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Australian Energy Market Commission

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Allowing AEMO to accept cash as credit support draft determination

AGL Energy (AGL) welcomes the opportunity to respond to the Australian Energy Market Commission (AEMC) draft determination on Delta Electricity's rule change proposal to allow AEMO to accept cash as credit support.

Draft determination

AGL welcomes the AEMC's decision to undertake a full-length review process for this rule change and the work undertaken to deliver a more preferred draft rule. The draft rule has substantially improved upon the original rule change request. AGL generally supports the draft determination, however we have concerns that the proposed use of surety bonds and expansion of credit support providers will introduce new risks into the prudential framework that all market participants, and ultimately consumers, will have to bear.

About AGL

At AGL, we believe energy makes life better and are passionate about powering the way Australians live, move, and work. Proudly Australian for more than 185 years, AGL supplies around 4.5[1] million energy, telecommunications, and Netflix customer services. AGL is committed to providing our customers simple, fair, and accessible essential services as they decarbonise and electrify the way they live, work, and move.

AGL operates Australia's largest private electricity generation portfolio within the National Electricity Market (NEM), comprising coal and gas-fired generation, renewable energy sources such as wind, hydro and solar, batteries and other firming technology, and storage assets. We are building on our history as one of Australia's leading private investors in renewable energy to now lead the business of transition to a lower emission, affordable and smart energy future in line with the goals of our Climate Transition Action Plan. We'll continue to innovate in energy and other essential services to enhance the way Australians live, and to help preserve the world around us for future generations.

A robust prudential framework is a key pillar of the NEM

The prudential standard and framework is important to ensure 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.

The prudential framework plays a critical role in securing the systemic financial stability of the NEM, minimising market participant exposure to another participant's inability to meet their financial obligations. It is important that changes to the framework are thoroughly examined and subject to a robust consultation process with stakeholders to maximise benefits and minimise risk of unintended adverse consequences for other market participants or consumers if these protections were to be amended.

AGL supports additional flexibility in the prudential framework as long as it maintains or strengthens the existing credit support arrangements

We support the intent and direction of the AEMC's draft determination as it seeks to provide for greater flexibility in the prudential framework while introducing new safeguards to mitigate risk. The addition of cash,

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[1] Services to customers number is as at 31 December 2024.

or other mechanisms, to provide more options for participants to meet their prudential requirements provides greater flexibility but should only be pursued if these safeguards are effective and do not unduly shift the risk and cost of default to other participants.

AGL notes the AEMC's draft determination states that the provision of cash security is expected to deliver two key benefits:

- Reducing the cost of providing credit support, particularly for small retailers, by avoiding lender fees associated with obtaining and maintaining credit support arrangements.
- Reduce risk of participants failing to provide credit support, by enabling them to provide credit support at short notice without reliance on a third-party.

We acknowledge greater flexibility in credit support requirements will reduce barriers to entry for new technologies and business models.

However, we note this change ultimately increases the risk profile of the prudential framework. That is why we consider an appropriate cap on cash as credit support, and additional safeguards should be implemented, discussed further below.

The $5 million cap should be maintained or reduced

We consider allowing participants to provide cash as credit support up to a limit of $5 million is appropriate; however, this cap should be further scrutinised to ensure it is set at the absolute minimum level required as it introduces inherent risk to the prudential framework. The cap should not be set at a higher value than $5 million.

The cap should strike a balance between allowing participants the flexibility to use cash as credit support while minimising the risk introduced to the market from potential clawback. Holding a substantial level of cash reserve as credit support represents a significant opportunity cost for most participants and consequently is not an attractive option. Therefore, applying a cap of $5 million is unlikely to diminish the benefits of allowing cash as credit support.

While we support elements of draft rule proposed by the AEMC, we consider appropriate safeguards and limits are necessary as ultimately the introduction of cash as credit support reduces the strength of the current prudential framework. Broader issues, including the impact of ESG policies impacting participants access to credit support, should not be reallocated to the rest of the market through over-relaxation of existing prudential requirements in the form of a cap that is too high.

Appropriate safeguards should be implemented to prevent misuse of the system

We note the risk of participants exploiting structural decisions, such as spinning off assets or retail books, to manipulate the cap to their advantage. This highlights the importance of setting the cap at an appropriate level that minimises opportunities for such gaming. To address this risk effectively, robust safeguards should be implemented to ensure the integrity of the market and maintain a level playing field. These safeguards could include mechanisms to detect and deter such behaviour and ongoing monitoring to prevent exploitation, particularly if a retailer has several participants.

Additional safeguards should also include eligibility requirements to access the proposed flexible credit support provisions (including the use of cash), with a requirement for clear evidence that demonstrates a market participant has been unable to obtain credit support or that it would be prohibitively expensive to do so under standard mechanisms. This would minimise the additional risk introduced to the market while allowing for a degree of flexibility for market participants.

Furthermore, we consider it prudent to limit the eligibility of using cash as credit support to the parent company of a market participant (or one related party in a group) rather than all individual registered entities, subsidiaries, and related parties etc. to reduce the risk of strategic gaming of the cap.

AGL does not support the introduction of surety bonds

Allowing the use of surety bonds as a form of credit support risks undermining the integrity of the prudential framework and increasing administrative costs. We do not consider the AEMC has provided clear evidence which demonstrates the benefits of this change for the market or consumers.

Surety bonds, while providing an alternative form of credit support, carry a higher level of risk compared to bank guarantees. Unlike bank guarantees, which are direct commitments from a bank with a strong financial standing to cover obligations if the applicant defaults, surety bonds are issued by insurance companies or specialised providers whose creditworthiness can vary significantly. In periods of financial stress or market volatility, the reliability of surety providers may be less predictable, increasing the risk of non-payment. Furthermore, enforcing claims on surety bonds can be more complex and time-consuming due to potential disputes over terms or conditions, whereas bank guarantees are typically more straightforward to execute in a timelier manner. These factors make surety bonds a less secure option for credit support in environments where financial stability and prompt recourse are critical.

Settlement shortfalls would be short-term cost that would be borne by participants receiving payments (typically generators) which they cannot mitigate. While such costs would be temporary, which would reduce impacts for participants, it is still not acceptable and represent a deterioration of the prudential framework.

AGL does not support expansion of credit support providers beyond APRA-regulated entities

We believe the heightened risk and complexity associated with non-APRA regulated entities to provide credit support significantly increases potential market exposure, which diverges from the core principles of the prudential framework.

It remains uncertain whether there is demand from participants for this option. It is also not clear whether expanding the number of credit support providers would offer any significant benefits over the proposal to allow cash as credit support within the cap of $5 million.

In AGL’s view, there is insufficient evidence in the draft determination outlining the extent and nature of non-APRA approved entities that are capable of providing credit support. Further investigation is required to ascertain the scale of the market which could provide credit support and for this to be made clear before any changes are contemplated.

Clawback risk still remains

We do not oppose allowing cash as credit support if the strength of the credit support arrangements can be maintained or improved. We support the AEMC’s proposed measures to address clawback risk, including:

- Corporations Act displacement
- first ranking charge
- return rights
- set off rights.

We note the AEMC considers that generators should bear the costs of a clawback since requiring retailers (or more generally, participants paying amounts to AEMO) to bear the costs, would entail them to make additional payments to AEMO during a billing period. This then increases complexity or increase risks of default on that payment or future payments.

We do not agree with this approach. If the prudential framework is made less stringent as a result of the proposed changes, the risk of clawback should not be arbitrarily allocated to generators. Generators already bear a risk in providing electricity to the market on credit. This change would result in a further transfer of risk to generators. The beneficiaries of this change are primarily small retailers.

We consider the AEMC should explore other options to more equitably distribute clawback risk across all market participants.

The AER may need to re-examine the authorisation process for new participants

We note the Australian Energy Regulator (AER) authorisation process for new entrants will become even more critical if changes are implemented under which participants no longer have the scrutiny of banks in securing support as they currently do. AEMO have noted that many would-be participants are unable to secure such guarantees due to the nature of their business model or other issues of capacity. We consider that the authorisation process and associated criteria should be examined to ensure it is fit for purpose if the current prudential framework is amended to be made more flexible.

The proposed implementation timeframe is suitable and should not be expedited

We note the draft rule is scheduled to commence on 9 August 2026 and is also aligned with the commencement of the *Shortening the settlement cycle* rule change, which will shorten the settlement cycle to nine business days following the end of a billing period.

We support the proposed timeline and do not consider it should be expedited. This will enable market participants to review the impact of, and adequately prepare for, any changes.

If you have queries about this submission, please contact Alifur Rahman at ARahman3@agl.com.au.

Yours sincerely,

Ralph Griffiths

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