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

Friday, 31 July 2026

Gavin Fox
General Manager Network Pricing
Australian Energy Regulator
Lodged online: RateOfReturn@aer.gov.au

Dear Gavin,

Draft 2026 Rate of Return Instrument

Transgrid welcomes the opportunity to respond to the Australian Energy Regulator's (**AER**) Draft 2026 Rate of Return Instrument (**draft RORI**).

As the primary Transmission Network Service Provider and System Strength Service Provider for New South Wales, Transgrid is responsible for delivering a substantial share of the network investment required to support Australia's energy transition. That investment is nationally significant. It requires access to large amounts of debt and equity capital on reasonable terms, and confidence that the regulatory framework will continue to provide a reasonable opportunity for network businesses to recover their efficient financing costs.

Transgrid thanks the AER for the opportunity to participate in the 2026 review and acknowledges the constructive engagement that occurred at the start of the process leading into the initial submission deadline in December 2025. Transgrid's earlier submission was prepared on the basis that the review would be targeted, collaborative and focused on discrete issues within the rate of return framework.

From that starting point, Transgrid is concerned that aspects of the draft RORI now appear to reopen broader issues, or depart from established approaches, without clear prior notice or a sufficient opportunity for stakeholders to respond. This creates uncertainty at a time when regulatory stability and confidence in the national framework are essential to support efficient investment and promote the long-term interests of consumers.

Transgrid supports the Energy Networks Australia (**ENA**) submission on the draft RORI. Transgrid has been a key contributor to that submission and supports the positions advanced by ENA.

Transgrid's own submission focuses on the implications of the draft RORI for investment confidence and the continued stability and credibility of the regulatory framework. Our concern is not simply that the draft RORI produces a lower allowed rate of return. Rather, our concern is that the AER appears to have departed from established principles, evidence and process

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in a way that weakens confidence that the framework will continue to support efficient investment.

The allowed rate of return is central to the National Electricity Objective (**NEO**) and the Revenue and Pricing Principles (**RPPs**). It must be set in a way that provides network service providers with a reasonable opportunity to recover efficient financing costs, supports efficient investment, and promotes the long-term interests of consumers. Those objectives are closely linked. Consumers ultimately benefit from a framework that attracts capital, supports timely investment, and allows critical infrastructure to be delivered efficiently and at scale.

Transgrid has three principal concerns with the draft RORI:

- **First, the draft RORI moves away from efficient financing costs.** The proposed reductions to the equity beta and market risk premium (**MRP**), together with the decision not to adopt a weighted trailing average return on debt, would move the allowed rate of return further away from the efficient financing costs faced by network businesses undertaking major capital programs.

- **Second, the reasoning used to support key changes is not sufficiently coherent or evidence-based.** The draft RORI appears to reinterpret evidence that the AER has previously considered, while placing different weight on evidence than it has in prior reviews. The pattern of changes gives rise to concern that the AER has back solved inputs to match a desired outcome (a lower allowed rate of return) rather than allowing evidence based inputs to generate a robust and defensible allowed rate of return.

- **Third, the process has undermined confidence in the review.** Transgrid and other network businesses engaged constructively with the AER on the basis that the 2026 review would be targeted and focused on a discrete set of matters. The draft RORI proposes material changes that stakeholders were not given a genuine opportunity to address before the draft decision was released.

These concerns matter because the regulatory framework depends on trust. Investors accept that rate of return estimation involves judgement. However, confidence in the framework depends on that judgement being exercised transparently, predictably and consistently with established principles. That confidence is particularly important now, when Australia requires unprecedented levels of investment in transmission infrastructure to support the energy transition.

Transgrid therefore asks the AER to:

1. reverse the proposed changes to the equity beta and MRP and consider future processes to address the recommendations raised in the independent panel report which is to be undertaken in a robust, collaborative and consultative way with stakeholders;

2. reconsider the decision not to adopt the QTC weighted trailing average return on debt approach; and

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3. undertake further consultation on any material departure from established approaches before finalising the 2026 RORI.

If you or your staff require any further information or clarification on this submission, please contact Alex McPherson, General Manager of Regulation and Policy at Alex.McPherson@transgrid.com.au.

Yours sincerely

Nadine Lennie

Chief Financial Officer

Transgrid

People. Power. Possibilities.

Submission on Draft 2026 Rate of Return Instrument

1. The rate of return must reflect efficient financing costs

The RORI performs a central role in the national energy regulatory framework. Its purpose is not to maximise returns to investors. Its purpose is to set an allowed rate of return that provides a network business with a reasonable opportunity to recover its efficient financing costs.

That principle is essential to the NEO and the RPPs. It is also essential to the delivery of the energy transition. Network investment is capital intensive, long lived and dependent on continued access to debt and equity capital. Investors will provide that capital only where they have confidence that the regulatory framework is stable, predictable and capable of providing a reasonable opportunity to recover efficient financing costs.

As the primary transmission network service provider in New South Wales, Transgrid is being asked to deliver one of the most significant network investment programs in Australia. The scale of investment required in New South Wales is unprecedented. It is needed to maintain reliability, connect new generation and storage, support system strength, and enable the transition to a lower-emissions electricity system.

Against that context, the allowed rate of return must reflect market conditions at the time financing is assumed to occur. An approach that relies on outdated evidence, or that knowingly sets allowances below efficient financing costs, will weaken confidence in the regulatory framework, increase the risk that capital is not available on efficient terms and significantly delay the transition, at the cost to consumers.

Transgrid is concerned that the draft RORI does not meet that standard.

In relation to the **return on equity**, the draft RORI proposes to reduce the equity beta despite the increasing scale and risk of network investment and despite evidence from international comparators that should support a higher, not lower, estimate. The domestic comparator evidence has become increasingly stale, with most firms in the historical Australian sample now delisted. Transgrid's previous submission supported the use of international comparators to improve the relevance and robustness of the beta estimate, particularly given the limitations of the domestic sample and the increasingly global nature of competition for capital.[1] The Independent Panel's report reinforces this concern, observing that the AER has not assessed the weaknesses of the out-of-date domestic sample in the same way as the international sample and that the conclusion to attach more weight to domestic evidence is therefore not made out.[2]

In relation to the **MRP**, the draft RORI proposes to reduce the MRP despite the AER having previously treated the approach to MRP as largely settled. The effect is to reduce the allowed rate of return in circumstances where the AER has not clearly identified, consulted on or justified a change in its approach. The Independent Panel similarly concluded that applying

[1] Transgrid, Rate of Return Instrument – Review discussion paper, 19 December 2025, pp.5–9; see link.
[2] Independent Panel, Independent Panel Report – AER Draft Rate of Return Instrument, July 2026, p.3; see link.

the 2022 methodology and updated data does not make a persuasive case for reducing the MRP, and that a 6.1 per cent estimate would require a different and more expansive rationale.[3]

In relation to the **return on debt**, the AER has missed an important opportunity to better align the regulatory allowance with efficient debt financing costs. Transgrid's previous submission supported a weighted trailing average return on debt approach, which provides an unbiased estimate of efficient debt financing costs. AER's draft 2026 RORI decision refers to any 'incorrect compensation' from the simple trailing average approach is likely to be transitory and that the benefits of the weighted trailing average approach will only impact some NSPs with material debt increases. Transgrid agrees with the ENA and QTC submission that these costs are not transitory but permanent and the simple trailing average could result in significant over or under compensation for all NSPs, even without material capex changes. Certainly, the impact to Transgrid would be more material, particularly given the step change in investment facing transmission network businesses and the practical mismatch that arises when significant new debt must be raised at prevailing rates while the allowance reflects a simple historical trailing average.[4]

The weighted trailing average issue is particularly important because it goes directly to principle. If a benchmark efficient network business must raise new debt at prevailing market rates to fund major capital expenditure, the regulatory allowance should recognise and provide a 'reasonable opportunity to recover efficient costs' as set out within the RPPs. A framework that assumes new debt can be financed at rates that prevailed in the past does not reflect the financing task confronting businesses such as Transgrid.

This is not simply an investor concern. Efficient investment requires a reasonable opportunity to recover efficient costs. Consumers benefit from a framework that allows necessary infrastructure to be financed and delivered at efficient cost over time. Conversely, consumers do not benefit from a framework that weakens confidence in cost recovery, increases financing risk or makes the delivery of required investment more difficult. Certainly the draft 2026 RORI refers to impact on consumer bills from changing RORI parameters, without considerations of long term impacts to consumers as a result of any delay in the energy transition.

2. The draft RORI departs from evidence and established regulatory reasoning

Transgrid accepts that setting the rate of return involves judgement. Reasonable minds can differ on how evidence should be weighed. However, the exercise of judgement must be transparent, internally consistent and grounded in evidence.

Transgrid is concerned that the draft RORI falls short of that standard.

3 Independent Panel, Independent Panel Report – AER Draft Rate of Return Instrument, July 2026, p.3.
4 Transgrid, Rate of Return Instrument – Review discussion paper, 19 December 2025, pp.10–14; see link.

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The clearest example is the AER's proposed treatment of **equity beta**. Transgrid and other stakeholders understood that the 2026 review would consider how international evidence should be incorporated into the beta estimate, given the limitations of the domestic Australian comparator set. That was a reasonable and targeted issue for review.

The draft RORI appears to have gone much further. Rather than developing a structured approach to incorporating international beta evidence, the AER appears to have reinterpreted the same historical Australian evidence that it considered in previous reviews. The concern is not merely that the AER has reached a different conclusion. The concern is that the AER has reached a materially different conclusion on the basis of evidence that has not materially changed, and without having clearly identified that this was under consideration. This concern is consistent with the Independent Panel's observation that the reasons stated for reducing beta from the 2022 level are not sufficiently compelling and appear inconsistent with the reasoning applied in 2022.[5]

That approach undermines the stability and predictability that the RORI is intended to provide. Investors do not require the AER to agree with every submission made by network businesses. But they do require confidence that evidence will be treated consistently and that material departures from past reasoning will be clearly explained and consulted on.

Similar concerns arise in relation to the **MRP**. The AER had previously identified MRP as a settled issue following the 2022 RORI review. Stakeholders engaged in the 2026 process on that basis. The draft RORI now proposes a materially different outcome without having clearly identified MRP as an issue requiring further consideration. The AER's Discussion Paper had characterised the 2026 review as targeted and had treated several matters, including MRP, as largely settled.[6]

The effect of the proposed beta and MRP decisions is that evidence appears to have been weighed asymmetrically. Evidence that supports a lower allowed rate of return appears to have been given greater significance, while evidence that supports maintaining or increasing the allowed return appears to have been discounted or reinterpreted. The Independent Panel's report reinforces the need for greater transparency on these judgements, recommending that the AER provide clearer reasoning and a more transparent explanation of how regulatory judgement has been applied on beta and MRP.[7]

That pattern gives rise to serious concern. Transgrid's concern is not that the AER has exercised judgement. It is that the draft RORI gives the appearance that the AER has worked backwards from a desired reduction in the allowed rate of return rather than applying a stable and evidence-based framework to determine the efficient cost of capital.

The same concern arises in relation to the decision not to adopt a weighted trailing average return on debt approach. The AER has recognised that the simple trailing average approach

5 Independent Panel, Independent Panel Report – AER Draft Rate of Return Instrument, July 2026, p.3.
6 AER, *Rate of Return Instrument – Review Discussion Paper*, August 2025, pp.2,7&12; see link.
7 Independent Panel, Independent Panel Report – AER Draft Rate of Return Instrument, July 2026, pp.5–6.

can create a mismatch between the regulatory allowance and the efficient debt financing costs faced by businesses undertaking significant capital expenditure.[8] Yet the draft RORI does not address that mismatch. For a business such as Transgrid, which is required to raise significant new capital to deliver major transmission investment, this is a material issue. At a minimum, and consistent with the Independent Panel's comments, the AER should ensure that its final reasoning is based primarily on the merits of the methodology rather than the bill impact of a particular outcome.

The cumulative effect is a draft RORI that weakens, rather than strengthens, confidence in the rate of return framework. It does not provide the stable and predictable foundation that investors require when committing capital to long-lived network assets.

3. The review process has undermined confidence in the framework

The AER's engagement at the start of the 2026 review was constructive. It indicated that the review would be targeted, collaborative and focused on discrete issues, including the cost of debt mismatch identified by the AER and the relevance of older beta estimates, while maintaining the stability of the rate of return framework. Transgrid welcomed this approach and engaged actively and constructively on that basis. Transgrid understood that the AER's process would build on the 2022 RORI rather than reopen foundational positions without clear notice and an opportunity for stakeholders to respond.

The draft RORI is inconsistent with that expectation.

The AER has proposed material changes to equity beta and MRP, in circumstances where stakeholders were not given a genuine opportunity to engage with the full scope of those proposed changes before the draft decision was released.

This is a serious process concern. Regulatory process matters because it is one of the foundations of confidence in the framework. Network businesses and investors need to understand the issues being considered, the evidence being relied upon, and the framework within which regulatory judgement will be exercised. Where material changes emerge for the first time in a draft decision, stakeholders are deprived of the opportunity to engage meaningfully before the regulator's views have substantially formed.

The consequences extend beyond this review. The RORI is intended to provide a stable framework for estimating the allowed rate of return over time. If stakeholders cannot rely on the scope of a review, or on the AER's previous statements about settled issues and targeted matters, confidence in the framework is weakened.

For Transgrid, that confidence has practical consequences. Transgrid is delivering, and will continue to be required to deliver, nationally significant transmission investment in New South

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8 AER, *Draft 2026 Rate of Return Instrument – Explanatory Statement*, 29 May 2026, p.60 ; see link.

Wales. That investment will support reliability, system security and the integration of new generation and storage. It will also require substantial ongoing access to capital.

Recent developments show that governments are increasingly willing to consider alternative arrangements where there are concerns that existing frameworks may not support the scale and pace of investment required for the energy transition. Transgrid has direct experience with the practical investment challenge in New South Wales, including through the use of Electricity Infrastructure Investment framework introduced by the New South Wales government to support major transmission investment. The draft RORI risks reinforcing concerns that the national framework, as applied by the AER, may not be capable of providing the confidence required for the next phase of network investment.

That is not a desirable outcome. Regulatory fragmentation adds complexity, uncertainty, unnecessary costs and ultimately delays. A strong national framework remains the preferable way to deliver efficient network investment in the long-term interests of consumers. But that framework must be capable of attracting capital and supporting investment at the scale and pace now required.

The importance of sound process is heightened by the limited avenues available to test the merits of the AER's judgement. The removal of merits review places greater weight on the quality of the AER's consultation, reasoning and evidentiary discipline. Where the AER proposes material departures from established approaches, it should consult clearly and substantively before finalising its position.

Transgrid therefore considers that further consultation is required before the 2026 RORI is finalised. At a minimum, the AER should:

- reverse the proposed reductions to equity beta and MRP;
- reconsider the decision not to adopt the QTC weighted trailing average return on debt approach;
- identify clearly any material departure from established approaches and the reasons for that departure; and
- provide stakeholders with a genuine opportunity to respond before the final RORI is made.

The draft RORI risks diminishing confidence in the regulatory framework at a time when Australia requires unprecedented investment in transmission infrastructure. That confidence matters to investors who provide the capital needed to fund the energy transition. It also matters to consumers, whose long-term interests depend on that investment being delivered efficiently, at scale and on time. This is consistent with the Independent Panel's emphasis that

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the AER should demonstrate that consumers are not overpaying while also ensuring that the RORI supports the investment required for Australia's future network needs.[9]

Transgrid urges the AER to reconsider the draft RORI so that the final instrument remains anchored in efficient financing costs, evidence-based reasoning and a process that restores confidence in the stability and predictability of the national regulatory framework.

[9] Independent Panel, Independent Panel Report – AER Draft Rate of Return Instrument, July 2026, p.6.

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