Transgrid

ABN 70 250 995 390
180 Thomas Street, Sydney
PO Box A1000 Sydney South
NSW 1235 Australia
T (02) 9284 3000
F (02) 9284 3456

Thursday, 2 November 2023

Ms Clare Savage
Chair
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3001

Via email: [redacted]
cc: [redacted]

Dear Ms Savage,

Revised Revenue Proposal Waratah Super Battery

Thank you for the AER's September 2023 Draft Decision[1] on our initial Waratah Super Battery (non-contestable) Revenue Proposal (initial WSB Revenue Proposal) for the regulatory period commencing 1 July 2024 and ending 30 June 2029 (2024-29).[2] This letter sets out our responses to the AER's Draft Decision and therefore constitutes our Revised Revenue Proposal.

This Revised Revenue Proposal reflects the valuable feedback received from our customers and other stakeholders since submitting our initial WSB Revenue Proposal. In particular, it reflects the feedback we received from our Transgrid Advisory Council (TAC) on the AER's Draft Decision.

The WSB Project

WSB will be the largest standby network battery in the Southern Hemisphere.[3] It is part of the NSW Electricity Infrastructure Roadmap and is critical to the affordability, reliability, security and sustainability of electricity supply in NSW given the expected closure of Eraring Power Station in August 2025. WSB comprises contestable and non-contestable components:[4]

- the non-contestable component involves augmentation of our existing transmission network and the installation of the System Integrity Protection Scheme (SIPS) control, and
- the contestable components are the SIPS (battery) and paired generation services.

[1] AER, Draft Decision, Transgrid Waratah Super Battery (non-contestable) (1 July 2024 to 30 June 2029), 29 September 2023
[2] Transgrid, 2024-29 Revenue Proposal June 2023 Waratah Super Battery Project (non-contestable), 30 June 2023
[3] EnergyCo, Draft Network infrastructure Strategy for NSW, September 2022
[4] The Minister directs Transgrid to carry out the WSB Project in accordance with Section 32 of the EII Act

Our initial WSB Revenue Proposal, and the AER's Draft Decision, relate only to the non-contestable work, which is referred to as 'the Project' or 'WSB Project'.

Our WSB Revenue Proposal is the first non-contestable Revenue Proposal to be assessed by the AER under the Electricity Infrastructure Investment (EII) Act 2020 (NSW) and the NSW Regulatory framework regulatory framework.

The AER's Draft Decision and our Response

We are pleased that the AER's Draft Decision found our initial WSB Revenue Proposal capable of acceptance and as a result accepted all major aspects of it. The key areas of difference between our initial Revenue Proposal and the AER's Draft Decision relate to two matters:

- the application of the Capital Expenditure Sharing Scheme (CESS), and
- our adjustment to depreciation to ensure the Project is financeable in each year of the 2024-29 regulatory period.

This Revised Revenue Proposal accepts all major aspects of the AER's Draft Decision, except its decision to apply the CESS and reverse our financeability adjustment to depreciation which in turn impacts our forecast revenue and regulatory asset base (RAB). We have adopted (rather than accepted) the AER's positions on these two matters given:

- based on our competitive procurement process, we have already executed the contract with the substations and transmission lines delivery partner to meet the 2024/2025 delivery timeframe in the NSW Electricity Infrastructure Roadmap, and
- the Project's unique characteristics and in particular the size of the project relative to Australian Energy Market Operator's (AEMO) Actionable Integrated System Plan (ISP) projects and the New South Wales (NSW) Government's other priority transmission infrastructure projects (PTIPs).

We maintain our overall position on the application of the CESS and financeability to Actionable ISP Projects including HumeLink and the Victoria to NSW Interconnector West (VNI West) and NSW PTIPs including Hunter Transmission. We have explained to the AER and the TAC that to attract the capital required to deliver these projects, they must be commercially viable such that investors have the necessary confidence to finance them. This means that their net cashflows must support the AER's benchmark credit rating and return on capital, while maintaining the same relative risk profile as the broader business. If these projects are not financeable, investors may not be willing to commit capital to them, which is not in the long-term interest of consumers, because these projects are critical to:

- the urgent energy transition, which in turn will drive down overall energy prices
- support the Australian and NSW Government's commitment to a net-zero future, and
- ensure consumers continue to receive reliable and secure electricity.

Attachment A details our response to each key element of the AER's Draft Decision and the accompanying post tax revenue model is provided at **Attachment B**.

Closing

We understand that the AER will invite submissions on our Revised Revenue Proposal until 24 November 2023. We will continue to engage with our customers and other stakeholders on our Revised Revenue Proposal up to and after this date, including through the TAC.

We would welcome the opportunity to engage on the key positions in our Revised Revenue Proposal with the AER. If you have any questions on this letter, please feel free to contact me.

Yours sincerely,

[redacted]

Brett Redman
Chief Executive Officer

Attachment A - Our Response to the AER's Draft Decision

Our response to the AER's Draft Decision is set out in sections 1.1 and 1.2 below:

- Section 1.1 sets out two key areas of difference between our initial WSB Revenue Proposal and the AER's Draft Decision, being the CESS and financeability. This Revised Revenue Proposal adopts, rather than accepts, the AER's positions on these two matters given the Project's unique characteristics. This is consistent with feedback from our TAC, and
- Section 1.2 overviews the AER's Draft Decision to accept all other major aspects of our initial WSB Revenue Proposal. This Revised Revenue Proposal accepts the AER's Draft Decision on these matters, with one minor exception, being the inflation-adjusted nominal rate of return for the 2022-23.

Unless otherwise stated, all expenditure forecasts in this Revised Revenue Proposal are expressed in end-year (to 30 June) real 2023-24 dollars, and all revenue forecasts are expressed in nominal terms, consistent with our initial Revenue Proposal and the AER's Draft Decision.

1.1. Areas of difference – the CESS and financeability

There are two key areas of difference between our initial WSB Revenue Proposal and the AER's Draft Decision:

- The application of the CESS, noting that our initial Revenue Proposal requested the AER to exclude the WSB Project from the CESS. This is because, in an inflationary and uncertain operating environment with high value, complex and specialised projects, applying the CESS introduces an asymmetric risk for network service provides. The asymmetric risk occurs because the probability of overspending the AER's capex allowance is greater than the probability of underspending it. Further, it is not in the long-term interest of consumers to apply penalties or rewards based on the CESS for differences between actual and forecast expenditure where these differences are driven by factors other than true efficiency savings or losses, and
- Our proposed financeability adjustment, which involved accelerating depreciation to ensure that the Project is financeable (i.e., that we can efficiently obtain finance to carry out the project)[5] in each year of the 2024-29 regulatory period. Our approach is consistent with the Energy Networks Australia's (ENA) Rule Change Proposal, Ensuring the Financeability of Actional ISP Projects.[6]

While the AER's Draft Decision did not accept our proposal on these two matters for WSB, the AER explained that this was because of the specific characteristics of the WSB project rather than our rationale and justification for our position on these matters in the context of major transmission projects. In particular, the AER highlighted that the WSB Project is a relatively small project compared to the AEMO ISP projects such as HumeLink and VNI West and the NSW PTIPs such as Hunter Transmission.

On this basis, as well as the specific aspects of our contractual arrangements with EnergyCo which provide some protection for CESS penalties given the inflationary operating environment, the AER determined that it would apply the CESS and reverse our adjustments to depreciation.

5 In accordance with clause 6A.6.3(d) of the EII Chapter 6A. This requires the AER to modify the depreciation schedules to ensure the Revenue Determination is consistent with the objects specified in Section 3(1)(a) to (c) of the EII Act and to ensure that the Network Operator is capable of efficiently obtaining finance to carry out the network infrastructure project.

6 ENA, Ensuring the financeability of actionable ISP Projects – Proposal to change the National Electricity Rules, 9 June 2023

This Revised Revenue Proposal adopts the AER's Draft Decisions on these matters given the unique characteristics of the WSB project and feedback from our TAC. We maintain, however, our position on these matters for all other ISP projects and PTIPs.

1.2. Draft Decision accepts initial WSB Revenue Proposal

We are pleased that the AER's Draft Decision accepted most aspects of our initial Revenue Proposal in full or with minor adjustments.

Figure 1: Revenue Proposal, AER Draft Decision and Revised Revenue Proposal comparison, $Million or %

	Total forecast capex ($Million)	Total forecast opex ($Million)	Rate of Return (%)	Regulatory Asset Base ($Million)	Maximum Allowed Revenue (MAR) ($Million)	Payment Schedule ($Million)
Initial Revenue Proposal	254.7	28.1	6.80	108.1	137.7	134.3
Draft Decision	248.5	24.7	6.80	105.2	104.1	101.6
Revised Revenue Proposal	248.5	24.7	6.80	105.2	104.3	101.8

Notes:
1. Capex and opex are in $Real, 20223-24.
2. The nominal vanilla rate of return (or weighted average cost of capital) using market data from placeholder averaging periods.
3. the RAB reflects the opening RAB for 2024-25 and is in $Nominal.
4. the payment schedule is the total for the 2024-29 period and is in $Nominal.
5. the MAR is the total for the 2024-29 period and is in $Nominal.
6. The reduction in the AER's Draft Decision on the MAR and payment schedule compared to our initial Revenue Proposal reflects the AER's draft decision to reverse our proposed financeability adjustment.

Overview of Revised Revenue Proposal

The AER's Draft Decision and our response is as follows - The AER's Draft Decision:

- **Accepted** our forecast **capex** of $254.7 million other than $6.2 million relating to future paired generation capex. Given the uncertainty of future paired generation capex, the AER decided that these costs would be better addressed via an adjustment mechanism once they are known. We support this approach and the AER's alternative capex forecast of $248.5 million.
- **Accepted** our forecast **opex** of $28.1 million subject to a minor reduction of $3.3 million to reflect its view of the required operating costs. We accept the AER's alternative opex forecast of $24.7 million
- **Accepted** our opening **RAB** of $108.1 million as at 1 July 2024 ($Nominal), with minor updates to remove the future paired generation capex and reflect the pre-period rate of return based on its Revenue Determinations made under the NER. We accept the AER's alternative opening RAB of $105.2 million ($Nominal)

- **Accepted** our approach to forecast **depreciation** of $31.6 million, which was based on the straight-line approach, albeit reduced this by $32.0 million to reflect its decision to reverse our financeability adjustment. As noted in section 1.1, we have adopted the AER's position on financeability and therefore we have adopted the AER's alternative value for regulatory depreciation of -$0.3 million.
- **Accepted** our proposal to apply the **rate of return** to the **pre-period costs** in 2022-23 and 2023-24 respectively. The AER adopted the rate of return for these years, based on its Revenue Determinations for our Prescribed Transmission Services made under the National Electricity Rules (NER). We accept this approach. We did, however, use the 11.31 per cent inflation-adjusted nominal rate of return for the 2022-23 year in the AER's 2023-28 Revenue Determination, rather than the 5.75 per cent adopted by the AER in its WSB Draft Decision, which was based on forecast inflation.
- **Accepted** our proposed **rate of return** for the 2024-29 regulatory period of 6.80 per cent calculated, using the 2022 Rate of Return Instrument (RoRI) and observable market data from placeholder averaging periods. The AER **accepted**:
  - our proposal to commence the trailing average cost of debt in the first year of the regulatory period. This is because the AER accepted our proposal that EII services are distinct from the prescribed transmission services under the NER. As such, the AER has accepted our proposal that 2024–25 is the first time a trailing average is applied to the EII services and should therefore commence in the first year of the 2024-29 regulatory period.
  - our proposed risk-free rate and debt averaging periods and will calculate the rate of return in its Final Decision using these if the periods if at the time of making its Final Decision they have passed or otherwise the AER will subsequently adjust revenues once it has published its Final Decision.
- **Accepted** our estimate **forecast inflation**, calculated using the method in the AER's PTRM, updated for the latest available information at the time of its Draft Decision. We accept the AER's Draft Decision on the rate of return and inflation and note that the AER may update this for the latest available information at the time of making its Final Decision.
- **Accepted** proposed approach to other **incentives schemes** including the Service Target Incentive Scheme. The AER agrees that is not able to be applied to non-contestable revenue determinations under the EII Act in the initial regulatory period. We have adopted the AER's Draft Decision to apply the Efficiency Benefit Sharing Scheme.
- **Accepted** our proposed **16 Revenue Adjustment Mechanisms**, with minor wording amendments to four of these mechanisms, to improve their clarity. We accept the AER's proposed wording amendments. We also accept the introduction of a capex cap (i.e., a maximum cumulative increase) of $30 million for the unavoidable contract variation adjustment mechanism.
- **Accepted** our **forecast MAR** of $137.7 million ($Nominal) subject to its reduction to other building blocks, noting the primary driver of the reduction is the AER's reversal of our financeability adjustment, which in turn impacts the return on capital and depreciation. We have adopted the AER's alternative MAR is $104.1 million ($Nominal), updated for the higher 2022-23 rate of return value. This results in a MAR of $104.3 million ($Nominal). We have also adopted the AER's forecast **quarterly schedule of payments** for the 2024-29 period totalling $101.6 million ($Nominal), updated for the higher 2022-23 rate of return value. This results in a **quarterly schedule of payments** $101.8 million ($Nominal).