AUSTRALIAN ENERGY
REGULATOR

Level 17, Casselden
2 Lonsdale Street
Melbourne Vic 3000

28 May 2021

Mr Paul Italiano
Chief Executive Officer
TransGrid

By email: [redacted]

Dear Mr Italiano

Re: Contingent project application for Project EnergyConnect

I am writing in response to your letter of 30 April 2021 submitting TransGrid's revised contingent project application for Project EnergyConnect.

As you know, the AER's role is to determine the forecast prudent and efficient capital expenditure and operating expenditure required to deliver the project, and the incremental revenues TransGrid can recover from customers. However, we must only do so when the need and timing of the project is certain.

I am pleased to inform you that the AER has considered TransGrid's application, and additional supporting information provided, and made a determination in accordance with clause 6A.8.2 of the National Electricity Rules (NER).

We are satisfied that TransGrid's Board has now committed to proceed with the project. Our determination means that TransGrid is now entitled to begin to recover the prudent and efficient costs of delivering the project in the 2018–23 regulatory control period.

The AER has determined that TransGrid is allowed to recover $61.5 million in additional revenue from customers in 2022-23, the final year of the current regulatory control period. We estimate that the impact of delivering the project is that the average residential electricity bill in New Sales Wales will increase by $11 in 2022-23. This will increase to $22 per year over the next five year regulatory period.

This increase in allowed revenues reflects our determination on the prudent and efficient costs of delivering the project. TransGrid's revised application proposed $1,866 million in capital expenditure to deliver the project. We have determined an alternative forecast of $1,818 million, which has been informed by the latest available information on likely costs.

We have also made a determination on ElectraNet's forecast expenditure and incremental revenue reasonably required to deliver the South Australian component of the project.

We acknowledge that this decision is a significant milestone for TransGrid, ElectraNet and Project EnergyConnect, and we have sought to provide this letter to you as expediently as possible. The attachment to this letter provides a summary of our decision, and we intend to publish the full determination and post-tax revenue model on our website shortly. This letter will be published on our website on 31 May 2021.

Please contact me should you have any questions.

Yours sincerely

[redacted]

Clare Savage
Chair
Australian Energy Regulator

Cc: Mr Steve Masters - ElectraNet

Attachment — Summary of AER determination on Project EnergyConnect

Requirements for the AER to make a determination

The AER may only determine the forecast expenditure and incremental revenue required to deliver this project if the following three conditions are met:

- The successful completion of the *South Australian Energy Transformation* Regulatory Investment Test for Transmission (RIT-T) that identifies Project EnergyConnect as the preferred investment option that delivers positive net economic benefits.
- Determination by the AER that the proposed investment satisfies the requirements of the Regulatory Investment Test for Transmission.
- TransGrid Board commitment to proceed with the project subject to the AER amending the revenue determination pursuant to the NER.

We are satisfied that all three conditions have been met and as such TransGrid is entitled to recover revenues from consumers to deliver the project.

The process undertaken by ElectraNet, described below, has satisfied the first condition to trigger the contingent project.

In February 2019, ElectraNet completed the *South Australia Energy Transformation* RIT-T demonstrating that a new SA-NSW interconnector was the preferred option that maximised net economic benefits.

On 24 January 2020, we determined that this preferred option identified by ElectraNet satisfies the requirements of the regulatory investment test for transmission, as set out in the NER, satisfying the second condition to trigger the contingent project.

Under the NER, ElectraNet is required to re-apply the regulatory investment test process if, in its reasonable opinion, the project is no longer the preferred option that maximises the net economic benefits.

In September 2020, ElectraNet published an updated cost benefit analysis that accounted for updated project cost estimates as well as inputs and assumptions from the Australian Energy Market Operator's 2020 Integrated System Plan. This updated analysis indicated that the net benefits of the project are likely to be positive and that the project remains the preferred option. Therefore, ElectraNet concluded that there is no need to reapply the regulatory investment test for this project.

On 28 September, we advised ElectraNet that its updated cost benefit analysis provided a not unreasonable basis for its opinion that the project remains the preferred option.

On 31 March 2021, ElectraNet published a review of whether recent market developments could result in a material change of circumstances that may lead to the project no longer being the preferred option. ElectraNet's assessment concluded that the announcements were likely to have an overall positive impact on the modelled net benefits of the project. This was supported by further analysis undertaken by AEMO.

On 29 April 2021, the TransGrid Board made a resolution committing to the project, satisfying the third and final condition to trigger the contingent project.

Project commencement and completion dates

We are required to determine the likely project commencement and completion dates. Based on the information provided by TransGrid, we are satisfied that the project has commenced and is likely to be completed by June 2023. This is within the current 2018–23 regulatory control period.

Forecast expenditure

Table 1 sets out our determination on the forecast capex and opex reasonably required by TransGrid to deliver the project. These forecasts are reflected in the maximum revenue TransGrid is allowed to recover from customers for the 2018-23 regulatory control period.

Table 1 Forecast capital and operating expenditure (million, $2017-18)

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
Forecast capex	3.4	22.8	214.2	878.4	699.0	1,817.9
Forecast opex	-	0.0	0.1	0.6	1.9	2.5

Source: AER analysis

We not have accepted TransGrid's forecast capital expenditure for the project. We consider that the majority of TransGrid forecast reasonably reflects prudent and efficient expenditure required to deliver the project.

Our determination differs from TransGrid's forecast because we have considered further information provided by TransGrid since it submitted its revised proposal, including the impact of further completed biodiversity field survey results, land valuations and identified route deviations.

However, we have not included additional allowances for project risk costs as proposed by TransGrid, as we consider that our forecast of capex provides for TransGrid's prudent and efficient project costs and TransGrid is best placed to mitigate the likelihood of additional costs being incurred in the delivery of the project.

We also recognise that TransGrid proposes to enter into fixed price contracts to deliver the majority of the works required for the project. This approach in large part protects both TransGrid and consumers from the risk of project cost overruns.

This final decision reflects the assessment we have undertaken since September 2020, informed by submissions from stakeholders and TransGrid's engagement with us over the process. This has included responding to our information requests and providing a revised capex forecast in response to the preliminary assessment we published in December 2020. TransGrid also engaged constructively with us since submitting its revised capex forecast and provided further information to support this final decision.

Forecast maximum allowable revenues and customer bill impact

Table 2 sets out our determination of the amount of incremental revenue TransGrid is allowed to recover from customers over the 2018-23 regulatory control period to undertake the project. These revenues reflect our standard annual building block revenue approach, in accordance with clause 6A.8.2(h) of the NER, consistent with TransGrid's application.

The amount of incremental revenue required by TransGrid in 2022-23 as a result of undertaking the project is $61.5 million, an increase in annual maximum allowed revenue of 7.2 per cent. As a result of recovering these revenues, we estimate that the transmission component of the average residential electricity bill in NSW will increase by $11 in 2022-23. This will increase to $22 per year for the 2023–28 regulatory control period.[1]

[1] For the South Australian component of the project, we estimate the incremental revenue required by ElectraNet in 2022-23 as a result of undertaking the project is $10.2 million, resulting in the transmission component of the average residential electricity bill in South Australia increasing by $6. This would increase to $17 per year for the 2023-28 regulatory control period.

Table 2 Annual allowed revenues ($m, nominal)

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
Annual building block revenue requirement (unsmoothed)	0.0	0.7	1.6	10.5	47.7	60.5
Annual expected maximum allowable revenue (smoothed)	0.0	0.0	0.0	0.0	61.5	61.5
Increase to annual expected revenue (%)	0.0%	0.0%	0.0%	0.0%	7.2%	1.6%

Source: AER analysis

Capital Expenditure Sharing Scheme

The capex approved in this determination will be added to the target capex for the capital expenditure sharing scheme (CESS). This is consistent with TransGrid's current revenue determination for the 2018–23 regulatory control period, which determined that the CESS will apply to all capital expenditure including that added in a contingent project.

TransGrid's revised proposal requested that the environmental offsets component of projects costs be excluded from the application of the CESS, if the AER were to not apply a risk allowance for environmental offsets in its determination.

We are not able to make a decision on whether the CESS will apply as part of the contingent project decision. The scope of contingent project decisions is limited to only varying the revenue determination to the extent necessary to adjust forecast capex, opex and revenue. The decision on the rewards or penalties applied under the CESS as a result of expenditure in the 2018–23 regulatory control period will be made at the time of the next revenue determination.

Our preference is to apply the CESS where possible, and provide for a prudent and efficient forecast of all project costs consistent with the intent of the ex-ante framework, with actual capex rolled into the RAB at the end of the regulatory control period. This is important to maintain incentives on TransGrid to minimise its costs, including on environmental offsets.