

**Draft rule determination**

National Electricity Amendment  
(Allowing AEMO to accept cash as  
credit support) Rule

Proponent

Delta Electricity

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## About the AEMC

The AEMC reports to the energy ministers. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the energy ministers.

## Acknowledgement of Country

The AEMC acknowledges and shows respect for the traditional custodians of the many different lands across Australia on which we all live and work. We pay respect to all Elders past and present and the continuing connection of Aboriginal and Torres Strait Islander peoples to Country. The AEMC office is located on the land traditionally owned by the Gadigal people of the Eora nation.

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## Summary

- 1 The Australian Energy Market Commission (AEMC or Commission) has decided to make a more preferable draft rule in response to a rule change request submitted by Delta Electricity (the proponent).
- 2 The draft rule would amend the credit support arrangements in the National Electricity Market (NEM) to increase optionality and flexibility for market participants to provide credit support and meet their prudential requirements, without weakening the credit support arrangements. It would achieve this by:
  - allowing participants to provide cash as credit support up to a limit of \$5 million each
  - allowing participants to provide surety bonds as credit support
  - broadening the pool of acceptable credit support providers.
- 3 Increased optionality and flexibility in the credit support arrangements would enable participants to utilise the least cost credit support option for their individual circumstances. This would reduce costs and/or lower working capital requirements for participants, which would be of particular benefit to small and prospective retailers. In turn, this would foster increased retail competition and better service offerings for consumers, delivering material long-term benefits for consumers and promoting the National Electricity Objective (NEO).
- 4 Additionally, allowing cash as credit support would increase flexibility for participants to provide credit support to the Australian Energy Market Operator (AEMO) at short notice and without reliance on a third-party. This would reduce risks of participants triggering a default event from potential delays in providing additional or replacement credit support, or from restrictions in obtaining credit support from a lender.
- 5 We are seeking feedback on our draft determination and rule by **15 May 2025**.

### Increased optionality and flexibility would benefit participants and consumers

- 6 In the NEM, the prudential requirements allow AEMO to manage financial risks in the event that a participant defaults and is unable to pay its outstanding settlement. Market participants are required to provide credit support as part of their prudential requirements when they are a net debtor (typically retailers).
- 7 Currently, credit support must be provided in the form of a bank guarantee or bank letter of credit and must be issued by an institution that, among other conditions, is prudentially regulated by the Australian Prudential Regulation Authority (APRA) or by a central borrowing authority of an Australian State or Territory.
- 8 The draft rule would increase optionality and flexibility for participants to meet their credit support requirements, by expanding the permitted forms of credit support to allow participants to provide:
  - cash as credit support to AEMO up to a limit of \$5 million per participant and on terms and conditions prescribed by AEMO
  - surety bonds to AEMO for credit support, issued by an Australian or overseas entity with an acceptable credit rating and supervised by APRA or an equivalent regulator.
- 9 The key benefits of these changes to the credit support arrangements under the draft rule are:
  - **reduced costs:** participants would be able to provide credit support using the least cost option available to them

- **reduced risk of failing to provide credit support:** participants would be able to use cash if they need to provide credit support on short notice or if they are unable to obtain other forms of credit support.

- 10 The draft rule would also allow credit support to be provided by overseas entities that are regulated by a member of the Basel Committee of Bank Supervision (BCBS) or by a financial or insurance regulator with regulatory equivalence to APRA (as determined by AEMO). These entities would need to comply with existing criteria for credit support providers, such as credit rating requirements. Combined with allowing surety bonds, these changes would broaden the pool of acceptable credit support providers to allow insurers and overseas financial institutions (operating under equivalent regulatory arrangements) and further increase benefits of the draft rule.
- 11 The draft rule would be most beneficial for smaller retailers, who typically have higher financing costs and lower access to capital. Smaller retailers play a critical role in driving competition and value for consumers in the NEM, and may face different costs, risks, and pressures compared to other participants. This increases the relative importance of benefits for small retailers from improvements to the credit support arrangements.
- 12 There would be broader benefits beyond reduced costs and risks for participants providing credit support. Reduced costs and risk of failing to meet prudential requirements would support retailers in offering lower prices to consumers, increasing investment in service innovation, and/or expanding offerings for consumers. In turn, this would support increased competition in, and reduced barriers to entry into, the retail market which would lead to consumer benefits.
- 13 In response to the consultation paper, stakeholders broadly considered that allowing cash as credit support would deliver benefits, while surety bonds were not discussed in the consultation paper nor raised in stakeholder submissions. We consider that cash and surety bonds each have advantages that would contribute to the broader benefits, and we are interested in understanding stakeholder views on the benefits of allowing cash and/or surety bonds as credit support.
- 14 The draft rule would also address the issue raised by the proponent. In the rule change request, the proponent noted that it was unable to obtain credit support from lenders under the existing arrangements due to their exposure to fossil fuels. The draft rule would increase the credit support options available to participants, including broadening the pool of acceptable credit support providers and allowing participants to use cash as credit support which does not rely on a lender.

## The Commission considers the benefits would outweigh the potential risks

- 15 In making this draft determination, the Commission has been cognisant of potential credit and insolvency-related risks to the NEM by amending the credit support arrangements. We have sought to manage risks in the draft rule and consider that the benefits would outweigh potential risks and costs. We are particularly interested in stakeholder feedback on this point in response to the draft determination.
- 16 One risk that the Commission considered for the draft rule is the potential for any cash used as credit support to be clawed back. If a participant provides cash as credit support and becomes insolvent, a liquidator appointed to them may seek to clawback any cash used as credit support as an unfair preference payment. The cash could be an unfair preference payment if AEMO receives more in the liquidation of a market participant, in respect of an unsecured debt, than it would have received otherwise.
- 17 We have analysed and assessed a range of options to mitigate and manage these risks. The draft

rule includes several layers of protection from those potential risks, including:

- granting AEMO a first ranking charge over that cash
- imposing a limit of \$5 million on the amount of credit support a participant can provide in cash
- set off rights for the cash held as credit support if the participant defaults, which AEMO could choose to use subject to any implementation considerations
- measures to avoid financial exposure to AEMO by enabling it to recover potential costs from participants receiving net payments.

18 The draft rule also seeks to clarify the application of existing National Electricity Law (NEL) displacement provisions relating to the provision and use of credit support, which we consider could mitigate clawback and insolvency-related risks. We are conscious that greater certainty could be obtained through an appropriate amendment to the NEL, however NEL amendments are not within the remit of the AEMC. We are interested in stakeholder feedback on the additional value that such an amendment to the NEL could deliver, noting that this would need to be endorsed and implemented by Energy Ministers through legislation.

19 Another risk from the draft rule is that surety bonds, when called upon, may be delayed and not paid out in time for the completion of the settlement run. This could result in a temporary settlement shortfall to participants, until AEMO receives and is able to distribute the funds to participants. Under the existing arrangements, the distribution of delayed payments occurs at the end of the financial year, meaning that participants could be short for an extended period.

20 Our draft rule seeks to reduce this risk by allowing AEMO to distribute delayed payments to short paid participants in a more timely manner through the routine revised statements process. While participants could temporarily be short paid when credit support from a surety bond is called upon, we expect the shorter, 20-business day, distribution timeframe and the likely magnitude of short payments would not have material or lasting impacts on participants. The draft rule would also address similar, existing issues in the current process regarding delayed payments from participants or bank guarantees.

21 Overall, we consider that there is potential for the optionality and flexibility introduced in draft rule to increase certain risks in the NEM. However, we have sought to mitigate this through the checks and balances described above. Therefore, we consider the impact of such risks on the NEM would likely be low, such that the benefits of the draft rule outweigh the risks and promote the long-term interests of consumers.

## The Commission has considered stakeholder feedback in making its decision

22 Our draft determination has been shaped by 20 stakeholder submissions to the consultation paper.

23 In general, stakeholders supported the rule change request to allow cash to be accepted by AEMO as credit support. Many stakeholders considered that there would be material benefits for participants to be able to provide cash as credit support, particularly for smaller retailers. These benefits would allow for cost reductions and reduced risks of triggering a default event, which would contribute to reduced barriers to entry for retailers, improved competition among retailers, and lower prices for consumers. Our draft rule seeks to provide for these benefits.

24 Several stakeholders considered that the rule change would address issues for participants who are unable to obtain bank guarantees due to fossil fuel exposure. Conversely, some stakeholders considered that allowing such participants to continue providing credit support would impact emissions reductions. We recognise that the counterfactual for considering the impact on

emissions is complex and uncertain as there are many factors and dependencies that could affect outcomes. For example, AEMO has discretion in making suspension decisions regarding failing to provide credit support, and credit support arrangements do not directly impact the dispatch of assets. More generally, we have sought to address the broader point raised in the rule change request that there would be benefits in having more flexibility in credit support arrangements. Our approach to increase credit support options is also consistent with credit support arrangements in other jurisdictions.

- 25 Stakeholders expressed varying degrees of concern regarding potential risks and impacts from a clawback of cash credit support. Stakeholders supported the consideration of options to mitigate and manage these risks, with views generally considering that allowing cash as credit could deliver net benefits if risks are appropriately managed. As discussed above, we have sought to mitigate and manage these risks.

## We assessed our draft rule against four assessment criteria

- 26 The Commission has considered the NEO and the issues raised in the rule change request and assessed the draft rule against the assessment criteria outlined below.<sup>1</sup> We considered stakeholder feedback and undertook regulatory impact analysis in relation to these criteria.
- 27 The more preferable draft rule would contribute to achieving the NEO, as it would:
- **Promote flexible credit support arrangements:** The draft rule would increase the range of credit support options and expand the pool of acceptable credit support providers. This would increase the flexibility for participants to provide credit support, in particular the use of cash which can be provided at short notice and allows participants to provide credit support to AEMO without relying on a third-party.
  - **Promote predictable and stable regulatory frameworks:** The draft rule would support clear, predictable, and stable credit support arrangements for participants to meet their prudential requirements.
  - **Maintaining safety, security and reliability:** While safety, security and reliability would likely be maintained under the existing arrangements, the draft rule would increase options for participants to provide credit support, avoiding potential suspensions and impacts on security and reliability from not complying with prudential requirements.
  - **Not materially impacting emissions reductions:** While there is uncertainty in outcomes under the status quo, as outlined above, we consider that any impact on emissions reductions is likely to be outweighed by the benefits of maintaining reliability and addressing issues in the credit support arrangements.

## The draft rule would commence on 9 August 2026

- 28 The draft rule would commence on 9 August 2026. This would allow AEMO to implement any necessary changes to processes, systems, and procedures to accept cash or surety bonds as credit support. The commencement date 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 will continue to work with AEMO to understand potential implementation timeframes ahead of the final determination.

<sup>1</sup> The NEO is in section 7 of the NEL.

- 29 The draft rule includes transitional provisions for AEMO to develop and publish the cash security guidelines by 9 May 2026, three months prior to the commencement of the draft rule. This would allow AEMO adequate time to develop and consult on, if necessary, the cash security guidelines, while providing participants enough time to understand the guidelines prior to the commencement of the rule.

## How to make a submission

### We encourage you to make a submission

Stakeholders can help shape the solution by participating in the rule change process. Engaging with stakeholders helps us understand the potential impacts of our decisions and contributes to well-informed, high quality rule changes.

### How to make a written submission

**Due date:** Written submissions responding to this draft determination and rule must be lodged with Commission by 15 May 2025.

**How to make a submission:** Go to the Commission's website, [www.aemc.gov.au](http://www.aemc.gov.au), find the "lodge a submission" function under the "Contact Us" tab, and select the project reference code ERC0403.<sup>2</sup>

Tips for making submissions on rule change requests are available on our website.<sup>3</sup>

**Publication:** The Commission publishes submissions on its website. However, we will not publish parts of a submission that we agree are confidential, or that we consider inappropriate (for example offensive or defamatory content, or content that is likely to infringe intellectual property rights).<sup>4</sup>

### Next steps and opportunities for engagement

There are other opportunities for you to engage with us, such as one-on-one discussions or industry briefing sessions. You can also request the Commission to hold a public hearing in relation to this draft rule determination.<sup>5</sup>

**Due date:** Requests for a hearing must be lodged with the Commission by 10 April 2025.

**How to request a hearing:** Go to the Commission's website, [www.aemc.gov.au](http://www.aemc.gov.au), find the "lodge a submission" function under the "Contact Us" tab, and select the project reference code **ERC0403**. Specify in the comment field that you are requesting a hearing rather than making a submission.<sup>6</sup>

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2 If you are not able to lodge a submission online, please contact us and we will provide instructions for alternative methods to lodge the submission

3 See: <https://www.aemc.gov.au/our-work/changing-energy-rules-unique-process/making-rule-change-request/our-work-3>

4 Further information about publication of submissions and our privacy policy can be found here: <https://www.aemc.gov.au/contact-us/lodge-submission>

5 Section 101(1a) of the NEL.

6 If you are not able to lodge a request online, please contact us and we will provide instructions for alternative methods to lodge the request.



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# 1 The Commission has made a draft determination

The Australian Energy Market Commission (AEMC or Commission) has made a draft determination to make a more preferable draft rule (the draft rule) in response to a rule change request submitted by Delta Electricity (the proponent). The proponent’s rule change request sought to allow the Australian Energy Market Operator (AEMO) to accept cash as credit support in the National Electricity Market (NEM).

Our draft rule seeks to increase optionality and flexibility for participants to provide credit support and meet their prudential requirements, without weakening the credit support arrangements. We are seeking feedback on this draft rule by 15 May 2025.

This chapter provides an overview of the draft rule, how it would deliver net benefits, and stakeholder views that shaped our draft determination.

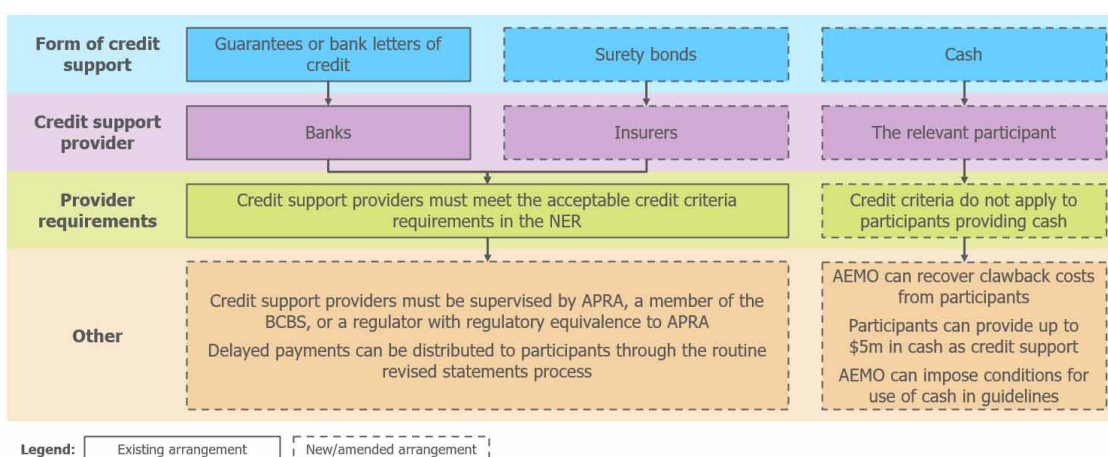
## 1.1 Our draft rule would increase optionality and flexibility for participants to provide credit support

The Commission has made a draft determination to increase optionality and flexibility for participants providing credit support without weakening the credit support arrangements in the NEM. At a high-level, key aspects of the more preferable draft rule are:

- allowing participants to provide cash as credit support up to a limit of \$5m
- allowing participants to use surety bonds as credit support from a surety that meets the acceptable credit criteria
- expanding the requirement for credit support providers to be regulated by APRA.

Figure 1.1 illustrates the changes to the credit support arrangements under the draft rule.

**Figure 1.1: Overview of the draft rule**



We consider that increased optionality and flexibility in the credit support arrangements from the draft rule would deliver net benefits to the NEM. The draft rule would deliver material benefits for small and prospective retailers and have positive impacts on retail competition, as small retailers

typically have higher financing costs and lower access to capital. There are also material benefits for participants who are unable to obtain and provide credit support under the current arrangements, such as those raised by the proponent in the rule change request.

As the draft rule would require systems and process changes, primarily for AEMO, it would commence on 9 August 2026. AEMO would also develop, update and publish relevant guidelines by 9 May 2026 to account for changes to the credit support arrangements and allow stakeholders to understand procedures prior to implementation of the draft rule. We will continue to work with AEMO to understand potential implementation timeframes ahead of the final determination and final rule (if made).

Chapter 2 contains more information on the benefits and costs of the draft rule, and how it contributes to the National Electricity Objective (NEO). Chapter 3 provides information on the design and operation of the draft rule.

While direct comparisons cannot be made with other energy markets internationally, it is worth noting that the draft rule would align with credit support arrangements in other energy markets. Many other energy markets allow cash as credit support, with some markets accepting surety bonds. See appendix C for information on the existing credit support arrangements in the NEM and appendix D for information on credit support options in other energy markets.

### 1.1.1 The draft rule would reduce credit support costs and risks of default

This draft rule would increase optionality and flexibility for participants in providing credit support, which would improve the ability for, and efficiency of, participants meeting their prudential requirements. The draft rule would not weaken the credit support arrangements in the NEM. The key benefits of this increased optionality and flexibility, which would promote the long-term interests of consumers, are:

- participants can choose the credit support option that is lowest cost and most suitable to them
- reduced risks of participants triggering a default event by allowing them to provide cash as credit support to AEMO on short notice and without reliance on a third-party.

The draft rule is most likely to be beneficial for small and prospective retailers, whose credit support costs are typically higher due to higher financing costs and lower access to capital. Lower credit support costs and reduced risks of failing to provide credit support to smaller retailers would lower barriers to entry, and support increased competition and lower prices for consumers.

Furthermore, increasing options for credit support would improve the ability for market participants to obtain and provide credit support. In particular, allowing cash would allow participants to provide credit support without needing to obtain credit support from a third-party. Other aspects of the draft rule would expand the pool of acceptable credit support providers that participants could obtain credit support from. We consider that this would address the principal issue raised by the proponent and that the draft rule is in line with the intent of the requested rule change, as participants unable to obtain credit support from lenders could provide cash as credit support.

For more information on the benefits of the draft rule, refer to section 2.4.

### 1.1.2 We consider that any increased risks would be outweighed by benefits

The draft rule would increase certain risks to participants, however we have sought to mitigate and manage these risks as discussed below. Therefore, we consider that on balance the draft rule would deliver net benefits for the NEM.

There is a potential risk that cash used as credit support could be ‘clawed back’ as an unfair preference payment if the participant, who provided the cash, becomes insolvent.<sup>7</sup> Our draft rule seeks to minimise these risks such that we consider they are sufficiently low to the NEM and would likely be materially outweighed by the benefits of allowing cash as credit support. Specifically, we consider that risks would be reduced through:

- limiting the amount of cash that a participant can provide as credit support to \$5 million
- several layers of protection from potential clawback and insolvency-related risks, such as granting AEMO a first ranking charge over cash provided as credit support or set off rights in the event of a default
- participants receiving payments from AEMO (typically generators) bearing any clawback costs, avoiding any exposure to AEMO and reducing risks of contagion.

There is a further risk to generators in the form of temporary settlement shortfalls. Under the existing arrangements, delayed payment from a participant or a credit support provider would lead to generators being short-paid until the payment is distributed at the end of financial year (EOFY). When considering surety bonds, we found that surety bonds can be equivalent to bank guarantees, but may not be able to pay out as fast as a bank guarantee and so could exacerbate the risks of delayed payment. Therefore, our draft rule seeks to address this issue that currently exists by distributing delayed payments (regardless of the form of credit support provided) to generators in a more timely manner as opposed to waiting until EOFY. This would reduce the impact and costs to generators for being short-paid.

For more information on these risks, refer to section 2.5.

## 1.2 Stakeholder feedback and views have shaped our determination

Based on a number of considerations, the Commission made its draft determination to increase optionality and flexibility for participants to provide credit support in the NEM, without weakening the credit support arrangements that underpin NEM settlement.

The draft determination has been shaped by stakeholder feedback. In response to our consultation paper, we received 20 submissions from a range of stakeholders. General views provided by stakeholders in submissions are:

- most stakeholders were supportive of allowing cash as credit support
  - many stakeholders considered that the current credit support options are inflexible, and increase costs and uncertainty for retailers (particularly small retailers) in meeting prudential requirements
  - some stakeholders expressed concerns about the ability for fossil-fuel exposed participants to obtain credit support under the current arrangements, while some stakeholders considered that amending the credit support arrangements to accommodate fossil-fuel exposed participants could have implications on emissions reductions

<sup>7</sup> References in this draft determination to clawbacks correspond to the potential for a liquidator, appointed to an insolvent market participant, seeking to recover any cash deposits paid by the participant to AEMO as an unfair preference payment if the payment results in AEMO receiving more in the liquidation of the participant in respect of an unsecured debt than it would have received otherwise. See section 2.5.1 for more information.

- several stakeholders considered that clawback risks, associated with the use of cash as credit support, could have material impacts and options should be considered to address such risks
  - AEMO considered that the potential for, and any consequential impacts, of a clawback are highly uncertain, and that AEMO cannot be financially exposed to any clawbacks.

We acknowledge the issues raised by stakeholders in relation to the current credit support arrangements. Therefore, our draft rule would allow cash to be used as credit support (in line with the rule change request) to address these issues. The draft rule would also allow surety bonds as credit support and broaden the pool of credit support providers, which would provide additional credit support options that could address issues raised by stakeholders.

In consideration of stakeholder feedback in relation to clawback risks, we have considered options to mitigate them. Our draft rule to allow cash security seeks to mitigate the insolvency-related risks associated with the provision of cash security, including by limiting the amount of cash security that may be provided by a participant and thereby limiting the maximum amount that could be subject to a clawback. Refer to section 2.5.1 for further discussion on clawback and other insolvency-related risks.

## 2 The rule would contribute to the National Electricity Objective

The draft rule would contribute to the National Electricity Objective (NEO) by promoting improved efficient investment in, and operation of, electricity services in the NEM.

By increasing optionality and flexibility in the credit support arrangements for the NEM, participants would be able to provide credit support in the form most suitable for their individual circumstances. We consider that this would lead to reduced costs and risks for participants providing credit support and address issues raised by the proponent and other stakeholders, which would contribute to the NEO by promoting more efficient investment and operation in the NEM. Furthermore, benefits for participants from the draft rule would flow through to, and deliver material long-term benefits for, consumers.

There could be increased risks associated with the potential clawback of cash used as credit support, or with temporary settlement shortfalls to generators in the event of delayed credit support payments. However, the draft rule seeks to mitigate those risks and we consider that residual risks are outweighed by the benefits.

This chapter outlines:

- that the Commission must consider the NEO and the long-term interests of consumers, discussed in section 2.1
- that the Commission may make a more preferable rule, discussed in section 2.2
- how the draft rule would contribute to the NEO against assessment criteria, discussed in section 2.3
- benefits of the draft rule by increasing optionality and flexibility in the credit support arrangements, discussed in section 2.4
- potential risks and costs of the draft rule which would be outweighed by the benefits, discussed in section 2.5.

### 2.1 The Commission must act in the long-term interests of energy consumers

The Commission can only make a rule if it is satisfied that the rule will, or is likely to contribute to, the achievement of the relevant energy objectives.<sup>8</sup> The NEO is:<sup>9</sup>

to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to—

- (a) price, quality, safety, reliability and security of supply of electricity; and
- (b) the reliability, safety and security of the national electricity system; and
- (c) the achievement of targets set by a participating jurisdiction—
  - (i) for reducing Australia’s greenhouse gas emissions; or
  - (ii) that are likely to contribute to reducing Australia’s greenhouse gas emissions.

<sup>8</sup> Section 88(1) of the NEL.

<sup>9</sup> Section 7 of the NEL.

The targets statement, available on the AEMC website, lists the emissions reduction targets to be considered, as a minimum, in having regard to the NEO.<sup>10</sup>

We consider that the draft rule would contribute to the NEO by promoting efficient investment in, and operation of, electricity services for the long term interests of consumers. The draft rule is likely to deliver benefits for participants providing credit support such that the credit support arrangements operate more efficiently, which would lead to benefits for consumers. We consider that these benefits would outweigh potential risks and costs associated with the draft rule, such that it would contribute to the NEO on balance. See section 2.4 and section 2.5 below for more information.

As described in our guidelines on how we consider the national energy objectives, we can weight each component of the NEO as we consider appropriate in the circumstances.<sup>11</sup> In our consultation paper, we considered weighting the reliability, safety and security components of the NEO higher than the emissions component due to the particular circumstances of the proponent. Consistent with the NEO, we still considered emissions in making our determination on the rule change request. Nonetheless, we consider that our draft rule would maintain reliability, safety and security in the NEM and would not materially impact emissions reductions.<sup>12</sup>

## 2.2 We have considered whether to make a more preferable rule

The Commission may make a more preferable rule that is different, including materially different, to a proposed rule if it is satisfied that, having regard to the issue or issues raised in the rule change request, the more preferable rule is likely to better contribute to the achievement of the NEO.<sup>13</sup>

The rule change request from the proponent sought to allow cash as credit support in the NEM, aiming to ensure the continued supply of secure and reliable electricity in the NEM, promote efficiency, and potentially reduce operating costs for market participants.<sup>14</sup> Specifically, the proponent proposed for cash to be allowed as credit support by amending NER clause 3.3.2(b) to insert 'cash or' after the word 'is'.<sup>15,16</sup>

For this rule change, the Commission has made a more preferable draft rule that we consider, compared to the rule change request, would address risks arising from allowing cash as credit support and deliver additional benefits. The more preferable draft rule, while broadly aligned with the rule change request in allowing cash as credit support, seeks to address clawback and insolvency-related risks that the rule change request did not address and we consider should be mitigated and managed.<sup>17</sup> The draft rule also allows surety bonds as credit support and broadens the pool of acceptable credit support providers, which we consider would provide further benefits from increased optionality and flexibility. The benefits and risks of the draft rule are discussed in section 2.4 and section 2.5 respectively.

For more information on the legal requirements for our decision, see appendix F.

<sup>10</sup> Section 32A(5) of the NEL.

<sup>11</sup> AEMC, How the national energy objectives shape our decisions, Final guidelines, 1 August 2024, p.15. See also section 88(2) of the NEL regarding the application of the national electricity objective by the AEMC.

<sup>12</sup> See section 2.3.3 and section 2.3.4 for further discussion.

<sup>13</sup> Section 91A of the NEL.

<sup>14</sup> See appendix A and the rule change request published on our website for more information.

<sup>15</sup> Delta Electricity, Rule Change Proposal - Allowing AEMO to accept cash as credit support, 17 October 2024, p.2.

<sup>16</sup> For reference, clause 3.3.2(b) of the NER states that credit support must be an obligation in writing that "is a guarantee of bank letter of credit in a form prescribed by AEMO".

<sup>17</sup> See section 2.5.1 for more information on these risks.



## 2.3 How we have applied the legal framework to our decision

The Commission has considered how to address issues associated with the existing options to provide credit support against the legal framework.

We identified the following criteria to assess whether the proposed rule change, no change to the rules (business-as-usual), or other viable, rule-based options are likely to better contribute to achieving the NEO:

- flexibility, discussed in section 2.3.1
- predictability and stability, discussed in section 2.3.2
- emissions reductions, discussed in section 2.3.3
- safety, security and reliability, discussed in section 2.3.4.

These assessment criteria reflect the key potential impacts, costs, and benefits of the rule change request, for impacts within the scope of the NEO. Our reasons for choosing these criteria are set out in chapter 4 of the consultation paper.

The Commission has undertaken regulatory impact analysis to evaluate the impacts of the various policy options against the assessment criteria. See appendix B for more information.

The rest of this section explains why the draft rule best promotes the long-term interest of consumers when compared to other options and assessed against the criteria.

### 2.3.1 The draft rule would promote flexible credit support arrangements

We consider that flexibility in providing credit support would improve under the draft rule. This is due to the increased optionality for participants to provide credit support, both in newly allowed forms of credit support and a broader pool of credit support providers.

The current allowed options for providing credit support are bank guarantees or bank letters of credit, which must come from a bank that meets the acceptable credit support provider criteria.<sup>18</sup> While these arrangements ensure a high level of prudential strength in the credit support arrangements, the limited options available to participants creates a degree of inflexibility in obtaining and providing credit support.

Allowing cash as credit support would greatly promote flexibility in the credit support arrangements. Participants would no longer be required to obtain credit support from a third-party to provide credit support to AEMO, as they could provide cash directly to AEMO by themselves. Providing cash would also allow participants to flexibly respond to changes in their maximum credit limit (MCL) in a more timely manner.<sup>19</sup> Flexibility would also increase for AEMO, who would be able to draw on any cash provided as credit support without needing to contact and arrange for a lender to pay out at short notice.<sup>20</sup>

Allowing participants to provide surety bonds to AEMO would broaden the pool of credit support providers from banks to include insurers. This would allow participants with more flexibility to obtain credit support from a wider range of credit support providers. Insurers would need to meet the acceptable credit criteria that currently apply to banks providing credit support in the NEM. This would provide a consistent and robust framework to ensure that credit support providers are sufficiently reputable and capable to pay out on credit support if required.

<sup>18</sup> See clause 3.3.2(b) of the current NER and appendix C for more information.

<sup>19</sup> Under clause 3.3.5 of the NER, participants are required to provide valid credit support that, in aggregate, is not less than their MCL. In other words, the MCL is the minimum amount of credit support a participant must provide.

<sup>20</sup> If a lender is delayed in paying the credit support to AEMO, this could lead to a shortfall in payments to participants until AEMO is able to distribute payments to participants. See section 2.5.2 and section 3.2.2 for more information.

### 2.3.2 The draft rule would promote predictable and stable credit support arrangements

The draft rule would expand the credit support options that participants can use to meet their prudential requirements by allowing participants to provide cash and surety bonds in addition to bank guarantees. By making corresponding changes to the NER, this offers predictability and stability to participants in what options for credit support they can provide to AEMO.

The stability of participants in being able to meet their prudential requirements would likely increase, as participants would have greater optionality and flexibility to ensure that they can provide credit support as required and avoid risks of failing to provide credit support.

We acknowledge that there is a degree of unpredictability and uncertainty associated with the clawback risks of the draft rule (see section 2.5), however we consider that the broader predictability and stability of the prudential framework as a whole would be retained.

### 2.3.3 The draft rule would not materially impact emissions reductions

We consider that the draft rule would not have any material impact on emissions reductions and that the benefits, including maintaining reliability, from the draft rule would outweigh any impacts on emissions reductions.

The draft rule, if made as a final rule, would amend the credit support arrangements for participants in the NEM. We have sought to address the broader point raised in the rule change request that there would be benefits in having more flexibility in credit support arrangements, which could lower costs. The credit support options proposed in the draft rule are also used in other jurisdictions and energy markets.<sup>21</sup>

However, as noted in the consultation paper, maintaining the current arrangements could theoretically lead to some emissions reductions in respect of the proponent, Delta Electricity. This is because the proponent stated in its rule change request that they have not been able to obtain and provide credit support from the end of 2024 under the existing arrangements, which could potentially lead to their suspension from the NEM if it is required to provide credit support but is unable to. Since the proponent operates the 1320MW coal-fired Vales Point power station, a suspension on their generation activities could lead to emissions reductions.<sup>22</sup>

We consider the counterfactual for assessing the impact on emissions is complex and uncertain, as there are multiple factors and dependencies that could affect outcomes. For example, AEMO has discretion under clause 3.15.21 (default procedure) of the NER in suspending participants when they are in default to AEMO. Of particular note, AEMO has flexibility to suspend participants from specific registration categories, such as suspending a participant from being a retailer but not suspending them in relation to being a generator. While AEMO has not indicated what decision it might make if the proponent were required but unable to provide credit support, AEMO has statutory obligations to maintain power system security and promote the effectiveness of the NEM. Regardless, if the proponent's generation activities were suspended, potential emissions reductions may be immaterial. For example, other thermal plants may need to increase output for demand to be met, or Vales Point power station may only be non-operational for a short period if it is acquired by another party or government for operation and/or to maintain reliability.

This discussion could be generalised for possible future issues for other fossil-fuel exposed participants in obtaining credit support. While there are multiple dependencies and uncertainties in potential outcomes under the existing arrangements, we consider that the draft rule would likely

<sup>21</sup> See appendix D for more information.

<sup>22</sup> The current expected closure year for Vales Point is 2033, which can be found on AEMO's Generation Information webpage [here](#).

not have a material impact on emissions reductions. We have also weighed any impact on emissions reductions from amending the credit support arrangements against key benefits such as lowering of costs to consumers (discussed in section 2.4) and reliability considerations (discussed in section 2.3.4), which we consider would deliver broader benefits and net positive outcomes.

Stakeholder views varied on the potential impact of emissions reductions by allowing cash as credit support:

- some stakeholders considered that allowing cash as credit support, to allow the proponent to provide credit support, would not meet the emissions reductions assessment criteria<sup>23</sup>
- some stakeholders considered that allowing cash as credit support would have minimal impacts on emissions<sup>24</sup>
- one stakeholder considered that emissions reductions should not be a criterion as the rule change would apply to all NEM participants<sup>25</sup>
- one stakeholder considered that allowing cash as credit support would not be technologically neutral as it would only be necessary to accommodate circumstances for emissions intensive generators.<sup>26</sup>

### 2.3.4 The draft rule would maintain safety, security and reliability

We consider that the draft rule would maintain safety, security and reliability.

There is a potential risk under the current arrangements that the proponent and their generation operations could be suspended from the market by AEMO if they are unable to provide credit support, which could have implications on safety, security and reliability in the NEM. However, similar to the discussion in section 2.3.3 on emissions reductions, suspension of generation operations might not occur (AEMO has flexibility in making suspension decisions to maintain safety, security and reliability) or be long-lasting.

Regardless, the draft rule would allow the proponent, or any other participant in similar circumstances, to provide cash as credit support or seek credit support from a wider range of lenders. This would further ensure that safety, security and reliability would be maintained as participants could avoid potential suspension from not meeting prudential requirements.

Several stakeholders considered that, if the proponent is unable to provide credit support and is suspended, there could be sudden and material impacts on reliability and security.<sup>27</sup> Conversely, one stakeholder considered that reliability and security risks can be managed under existing arrangements.<sup>28</sup> Some stakeholders considered that analysis is needed to assess potential reliability gaps if the proponent were suspended.<sup>29</sup>

## 2.4 Increased optionality and flexibility would deliver benefits

We consider that increasing the optionality and flexibility for participants to provide credit support would lead to net benefits. The key benefits would be:

23 Submissions to the consultation paper: CEIG, p.2; Ryan Harris, p.1.

24 Submissions to the consultation paper: Delta Electricity, p.3; EUAA, p.5.

25 Submission to the consultation paper: Perpetual Energy, p.4.

26 Submission to the consultation paper: JEC, p.2.

27 Submissions to the consultation paper: EUAA, p.5; Genuity, p.1.

28 Submission to the consultation paper: AGL, p.1.

29 Submissions to the consultation paper: CEIG, p.2; JEC, p.2.

- cost reductions in providing credit support, discussed in section 2.4.1
- reduced risks of triggering a default event from not being able to provide credit support when required, discussed in section 2.4.2.

#### 2.4.1 Increasing optionality would allow participants to provide credit support at least cost

Participants are currently required to obtain a bank guarantee or letter of credit for credit support, and are accordingly charged fees by their lender. These fees can vary between participants and lenders.

By allowing cash and surety bonds to be provided as credit support, the draft rule is likely to enable cost reductions for many participants. We consider that there could be opportunities for participants to reduce costs by using cash as credit support, including not paying fees for a bank guarantee. We also consider that participants could have opportunities to reduce costs by using surety bonds, which may have lower costs than bank guarantees or have lower working capital requirements, since surety bonds are typically unsecured.

Increasing available credit support options may also contribute to lower credit support costs by increasing competition among credit support providers. This could contribute to reductions in fees and costs for participants as lenders compete to offer and provide credit support.

The materiality of potential cost reductions is likely to vary between participants depending on their current credit support arrangements. We consider that the draft rule would likely deliver material cost reductions in aggregate. These cost reductions would lead to reduced operating costs and/or working capital requirements for retailers (particularly small and prospective retailers), and reduced barriers to entry. This would support increased investment in service innovation, expanded offerings for consumers, a more competitive retail market and lower prices for consumers, all contributing to benefits for consumers.

##### **Cost reductions would likely be more material for smaller retailers**

We consider that potential cost reductions from the draft rule would likely be more material for small retailers, as they typically have higher financing costs and lower access to capital relative to larger retailers. Smaller retailers play a critical role in driving competition and value for consumers in the NEM, and may face different costs, risks, and pressures compared to other participants. This increases the relative importance of benefits for small retailers from improvements to the credit support arrangements.

The materiality of impacts for small retailers is further highlighted by the ability for participants to use reallocations to manage their net position and reduce their credit support obligations, and hence reduce their costs of credit support. Reallocation instruments allow two participants to request AEMO to make matching debits and credits and reflect their net positions in settlement. This can reflect effects of vertical integration or off-market hedge contracts such as cap and swap contracts. For small non-vertically-integrated retailers, reallocations are typically more costly or difficult to access to reduce credit support amounts and costs, thereby meaning reductions in credit support costs are likely to be more impactful for small retailers.<sup>30</sup>

30 For further reference, AEMO's submission to the consultation paper for *Shortening the settlement cycle* rule change noted that more than 80% of reallocations are intra-company reallocations and, if only energy inter-company reallocations are considered, smaller retailers make up 20 to 30% of inter-company MWh reallocated.

### **Our draft rule is complementary with the *Shortening the settlement cycle* rule change**

This draft determination is complementary with the *Shortening the settlement cycle* rule change that was made by the AEMC on 12 December 2024, which made a final rule to shorten the settlement cycle to nine business days following the end of a billing period.<sup>31</sup> A key benefit of the final rule was that, by shortening the settlement cycle, the MCLs of participants would be lowered and thus they would need to provide lower amounts of credit support. Lower credit support amounts would lower financing costs and working capital requirements for participants and, similar to this draft determination, would be of particular benefit for smaller retailers. Increasing the optionality and flexibility for participants to provide credit support would supplement the benefits of the *Shortening the settlement cycle* rule change.

### **Stakeholders considered that cash would allow for reductions in credit support costs**

Many stakeholders considered that cash could be lower cost than a bank guarantee for providing credit support, particularly for smaller retailers.<sup>32</sup> One stakeholder considered that cash is generally more expensive than bank guarantees, but acknowledged the increased flexibility in allowing cash.<sup>33</sup> Surety bonds were not mentioned in the consultation paper and no stakeholder raised them in submissions.

In its submission to the consultation paper, Origin noted that bi-directional units (BDU) will often be owned by a special purpose vehicle (SPV) and generally have positive settlement balances with AEMO due to the nature of their operation.<sup>34</sup> Origin considered that allowing cash as credit support would allow BDUs to avoid expenses and administrative burden in obtaining bank guarantees to meet prudential requirements. The nominal MCL for BDUs is \$10k per 100MW of capacity, however this may vary for individual participants.<sup>35</sup> We agree that allowing cash to be used as credit support would be beneficial for BDUs in reducing costs and improving flexibility for them to provide credit support.

#### **2.4.2 Increased flexibility would reduce risks of triggering default events for participants**

There are risks to participants under the current credit support arrangements due to the reliance on obtaining credit support from a bank to provide credit support to AEMO. If a participant is unable to obtain credit support or respond at short notice to changes in their MCL, a default event could be triggered in relation to that participant. This could lead to their suspension from the market, with potential broader impacts if a participant's retail customers are transferred to a new retailer under the Retailer of Last Resort (RoLR) scheme or if a participant is no longer able to operate their generation or storage assets.

The draft rule would increase the credit support options available to participants, thereby increasing the flexibility in being able to provide credit support and meet prudential requirements. Allowing cash would ensure that a participant could provide credit support without needing to seek and obtain credit support from a lender, in addition to reducing the time to process and provide credit support to AEMO. Furthermore, allowing surety bonds and broadening the pool of credit support providers would increase the number of lenders available to participants to obtain credit support from.

31 The AEMC project page for the *Shortening the settlement cycle* rule change can be found [here](#).

32 Submissions to the consultation paper: AEMO p.5; AFMA, p.1; Energy Locals, p.2; Genuity, p.2; GloBird Energy, p.1; Iberdrola, p.1; MTA Energy, p.1; Perpetual Energy, p.2; ZEN Energy, p.3.

33 Submission to the consultation paper: Origin Energy, p.1.

34 Ibid.

35 AEMO, NEM Credit Limit Procedures, 3 June 2024, pp.37-38.

### **Risks of default due to administrative delays in providing credit support would be reduced**

Under the current arrangements, we understand that there are risks to participants if they are unable to provide or update their bank guarantee in the required time. While fault could lie with the participant, it could also be due to administrative difficulties or delays that the participant has no control over. For example, a bank may be delayed or too slow in approving and providing an updated bank guarantee for a participant, which could be due to a range of reasons such as administrative delays or a lengthy approval process. This creates risks in creating a default event in relation to participants needing to provide or update credit support, which could lead to their suspension and exit from the market.

Allowing participants to provide cash would introduce an option to provide credit support on short notice and without reliance on a third-party. This means that participants would be able to avoid risks of triggering a default event from delays in providing or updating credit support.

Numerous stakeholders expressed concerns regarding these existing risks, and considered that the process for obtaining bank guarantees can be time-consuming, cumbersome, and challenging to meet deadlines to provide credit support.<sup>36</sup>

### **Risks of fossil-fuel exposed participants failing to provide credit support would be reduced**

In the rule change request, the proponent claimed that they have been unable to obtain new credit support arrangements due to the ESG constraints of lenders. We consider that the impact of ESG policies on the ability for NEM participants to obtain credit support is highly uncertain, both in the current environment and into the future. A potential indicator for future impacts of lender ESG constraints could be lender ESG policies and any corresponding emissions reductions targets, however we note that ESG policies vary between lenders and can be altered, in addition to likely being only one consideration in lender decisions to offer finance.

Nonetheless, we consider that it would be prudent to allow all participants, including fossil-fuel exposed participants, to provide credit support and appropriately meet prudential requirements. While it may be viewed that the inability for a participant to obtain credit support from a lender corresponds to increased risk of their default, we note that the other arrangements exist beyond acceptable forms of credit support to limit default and credit risks to the market.<sup>37</sup>

Some stakeholders considered that requiring credit support from a lender were too restrictive and could impact supply of electricity from fossil fuels in the future before replacement assets are in place.<sup>38</sup> One stakeholder considered that lender ESG policies reflect the broader market and regulatory transition and should be viewed as a market signal on the viability of assets in the transition.<sup>39</sup> Other stakeholders also considered that lenders are less likely to provide credit support to smaller retailers and new participants, due to potential risks in the volatile wholesale market and/or a lack of proven historical operation.<sup>40</sup> One stakeholder considered that only allowing bank guarantees as credit support provides banks with an effective veto on the operations of participants, including the proponent and small retailers.<sup>41</sup>

36 Submissions to the consultation paper: BlueNRG, p.2; Energy Locals, pp.1-2; GloBird Energy, p.2; Localvolts, pp.1-2; MTA Energy, p.1; ZEN Energy, p.2.

37 For example, the requirement for participants to provide a minimum amount of credit support serves to manage risks to the market by ensuring AEMO has access to funds in the event of short payments. Furthermore, retailers are required to obtain a retailer authorisation from the AER, in which the AER assesses the organisational, technical, and financial capacity for an organisation to operate as a retailer. The AER's Retailer Authorisation Guideline can be found [here](#).

38 Submissions to the consultation paper: Delta Electricity, p.1; EUAA, p.2; Genuity, p.1; Perpetual Energy, p.2.

39 Submission to the consultation paper: CEIG, p.2.

40 Submissions to the consultation paper: Energy Locals, p.2; GloBird Energy, p.2; Localvolts, p.1; Perpetual Energy, p.2.

41 Submission to the consultation paper: Localvolts, p.1.



## 2.5 Potential risks and costs to participants would be outweighed by benefits

We consider that the draft rule would deliver benefits for participants and consumers, discussed in section 2.4, that outweigh risks and costs to participants associated with the draft rule. These potential risks and costs could arise from:

- potential clawbacks and other insolvency-related risks of cash used as credit support, discussed in section 2.5.1
- potential temporary settlement shortfalls when surety bonds are used as credit support, discussed in section 2.5.2
- implementation and ongoing costs to AEMO, discussed in section 2.5.3.

We consider that the impacts on participants are likely to be low from clawbacks or temporary settlement shortfalls, with the likelihood and potential impacts mitigated by the draft rule. Costs to AEMO to implement the draft rule are likely to be low and we will continue to work with AEMO to understand the magnitude of costs. We are interested in stakeholder views and feedback on these potential risks and how the draft rule seeks to address them.

This section discusses the potential risks, proposed protections, and costs associated with the draft rule. Refer to chapter 3 for more information on how the specific changes in the draft rule would operate.

### 2.5.1 Allowing cash would introduce risks of clawbacks to participants

The use of cash as credit support could increase risks to the market where a market participant becomes insolvent and cash used as credit support is clawed back by a liquidator. The draft rule includes protections to reduce these risks. However, these risks cannot be eliminated absent an amendment to the NEL to expand the existing Corporations Act displacement provision.

These risks cannot be quantified due to the high degree of uncertainty, but we consider that probabilities and impacts of clawbacks would likely be low. Nonetheless, our draft determination has been made to manage risks and costs associated with clawbacks and we consider the benefits would outweigh costs.

#### **Cash used as credit support could be clawed back if a participant becomes insolvent**

There is a potential risk that the provision and use of cash credit support could constitute an unfair preference. This arises if the provision of the cash credit support, and/or the use of it by AEMO, results in AEMO receiving from the participant, in respect of an unsecured debt that the participant owed to AEMO, more than AEMO would receive if the transaction were set aside and AEMO were to prove for the debt in the winding up of the market participant, and no relevant defence applies.<sup>42</sup>

Broadly, section 588FE of the Corporations Act is that, unless certain conditions are satisfied, a transaction that is an unfair preference may be set aside or modified (i.e. subject to clawback) if, at the time of entering into a transaction the participant was insolvent or it became insolvent because of the transaction and the transaction occurred during the suspect period.<sup>43</sup>

<sup>42</sup> Put simply, if AEMO uses cash credit support provided by a participant that becomes insolvent, that cash could potentially be clawed back. However, the outcome of this is subject to multiple considerations.

<sup>43</sup> *Corporations Act 2001* (Cth), sections 588FA, 588FC and 588FE(2). Generally, being in respect of an administration of liquidation, 6 months prior to the commencement of the administration or liquidation.

In the context of defences, a court could not make an order in respect of an unfair preference which materially prejudices a right or interest of a person if (amongst other requirements) at the time when the person became a party to the transaction:

- the person had no reasonable grounds for suspecting that the participant was insolvent (in the sense that the participant was unable to pay all its debts as and when they become due and payable) or would become insolvent if it entered into the transaction, and
- a reasonable person in their circumstances would have had no grounds for suspecting so.

Due to its role in the operation and settlement of the NEM, it is possible that AEMO may have knowledge that a market participant is having financial difficulties. This could make it harder to rely on this defence.

Clawbacks can also take place for other reasons, such other voidable transactions such as uncommercial transactions. This could result in the cash being at risk of being clawed back from AEMO.

In the WEM, market participants are able to provide cash as credit support and must provide a security deed to AEMO. AEMO registers its security interest in the cash on the Personal Property Securities Register (PPSR). However, there are a number of limitations with this approach and it also does not eliminate clawback risk. This is discussed further in appendix E.3.

### **Stakeholders consistently consider that clawback risks should be addressed to allow cash as credit support**

Insolvency risks were previously considered in AEMO's *Energy Market Prudentials Readiness Review*, where stakeholders and AEMO considered there were benefits in allowing cash as credit support, subject to the mitigation of clawback risks.<sup>44</sup> The outcome of that review was:<sup>45</sup>

AEMO will seek to establish a mechanism for the lodgement of cash as an alternative to bank guarantees. A key consideration is to ensure that any proposal adequately manages the risk of clawback through changes to the Rules. Legal advice has been sought to identify an option which gives cash based collateral no greater risk than the bank guarantees that are currently used. Subject to the outcome of this work, AEMO would promote a change to the Rules.

In our consultation paper, we noted the potential impact of clawbacks and sought stakeholder views on their potential risks. Numerous stakeholders commented on these potential risks:

- multiple stakeholders considered that the potential clawback risks could be managed and addressed, such that they are not a material issue<sup>46</sup>
- the AEC considered that managing exposure and risks from allowing cash should be guided by their materiality<sup>47</sup>
- AEMO considered that the potential for, and magnitude of, a clawback is highly uncertain in the context of the NEM, and that AEMO should not be financially exposed to any clawbacks<sup>48</sup>

44 AEMO, *Energy Market Prudential Readiness Review - Final Report to the MCE*, April 2011, p.45.

45 *Ibid*, p.7.

46 Submissions to the consultation paper: BlueNRG, p.3; Delta Electricity, p.3; Energy Locals, p.2; Perpetual Energy, p.3; ZEN Energy, p.3.

47 Submission to the consultation paper: AEC, p.1.

48 Submission to the consultation paper: AEMO, pp.5-6.



- AFMA considered that, despite the potential for increased risk from clawbacks, it is worth exploring alternative credit support options to bank guarantees due to potential benefits from cost reductions for participants and improvements to administrative processes<sup>49</sup>
- AGL noted that they did not oppose allowing cash as credit support if the strength of the credit support arrangements could be maintained or improved<sup>50</sup>
- CEIG and JEC expressed concerns about clawback costs being passed onto consumers<sup>51</sup>
- EUAA considered that, in relation to the issue faced by the proponent, the risks of insolvencies are less than risks to reliability and impacts on the market from early withdrawal of capacity<sup>52</sup>
- Iberdrola considered that the clawback risk is material and that consideration of options to address them is appropriate.<sup>53</sup>

**We consider that clawback risks can be mitigated, but not eliminated, by this rule change**

We have considered a range of options to address the clawback and other insolvency-related risks in relation to cash credit support referred to above. See appendix E for more information on options considered.

Having considered various options, there are layers of protections to mitigate clawback risks under the draft rule, including:

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

***Corporations Act displacement***

The Corporations Act contains the insolvency regime, including the clawback provisions related to unfair preferences. The Corporations Act can be expressly displaced, such that these provisions do not apply, in a law of a State or Territory in certain circumstances.

The NEL Regulations currently provide for a displacement of the Corporations Act for clause 3.15.21 (default procedure). This regulation was made under section 10A of the NEL which provides that the NEL Regulations may declare provisions of the Rules that relate to any of the following:

- the application by AEMO of money in any security deposit fund
- the functions of AEMO under procedures relating to defaults by retailers.

The draft rule proposes amendments to aspects of the NER that include the default procedure to provide for set off arrangements (discussed below) as part of the default procedures.<sup>54</sup>

Additionally, the draft rule proposes to insert a note in clause 3.15.21 of the NER that is intended to, and we consider would, clarify that the provision of credit support by a participant to AEMO is for the purposes of AEMO exercising its functions under the default procedures. These are intended to get the benefit of the existing Corporations legislation displacement provision.

49 Submission to the consultation paper: AFMA, p.2.

50 Submission to the consultation paper: AGL, p.1.

51 Submissions to the consultation paper: CEIG, p.2; JEC, p.1.

52 Submission to the consultation paper: EUAA, p.3.

53 Submission to the consultation paper: Iberdrola, p.1.

54 See clause 3.15.21(b) of the draft rule.

Where an amendment is made to a provision that is subject to a Corporations Act displacement provision, there is a requirement under the Corporations Act that the amendment is not material. For an amendment to not be material, it must not materially reduce the range of persons, acts, and circumstances to which the Corporations Act would otherwise apply.<sup>55</sup> We consider that the draft rule does not change the market participants to whom the default procedures apply to and are not material changes as they are within the scope of the existing default procedures (including set off for security deposits and the use of credit support).

Overall, we consider that the draft rule would clarify that the whole default procedure (clause 3.15.21 of the NEL) would fall within the displacement provisions in the NEL, which could mitigate clawback and insolvency-related risks associated with the provision and use of cash credit support.

We consider that greater certainty could be obtained through an appropriate amendment to the NEL to eliminate such risks arising from Chapter 5 of the Corporations Act.<sup>56</sup> However, the AEMC does not have powers to amend the NEL and any amendment would need to be endorsed and implemented by Energy Ministers through legislation.

### ***First ranking charge***

The draft rule seeks to ensure that the rights of the participant to the return of any monies in the cash security fund are subject to a first ranking charge in favour of AEMO securing payment of any money actually or contingently owing by the participant to AEMO.<sup>57</sup> The draft rule also provides that any cash security provided to AEMO as credit support must not be, and must not become, subject to any security interest, trust or other proprietary interest other than in favour of AEMO, unless AEMO has agreed otherwise.<sup>58</sup>

While there are issues with relying solely on security, the inclusion of the charge is likely to be incrementally beneficial and would not adversely affect the set-off rights to be afforded to AEMO (if set off arrangements were to be used). AEMO may elect to register this charge on the PPSR, but the intention is the set off rights are its primary mechanism and protection.<sup>59</sup>

### ***Return rights***

The draft rule includes provisions that AEMO must return the cash credit support, subject to any liabilities and expenses, to the market participant if:<sup>60</sup>

- it ceases, or intends to cease, being a market participant, and the market participant has paid all money owing to AEMO, and
- AEMO reasonably considers that the participant will not owe any money to AEMO in the future.

If an administrator or restructuring practitioner claimed a lien over the cash credit support, or another person claimed a security interest, trust or other proprietary interest in it, the draft rule is intended to have the effect that they should not be able to recover any cash credit support until the above has occurred.

<sup>55</sup> See section 5G(17) of the Corporations Act.

<sup>56</sup> For example, an appropriate amendment could expressly specify that the cash credit support rules are Corporations legislation displacement provisions.

<sup>57</sup> See clause 3.3.2A(e) of the draft rule.

<sup>58</sup> See clause 3.3.2A(d) of the draft rule.

<sup>59</sup> Set-off rights themselves should not be a security interest to which the PPSA applies. It is a more complex question whether a charge will need to be registered under the PPSA where created under the Rules in this case. See discussion in appendix E.

<sup>60</sup> See clause 3.3.13B of the draft rule.

The participant may also request the return of cash as long as AEMO would maintain credit support that, in aggregate, is no less than the participant's MCL. For example, a participant could swap out cash provided as credit support for a bank guarantee.

### **Set off rights**

Cash provided as credit support would be held by AEMO in a specific Rule Fund. The draft rule makes amendments so that, if a default event occurs in relation to the participant, AEMO may set-off:<sup>61</sup>

- any amount owing by AEMO to the participant in respect of the return to that participant of monies in the cash security fund, against
- any amounts actually or contingently owing by the participant to AEMO pursuant to the NER.

The set off right provides more robust protections against clawback risk than registering a security interest under the PPSR, particularly where it gets the benefit of the Corporations Act displacement provision.

Having a set off arrangement also attracts the operation of section 553C(1) of the Corporations Act which provides for the automatic set-off of mutual credits, mutual debts and other mutual dealings with an insolvent company that is being wound up (provided there is no notice of insolvency).

While the draft rule accommodates the use of set offs by AEMO in accepting cash as credit support, AEMO is not required to do so. We consider that AEMO should have the ability to use set off arrangements if it chooses to do so, subject to any implementation considerations and noting that there are other protections to reduce clawback and other insolvency-related risks. The potential use of set off arrangements could be considered by AEMO among other implementation considerations.

### **Our draft rule seeks to manage potential costs of a clawback**

Given the potential risks considered above, including in relation to clawback, we have considered how to manage the costs associated with any clawback in respect of cash credit support if they were to eventuate.

To avoid financial risk to AEMO, the draft rule would allow AEMO to recover any clawback costs from participants receiving net payments. Under the existing arrangements, AEMO would bear the cost of a clawback since they would be the party instructed to pay back any cash used as credit support. As noted by AEMO in its submission, there is currently no option for AEMO to passthrough those costs to participants and it would not be appropriate for AEMO to bear this financial risk due to its role as the independent market operator.<sup>62</sup> We agree with that AEMO should not bear any financial risk associated with clawbacks.

Additionally, the draft rule places a \$5m limit on how much cash credit support a participant can provide, effectively placing a limit on the maximum size of a clawback in respect of a single participant. We consider a limit on cash is appropriate given that the potential magnitude of a clawback is highly uncertain and could, in theory if there is no limit, be sufficiently large to threaten financial contagion on the market.

Refer to section 3.1 for more information on how the draft rule seeks to manage clawback costs.

<sup>61</sup> See clause 3.15.21(b)(2) of the draft rule.

<sup>62</sup> Submission to the consultation paper: AEMO, p.6.

### 2.5.2 Allowing surety bonds would introduce a risk of temporary settlement shortfall

We have been advised that surety bonds may not be able to pay out in time to ensure the settlement run can be completed without a temporary settlement shortfall to participants. While this can happen with bank guarantees, we understand that it is more likely to occur with surety bonds. Under the existing arrangements, delayed credit support payments are distributed to any short-paid participants at the EOFY.<sup>63</sup> This creates the potential for participants to bear a settlement shortfall for up to 12 months.

Our draft rule allows AEMO to distribute delayed credit support payments to market participants in a more timely manner through the routine revised statements process. Once the *Shortening the settlement cycle* rule change commences on 9 August 2026, routine revised statements will be provided three times after the relevant billing period: 20 business days after the billing period, 20 weeks after the billing period, and 30 weeks after the billing period. The draft rule would ensure that there is an opportunity for any settlement shortfall due to a delayed payment from a surety bond to be remedied at each of those intervals. This would reduce the time and impacts from a participant being temporarily short-paid, compared to waiting until the EOFY under the existing arrangements. See section 3.2.2 for more information.

Nonetheless, we recognise that a settlement shortfall is a short-term cost that would be borne by participants receiving payments (typically generators) which they cannot mitigate. However, we note that such costs would be temporary which would reduce impacts for participants.

More broadly, we consider that the benefits of potential cost reductions and increased optionality in credit support outweigh the cost of temporary settlement shortfalls, which would only occur if a credit support provider does not pay out to AEMO in time for the settlement run to be completed on the settlement date.

### 2.5.3 Implementation and ongoing costs are likely to be low

In its submission to the consultation paper, AEMO noted that:<sup>64</sup>

There would be upfront costs associated with the necessary system and procedural changes to allow AEMO to accept cash as NEM credit support in addition to bank guarantees. AEMO is not yet in a position to estimate the amount of those costs but considers that, over time, the administrative effort to AEMO in receiving cash as credit support may be comparable to that of handling bank guarantees. If applicable and appropriate, AEMO may look to leverage existing WEM processes for handing cash as credit support.

Two other stakeholders considered that implementation costs would be low, and that set up administration costs could be further lowered by using standard AEMO agreements.<sup>65</sup>

We will continue to engage and work with AEMO to understand and estimate implementation and ongoing costs. While AEMO is yet to estimate potential implementation costs, we consider that it is likely that implementation and ongoing costs would be low compared to the benefits of the draft rule.

We also consider that implementation costs for market participants are likely to be minimal. We expect only participants seeking to change their credit support arrangements in light of a final rule

63 Clause 3.15.23 of the NER.

64 Submission to the consultation paper: AEMO, p.6.

65 Submissions to the consultation paper: BlueNRG, p.5; Genuity, p.2.

(if made) would incur costs from seeking and setting up new arrangements, which are likely to be very low.

## 3 How the draft rule would operate

Upon consideration of stakeholder feedback and potential options to address issues raised by the proponent and stakeholders, we have made a more preferable draft rule to improve the credit support arrangements.

This chapter outlines how the draft rule would operate, by:

- allowing participants to provide cash as credit support up to a limit of \$5 million each, discussed in section 3.1
- allowing participants to use surety bonds as credit support from a surety that meets the acceptable credit criteria, discussed in section 3.2
- enabling delayed credit support payments to be distributed to participants in a more timely manner, discussed in section 3.2.2
- broadening the pool of credit providers by allowing providers from other jurisdictions with robust regulatory regimes, discussed in section 3.3
- maintaining other aspects of the credit support arrangements, discussed in section 3.4
- commencing on 9 August 2026, discussed in section 3.5.

### 3.1 The draft rule would allow cash to be used as credit support

#### **Box 1: The draft rule would allow cash as credit support**

Under the draft rule, participants would be allowed to provide cash as credit support to AEMO, which would count towards their obligations to provide credit support.

We consider that clawback risks are likely to be low. If a clawback eventuated, participants receiving net payments from AEMO (typically generators) would bear the costs of any clawback via a settlement shortfall in the billing period that a clawback occurs. There would be a \$5 million limit on the maximum amount of cash each participant could provide as credit support, which would limit the maximum size of a clawback and consequential impact to market participants.

AEMO would publish guidelines on the process to provide cash as credit support and may set conditions on the use of cash to manage any potential issues.

Interest would be earned on cash provided as credit support, less any liabilities or expenses incurred by AEMO. Interest is also applied on any late credit support payments and passed through in any compensation calculations.

The draft rule would allow participants to provide cash to AEMO as credit support to meet their prudential requirements. This would enable participants to provide credit support without relying on a third-party credit support provider.

We consider that the use of cash would not materially weaken the credit support arrangements in the NEM, as we consider that risks of a clawback, while existent, are likely to be low. Furthermore, the draft rule also includes provisions for AEMO to recover costs of a clawback from participants receiving net payments in a billing period, in addition to limiting the amount of cash a participant can provide.

This section provides information on the design aspects of the draft rule that relate to allowing cash as credit support.

### 3.1.1 Participants could provide cash as credit support

The draft rule would allow participants to provide cash as credit support to AEMO.<sup>66</sup> As with other forms of credit support, cash provided as credit support would contribute to participant obligations to provide credit support that is greater than or equal to their current and individual MCL. Participants can provide multiple forms of credit support to meet their obligations, both under the existing arrangements and under the draft rule. For example, a participant could provide a combination of cash and bank guarantees that, in aggregate, is not less than their MCL to comply with their prudential requirements.

The current arrangements require participants who do not meet the acceptable credit criteria to obtain credit support from an entity that does meet those requirements and is not a market participant.<sup>67</sup> However, under the draft rule, all participants would be allowed to provide cash for their credit support obligations. Participants would not be allowed to provide cash as credit support on behalf of another participant.

As discussed in section 2.5.1, allowing cash as credit support would introduce clawback risks that, while they could be reduced, cannot be eliminated. To manage these risks and associated costs, the draft rule would:

- allow AEMO to recover any clawback costs from participants receiving payment (typically generators), with costs distributed pro-rata based on payment
- place a limit of \$5m on the maximum amount of cash each participant could provide as credit support.

AEMO would be required to publish a guideline to outline the processes and procedures for providing cash as credit support. Furthermore, AEMO would be able to set conditions regarding the use of cash, which should be included in its guidelines.<sup>68</sup> We consider that this would provide AEMO with the ability to manage any currently unforeseen operational issues and/or allow them to flexibly manage risks. We expect AEMO to clearly communicate with stakeholders on any conditions and corresponding reasons.

AEMO must pay interest on cash provided as credit support, less any liabilities or expenses incurred by AEMO for processing or managing the cash.<sup>69</sup> This is broadly aligned with views from several stakeholders that interest earned on cash provided as credit support should be returned to the relevant participant.<sup>70</sup>

Cash provided to AEMO as credit support would be managed as a Rule Fund under the draft rule.<sup>71</sup> This would combine and store cash provided as credit support in a single fund, would ensure individual accounting for each participant, and allow interest and administrative costs to be effectively managed. Managing cash credit support in this manner is also similar to the management of cash security deposits provided in response to call notices.<sup>72</sup>

66 See clause 3.3.2 of the draft rule.

67 The acceptable credit criteria are outlined clause 3.3.2 of the NER, and described in appendix C.3.

68 Clause 3.3.2A(c) of the draft rule.

69 Note that the draft rule does not specify the interest rate. Similar to the treatment of interest on security deposits provided to AEMO, participants would receive any actual interest (or other income) earned on their cash provided to AEMO, less any liabilities or expenses. See clause 1.11(c-d) in the draft rule.

70 Submissions to the consultation paper: AFMA, p.2; Delta Electricity, p.4; Iberdrola, pp.1-2.

71 See changes to clause 1.11 (AEMO Rule Funds) of the draft rule.

72 Refer to rule 1.11 of the NER, which defines the security deposit fund used to manage security deposits (cash) provided by participants in response to call notices.

### Allowing cash would deliver benefits to participants

We consider that allowing cash as credit support would deliver multiple key benefits:

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

These benefits are discussed in more detail in section 2.4, which would flow onto benefits for consumers. Many stakeholders supported allowing cash as credit support due the potential benefits, although support from some stakeholders was dependent on the resolution and management of clawback risks (discussed in section 3.1.2).<sup>73</sup> One stakeholder opposed allowing cash as credit support, as it considered the current arrangements were established for sound reasons and allowing cash would increase risks.<sup>74</sup>

### The draft rule seeks to manage risks associated with the clawback of cash

Section 2.5.1 provides a discussion on the potential for clawback risks when cash is used as credit support, and the protections included to reduce clawback risk.

We consider that, absent a change to the NEL which is beyond the remit of the AEMC, clawback risks are likely to be low, but still existent. As discussed in section 3.1.2 and section 3.1.3, there are multiple layers of protection in draft rule that seek to reduce and mitigate these risks. Nonetheless, it is prudent for the draft rule to also manage any potential clawback costs, while continuing to deliver net benefits from allowing cash as credit support, by:

1. allowing AEMO to recover clawback costs from participants receiving net payments
2. placing a \$5m limit on the amount of cash a participant can provide as credit support.

### 3.1.2 AEMO would recover clawback costs from generators

Our draft rule amends the existing arrangements to allow AEMO to recover any clawback costs from participants receiving net payments during a billing period. Specifically, this cost recovery mechanism would operate as follows (see Box 2 for an example):

- when AEMO is required to make payments in relation to a clawback of cash used as credit support, it can recover that amount from participants in the current billing period
- the amount would be recovered on a pro-rata basis from participants who are receiving net payments (typically generators) from AEMO.

This would allow AEMO to cover any clawback costs in a timely manner using processes that are simple, effective, and familiar. Clawback costs would be distributed through the existing process for settlement shortfalls under clause 3.15.22 of the NER.<sup>75</sup> Mathematically, a participant receiving payment from AEMO during a billing period would receive a reduced payment from a clawback equal to:

$$\bullet \quad \$_{\text{received by participant}} = \$_{\text{due to participant}} \times [(\$_{\text{total NEM received}} - \$_{\text{amounts paid by AEMO from clawback}}) / \$_{\text{total NEM due}}].$$

73 Submissions to the consultation paper: AFMA, p.1; BlueNRG, p.1; Delta Electricity, p.3; Energy Locals, p.1; EUAA, p.2; Genuity, p.1; GloBird Energy, p.1; Iberdrola, p.1; Localvolts, p.2; MTA Energy, p.1; Origin Energy, p.1; Perpetual Energy, p.1; ZEN Energy, p.2.

74 Submission to the consultation paper: CEIG, pp.1-2.

75 In clause 3.15.22 (maximum total payment in respect of a billing period) of the NER, if there are insufficient received funds for AEMO to pay generators in a billing period, the generators receive payments that are reduced proportional to the settlement shortfall.



We expect that this would reduce uncertainty and complexity in the outcomes for participants in the event of a clawback, while allowing AEMO to utilise existing methods to avoid financial exposure.

This mechanism would ensure that AEMO would not be exposed to clawback risks and costs under the draft rule. Under the existing arrangements, AEMO would bear the costs of any clawback, since they do not allow AEMO to recover any such costs from market participants. In its submission to the consultation paper, AEMO considered that:<sup>76</sup>

In the absence of a legislated solution to fully remove clawback risk, any NER change allowing for cash as credit support will need a clear mechanism for AEMO to fully recover any related liabilities if they are incurred, at the time they are incurred. As the independent non-profit market operator who facilitates the settlement and prudentials framework on behalf of market participants, exposure to potentially significant unfunded liabilities presents a serious threat to AEMO's solvency and the ongoing orderly operation of energy systems and markets.

#### Box 2: Example AEMO recovery of clawback costs

Consider a retailer, Reta Retailer, who defaults in the 5th billing period of 2025 and becomes insolvent. Reta Retailer had provided \$5m cash as credit support, of which AEMO uses to cover Reta Retailer's outstanding settlement. Since there was sufficient credit support that AEMO could use, there are no short payments to generators in the 5th billing period of 2025.

A liquidator is appointed to Reta Retailer and considers the cash used as credit support to be an unfair preference payment. Eventually, it is determined in 2026 that the cash used as credit support was an unfair preference payment to AEMO and \$5m is clawed back from AEMO in the 10th billing period of 2026.

Therefore, AEMO recovers the \$5m in costs from participants receiving net payments in that 10th billing period of 2026, in which participants were due to receive \$400m in aggregate.

Among the participants is Gene Generator, who was due to receive \$40m. However, due to AEMO recovering the costs of the clawback, Gene Generator will only receive \$39.5m (i.e. a payment reduction of \$500k). The revised payment is calculated as:

- $\$40m \times (\$400m - \$5m) / (\$400m) = \$39.5m$ .

Similar payment reductions for all participants due to receive payment would ensure AEMO recovers the full \$5m, meaning AEMO is not exposed to any of the clawback costs.

Note: This is a simple example constructed to demonstrate the basic methodology in how participants would bear the costs of a clawback.

#### We consider generators would be best placed to bear clawback risks

We consider that generators are best placed to bear the costs of a clawback. While there could be risks of financial contagion for any party bearing the costs, we consider that generators are better placed than retailers for bearing or recovering any losses. If retailers (or more generally, participants paying amounts to AEMO) were required to bear the costs, they would be required to make additional payments to AEMO during a billing period, which could increase complexity, or increase risks of default on that payment or future payments.

76 Submission to the consultation paper: AEMO, p.1.

The limit on the maximum amount of cash that a participant can provide also seeks to limit risks and costs to generators, by effectively placing a limit on the maximum size of a clawback. See section 3.1.3 for more information.

We recognise that this cost allocation does not place the risks of a clawback from the use of cash onto participants that are providing cash as credit support. A framework that could allocate risks to participants providing cash would need to be an ex-ante mechanism.<sup>77</sup> For example, Iberdrola suggested for participants providing cash to pay an additional premium to compensate for clawback risks.<sup>78</sup> However, due to the likely low probability of clawbacks and high variability in any subsequent costs, we consider that any ex-ante mechanism would not be efficient and would reduce potential benefits, with generators still needing to bear residual risk.

### 3.1.3 An individual limit on cash as credit support would limit clawback costs

The draft rule would allow each participant to provide up to \$5m in cash as credit support.<sup>79</sup> This would prevent participants from providing excessively large amounts of cash as credit support, which could lead to large costs on participants and increased risks of financial contagion if a large clawback were to occur.

We consider that this \$5m limit would balance the benefits of allowing cash as credit support against the potential costs in the event of a clawback. Benefits for participants providing credit support reduce as the limit decreases, while potential costs increase for generators as the limit increases. This is because participant benefits would be reduced if they are unable to provide the desired amount of cash as credit support, while the potential cost of a clawback is proportional to the amount of cash provided by the relevant insolvent participant. We chose \$5m to be the value of a limit on cash as we consider that it would likely balance benefits with potential costs.

#### Net benefits would likely be reduced with a limit

A limit on the maximum amount of cash a participant can provide as credit support would reduce benefits. Specifically, benefits would be reduced for participants who have MCLs greater than the limit. However, we consider that a limit of \$5m would likely deliver material and meaningful benefits.

We expect that a \$5m limit would allow many participants that need to provide credit support to provide their entire MCL in cash.<sup>80</sup> We expect that this limit would not affect potential benefits for these participants, who are likely to be small retailers and BDUs.

Some small to medium-sized retailers may not be able to fully rely on cash if their MCL is greater than \$5m, and would need to obtain other (potentially more costly) forms of credit support to meet their prudential requirements. However, they could still benefit from providing up to \$5m in cash as credit support and we expect that such participants should generally be capable of obtaining other forms of credit support (i.e. bank guarantees or surety bonds). Furthermore, the flexibility benefit of cash would still be retained for such participants, as headroom below the limit could be left to allow additional cash to be provided if necessary. In other words, participants could reduce risks of triggering a default event by ensuring that they are able to provide cash as credit support at short notice if needed.

77 An ex-ante mechanism would allocate risks to all cash providers, including any cash provider that eventually defaults and becomes insolvent. Any ex-post mechanism would mean a defaulting cash provider would not be exposed to the clawback costs they create, leaving remaining participants to bear the costs.

78 Submission to the consultation paper: Iberdrola, p.1.

79 See clause 3.32(d-h) of the draft rule.

80 The Commission's view was informed by confidential information provided by AEMO on participant MCLs (anonymised and segmented).

Currently, any participants who need to provide credit support, but cannot obtain a bank guarantee or bank letter of credit, would not be able to meet their prudential requirements. Under the draft rule, such participants would be able to provide cash as credit support to meet their prudential requirements if their MCL does not exceed \$5m. If their MCL is greater than \$5m, any such participants would need to consider options to reduce their MCL (such as reallocations or reducing their spot-exposed load) so that they can provide their entire MCL in cash. Alternatively, the draft rule also allows surety bonds and expands the pool of credit support providers, increasing the range of options for participants to obtain credit support.

### **Costs to generators would be limited in the event of a settlement shortfall**

The benefits and limitations described above from a \$5m limit would be balanced against the potential costs to generators. If a \$5m clawback were to occur, this would result in a shortfall in payments of roughly 1.5% to generators from AEMO in an average week-long billing period.<sup>81</sup> See Box 2 for a simple example of a payment reduction to a generator in the event of a \$5m clawback.

Noting the potential variability in the magnitude of payments to generators, increasing the limit (for example, to \$10m or \$50m) could result in more material costs to generators in the event of a clawback.

### **The \$5m limit in the draft rule would be indexed to maintain real value**

Our draft rule would index the \$5m limit to the Australian Consumer Price Index (CPI) published by the Australian Bureau of Statistics. The indexation of the \$5m limit would work to maintain its real value over time, which would be important in maintaining the value of benefits over time in allowing participants to provide cash as credit support.

The indexation of the \$5m limit to the CPI would be identical to the indexation of the market price cap and cumulative price threshold, with \$5m serving as the base value.<sup>82</sup> The AEMC would calculate and publish the indexation adjusted limit on cash that can be provided as credit support prior to the start of each financial year.

We note that this approach for indexation would be consistent and aligned with the indexation of the market price cap and cumulative price threshold, which is calculated and published by the AEMC each year. While our draft rule seeks to provide consistency with the AEMC indexing the \$5m limit, we note that an alternative approach may be for AEMO to calculate and publish (either on its website or in a guideline) the indexation adjusted limit. Impacts on implementation would be negligible in either case and the limit would be indexed to the CPI as described above.

## **3.2 The draft rule would allow surety bonds to be used as credit support**

### **Box 3: The draft rule would allow surety bonds as credit support**

Under the draft rule, participants would be allowed to provide surety bonds as credit support to AEMO, which would count towards their obligations to provide credit support.

To ensure consistency with bank guarantees and that surety bonds provided are robust, issuers of

<sup>81</sup> In 2024, average and median daily NEM spot costs were \$66m and \$47m respectively, calculated as  $(RRP \times \text{regional demand} / 12)$  for each dispatch interval in each region for each day. Therefore, generators receive roughly \$350m in a normal week from the spot market (ignoring effects of contracts and reallocations, etc.), and a \$5m reduction in payments to generators in a normal week during 2024 would represent a 1.4% settlement shortfall. We note that the total revenue received in a billing period can vary greatly depending on market conditions and that contracts can have material impacts on the net revenue received by a generator.

<sup>82</sup> The base year for indexing would be 2025, consistent with the implementation date of the draft rule.

surety bonds would be required to meet acceptable credit criteria, outlined in clause 3.3.3 of the NER. AEMO could also publish a pro forma template to be used for surety bonds, to provide further consistency and transparency.

The draft rule also includes a provision to facilitate the more timely distribution of delayed credit support payments to participants due payment. On the settlement day a shortfall is identified and credit support must be called upon, credit support providers may not be able to pay out within the timeframe required to avoid a settlement shortfall, with payments to be distributed to participants at a later time.

The draft rule would allow participants to provide surety bonds to AEMO as credit support to meet their prudential requirements. This would broaden the suite of options available to participants to meet their credit support obligations. It could provide benefits to participants by:

- reducing credit support costs by increasing competition amongst credit support providers
- increasing optionality and flexibility by expanding the availability of credit support and credit support providers.

We consider that, similar to bank guarantees, the acceptable credit criteria for credit support providers (set out in clause 3.3.3 of the NER) would ensure that accepted providers of surety bonds are creditworthy and support robust prudential arrangements in the NEM.

We have been advised that providers of surety bonds may not be able to pay out before the time required to avoid a settlement shortfall on the settlement day that the surety bond is called upon. Therefore, there could be temporary short payments to participants when surety bonds are called upon, as the payment would be received by AEMO at a later time. Throughout this draft determination we refer to these payments as delayed credit support payments which, under the existing arrangements, would not be distributed to participants until the EOFY.

To ensure that participants due payment are made whole as soon as practicable, the draft rule includes new provisions to facilitate the timely distribution of credit support received after the payment cutoff for the settlement day. This mechanism addresses both new (from surety bonds) and existing (from bank guarantees) risks to participants due payment of carrying a short payment until EOFY in the event of a delayed payment of credit support.

This section provides information on the design aspects of the draft rule that relate to allowing surety bonds as credit support.

### 3.2.1 Participants could provide surety bonds as credit support

The draft rule would allow participants to provide a surety bond as credit support to meet their prudential requirements.<sup>83</sup> For a surety bond to be accepted by AEMO, it must be issued by an entity that meets the acceptable credit criteria, as outlined in clause 3.3.3 of the NER (see appendix C.3 for more information). We consider these criteria, which already apply to lenders providing bank guarantees, ensure that any issuer of surety bonds is a creditworthy party and would not increase credit risk in the NEM.

We expect that AEMO would publish a pro forma template that sets out the form of the surety bond that participants must procure, similar to bank guarantees.<sup>84</sup> This would reduce the administrative burden required from participants and ensure AEMO has confidence the bond

83 See clause 3.3.2(b) of the draft rule.

84 The AEMO pro forma for bank guarantees can be viewed [here](#).

would function similar to a bank guarantee and as required when called upon. Additionally, requiring all bonds to be of a consistent form would support engagement from sureties for providing surety bonds in the NEM by providing a consistent format to follow.

Among other conditions, the pro forma could specify the time at which payment is to be made to AEMO. The current bank guarantee pro forma specifies that this can be any time “not less than one hour after the demand is received by the Financial Institution”.<sup>85</sup> We expect AEMO would work with sureties to identify achievable timing requirements.

### **Allowing surety bonds as credit support would deliver net benefits**

Allowing participants to meet their MCL using surety bonds would provide participants a greater range of options in credit support. As discussed in section 2.4, allowing surety bonds as credit support could deliver several benefits:

- cost reductions by increasing competition among credit support providers
- reduce risks of participants failing to provide credit support by increasing the amount of available credit support options and providers
- lower working capital requirements, as we understand that surety bonds are typically unsecured.

We consider that these benefits would increase optionality and flexibility for participants to provide credit support without weakening the credit support arrangements that underpin NEM settlement. It also supports lowering credit support costs that would lead to benefits for consumers. Furthermore, small retailers are likely to benefit most from the draft rule, due to their typical higher financing costs and lower access to capital.

In response to the consultation paper, multiple small to medium retailers considered that bank guarantees are overly burdensome to obtain, and the process is too reliant on a small number of institutions.<sup>86</sup> While stakeholders did not specifically suggest surety bonds, we consider that allowing surety bonds would increase the number of entities that can provide credit support, which would lead to the potential benefits mentioned above.

### **Surety bonds come with some costs, including delayed payment and implementation costs**

Surety bonds may not be able to pay out as fast as bank guarantees have historically been required to in the NEM. To address this, the draft rule includes a mechanism to distribute any delayed funds received from credit support to payees in a more timely manner. This is covered in more detail in section 3.2.2.

Noting the slightly different characteristics of surety bonds to bank guarantees, AEMO would need to set up new processes to facilitate the inclusion of surety bonds as a credit support option. This would include a new pro forma template, new processes to reflect the new late payment distribution mechanism, as well as relationship building with sureties, as is done with banks that provide credit support. We expect there to be a fairly low upfront cost to make these process changes, and an ongoing cost once set up that is equivalent to existing costs for credit support.

<sup>85</sup> See the current AEMO bank guarantee pro forma [here](#).

<sup>86</sup> Submissions to the consultation paper: BlueNRG, p.1; GloBird Energy, p.3; Localvolts, p.1; MTA Energy, p.1; ZEN Energy, p.3.

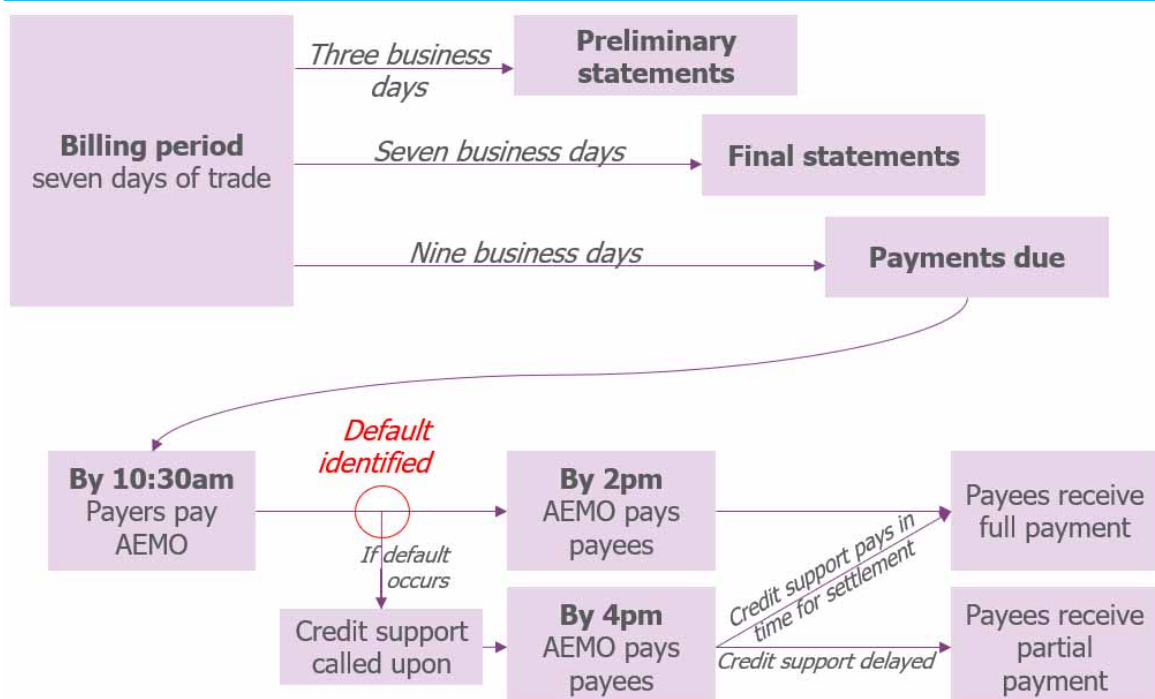
### 3.2.2 The draft rule would allow delayed payments to be distributed earlier

The draft rule introduces a new mechanism to facilitate the distribution of delayed credit support payments through the revised settlement statements process.<sup>87</sup> This brings forward the distribution of delayed credit support payments to payees from the next EOFY to 20 business days after the billing period.

#### AEMO settlement timeframes require credit support to pay out quickly to avoid a settlement shortfall

AEMO conducts settlements according to a settlements timetable that is built around requirements under the NER and the constraints of the financial payment and settlement systems used by AEMO and the industry.<sup>88</sup> Figure 3.1 sets out how the drawing on a defaulted participant's credit support fits within this timetable. During a settlement run, AEMO has 5.5 hours to identify a short payment, call on the participant's credit support, receive the funds, and process the payments for the settlement run. Therefore, if credit support does not pay out within a short period of time (i.e. several hours), a situation will arise where AEMO has not received sufficient funds to pay all payees their full due amounts. When this occurs, a settlement shortfall can occur and AEMO spreads any shortfall across all payees in the form of reduced payments.

Figure 3.1: NEM settlements timetable with participant default



Note: The settlements timetable depicted in this figure is the timetable once the [Shortening the settlement cycle](#) rule change has commenced on 9 August 2026. Prior to this date, from the end of a billing period, preliminary statements are issued after five business days, final statements are issued after 18 business days, and payments are due after 20 business days.

87 See clause 3.15.22A of the draft rule.

88 Clauses 3.15.16 and 3.16.17 of the NER respectively require payers to pay AEMO on the payment date, and AEMO to pay payees on that same payment date. AEMO also outlines the process in its NEM Settlements Process document, found [here](#).



### **Surety bonds may not pay out in time to avoid a settlement shortfall**

We have been advised that surety bonds may not be able to pay out in time to ensure the settlement run can be completed without a settlement shortfall to participants. Under the existing arrangements, delayed credit support payments are distributed to any short-paid participants at the EOFY.<sup>89</sup>

### **The draft rule would allow for the revised statement process to distribute delayed credit support**

As outlined above, a settlement shortfall may occur if surety bonds cannot pay out without any delay. To ensure generators are short paid for the briefest possible period, our draft rule allows for the distribution of any delayed funds from credit support through the routine revision procedure. We consider leveraging an existing process reduces the implementation burden on AEMO and is more familiar to stakeholders than alternative, new options.

The draft rule would commence concurrently with the *Shortening the settlement cycle* rule change, so this would distribute delayed credit support through routine revised statements 20 business days after the end of the billing period, in line with the new revised statements timing.<sup>90</sup> Noting payment occurs two days after settlements are issued, this allows for a more timely distribution of credit support to payees and means that they would only be short for 13 business days. We consider this could be an acceptable trade-off for the added flexibility and potential cost savings of allowing surety bonds.

## **3.3 The draft rule would expand the pool of credit support providers**

The draft rule would broaden the selection of providers of credit support by allowing credit support from providers that are regulated by a member of the Basel Committee on Banking Supervision (BCBS), or that have regulatory equivalence with Australia as determined by AEMO.<sup>91</sup> Under the existing arrangements, all credit support providers must be under the prudential supervision of APRA. Broadening this requirement to include BCBS member regulators, or those with regulatory equivalence, allows for a broader range of credit support providers without materially increasing credit risk. This would provide several benefits including:

- increasing competition in the provision of credit support, applying downward pressure on prices
- reducing the risk of industry policy changes in one jurisdiction affecting the ability for participants to obtain credit support from a lender
- enabling the provision of credit support from other jurisdictions which may be lower cost due to, for example, specific regulatory requirements.

In response to the consultation paper, AGL suggested consideration of whether the existing acceptable credit criteria unnecessarily limit the number of credit support providers.<sup>92</sup>

### **3.3.1 Allowing credit support providers from jurisdictions with robust regulatory regimes would not materially increase credit risk in the NEM**

The draft rule change is intended to ensure credit support providers are creditworthy by requiring them to be regulated by a central bank or other authority with formal responsibility for the

<sup>89</sup> This process is set out clause 3.15.23 of the NER.

<sup>90</sup> For more information on revised settlements under the Shortening the settlement cycle rule, see Section 3.2 of the final determination found [here](#).

<sup>91</sup> See clause 3.3.3(a) of the draft rule.

<sup>92</sup> Submission to the consultation paper: AGL, p.3.

supervision of banking business that is a member of BCBS, or a financial or insurance regulator with regulatory equivalence to APRA as determined by AEMO.

Combined with the other acceptable credit criteria outlined in appendix C.3, including minimum credit ratings for credit support providers, this change is intended to ensure that expanding the pool of credit support providers would not materially increase credit risk in the NEM. Our views in relation to this have formed in consultation with APRA staff.

### **BCBS members are required to implement regulations that support bank stability and creditworthiness**

The BCBS developed the Basel III requirements, which are a standardised set of requirements that are designed to enhance the stability and creditworthiness of banks. BCBS members are committed to implement and apply the standards, which include:

1. **Capital requirements:** Basel III mandates that banks hold more high-quality capital, specifically Tier 1 capital, which includes common equity and retained earnings. This ensures that banks have a stronger financial cushion to absorb losses.
2. **Leverage ratio:** Basel III introduces a leverage ratio to limit the amount of debt a bank can take on relative to its equity. This helps prevent excessive borrowing and reduces the risk of insolvency.
3. **Liquidity requirements:** The Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) are two key liquidity measures under Basel III. The LCR requires banks to hold enough high-quality liquid assets to cover net cash outflows for 30 days, while the NSFR ensures that banks have stable funding to support their long-term assets.
4. **Risk management:** Basel III emphasises improved risk management practices, including better assessment and management of credit risk, market risk, and operational risk. This ensures that banks are better prepared to handle potential financial stress.

Through these measures, Basel III helps ensure that banks are more resilient and capable of withstanding financial shocks. Therefore, we consider that allowing issuers of credit from BCBS jurisdictions would provide participants with a clear list of jurisdictions from which they could seek credit, without materially increasing credit risk in the NEM.

### **Jurisdictions with regulatory equivalence to Australia have similar financial regulations and robustness in their banking system**

Regulatory equivalence in banking refers to a process where one jurisdiction recognises that another jurisdiction's regulatory, supervisory, and enforcement frameworks are equivalent to its own.

Consequently, we consider that, in conjunction with other acceptable credit criteria, allowing providers of credit from jurisdictions with regulatory equivalence would not materially increase credit risk in the NEM.

However, compared to a pre-defined list of acceptable regulators, regulatory equivalence would require an assessment of whether a particular jurisdiction has regulatory equivalence to Australia. We consider that AEMO may not be well-placed to make this assessment on its own, however we consider that AEMO could seek input from APRA to make an informed assessment and decision on whether a jurisdiction's regulatory regime is equivalent.



### 3.3.2 Broadening the pool of issuers of credit would bring benefits through increased competition and lower cost surety bonds

Allowing providers of credit from other jurisdictions would increase the number and variety of providers. We consider this would apply downward pressure on prices, reducing costs for participants.

Similarly, allowing providers of credit that are not regulated by APRA could enable the provision of lower cost credit support. For example, APRA categorises surety bonds in the same way as bank guarantees, which subjects sureties to the same suite of capital adequacy requirements.<sup>93</sup> However, some other jurisdictions regulate surety guarantees as insurance products, as opposed to financial guarantees, which can impose different requirements and could lead to lower costs.

Reducing costs of credit support would allow retailers to lower prices for consumers and/or increase investment in service innovation, in addition to reducing barriers to entry. Altogether, this is expected to deliver benefits for consumers.

## 3.4 Other aspects of the credit support arrangements would remain unchanged

Under the draft rule, the existing options for providing credit support (bank guarantee and bank letters of credit) would remain available. These options would continue to be of value to AEMO and market participants, and there is no justification for removing them.

In terms of providing bank guarantees or letters of credit, the only amendment to the relevant rules is in relation to the acceptable credit criteria. As discussed in section 3.3, our draft rule would expand the requirement for credit support providers to be regulated by APRA. Other than this change, the acceptable credit criteria for credit support providers would remain unchanged.

We have also not assessed, nor considered, changes to the broader prudential arrangements. Consideration of the broader prudential arrangements in the NEM are beyond the scope of this rule change, which is focused on the ability for participants to provide credit support to meet their prudential requirements.

## 3.5 The draft rule would take effect on 9 August 2026

If the draft rule is made as a final rule, it would take effect on 9 August 2026. This would give AEMO time to develop systems and processes to accommodate changes to the settlement and prudential frameworks, which AEMO estimated in its submission could take between 6 and 18 months.<sup>94</sup> We will continue working with AEMO on an estimated timeframe for implementation toward the final determination, if a final rule is made.

We are not proposing transitional rules to amend the credit support arrangements prior to 9 August 2026, except for the development and publication of relevant guidelines (see section 3.5.1). We consider that AEMO systems and processes need to be in place to accommodate changes associated with any final rule, and hence it would not be appropriate to allow changes to the settlement or prudential arrangements prior to 9 August 2026.

We consider that the commencement of the draft rule on 9 August 2026 would also align with the commencement of the *Shortening the settlement cycle* rule change, which may reduce disruption to participants since both rule changes (if the draft rule were to be made) impact the settlement

<sup>93</sup> These requirements are outlined in APRA's Prudential Standard GPS 114, found [here](#).

<sup>94</sup> Submission to the consultation paper: AEMO, p.10.

and prudential arrangements. The *Shortening the settlement cycle* rule change will shorten the NEM settlement cycle to nine business days following the end of a billing period and introduces a new revision 20 business days following the end of the billing period.

Two stakeholders considered that a rule to allow AEMO to accept cash as credit support should be effective immediately.<sup>95</sup> Some stakeholders considered transitional rules may be necessary for an interim period to ensure the proponent could provide credit support.<sup>96</sup> Other stakeholders considered that transitional rules are not necessary.<sup>97</sup> AEMO considered that:<sup>98</sup>

Given the complexity and potential materiality of clawback risk, AEMO does not support any transitional rule or process that would require AEMO to accept cash as credit support prior to the establishment of clear rule-based provisions for immediate recovery of clawback liability from the market. AEMO considers the existing provisions and discretions in the prudential framework, as discussed earlier in this submission, are relevant to the assessment of any transitional requirements for this rule change.

### 3.5.1 The draft rule would require AEMO to publish cash security guidelines by 9 May 2026

AEMO would publish cash security guidelines that set out the terms and conditions that relate to cash security that is provided by participants to meet their MCL. This is discussed in more detail in section 3.1.1. The draft rule includes a transitional rule that requires AEMO to develop and publish these guidelines by 9 May 2026.

We consider this gives AEMO adequate time to develop and, if necessary, consult on these guidelines, while also providing participants with 3 months to understand the new guidelines prior to the commencement of the rule. This would allow participants to change their credit support arrangements, if desired, from the commencement of the rule.

<sup>95</sup> Submissions to the consultation paper: GloBird Energy, p.4; Localvolts, p.5.

<sup>96</sup> Submissions to the consultation paper: Delta Electricity, p.4; EUAA, p.4.

<sup>97</sup> Submissions to the consultation paper: BlueNRG, p.4; Energy Locals, p.3; Perpetual Energy, p.4.

<sup>98</sup> Submission to the consultation paper: AEMO, p.10.

## A Rule making process

In October 2024, the AEMC received a rule change request from Delta Electricity (the proponent) to allow AEMO to accept cash as credit support.

The rule making process for a standard rule change request includes the following stages:

- a proponent submits a rule change request
- the Commission initiates the rule change process by publishing a consultation paper and seeking stakeholder feedback
- stakeholders lodge submissions on the consultation paper and engage through other channels to make their views known to the AEMC project team
- the Commission publishes a draft determination and draft rule (if relevant)
  - stakeholders lodge submissions on the draft determination and engage through other channels to make their views known to the AEMC project team
- the Commission publishes a final determination and final rule (if relevant).

The Commission is using a longer-than-standard process for this rule change due to the complexity of the issues involved. A notice under section 107 of the NEL extending the time for making the draft rule was published on 19 December 2024.

You can find more information on the rule change process on our website.<sup>99</sup>

### A.1 The proponent proposed a rule to allow AEMO to accept cash as credit support

On 1 October 2024, the AEMC received a rule change request from Delta Electricity (the proponent) to amend the NER and National Gas Rules (NGR) to allow AEMO to accept cash to meet credit support requirements in the NEM and Short Term Trading Market (STTM). On 17 October 2024, the proponent resubmitted the rule change request to clarify that the proposed changes only relate to the NER and NEM.

Under the NER, credit support must be provided when required and in the form of a bank guarantee or a letter of credit from an acceptable credit support provider.<sup>100</sup> The proponent considered that:<sup>101</sup>

A significant number of financial institutions, that would be acceptable to AEMO, are no longer providing financing facilities to fossil fuel generators. While the energy transition is progressing, there will be an ongoing reliance on fossil fuel generators, at least in the immediate future. There is an urgent and emerging need to ensure that market participants who, due to the ESG policies of credit support providers, are unable to meet the requirements of Rule 3.3.2(b) have alternative options.

The proponent also noted that their current bank guarantee facility was due to expire at the end of 2024 and, due to their association with thermal coal, they had been unsuccessful in obtaining new arrangements for a bank guarantee from an accepted credit support provider.<sup>102</sup>

<sup>99</sup> See our website for more information on the rule change process: <https://www.aemc.gov.au/our-work/changing-energy-rules>

<sup>100</sup> See appendix C for more information on the current credit support arrangements.

<sup>101</sup> Delta Electricity, Rule Change Proposal - Allowing AEMO to accept cash as credit support, 17 October 2024, p.2.

<sup>102</sup> Ibid.

The proponent considered that the current arrangements should be broadened to allow participants to provide credit support in a form other than a bank guarantee or letter of credit. Specifically, the proponent proposed that cash should be allowed as credit support and that NER clause 3.3.2(b) be amended by inserting 'cash or' after the word 'is'.<sup>103</sup> The proponent considered that this would contribute to the NEO by ensuring the continued supply of secure and reliable electricity in the NEM, in addition to promoting efficiency and potentially reducing operating costs for market participants.<sup>104</sup>

The proponent also considered that the rule change request was simple, non-controversial, and relatively urgent, and requested that the proposal be assessed under the expedited rule change process.<sup>105</sup>

## A.2 The process to date

On 24 October 2024, the Commission published a notice advising of the initiation of the rule making process and consultation in respect of the rule change request.<sup>106</sup> A consultation paper identifying issues for consultation was also published. Submissions to the consultation paper closed on 21 November 2024.

In the consultation paper, the Commission considered that the rule change request was a request for an urgent rule as defined in section 87 of the NEL. Accordingly, the Commission proposed to use the expedited rule change process, subject to any written requests not to do so. The closing date for receipt of written requests was 7 November 2024.

The Commission received one written request not to expedite the rule change request. The Commission decided that the reasons contained in the written request were not misconceived nor lacking in substance. Accordingly, the Commission is assessing the rule change request under the standard rules consultation process.<sup>107</sup>

In response to the consultation paper, the Commission received 20 submissions from stakeholders. The Commission considered all issues raised by stakeholders in making this draft determination, with issues raised discussed and responded to throughout this draft rule determination. A summary of other issues raised in submissions and the Commission's response is contained in appendix G.

On 19 December 2024, the Commission published a notice under section 107 of the NEL advising of the extension to the time for making this draft determination. The time for making the draft determination was extended to 3 April 2025.

<sup>103</sup> For context, NER clause 3.3.2(b) corresponds to the accepted forms of credit support that can be provided.

<sup>104</sup> Delta Electricity, Rule Change Proposal - Allowing AEMO to accept cash as credit support, 17 October 2024, p.3.

<sup>105</sup> Ibid, p.1.

<sup>106</sup> This notice was published under section 95 of the NEL.

<sup>107</sup> Under section 96 of the NEL, the AEMC must not make a rule under the expedited process if the AEMC receives a written request not to do so and if the reasons in the request are not, in the AEMC's opinion, misconceived or lacking in substance.

## B Regulatory impact analysis

The Commission compared a range of viable policy options that are within our statutory powers. The Commission analysed these options: the rule proposed in the rule change request, a business-as-usual scenario where we do not make a rule, and a more preferable rule that allows cash and surety bonds as credit support and broadens the pool of credit support providers (the draft rule).

The Commission has undertaken regulatory impact analysis to make its draft determination using primarily qualitative methods. It involved consideration of impacts within the scope of the NEO, identification of impacted stakeholders, assessment of issues raised in the rule change request and by stakeholders, and assessment of the benefits and costs of various policy options. The depth of analysis was commensurate with the potential impacts. Where commensurate and feasible, the Commission has quantified the impacts.

The potential benefits from cost reductions in providing credit support could be quantified in theory, however this is highly dependent on assumptions of the fees for bank guarantees and surety bonds (which are variable between participants and lenders), the uptake of cash and/or surety bonds as credit support (which cannot be accurately predicted), and amounts of credit support being provided by participants (which is confidential). Based on stakeholder feedback and engagement, the Commission considers that these benefits are likely to be material and deliver benefits to consumers. The Commission also sought confidential information from AEMO on participant MCLs (anonymised and segmented), which provided additional insight. The Commission considers that other benefits associated with the draft rule, such as reduced risks of triggering default events or reductions in administrative costs, would be additive to cost reductions and would have positive impacts for participants providing credit support.

Risks and costs associated with clawbacks of cash cannot be quantified due to a high degree of uncertainty in the likelihood or frequency of a clawback, and the potential size of a clawback (which could be across many orders of magnitude). Similarly, potential impacts on participants from temporary short payments cannot be quantified due to high uncertainty in the relevant factors that would lead delayed credit support payments and the potential magnitude of a shortfall. However, on a qualitative basis, the Commission considers that these risks are likely to be low and less than the benefits of the draft rule. The Commission considers that other risks associated with the draft rule would be low or negligible compared to potential benefits.

The Commission will continue to engage with stakeholders to better understand impacts associated with the draft rule, and continue to assess and analyse policy options. The Commission will also continue to work with AEMO to understand likely implementation costs associated with the draft rule and (if applicable) final rule and whether they would affect the balance of benefits and costs.

## C Existing credit support arrangements in the NEM

In the NEM, market participants are required to meet prudential requirements under Rule 3.3 in the NER. These prudential requirements aim to ensure stability in the NEM in the event of a participant defaulting. Participants are required to lodge credit support that AEMO can use to cover shortfalls if that participant defaults and is unable to settle its outstandings.

### C.1 The prudential standard targets no payment shortfall in 98% of participant default

Under clause 3.3.4A of the NER, the prudential standard is set at 2%. This means that AEMO should determine prudential settings (maximum credit limits, outstandings limits, and prudential margins) that target no shortfalls in payments in 98% of instances when a market participant defaults on its payments. In other words, AEMO would not have sufficient prudential collateral in 2% of participant defaults, which would result in settlement shortfalls to market participants who are net creditors.

### C.2 Participants must provide credit support that is not less than their maximum credit limit

Under clause 3.3.5 of the NER, participants must provide current and valid credit support that, in aggregate, is not less than their maximum credit limit (MCL). AEMO determines the MCL for each participant using a methodology published in AEMO's Credit Limit Procedures.<sup>108</sup> The MCL is the sum of two components:

- **the outstandings limit (OSL):** AEMO's estimate of the maximum value that a participant's outstandings can reach over the payment period if they have lodged credit support equal to the MCL
- **the prudential standard (PM):** the allowance made by AEMO in determining a participant's MCL for the accrual of their outstandings during the reaction period (7 days).

Currently, the OSL is based on a 7-day billing period and an estimated 28-day (20 business day) settlement period, meaning that the OSL is calculated on a 35-day period. The *Shortening the settlement cycle* rule change will reduce the calculation of the OSL from 35 days to 19 days, thereby reducing the MCL and subsequent minimum amount of credit support participants will need to provide.<sup>109</sup>

### C.3 The NER prescribes the accepted forms and providers of credit support

This sub-section details the current requirements for credit support and credit support providers in the NER.

Under the current clause 3.3.2 of the NER, when a market participant does not meet the acceptable credit criteria, they must provide credit support that:

- is an obligation in writing
- is from an entity (credit support provider) which meets the acceptable credit criteria and is not a market participant

<sup>108</sup> AEMO's Credit Limit Procedures can be found [here](#).

<sup>109</sup> AEMC, Shortening the settlement cycle - final determination, p.12.

- is a guarantee or bank letter of credit in a form prescribed by AEMO
- 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
- permits drawings or claims by AEMO to a stated certain amount.

An entity must meet all of the acceptable credit criteria to provide credit support, which are outlined in clause 3.3.3 of the NER. Entities must:

- be either:
  - any entity under the prudential supervision of the Australian Prudential Regulation Authority
  - a central borrowing authority of an Australian State or Territory which has been established by an Act of Parliament of that State or Territory
- be resident in, or have a permanent establishment in, Australia
- not be an externally administered body corporate (as defined in the Corporations Act) or under a similar form of administration under any laws applicable to it in any jurisdiction
- not be immune from suit
- be capable of being sued in its own name in a court of Australia
- have an acceptable credit rating, as determined under clause 3.3.4.

Clause 3.3.4 of the NER outlines the acceptable credit rating for a credit support provider. AEMO can determine the acceptable credit rating through a rules consultation process. AEMO has not made a determination on the acceptable credit rating to date, meaning that the acceptable credit rating, until varied by determination of AEMO, is:

- a rating of A-1 or higher for short term unsecured counterparty obligations of the entity, as rated by Standard and Poor's (Australia) Pty. Limited
- a rating of P-1 or higher for short term unsecured counterparty obligations of the entity, as rated by Moodys Investor Service Pty. Limited.

## C.4 Cash can be used in response to call notices

Under clauses 3.3.11 of the NER, when a participant's outstandings exceed their trading limit, AEMO may issue a call notice to that participant.<sup>110</sup> Clause 3.3.13 of the NER allows participants to respond to a call notice by providing a security that is equal to, or greater than, the call amount.

In other words, participants are allowed to provide cash in response to a call notice to secure liabilities above their trading amount. However, the use of cash in these circumstances is not directly comparable to the use of cash as credit support. Cash used in response to call notices are more temporary arrangements as opposed to credit support. As noted by AEMO in their submission to the consultation paper:<sup>111</sup>

Call notices are more frequent during periods of high price volatility where the credit support provided could become insufficient to cover participant outstandings. Given their function, security deposits are typically significantly lower in value than credit support

<sup>110</sup> The trading limit is defined under clause 3.3.10 of the NER as the difference between the credit support provided by the participant and the prudential margin.

<sup>111</sup> Submission to the consultation paper: AEMO, p.8.



amounts. They are also temporary in nature, generally removed quickly by being credited against an upcoming participant final statement.

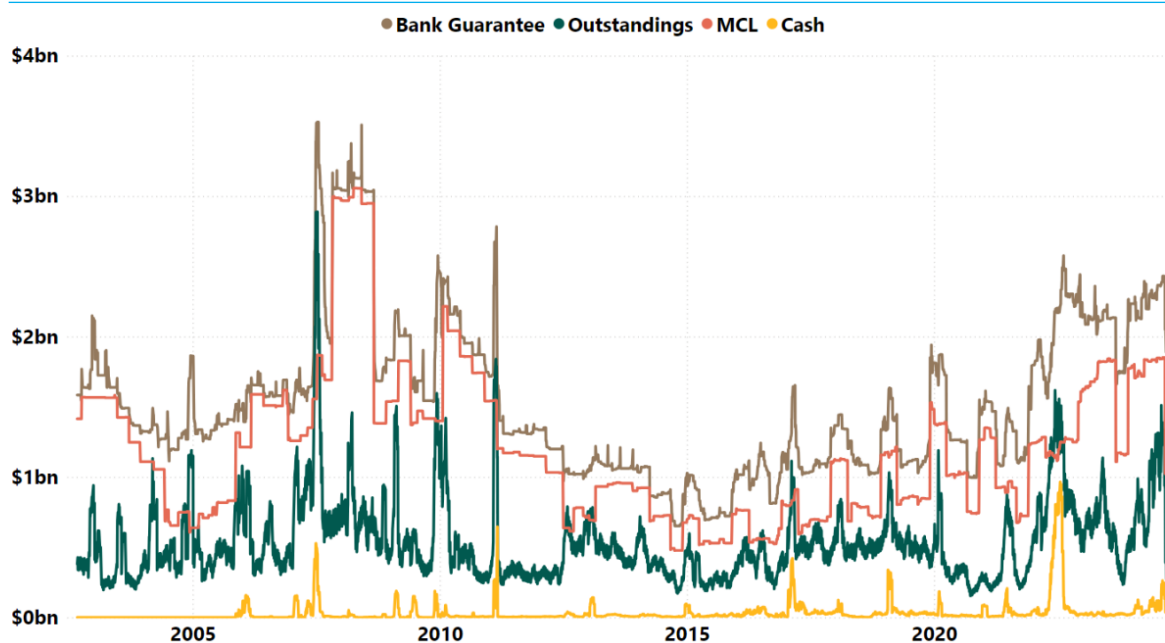
...

In contrast to the security deposits framework, participant credit support is required to mitigate enduring and systemic credit risk of the NEM.

Furthermore, the NEL includes a Corporations Act displacement provision for the application of the security deposits against amounts owing to AEMO. This removes the clawback risk for cash that is provided to AEMO in response to a call notice. This is different to clawback and insolvency-related risks that are associated with cash credit support, in addition to the differences for cash used in response to call notices.<sup>112</sup>

For further context, Figure C.1 shows the levels of total MCL, guarantees, outstandings, and cash (used in response to call notices) over the life of the NEM.

**Figure C.1: Key prudential indicators in the NEM (1999-2024)**



Source: AEMO, Report on Effectiveness of the NEM Prudential Settings Methodology 2024, p.9.

## C.5 AEMO has discretion in making suspension decisions

Clause 3.15.21 outlines the rules and procedures for default events in the NEM. Default events in relation to a market participant include (without limitation):<sup>113</sup>

- a participant does not pay money due for payment to AEMO by the appointed time on the due date
- a participant fails to provide credit support required by the appointed time on the due date.

<sup>112</sup> Cash used in response to call notices can be provided when credit support amounts are insufficient, is provided on a temporary basis, and is typically lower in value than credit support amounts.

<sup>113</sup> Refer to clause 3.15.21(a) for a full list of defined default events.



AEMO has a range of powers under the NER to respond to a default event and often has discretion in how it may exercise such powers, where:<sup>114</sup>

In exercising these discretions [to issue a default notice or suspension notice], AEMO will consider the relevant circumstances, including the power system implications and broader market impacts of any suspension decision, as well as the financial risk posed to the market by the defaulting participant.

Notably, AEMO may issue a default notice or make a claim on credit support if a default event occurs, and may issue a suspension notice if the default event is not remedied.<sup>115</sup>

Under clause 3.15.21(c2) of the NER, AEMO may also make a non-suspension decision if, among other conditions, AEMO considers that the defaulting participant should not be suspended taking into account the potential impact of the suspension on the reliability of the power system or any other matters AEMO considers relevant.

Importantly, AEMO is not required to suspend (or not suspend) all activities or registration categories of a market participant. For example, a suspension notice could suspend a participant from some specified activities or registration categories, and make a non-suspension decision in relation to the activities or registration categories that are not the subject of the suspension notice.<sup>116</sup> As noted by AEMO in their submission to the consultation paper:<sup>117</sup>

As an example, if a market participant is both a creditor (generator) and debtor (market customer), the NER would allow AEMO to suspend only the market customer registration and related activities if AEMO deems that to be the most appropriate action in the circumstances. In practice, AEMO could take this course of action if it were considered necessary to keep a generator operating in the market for system security or reliability reasons, while restricting participant spot market purchases to minimise any potential financial risk to the market.

Note that partial suspensions could be complex in practice due to ring-fencing implications between different market registrations, especially with regard to financial obligations.<sup>118</sup> Therefore, AEMO would need to factor in any relevant considerations on a case-by-case basis when making suspension or non-suspension decisions in relation to a defaulting participant.

114 Submission to the consultation paper: AEMO, p.4.

115 Clauses 3.15.21(c)-(c1) of the NER.

116 Clause 3.15.21(c1)(3) of the NER.

117 Submission to the consultation paper: AEMO, p.4.

118 AEMC, Market Participant Suspension Framework - Final determination, 1 December 2016, p.17.

## D Credit support arrangements in other energy markets

This section provides a non-exhaustive summary of acceptable forms of credit support in other energy markets. While it can be insightful to compare credit support arrangements in other markets, it is worth emphasising that differences in legislative and regulatory environments, as well as market structures, mean that direct comparisons and inferences on the suitability of various credit support options cannot be made. Notwithstanding those differences, our draft rule would bring the NEM's credit support arrangements more in line with those of other energy markets.

### D.1 All markets accept guarantees and/or letters of credit

In general, all markets accept bank guarantees and/or letters of credit to be used as credit support. There are often requirements for the obligation to be written and in a format acceptable to the relevant market body (i.e. the market operator), as well as minimum credit ratings for the credit support providers.

A non-exhaustive list of minimum credit ratings in other markets is:

- NEM and WEM: A-1 (Standard and Poor's) or P-1 (Moody's) for short-term unsecured counterparty obligations<sup>119</sup>
- New Zealand: long-credit rating of A3 (Moody's), A- (Standard & Poor's or Fitch), or B+ (AM Best)<sup>120</sup>
- PJM: senior unsecured, issuer or senior secured rating of at least A (Standard & Poor's or Fitch) or A2 (Moody's), or an equivalent short-rating rating of at least A-1+ (Standard & Poor's)<sup>121</sup>
- CASIO: corporate debt rating of A- (Standard & Poor's, Duff & Phelps, or Fitch) or A3 (Moody's), or an equivalent short-term debt rating.<sup>122</sup>

### D.2 Many energy markets accept cash as credit support

Cash is accepted as a form of credit support in many other energy markets, for example by AEMO in the WEM, NZX (New Zealand), SWEM (Singapore), and US system operators (CAISO, ISONE, NYISO, PJM, MISO, SPP).

Some of these markets require participants providing cash to use a security deed or agreement to secure first priority interest of the market operators in respect of the cash, with the aim of trying to protect against a clawback in the event of a participant becoming insolvent. Therefore, while not being directly comparable to the NEM, it is worth noting that other jurisdictions accept cash as credit support and, while attempting to reduce risks, accept some degree of clawback risk.

For example, participants in the WEM must provide a security deed to AEMO when providing cash as credit support, and AEMO registers their security interest in the cash on the PPSR.<sup>123</sup> While the WEM is under the same national legislation as the NEM, we note that differences in market size and structure, and the degree of privatisation among market participants, means risks associated with the use of cash as credit support are not directly comparable.

119 Clause 3.3.4(b) of the NER for the NEM and clause 2.38.6(f) of the WEM Rules for the WEM.

120 Section 14A.3 of the Electricity Industry Participation Code 2010.

121 PJM, Credit Overview and Supplement to the PJM Credit Risk Management Policy, January 2024, p.14.

122 CAISO, Business Practice Manual for Credit Management & Market Clearing, version 16, p.51.

123 AEMO's WEM procedures on prudential requirements can be found [here](#).

The credit support arrangements that IESO (Canada) uses differ from others mentioned, in that it used to accept cash prior to 2004, when it ceased accepting cash as credit support and participants that had been providing less than CA\$200k in cash were grandfathered.<sup>124</sup>

### D.3 Surety bonds are acceptable in some markets

Surety bonds are a less commonly accepted form of credit support in other energy markets, with example markets that accept surety bonds being New Zealand and some US markets (NYISO, PJM, SPP). Where accepted, sureties are typically required to meet minimum credit ratings that reflect the requirements for banks providing bank guarantees or letters of credit, in addition to providing the surety bond in writing that adheres to a template provided by the system operator. PJM and SPP have limits on the surety bonds, namely a \$10m limit on surety bonds from a single surety for a single participant, and a \$50m limit on the total value of surety bonds from a single surety.

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124 IESO, 2016 Prudential Framework Report, 16 December 2016, p.18.

## E Options to mitigate clawback risks

In making this draft determination, we considered a range of possible options to mitigate clawback risks associated with the use of cash as credit support. This appendix provides information on the options considered and our assessment of their viability and potential in mitigating clawback risks.

### E.1 Corporations Act displacement provision in the NEL

#### E.1.1 Operation of section 5F of the Corporations Act

Section 5G of the Corporations Act provides a framework for Australian States and Territories to disapply the Corporations Act in full or in part. Relevantly, to enliven section 5G, in respect of a provision of a law of a State or Territory which either comes into force, or is materially amended, after the Corporations Act commenced (State Provision), the provision (where relevant, as amended) must be *“declared by a law of a State or Territory to be a Corporations legislation displacement provision for the purposes of [section 5G] (either generally or specifically in relation to the Commonwealth provision).”* The National Electricity Rules have the force of law in New South Wales, Queensland, Victoria, South Australia, Tasmania and the Australia Capital Territory.

If such a declaration is made, then the inconsistent provision of the Corporations legislation (here, Chapter 5) is taken to not:

- prohibit the doing of an act, or impose a liability for doing an act that the State Provision specifically authorises or requires, or
- operate in a State or Territory to the extent necessary to ensure that no inconsistency arises.

Section 10A of the NEL currently enables the Regulations to declare a “relevant provision” to be a Corporations legislation displacement provision for the purposes of section 5G of the Corporations Act in relation to the provisions of Chapter 5 of the Corporations Act (which deals with external administration). The current relevant provisions most relevant to this rule change include a provision of the rules that relates to any of the following:

- the application by AEMO of money in any security deposit fund
- the functions of AEMO under procedures relating to defaults by retailers.

Relevantly, section 5A of the NEL Regulations provide the following provisions of the Rules are declared to be Corporations legislation displacement provisions for the purposes of section 5G of the Corporations Act 2001 of the Commonwealth in relation to the provisions of Chapter 5 of that Act:

- clause 3.3.13A (which relates provision of security deposits)
- clause 3.15.21 (which sets out the default procedure).

If a transaction under a rule which is a Corporations legislation displacement provision was inconsistent with the sections of Chapter 5 of the Corporations Act (including those related to claw back and insolvency set-off), the relevant section of the Corporations Act should not operate to the extent of such inconsistency with the rule.

#### E.1.2 Application of the displacement provision to this rule change

The set off rights and first ranking security, discussed below in appendix E.2 and appendix E.3, have been included in the draft rule with the intention that they would get the benefit of the Corporations Act displacement.

In its submission to the consultation paper, AEMO noted that:<sup>125</sup>

Where a displacement provision applies to a transaction that may otherwise be an unfair preference under the Corporations Act, it will have the effect of removing clawback risk entirely, with no need for NER mechanisms to recover any liability associated with that transaction.

AEMO is of the view that the existing NEL displacement provisions do not eliminate clawback risk, because they are explicitly limited to the application of security deposits and the default process (in which AEMO is entitled to apply both security deposits and credit support). Although open to interpretation, it remains arguable that the provision of cash amounts to AEMO by an insolvent participant is a distinct transaction, which is still capable of being an unfair preference. The provision of cash as credit support increases the potential market exposure to this risk.

AEMO suggests that the most straightforward means of eliminating clawback risk from the NEM settlement and prudential process is to broaden the displacement provisions to cover all AEMO settlement and prudential transactions.

Where an amendment is made to a provision that is subject to a Corporations Act displacement provision, there is a requirement under the Corporations Act that the amendment is not material. This means that the amendment must not materially reduce the range of persons, acts and circumstances to which the Corporations Act would otherwise apply.<sup>126</sup>

Our draft rule has added a note to clause 3.15.21 (default procedures) of the NER that is intended to, and we consider would, clarify that the provision of credit support by a participant to AEMO is within the existing displacement provision that relates to the functions of AEMO in relation to default procedures. We consider the draft rule would not materially reduce the range of persons, acts and circumstances to which the Corporations would otherwise apply, given that the amendments (including set offs and the use of credit support) are within the scope of the existing default procedure.

However, we consider that an amendment to the NEL, such that the Corporations Act displacement provisions expressly include the rules related to cash credit support, could provide greater certainty on the elimination of clawback risk by specifying that the use of cash as credit support is a displacement provision. However, as the AEMC does not have powers to amend the NEL, it cannot amend section 10A of the NEL or the relevant regulations under it. Any such amendment would need to be endorsed and implemented by Energy Ministers through a law change.

## E.2 Set off arrangements

A set off occurs when one or both parties set off their monetary obligations to each other. The set off rights in the amended clause 3.15.21(b)(2) of the draft rule are intended to be the key rights of AEMO in respect of cash credit support under the default procedures in clause 3.15.21(b) of the NER.

While the NER has the force of law, section 553C(1) of the Corporations Act also provides for the set off of mutual credits, mutual debts and other mutual dealings between an insolvent company

<sup>125</sup> Submission to the consultation paper: AEMO, p.7.

<sup>126</sup> See section 5G(17) of the Corporations Act.

that is being wound up. The circumstances in which such set off may not apply are discussed below.

In respect of the provision of the cash credit support and set-off right in a particular circumstance, there is a potential risk that there may be an unfair preference. This could occur if the provision of the cash credit support and/or exercise of the set-off right resulted in AEMO receiving from the participant, in respect of an unsecured debt that the participant owed to AEMO, more than AEMO would receive if the transaction were set aside and AEMO were to prove for the debt in the winding up of the market participant, and no relevant defence applies. Broadly, section 588FE of the Corporations Act is that, unless certain conditions are satisfied, a transaction that is an unfair preference may be set aside or modified (i.e. subject to clawback) if, at the time of entering into a transaction the participant was insolvent or it became insolvent because of the transaction and the transaction occurred during the suspect period.<sup>127</sup>

In the context of defences, a court could not make an order in respect of an unfair preference which materially prejudices a right or interest of a person if (amongst other requirements) at the time when the person became a party to the transaction:

- the person had no reasonable grounds for suspecting that the participant was insolvent (in the sense that the Australian Company was unable to pay all its debts as and when they become due and payable) or would become insolvent if it entered into the transaction; and
- a reasonable person in their circumstances would have had no grounds for so suspecting.

Furthermore, AEMO may not be entitled to claim the benefit of a set-off under section 553C(1) if AEMO had notice of the fact that the participant was insolvent at the relevant time (when AEMO is provided the cash credit support or entered into the transaction). This may be relevant given AEMO's role in the operation of the market and its settlement processes. Additionally, one of the requirements for set off under section 553C(1) to apply is mutuality.<sup>128</sup>

Therefore, a set off does not eliminate clawback risk. However, the draft rule includes amendments intended to support, together with section 10A of the NEL and related Regulations, the aspects of NER related to the provision of the cash credit support and set-off right being Corporations Act displacement provisions in relation to Chapter 5 (External administration) of the Corporations Act. The sections of the Corporations Act relevant to voidable transactions (including unfair preferences) and section 553C are in Chapter 5 of that Act.

As the Personal Property Securities Act (PPSA) does not apply to any right of set-off, AEMO should not need to register a financing statement merely in respect of the set-off right. Also, the exercise of a set-off right should not be subject to the stay on the enforcement of security during the administration of an Australian company under section 440B of the Corporations Act.

## E.3 Security

### E.3.1 Security interests

AEMO could accept cash and register a security interest in the cash. In the WEM, participants are allowed to provide cash as credit support to AEMO subject to entering into a security deposit

<sup>127</sup> *Corporations Act 2001* (Cth), sections 588FA, 588FC and 588FE(2).

Generally, being in respect of an administration of liquidation, 6 months prior to the commencement of the administration or liquidation. Note that clawbacks can also take place for other reasons, for example other voidable transactions such as uncommercial transactions.

<sup>128</sup> This means that the obligations must be owing between parties in the same capacities and each party must be both beneficially entitled to performance of the other party's obligations and personally liable for its obligations. This may be an issue where the market participant is a trustee or a partner. Mutuality may also be affected where the participant purports to grant security in its rights of the participant under the NER, including the return of the cash security deposit.

deed. In doing so, this gives rise to a security interest under the PPSA and is registered on the Personal Property Securities Register (PPSR) in order to safeguard the security.

There are a number of limitations with accepting cash as credit support and relying on the PPSR to eliminate clawback risk:

- If the stay on the enforcement of security during the administration of an Australian company under section 440B of the Corporations Act 2001 applied, then AEMO could not enforce the security during the administration of a market participant except with the administrator's consent or the leave of the Court. Whilst the stay would not invalidate the security, it could result in AEMO being unable to enforce the security in the cash to discharge any outstanding settlement amount.
- Registering cash credit support on the PPSR does not address clawback risks, as it would not resolve a scenario where the provision of cash is a voidable transaction in the first place.
- If an interest in personal property is a 'security interest' within the meaning of the PPSA, then the security interest must be perfected. This is most often done by way of registration of that security interest on the PPSR. Perfection determines priority between secured parties when the grantor of the security interest becomes insolvent. AEMO's security, even if registered on the PPSR, may not be first ranking.<sup>129</sup> It may not be practical for AEMO to negotiate and enter priority deeds with financiers of each market participant providing cash as credit support to ensure AEMO's priority over the cash security.
- Using the PPSR for a large number of participants providing cash as credit support would be administratively burdensome.

Due to these limitations, we consider the use of the PPSR would not eliminate clawback risk nor could be relied upon to materially reduced clawback risk.

### E.3.2 First ranking charge

While the draft rule has been prepared on the basis that set-off rights could be used in respect of cash credit support, clause 3.3.2A(e) of the draft rule provides that the rights of the participant to the return of any monies in the cash security fund are subject to a first ranking charge in favour of AEMO securing payment of any money actually or contingently owing by the participant to AEMO pursuant to the NER.

There is a potential risk that, if AEMO sought to enforce the charge in respect of a participant, the stay on the enforcement of security during the administration of a participant under section 440B of the Corporations Act. However, as noted above, the draft rule includes amendments intended to support, together with section 10A of the NEL and related Regulations, the aspects of the NER related to the charge provision of the cash credit support and set-off right in a particular circumstance being Corporations legislation displacement provisions in relation to Chapter 5 (External administration) of the Corporations Act.<sup>130</sup> The enforcement of security is distinct from the exercise of set-off rights, which are not expected to be subject to this stay on administration. Set-off rights are also excluded from the "ipso facto stays".

Determining whether the PPSA applies to the charge is complex given that charge is provided for in the draft rule and the NER have the force of law on the basis previously discussed. Given this complexity, while the PPSA does not require a secured party to "perfect" its security interest in the collateral, AEMO may wish to perfect the charge by registration of a financing statement in respect

<sup>129</sup> For example, where the market participant has already granted all monies security to another secured party (which is not uncommon).

<sup>130</sup> Section 440B of the Corporations Act is in Chapter 5 of that Act.



of the grantor on the PPSR and perfect any other security interests granted to it. This may mitigate the risks that, if AEMO does not do so and a court were to determine that the PPSA does apply to this charge:

- another security interest may take priority
- another person may acquire an interest in the collateral free of the secured party's security interest, and
- it may not be able to enforce the security interest against the participant if the participant becomes subject to winding up, administration or restructuring, executes a deed of company arrangement or makes a restructuring (that is, the security interest may vest in the grantor).

However, despite these considerations regarding registrations, the inclusion of the charge is likely to be incrementally beneficial and not adversely affect the set-off rights to be afforded to AEMO under the draft rule (noting that the set-off rights themselves should not be a security interest to which the PPSA applies and AEMO is not obliged to use set off arrangements).

Accordingly, there may still be some value in the use of the PPSR by AEMO when accepting cash as credit support, however we also recognise that the potential administrative burden might not be proportional to additional benefits. Our draft rule does not place any obligations or expectations on the use of the PPSR.

In addition, the draft rule includes provisions intended to minimise the risk that any cash security provided to AEMO as credit support is or becomes subject to any security interest, trust or other proprietary interest (whether legal, equitable or statutory), other than in favour of AEMO at any time whilst it is held by AEMO, unless AEMO has (in its absolute discretion) agreed otherwise with the participant.

## E.4 Netting arrangements

The Payment Systems and Netting Act 1998 (PSNA) was enacted to remove certain legal doubts as to the efficacy of netting operations in Australia. The PSNA validates netting under certain close-out netting contracts, market netting contracts, approved real time gross settlement payment systems and multilateral netting arrangements. This applies despite any other law (including the insolvency provisions of the Corporations Act, essentially provisions concerning voidable and void transactions) but, in some cases, subject to certain specified stay provisions.

### E.4.1 Close out netting arrangements

The PSNA can apply to a 'close-out netting contract', as defined in that Act, and we have considered whether cash credit support could be provided pursuant to a close-out netting contract between a participant and AEMO.

Some of the benefits of a close-out netting contract include that, if the PSNA applied to validate close-out netting under it:

- the PSNA does not require that mutuality be present for netting to take place (unlike the insolvency set-off provisions in section 553C of the Corporations Act)
- the protection under the PSNA would be available both prior to, and following, the participant becoming subject to insolvency proceedings
- close-out netting is not subject to the stay on the enforcement of security during the administration of an Australian company (under section 440B of the Corporations Act, as described above).

However, the complexities associated with this option include:



- There would need to be a contract created between AEMO and each market participant who provides cash credit support. This could be a very short form contract reflecting the NER or it may be possible for the contract to be created in the NER. However, this would be a major conceptual change given the NEM was changed from contractual framework under the National Electricity Code to the National Electricity Rules in 2005 due to competition concerns. Any contractual arrangements would require careful consideration, including in respect of liability, minimum legal requirements for contracts and competition issues.
- AEMO could not rely on the PNSA protection of close-out netting in respect of an obligation created by a transaction that was entered into when AEMO had reasonable grounds for suspecting that the participant was insolvent at that time or would become insolvent because of matters including entering into the transaction or doing an act, or making an omission, for the purposes of giving effect to the transaction.

While close-out netting arrangements could have potential in mitigating clawback and other insolvency-related risks, due to these limitations and the complexity of this option, we consider that close-out netting contracts are not the preferred method for mitigating clawback risks.

#### E.4.2 Market netting contracts

Another type of netting arrangement described in the PNSA is a market netting contract.

As an example, the clearing and settlement facility operated by the ASX Clear Pty Limited is approved as a netting market and the PNSA provides protection from reversal or invalidation under insolvency law for the termination, calculation and netting of obligations, payments and transfers of property to meet obligations and the enforcement of security by ASX Clear.

While this approach would significantly reduce clawback risk, it would require significant restructuring of the NEM, including contracts between AEMO and market participants and AEMO potentially requiring a financial markets licence under Chapter 7 of the Corporations Act 2001.

As such, we consider that market netting contracts would be an overly complex and disproportional response to the intended purpose of mitigating clawback risks.

### E.5 Providing cash for credit support as a pre-payment

AEMO could receive the cash as a pre-payment of a settlement, however there are several limitations with this approach:

- a pre-payment is still subject to clawback and other insolvency-related risks, although where it relates to a transaction (in this case a sale of electricity or other services) for which both parties give consideration, then it is unlikely that a preference or clawback risk will arise
- pre-payments would usually be applied to amounts owing on a periodic basis, however cash provided as credit support would not be intended to be applied to pay settlement amounts in the ordinary course of trading
- if the cash was paid to AEMO as a pre-payment of the amounts estimated to be due under a final statement, there is a risk that all of the GST payable over the course of the arrangement would be payable up front (even where the final statement has not yet been issued).<sup>131</sup>

Due to these limitations, we do not consider that structuring cash credit support as a pre-payment would be an appropriate method to mitigate clawback risks.

<sup>131</sup> In other words, the GST liability would be accelerated.

## F Legal requirements to make a rule

This appendix sets out the relevant legal requirements under the NEL for the Commission to make a draft rule determination.

### F.1 Draft rule determination and draft rule

In accordance with section 99 of the NEL, the Commission has made this draft rule determination for a more preferable draft rule in relation to the rule proposed by the proponent.

The Commission's reasons for making this draft rule determination are set out in chapter 2.

A copy of the more preferable draft rule is attached to and published with this draft determination. Its key features are described in chapter 3.

### F.2 Power to make the rule

The Commission is satisfied that the more preferable draft rule falls within the subject matter about which the Commission may make rules.

The more preferable draft rule falls within section 34 of the NEL as it relates to regulating:<sup>132</sup>

- the operation of the national electricity market
- the operation of the national electricity system for the purposes of the safety, security and reliability of that system
- the activities of persons (including Registered participants) participating in the national electricity market or involved in the operation of the national electricity system.

Additionally, by amending the credit support arrangements for participants in the NEM, the more preferable draft rule falls within the matters set out in item 3 of Schedule 1 to the NEL as it relates to prudential requirements to be met by a person before being registered as a registered participant, and as a registered participant.<sup>133</sup>

### F.3 Commission's considerations

In assessing the rule change request the Commission considered:

- its powers under the NEL to make the draft rule
- the rule change request
- submissions received during first consultation round
- the Commission's analysis as to the ways in which the draft rule will or is likely to contribute to the achievement of the NEO
- the application of the draft rule to the Northern Territory
- the assessment criteria and the likely benefits and costs of the draft rule, as outlined in chapter 2.

<sup>132</sup> NEL section 34(1)(a)(i)-(iii).

<sup>133</sup> Item 3 of Schedule 1 of the NEL.

There is no relevant Ministerial Council on Energy (MCE) statement of policy principles for this rule change request.<sup>134</sup>

## F.4 Making electricity rules in the Northern Territory

The NER, as amended from time to time, apply in the Northern Territory, subject to modifications set out in regulations made under the Northern Territory legislation adopting the NEL.<sup>135</sup> Under those regulations, only certain parts of the NER have been adopted in the Northern Territory.

The more preferable draft rule does not relate to parts of the NER that apply in the Northern Territory, as it amends provisions in NER chapter 3 that do not apply to the Northern Territory. As such, the Commission has not considered Northern Territory application issues.

## F.5 Civil penalty provisions and conduct provisions

The Commission cannot create new civil penalty provisions or conduct provisions. However, it may recommend to the Energy Ministers' Meeting that new or existing provisions of the NER be classified as civil penalty provisions or conduct provisions.

The NEL sets out a three-tier penalty structure for civil penalty provisions in the NEL and the NER.<sup>136</sup> A Decision Matrix and Concepts Table, approved by Energy Ministers, provides a decision-making framework that the Commission applies, in consultation with the AER, when assessing whether to recommend that provisions of the NER should be classified as civil penalty provisions, and if so, under which tier.<sup>137</sup>

Where the draft rule amends provisions that are currently classified as civil penalty provisions, the Commission does not propose to recommend to the Energy Ministers' Meeting any changes to the classification of those provisions.<sup>138</sup>

<sup>134</sup> Under s. 33 of the NEL and s. 73 of the NGL the AEMC must have regard to any relevant MCE statement of policy principles in making a rule. The MCE is referenced in the AEMC's governing legislation and is a legally enduring body comprising the Federal, State and Territory Ministers responsible for energy. On 1 July 2011, the MCE was amalgamated with the Ministerial Council on Mineral and Petroleum Resources. In December 2013, it became known as the Council of Australian Government (COAG) Energy Council. In May 2020, the Energy National Cabinet Reform Committee and the Energy Ministers' Meeting were established to replace the former COAG Energy Council.

<sup>135</sup> These regulations under the NT Act are the National Electricity (Northern Territory) (National Uniform Legislation) (Modifications) Regulations 2016

<sup>136</sup> Further information is available [here](#).

<sup>137</sup> The Decision Matrix and Concepts Table is available [here](#).

<sup>138</sup> In the draft rule, clause 3.3.2(b) is amended and currently classified as a civil penalty provision.

## G Summary of other issues raised in submissions

**Table G.1: Summary of other issues raised in submissions**

Stakeholder	Issue	Response
AEMO	Allowing cash in lieu of bank guarantees would remove the credit risk screening process conducted by lenders in approving bank guarantees. This provides an additional layer of credit risk assurance, which would not exist when cash is provided as credit support.	We agree that participants providing cash as credit support would not be subject to credit risk screening processes conducted by lenders. However, we consider that any increased risks would be immaterial. This is because participants would still need to provide credit support that is greater than or equal to their MCL, which should be aligned with the prudential standard. Furthermore, there are other financial checks of participants, such as through obtaining retailer authorisation from the AER.
AEMO	NER 3.3.8A allows for participants to provide cash to secure payment which may become payable in respect of a billing period. AEMO cautions against comparisons between this and allowing cash as credit support, given their different purposes and usage.	We agree that there are key differences between the use of cash under clause 3.3.8A of the NER and the use of cash as credit support, and we agree that credit support should mitigate enduring and systemic risks to the NEM.
AEMO	The proposed amendment in the rule change request to insert 'cash or' in NER 3.3.2(b) may not work from a drafting perspective in the broader context of NER 3.3.2.	The drafting of the draft rule has been carefully considered to ensure that the policy intent of the draft determination is delivered.
AFMA	In the short-term, it is important for market stability to ensure that existing conventional generation is able to continue operating and supporting the market by offering financial hedge product and reallocations.	We recognise the value that conventional generation provides by offering financial hedge products and consider that the draft rule would support market stability.
AFMA	There would be benefit in a longer-term review of the settlement and prudential frameworks, for both the electricity and gas markets, to ensure they are fit for purpose and consider alternative approaches to managing risks of participant failure.	We acknowledge that there may be value in a broader review of the prudential frameworks. Consideration of such a review is not within scope of this rule change.
AGL	Careful consideration should be given	The drafting of the draft rule has been

Stakeholder	Issue	Response
	to the drafting of any rules to allow cash as credit support. In particular, the proposed amendment in the rule change request does not address the current requirement that market participants are not allowed to provide credit support.	carefully considered to ensure that the policy intent of the draft determination is delivered.
CEIG	The inability for Delta to secure credit support under the existing arrangements should be viewed as a market signal and, should the rule change progress, any generator seeking to use cash as credit support should trigger a notice of closure period of 3.5 years.	We consider that there are a wide range of reasons for which participants may prefer to use cash as credit support, and that it would not be appropriate for the use of cash by a generator to trigger a notice of closure period.
Delta Electricity	The AEMC could investigate additional alternatives: <ul style="list-style-type: none"> <li>• a parent company guarantee</li> <li>• cash as credit support above a certain threshold could be limited to participants who are typically net generators.</li> </ul>	We have considered such alternatives and consider that they could pose additional risks and limitations.
Genuity	In addition to allowing cash as credit support, the AEMC should consider broadening the list of banks and acceptable credit levels.	We have considered broadening the pool of credit support providers. The draft rule achieves this by allowing sureties to provide surety bonds for NEM participants, as well as broadening the requirement for credit support providers to be regulated by APRA. We consider the acceptable credit levels currently remain appropriate.
Iberdrola	Any additional setup or transaction costs that AEMO incurs should be borne by participants providing cash as credit support.	We consider that general AEMO implementation costs should be borne as per standard NEM reform initiatives and projects. Any expenses incurred by AEMO in the management and investment of cash would be deducted from interest payments to participants providing cash.
JEC	Socialising any costs from less secure forms of credit support would pass risks to consumers, who have no means to mitigate this risk.	Our draft rule socialises potential costs, namely clawback costs and potential delay in credit support payments, among generators. While these costs may pass through to consumers, we consider that this approach best insulates consumers from such risks. We also consider that, on balance, the draft rule would deliver net

Stakeholder	Issue	Response
		benefits for consumers.
JEC	Cash should only be accepted from named fossil-fuel generators, with respect to trading in a specific NEM region, and for a specific time. It should be no smaller than required by a bank guarantee, and it may be appropriate to require a risk premium.	We consider that allowing cash as credit support would have broad and material benefits for a range of participants, in particular small retailers. We consider that such restrictions on the use of cash would materially reduce potential benefits.
Origin Energy	While possibly out of scope for this process, there would be value in allowing for meter following offset reallocations in recognition of the large volume of energy traded under Power Purchase Agreements (PPA).	Consideration of accepted types of reallocations are not within scope of this rule change.
Perpetual Energy	The issues in the NEM credit support arrangements raised in this process are also issues in the gas markets, and this rule change is important in progressing an equivalent rule change in the gas markets.	Consideration of issues in the gas market is not within scope of this rule change.
ZEN Energy	The ASX accepts cash as credit support without compromising stability, which demonstrates cash collateral can serve as a secure and efficient form of credit support in large-scale, complex markets.	We acknowledge the acceptance of cash as credit support by the ASX, and have investigated options to mitigate and manage associated risks in the context of the NEM.

## Abbreviations and defined terms

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
APRA	Australian Prudential Regulation Authority
BCBS	Basel Committee of Bank Supervision
BDU	Bidirectional unit
Commission	See AEMC
Corporations Act	<i>Corporations Act, 2001 (Cth)</i>
EOFY	End of financial year
ESG	Environmental, social, and governance
MCL	Maximum credit limit
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National Electricity Objective
NER	National Electricity Rules
NGR	National Gas Rules
PPSA	Personal Property Securities Act 2009
PPSR	Personal Property Securities Register
Proponent	The organisation who submitted the rule change request
PSNA	<i>Payment Systems and Netting Act, 1998 (Cth)</i>
RoLR	Retailer of Last Resort
STTM	Short Term Trading Market
WEM	Wholesale Electricity Market