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Submitted via the AEMC's website: <https://www.aemc.gov.au/contact-us/lodge-submission>

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The AEMC's consultation paper – Allowing AEMO to accept cash as credit support

AGL Energy (**AGL**) welcomes the opportunity to make a submission in response to the AEMC's consultation paper on Delta Energy's (**Delta**) rule change request to allow AEMO to accept cash as credit support.

Proudly Australian since 1837, AGL delivers around 4.3 million gas, electricity, and telecommunications services to our residential, small, and large business, and wholesale customers across Australia. We operate Australia's largest electricity generation portfolio and have the largest renewables and storage portfolio of any ASX-listed company, having invested \$4.8 billion in renewable and firming generation over the past 20 years and added more than 2,350 MW of new generation capacity to the grid since 2003.

The National Electricity Market (**NEM**) prudential regime plays a critical role ensuring the confidence in the financial stability of the NEM. In particular, the prudential standard and framework ensures that generators, who are required to sell all their output to AEMO on credit, have confidence they will be paid in full by ensuring that AEMO is paid in full by Market Customers (retailers) for outstanding amounts, even in the circumstances where the retailer or direct customer goes into default. This ensures generators can hedge and trade in the forward market confident that their spot sales will be honoured to support contracts for difference.

AGL supports consideration of the proposal to allow AEMO to accept cash as credit support from market participants. However, it is important that the risks and implications are fully explored, and any resulting rules and procedures be designed to ensure they maintain or strengthen the existing standard and robustness of the prudential framework. The addition of cash, or other mechanisms, to provide more options for participants to meet their prudential requirements would be desirable, but only if they are effective and do not shift the risk and cost of default to other participants.

Key points

- We consider Delta's proposed changes to the National Electricity Rules (**NER**) may not address the issue Delta has described
- Further consultation with stakeholders is critical as extensive changes to the NER will be required should the AEMC agree that AEMO should be able to accept cash as credit support
- The risks to the reliability and security of the power system of a generator defaulting as outlined in Delta's request can be managed under existing arrangements without the AEMC using the expedited rule change process
- The prudential regime is primarily focussed on managing the risk of market customer (retailer) default and this should be a key focus of the analysis (as the act of generating does not inherently

create a credit risk, this typically results from other activities that a generator may undertake as a market customer or reallocator)

- In principle, AGL does not oppose allowing AEMO to accept cash as credit support if the AEMC can demonstrate it can be done in a way that maintains or strengthens (in terms of risks and costs respectively) the existing credit support arrangements
- It is critical that any changes to the prudential and credit support arrangements are thoroughly examined and subject to a robust consultation process with stakeholders to maximise benefits and minimise risk of unintended adverse consequences for market participants and consumers

Potential risks with changing the current prudential and credit support arrangements

In principle, AGL does not oppose allowing AEMO to accept cash as credit support from market participants if the AEMC can demonstrate it can be done in a way that maintains or strengthens (in terms of risks and costs respectively) the existing arrangements.

Key elements of the existing arrangements limit the forms of credit support to bank guarantees or letters of credit, and that credit support must be procured by a market participant *from a credit support provider* which must be an entity which *is not itself a market participant*.

Delta's proposal does not address the fact that market participants cannot currently provide credit support. This issue and related matters are explored in more detail in the next section of this submission.

Should the AEMC be open to the idea that market participants should be able to provide, and AEMO to accept, credit support in the form of cash – there are potentially a range of changes to the NER that could be needed to first allow market participants to provide credit support directly to AEMO without the need for a credit support provider.

It is critical that the AEMC consider this aspect of the proposal carefully. The design of the current arrangements includes the following elements which help protect market participants and ultimately consumers:

- credit support must be from a credit support provider which meets the acceptable credit criteria, and which is not itself a market participant
- is duly executed by the credit support provider and delivered unconditionally to AEMO
- constitutes valid and binding unsubordinated obligations of the credit support provider to pay to AEMO amounts in accordance with its terms which relate to obligations of the relevant Market Participant under the Rules

AGL acknowledges that the AEMC's consultation paper does highlight some of the risks associated with removing credit support providers from the current arrangements and allowing market participants to provide cash to AEMO directly as credit support.¹

For example, there are increased risks should a market participant providing cash directly to AEMO as credit support becomes insolvent. A liquidator appointed to the market participant may seek to 'claw back' any cash deposits paid by the market participant or applied by AEMO within the 6 months prior to the commencement of the administration or liquidation as an unfair preference if the payment and/or use of the cash deposit results in AEMO receiving more in the liquidation of a market participant in respect of an unsecured debt than it would have received otherwise.²

¹ AEMC, *Consultation paper – National Electricity Amendment (Allowing AEMO to accept cash as credit support)* Rule 2024, p. 8

² AEMC, *Consultation paper – National Electricity Amendment (Allowing AEMO to accept cash as credit support)* Rule 2024, p. 8

It is encouraging to see that the AEMC is considering these issues, and potential solutions – such as the structure of the arrangements to which cash deposits are held by AEMO, and requirements on market participants who wish to provide credit support by way of a cash deposit to enter into a security deposit deed and consent to the making of all required *Personal Property Securities Act 2009* (Cth) registrations by AEMO.

There may also be other options available should the AEMC consider there is a case for change. For example, clause 3.3.3 of the NER – which sets out the acceptable credit criteria – determines when market participants are required to procure that AEMO holds the benefit of credit support, and also the entities which are able to be a credit support provider. It sets out a number of requirements, one being that for an entity to meet the acceptable credit criteria, it must be either under the prudential supervision of the Australian Prudential Regulation Authority, or a central borrowing authority of an Australian State or Territory which has been established by an Act of Parliament of that State or Territory. Consideration of whether the acceptable credit criteria may be unnecessarily limiting the number of eligible credit support providers may also be appropriate.

Market participants are not currently allowed to provide credit support

The current credit support arrangements in the NER require market participants, under certain circumstances, to procure that AEMO holds the benefit of credit support *from a credit support provider which meets the acceptable credit criteria*. A credit support provider must be an entity which *is not itself a market participant* (eligible credit support provider).³

The problem currently faced by Delta appears to be that it has been unable to obtain a bank guarantee facility or arrangement with an eligible credit support provider because of, at least in part, the Environmental, Social and Governance (**ESG**) policies of credit support providers.⁴

Delta states the rule change will “allow market participants to provide, and for AEMO to accept, credit support in the form of cash.”⁵

AGL acknowledges that decisions by credit support providers to provide credit support in relation to market participants are ultimately a matter for those credit support providers. When considering whether to provide credit support to a market participant, the credit support provider would likely take into account a range of factors, including its ESG policies. The proposed amendment relates to clause 3.3.2(b) of the NER and is shown in red text below. We have reproduced clause 3.3.2 in full as the proposed change cannot be read in isolation.

Clause 3.3.2 Credit support

Where at any time a *Market Participant* does not meet the *acceptable credit criteria*, the *Market Participant* must procure that AEMO holds the benefit of *credit support* in respect of that *Market Participant*. A *credit support* is an obligation in writing which:

- (a) is from an entity (the *Credit Support Provider*) which meets the *acceptable credit criteria* and which is not itself a *Market Participant*;
- (b) is **cash or** a guarantee or bank letter of credit in a form prescribed by AEMO;
- (c) is duly executed by the *Credit Support Provider* and delivered unconditionally to AEMO;

³ Clause 3.3.2(a) of the NER

⁴ Delta Energy, *Rule Change Proposal – Allowing AEMO to accept cash as credit support*, p. 2 & 3

⁵ Delta Energy, *Rule Change Proposal – Allowing AEMO to accept cash as credit support*, p. 3

- (d) constitutes valid and binding unsubordinated obligations of the *Credit Support Provider* to pay to *AEMO* amounts in accordance with its terms which relate to obligations of the relevant *Market Participant* under the *Rules*; and
- (e) permits drawings or claims by *AEMO* to a stated certain amount.

Further, we consider that the issue currently faced by Delta would not be solved by its proposed rule change. This is because other provisions in the NER require, as noted above, that AEMO holds the benefit of credit support *from a credit support provider which meets the acceptable credit criteria and which is not itself a market participant*.

Delta's proposed amendment does not address the current requirement that market participants are not allowed to provide credit support – regardless of whether it takes the form of cash, or a guarantee or bank letter of credit.

In its rule change request, Delta notes it has conducted a refinancing process which has identified that 13 of the 15 lenders declined due to ESG constraints, and the remaining financial institutions were prepared to offer a bank guarantee facility to provide credit support related only to requirements for mining rehabilitation obligations and renewable Power Purchase Agreements.

AGL notes that the Guide to AEMO credit support management states that in “May 2022, AEMO was holding credit support provided by 23 different financial institutions”.⁶ While the number of financial institutions providing credit support may have changed since then, it is also possible that there are more financial institutions that are able to meet the requirements of being an eligible credit support provider, which are also able and willing to provide credit support to market participants.

AGL encourages the AEMC to understand the extent of the problem described by Delta as part of its rule change process before making a decision that may remove credit support providers from the existing arrangements. While we acknowledge that the AEMC is in part doing this as part of its consultation paper, it may be appropriate for the AEMC to approach AEMO and financial institutions directly to better understand these matters. Speaking directly with financial institutions about how they go about making decisions to provide credit support to market participants in the NEM, including the role ESG has in these decisions and expectations around the influence of ESG in future would be appropriate. This will then allow the AEMC to consider what implications this may have on a rapidly changing NEM.

We would be happy to discuss our submission and the topics raised in the consultation paper in more detail with the AEMC if this would be useful. Please contact Warren Vosper at wvosper@agl.com.au.

Yours sincerely,

Ralph Griffiths

General Manager
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⁶ AEMO, *Guide to AEMO credit support management*, September 2023, p. 5