also commented on how Transgrid did not previously engage on provisional sums as it considered them to be contestable.

Furthermore, Louise Benjamin and Gavin Dufty submitted that:

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<sup>159</sup> Consumer Challenge Panel 35, *Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, pp. 5, 14, 16–17; Louise Benjamin and Gavin Dufty, *Late Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, pp. 4–6, 8, 14.

- a risk allowance should not be provided for third-party interface risks
- they were concerned with the steps that Transgrid took with impacted communities and what noise abatement measures might be needed.

### Final decision

Our final decision accepts Transgrid's alternative risk allocation approach and reflects the ex-ante capex allowance now including some contract-related risks. We are satisfied that these risk events are at least partially within Transgrid's control and are estimated on a reasonable basis (at the P50 level). The remaining risk events are reasonable to be provided through an adjustment mechanism because they represent highly variable, unknown costs or are reliant on a third party that the Network Operator cannot control. We consider our decision best balances incentives for Transgrid to manage and mitigate project risks efficiently while avoiding the need for customers to pay more than necessary for risks where costs are uncertain.

This approach is consistent with Louise Benjamin and Gavin Dufty's submission that a risk allowance should not be provided for third-party interface risks. We have also reviewed Transgrid's revised risk register and cross-referenced the risks with capital expenditure in other categories to ensure no duplication. We note that expenditure for noise abatement is provided in the base capex forecast as well as potential additional works being captured in the 'Environment and community' risk category in the risk cost allowance.

To support our decision, we conducted top-down benchmarking of Transgrid's risk costs under our decision against recent comparator EII framework projects, by comparing the risk cost to total capex ratios. While the other projects are not directly comparable because they involve the construction of new transmission lines rather than the installation of synchronous condensers, all projects involve some level of substation works. We found that given the complexity of this project, our decision on capex for risk costs is broadly consistent with our previous decisions for the comparator projects. We also reviewed Aurecon's analysis of Transgrid's alternative approach and agree with its conclusion that Transgrid's input assumptions are transparent and that Transgrid's approach addresses the concerns we raised.

### 10.2.5 Middle East conflict costs

Our final decision accepts Transgrid's proposed additional costs associated with the Middle East conflict.<sup>160</sup> The amount is approximately equivalent to 2% of the total capex allocated to contestable contracts and is included in the risk costs capex allowance set out in section 10.2.4. These costs will not be subject to the CESS.

At the time of Transgrid's revenue proposal, it was in negotiation with the D&C contractors in relation to treatment of risks associated with the Middle East conflict. Given this, Transgrid proposed to manage this risk through a D&C contract adjustment mechanism, and that the CESS should not apply to these costs.

In our preliminary position paper, we noted that the adjustment triggers related to the Middle East conflict were not an outcome of the competitive assessment process, but that it was

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<sup>160</sup> Specific contract amounts are commercially sensitive and have been combined with risk costs related to 'Equipment issues' in Table 10.3.

reasonable, in principle, to recover higher fuel and commodity costs because of the conflict.<sup>161</sup> We also noted that we would consider whether the CESS should apply to any adjustment amounts.

CCP35 supported us continuing our assessment of whether the CESS should apply to the Middle East costs. Similarly, the submission from Louise Benjamin and Gavin Dufty supported consideration of whether the Middle East adjustment event was beyond Transgrid's control.

Transgrid finalised negotiations with the D&C contractors in relation to additional costs associated with the Middle East conflict around the time we published our preliminary position paper. This included agreements for fixed and contingent payments based on future fuel prices. Transgrid subsequently confirmed that the triggers for the contingent payments to the D&C contractors had been met. Transgrid also reiterated its view that the CESS should not apply to Middle East conflict costs as the payments were the subject of intensive negotiations with the contractors and are entirely outside Transgrid's control.

Our final decision accepts the amount for Middle East conflict costs payable by Transgrid to the D&C contractors. Having regard to the information provided by Transgrid in response to information requests, including an independent review of the agreed costs that Transgrid commissioned from North Projects,<sup>162</sup> we are satisfied that the proposed costs are prudent, efficient and reasonable.

Transgrid proposed for these costs to be recovered through an adjustment mechanism. However, as these costs are now known, we have instead included the amount in the ex-ante capex forecast.<sup>163</sup> This approach avoids the need for making a future revenue adjustment.

These costs will not be subject to the CESS as they are fixed amounts agreed by Transgrid through the contractual arrangements with the D&C contractors. The application of the CESS would not have any practical effect in relation to incentives on Transgrid to efficiently manage these costs. Further discussion of this is in section 13.2.1.

### 10.2.6 Other capital expenditure

Our final decision is to accept Transgrid's proposed \$18.1 million (\$ September, 2026) for other capex related to easement acquisition, equipment, fleet acquisition and buildings. In our preliminary position paper, we noted that for these categories of capex, Transgrid's forecast is based on either independent advice or competitive market rates. Following our further analysis, we are satisfied the proposed capex for these activities is prudent, efficient and reasonable.

#### Easement acquisition

Transgrid proposed \$0.05 million (\$ September, 2026) in costs related to the acquisition of an easement at the Armidale substation from Crown Lands for the construction of the

<sup>161</sup> AER, *Preliminary Position Paper – System Strength Project*, June 2026, p. 41.

<sup>162</sup> North Projects, *CPP War Escalation Variation Assessment Report*, May 2026, Confidential.

<sup>163</sup> The triggers for cost relief associated with a change in law related to the Middle East conflict remain in the adjustment mechanisms for the D&C contract variation events (Appendix B).

synchronous condensers. These costs are expected to be incurred in the pre-period and include compensation payments and legal fees. We are satisfied these activities are necessary to deliver the project and the costs have been estimated reasonably.

### **Equipment**

Transgrid proposed \$10.3 million (\$ September, 2026) in equipment costs for high-voltage plant, equipment and secondary systems. Most of these costs are forecast to be incurred in the pre-period, as Transgrid ordered its high-voltage plant early due to significant lead times for this type of equipment. The high-voltage plant includes 330 kV circuit breakers, current transformers, earth switches and insulators required for Transgrid's substations. Transgrid's forecast of these costs is based on existing supplier agreements, which were established through competitive procurement processes. We are satisfied with Transgrid's approach to procuring this equipment and that the costs have been reasonably estimated.

### **Fleet acquisition**

Transgrid proposed \$0.6 million (\$ September, 2026) in fleet acquisition costs, which it forecasts will be incurred in the pre-period. The forecast costs are for site vehicles for construction management staff and are based on Transgrid's existing vehicle supply arrangements. We are satisfied these vehicles are necessary to enable travel to each site and the costs have been estimated reasonably.

### **Buildings**

Transgrid proposed \$7.1 million (\$ September, 2026) in construction costs to enable the storage of synchronous condenser, primary system and secondary system spares. Transgrid submitted that its new storage requirements will exceed the currently available capacity at its warehousing locations, and that upgrading existing storage facilities is more cost-effective than purchasing new facilities. The forecast costs are based on early market rates from suppliers. We are satisfied that additional storage for capital spares is necessary, and the costs have been estimated reasonably.

# 11 Operating expenditure

Operating expenditure (opex) refers to operating, maintenance and other non-capital expenses associated with the project. Forecast opex for regulated network services is one of the building blocks we use to determine a Network Operator's total revenue cap.<sup>164</sup>

Under the regulatory framework, Transgrid's revenue proposal must include the total forecast opex it considers is required to meet or manage the expected demand for regulated network services, comply with all applicable regulatory requirements and maintain the safety of the network infrastructure project through the supply of regulated network services (the opex objectives).<sup>165</sup> We must determine whether or not we are satisfied Transgrid's forecast opex (including pre-period opex) reasonably reflects the opex criteria.<sup>166</sup> In doing so, we must have regard to the opex factors specified in EII Chapter 6A.<sup>167</sup> If we are not satisfied, we must explain this decision and provide an estimate of the total opex we are satisfied reasonably reflects the opex criteria, taking into account the opex factors.<sup>168</sup>

Our assessment approach for opex is detailed in section 8 of our assessment approach guidance note.<sup>169</sup>

## 11.1 Transgrid's proposal

Transgrid proposed \$60.1 million (\$ September, 2026) in forecast opex over the 2026–31 regulatory period. Transgrid has not sought to recover any pre-period opex in its revenue proposal. Table 11.1 sets out the total forecast opex by category and year.

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<sup>164</sup> EII Chapter 6A, cl. 6A.5.4(a)(6).

<sup>165</sup> EII Chapter 6A, cl. 6A.6.6(a).

<sup>166</sup> The opex criteria include: (1) the efficient costs of achieving the opex objectives; (2) the costs a prudent operator would require to achieve the opex objectives; and (3) a realistic expectation of the cost inputs required to achieve the opex objectives. See: EII Chapter 6A, cl. 6A.6.6(c).

<sup>167</sup> EII Chapter 6A, cl. 6A.6.6(e).

<sup>168</sup> EII Chapter 6A, cl. 6A.14.1(3).

<sup>169</sup> AER, *Guidance note on the AER's EII Assessment Approach for Non-contestable revenue determinations*, August 2026.

**Table 11.1 Transgrid’s proposed opex by category (\$ million, September 2026)**

| Category                                         | 2026–<br>27 | 2027–<br>28 | 2028–<br>29 | 2029–<br>30 | 2030–<br>31 | Total       |
|--------------------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Contestable components                           | -           | 2.0         | 7.1         | 6.7         | 8.6         | 24.4        |
| Maintenance costs                                | -           | 1.5         | 2.6         | 3.4         | 3.4         | 10.9        |
| Operating costs                                  | 0.5         | 3.0         | 4.6         | 5.6         | 5.2         | 18.9        |
| Insurance costs                                  | -           | 0.2         | 0.8         | 0.9         | 0.9         | 2.8         |
| Real input cost escalation                       | -           | 0.0         | 0.1         | 0.3         | 0.4         | 0.8         |
| <b>Total opex (excluding debt raising costs)</b> | <b>0.5</b>  | <b>6.9</b>  | <b>15.2</b> | <b>16.9</b> | <b>18.3</b> | <b>57.8</b> |
| Debt raising costs                               | 0.2         | 0.4         | 0.6         | 0.6         | 0.6         | 2.2         |
| <b>Total opex (including debt raising costs)</b> | <b>0.6</b>  | <b>7.3</b>  | <b>15.8</b> | <b>17.4</b> | <b>18.9</b> | <b>60.1</b> |

Source: Transgrid, *M.3 – System Strength Project 2026–31 – Opex Forecast Model*, April 2026.

Note: Numbers may not sum due to rounding.

## 11.2 AER final decision

Our final decision is to provide an alternative opex estimate of \$58.6 million (\$ September, 2026), which is \$1.4 million less than Transgrid’s proposal. We consider this forecast to reflect prudent, efficient and reasonable costs to meet the opex objectives. Our alternative opex estimate reflects our decision that Transgrid’s proposed provisional sums opex (within the proposed contestable components) should instead be recoverable through the adjustment mechanism for the LTSA contract variation events (discussed in section 14.2.2). This final decision also reflects our updates to the return on debt (due to its impact on debt raising costs) and our decision on forecast inflation.

**Table 11.2 AER's final decision total opex forecast (\$ million, September 2026)**

| Category                                         | 2026–<br>27 | 2027–<br>28 | 2028–<br>29 | 2029–<br>30 | 2030–<br>31 | Total       |
|--------------------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Contestable components                           | -           | 2.0         | 7.1         | 6.7         | 6.7         | 22.6        |
| Maintenance costs                                | -           | 1.5         | 2.6         | 3.4         | 3.4         | 10.9        |
| Operating costs                                  | 0.5         | 3.0         | 4.6         | 5.6         | 5.2         | 18.9        |
| Insurance costs                                  | -           | 0.2         | 0.8         | 0.9         | 0.9         | 2.8         |
| Real input cost escalation                       | -           | 0.0         | 0.1         | 0.3         | 0.4         | 0.8         |
| <b>Total opex (excluding debt raising costs)</b> | <b>0.5</b>  | <b>6.9</b>  | <b>15.3</b> | <b>16.9</b> | <b>16.5</b> | <b>56.0</b> |
| Debt raising costs                               | 0.2         | 0.5         | 0.6         | 0.7         | 0.6         | 2.6         |
| <b>Total opex (including debt raising costs)</b> | <b>0.7</b>  | <b>7.4</b>  | <b>15.9</b> | <b>17.5</b> | <b>17.2</b> | <b>58.6</b> |

Source: AER analysis.

Note: Numbers may not sum due to rounding.

### 11.2.1 Contestable opex

Transgrid proposed \$24.4 million as contestable opex for LTSA and generator performance standard compliance testing costs. This included \$1.9 million for provisional sums in the forecast regulatory period.

The LTSA is a contract between Transgrid and GE to undertake maintenance activities on the synchronous condensers over a 10-year period. Our preliminary position was to accept Transgrid's contract sums as the outcome of a genuine and appropriate competitive assessment process. However, our preliminary position was not to accept the proposed provisional sums because Transgrid was able to recover relevant costs through the adjustment mechanism for the LTSA contract variation events. Any recovery through that mechanism will be subject to our review once the scope of works to be performed by GE under the LTSA is confirmed at the time of its adjustment proposal. Transgrid accepted this position.<sup>170</sup>

Consistent with our preliminary position, we excluded the proposed provisional sums from our alternative opex estimate. The total contestable component of our alternative opex estimate is \$22.6 million.

### 11.2.2 Non-contestable opex

Transgrid proposed \$35.6 million in non-contestable opex for maintenance costs, operating costs, insurance, labour escalation and debt raising costs. GHD reviewed Transgrid's non-contestable opex forecast and concluded its bottom-up build was robust, based on the

<sup>170</sup> Transgrid, *Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, pp. 2, 10.

incremental activities required, and that the expenditure was needed to manage life cycle risks and regulatory obligations.<sup>171</sup>

As this is Transgrid's initial revenue determination for the System Strength Project we do not have a base year from a preceding regulatory period on which to assess its proposed opex. As such, we were not able to rely on our usual base-step-trend forecasting approach to develop an alternative estimate for opex. Instead, we relied on a bottom-up cost assessment approach to evaluate whether each of the forecast opex cost categories was prudent, efficient and reasonable.

We reviewed the information and assumptions provided by Transgrid, including GHD's assessment, and found that the forecast non-contestable opex has been reasonably estimated and should form the base operating expenditure for the project. On this basis, we are satisfied the proposed non-contestable opex is prudent, efficient and reasonable.

### **Maintenance costs**

Transgrid proposed \$10.9 million for maintenance costs relating to activities not covered by the LTSA, including residual maintenance, access and site-based activities to ensure the ongoing safety, reliability and availability of the transmission network. The proposed maintenance activities are assumed to commence from commissioning of assets and then ramp up progressively.

We are satisfied that the proposed maintenance costs are prudent, efficient and reasonable as the estimated number and frequency of maintenance activities is appropriate, and costs are based on current unit rates and historical defect allowances. GHD's assessment of workforce constraints also substantiated the need for incremental resources.<sup>171</sup>

### **Operating costs**

Transgrid proposed \$18.9 million for operating costs related to asset management, maintenance program development, coordination and oversight, network planning and asset operation; and regulatory activities. The proposed operating activities are assumed to commence from commissioning of assets, except for regulatory activities.

We are satisfied that the proposed operating costs are prudent, efficient and reasonable as these activities are necessary to operate the new assets, meet regulatory requirements and securely manage the network once the synchronous condensers are operational. GHD supported the proposed operating costs and noted the cost components are also based on current rates.<sup>172</sup>

### **Insurance costs**

Transgrid proposed \$2.8 million for insurance costs, covering estimated premiums for operational property damage and liability, internal administration and annual broker fees. The estimate is based on independent advice from Marsh and applies only once the assets progressively enter operation.<sup>173</sup>

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<sup>171</sup> Transgrid, *GHD – S.6 – System Strength Project 2026–31 – Accelerated Syncon Project*, March 2026, pp. iv–v.

<sup>172</sup> Transgrid, *GHD – S.6 – System Strength Project 2026–31 – Accelerated Syncon Project*, March 2026, p. v.

<sup>173</sup> Transgrid, *Marsh – S.3 – System Strength Project 2026–31 – Insurance Report*, February 2026.

We are satisfied the proposed insurance costs are prudent, efficient and reasonable, as the insurance is required to cover risks that cannot be avoided cost effectively, and costs have been estimated independently.

### **Labour escalation costs**

Transgrid proposed \$0.8 million for labour escalation costs over the regulatory period using forecasts prepared by Oxford Economics.<sup>174</sup> This involves using the official near-term CPI forecasts from the Reserve Bank of Australia (RBA) and a longer-term average based on the 2.5% mid-point of the RBA's inflation target band of 2% to 3%.

Our standard approach to labour escalation involves adopting the average of two Electricity, Gas, Water and Waste Services wage price index forecasts. However, in this instance, it would not lead to a materially different forecast than that proposed by Transgrid. Therefore, our final decision adopts the labour escalation costs proposed by Transgrid.

### **Debt raising costs**

Transgrid proposed \$2.2 million for debt raising costs using the AER's preferred benchmarking approach from Transgrid's 2023–28 revenue determination. As noted in section 8.2.5, debt raising costs have increased due to changes in the cost of debt. In our alternative opex estimate we have included \$2.6 million for debt raising costs.

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<sup>174</sup> Transgrid, *Oxford Economics – System Strength Project 2026–31 – Labour escalation Forecasts to 2031*, February 2026, p. 16.

## 12 Corporate income tax

Our revenue determination includes the estimated cost of corporate income tax for Transgrid's 2026–31 period.<sup>175</sup> Under the post-tax framework, the cost of corporate income tax is calculated as part of the building block assessment using our EII PTRM. This amount allows Transgrid to recover the costs associated with the estimated corporate income tax payable during the 2026–31 period. Our assessment approach for corporate income tax is detailed in section 9 of our assessment approach guidance note.<sup>176</sup>

### 12.1 Transgrid's proposal

Transgrid proposed an estimated cost of corporate income tax of \$0.4 million (\$ nominal) for the 2026–31 period using the EII PTRM, with the following inputs:<sup>177</sup>

- a zero opening tax asset base (TAB) value as at 1 October 2026, reflecting Transgrid's proposal to begin commissioning capex in the first year of the 2026–31 regulatory period
- an expected statutory income tax rate of 30% per year
- a value of imputation credits (gamma) of 0.57
- asset classes and standard tax asset lives for depreciating its forecast capex for the 2026–31 period consistent with those approved by the AER for Transgrid's 2023–28 determination under the NER.<sup>178</sup>

Transgrid has also proposed to use our EII PTRM in calculating tax depreciation on a diminishing value approach, except for 'Buildings – capital works' and equity raising costs which are depreciated on a straight-line basis.

Table 12.1 sets out Transgrid's proposed cost of corporate income tax for the 2026–31 regulatory control period.

**Table 12.1 Transgrid's proposed cost of corporate income tax for the 2026–31 regulatory control period (\$ million, nominal)**

|                                         | 2026–27    | 2027–28  | 2028–29  | 2029–30  | 2030–31  | Total      |
|-----------------------------------------|------------|----------|----------|----------|----------|------------|
| Tax payable                             | 0.8        | -        | -        | -        | -        | 0.8        |
| Less: value of imputation credits       | 0.5        | -        | -        | -        | -        | 0.5        |
| <b>Net cost of corporate income tax</b> | <b>0.4</b> | <b>-</b> | <b>-</b> | <b>-</b> | <b>-</b> | <b>0.4</b> |

Source: Transgrid, *M.6 – System Strength Project 2026–31 – EII Post Tax Revenue Model (PTRM)*, April 2026.

<sup>175</sup> EII Regulation, cl. 50A(b), EII Chapter 6A, cl. 6A.5.4(a)(4).

<sup>176</sup> AER, *Guidance note on the AER's EII assessment approach for non-contestable revenue determinations*, August 2026, pp. 33–37.

<sup>177</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 105; Transgrid, *M.6 – System Strength Project 2026–31 – EII Post Tax Revenue Model (PTRM)*, April 2026.

<sup>178</sup> AER, *Transgrid 2023–28 – Final Decision – PTRM*, April 2023.

Note: Totals may not sum due to rounding.

## 12.2 AER final decision

Our final decision estimates a cost of corporate income tax of \$0.5 million (\$ nominal) over the 2026–31 period. This represents an increase of \$0.1 million from Transgrid's proposal of \$0.4 million. The primary reason for this increase is due to our final decision on a higher rate of return on equity (section 8.2).

Table 12.2 sets out our final decision on the estimated cost of corporate income tax for Transgrid over the 2026–31 period.

**Table 12.2 AER's final decision on Transgrid's cost of corporate income tax for the 2026–31 period (\$ million, nominal)**

|                                         | 2026–27    | 2027–28  | 2028–29  | 2029–30  | 2030–31  | Total      |
|-----------------------------------------|------------|----------|----------|----------|----------|------------|
| Tax payable                             | 1.1        | -        | -        | -        | -        | 1.1        |
| Less: value of imputation credits       | 0.6        | -        | -        | -        | -        | 0.6        |
| <b>Net cost of corporate income tax</b> | <b>0.5</b> | <b>-</b> | <b>-</b> | <b>-</b> | <b>-</b> | <b>0.5</b> |

Source: AER analysis.

Our final decision also forecasts a total tax loss of \$64.2 million (\$ nominal) in the final year of the 2026–31 period, resulting from estimated tax losses in the last four years of the regulatory period (section 12.2.3). This is because the System Strength Project is a new standalone project under the EII Act, and therefore total tax expenses outweigh taxable revenues.

The key components of our tax treatment are discussed in the following sections.

### 12.2.1 Opening TAB as at 1 Oct 2026 and remaining tax asset lives

Our final decision is to determine an opening TAB of zero, consistent with Transgrid's proposal. This is because there is no as commissioned capex prior to 1 October 2026.<sup>179</sup> Given that there is no opening value for the TAB, there is no need to nominate remaining tax lives in this decision.

### 12.2.2 Standard tax asset lives

We accept Transgrid's proposed standard tax asset lives for Transmission lines, Substations, Secondary systems, Minor Plant, Motor Vehicles & Mobile Plant, Land and easements, Synchronous Condensers, Buildings - capital works and Equity raising costs, as they are:

<sup>179</sup> The EII PTRM calculates tax depreciation on an as commissioned basis.

- consistent with the values prescribed by the Deputy Commissioner of Taxation in ATO Taxation Ruling 2025/20<sup>180</sup>
- the same as the approved standard tax asset lives in our 2023–28 determination for Transgrid under the NER.<sup>181</sup>

Consistent with section 9.2.1, our final decision PTRM removes the 'In-house software' asset class alongside several placeholder asset classes<sup>182</sup> as they do not have any forecast capex allocated and, as such, we are not required to make a decision on the corresponding standard tax lives for these asset classes.

Table 12.3 sets out our final decision on the standard tax asset lives for Transgrid. We are satisfied that:

- the standard tax asset lives are appropriate for application over the 2026–31 period.
- the standard tax asset lives provide an estimate of the tax depreciation amount that would be consistent with the tax expenses used to estimate the annual taxable income for a benchmark Network Operator delivering an efficient service.<sup>183</sup>
- all tax asset classes will depreciate under a diminishing value approach other than 'Buildings – capital works' and equity raising costs (which will depreciate under a straight-line methodology), consistent with the ATO rulings.<sup>184</sup>

**Table 12.3 AER's final decision on Transgrid's standard tax asset lives for the 2026–31 regulatory control period (years)**

| Asset class                                | Standard tax asset life |
|--------------------------------------------|-------------------------|
| Transmission lines                         | 50.0                    |
| Substations                                | 40.0                    |
| Secondary systems                          | 15.0                    |
| Minor Plant, Motor Vehicles & Mobile Plant | 8.0                     |
| Land and easements <sup>a</sup>            | n/a                     |
| Synchronous Condensers                     | 30.0                    |
| Buildings - capital works <sup>b</sup>     | 40.0                    |
| Equity raising costs <sup>b</sup>          | 5.0 <sup>c</sup>        |

Source: AER analysis.

a) Not applicable. We have not assigned a standard tax asset life to the Land and easements asset class because this asset is not subject to tax depreciation.

<sup>180</sup> ATO, *Taxation Ruling LI 2025/20 – Income tax: effective life of depreciating assets* (applicable from 16 September 2025).

<sup>181</sup> AER, *Final Decision – Overview – Transgrid – 2023–28 Transmission revenue proposal*, April 2023.

<sup>182</sup> This includes several placeholder financeability asset classes as well as a placeholder asset class for tax straight-line depreciation.

<sup>183</sup> EII Chapter 6A, cl. 6A.6.4.

<sup>184</sup> AER, *Guidance note on the AER's EII assessment approach for non-contestable revenue determinations*, August 2026, pp. 35–36.

- b) The 'Buildings - capital works' and Equity raising costs asset class use the straight-line method for tax depreciation. All other asset classes use the diminishing value method of tax depreciation.
- c) Under section 40-880 of the ITAA 1997, certain business capital expenditures, such as equity raising costs in this instance, are deductible on a straight-line basis over five years.

### **12.2.3 Tax loss carryover**

A business that has tax expenses which are greater than its taxable revenue in a period would not be subject to tax and generate a tax loss. A tax loss can be carried forward to offset against tax payable in the future.

Our final decision calculates tax losses for Transgrid for the four regulatory years from 2027–28 to 2030–31. The total tax loss at the end of the 2026–31 regulatory period is \$64.2 million (\$ nominal). This will be carried forward to Transgrid's following regulatory period and offset against future tax payable amounts.

## 13 Incentive schemes

When making a revenue determination, we are required to take into account the principle that incentives should be given to Network Operators to promote economic efficiency, and to pass such efficiencies on to consumers.<sup>185</sup>

Under the NER framework, we have developed the Capital Expenditure Sharing Scheme (CESS) and the Efficiency Benefit Sharing Scheme (EBSS) to provide financial incentives to Network Service Providers to achieve efficiencies in the construction, and ongoing operation, of projects. In accordance with our Non-contestable Guideline, we will apply these incentive schemes when making a non-contestable revenue determination, noting there are several matters our Non-contestable Guideline must not deal with including small-scale incentive schemes, the demand management innovation allowance mechanism, and removal of assets from the RAB.<sup>186</sup> Our current CESS is set out in version 4 of the Capital Expenditure Incentive Guideline.<sup>187</sup> Our current EBSS and assessment approach (for both the CESS and the EBSS) is detailed in section 11 of our assessment approach guidance note.<sup>188</sup>

Under the EII framework, the CESS and EBSS only apply to non-contestable expenditure and do not apply to a contestable component of a non-contestable revenue determination.<sup>189</sup> We must decide how any CESS is to apply to the Network Operator.<sup>190</sup> EII Chapter 6A sets out the factors we must take into account when deciding whether to apply a CESS, including the capital expenditure sharing scheme principles.<sup>191</sup> We have the discretion to decide whether to apply the EBSS to the Network Operator.<sup>192</sup>

### 13.1 Transgrid's proposal

#### 13.1.1 Transgrid's proposed CESS

Transgrid proposed to apply the CESS to its non-contestable expenditure for the 2026–31 regulatory period as per our Capital Expenditure Incentive Guidelines.<sup>193</sup> However, it proposed that major transport works, local council transport works,<sup>194</sup> and Middle East conflict-related costs be excluded from the CESS.<sup>195</sup> Transgrid proposed that it would be inappropriate to apply the CESS to these costs as they were outside of its control. To support

<sup>185</sup> EII Act, s. 37(1)(b).

<sup>186</sup> AER, *Revenue determination guideline for NSW non-contestable projects*, August 2026, p. 4; EII Regulation, cl. 47A(5)(f) to (g), (j).

<sup>187</sup> AER, *Capital Expenditure Incentive Guidelines for Electricity Network Service Providers (Version 4)*, August 2025.

<sup>188</sup> AER, *Guidance note on the AER's EII Assessment Approach for Non-contestable revenue determinations*, August 2026, pp. 46–52.

<sup>189</sup> EII Regulation, cl. 47B(1A).

<sup>190</sup> EII Chapter 6A, cl. 6A.4.2(a)(6A), 6A.14.1(5A).

<sup>191</sup> EII Chapter 6A, cl. 6A.6.5A.

<sup>192</sup> EII Chapter 6A, cl. 6A.6.5(a).

<sup>193</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026. p.137.

<sup>194</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026. p.138.

<sup>195</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026. p.140.

its position, Transgrid’s revenue proposal contained justification for the CESS exclusions based on our CESS application factors.<sup>196</sup> In summary, its position was that:<sup>197</sup>

- the scope, timing and cost of the associated transport works upgrades— such as road, bridge and civil works—had not yet been fully identified or approved.
- the need for, and cost of, transport works upgrades remains highly uncertain at the current time.
- delivering or managing transport projects is not Transgrid’s core business. In these circumstances, it is prudent and efficient for Transgrid to minimise its role in managing and delivering this work. This is contrary to the purpose of the CESS, which is to enhance the TNSP’s incentives to drive cost efficiencies.
- costs caused by the Middle East conflict are entirely beyond its control and it would not be appropriate to apply the CESS to costs caused by the Middle East conflict.<sup>198</sup>

Transgrid also proposed ex-post adjustment mechanisms to enable cost recovery for major transport work and council-related transport work (discussed in section 14.2.1), as well as Middle East conflict-related costs (discussed in section 10.2.5).<sup>199</sup>

### 13.1.2 Transgrid’s proposed EBSS

Transgrid proposed that we do not apply the EBSS to the System Strength Project over the 2026–31 regulatory period because:

- there is currently no historical revealed opex upon which to base forecasts
- the one-off and bespoke nature of EII non-contestable projects means we cannot use suitable benchmarking
- the initial regulatory period will be a design and construction phase meaning opex may not reach a level of recurrency or a steady state.

Transgrid indicated its proposed approach aligned with our draft position in the Incentive schemes for non-contestable network projects in NSW Guidance and our final decision on the non-contestable components for the Waratah Super Battery, Ausgrid’s HCC Project, and the Enabling CWO REZ project.<sup>200</sup>

Transgrid also proposed that the Service Target Performance Incentive Scheme (STPIS) not apply to the System Strength Project for the 2026–31 regulatory period, as a specific scheme is yet to be developed and would only apply from the second regulatory period.<sup>201</sup>

<sup>196</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026. pp. 139–140.

<sup>197</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026. pp. 138–139.

<sup>198</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026. p. 140.

<sup>199</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026. pp.124–130.

<sup>200</sup> AER, *Draft Guidance note – Incentive schemes for non-contestable projects in NSW*, August 2023.

<sup>201</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026. p. 137.

## 13.2 AER final decision

### 13.2.1 Application of the CESS over the 2026–31 period

Our final decision is to apply the standard CESS as set out in version 4 of the Capital Expenditure Incentive Guideline,<sup>202</sup> for Transgrid’s non-contestable capex excluding capex related to IPFs, council or other state road authority transport works, and the Middle East conflict costs.<sup>203</sup> We consider Transgrid has justified its proposal to exclude these costs from the CESS in our 2026–31 revenue determination for the System Strength Project. However, we do not consider Transgrid has adequately justified its proposal to exclude major transport works costs from this revenue determination at this point in time.

In considering CESS exclusions, our default position is to apply the standard CESS to all non-contestable capital expenditure (excluding equity raising costs), as set out in the Capital Expenditure Incentive Guideline, and make exclusions in only limited circumstances where there is a strong case to do so.<sup>204</sup> In determining whether to exclude costs from the CESS for the System Strength Project, we considered the factors outlined in Clause 6A.6.5A of EII Chapter 6A, our Capital Expenditure Incentive Guideline for Electricity Network Service Providers (Version 4),<sup>205</sup> the EII Act and EII Regulation,<sup>206</sup> and the circumstances noted in Transgrid’s revenue proposal.

We consider that:

- Council or other state road authority transport works costs are sufficiently outside of Transgrid’s control. Given this, changes in these costs are unlikely to be related to improvements or declines in the efficiency of its capex. Transgrid should not be rewarded or penalised by the CESS for changes unrelated to the efficiency of its capex.
- Middle East conflict costs are also sufficiently outside of Transgrid’s control, and so Transgrid should not be rewarded or penalised for changes in these costs. We also note that the Middle East conflict costs included in our determination are fixed (thus unable to change) and are therefore incentive-neutral.
- IPFs should be excluded from the CESS as they reflect contractual amounts payable to the Infrastructure Planner. These payments are outside of Transgrid’s control and are not subject to our assessment for prudence, efficiency and reasonableness. This is consistent with our application of the CESS in our final decision for previous EII non-contestable determinations.<sup>207</sup>

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<sup>202</sup> AER, *Capital Expenditure Incentive Guideline*, August 2025.

<sup>203</sup> This is the updated name for the local council Transport works which also includes the recovery of other state road authority costs.

<sup>204</sup> AER, *Guidance note on the AER’s EII Assessment Approach for Non-contestable revenue determinations*, August 2026, p. 49.

<sup>205</sup> AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers (Version 4)*, August 2025, p. 9.

<sup>206</sup> This includes the principles in section 37 of the EII Act and clause 46(1)(b) of the EII Regulation.

<sup>207</sup> AER, *Final decision – Transgrid – Central-West Orana Enabling REZ non-contestable project 2026–31*, January 2026, p. 62.

Applying CESS for the above expenditure would not promote efficient outcomes and would not be in the long-term interests of consumers.

We are currently unable to determine Transgrid's ability to influence its major transport works costs due to the high degree of uncertainty around the major transport works at this time. However, as noted in section 14.2, our final decision for the major transport works adjustment mechanism is to require a review and remake of our revenue determination for these costs. We expect that Transgrid will have greater certainty over its major transport works costs at that time, including the procurement process undertaken, the costs likely to be incurred, the degree of forecasting risk associated with any forecast capex, and its ability to influence these costs.

Louise Benjamin and Gavin Duffy's and the CCP35's submissions to our preliminary position paper did not support the application of the CESS to Transgrid's major transport works costs.<sup>208</sup> They were not confident that Transgrid or the AER had the relevant expertise to assess the prudence, efficiency and reasonableness of these works, or that Transgrid could control its costs for these works, irrespective of any CESS incentive. We acknowledge the concerns raised in these submissions and agree that if Transgrid cannot respond to CESS incentives due to its lack of control over major transport works then these costs should not be subject to the CESS. However, at the time of making our revenue determination we are not satisfied this is the case, due to the high degree of uncertainty around the major transport works. As noted in section 5.2.2.2, where we consider it necessary, we may seek independent expert advice to assist us in our assessment of major transport works.

As such, our decision is to apply the CESS (i.e. not exclude from the CESS) to major transport works in our 2026–31 revenue determination for the System Strength Project. However, Transgrid may apply for a CESS exclusion for major transport works costs at the time of our review and remake decision triggered by a major transport works adjustment mechanism.

We are satisfied that our application of the CESS will provide Transgrid with an appropriate incentive to undertake efficient capex for the System Strength Project, and the approved adjustment mechanisms (discussed in section 14.2) will allow Transgrid to manage any remaining uncertainty associated with the project.

We do not consider that the application of the CESS interacts with any other incentive scheme, as our final decision does not apply any other relevant incentive scheme.<sup>209</sup>

Table 13.1 provides the capex values that will be subject to the CESS under our decision.

**Table 13.1 AER's final decision on capex subject to CESS (\$ million, September 2026)**

|                       | 2026–27 | 2027–28 | 2028–29 | 2029–30 | 2030–31 | Total |
|-----------------------|---------|---------|---------|---------|---------|-------|
| Capex subject to CESS | 95.5    | 79.1    | 27.3    | -       | -       | 201.8 |

<sup>208</sup> Louise Benjamin and Gavin Duffy, *Late Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, pp. 9–11; Consumer Challenge Panel 35, *Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, p. 17.

<sup>209</sup> EII Chapter 6A cl. 6A.6.5A (g)(1).

Source: AER analysis.

### 13.2.2 Application of the EBSS over the 2026–31 period

Our decision on whether to apply the EBSS to non-contestable opex will be made at the end of the 2026–31 period as there is currently no historical opex upon which to base forecasts. At that time, we will consider whether Transgrid has revealed opex that is efficient and whether the 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 and final decision on non-contestable components for previous EII projects.<sup>210</sup>

Additionally, we consider that no STPIS should be applied to this project as no scheme under the EII framework has been developed and is only required to be applied at the remaking of the determination for the Network Operator.

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<sup>210</sup> AER, *Guidance note on the AER's EII Assessment Approach for Non-contestable revenue determinations*, August 2026, pp. 50–52; AER, *Final decision – Transgrid – Central-West Orana Enabling REZ non-contestable project 2026–31*, January 2026, p. 63.

## 14 Adjustment mechanisms

Adjustment mechanisms are pre-defined circumstances that allow a Network Operator to request the adjustment of an amount set out in a revenue determination.<sup>211</sup> These mechanisms are intended to account for risks that are outside a Network Operator's control and cannot be efficiently mitigated through other means.

Our approach to considering revenue adjustment mechanisms is described in our Non-contestable Guideline, Contestable Guideline and our assessment approach guidance note.<sup>212</sup>

Our role as the Regulator in a non-contestable EII process is to determine the amount payable to the Network Operator for carrying out the network infrastructure project based on our assessment of its revenue proposal and supporting information.<sup>213</sup> A Network Operator may include in its revenue proposal mechanisms to adjust an amount provided for in our revenue determination. The EII Regulation provides the AER with discretion as to whether to include an adjustment mechanism in its determination.<sup>214</sup>

As a general principle, negotiations between a Network Operator (in this case, Transgrid) and the Infrastructure Planner do not constrain us when making our determination under a non-contestable framework. We act as an independent assessor<sup>215</sup> of whether the proposed adjustment mechanisms will contribute to the recovery of prudent, efficient and reasonable costs.<sup>216</sup>

For adjustment mechanisms related to the contracts from the contestable packages, if we are satisfied that they are the outcome of a genuine and appropriate competitive assessment process, then we would accept them as part of our determination pursuant to the EII Regulation.<sup>217</sup>

### 14.1 Transgrid's proposal

Transgrid proposed 20 adjustment mechanisms in its revenue proposal. These were:<sup>218</sup>

- 4 prescribed adjustment mechanisms, for events contained in EII Chapter 6A of the Non-contestable Guideline.

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<sup>211</sup> EII Act, s. 38(3), EII Regulation, cl. 51.

<sup>212</sup> AER, *Revenue determination guideline for NSW non-contestable projects*, August 2026, p. 31–32; AER, *Revenue determination guideline for NSW contestable network projects*, August 2022, pp. 23–24; AER, *Guidance note on the AER's EII Assessment Approach for Non-contestable revenue determinations*, August 2026, pp. 38–45.

<sup>213</sup> EII Act, s. 38(1).

<sup>214</sup> EII Regulation, cl. 51.

<sup>215</sup> EII Act, s. 64(5).

<sup>216</sup> EII Act, s. 37(1)(a).

<sup>217</sup> EII Regulation, cl. 45(6).

<sup>218</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 109.

- 3 adjustment mechanisms for routine administrative events, to ensure inflation, return on debt and return on equity are able to be updated as required.
- 4 standard adjustment mechanisms that are commonly accepted in AER revenue determinations
- 5 adjustment mechanisms for cost change events reflected in competitively procured contracts, including minor transport works.<sup>219</sup>
- 4 adjustment mechanisms to cover changes to Transgrid's costs from events outside of its control and which cannot be reasonably mitigated, prevented or insured against, including:
  - A mechanism to capture consequential impacts on Transgrid's incurred costs due to variations to the competitive contracts.
  - Three transport works adjustment mechanisms to reflect the different pathways which may be followed for procurement and delivery of specific categories of transport works.

#### 14.1.1 Transgrid's proposed contractual adjustment mechanisms

The 4 contestable package contracts (the OEM, LTSA and 2 D&C contracts) include processes for varying the amounts payable under the contracts when specified risk events occur. The contracts also set out specific rates and indexation methods that may apply when calculating variation amounts.

To support the contractual processes, Transgrid included in its revenue proposal additional steps it would follow to assess variation claims under the contracts.<sup>220</sup> Transgrid developed 2 process flows: one for contract variations directed by Transgrid and the other for variations initiated by the contractor. The 2 processes were reviewed by NSW DCCEE and a third-party consultant, Qubist.<sup>221</sup> The processes expand on the contractual requirements for determining a variation amount by:

- establishing a role for the Infrastructure Planner in approving variations that are likely to have a value of more than \$5 million or may impact the project completion date
- describing additional steps Transgrid would take in assessing a variation amount, such as use of a quantity surveyor for claims over \$5 million or where internal expertise is not available.

Transgrid proposed that all variation amounts agreed with contractors should be recovered in full through the revenue determination and that the amounts would be prudent, efficient and reasonable if Transgrid followed the additional processes outlined in the proposal.

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<sup>219</sup> One contestable adjustment mechanism was proposed in the revenue proposal for all D&C contract variation events but in its response to Information Request #003, Transgrid split this into two; one adjustment mechanism for each D&C contract.

<sup>220</sup> Transgrid, *System Strength Project 2026–31 - Revenue Proposal*, April 2026, pp. 115, 165.

<sup>221</sup> Transgrid, *Qubist, S.2 – Accelerated Syncons – Review of Contractual Variation Process (confidential)*, March 2026.

## 14.2 AER final decision

Our final decision is to accept 17 of the 20 adjustment mechanisms proposed by Transgrid and to include 2 additional adjustment mechanisms, being the 'Major Transport Works' and the 'Council or Other State Road Authority Transport Works True Up' events. While these two adjustment mechanisms are based on those in Transgrid's revenue proposal of the same (or very similar) names, we consider they have been significantly modified or split off from an existing mechanism so as to be classified as new adjustment mechanisms.

We accept 10 adjustment mechanisms as proposed by Transgrid (some with minor changes for clarity or consistency with our final decision for the Enabling CWO Project). These are adjustments 1 to 4 and 6 to 11 in Table 14.1 below. We also accept 7 of Transgrid's proposed adjustment mechanisms with more substantial amendments relating to the costs covered by the adjustment mechanisms. These are:

- Transport Enabling Works event<sup>222</sup> – we have amended this mechanism to allow Transgrid to recover its costs related to transport enabling measures undertaken in lieu of route upgrades in addition to the other costs it proposed in this adjustment mechanism. This is discussed further in section 14.2.1.
- Council or Other State Road Authority Transport Works event<sup>223</sup> – we have amended this mechanism to allow Transgrid to recover costs related to contracts with a State Road authority (other than a Council) in addition to the other costs it proposed in this adjustment mechanism. We have also split the forecast and true up events (parts A and B) of this adjustment into 2 separate mechanisms. This is discussed further in section 14.2.1.
- Contract variation events under the OEM, LTSA and the 2 D&C contracts<sup>224</sup> – we have made several adjustments to these mechanisms, which are discussed further in section 14.2.2.
- Annual update for actual inflation<sup>225</sup> – we have added an additional element to this adjustment mechanism to allow us to update pre-period inflation.

We are not accepting the remaining 3 adjustment mechanisms proposed by Transgrid and instead include alternative adjustment mechanisms or cost recovery pathways. Specifically:

- Minor transport works adjustment mechanism – we are not accepting Transgrid's proposed standalone adjustment mechanism for costs Transgrid is required to pay D&C contractors for minor transport infrastructure works, as these costs can be covered by adjustment mechanisms for the D&C contract variation events (Appendix B).
- Major Transport Works adjustment mechanism – we are not accepting Transgrid's proposed adjustment mechanism for major transport works and instead substitute an adjustment mechanism which triggers a review and remake of this revenue

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<sup>222</sup> Originally proposed as the 'Transport route due diligence and enabling works' event.

<sup>223</sup> Originally proposed as the 'Transport works undertaken by local council' event.

<sup>224</sup> Originally proposed as the OEM contract, LTSA contract and D&C contract adjustments.

<sup>225</sup> Originally proposed as the 'Updates for actual inflation' adjustment mechanism.

determination, limited to costs directly related to major transport works. This is discussed further in section 14.2.1.

- Return on equity adjustment mechanism – we are not accepting this adjustment mechanism as it is unnecessary for the System Strength Project. Our final decision risk-free rate contains the actual averaging period because the range of possible dates for which Transgrid must nominate an averaging period for its risk-free rate finishes prior to the date we make our revenue determination.<sup>226</sup>

A summary of all adjustment mechanisms in our final decision is set out in Table 14.1 below, accompanied by a brief description of each adjustment event. The precise wording of each adjustment mechanism is contained in Appendix B of this final decision, alongside our reasons for the inclusion of each adjustment mechanism.

Where there was an adjustment event or a category of events referred to by multiple names in Transgrid's proposal we have standardised the name of the adjustment event. Where possible we have tried to align these names with the names used in our final decision for the Enabling CWO Project.

**Table 14.1 Adjustment mechanisms accepted in our final decision**

| #                                                             | Accepted mechanism                                           | Brief description of the adjustment event                                                             |
|---------------------------------------------------------------|--------------------------------------------------------------|-------------------------------------------------------------------------------------------------------|
| Adjustment Mechanisms for events prescribed in EII Chapter 6A |                                                              |                                                                                                       |
| 1.                                                            | Regulatory Requirements as in cl.46(3) of the EII Regulation | A change in costs arising from complying with regulatory requirements.                                |
| 2.                                                            | A service standard event                                     | A change in costs arising from accommodating a service standard event.                                |
| 3.                                                            | A tax change event                                           | A change in costs arising from accommodating a tax change event.                                      |
| 4.                                                            | An insurance event                                           | A change in costs arising from an insurance event.                                                    |
| Adjustment mechanisms for routine adjustment events           |                                                              |                                                                                                       |
| 5.                                                            | Annual update for actual inflation                           | Annual updates to revenue to account for actual (as opposed to forecast) inflation.                   |
| 6.                                                            | Return on debt update                                        | Update to the allowed rate of return, using more recent averaging periods.                            |
| Adjustment mechanisms for standard events                     |                                                              |                                                                                                       |
| 7.                                                            | Insurance coverage event                                     | A change in costs arising from a change in insurance coverage due to changes in the insurance market. |

<sup>226</sup> AER, *2022 Rate of return instrument (version 1.2)*, March 2024, cl. 8(c). This is different to our previous decisions for the Hunter Central Coast and Central West Orana Enabling decisions due to the timing of making our determination for those projects occurring much earlier than the start of the regulatory period.

|                                        |                                                                                    |                                                                                                                                                              |
|----------------------------------------|------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 8.                                     | Insurer's credit risk event                                                        | A change in costs due to an insurer of this project becoming insolvent.                                                                                      |
| 9.                                     | Natural disaster event                                                             | A change in costs due to a natural disaster.                                                                                                                 |
| 10.                                    | Terrorism event                                                                    | A change in costs due to a terrorism event.                                                                                                                  |
| Adjustment mechanisms for other events |                                                                                    |                                                                                                                                                              |
| 11.                                    | Contract Variation Impact on Transgrid's Costs event                               | An increase in Transgrid's costs due to approved contractual variations in competitively procured contracts.                                                 |
| 12.                                    | Transport Enabling Works event <sup>227</sup>                                      | An increase in costs due to due diligence, preparatory work, contract procurement and management, and transport enabling measures in lieu of route upgrades. |
| 13.                                    | Major Transport Works event                                                        | An increase in costs due to major transport works which requires a review and remake of our revenue determination.                                           |
| 14.                                    | Council or Other State Road Authority Transport Works event <sup>228</sup>         | An increase in costs due to local council and/or state road authority related transport works.                                                               |
| 15.                                    | Council or Other State Road Authority Transport Works True Up event <sup>229</sup> | An annual true-up for the difference between Transgrid's forecast and actual local council and/or state road authority related transport works costs.        |
| Contractual adjustment mechanisms      |                                                                                    |                                                                                                                                                              |
| 16.                                    | OEM contract variation event                                                       | A change in costs Transgrid is required to pay GE arising from an approved variation claim under the OEM contract.                                           |
| 17.                                    | LTSA contract variation event                                                      | A change in costs Transgrid is required to pay GE arising from an approved variation claim under the LTSA contract.                                          |
| 18.                                    | D&C (CPP) contract variation event                                                 | A change in costs Transgrid is required to pay CPP arising from an approved variation claim under the relevant D&C contract.                                 |
| 19.                                    | D&C (UGL) contract variation event                                                 | A change in costs Transgrid is required to pay UGL arising from an approved variation claim under the relevant D&C contract.                                 |

Source: Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, pp. 109–133; Transgrid response to Information Request #003; AER analysis.

<sup>227</sup> Originally proposed as the 'Transport route due diligence and enabling works' event.

<sup>228</sup> Originally proposed as the 'Transport works undertaken by local council' event part a.

<sup>229</sup> Originally proposed as the 'Transport works undertaken by local council' event part b.

### 14.2.1 Non-contestable Transport Works

Our final decision is to accept the Transport Enabling Works, and Council or Other State Road Authority Transport Works event (and true up) adjustment mechanisms proposed by Transgrid, subject to the amendments described in this section. Our final decision is to not accept the major transport works adjustment mechanism (forecast and true up) and instead substitute them with an adjustment mechanism for major transport works which requires this revenue determination to be reviewed and remade.

In our preliminary position paper, we agreed that Transgrid should be able to recover all its prudent, efficient and reasonable transport works costs as these works are included in the scope of the PNIP Direction. However, we could not determine whether Transgrid's proposed adjustment mechanisms would limit its cost recovery to prudent, efficient and reasonable costs, due to the level of uncertainty surrounding the required transport works and the associated risks.

Our suggested approach was to adopt a single adjustment mechanism that would trigger a review and remake of the revenue determination for all the non-contestable transport works, upon receiving executed contracts for all transport works required. We considered this would enable our decision on transport works to be made at a time when both we and Transgrid have greater certainty about the scope of the costs, risks and any future contractual adjustments. It would also provide us with the flexibility required to address Transgrid's residual risks through either an adjustment mechanism or a risk cost allowance, as appropriate. Additionally, the greater clarity around Transgrid's control over transport costs at the time of our review and remake would support a better-informed decision on whether to exclude those costs from the CESS.

Transgrid raised concerns in meetings with us regarding our preliminary position of a single review and remake for all transport works costs. It noted that due to the staggered installation of the synchronous condensers at each site, our suggested approach would require Transgrid to wait up to a year for all transport works contracts to be signed for all five sites. For example, if major transport works were required on the first route, it would be held up until all five routes had been scoped and the works contracted. NSW DCCEEW considered that the AER's preliminary position on transport works may cause delays to the project and erode the benefits of accelerating the delivery of the synchronous condensers.

Furthermore, Transgrid submitted that our suggested approach would require it to execute transport contracts prior to us determining the cost recovery arrangements.<sup>230</sup> It stated that it could not know with any degree of confidence whether these competitively let transport works contracts will be fixed price or include adjustment mechanisms of some kind. So as the transport costs are entirely outside its control, our preliminary position would expose Transgrid to significant and unacceptable cost recovery risk.

In their submissions to our preliminary position paper, Louise Benjamin and Gavin Duffy (members of Transgrid's CAG) and the CCP35 submitted that Transgrid was not an expert in

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<sup>230</sup> Transgrid, *Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, p. 11.

road and bridge upgrades, nor is the AER an expert in assessing transport related costs.<sup>231</sup> Louise Benjamin and Gavin Dufty's position was that the transport works should be removed from the scope of the project and were concerned about incentives being applied to this element should it remain part of the project. We acknowledge the concerns raised by these submissions and Louise Benjamin and Gavin Dufty's preferred approach. However, we consider it is not our role to determine the scope of this project, and the PNIP Direction requires Transgrid to undertake the transport works as part of the project. As a result, if Transgrid seeks to recover transport works costs, our role under the EII framework is to determine the prudent, efficient and reasonable costs of those works.

In response to the concerns raised by Transgrid, we reviewed our preliminary position and no longer recommend a single adjustment mechanism, based on executed contracts, which would trigger a review and remake for all non-contestable transport works. In our final decision we allow Transgrid to recover non-contestable transport works costs via 4 adjustment mechanisms, for:

- Transport Enabling Works
- Council or Other State Road Authority Transport Works
- True up for Council or Other State Road Authority Transport Works
- Major Transport Works (which will trigger a review and remake of this revenue determination).

### Transport enabling works

Transport enabling works are activities required to be undertaken to facilitate oversize over-mass (OSOM) transport movements on viable routes before the transport works can proceed. These costs include due diligence on those routes, necessary preparatory work, and procurement and contract management for major transport works (but not the works themselves).<sup>232</sup>

Additionally, Transgrid proposed the inclusion of 'Transport enabling measures in lieu of route upgrades' (transport works undertaken to mitigate the need for major transport works) as part of this adjustment mechanism.<sup>233</sup> It proposed that allowing for recovery of these costs would enable transport works to occur on time and via the most efficient means available by avoiding unnecessary major transport works. Specific examples of activities which would fall under this adjustment include:<sup>234</sup>

- relocation and reinstatement of roadside infrastructure,
- temporary protection, strengthening or bridging of utilities and other route infrastructure,

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<sup>231</sup> Louise Benjamin and Gavin Dufty, *Late Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, pp. 9–11; Consumer Challenge Panel 35, *Submission – System Strength Project – 2026–31 Revenue Proposal*, July 2026, p. 17.

<sup>232</sup> Transgrid, *Response to information request IR#003*, May 2026.

<sup>233</sup> Transgrid, *Response to information request IR#017 part 1*, August 2026.

<sup>234</sup> Transgrid, *Response to information request IR#017 part 1*, August 2026.

- temporary use of existing route infrastructure, including any associated reinstatement, remediation or repair works,
- use of alternative OSOM vehicles, convoy arrangements or laydown locations, including any permits, permit variations, permit conditions and associated compliance requirements required to facilitate the movement,
- temporary lifting, de-energisation or disconnection of overhead or adjacent utility services.

Transgrid did not propose providing a forecast for these costs but proposed recovery via an annual true up mechanism. In its response to our request for further information, Transgrid noted it had limited ability to accurately forecast Transport enabling costs at the time of route notification and any forecast provided would have low confidence and require a wide contingency range.<sup>235</sup>

We consider including ‘Transport enabling measures in lieu of route upgrades’ as an adjustment mechanism provides Transgrid with the flexibility to pursue the most prudent and efficient transport solution on a case-by-case basis. We also consider that due to the level of uncertainty around these costs any forecasts would likely result in consumers paying a considerable risk premium for costs which may not eventuate. We note that waiting until risks can be adequately forecast is not a reasonable approach, as it would likely cause substantial delays to the project which would reduce benefits to consumers of its accelerated delivery. Given these circumstances, we consider that an ex-post adjustment mechanism is the most appropriate cost recovery approach for Transport enabling works.

Our final decision is to accept Transgrid’s proposed adjustment mechanism for Transport enabling works, including costs for transport enabling measures in lieu of route upgrades. However, in its adjustment applications, we expect Transgrid to justify how the activities it undertook (and associated costs), were prudent, efficient and reasonable considering the circumstances it faced at that time. We would also expect Transgrid to detail the costs which were mitigated by its actions, for any costs related to transport enabling measures in lieu of route upgrades. Costs associated with the adjustment mechanism for transport enabling works would be exempt from the CESS as we consider they cannot be forecast at this time – as further discussed in section 13.2.1.

### **Council or other state road authority transport works**

Council or other state road authority transport works are works which local councils or state road authorities mandate be undertaken on their infrastructure, including restoration and maintenance, which can only be completed by themselves or by their certified contractors.<sup>236</sup> Examples of these costs include specific council/transport authority requirements and council/transport authority costs including for quality checks, dilapidation studies, design requirements, engineering studies, site attendance, additional project management, defect rectification, sign-off and restoration works. For costs of this type incurred on the identified transport routes for the System Strength Project, the relevant councils and state road authorities will seek payment from Transgrid for the costs of the required works.

<sup>235</sup> Transgrid, *Response to information request IR#017 part 2*, August 2026.

<sup>236</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 128.

Transgrid did not include local council-related transport works costs within its capex forecast due to uncertainty over the transport routes and the scope of the transport works required at the time of its proposal. Instead, it proposed recovery of these costs via an adjustment mechanism with two parts, a forecast (Part A) and an annual true up mechanism (Part B). Transgrid's revenue proposal indicated that it would be able to forecast these costs once it had an executed transport works contract with the relevant councils.<sup>237</sup> However, it noted that it had very limited control over the costs it will incur as it must follow council and/or state road authority requirements for the required work. Transgrid stated that this was why both the forecast and the true up parts of the adjustment mechanism were appropriate.

Transgrid subsequently noted in its response to our request for further information that it had become aware that Transport for NSW may now also undertake transport works for the project and invoice Transgrid for the cost.<sup>238</sup> Given the similarities between the type of work involved and cost recovery approaches of local councils and state road authorities like Transport for NSW, it suggested that state road authority costs should be recovered via the same adjustment mechanism. However, it noted that it only anticipates entering pre-work agreements with local councils, so forecasts of costs for transport works directed by a state road authority may not be possible.

In meetings with the AER, Transgrid provided evidence of the type of local council cost schedule it would be subject to for these works. It also noted that the quantity of the works would be largely set by the scoping report on the required transport upgrades for each transport route (being developed by the OEM). We consider that recovery via an adjustment mechanism is appropriate as these costs cannot be reasonably forecast at the time of this revenue determination due to the level of uncertainty around the viable transport routes and scope of the works required.

We also consider the processes and costs directed by the state road authority are similar in nature to those used by local councils. We consider recovery of these costs via the same adjustment mechanisms is appropriate even if Transgrid is unable to provide cost forecasts of transport works directed by a state road authority. In such circumstances, Transgrid would be able to recover its incurred costs via the true up adjustment mechanism.<sup>239</sup> Similar to local council costs, Transgrid has very limited ability to influence these costs (i.e. it is a price taker in this arrangement) and the quantities will be determined by the scoping reports on the required transport upgrades for each transport route. As such, we consider an adjustment mechanism for these costs is appropriate, noting that Transgrid will only likely use the true up mechanism.

Our final decision is to accept Transgrid's proposed adjustment mechanism for Council and other state road authority transport works costs but to split the forecast and true up elements into two separate adjustment mechanisms to provide greater clarity over the costs being trued up. Our final decision is to also exclude the costs recovered under both mechanisms from the CESS due to Transgrid's very limited influence over these costs.

As there are five transport routes (one for each installation site in this project), there may be multiple instances of this event. We expect revenue adjustment proposals to clearly

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<sup>237</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 128.

<sup>238</sup> Transgrid, *Response to information request IR#017 part 1*, August 2026.

<sup>239</sup> As the difference between its forecast and incurred costs would be equal to its incurred costs.

distinguish between the costs related to each route, to avoid confusion and possible duplication of the costs recovered.

### Major transport works

Major transport works are works which Transgrid's D&C contractors were not willing or able to undertake, but which are required to be made to transport assets such as roads and bridges to ensure the safe transportation of the synchronous condensers from port to each of the 5 sites.<sup>240</sup> These will typically involve large-scale civil works (e.g. road widening) and must be procured through a separate procurement process, outside the existing D&C contracts. Transgrid proposed a forecast and an annual true up mechanism for these costs, with the true up being used primarily to adjust for contractual variations.

We consider that an adjustment mechanism which requires the revenue determination to be reviewed and remake remains the appropriate approach for this category of transport works, but with amendments to address the potential for delays. This is because we are not satisfied that Transgrid's proposed adjustment mechanisms would limit its cost recovery to prudent, efficient and reasonable costs, due to the level of uncertainty surrounding the required transport works and the associated risks. We do not consider it reasonable to approve adjustment mechanisms for variations under contracts that have not yet been drafted, tendered or negotiated. This may reduce the competitiveness of any future tender processes by establishing baseline costs that consumers would bear, weakening Transgrid's bargaining position in negotiations with contractors.

We consider our review and remake approach enables our decision on the costs of major transport works to be made at a time when both we and Transgrid have greater certainty over the scope of the costs, risks and contractual variations required. It provides us with the flexibility required to address Transgrid's residual risks through either an adjustment mechanism or a risk cost allowance, as appropriate. Additionally, the greater clarity around Transgrid's control over transport costs at the time of our review and remake would support a better-informed decision on whether to exclude costs from the CESS. As mentioned in section 13.2.1, we will apply the CESS (i.e. not exclude from the CESS) to major transport works in this revenue determination. However, Transgrid may apply for a CESS exclusion for major transport works costs at the time of our review and remake decision.

Our final decision is to substitute Transgrid's proposed major transport works adjustment mechanism (forecast and true up) with a major transport works adjustment mechanism which would require a review and remake of this revenue determination. Our review and remake will follow a process very similar to that of a standard adjustment mechanism but will allow for stakeholder consultation on Transgrid's adjustment application. We outline this review and remake process below.

1. The trigger for a non-contestable major transport works adjustment is the time at which Transgrid can provide the following items to the AER:
  - a) a forecast of the increase in costs associated with the major transport works, noting any limitations or assumptions relied on in forecasting;

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<sup>240</sup> Transgrid, *System Strength Project 2026–31 – Revenue Proposal*, April 2026, p. 128.

- b) a description of any tender and/or negotiation process in relation to the major transport works, highlighting any measures used to ensure it resulted in a prudent, efficient, and reasonable outcome;
- c) any additional adjustment mechanisms proposed to reflect contract variations or the difference between forecast and actual costs;
- d) a justification for each proposed additional adjustment mechanism, explaining why Transgrid considers it more appropriate for these costs to be recovered via an adjustment mechanism than via its forecast capex as a risk cost; and
- e) any proposed CESS exclusions along with a justification for the CESS exclusion.

We also encourage Transgrid to consider providing independent expert advice attesting to the prudence, efficiency and reasonableness of its forecasts to support its adjustment proposal.

2. Once the trigger for the adjustment mechanism has occurred, Transgrid may submit a review and remake proposal to the AER. We will then publish Transgrid's proposal on our website and provide stakeholders with time to provide submissions on it, which we would consider and respond to in our review and remake decision.
3. We will then assess whether Transgrid's forecast transport works, including any claims for proposed CESS exclusions and adjustment mechanisms, are prudent, efficient and reasonable, and review and remake the revenue determination accordingly. However, we would not expect Transgrid to seek any other changes to the revenue determination through this review and remake process.

We consider the appropriate timeframe for our review and remake decision is dependent on the scope of the proposal and the quality of the information received from Transgrid to support it. However, we will endeavour to complete our assessment as soon as practicable, balancing the:

- accelerated nature of the project,
- appropriate consideration of stakeholder submissions, and
- time required to review Transgrid's prudent, efficient and reasonable major transport works costs.

### 14.2.2 Contractual adjustment mechanisms

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 clause.<sup>241</sup>

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 the network operator.
- Method – the approach to determining the adjustment amount once a trigger is satisfied.

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<sup>241</sup> AER, *Revenue determination guideline for NSW non-contestable projects*, August 2026, p. 41.

To accept the risk allocation (triggers) reflected in contract variation clauses as a contestable outcome we must be satisfied that the risk allocation was agreed through the genuine and appropriate competitive assessment process.

Our decision is to accept all risk events covered by contract variation clauses (except the one related to the Middle East conflict) as outcomes of the genuine and appropriate competitive assessment process. We do not consider the contract variation clauses related to the costs of the Middle East conflict to be competitive outcomes as they were negotiated by Transgrid and the D&C contractors following completion of the competitive assessment processes. Treatment of the Middle East conflict costs is discussed further in section 10.2.5.

For the risk events that we consider Transgrid is entitled to cost recovery, we do not consider that the processes (method) described in the contracts for deciding variation costs can be accepted as contestable outcomes. To accept that a method to determine a variation amount is contestable, we must be satisfied that it is an outcome of a genuine and appropriate competitive assessment process. In making this assessment, we considered whether:

- the proposed method to vary the contract amount was agreed as part of the competitive assessment process, and
- the method is clearly specified such that it can be applied through our adjustment process (in line with Criterion 4 of our Contestable Guideline). We consider ‘clearly specified’ in this context to be that a variation clause must set out a method that is likely to constrain costs to those that are prudent, efficient and reasonable.

The processes in the contestable contracts for deciding cost variation amounts give Transgrid significant discretion in how it initiates variation processes and assesses variation claims. On this basis, we do not consider the processes to be clearly specified. Our specific concerns include that:

- the contract variation clauses generally allow parties some discretion in determining the variation amount, rather than relying strictly on formulas or pre-determined amounts
- Transgrid has little incentive to closely scrutinise contractors’ variation claims if it can fully pass through these costs
- some variations are initiated by Transgrid, such as directions to accelerate works or vary the 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.

We also do not accept the additional processes described in the revenue proposal to assess contract variation amounts as outcomes of the competitive assessment process, as they include elements that were not agreed as part of the competitive assessment process and are not reflected in the contractual arrangements.

Our final decision is to accept Transgrid’s entitlement to recover prudent, efficient and reasonable costs arising from the contract variation clauses set out in its proposal. These

costs are recoverable through either an adjustment mechanism (Appendix B) or through the capex allowance (section 10.2.4 (risk costs)).

For those events subject to an adjustment mechanism, we will conduct a prudence, efficiency and reasonableness assessment of all adjustment amounts at the time of an adjustment proposal. In undertaking this assessment, we would apply the principle that any elements of the adjustment proposal that were an outcome of the competitive assessment process can be taken to be prudent, efficient and reasonable. These elements would include:

- any agreed amounts, rates (fixed or indicative) or quantities that were set through the competitive assessment process that are relied upon
- the labour and material escalation formulae 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 the contestable elements of the adjustment mechanisms, our review would be limited to confirming entitlement based on the relevant trigger and checking that the relevant contractual values or processes were applied.

In assessing the prudence, efficiency and reasonableness of adjustment proposals we will have regard to our assessment approach guidance note. Section B.6 of Appendix B sets out additional guidance to Transgrid on the types of information it can provide to substantiate that revenue adjustment proposals are prudent, efficient and reasonable with respect to contractual adjustment mechanisms.

Our decision is consistent with that set out in our preliminary position paper. Transgrid's submission to that paper, summarised in section 3.2.1, did not change our view on the contestability of contractual adjustment mechanisms. We advised Transgrid that new steps or safeguards in the process for assessing contract variation costs could not be considered outcomes of the competitive assessment process.

Transgrid's submission also suggested that the 4 contractual adjustment mechanisms (one for each contract) could be recast to 3 adjustment mechanisms (based on broad risk categories excluded from the risk allowance). We have not adopted this approach, as it did not improve clarity, transparency or the ease with which annual adjustment proposals would be assessed.

Following the submission of its revenue proposal and in response to information requests, Transgrid proposed several additions and clarifications to the contractual adjustment mechanisms. Many of the updates to improve completeness, clarity and limit duplication were incorporated in the adjustment mechanisms published in our preliminary position paper. Changes made since the preliminary position paper include:

- adding new triggers that Transgrid had inadvertently left out of its revenue proposal
- removing the triggers related to the Middle East pre-agreed variations (as these costs are now included in the ex-ante capex allowance)

- removing the adjustment mechanism to true-up the timing of contestable costs (not in Transgrid's original proposal but contemplated in the preliminary position paper)
- specifying that costs recoverable through the adjustment mechanisms are limited to those for risk events not covered by the capex allowance (section 10.2.4)
- removing the true-up adjustment mechanism for provisional sums (as we did not include the provisional sums proposed by Transgrid in the capex allowance).

The contractual adjustment mechanisms are set out in section B.5 of Appendix B.

## 15 Components of our final decision

Our final decision on Transgrid's System Strength Project for the 2026–31 regulatory control period comprises the components set out in Table 15.1 below.

**Table 15.1 Components of our final decision under the EII Act, the EII Regulation, and the EII Chapter 6A**

| Provision reference                            | AER final decision                                                                                                                                                                                                                                                                                                                             |
|------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| EII Act, s.38(1)                               | The AER's final decision is to determine a total revenue of \$385.6 million (\$ nominal) for the 2026–31 period.                                                                                                                                                                                                                               |
| EII Act, s.38(2)(a)                            | The AER's final decision is to approve \$82.2 million (\$ nominal) in repayment of capital costs as determined under the transmission efficiency test.                                                                                                                                                                                         |
| EII Act, s.38(2)(b)                            | The AER's final decision is to approve a return on capital costs amount of \$324.9 million (\$ nominal) for capital costs that have not been repaid.                                                                                                                                                                                           |
| EII Act, s.38(2)(c)                            | The AER's final decision is to approve a revenue allowance of \$64.4 million (\$ nominal) for operating costs.                                                                                                                                                                                                                                 |
| EII Regulation, cl.50A(a)                      | The AER's final decision is to approve an allowance of \$111.1 million (\$ nominal) for the indexation of the regulatory asset base.                                                                                                                                                                                                           |
| EII Regulation, cl.50A(b)                      | The AER's final decision is to approve an allowance for the estimated corporate income tax of \$0.5 million (\$ nominal).                                                                                                                                                                                                                      |
| EII Regulation, cl.50A(c)                      | The AER's final decision does not include an allowance for any revenue increments or decrements resulting from the operation of incentive schemes as there are no incentive schemes in operation at the time of this final decision.                                                                                                           |
| EII Regulation, cl.50A(d)                      | The AER's final decision is to approve an allowance of \$24.8 million (\$ nominal) for the repayment of prudent, efficient and reasonable capital costs not included in the component specified in section 38(2)(a) of the EII Act.                                                                                                            |
| EII Regulation, cl.50A(e)                      | The AER's final decision does not include any allowances for other risks not already compensated under section 38(2)(b) of the EII Act.                                                                                                                                                                                                        |
| EII Regulation, cl. 52(1) and cl. 52(2)(a)&(c) | Our final decision includes a schedule of the amounts to be paid to the Network Operator and the date on which each amount is to be paid for the 5 years of the 2026–31 regulatory control period, as set out in section 6.2.2 and Appendix A to this final decision.                                                                          |
| EII Chapter 6A, cl.6A.14.1(1)(i)               | The AER's final decision is not to approve the total revenue cap set out in Transgrid's building block proposal.<br><br>Our final decision on Transgrid's total revenue cap is \$385.6 million (\$ nominal) for the 2026–31 regulatory control period. This decision is discussed in section 6.2 of this final decision.                       |
| EII Chapter 6A, cl.6A.14.1(1)(ii)              | The AER's final decision is not to approve the maximum allowed revenue (MAR) for each regulatory year of the regulatory control period set out in Transgrid's building block proposal.<br><br>Our final decision on Transgrid's MAR for each year of the 2026–31 regulatory control period is set out in section 6.2.1 of this final decision. |

| Provision reference                | AER final decision                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
|------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| EII Chapter 6A, cl.6A.14.1(1)(iii) | The AER has not made a decision on the values that are to be attributed to the performance incentive scheme parameters for any service target performance incentive scheme, as this scheme is not applicable for the 2026–31 regulatory control period.                                                                                                                                                                                                                                                                                                                                                                                  |
| EII Chapter 6A, cl.6A.14.1(1)(iv)  | <p>The AER has not made a decision on the values that are to be attributed to the efficiency sharing benefit scheme parameters for any efficiency benefit sharing scheme (EBSS), as the AER's final decision does not include application of the EBSS for the 2026–31 regulatory control period.</p> <p>The decision on whether to apply the EBSS will be delayed until the end of the 2026–31 regulatory control period as set out in section 13.2.2 of this final decision.</p>                                                                                                                                                        |
| EII Chapter 6A, cl.6A.14.1(1)(v)   | <p>The AER's final decision is to approve the commencement and length of the regulatory control period as Transgrid proposed in its revenue proposal.</p> <p>The regulatory control period will commence on 1 October 2026 and the length of this period is five years, expiring on 30 September 2031.</p>                                                                                                                                                                                                                                                                                                                               |
| EII Chapter 6A, cl.6A.14.1(2)(ii)  | <p>Acting in accordance with clause 6A.6.7(d) of EII Chapter 6A, the AER's final decision is to not accept the total forecast capital expenditure of \$872.5 million (\$ September 2026, inclusive of equity raising costs) set out in Transgrid's proposal.</p> <p>Our final decision, therefore, includes a substitute estimate of Transgrid's total forecast capital expenditure for the 2026–31 regulatory control period of \$740.2 million (\$ September 2026, inclusive of equity raising costs). The reasons for our decision are set out in section 10.2 of this final decision.</p>                                            |
| EII Chapter 6A, cl.6A.14.1(3)(i)   | <p>Acting in accordance with clause 6A.6.7(d) of EII Chapter 6A, the AER's final decision is to not accept the total forecast operating expenditure inclusive of debt raising costs of \$60.1 million (\$ September, 2026) for the 2026–31 regulatory control period as set out in Transgrid's proposal.</p> <p>Our final decision, therefore, includes a substitute estimate of Transgrid's total forecast operating expenditure inclusive of debt raising costs of \$58.6 million (\$ September, 2026) for the 2026–31 regulatory control period. The reasons for our decision are set out in section 11.2 of this final decision.</p> |
| EII Chapter 6A, cl.6A.14.1(5)      | In accordance with 6A.6.3A of EII Chapter 6A, the AER's final decision has not applied a financeability test for the System Strength Project as Transgrid did not submit a financeability request.                                                                                                                                                                                                                                                                                                                                                                                                                                       |
| EII Chapter 6A, cl.6A.14.1(5A)     | The AER's final decision is that the capital expenditure sharing scheme (CESS) as set out in the version 4 of the Capital Expenditure Incentive Guidelines, will apply to Transgrid in the 2026–31 regulatory control period. This is set out in section 13.2.1 of this final decision, including relevant CESS exclusions (if any).                                                                                                                                                                                                                                                                                                     |
| EII Chapter 6A, cl.6A.14.1(5B)     | <p>Acting in accordance with clause 6A.6.2 of EII Chapter 6A, the AER's final decision is that the allowed rate of return for the 2026–31 regulatory year is 7.37% (nominal vanilla), as set out in section 8.2 of this final decision.</p> <p>The rate of return for the remaining regulatory years may be updated in accordance with the approved adjustment mechanisms for the annual return on debt.</p>                                                                                                                                                                                                                             |
| EII Chapter 6A, cl.6A.14.1(5C)     | The AER's final decision is that the allowed imputation credits for each regulatory year of the 2026–31 regulatory control period, as also referred to in clause 6A.6.4, is 0.57. This is set out in section 8.2.4 of this final decision.                                                                                                                                                                                                                                                                                                                                                                                               |

| Provision reference            | AER final decision                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
|--------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| EII Chapter 6A, cl.6A.14.1(5D) | Acting in accordance with clause 6A.6.1 and schedule 6A.2 of EII Chapter 6A, the AER's final decision is that the opening regulatory asset base as at the commencement of Transgrid's 2026–31 regulatory control period, being 1 October 2026, is \$323.8 million (\$ nominal). This is set out in section 7.2.1 of this final decision.                                                                                                                                                                         |
| EII Chapter 6A, cl.6A.14.1(5E) | <p>The AER's final decision is that the depreciation approach used to establish the regulatory asset base at the commencement of Transgrid's 2031–36 regulatory control period as at 1 October 2031 is based on forecast capital expenditure (forecast depreciation). This is set out in section 7.2.3 of this final decision.</p> <p>For completeness, the regulatory depreciation amount that is approved in this final decision is –\$4.1 million (\$ nominal) for the 2026–31 regulatory control period.</p> |
| EII Chapter 6A, cl.6A.14.1(6)  | The AER's final decision is to not modify the depreciation schedules under clause 6A.6.3(d) and EII Regulation, clause 47D(3). For completeness, the AER's final decision has determined the depreciation schedules in accordance with 6A.6.3(b) of EII Chapter 6A, as set out in section 9.2 of this final decision.                                                                                                                                                                                            |
| EII Chapter 6A, cl.6A.14.1(9)  | <p>Acting in accordance with clause 6A.6.9 of EII Chapter 6A, the AER's final decision does not determine additional pass-through events that are to apply for the regulatory control period other than those set out in adjustment mechanisms section of this final decision.</p> <p>Our final decision on adjustment mechanisms is set out in section 14.2 and Appendix B of this final decision.</p>                                                                                                          |

# Glossary

| Term                              | Definition                                                                                                                                           |
|-----------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------|
| 2022 Instrument                   | 2022 Rate of Return Instrument                                                                                                                       |
| AEMO                              | Australian Energy Market Operator                                                                                                                    |
| AER                               | Australian Energy Regulator                                                                                                                          |
| Assessment approach guidance note | guidance note on the AER's EII Assessment Approach for Non-contestable revenue determinations (September 2025)                                       |
| ATO                               | Australian Taxation Office                                                                                                                           |
| CAG                               | Consumer Advisory Group                                                                                                                              |
| CAM                               | cost allocation method                                                                                                                               |
| capex                             | capital expenditure                                                                                                                                  |
| CCP35                             | Consumer Challenge Panel                                                                                                                             |
| CESS                              | Capital Expenditure Sharing Scheme                                                                                                                   |
| Contestable Guideline             | Revenue determination guideline for NSW contestable network projects                                                                                 |
| CPI                               | Consumer Price Index                                                                                                                                 |
| CPP                               | Consolidated Power Projects Australia                                                                                                                |
| D&C                               | Design and construct                                                                                                                                 |
| 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)                                                                                          |
| Enabling CWO project              | Enabling Central-West Orana REZ network infrastructure project carried out by Transgrid                                                              |
| FTE                               | full-time equivalent                                                                                                                                 |
| GE                                | GE Vernova                                                                                                                                           |
| IPFs                              | Infrastructure Planner Fees                                                                                                                          |
| 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 over-mass                                                                  |
| PACR                      | Project Assessment Conclusions Report                                               |
| PNIP                      | Priority Network Infrastructure Project                                             |
| PTRM                      | Post Tax Revenue Model                                                              |
| RAB                       | regulatory asset base                                                               |
| RBA                       | Reserve Bank of Australia                                                           |
| REZ                       | Renewable Energy Zone                                                               |
| RFT                       | request for tender                                                                  |
| RIT-T                     | Regulatory Investment Test – Transmission                                           |
| RoRI                      | 2022 Rate of Return Instrument                                                      |
| STPIS                     | Service Target Performance Incentive Scheme                                         |
| TAB                       | tax asset base                                                                      |
| TAC                       | Transgrid Advisory Council                                                          |
| TNSP                      | Transmission Network Service Provider                                               |
| UGL                       | UGL Engineering                                                                     |
| WACC                      | weighted average cost of capital                                                    |