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# Dealing with Financial Distress in the National Electricity Market

## Special Administration Regime for Electricity Retailers

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# Part 1: Introduction

## 1. Background

### 1.1 The Options Paper

In June 2012, the Standing Council on Energy and Resources requested advice from the AEMC on NEM financial market resilience. In developing its response, the AEMC issued an options paper in November 2012 which considered means to mitigate the financial risks that may arise if a large electricity retailer participating in the National Electricity Market (***NEM***) were to suffer financial distress (the ***Options Paper***). Public submissions were received both before and after the publication of the Options Paper and the AEMC is now preparing a report to the Standing Council on Energy and Resources.

While similar issues may arise in relation to the gas market, neither the Options Paper nor this Report consider the gas market.

### 1.2 The ROLR Regime

The National Electricity Retail Law (***NERL***) sets out procedures to apply in circumstances where a retailer is suffering financial distress. In particular, a retailer of last resort (***ROLR***) regime has been established pursuant to which retail customers will be transferred to an alternate electricity retailer if their retailer fails. The ROLR regime is summarised in Schedule 1.

## 2. Limitations of the ROLR – large retailers

The ROLR regime has been called into operation effectively for small retailers. However, if a large retailer suffers financial distress and the ROLR regime is invoked there is a risk that the operation of the regime may lead to financial contagion, with significant adverse flow-on effects to the designated ROLR, other retailers, other electricity market participants and, ultimately, customers. The reasons for this are articulated in the Options Paper (and earlier Issues Paper[1]) as follows:

> The issues paper explained that the insolvency of a large retailer and associated ROLR event could potentially lead to financial contagion in the form of a "cascading retailer failure". The key factors leading to this risk are that following the ROLR event, the designated ROLR:
>
> - will be required to provide increased credit support to AEMO to cover the potential spot market energy costs of the customers that it acquires from the failed retailer;
> - may be required to provide increased credit support to distribution network service providers (***DNSP***s) to cover the network costs in relation to the acquired customers;
> - will likely be unhedged in relation to the acquired customers and will need to obtain additional hedge cover or be exposed to the spot price for the load of the acquired customers;

[1] AEMC Issues Paper – NEM financial market resilience, 8 July 2012.

- may face considerable increased wholesale energy costs, particularly given that a retailer failure may be most likely to occur at a time of high spot prices; and
- may be constrained in its ability to pass these increased costs on to customers due to retail price regulation or competitive pressures.

In combination, these additional obligations are likely to be very large and require the designated ROLR to access a large amount of funds and credit support in a very short period. Although the designated ROLR will be earning increased revenue from its new customers to offset its increased cash flow obligations, it is unlikely that it will be able to begin billing these customers immediately. As a result, there is a risk that the designated ROLR would not be able to meet these additional obligations.

If the designated ROLR is unable to meet its obligations, the designated ROLR itself may be suspended from the NEM. In a worst case scenario, this could trigger a "cascading retailer failure" as other retailers are then appointed as designated ROLRs and fail for the same reasons. In these circumstances, it is possible that there may be no one that can effectively perform the role of designated ROLR.[2]

## 3. One proposed response – a special administration regime

The Options Paper discusses a range of means to mitigate the risks of financial contagion resulting from a large retailer suffering from financial distress. Many of these do not involve any support to the distressed retailer, but rather, they amend the ROLR regime to better support the designated ROLR.

In contrast, the option we have been asked to consider involves mitigating the risks of financial contagion by establishing a new form of external administration regime that would apply to retailers suffering financial distress. There are precedents for establishing specific forms of external administration to address particular industries or important State interests to deal with situations that are not able to be satisfactorily dealt with by traditional forms of external administration. By way of example, we set out descriptions of the Australian judicial management regime for insurers and the UK special administration regime for energy supply companies in Schedule 5.

The special administration regime would operate as an alternative to the ROLR regime. As the ROLR regime operates automatically following a ROLR event, before a ROLR event occurs there would need to be a decision made as to the regime that will apply on occurrence of that event. It is envisaged that the special administration regime would be triggered if there is a risk that relying on the ROLR regime may result in a further ROLR event affecting the designated ROLR and, potentially, cascading market failure.

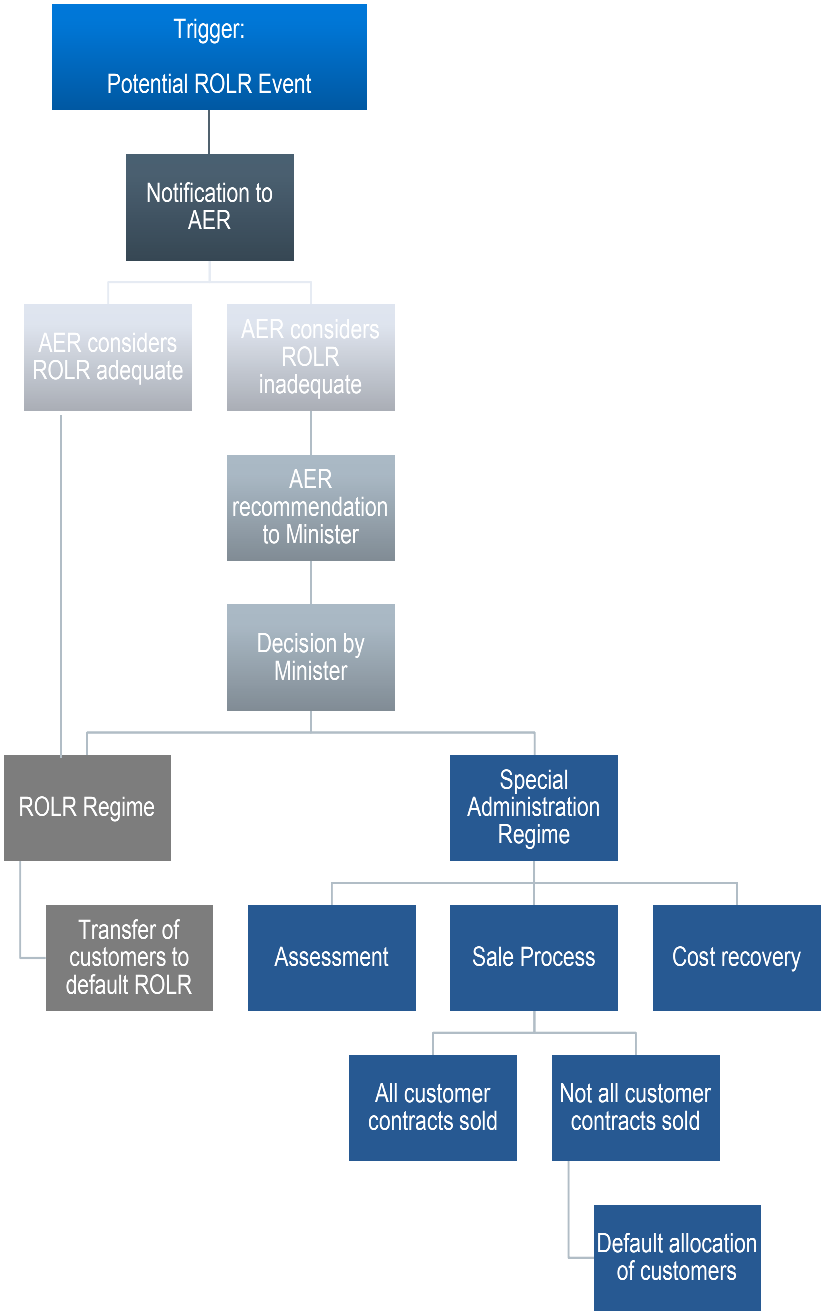
Once triggered, an administrator would be appointed to the distressed retailer. The administrator's objectives would differ from those of traditional external administrators, as discussed in Part 2, below. The administrator's key tasks would be to assess the position of the company and the electricity market and, based on that assessment, conduct a process to sell retail customer contracts (and, potentially, other related assets) or otherwise transfer retail customers in a manner that minimises the risk of financial contagion to the

[2] Options Paper, pg 11.

market. The administrator would continue to trade the distressed retailer's business as necessary to achieve those tasks.

The special administration regime would require short term government funding. A cost recovery scheme would be implemented to allow the government to recover its costs.

Set out below is a flowchart setting out key steps in the proposed special administration regime. We have assumed, for this purpose, that a Commonwealth Minister will be the decision-maker with AER providing recommendations. This follows from the assumption that any necessary short term government funding will be initially sourced from the Commonwealth government. Options in relation to this are discussed in Parts 3 and 4.



## 4. This Report

### 4.1 Instructions

We have been asked to prepare a Report on the proposed option to establish a special administration regime for electricity retailers. In particular, we have been instructed to:

- outline the objectives of the special administration regime;
- discuss key issues to be considered in designing an effective special administration regime; and
- highlight key areas where policy decisions are required to facilitate more in-depth consideration of potential features of the special administration regime.

To assist in identifying key focus areas and determine the scope of this Report we have consulted closely with the AEMC.

For the purposes of this Report, we have been instructed to make the assumptions set out below:

- That the NERL will be adopted by all States participating in the NEM before any special administration regime is adopted. Accordingly, we have not discussed any jurisdictional issues which will be superseded by the NERL.
- That the Commonwealth government will be the entity providing any necessary financial support for the special administration regime. This assumption has been made to simplify the discussion. An alternative would be for the participating jurisdictions to each contribute to the funding requirements.
- That the special administration regime must include a mechanism for the Commonwealth government to recover any funding advanced.

This Report is given to the AEMC and the AEMC is the only person entitled to rely upon it. The Report does not purport to address all of the issues that will need to be addressed in designing and adopting a special administration regime. We have considered key issues at a high level. If a decision is made to progress the model, further analysis of these and other issues will be required. We do not express a view as to the desirability or otherwise of a special administration regime and the contents of this Report should not be taken to imply any recommendation, inducement or invitation by Allens with respect to any course of action unless explicitly set out in this Report.

### 4.2 Outline of this Report

Part 2 of this Report sets out the objectives of a special administration regime, as we understand them. The objectives must be clearly defined as they should inform all decisions relating to the design of the regime.

Part 3 of this Report provides an executive summary of the issues considered and sets out key areas where decisions will need to be made in order to develop a special administration regime model.

Part 4 of this Report discusses key issues for consideration in the development of a special administration regime model.

Part 5 attaches a number of schedules. These contain useful information relevant to this Report, in particular, the key issues discussed in Part 4.

## Part 2: Objectives of a special administration regime

Should an electricity retailer go into a traditional form of insolvent external administration[3], the most common primary objective of the insolvency practitioner appointed would be to obtain the best financial recovery possible for the retailer's creditors. Where there is financial benefit to creditors in doing so, this may involve the practitioner continuing to trade the company while it undergoes a process of rehabilitation or to allow for the sale of its business or assets as a going concern. Where there is no financial benefit to creditors in continuing to trade the company, the practitioner may instead cease trading the business and focus solely on realisation of the company's assets, even if this action were to be severely detrimental to the retailer's customers.

It is this prioritisation of the interests of the retailer's creditors over the interests of its electricity customers that means that traditional forms of external administration may not be adequate to ensure the continuity of supply to customers that is one of the primary limbs of the National Electricity Objective.

*High level objectives*

We are instructed that the high level objectives of any special administration regime for electricity retailers would be[4]:

(a) to support the National Electricity Objective (ie, 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: price, quality, safety, reliability and security of supply of electricity; and the reliability, safety and security of the national electricity system);

(b) to reduce the overall risk in the NEM and to share risks amongst those best able to manage them (including retailers, distributors, generators, consumers and taxpayers); and

(c) to establish a regime under which the costs of implementation are commensurate with the benefits of the regime (having regard to the likelihood of the event and the scale of the potential consequences).

*Specific objectives*

More specific objectives of an alternative special administration regime would be:

(d) to maintain continuity of supply of electricity to customers;

(e) to allow an orderly transfer of customers from the distressed retailer to one or more other retailers;

(f) to reduce the likelihood of financial contagion resulting from the financial distress of an individual retailer;

[3] See Schedule 3 for an overview of the traditional forms of external administration in Australia.

[4] Note that many of these objectives apply to all options considered in the Options Paper.

(g) increased flexibility and time (when compared with the ROLR regime) to determine the best outcome for the distressed retailer, customers and other retailers;

(h) to allow other retailers to agree to take on the distressed retailers' customers (and possibly pay to acquire them); and

(i) to enable other retailers to better manage any additional customers and liabilities acquired from the distressed retailer.

We are further instructed that rehabilitation of the distressed retailer would not be a key objective of the regime.

*Key design elements*

Key design elements that have been suggested as important in achieving these objectives are as follows:

- processes must be clear to enable:
    - informed assessment of the situation;
    - key trigger points to be identified; and
    - a rapid response;
- the government role should be limited to the minimum level required to avoid financial contagion, to reduce the 'moral hazard risk' whereby market participants assume an implicit government guarantee of electricity retailers; and
- the special administration regime should involve the least intrusion possible on established insolvency processes, while furthering the objectives set out above.

## Part 3: Executive Summary – Key issues

We summarise below the key issues that we have considered and key issues to determined by policymakers. Detailed discussions of these issues are set out in Part 4.

### 1. Structure of a special administration regime

Of particular difficulty in the design of any special administration regime is the fact that some large retailers in the NEM do not currently structure their electricity retail operations in single-purpose corporate vehicles[5]. Large retailers may therefore also operate other businesses, including electricity generation or gas retailing, which may be the cause of any financial distress that causes the retailer to default on its obligations, rather than its electricity retail operation.

A special administration regime would be most effective if there was legal ring fencing of a retailer's electricity retail operations into a single corporate entity over which an administrator could then be appointed. Other forms of ring fencing requirements may be considered (as discussed in Part 4, section 1.1 below), but we would consider legal ring fencing to be the minimum necessary to allow for the benefits sought by the proposed special administration regime. Without legal ring fencing:

- it may be exceedingly difficult to disentangle the retailer's electricity retail operations from its other business operations;
- an administrator may therefore need to manage those non-retail operations during the special administration period in order to continue trading the company;
- if those non-retail operations are unprofitable, this may require that any government funding to be provided be used to support non-retail operations; and
- more consideration should be given as to whether the proposed objectives of special administration should be expanded to include a rehabilitation or restructuring of the distressed retailer.

We expect that before taking any decision on whether or not to implement the ring fencing of retail operations in the NEM, policy makers will need to undertake a fulsome cost benefit analysis in consultation with retail market participants. If a form of ring fencing is to be introduced, further detailed consideration will need to be given to the extent of the obligations to be imposed on retailers.

If ring fencing is not to be implemented, further consideration should be given as to whether the special administration regime could be practically structured so that the administrator was appointed solely over the necessary electricity retail assets of the retailer, rather than over the corporate entity operating the business. This raises a number of difficult issues that are discussed in detail below at Part 4, section 1.2. In practice, we think that such a structure would likely be difficult to implement to achieve the objectives of the special administration regime.

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[5] See the corporate structure diagrams set out at Schedule 2.

**Key issues to be determined:**

- Is ring fencing required in order to implement an effective special administration regime to achieve the specific objectives set out in Part 2 above?
- If required, is the cost of imposing ring fencing on retailers commensurate with the benefit to be obtained from the special administration regime?
- If retailers are not ring-fenced, what role, if any, will administrators play in respect of the company's non-retail assets?

## 2. Appointment

Based on our discussions with the AEMC, we contemplate that special administration would be a court-supervised process commenced by a court application. The alternative to court appointment is to allow a qualified party to appoint an administrator directly. While this would have some advantages (speed, reduced costs), it would not afford the qualified party the protection from discretionary challenge that a court appointment would give.

If a court is to be the appointing party, the implementing legislation would need to set out the necessary power of the court and the factors which need to be satisfied by the applicant in order for an appointment to be made.

As the special administration regime is, essentially, intended to provide an alternative to the ROLR regime that will operate in circumstances where it is considered that the ROLR regime could lead to financial contagion in the market, a notice requirement would need to be introduced into the ROLR regime before it may be triggered.

Receipt of that notice would be the trigger for a qualified party to elect whether to apply to court to commence a special administration or, alternatively, to allow the ROLR regime to operate.

The decision whether or not to commence the special administration process would need to be made by the qualified party within a set period of time, failing which the ROLR regime would be triggered. The longer this period of time is, the more damage may be caused to third parties by the delay and the greater the potential financial implications on the NEM from the retailer's distress.

In light of its existing discretionary powers in the operation of the ROLR regime and reporting obligations under the NERL, it is sensible that the AER be involved in the appointment process. Similarly, if there is to be government funding required, it is sensible that whoever is to be providing that funding also be involved in the appointment process.

While a distressed retailer is subject to special administration, the ROLR regime may not be triggered, no other form of external administration may commence and other restrictions are imposed on parties taking action that may hinder the administrator's achieving the objectives set out in Part 2 above.

If no special administration appointment is made, the usual ROLR regime would apply and the retailer could be placed into one of the traditional forms of external administration if appropriate.

**Key issues to be determined:**

- Should the court be involved in the appointment process and, if so, what question will the court be asked to consider?
- Who is the most appropriate party to apply to court or otherwise make a decision to commence a special administration?
- If the AER is to make a recommendation to a government funder to commence a special administration, what advice will need to be given to the government?
- How much time is the qualified party to be given to decide whether or not to make an application?

## 3. Features of a special administration regime

We envisage that the legislation implementing the special administration regime would grant an administrator broad powers to do all things necessary to achieve the objectives set out in Part 2 above. This is similar to the scope of powers generally afforded to most external administrators under the *Corporations Act* regime to achieve the objectives for which they have been appointed (which vary as between forms of external administration and which are substantially different to those that would apply in a special administration).

The usual duties of an external administrator to act in the interests of creditors or other company stakeholders would be superseded to the extent necessary to allow the administrator to achieve the objectives set out in Part 2 above.

We recommend that an administrator be granted a broad statutory immunity from liability, as has been the case with other forms of non-*Corporations Act* external administration and that protective measures be introduced for the duration of the special administration to allow the administrator to pursue the objectives in the most timely and efficient manner possible.

We anticipate that the major stages of the special administration will be:

- assessment of the company and the electricity retail market to inform subsequent decisions;
- conduct of a sale process; and
- if any customer contracts remain with the distressed retailer after the conduct of a sale process, management of the distressed retailer until the default allocation mechanism is complete.

The transfer of a significant number of new customers to an existing large retailer may breach the prohibition set out in section 50 of the *Competition and Consumer Act 2010* on acquisitions that have the effect or likely effect of substantially lessening competition in a market. There are a number of options that could be considered to address this issue, however, we expect that this is an issue that the administrator will need to consider in structuring any sale process.

**Key issues to be determined:**

- Should the form of all special administration sale processes be determined in advance or left to the discretion of the administrator?
- Should there be any court or Ministerial approval necessary for the sale process?
- Should a legislative transfer mechanism be established to assist in implementation of the sale process?
- How will competition issues be addressed?
- What form will the default allocation mechanism take?

## 4. Cost recovery

There are a number of ways in which the Commonwealth government could recover the costs that it incurs in respect of the special administration regime. These are as follows:

- recovery under new Commonwealth laws; and
- recovery under new co-operative State based laws.

*Commonwealth legislation*

Options for recovery under new Commonwealth laws include:

- the imposition of an industry levy; and
- recovery from all tax-payers through the income tax system.

The first option gives rise to the question of whether it is constitutional to impose a levy on industry participants in the participating States, but not other States.

The advantage of the second option is that is would distribute the costs of the special administration regime across the broadest base as all States and Territories would be affected. However, there may be a reluctance to impose any costs on taxpayers in jurisdictions that do not participate in the NEM.

*State co-operative legislation*

A State-based industry levy could be imposed on network service providers, retailers or customers. Imposition of the levy on network service providers will allow the costs to ultimately be spread across the broadest base as the relevant network service providers pass through their increased costs to other market participants and retailers seek to impose them on their customers. Any levy would need to be carefully designed to ensure that it does not constitute an excise duty, as excise duties can only be imposed by the Commonwealth government.

**Key issue to be determined:**

- What mechanism will be used to recover Commonwealth government funding?
- If an industry levy is required, how will that levy be allocated amongst participants and how will it be structured to ensure that it is not an excise duty?

## 5. Implementation of a special administration regime

We expect that implementation of a special administration regime would involve the following:

- Legislation to put in place the special administration regime. In our view, State based co-operative legislation is likely to be more appropriate than Commonwealth legislation.
- An intergovernmental agreement between the States and Territories that participate in the NEM and the Commonwealth. This would cover key aspects of the regime including the process for triggering of the regime and arrangements for cost recovery.
- Amendments to existing electricity laws. These would be required to ensure that before a ROLR event occurs, the decision-maker is notified of the potential ROLR event and the ROLR regime is not triggered until a decision has been made as to whether the to put the distressed retailer into special administration. The need for this decision-making period will mean that further amendments will be required, including to the prudential support requirements in favour of AEMO and, potentially, distributors.

  All of these amendments have the effect of changing the existing risk allocation amongst NEM participants, in particular increasing the risk of payment shortfalls for generators.
- The cost recovery mechanism will also need to be supported by legislation. We anticipate that the cost recovery mechanism itself would be included in the legislation that establishes the special administration regime. There may be some jurisdictions where legislative or other action is required to ensure that any increased costs imposed on NEM participants can ultimately be passed onto retail customers.
- Commonwealth legislation may be required to ensure that the Commonwealth has sufficient power to make payments in conjunction with the special administration regime and to specifically authorise the conferral of functions or powers or imposition of duties on a Commonwealth officer.

**Key issue to be determined:**

- What is the most appropriate legislative mechanism for implementing the special administration regime?

## Part 4: The special administration regime – Key issues

## 1. Structure of a special administration regime

### 1.1 Ring fencing

Any model for the structure of a special administration regime must consider what structure will allow an administrator to best achieve the objectives set out in Part 2 above.

As might be expected in a process designed to explore the potential options for mitigating the risks that could arise following the financial distress or failure of a large electricity retailer, the focus of those objectives is on the retail business of the affected entity. Issues relevant to mitigating the risks of financial distress or failure of an electricity retail business will not be the same as the issues relevant to mitigating the risks of financial distress or failure of non-retail businesses conducted by NEM participants.

In structuring a special administration model, a significant design issue arises due to the manner in which we are instructed some of the large retailers in the NEM have elected to structure their retail electricity operations. In Schedule 2 we have set out corporate structure diagrams of eight large privately-owned retailers.

Unlike network service providers, retail participants in the NEM are not required to have their retail electricity operations quarantined, or 'ring fenced', from their other business operations.

'Ring fencing' requirements in an industry are most often seen where there is a need to separate business activities with a regulated monopoly element from those which are subject to a competitive market. This is to prevent the abuse of market power and has been implemented, for example, in Australia in respect of DNSPs. However, this is not the only purpose served by ring fencing or for which ring fencing may be deployed. Ring fencing also provides significant benefits in an insolvency context that are difficult to achieve through other mechanisms. It is commonly used by corporate groups to protect assets from the potential insolvency of other group companies. A frequently cited example of this in the context of electricity utilities is the case of Portland General Electric. Portland General Electric was acquired by Enron in 1997 but was ringfenced by the State of Oregon before the acquisition was complete. This protected the company's assets and consumers when Enron declared bankruptcy in 2001. Another example is the regime now being debated in the UK whereby banks may be forced to ring fence their retail and investment arms in order to protect savers' deposits from the high-risk operations of the banks' other areas.

There are a number of different approaches to ring fencing that may be adopted to achieve the specific objectives for which they are introduced. Not all approaches are appropriate to all circumstances.

Some examples of different approaches to ring fencing include:

- accounting / financial separation;
- accounting / financial separation with additional non-financial requirements;
- legal separation; and
- full ownership separation.

The NER currently allows the AER to develop distribution ring fencing guidelines[6], but does not require the same guidelines to be applied in each NEM jurisdiction, although such an outcome is allowed. In September 2012, the AER issued a position paper on Electricity Distribution Ring Fencing Guidelines as part of its review of electricity distribution ring fencing arrangements and consideration of the development of a national distribution ring fencing guideline. By way of example, the NER provides that the distribution ring fencing guidelines may include provisions for legal separation, accounting arrangements, cost allocation, information flows and amendment or waiver provisions[7].

In its position paper, the AER notes that the following ring fencing requirements or obligations are currently applied to distribution network service providers through jurisdictional ring fencing guidelines (which will continue to apply in each jurisdiction unless the AER amends, revokes or replaces the guidelines[8]):

(a) **legal separation** – Legal separation requires standard control services and other specified services to be provided by separate legal entities. However, entities may be owned by a holding company or subsidiary of the DNSP. Legal separation creates clear boundaries between providers of regulated distribution services and providers of other services.

(b) **accounting separation** – Accounting separation requires DNSPs to establish and maintain consolidated and separate accounts for the provision of distribution services and its other businesses. Accounting separation differentiates the costs of providing services, assets, liabilities and revenues between the providers of regulated distribution services and providers of other specified services.

(c) **allocation of costs** – Cost allocation methods require DNSPs to identify and allocate costs between their regulated and other services in accordance with an agreed method that limits the ability to subsidise non-regulated services by allocating costs associated with providing non-regulated services to regulated services.

[6] NER, 6.17.2(a).

[7] NER 6.17.2.

[8] NER, 11.14.5.

(d) **limitations on the flow of information** – Restrictions on information sharing are considered necessary to prevent the inappropriate access to and the use of information which may result in a related business gaining a competitive advantage through information obtained by the affiliated DNSP.

(e) **physical, staffing and functional separation** – Physical, staffing and functional separation addresses inappropriate sharing of facilities and information and inadvertent discriminatory behaviour in the provision of unregulated services.

(f) **waiving ring fencing obligations** – Waiver or variation provisions allow for flexibility in the application of ring fencing arrangements in particular circumstances.

(g) **non-discrimination** – Non-discrimination provisions require that a DNSP shall not deal with a related business on more favourable terms than it deals with another.[9]

However, the AER notes that there are currently significant differences in the ring fencing obligations on DNSPs in different jurisdictions – primarily in the areas of legal and accounting separation, allocation of costs and the treatment of waiver applications. For example, legal separation of a distribution business from retail and/or generation activities is required in Queensland, ACT and South Australia, but not in NSW, Victoria or Tasmania.

In the context of designing a model for a special administration regime for electricity retailers, it is legal separation of the retail business from the other business activities of retail participants in the NEM that is the major (although not exclusive) issue. This is because, ideally, an administrator appointed under the special administration regime would only be appointed over the retail operations that are at risk of causing financial contagion in the NEM should the ROLR regime be allowed to apply. In order to ensure that an administrator would have sufficient ability to continue to trade the failed retailer's business during the special administration, other requirements may need to be imposed on retailers to support the legal ring fencing. These would need to be considered in detail, but might include obligations in respect of intra-group contracts, such as hedge contracts and employment contracts that are necessary to run the retailer's electricity retail business.

External administrators may either be appointed over all or part of an entity's property or over the corporate entity itself. Some discussion of the differences between those kinds of appointment and their benefits and detriments are set out in section 1.2 below, together with an outline of issues that would need to be considered in more detail in the absence of ring fencing.

[9] AER, Position Paper, Electricity Distribution Ring Fencing Guidelines, September 2012.

> We expect that before taking any decision on whether or not to implement the ring fencing of retail operations in the NEM, policy makers will need to undertake a fulsome cost benefit analysis in consultation with retail market participants.
>
> If a form of ring fencing is to be introduced, further detailed consideration will need to be given to the form that the ring fencing will take and the extent of the obligations to be imposed on retailers.

### 1.2 Administrator appointed over property or the company?

#### (a) Introduction

Traditional external administration appointments may be divided into 2 broad categories:

- appointments over property (privately-appointed receivers, court-appointed receivers); and
- appointments over companies (voluntary administrators, deed administrators, scheme administrators, liquidators, provisional liquidators, judicial managers).

The differentiation arises logically from the objectives of the various appointments. Generally speaking, these may be summarised as:

- appointments over property - to protect the rights of parties over specific property;
- appointments over companies – either:
  - (A) to rehabilitate a failing company; or
  - (B) to realise a company's assets for the benefit of its stakeholders (e.g. creditors or shareholders).

To give context to these alternatives, the key relevant features of these alternatives as seen in traditional forms of external administration are described in (b) below. These may be compared with the features of a special administration regime for electricity retailers that we propose in section 3.

We note that if there is to be ring fencing of the retail operations of NEM participants that includes legal separation of retail operations into separate entities, the question of whether an appointment should be over property or the legal entity is no longer of practical relevance. In that circumstance, we would recommend that the appointment be over the company.

#### (b) Traditional external administration appointments

##### (i) Appointments over property

Receivership is the only form of external administration in Australia where the appointment is over a company's property (and possibly business), rather than over the company itself. Receivers are insolvency practitioners who are appointed in respect of a company to take control of specific property, or to get it in, so as to protect the rights of a party entitled to that property. They may be appointed privately by a secured creditor in accordance with the terms of a security document or by a court on application of a party seeking to protect its interests. Receivers are *controllers* of the corporate property over which they are appointed and as such have statutory duties imposed on them by the *Corporations Act* in order to protect the company and its stakeholders from abuse by the controller.

The property subject to a controller's appointment must be adequately identified prior to the appointment being made. In our view, it would be inadequate to rely on a broad statement such as 'all property related to the retail business'. If property is not adequately identified, the controller will be personally exposed to claims for conversion of that property should the property be sold (or otherwise improperly dealt with) and later found to have been outside of the scope of the appointment.

If a receiver has, under the terms of their appointment, the right to manage the affairs of the company, they are termed a *receiver and manager*. This is most often seen when a secured creditor appoints a receiver over all or substantially all of the property of its debtor.

(A) **Privately-appointed receivers**

- appointed under the terms of security agreement between a company and its creditor;
- charged with the realisation or management of the secured assets over which they are appointed;
- if appointed as receiver and manager, empowered to take control of the debtor's business as a going concern for the purpose of repayment of the secured debt, either through realisation of the secured assets or through the income generated by the debtor's business;
- in current commercial practice, receivers and managers will make an effort to restore the financial prosperity of the company whose affairs they are appointed to administer;
- will act as the company's agent;
- owe their primary duty to the secured creditor who appointed them;
- have statutory duties imposed on them by the *Corporations Act* as to how they may administer the debtor's assets – of primary importance is section 420A which obliges receivers to take reasonable care to ensure that, if sold, the secured assets are

sold for market value or, if there is no market value, for the best price reasonably obtainable – this is to protect other stakeholders from a receiver selling valuable assets at an undervalue sufficient to repay the secured creditor but leaving no residual benefit for anyone else;

- directors are not formally displaced, but the powers of the receiver supersede those of the existing company management in respect of control of the secured assets;
- claims against the company are not suspended or barred during receivership;
- receivership will be terminated on repayment of the debt owed to the secured creditor or, if there are insufficient assets to fully repay the debt, when all available assets are exhausted.

(B) **Court-appointed receivers**

- appointed by a court at its discretion as an equitable remedy whenever it is just and convenient to do so;
- in practice, applicants are usually secured creditors but appointments could be sought by ordinary creditors or the company itself;
- not appointed for the same purpose as privately-appointed receivers – act only as caretakers of the assets or the business, not vendors or company doctors;
- accordingly, have far more limited powers than privately-appointed receivers – for example, they will often have no power of sale except with permission of the court.

(ii) **Appointments over companies**

All traditional forms of external administration in Australia other than receivership involve an appointment of an insolvency practitioner to the company itself.

While the powers, duties, objectives and effects relevant to the various forms of appointment vary significantly, commonly seen features include:

- commenced by the company itself, by its creditors or by the court;
- appointed for the purpose of, or in aid of, the rehabilitation of a company or the realisation of its assets for the benefit of stakeholders;
- rehabilitation may involve the sale of all or part of the company's business or assets;

- powers of company directors and management cease and are entrusted to the external administrator;
- duties are to the relevant stakeholders – most often creditors where a company is insolvent, but potentially a broader category;
- accordingly, stakeholders are involved in the process through mandatory meetings of stakeholders;
- claims against the company are barred – the claim process is substituted by a proof of debt process;
- often other rights of third parties are affected by the administration;
- often a greater level of court supervision and direction than receivership;
- terminated when rehabilitation is complete (the company is returned to solvency) or when all assets of the company are realised and distributed to stakeholders.

(c) **Key issues**

(i) **If appointment over entity's retail assets only**

(A) What assets will come under the control of the administrator? Where will the line be drawn as to what is a 'retail business asset'? For example, are in-the-money hedge contracts retail assets that will come under the administrator's control?

(B) If only some of the assets are to be controlled, is it possible to determine the scope of those assets in advance or only on appointment?

(C) If control of any company assets remains with the company directors and management during the administration, how is the interaction between those parties and the administrator governed?

(D) Will the administrator have the ability to act as the company's agent generally so as to allow them to operate the retail business if a decision is made to trade that business on during the course of the special administration?

| **PROS** |
| --- |
| • Allows an administrator to only take responsibility for the limited part of the retailer's business that may be necessary to fulfil their objectives. |

- Perhaps more consistent with a view of an administrator being appointed solely as the implementer of an extended RORL-type orderly sale/transfer of customer contracts with no duties to the retailer's creditors or obligation to consider means to improve the company's situation (rehabilitation/restructuring etc) to achieve a better outcome for the retailer than may be achieved by a wholesale transfer of customer contracts.

**CONS**

- Extremely difficult to isolate the assets over which the administrator will be appointed and that may be necessary to allow the administrator to trade on the retail business until an orderly sale/transfer of the customer contracts can be completed.
- Practical difficulties in interaction between administrator and company management during the course of the special administration where there is an overlap in responsibilities.

(ii) **If appointed over the corporate entity of the retailer**

(A) What role will the administrator have in respect of the non-retail aspects of the retailer's business? The default will be that the administrator will displace the directors' control of all aspects of the company's businesses during the course of the special administration – although the regime may be able to be structured so as to allow the administrator to delegate certain powers back to the company directors (e.g. to allow them to continue to manage those parts of the company's business not directly relevant to the achievement of the objectives of the special administration).

(B) What obligations, if any, might the administrator have to the company's stakeholders? For example:

- may the administrator continue trading an unprofitable business at the financial expense of stakeholders?
- may the administrator cease trading the whole of the business of the retailer in circumstances where that action would destroy the value of non-retail assets may have been able to be realised profitably for stakeholders on a going concern basis?
- will there be any obligation on the administrator to attempt to preserve value for stakeholders during the special administration?

(C) Will government funding extend to the cost of subsidising the non-retail aspects of the retailer's business during the special administration?

**PROS**

- Clearly gives the administrator the authority of the board to manage all aspects of the company's business to further the objectives of the special administration.

**CONS**

- May require the administrator to involve themselves in decisions in respect of the company's business that are not strictly limited to those necessary to achieve the objectives of the special administration (e.g. in respect of a generation business operated by the retailer).
- The financial support required to support the company during the course of the special administration could potentially extend to support of non-retail aspects of the company's business.

(iii) **Other issues relevant to the question of assets v legal entity appointment**

(A) Can there be an appointment if the part of the company's business that is failing is not the retail side but other aspects? In that situation, might you have an appointment that effectively transfers out the only profitable part of the company's business for, potentially, no value to creditors?

(B) When the objectives of the special administration have been achieved and the administrator retires, what becomes of the remainder of the company's business? Whether the appointment is over property or the company itself, the outcome of the special administration will be that the retail business of the company is removed from the company. In the current market, will the companies over which an administrator could be appointed be viable if their retail business was effectively removed without other forms of support being offered? Is there a risk that the proposed special administration regime could cause a failure of other parts of the retailer's business (e.g. generation)?

> For the purposes of the remainder of this Report, we have assumed that any appointment will be over the legal entity of the retailer and that there will be legal ring fencing of the retail operations of NEM participants.

## 2. Appointment

### 2.1 Process of appointment

We contemplate that a special administration would be a court-supervised process commenced by a court application. The application would only be able to be made by specific qualified parties. Who those parties might be is discussed in section 2.3 below.

The alternative to court appointment is to allow an appointment to be made directly by the party that would otherwise be applying to court. This is a common feature in many forms of traditional administration (e.g. private receivership, voluntary administration) and has the advantage of allowing for the appointment to be made extremely quickly if necessary. While this would have some advantages (speed, reduced costs), it may expose the appointing party to the risk of administrative challenges as to the validity of the appointment that would not be a factor in a court appointment.

If a court is to be the appointing party, the implementing legislation would need to set out the necessary power of the court and the factors which need to be satisfied by the applicant in order for an appointment to be made. The power granted to the court in respect of the special administration will also determine the level of court supervision that may apply – for example whether court approval was necessary prior to any sale undertaken by the administrator. In general, insolvency practitioners are given wide discretion to conduct external administrations within the scope of their statutory duties without the need to seek court approval of their actions and such discretion may be preferable in respect of their conduct of special administrations as well.

If the model were to require court appointment, the implementing legislation would need to specify the basis on which the court is able to make an appointment and what powers it may exercise in response to the application. By way of example, in the UK regime, section 157 of the *Energy Act 2004* provides [in part] that:

> (1) On hearing an application for an energy administration order, the court has the following powers:
> (a) it may make the order;
> (b) it may dismiss the application;
> (c) it may adjourn the hearing conditionally or unconditionally;
> (d) it may make an interim order;
> (e) it may treat the application as a winding-up petition and make any order the court could make [under its winding up powers];
> (f) it may make any other order which the court thinks appropriate.
>
> (2) The court may make an energy administration order in relation to a company only if it is satisfied:
> (a) that the company is unable to pay its debts;
> (b) that it is likely to be unable to pay its debts; or

(c) that, on a petition by the Secretary of State under section 124A of the 1986 Act (petition for winding up on grounds of public interest), it would be just and equitable (disregarding the objective of the energy administration) to wind up the company in the public interest.

(3) The court must not make an energy administration order in relation to a company on the ground set out in subsection (2)(c) unless the Secretary of State has certified to the court that the case is one in which he considers (disregarding the objective of the energy administration) that it would be appropriate for him to petition under section 124A of the 1986 Act [to wind up the company in the public interest].

For both court appointment and direct appointment, prior consent to act of an identified administrator will need to be obtained. We expect that potential administrators will require comfort as to the level of funding that will be forthcoming from the government if they have any concern of their ability to recover their costs and expenses out of the assets of the retailer. This will also be a significant factor in how the administrator conducts the special administration. The administrator will not be required to engage in any conduct for which adequate funding has not been secured.

Appointments of external administrators are made on an individual basis (although joint and several appointments of 2 to 3 individuals as administrators are extremely common).

### 2.2 Trigger(s) to appointment

As discussed above, the primary purpose for establishing a special administration regime for electricity retailers is to provide an alternative to the ROLR regime that will operate in circumstances where it is considered that the ROLR regime may not be adequate or may lead to financial contagion in the market.

In order for that to be accomplished, there must be a window of opportunity during which a decision is made on whether to commence a special administration or, alternatively, to allow the ROLR regime to operate. Only one of the regimes will be able to operate at any given time.

Under the NERL, a designated ROLR will be appointed:

- automatically on the occurrence of a ROLR event[10]; or
- before the occurrence of a ROLR event on notice in writing by the AER[11].

ROLR events that will trigger the automatic appointment of a designated ROLR are:

(a) the revocation of the retailer's retailer authorisation;

(b) the suspension of the right of a retailer to acquire electricity from the wholesale exchange;

(c) the retailer ceasing to be a registered participant in relation to the purchase of electricity directly through the NEM;

[10] NERL, section 132(1).

[11] NERL, section 132(2).

(d) the appointment of an insolvency official in respect of the retailer or any property of the retailer;

(e) the making of an order or the winding up of the retailer or the passing of a resolution for the winding up of the retailer;

(f) the retailer ceasing to sell electricity to customers (except in certain circumstances, such as the transfer of its business or retailer authorisation); and

(g) any other event or circumstance prescribed by the National Regulations.

Importantly, we note that in respect of the automatic appointment on occurrence of a ROLR event, such an appointment is explicitly subject to:

> any determination by the AER in the circumstances of the particular case (including a determination that has the effect of over-riding the operation of subsection (1) so that an appointment under that subsection will be taken not to have been made)[12].

In order to achieve the objectives set out in Part 2 above, a special administration would need to be able to be commenced before any of the above ROLR events was triggered. This will require that third parties be obliged to give notice to the party with power to decide whether or not to commence a special administration before taking any action that would cause a ROLR event to be triggered. For example:

(a) the AER must give notice prior to revoking any retailer authorisation;

(b) AEMO must give notice prior to suspending the right of a retailer to acquire electricity from the NEM;

(c) a retailer must give prior notice if it wishes to cease being a registered participant in relation to the purchase of electricity directly from the NEM or cease selling electricity to customers;

(d) a party wishing to enforce a security interest over property of the retailer must give notice before taking any enforcement action;

(e) any party wishing to appoint an external administrator to a retailer or any of its property must give notice before making such an appointment; or

(f) any party wishing to seek an order or propose a resolution for the winding up of a retailer must give notice before making such an appointment.

We contemplate that receipt of such notice would be the relevant trigger for a qualified party to elect to commence a special administration. Any action taken in breach of this notice requirement would be deemed to be void. As the proposed restrictions imposed on third parties restraining them from exercising their rights while notice is given to the qualified parties are onerous and potentially commercially damaging, we would expect that a decision on whether or not to commence a special administration would need to be made by the qualified parties within a limited period of time, failing which the third party would be free to proceed with its proposed action. For example, the UK energy supply company administration regime restricts parties from taking similar kinds of

[12] NERL, section 132(3a).

action unless they have served notice of their intention to do so on the relevant decision makers and a period of 14 days has elapsed[13].

Even a shorter period of time, such as 5 business days, would be significant in a NEM context but a time period of this nature is likely to be necessary in order for the process to consider whether to pursue the special administration to be undertaken. A key issue will be to determine who will bear the risk of non-payment during this period, given that government funding will only commence cone a decision has been made to appoint an administrator. See further discussion of this issue in section 5.5(b) below.

For the purpose of this Report, we have assumed that the notice requirement (and the special administration regime generally) would apply to all electricity retailers in the NEM, although for the objectives of the regime to be achieved it may only be necessary for the regime to be invoked in the case of a large retailer failure.

**2.3 Qualified parties**

One or more parties will need to be charged with the responsibility of deciding whether or not to put a retailer into special administration and the power to apply to court to do so.

Consistent with its discretionary powers in the operation of the ROLR regime, we believe that it would be sensible for the AER to be a qualified party.

The NERL already imposes obligations on AEMO[14] and electricity retailers[15] to notify the AER without delay of any event, circumstance or matter which it has reason to believe may affect or give rise to affecting a retailer's ability to maintain continuity of the sale of energy to its customers or give rise to some risk of a ROLR event. These are summarised by the AER in its Retailer of Last Resort Plan[16], which also provides that distributors may (but are not obliged to) give similar notification to the AER. Under the NERL, the AER is the party that is being provided with the relevant information that will factor into a decision of whether or not to appoint an administrator.

However, as there will be a government funding commitment necessary to the special administration which will not be provided by the AER (see section 4 on cost recovery below), we would recommend that the relevant Commonwealth minister (if the Commonwealth is to provide the necessary funding) also be named as a qualified party, or as a party from whom consent must be obtained if an appointment is to be made.

We would expect that on receipt of a notice as contemplated in section 2.2 above, a preliminary decision would be taken by the AER as to whether allowing the ROLR regime to be triggered is appropriate and adequate to deal with the relevant trigger event. If it is, then the ROLR regime would be allowed to operate as usual. If it is not, then the AER would advise the relevant Commonwealth minister that it may be

[13] See *UK Energy Act 2004*, sections 160 through 164.

[14] NERL, section 150(1).

[15] NERL, section 150(2).

[16] AER, Retailer of Last Resort Plan, section 2, August 2012, version 3.

appropriate to trigger the special administration regime in respect of the affected retailer. That advice would need to make clear the AER's assessment of whether allowing the ROLR regime to operate for the distressed retailer would risk cascading ROLR defaults, give an assessment of the scope of the risk and consequences of such cascading ROLR defaults and provide the minister with any other information that the AER thinks necessary to facilitate the minister's decision.

This is the process that has been adopted in the UK where it is the Secretary of State who provides funding to energy supply company administrations. Qualified parties to apply to court to appoint an energy administrator in that jurisdiction are therefore:

(a) the Secretary of State; or

(b) with the consent of the Secretary of State, the Gas and Electricity Markets Authority.

An important consideration in determining who will be a qualified party for the purposes of an appointment will be ensuring that whomever is nominated is able to act promptly in the making of an appointment so as not to defeat the purpose of the special administration regime or cause unnecessary harm to third parties whose rights are restrained during the decision making period.

## 3. Features of a special administration regime

### 3.1 Powers/duties/liabilities of the administrator

(a) **Powers**

We envisage that the legislation introducing the special administration regime would provide that the administrator would have broad powers to do all things necessary or convenient to be done for or in connection with, or as incidental to, the attainment of the objectives for which the administrator was appointed. To that end, a general statement as to the breadth of the administrator's powers (such as proposed in the previous sentence) is preferable, with any specifically enumerated powers being merely examples of common exercises of that general power.

If they are to be explicitly set out in the legislation, some specific powers that we expect the administrator to have include:

(i) to do all acts and execute in the name and on behalf of the company all deeds, receipts and other documents, using the company's common or official seal when necessary;

(ii) to enter upon and take possession of the property of the company;

(iii) to call in, collect or convert into money the property of the company;

(iv) to borrow or raise money, whether secured upon any or all of the assets of the company or unsecured, on any terms that the administrator sees fit;

(v) to pay creditors of the company or compromise claims of creditors on any terms that the administrator sees fit;

(vi) to carry on the business of the company on such terms and conditions and for such purposes and times as the administrator thinks fit;

(vii) to sell any or all of the property of the company including the whole of the business or undertaking of the company at any time and for any value the administrator thinks fit, either by public auction or by private contract; and

(viii) to close down the whole or any part of any business of the company.

Examples of the specific powers granted to different forms of external administrators under the *Corporations Act* regime are set out in Schedule 3.

(b) **Duties**

Unlike most forms of external administration under the *Corporations Act*, the primary duties of an administrator in special administration would not be to creditors, but rather to ensure that the objectives of the special administration are achieved in the most efficient and timely manner possible. Any supervisory or consultative role in the special administration would be held by the qualified parties nominated in accordance with section 2.3 above and not by creditors. The administrator should not, however, be entitled to ignore the interests of the retailers creditors.

We would recommend that the administrator be obliged to exercise their powers and duties in a manner which, so far as it is consistent with the objectives of the special administration to do so, best protects:

(i) the interests of creditors of the company as a whole; and

(ii) subject to those interests, the interests of the members of the company as a whole.[17]

Examples of the specific duties of different forms of external administrators under the *Corporations Act* regime are set out in Schedule 3.

(c) **Liabilities of the administrator**

Different forms of external administrator under the *Corporations Act* regime have different levels of personal liability imposed on them in acting pursuant to their appointment. These are described in Schedule 3.

For the few forms of non-*Corporations Act* external administration that have been introduced in Australia, it is common for the implementing legislation to provide for the external administrator to have statutory immunity from liability. For example:

(i) judicial managers appointed under the *Insurance Act* have statutory immunity from liability as long as they act 'in good faith'; and

[17] This formulation replicates that applied to energy administrators under the UK *Energy Act 2004*.

(ii) statutory managers appointed under the *Banking Act* have statutory immunity from liability unless that immunity is lost because of the manager's fraud, dishonesty, negligence or wilful failure to comply with the provisions of that Act.

As the government will be funding the special administration – including, most likely, any liability accrued by the administrator that is unable to be recovered out of the retailer's assets, we would recommend that administrators similarly be granted broad statutory immunity from liability. We prefer the more specific formulation of circumstances in which immunity will not be granted as set out in the *Banking Act* over that in the *Insurance Act* and would recommend that that formulation be adopted in respect of special administration.

### 3.2 Consequences of appointment

We recommend that any legislation introducing a special administration regime afford the insolvent retailer at least the same protections extended to companies in different forms of external administration under the *Corporations Act* during the course of the special administration. This will be necessary to ensure that the administrator retains the ability to trade on the retailer's business for as long as is necessary to ensure an orderly transfer of customers to other retailers. These common protections would include:

- restrictions (or prohibitions) on the enforcement of security by secured creditors;
- a moratorium on the commencement or continuation of court proceedings against the retailer or in relation to any of its property; and
- limitations on the ability of owners or lessors of property used or occupied by the retailer to recover that property during the course of the special administration.

More detail on the specific protections afforded in the major forms of external administration under the *Corporations Act* is set out in Schedule 3.

In order to achieve the specific objectives of the special administration, we would recommend that additional protective measures be introduced for the duration of the special administration such as:

(a) prohibitions or restrictions on counter-parties to contracts with the retailer exercising rights of termination which may include, for example, the potential termination of the retailer's hedge contracts or other financial arrangements;

(b) prohibition or restrictions on the exercise of other contractual rights such as the acceleration of debt, the closing out of transactions, the repudiation of obligations etc.;

(c) restrictions on the ability of AEMO to suspend the retailer from the NEM;

(d) restrictions on the ability of the AER to revoke the retailer's retail authorisation;

(e) prohibitions on the revocation of any licences necessary for the continued operation of the retailer (such an Australian Financial Services Licence under the *Corporations Act*);

(f) providing super-priority to parties who provide new financing to the generator (for example, over pre-existing secured debt); and

(g) exemption from *Corporations Act* prohibitions on insolvent trading for the duration of the special administration.

Measures such as those described at (a) and (b) above are not seen in traditional forms of external administration in Australia under the Corporations Act. They do exist, however, in a more limited form in Australian judicial administration[18] and in a more fulsome scope in Chapter 11 restructurings in the United States[19]. The drafting of any proposed restrictions on third party contractual rights would need to be carefully considered. It is undesirable to restrict third party rights any more than necessary to achieve the objectives of the special administration. However, if stated too narrowly, those restrictions may not be sufficient to allow an administrator to effectively continue to trade the failed retailer's business and preserve any potentially recoverable value from its assets during that process.

### 3.3 Length of the special administration

The administrator should remain in place until all customer contracts are transferred to other retailers. It is desirable that this period be as short as possible, having regard to the need to fulfil the objective of the regime. A requirement for prompt action will also:

- reduce the 'moral hazard risk' whereby market participants assume an implicit government guarantee of large retailers; and
- give guidance in relation to the likely extent of financial support required from the Commonwealth government.

Sufficient time should be given to allow:

(a) the administrator to make an assessment of the distressed retailer and the market conditions and to determine an appropriate course of action;

(b) other retailers to 'gear up' for additional customers (including, for example, provision of greater credit support to AEMO and DNSPs and arranging additional hedge cover);

(c) a sale process to be conducted whereby other retailers bid for the customers of the distressed retailer; and

(d) a default allocation of the customers of the distressed retailer to other retailers if the sale process does not result in a transfer of all customer contracts to new retailers.

### 3.4 Major stages of a special administration

Below we outline what we anticipate would be the major stages of a special administration, and highlight some issues that will need to be considered, either in the

[18] *Insurance Act 1975*, section 62V(2).

[19] US *Bankruptcy Code*, 11 USC § 365(e)(1), 541(c).

design of the special administration model or by an administrator during the course of a special administration.

For the purposes of this section of the Report, we have assumed that:

- as noted in Part 2, 'rescue' or rehabilitation of the distressed retailer will not be a key objective of the special administration;
- a sale process will be undertaken prior to any default allocation of customers to other retailers. Strictly, this is not necessary to achieve the objectives set out above. However, this is a key distinguishing feature of the special administration regime that is not contemplated in most of the options that involve amending the existing ROLR regime[20]; and
- the conduct of the sale process will be at the discretion of the administrator and will not require the approval or sanction of the court before being completed.

(a) **Assessment period**

Following appointment, the administrator will need to make an assessment of the financial position of the distressed retailer and the broader electricity retail market. This will inform the administrator's actions, to the extent that they are not predetermined (by legislation or otherwise). Insolvency practitioners are adept at making such assessments and we would expect this part of the process to be conducted promptly.

> Material issues that the administrator will need to consider include:
>
> (a) competition aspects of the disposal of a large number of retail contracts (this is discussed further in section 3.5 below); and
>
> (b) how participation in a sale process (rather than reliance by retailers on the default allocation mechanism) will be encouraged.
>
> In respect of these issues we note:
>
> - If there are retailers willing to accept new customers, they may be keen to be involved in a sale process as they may fear missing out if they choose not to participate.
> - On the other hand if retailers consider it likely that the default allocation mechanism will be invoked, resulting in a transfer of customers without payment, there may be little market interest in a sale process.
> - The design of the default allocation mechanism is likely to impact upon any retailer's decision whether or not to participate in a sale process.

[20] Note that option 5.4 (Delaying the triggering of a ROLR event) and option 5.5 (Delaying the appointment of designated ROLRs) do contemplate the possibility of a tender or auction process.

(b) **Sale Process**

The administrator will need time to conduct a process allowing for other retailers to purchase the customer contracts of the distressed retailer. We assume that key objectives of any sale process would be:

- to maximise the proceeds from the sale of customer contracts;
- to avert any danger of financial contagion in the NEM; and
- to minimise the costs incurred by Commonwealth government (including by completing the sale process promptly).

While the sale process would need to provide for the sale of customer contracts, the administrator could also choose to sell other assets of the distressed retailer. Different assets could be sold to different purchasers or all assets of the distressed retailer could be sold to the one purchaser.

This sale process is to be contrasted to the ROLR regime or the default allocation mechanism proposed for the special administration regime. Any sale process would result in the transfer of some or all of the existing retail contracts of the distressed retailer to a new retailer with customers continuing to be supplied electricity on the terms and conditions of their original contract with the distressed retailer. Under ROLR or the default allocation mechanism, the customer contracts would be terminated. Customers would be transferred to the new retailer on default or pre-established terms under a new contract.

The model could also be structured so as to allow the administrator the option of negotiating a sale of the corporate entity of the distressed retailer itself (rather than of its assets). This is more unusual, as it involves the transfer of the shares of the distressed retailer owned by third parties, but there is a precedent to be found in the deed administration process in voluntary administration under the *Corporation Act*. Since 2007, a deed administrator has had the right to transfer shares in the company if it obtains the prior consent of the owner of the shares or leave of the court (if leave of the court is obtained the transfer may be done despite opposition from the shareholders)[21]. To grant such leave, the court must be satisfied that the transfer will not unfairly prejudice the interests of the members of the company. This condition will generally be met if the company is insolvent and there is no residual financial benefit that would be available to company members on a winding up of the company.

(i) **Options for a sale process**

(A) Competitive sale process

An auction or tender process could be adopted whereby retailers bid for some or all of the assets of the distressed retailer that are for sale.

[21] *Corporations Act 2001,* section 444GA.

Decisions would need to be made on key features such as:

- the confidentiality of bids;
- the extent to which negotiation is desirable or permitted following the submission of bids; and
- the rules, including timeframes, applicable to bids.

(B) Bilateral sale

An alternative to a competitive sale process would be sale arrangements agreed separately with one or more retailers. This would involve separate negotiations with the relevant retailers. The time and cost involved would depend, among other things, on the willingness of the retailers to purchase the customer contracts.

There are a number of issues that would need to be determined in respect of both of these options, including:

(a) Should the form that all special administration sale processes will take be determined (and associated pro forma documentation be prepared and available to the market) in advance?

On this issue we note that:

- The advantage of this approach would be the market knowledge of the process, facilitating prompt action by all participants.
- The disadvantage of this approach is that it takes away the flexibility that the administrator would otherwise have to determine the most appropriate sale process in the specific circumstances. As a result, it may lead to a less optimal outcome, particularly in terms of the sale price achieved for the customer contracts.
- A further disadvantage is that additional upfront costs would be imposed on the entity charged with the preparation of a sale plan and associated documentation. We would expect this to be a consultative process which would share some of the disadvantages identified in Option 5.2 of the Options Paper (which requires the AER to develop plans for how to designate multiple ROLRs), in particular, increases in costs for regulators.
- In our view, the preferable approach is to allow the administrator to determine how best to conduct the sale process. This will provide flexibility for different approaches taking into account the many factors that may vary, including the size of the distressed retailer and the electricity market conditions at the time.

(b) Should the court or relevant Minister be required to approve any sales prior to their completion?

On this issue we note that:

- Supervision by the court or the Minister would provide a check to ensure that the objectives of the special administration regime are being pursued.
- However:
  - it is difficult to see the benefit to requiring approval of sales where the likely alternative to the sale is that the default allocation mechanism will be triggered;
  - it is also difficult to justify an intrusion into the administrator's discretion in the conduct of the sale process in circumstances where the administrator will be in the best position to assess the relative benefits of the available sale options and will continue to be bound by duties to fulfil the objectives of the special administration.
- In our view, it would be preferable for the administrator to be granted the discretion to conduct the sale process within the scope of his or her appointment without having to seek approval from the court or the Minister prior to completion of any sale.

(c) Should a legislative transfer mechanism be established to assist in implementation of the sale process?

On this issue we note that:

- A mechanism of this nature would assist in overriding contractual provisions which could otherwise slow down or prevent a quick transfer of retail contracts (such as, for example, confidentiality provisions that may restrict disclosure of contracts or time consuming requirements to obtain third party consents).
- Co-operative state legislation would be required to implement a mechanism of this nature to ensure that any benefits introduced apply to contracts in all jurisdictions.

(c) **Default allocation mechanism**

A default mechanism will be required to ensure that any customers whose contracts are not purchased as part of a sale process are allocated to alternate default retailers. Key features are likely to include:

(i) the need to accommodate the potential allocation of customers to multiple default retailers (although the aim of the sale process will be to dispose of customer contracts, leaving few, if any, customers to be allocated through the default mechanism, the mechanism will need to be designed to cater for the possibility that there will remain a large number of customers to be allocated to default retailers);

(ii) a means of accommodating a situation where some, but not all, customers have had their contracts transferred to a new retailer pursuant to the sale process;

(iii) a published formula or other transparent mechanism for allocation of customers as between default retailers (this mechanism should be pre-determined and not left to the discretion of the administrator); and

(iv) prompt activation once the sale process is complete and it is evident that not all customer contracts have been successfully transferred to new retailers through that process, bearing in mind the overall objectives of the special administration and the need to avoid the risk of financial contagion.

The default mechanism will be an involuntary and mandatory process. Accordingly, default retailers to whom former customers of the distressed retailer are allocated should not be required to take on those customers under the terms of their original contracts with the distressed retailer. Rather, the allocated customers would need to accept either the standard terms and conditions of sale of the new retailer or specified pre-published terms and conditions which would apply in circumstances where the default mechanism was involved. This would be similar to the position under the ROLR regime, where small customers allocated to ROLRs are required to accept the ROLR's standard contract terms and conditions and large customers are required to accept the pre-published terms and conditions.[22]

To establish a robust default allocation mechanism, up-to-date information in respect of the capacity of other retailers to accept new customers will be required. This may involve giving AER additional information gathering powers and ensuring that this information is maintained and current.

During the sale process that precedes any activation of the default allocation mechanism, the lack of certainty in relation to the outcome is likely to hinder potential default retailers in ensuring that they put in place arrangements to cover requirements such as provision of additional credit support to AEMO and DNSPs. However, if the default allocation mechanism is sufficiently certain and transparent in its operation, retailers may be more likely to establish contingency plans for different possible sale outcomes allowing them to satisfy these requirements more promptly than would otherwise be the case.

(d) **Termination of the special administration**

The administrator should only remain in control of the distressed retailer until the objectives of the special administration have been met and, in particular, all

[22] NERL, sections 145, 146.

electricity customers have been transferred to another retailer. It may be possible to include a maximum timeframe for the administrator to complete its activities. However, we do not think this would be appropriate. While such an approach may offer some certainty, it is likely to cut across the objectives of the regime and result in a less than optimal outcome.

Once the objectives of the special administration have been met, the administrator would retire and the special administration regime would terminate. One of the obligations imposed on the administrator should be that the Minister be informed of the progress of the special administration and the likely date for achieving this aim.

When the special administration's objectives have been achieved, the company would either be returned to the control of its directors or placed directly into liquidation. Which of these alternatives is pursued could be a decision of the administrator or the court (on recommendation of the administrator). Alternatively, the regime could simply return the company to the control of its directors on termination and leave any decisions about its fate going forward to them.

### 3.5 Competition issues

The transfer of a significant number of new customers to an existing large retailer may breach the prohibition set out in section 50 of the *Competition and Consumer Act 2010* on acquisitions that have the effect or likely effect of substantially lessening competition in a market.

Set out below is a high level discussion of options that could be considered to address this issue.

(a) **Design scheme so as not to trigger the prohibition**

Section 50 of the Competition and Consumer Act is directed at acquisitions of shares or assets.

It may be possible to devise a scheme whereby there is no acquisition of assets and, consequently, no breach of section 50. This may involve some form of statutory allocation of customer contracts. However, we expect that, if the new retailer is making payments relating to this allocation, it would be difficult not to characterise these as payments for the acquisition of the contracts. Attempting to circumvent section 50 in this way may result in a scheme that is more focused on avoiding breaches of competition law than on achieving key objectives such as avoiding financial contagion in the NEM.

(b) **Commonwealth legislative override**

The Commonwealth government can pass legislation that overrides the provisions of the Competition and Consumer Act. If an acceptable alternative solution cannot be found, Commonwealth legislation may be required to support the special administration regime.

(c) **Authorisation of the special administration regime**

The Australian Competition Tribunal (***ACT***) may authorise anti-competitive conduct if it is satisfied that the public benefit from the arrangement outweighs the public detriment. This provides legal immunity to any authorised conduct.

This course of action would involve approaching the ACT to seek authorisation. The ACT would then conduct a public consultation process, issue a draft determination and then a final decision. The ACCC would participate in this process. In making its decision, the ACT will take into account public benefits, not just the competitive effects of the proposed conduct. In the normal course this is a lengthy process of at least three months with the likelihood of extensions to the statutory timeframes.

In the case of a special administration regime, an approach to the ACT would involve seeking a form of authorisation for the special administration regime as a whole rather than a particular acquisition. As the detriment of any acquisition resulting from the regime would vary depending upon the ultimate outcome of any sale process, the ACT may not be willing to provide this form of authorisation.

(d) **ACCC approval of acquisitions**

In ordinary circumstances, there is no requirement to seek approval to an acquisition of assets. However, if any acquisition has the effect or likely effect of substantially lessening competition, the purchaser will be in breach of the Competition and Consumer Act and the ACCC can take action in the Federal Court to seek remedies. Available remedies include an injunction, divestiture orders and financial penalties. The ACCC has a discretion in relation to the remedies that it seeks.

In light of this, it is common practice for purchasers to seek informal clearance from the ACCC to proposed purchases. In the normal course, this process takes 8 weeks or more. The normal timeline for this process and the uncertain results do not fit well with the objectives of the special administration regime.

However, it may be possible to approach the ACCC when designing the special administration regime to seek their agreement to shortening the timeframes for issuing clearances and agreeing guidelines which are to apply in the circumstances of a large retailer failure. The ACCC may be amenable to enter into a binding Memorandum of Understanding with those States who participate in the NEM in relation to the roles and actions of the parties should there be a large retailer failure and consequent sale process.

The approach outlined in paragraph (a) above is likely to lead to distortions and the options suggested in paragraphs (b) and (c) are likely to be problematic as any legislative sanction or ACT authorisation would be sought for a scheme with uncertain results. Accordingly, the preferable option is the final option and this should be explored further.

The competition issues associated with any sale will be one factor that the administrator will need to take into account in deciding how best to conduct a sale process.

## 4. Cost Recovery

### 4.1 The requirement for financial support

Financial support may need to be provided to the administrator for its services, including the cost of continuing to supply the distressed retailer's customers during the special administration. To the extent that any funding provided during the course of the special administration was not fully recovered by the Commonwealth government from the distressed retailer, any shortfall would be recovered through a cost recovery mechanism.

Set out in section 4.2 below is a discussion of options for recovery of costs incurred by the Commonwealth government.

We have not been asked to address the following issues in this Report:

- the nature of the costs that will attract government funding (however, we expect that this would include any shortfalls in wholesale market payments or distributor payments and retailer back office costs);
- the form of the financial support that the Commonwealth government will provide (however, we expect that this would comprise loans, indemnities and guarantees);
- the extent of cost recovery (ie whether all costs or a subset of costs will be recovered) and how this will be determined; or
- cost recovery mechanisms for any other affected parties, such as retailers who are allocated customers through a default allocation mechanism.

### 4.2 Options

Set out below is a brief discussion of options available for the recovery of the costs incurred by the Commonwealth government in respect of the special administration regime.

(a) **Cost recovery from the distressed retailer**

The Commonwealth government should recover its costs, in the first instance, from the distressed retailer. This may be through the repayment of any loans made by government to the distressed retailer (if, for example, the distressed retailer secures other finance and is able to be rehabilitated) or from funds that may be available from the sale of customer contracts or other assets (if the administrator's role extends to the sale of other assets).

The special administration regime could be designed so that Commonwealth government funding is repayable by the distressed retailer in priority to other creditors. Consideration must in that case be given to the potential intrusion on the pre-existing rights of creditors (in particular secured creditors) of the distressed retailer and the possible consequences that such a priority might have on the costs of funding available to retailers.

Examples of specific priorities given to parties over secured creditors in traditional insolvency regimes include:

- the *Corporations Act* allows voluntary administrators to recoup costs and expenses incurred during the administration out of a company's circulating assets in priority to creditors with security over those assets (but only until such time as the secured creditor enforces its security)[23]; and
- the *Insurance Act* allows the Federal Court to give a judicial manager's remuneration and allowances any priority in recovery from the insurer's assets over existing security interests in those assets that it sees fit[24].

Any statutory priority given to government funding of a special administration over existing secured creditors of the distressed retailer is likely to be a controversial issue. Further, even if such a priority were to be legislated, there would always be the possibility that the assets of the distressed retailer would not be sufficient to fully reimburse all of the funding advanced by the Commonwealth government. Accordingly, cost recovery mechanisms such as those described below, will also need to be considered to allow the Commonwealth government to recover any shortfall.

(b) **Cost recovery by the Commonwealth government**

(i) **Industry levy**

One means for the Commonwealth government to recover the costs it has incurred may be to pass legislation imposing a levy on particular participants in the NEM.

However, any levy imposed by the Commonwealth on participants in the NEM may be subject to challenge on constitutional grounds. Under the Commonwealth Constitution the Commonwealth government may not pass taxation laws that discriminate between States or parts of States.[25] Any levy on industry participants that does not include

[23] *Corporations Act* 2001, section 443E.

[24] *Insurance Act* 1973, section 62S(2).

[25] *Commonwealth of Australia Constitution Act* (Cth), s 51(ii).

businesses in Western Australia may be seen to be discriminatory and consequently contrary to the constitution.

(ii) **Taxpayer levy**

The Commonwealth government could impose a levy on all taxpayers to cover the costs associated with a special administration regime. This approach would distribute the costs across the broadest base as all States and Territories would be affected, not just those which participate in the NEM. It would be collected through the income tax system and may be structured to apply on a sliding scale with exemptions for low income earners. The Queensland flood levy is an example of a levy of this nature imposed on taxpayers for the 2011-2012 financial year.

We note, however, that there may be a reluctance to impose a levy on taxpayers from jurisdictions not affected by the retailer failure or not covered by the NEM.

(c) **Cost recovery under co-operative State laws**

A cost recovery scheme could be established under co-operative State-based laws enacted by all States that participate in the NEM. An industry levy is likely to be most appropriate and could take a number of forms. Key options are described below. These options are based on the assumption that the cost recovery amount (the ***SAR Payment***) would be determined (perhaps by AER with input from the Commonwealth government) and recovered by way of one or more of the options outlined below. Arrangements would then need to be put in place for remission of the proceeds to the Commonwealth government (as discussed in section 5.7 below).

**OPTIONS**

(i) **Network service provider levy**

This option would involve imposing the SAR Payment on all or some TNSPs or DNSPs. Each DNSP or TNSP would pass through their portion of the SAR Payment to Distribution Network Users or Transmission Network Users (as appropriate). In either case, this will mean that increased prices are payable by retailers. This would generally lead to increases in retail prices to accommodate the increased network services charges payable by the retailers.[26] As it is likely that the SAR Payment amount would be significant, payment arrangements would need to be structured so that payment is made over a period of time.

[26] Note that there may be some exceptions where retail prices are regulated. For example, regulated retail tariffs in Queensland for the 2012-13 financial year were frozen by the responsible Minister. The distributor, Energex was directed to lower the fixed component of its network charge to retailers for residential customers so that retailers were not negatively impacted. However, Energex was provided with a subsidy to compensate it for the impact of the freeze.

A benefit of imposing the levy on TNSP's is that any consumers who are directly connected to the high voltage network would, ultimately, contribute to the SAR Payment. If the levy were imposed on DNSP's, this would not be the case.

There are a number of established processes in the NER for the pass through of unforeseen costs incurred by TNSPs and DNSPs to network users. In particular, Rules 6.61 and 6A.7.3 each set out a regime under which DNSPs and TNSPs, respectively, may pass through certain categories of unforeseen costs incurred or saved in any regulatory year provided that those costs exceed a materially threshold of one percent of the annual revenue requirement (for a DNSPs) or one percent of the maximum allowed revenue (for a TNSPs) for that regulatory year[27].

Under those Rules, if a prescribed pass through event occurs and the cost threshold is exceeded (resulting in the occurrence of a positive or negative change event), the DNSP or TNSP may seek AER approval to the pass through of associated costs. Equally, the AER may require a DNSP or TNSP to pass through cost savings.

There are some examples where the materiality threshold does not apply to the pass through provisions. For example, for TNSPs, the materiality threshold does not apply to network support events[28]. Similarly, if the amount of land tax payable by SPI PowerNet in Victoria differs from the forecast amount, the difference is deemed to be a pass through event and either a positive or negative change event, regardless of whether the materially threshold is exceeded[29]. In these two examples, the pass through operates effectively as a true-up of actual costs against anticipated costs.

The ROLR cost recovery scheme under the NERL operates under the existing pass through provisions for DNSPs, but with some amendments as set out in section 167 of the NERL. Under this scheme, the AER must make a determination that one or more DNSPs are to make payments as part of a cost recovery scheme. Any such ROLR cost recovery scheme distributor payment determination is taken to be a positive change event without any reference to the materiality threshold and any payments to be made are taken to be approved pass through amounts[30].

[27] NER, Chapter 10, definition of 'materially'.

[28] NER, Chapter 10, definition of 'materially'. Pass through of amounts in respect of network support events is dealt with in Rule 6A.7.2. Network support events occur when TNSPs use means other than network augmentation to support the network, such as local generation, co-operation or demand side responses.

[29] NER, 11.6.21(d).

[30] NERL, section 167(2), (4).

The NER also sets out an alternative cost recovery scheme which applies to jurisdictional feed-in schemes and climate change funds[31]. These schemes impose obligations on DNSPs to make payments or apply credits to other parties or into a government fund. These payment amounts are not considered under the distribution determination process. Rather, recovery of the payments or foregone revenue is addressed through the annual pricing process with adjustments made annually for any over or under recovery. No materially threshold applies to recovery of these costs.

Any of the processes described above could be used as a model that could be adapted for recovery of the SAR Payment. The advantage of the approach adopted for the ROLR cost recovery scheme is that the pass through occurs without any need for further regulatory processes. On the other hand, if the AER is required to approve the pass through, this would provide regulatory oversight of how that pass through occurs, including over what period. This will be relevant in determining the short and long term impact of the SAR Payment on retail customers and may be preferable given that the likely quantum of any SAR Payment will not be known when preparing new legislation.

While we would expect any SAR Payment to be significant and to satisfy any materiality threshold, this will depend in part on how the payment is structured and the period over which payments are to be made. A decision may be required as to whether a materiality threshold should apply.

Regardless of whether the SAR Payment is imposed on TNSPs or DNSPs, a decision would be required as to how to allocate the SAR Payment amongst the network service providers. Options include allocating payments based on customer numbers or number of connections. The arrangements for setting and collecting the energy safety levy in Western Australia provide a precedent in this regard. These arrangements are very flexible and allow for the imposition of a levy on both electricity distributors and transmitters. The levy has been imposed on these industry participants on a proportional basis, by reference to the number of consumer sites that have an electrical installation connected directly to the relevant network. Participants with less than 500 consumer sites connected to their network have been exempted. These arrangements are described briefly in the attachment.

[31] NER 6.18.7A.

(ii) **Retailer levy**

This option would involve imposing charges directly on some or all retailers under the NERL. This would generally lead to increases in retail prices to ensure that the retailers are reimbursed for the extra charges imposed upon them. A decision would be required as to how to allocate the SAR Payment amongst the retailers.

(iii) **Consumer levy**

This option would involve imposing additional charges directly on electricity consumers. These charges could take a number of forms, including those set out below. In each case, retailers would collect the payments and remit them to the appropriate entity.

(A) Upfront fees could be imposed on transferred customers or some broader group of customers. The amount of these fees would need to be reasonable, bearing in mind issues of affordability for electricity consumers.

In the ROLR regime this is one means by which the costs of the designated ROLR can be recovered. However, under the ROLR regime, the ROLR is seeking to recover its own costs, not to recover costs that are then remitted to another entity. Further, where a special administration regime has been in place, upfront fees are unlikely to be sufficient, on their own to cover the costs incurred. However, they may form a component of a cost recovery scheme.

(B) Retail tariffs could be increased for a finite period. The amount of any increase would need to be reasonable, bearing in mind issues of affordability for electricity consumers. The increase would need to apply until the full SAR Payment was recovered.

The increase could take the form of a fixed levy on all electricity customers.

As for the upfront fee option discussed above, in the ROLR regime this is one means by which the costs of the designated ROLR can be recovered.

An example of a fixed levy imposed directly on electricity consumers is that adopted for the recovery of the costs of provision of ambulance services in Queensland. This scheme is outlined in the attachment.

**ISSUES**

The issues discussed below are relevant to each of the options described above.

(i) **Constitutional issues – excise duties**

The Commonwealth government has exclusive power to impose customs and excise duties[32]. Care would need to be taken in designing any industry based scheme whereby payment obligations are likely to be passed through to electricity consumers to ensure that the payments are not characterised as excise duties and, consequently, beyond the power of the States to impose. A duty of excise is a tax on a step in the production, manufacture, sale or distribution of goods. Linking payments to the amount or value of electricity sold or consumed is particularly problematic in this regard however, it is not essential that the amount of the tax be determined in this way for a tax to be characterised as a duty of excise. It is the substantive operation of the tax which will determine whether or not it is a duty of excise.

A cost recovery scheme that operated in the electricity industry in Victoria until 2004 was challenged in the High Court on the basis that the levy imposed was an excise. This scheme is outlined in Schedule 4.

(ii) **Payment Flows**

An industry levy imposed under State-based law would provide for the levy to be paid to the relevant State governments. Where the levy is imposed on an industry participant, the participant would pay this directly to the relevant government entity. In the case of a levy imposed on customers, it is likely that this would be collected by retailers and remitted by them to the State. This would involve the imposition of additional administrative functions and associated costs on retailers.

Arrangements would need to be put in place to provide for the transfer of funds collected by the State governments under the levy arrangements to the Commonwealth government to reimburse the Commonwealth government for costs incurred in supporting the energy administration. These are considered further in section 5.7, below.

(iii) **Legislative amendments**

Each of the options described above are likely to involve new State-based legislation and possibly amendments to the NEL, the NERL or the NER. Likely amendments are considered further in section 5.5 below. Further, some jurisdictions may need to take

[32] Commonwealth of Australia Constitution Act (Cth), section 90.

legislative or other action to allow retailers to pass such payments on to consumers. This is not an issue in Victoria or South Australia, where there is no longer any regulation of retail prices for small customers.

## 5. Implementation of a special administration regime

### 5.1 New legislation to introduce regime

We anticipate that the most efficient way to introduce a special administration regime would be through new legislation. This legislation would set out matters including (but not limited to):

(a) the objectives of the special administration;

(b) the means by which the special administration is commenced;

(c) specific restrictions on third parties taking action to trigger a ROLR event without notice, including by the commencement of a traditional insolvency process;

(d) restrictions on third party rights during the course of the special administration;

(e) provisions establishing the default mechanism for allocation of customer contracts;

(f) provisions in respect of financial support of the special administration; and

(g) provisions in respect of the cost recovery mechanism.

We would propose that the special administration regime be introduced through State co-operative legislation, rather than Commonwealth legislation for the reasons set out in section 5.2 below.

### 5.2 State co-operative legislation v Commonwealth legislation

A significant difference between a State-legislated regime and a Commonwealth-legislated regime is that under Commonwealth legislation there is the need to consider whether any of the provisions involve an unconstitutional acquisition of property other than on just terms (contrary to section 51(xxxi) of the Constitution).

One of the main features of the proposed special administration regime would be the implementation of a transfer of the distressed retailer's customers to other retailers. This includes the operation of a default mechanism whereby those customers may be required to be transferred for no compensation. While this may not be possible under Commonwealth legislation, it would not be an issue for a State-legislated regime.

Further, any Commonwealth legislation would need to recognise that the NEM does not include Western Australia or the Northern Territory, and that the NEL, NERL and National Electricity Rules are State co-operative legislation.

### 5.3 Interaction with *Corporations Act* insolvency regime

It is not intended that special administration be the only form of external administration ever available to electricity retailers. Where an order for special administration is made, however, that regime would take effect to the exclusion of the *Corporations Act* insolvency regime and the appointment of a special administrator would take precedence over all other forms of external administration.

If the qualified parties discussed in section 2.3 above elect not to seek an order putting a retailer into special administration, or a special administration terminates having achieved its objectives, there may be circumstances where it would then be appropriate for the retailer to fall back into one of the traditional forms of external administration governed by the *Corporations Act*.

Section 109 of the Constitution provides that 'when a law of a State is inconsistent with a law of the Commonwealth, the latter shall prevail, and the former shall, to the extent of the inconsistency, be invalid.' Thus, in situations of inconsistency, the default position is that the *Corporations Act* will prevail over those pieces of State legislation that regulate electricity retailers. However, as the *Corporations Act* came about by reason of the States referring power to the Commonwealth, it contains a number of sections which preserve the operation of State laws in specific categories, including external administration.

Section 5E of the *Corporations Act* provides that, wherever possible, both State law and the Corporations Act should operate concurrently (for example, if a State law were to impose additional obligations on a director of an electricity retailer that were not directly inconsistent with the director's obligations under the *Corporations Act*, the director would be required to comply with both sets of obligations).

Sections 5F and 5G of the *Corporations Act* allow for a State law to prevail over the *Corporations Act* in certain circumstances notwithstanding the fact that the State law may be inconsistent with certain provisions of the *Corporations Act*. Section 5F allows a State to explicitly declare a matter 'to be an excluded matter in relation to part or all of the *Corporations Act*'. Where that is done, the *Corporations Act* will not apply to that matter.

Section 5G(8) of the *Corporations Act* contemplates the States introducing their own forms of external administration in appropriate circumstances and specifically provides that:

> the provisions of Chapter 5 (being the Chapter of the *Corporations Act* dealing with external administrations) do not apply to a scheme of arrangement, receivership, winding up or other external administration of the company to the extent to which the scheme, receivership, winding up or administration is carried out in accordance with a provision of a law of the State or territory.

This means that the introduction of a specific State law-based special administration regime for electricity retailers would serve to resolve any conflict between that regime and the traditional insolvency administration process under the *Corporations Act* in favour of the State law-based regime. Where there was no conflict, both regimes could operate concurrently.

### 5.4 Limitations of State-legislated regime

Where a State puts into place a legislated insolvency regime for specific companies[33] or, as contemplated here, for a defined class of companies, for the purpose of displacing the insolvency regime established by the *Corporations Act*, that regime must include specific provisions to deal with the fact that action could potentially be taken against a corporation (including electricity retailers) in any Australian state.

Examples of some such provisions may include:

(a) an assertion of the intended extraterritorial operation of the legislation;

(b) an assertion that the legislation binds the other States, Territories and the Commonwealth in so far as the legislative power of the enacting State permits;

(c) obligations on electricity retailers maintaining their corporate registration within the particular state; and

(d) authority for the court to request the courts of any other State to act in aid of the special administration, which would include applications to enforce any moratorium on legal action and to give priority to any special administration over any insolvency proceeding commenced in another State.

### 5.5 Interaction with existing electricity laws

Existing electricity laws will need amendment to ensure that they operate well in circumstances where the special administration regime may be invoked. To the extent that amendments to the NER are required as part of a package of legislative changes to State-based electricity laws, if may be appropriate to include in the NEL specific powers for the South Australian Minister to make relevant rules or rule changes. This will allow a streamlined introduction of all required legislative and rule changes. This approach was adopted to introduce new rules and amendments to existing rules in conjunction with the NERL.[34]

The amendments described below are likely to be required to accommodate the special administration regime.

(a) **Notification and decision making period**

New provisions will be required to ensure that before a ROLR event occurs, the qualified party is notified of the potential ROLR event so that the ROLR regime does not commence before the qualified party decides whether or not to invoke the special administration regime (as described in section 2.2, above). As there are a number of events which trigger the ROLR regime, the requirement to give notice to the qualified party should be included in new, stand alone legislation introducing the special administration regime as set out in section 5.1 above. We suggest that it would be useful to also include amendments to the existing

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[33] See for example the State-legislated insolvency regime established in NSW by *James Hardie Former Subsidiaries (Winding Up and Administration) Act 2005 No 105.*

[34] NEL, section 90D.

provisions of the NERL, NEL and NER to make it clear that the operation of certain provisions or taking of decisions which will lead to a ROLR event is subject to the notice requirements and passing of the required decision-making period set out in the new legislation. These provisions are likely to include the following:

(i) Rule 2.10.1 of the NER, which sets out the procedure to be followed if a retailer wishes to cease to be a registered participant in relation to the purchase of electricity directly through the NEM (including the requirement for AEMO to decide whether or not to reject the request, following consultation with the AER);

(ii) Rule 3.15.21 of the NER, which sets out AEMO's ability to suspend a retailer from acquiring electricity from the NEM following a default event; and

(iii) section 107 of the NERL, which provides for revocation of a retailer's retail authorisation, either because the retailer is not a registered participant in relation to the purchase of electricity directly through the NEM or because AER is satisfied there has been a material failure to comply with the energy laws creating a reasonable apprehension that the retailer will not be able to meet it obligations under the NERL in future.

Further, Rule 3.3.1 sets out a requirements that any Market Participant must not be under external administration whilst participating in the market. This Rule will need to accommodate the possibility of a retailer continuing to participate in the market in circumstances where the special administration regime has been invoked.

(b) **Prudential requirements**

The inevitable result of the proposed inclusion of a notice requirement and decision making period is that other aspects of the operation of the NEM will also need amendment to accommodate the increased time frames involved before action is taken in response to the financial distress of a retailer. In particular, during the notice and decision-making period, the distressed retailer may not be able to make all payments that are due and may not meet the prudential requirements required by AEMO under the NER[35]. These requirements include the need to post adequate credit support.

If these requirements are breached, the new provisions relating to the notice and decision-making period should prevent AEMO from suspending the retailer's right to acquire electricity from the NEM during that period. If the special administration regime is invoked, an additional period will also be required to allow the administrator to rectify any breaches.

[35] See NER 3.3.

If the distressed retailer is not able to fulfil its payment obligations to AEMO, AEMO will reduce its payments to generators.

Similar issues arise in relation to the credit-support requirements in favour of distributors under the NEL (although retailers have a longer, 10 business day period in which to provide any additional credit support required by distributors).[36]

> One consequence of the increased time before implementing either the ROLR regime or the special administration regime is that generators may need to accept greater risks of short-payments than they do currently (although there may be scope for generators to recover any costs incurred through increasing their offer prices for the sale of electricity). The extent of this issue will depend on the timeframe for the notice and decision-making period. This should be kept as short as possible.
>
> An alternative may be that AEMO requests additional up front credit support from all retailers that would cover the additional notice and decision-making period. The additional cost of this is likely to be problematic for retailers.

(c) **Cost recovery**

The cost recovery scheme will need to be supported by legislation and we propose that it form part of the legislation introducing the special administration regime as set out in section 5.1 above. If the cost recovery scheme adopted involves imposition of a levy on network service providers, it is likely that the legislation will need to specify that the payments to be made by the network service providers are recoverable, most likely as pass through amounts.[37] Further, jurisdictions other than Victoria may need to take legislative or other action to allow retailers to pass such payments on to consumers. In Victoria, there is no longer any regulation of retail prices for small customers, so no legislative action would be required.

### 5.6 Commonwealth legislative amendments

For the purposes of this Report, we have not considered the characterisation of the financial arrangements between the States and the Commonwealth, but note that the correct characterisation will determine the framework that should apply and any legislative amendments that may be needed to support the scheme.

[36] NER 6B, Part B.

[37] One means of doing this is to adopt the approach taken under the ROLR scheme, whereby the relevant payment is deemed to be both a regulatory change event and a positive change event for the purposes of the NER (s 167, NERL).

Key issues for further consideration in this regard include the following:

(a) Whether specific authorisation is required to ensure that the Commonwealth has the power to make payments or provide other financial support associated with the energy administration.

If there is no clear existing legislative support for a payment of this nature, an amendment to the *Financial Management and Accountability Regulations 1997* may be considered necessary to include such payments within the ambit of the *Financial Management and Accountability Act 1997* (Cth). We note that there is some question as to whether an amendment to these regulations will always be effective to validate Commonwealth payments. However, for the purposes of this Report we have not considered whether any further constitutional issues may arise in association with these payments; and

(b) Whether specific authorisation is required to confer functions or powers or impose duties on a Commonwealth officer.

The *Australian Energy Market Act 2004* (Cth) authorises the conferral of functions or powers or the imposition of duties on a Commonwealth Minister by a State energy law (including the NEL and the NERL) provided that the conferral or imposition does not contravene constitutional doctrines restricting the duties that may be imposed on the Minister or otherwise exceed the legislative power of the Commonwealth.[38] Further, the Commonwealth Minister may only exercise any such power or perform any such duty or function in accordance with an agreement between the Commonwealth and the States concerned. The intergovernmental agreement discussed above would satisfy this requirement. However, the *Australian Energy Market Act* only authorises the conferral of functions and powers or the imposition of duties on the Minister administering that Act (currently the Minister for Resources and Energy). If a different Minister is considered to be the appropriate Minister, alternative arrangements will need to be established.

### 5.7 Commonwealth/State arrangements - Intergovernmental Agreement

We expect that an agreement between the relevant States, the ACT and the Commonwealth would be required to cover key aspects of the operation of the special administration regime. The content of this agreement will depend on whether the special administration regime is implemented by way of State based co-operative legislation or Commonwealth legislation. In either case, the participating States, the ACT and the Commonwealth will need to agree to the overall scheme and to a timetable for their required legislation amendments. If the proposed special administration regime is introduced through State co-operative legislation, the agreement is also likely to cover:

(a) the process for AER to make a recommendation to the Commonwealth that the special administration regime should be triggered (should the AER and the

[38] *Australian Energy Market Act 2004* (Cth), section 12A.

Commonwealth both be named as decision makers as proposed in section 2.3 above);

(b) the conferral of powers or imposition of duties on a Commonwealth officer;

(c) the timeframe for the Commonwealth to make a decision in relation to whether to put the distressed retailer into special administration (or make application to the court for the appointment of an administrator);

(d) any arrangements between the States, the ACT and the Commonwealth in relation to sharing obligations to fund the special administration regime;

(e) the arrangements for the trigger of the SAR Payment regime;

(f) agreement on how the amount of the SAR Payment will be determined; and

(g) the arrangements for remission of the proceeds of the industry levy to the Commonwealth or State governments.

The intergovernmental agreement will need to dovetail with the proposed State-based legislation and any supporting Commonwealth legislation as discussed above.

**Allens**
**Anna Collyer / Julie Freeman / Michael Popkin**
**10 May 2013**

## Schedule 1 – Summary of the ROLR regime

### 1.1 Introduction

Part 6 of the NERL establishes a retailer of last resort regime. The ROLR regime's objective is to protect electricity supply to retail customers in the event that an electricity retailer fails, by allocating the failed retailer's customers to another designated retailer, the ROLR.[39]

### 1.2 Appointment of a ROLR

The AER must appoint and register a default ROLR for each electricity connection point at all times.[40] The AER must call for expressions of interest from retailers to register as ROLRs. However, a retailer may be appointed as a default ROLR even where they have not submitted an expression of interest, provided that the AER consults with the relevant retailer before their appointment.[41]

If it considers it appropriate, the AER can appoint any number of additional ROLRs for a connection point in addition to the default ROLR, provided that any additional ROLRs have lodged expressions of interest for registration as a ROLR.[42]

There are several criteria which must be satisfied in order to become a ROLR:

(a) organisational and technical capacity;[43]

(b) financial resources;[44]

(c) suitability, taking into account:

(d) the number of customers the retailer has;

(e) the class/es of customers the retailer has;

(f) the area/s that the retailer currently serves; and

(g) any other relevant matters specified in the energy laws or that the AER considers relevant.[45]

If a ROLR event occurs, the 'designated ROLR' will need to take all customers of the failed retailer in their registered area at the time of the ROLR event.[46] The AER may appoint one or more registered ROLRs to be designated ROLRs for a particular ROLR

[39] Note that gas supply is also protected, however this paper focuses on electricity.

[40] NERL, sections 125(a), 128.

[41] NERL, section 125(3), (5).

[42] NERL, section 126(1) and AER Statement of Approach 3.4.

[43] NERL, section 123(1)(a).

[44] NERL, section 123(1)(b). According to a note, one matter to take under consideration under this criteria may be whether a retailer has hedging contracts adequate for it to be a ROLR.

[45] NERL, section 123(1).

[46] NERL, section 132(1) and AER Statement of Approach 3.3.

event before that event actually occurs.[47] If an appointment is not made before the occurrence of a ROLR event, the default ROLR will be taken to be appointed as the designated ROLR.

The AER has special information gathering powers to support its role in relation to the ROLR regime.[48]

### 1.3 How is the ROLR regime triggered?

The ROLR regime is triggered by the occurrence of a ROLR event. The defined ROLR events are:

(a) a retailer's retail authorisation is revoked;

(b) a retailer's right to acquire electricity from the National Electricity Market (***NEM***) wholesale exchange is suspended;

(c) a retailer ceases to be a Registered participant in relation to the purchase of electricity directly through the NEM wholesale exchange;

(d) an insolvency official is appointed in respect of a retailer or any property of a retailer;

(e) an order is made or resolution is passed for the winding up of a retailer;

(f) the retailer ceases to sell electricity to customers (except in certain circumstances, such as the transfer of its business or retailer authorisation); and

(g) other events prescribed by regulations.[49]

If a ROLR event occurs, the AER may decide to issue a ROLR notice. Amongst other things, the ROLR notice must specify:

(h) the failed retailer;

(i) the registered ROLR or ROLRs appointed by the notice as designated ROLRs for the ROLR event; and

(j) the transfer date (or means of determining the transfer date) on which customers of the failed retailer are transferred to the relevant designated ROLR/s.[50]

If the ROLR event is the revocation of the retailer's retailer authorisation or the suspension of the retailer's right to participate in the wholesale exchange market, the transfer date will be the date of the revocation or suspension, unless an earlier date is specified.[51]

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[47] NERL, sections 132(2), 134.

[48] Part 6, Division 7.

[49] NERL, section 122.

[50] NERL, section 136.

[51] NERL, section 136(5).

### 1.4 Contractual arrangements

Following a ROLR event, customers of the failed retailer immediately before the transfer date cease to be customers of the failed retailer and immediately become customers of the designated ROLR.[52] From the transfer date onwards the designated ROLR assumes the functions and powers of the failed retailer under energy legislation.[53] The contract of sale between the failed retailer and its customers is terminated on the transfer date.[54] If more than one ROLR is designated in the relevant ROLR notice, the AER will allocate electricity customers by the grouping of connection points as required by the circumstances.[55]

A person who was a small customer of a failed retailer becomes a customer of the relevant designated ROLR on the terms and conditions of the relevant ROLR's standard retail contract and with its standing offer prices.[56] A person who was a large customer become a customer of the relevant designated ROLR on the terms and conditions published by the ROLR on its website, but there is an additional requirement that these terms are fair and reasonable.[57]

There is no minimum period for the small customer to remain with a designated ROLR. After three months from the transfer date, the designated ROLR's standard retail contract is taken to have been formed. Alternatively, after this three month period (or earlier with the agreement of the ROLR) the small customer and designated ROLR may seek to negotiate a market retail contract.[58]

Similarly there is no minimum period for the large customer to remain with a designated ROLR and the parties may agree to terminate their arrangements at any time. Further, the designated ROLR can serve a notice to terminate on a large customer at any time stating that the arrangement will be terminated after the period of six months from the transfer date, unless a new retail contract is negotiated.[59]

### 1.5 Cost recovery

A registered ROLR may only recover costs incurred in relation to the ROLR regime in accordance with a ROLR cost recovery scheme under Division 9 of the NERL.[60] ROLR cost recovery schemes are determined by the AER upon application by a registered ROLR and are designed to allow the ROLR to recover its costs incurred in relation to the ROLR regime. This specifically includes:

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[52] NERL, section 140(1).

[53] NERL, section 140(2).

[54] NERL, section 141.

[55] AER ROLR Guidelines 3.1.

[56] NERL, section 145.

[57] NERL, section 146.

[58] NERL, section 147.

[59] NERL, section 148.

[60] NERL, section 165.

- costs incurred in preparing for ROLR events by default ROLRs; and
- costs incurred on and after a ROLR event by designated ROLRs.[61]

When making its decisions on cost recovery scheme applications, the AER must be guided by the following principles:

- the registered ROLR should be provided with a reasonable opportunity to recover the reasonable costs that it incurs;
- the recovery of costs should allow for a return commensurate with the regulatory and commercial risks related to the ROLR regime; and
- the registered ROLR will itself bear some of the costs, in proportion to its customer base.[62]

The AER is required to make a determination that one or more distributors are to make payments towards the costs of the ROLR regime. These distributor payments are characterised as approved positive pass through amounts for the purposes of the distribution determination of the relevant distributor.[63] As a result of this, the distributor is able to pass through the amount of the distributor payments to its customers. Retailers will then seek to pass these on to their customers.

### 1.6 Supporting materials

To support the legislative requirements, the AER has published:

- a ROLR Plan, which sets out the procedures for participants in a ROLR event to follow;
- a ROLR Statement of Approach, which sets out certain formation on ROLR registration, appointment and cost recovery; and
- ROLR Guidelines, which, amongst other things, specify when more than one ROLR may be designated for a ROLR event and information requirements in relation to cost recovery schemes

[61] NERL, section 166(3).

[62] NERL, section 166(7).

[63] NERL, section 167.

## Schedule 2 – Corporate structure diagrams (large electricity retailers)

The attached diagrams outline the corporate structure of the following entities, each large privately owned electricity retailers:

- ERM Power;
- Australian Power and Gas;
- Alinta;
- GDF Suez Australian Energy;
- Origin Energy;
- Energy Australia;
- Infratil; and
- AGL Energy.

We have conducted company searches to determine key relationships and, in some cases, reviewed information available in annual reports. We have not conducted company searches on all corporate group entities and in some cases have not listed all companies in the corporate group. However, all key relationships are noted. If you would like us to conduct more searches and provide more comprehensive diagrams please let us know.

**Legend:**

Direct Ownership

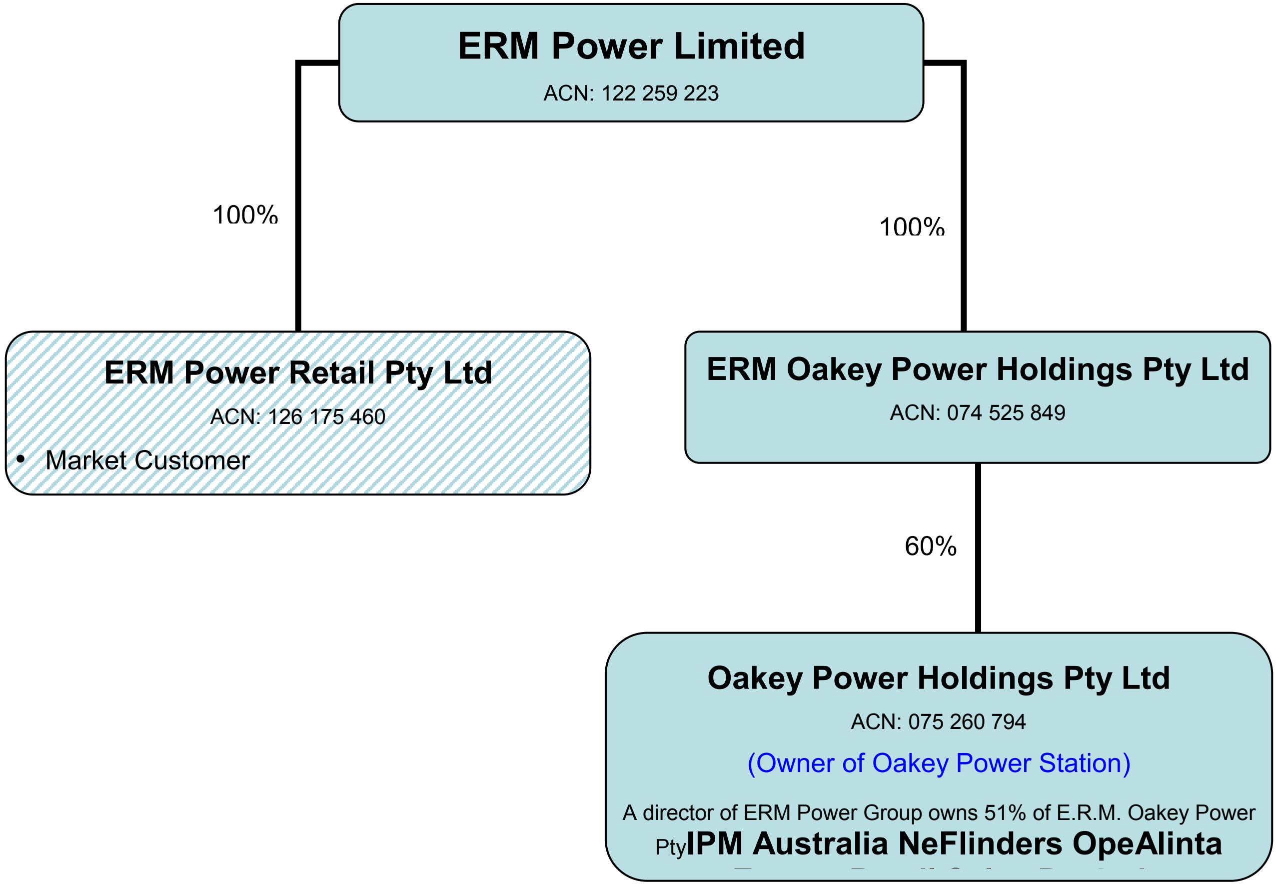
Indirect Ownership

Relationship confirmed by company Annual Report or other search, not ASIC company search

NEM registered participant

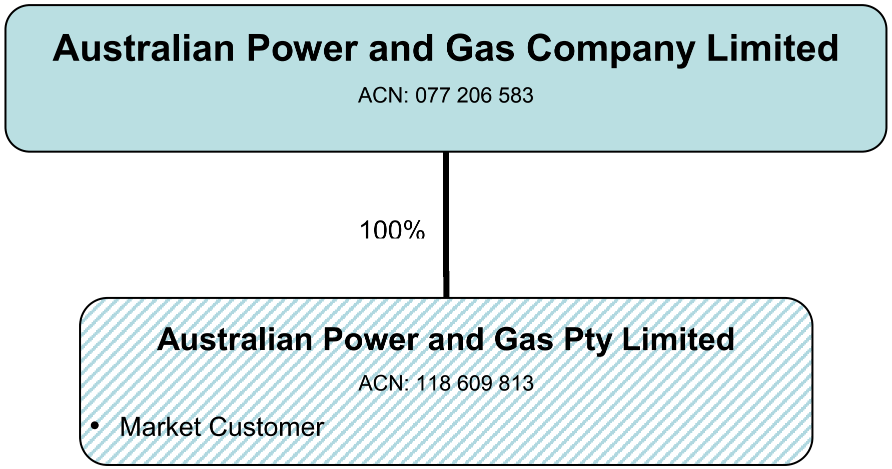
# Schedule 2 – Corporate structure diagrams (large electricity retailers)



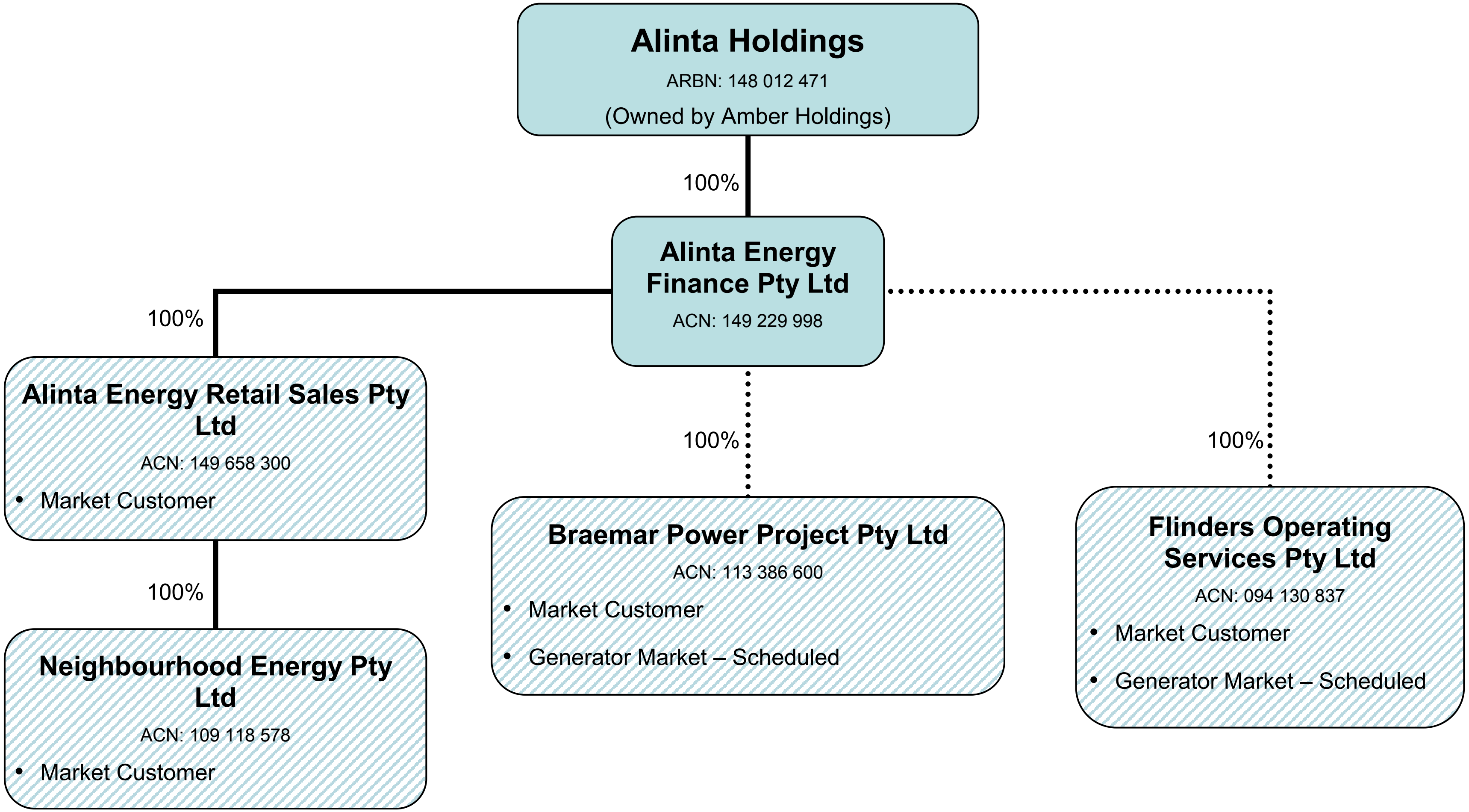


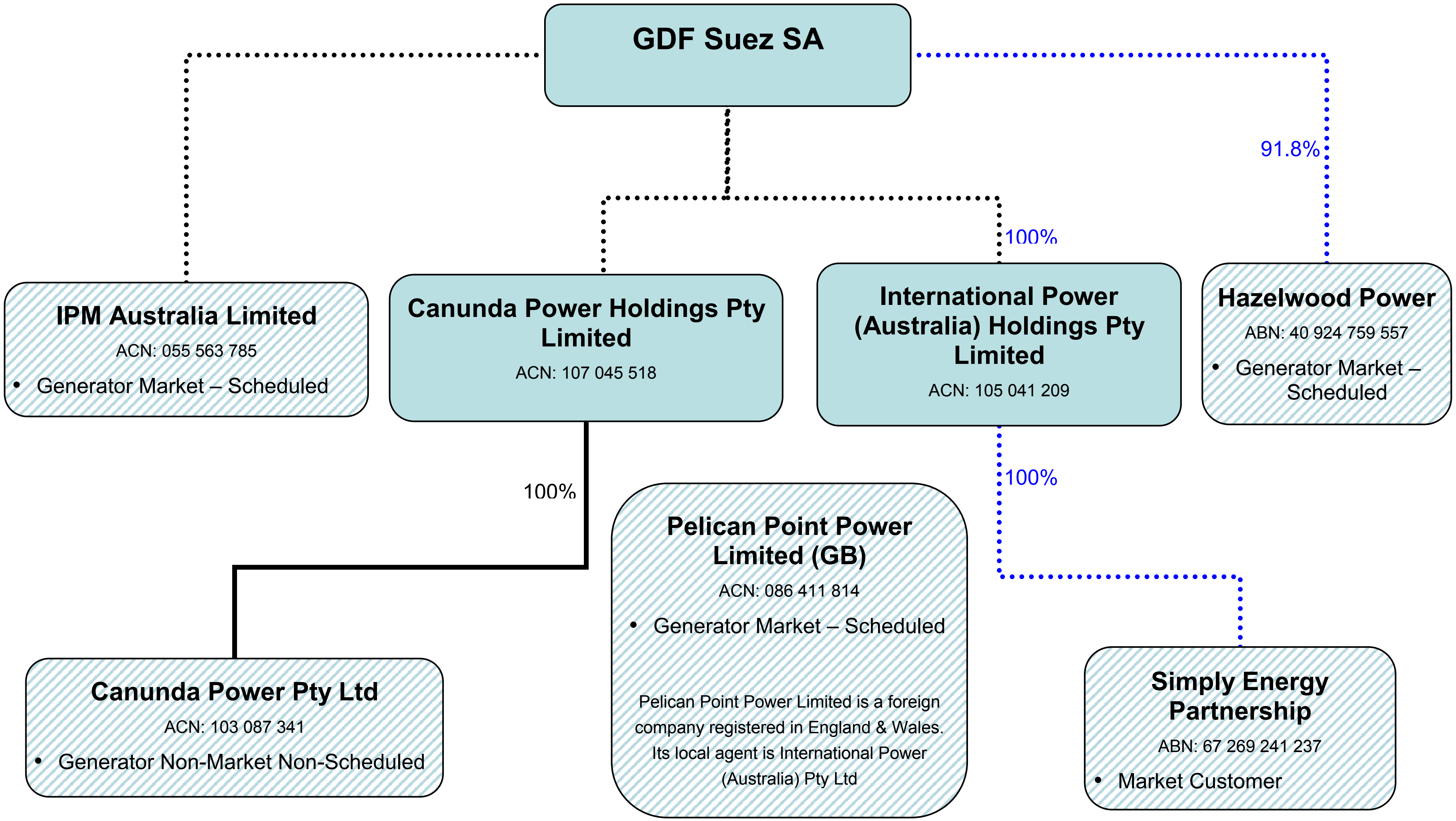
# Schedule 2 – Corporate structure diagrams (large electricity retailers)

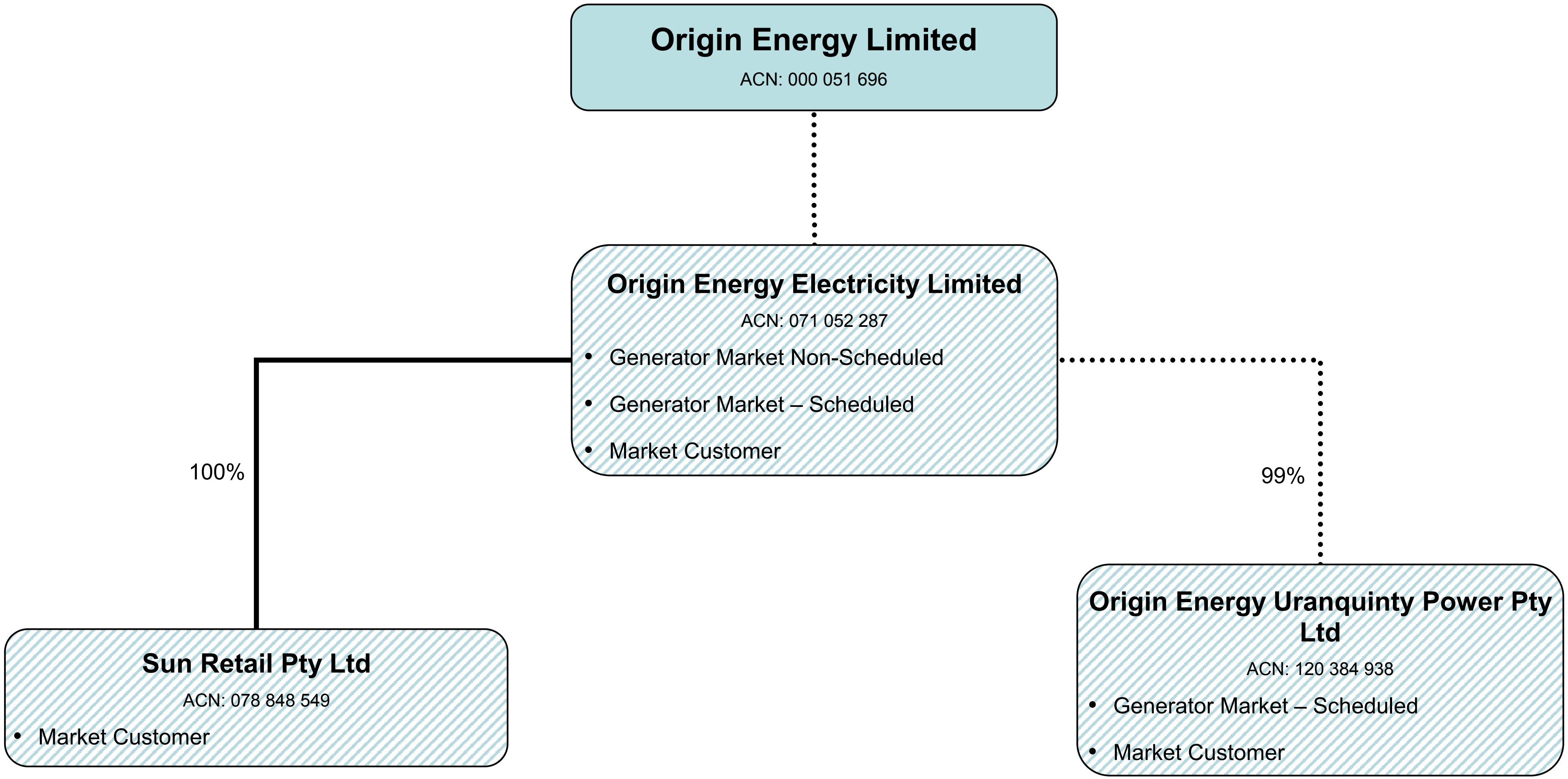


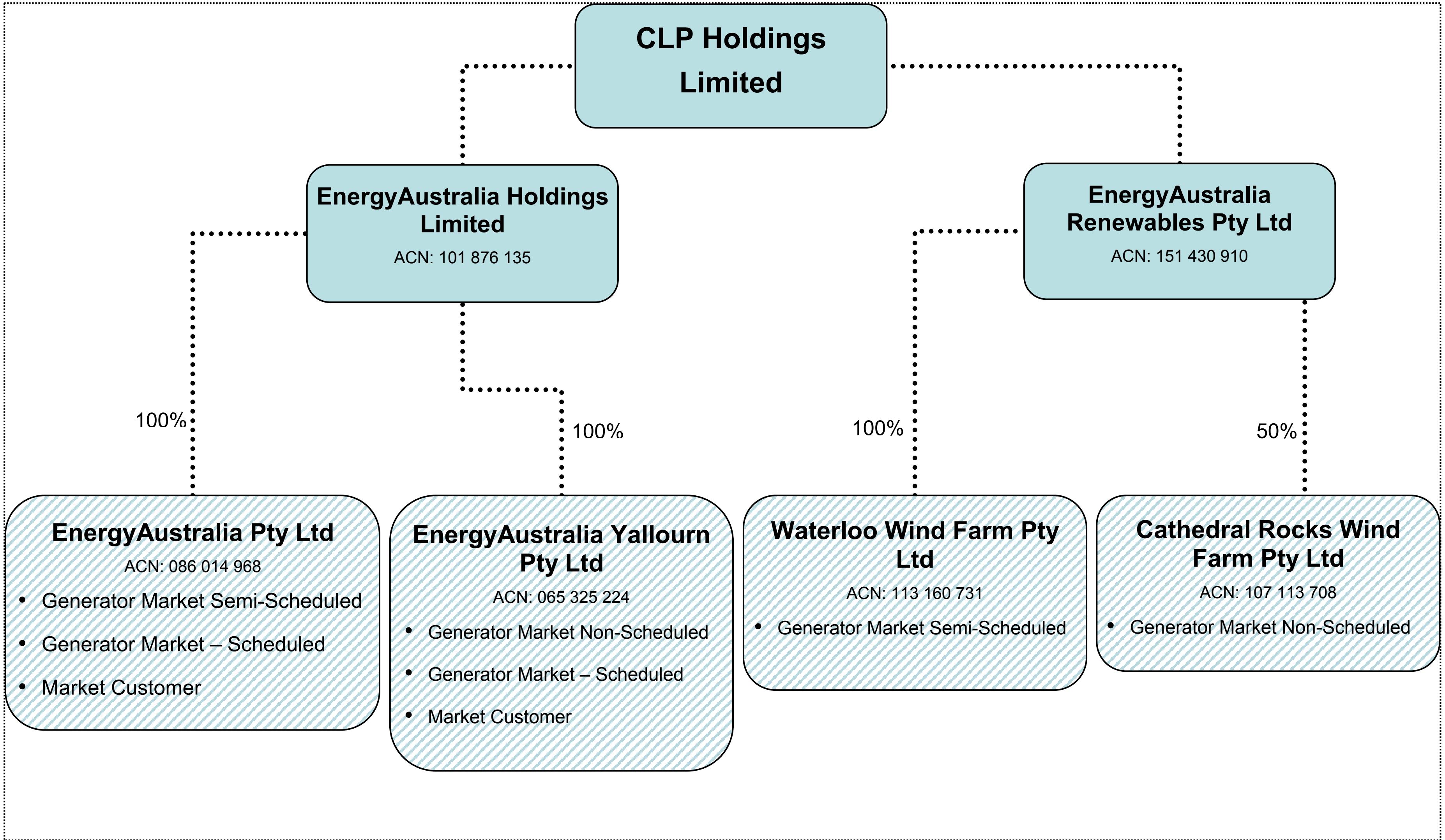


# Schedule 2 – Corporate structure diagrams (large electricity retailers)



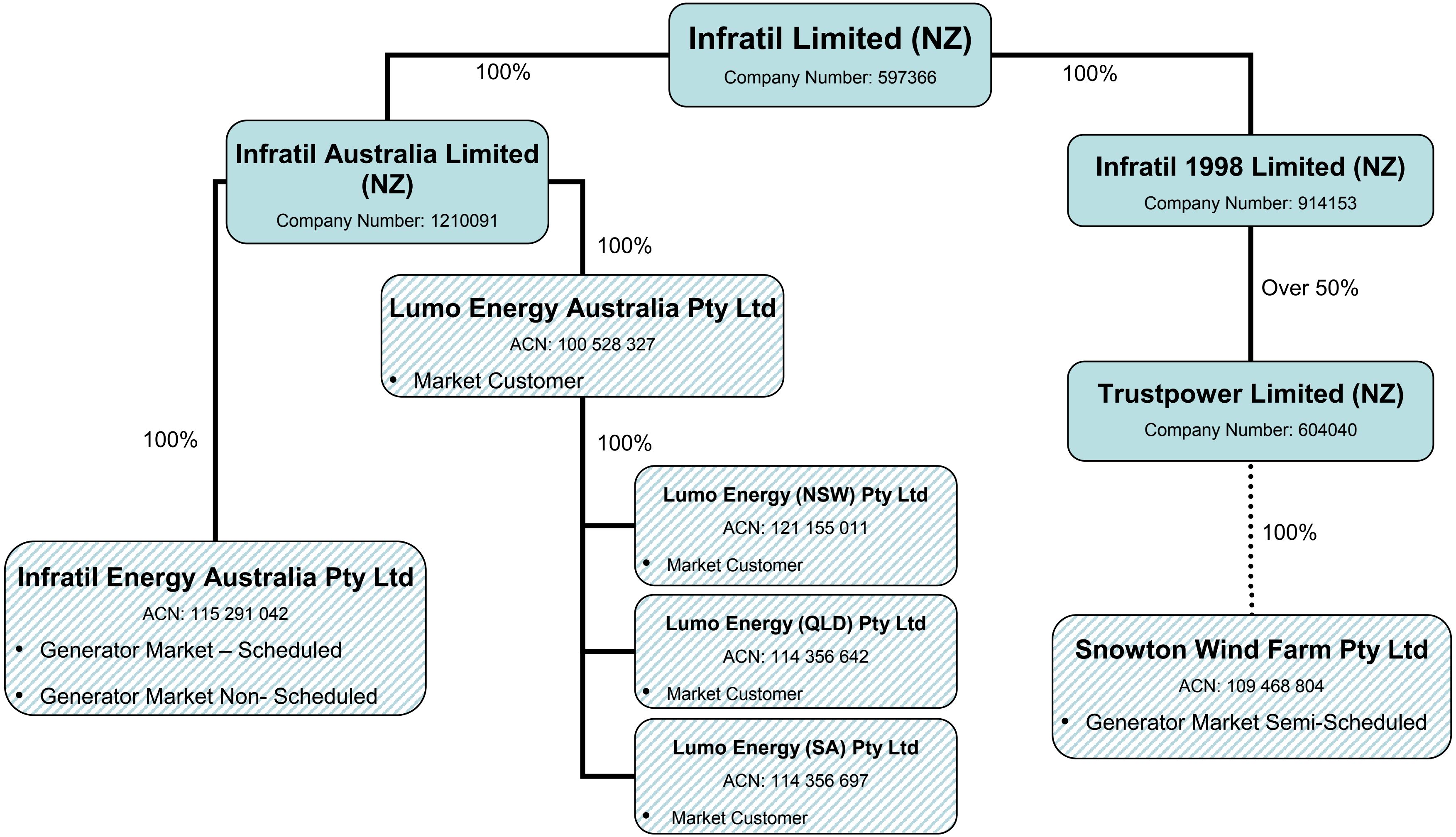

GDF Suez SA
91.8%
100%
IPM Australia Limited
ACN: 055 563 785
• Generator Market – Scheduled
Canunda Power Holdings Pty Limited
ACN: 107 045 518
International Power (Australia) Holdings Pty Limited
ACN: 105 041 209
Hazelwood Power
ABN: 40 924 759 557
• Generator Market – Scheduled
100%
100%
Pelican Point Power Limited (GB)
ACN: 086 411 814
• Generator Market – Scheduled
Pelican Point Power Limited is a foreign company registered in England & Wales. Its local agent is International Power (Australia) Pty Ltd
Canunda Power Pty Ltd
ACN: 103 087 341
• Generator Non-Market Non-Scheduled
Simply Energy Partnership
ABN: 67 269 241 237
• Market Customer

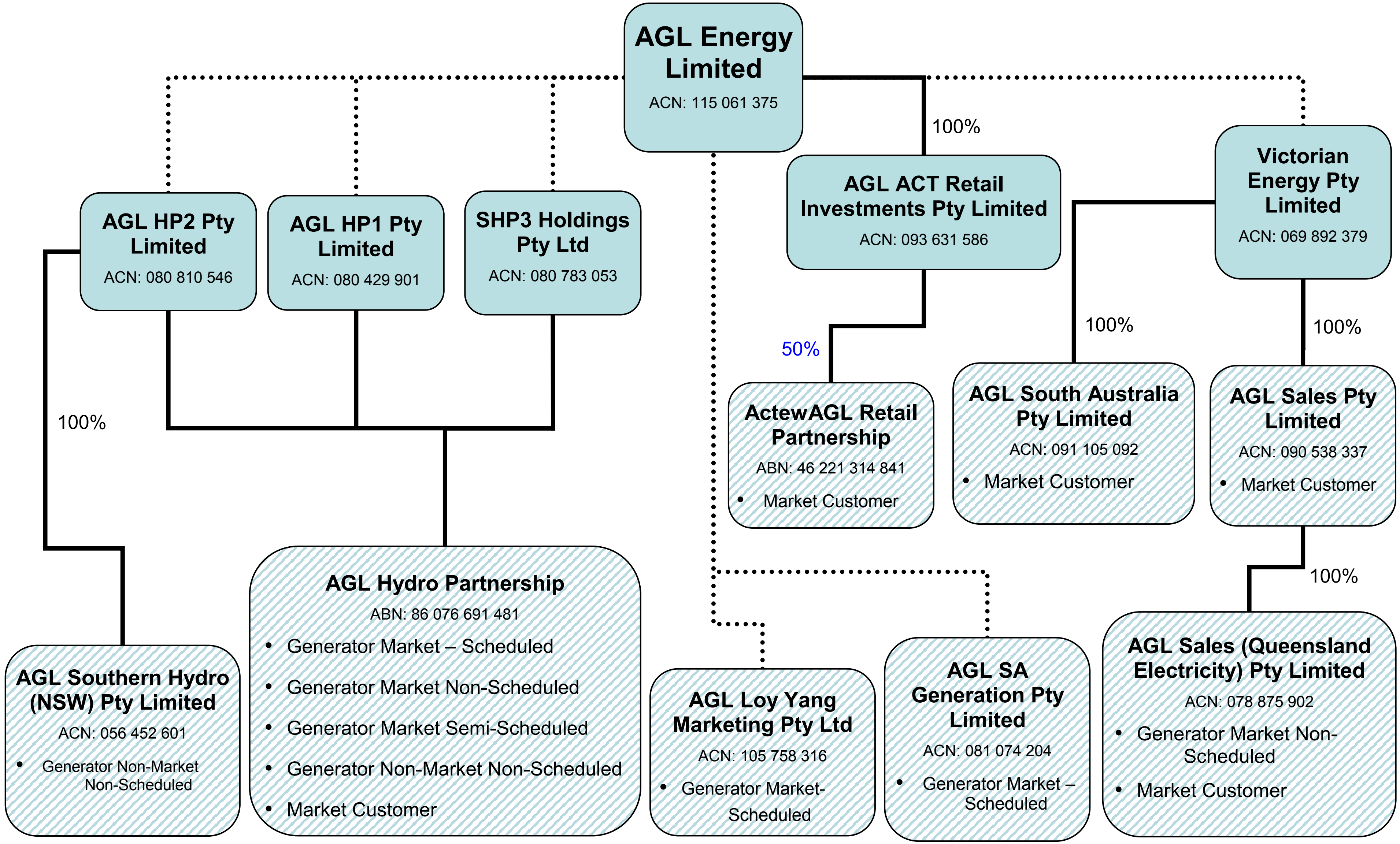

Origin Energy Limited
ACN: 000 051 696
Origin Energy Electricity Limited
ACN: 071 052 287
• Generator Market Non-Scheduled
• Generator Market – Scheduled
• Market Customer
100%
99%
Sun Retail Pty Ltd
ACN: 078 848 549
• Market Customer
Origin Energy Uranquinty Power Pty Ltd
ACN: 120 384 938
• Generator Market – Scheduled
• Market Customer


CLP Holdings Limited
EnergyAustralia Holdings Limited
ACN: 101 876 135
EnergyAustralia Renewables Pty Ltd
ACN: 151 430 910
100%
100%
100%
50%
EnergyAustralia Pty Ltd
ACN: 086 014 968
• Generator Market Semi-Scheduled
• Generator Market – Scheduled
• Market Customer
EnergyAustralia Yallourn Pty Ltd
ACN: 065 325 224
• Generator Market Non-Scheduled
• Generator Market – Scheduled
• Market Customer
Waterloo Wind Farm Pty Ltd
ACN: 113 160 731
• Generator Market Semi-Scheduled
Cathedral Rocks Wind Farm Pty Ltd
ACN: 107 113 708
• Generator Market Non-Scheduled

# Schedule 2 – Corporate structure diagrams (large electricity retailers)

Allens > < Linklaters




AGL Energy Limited
ACN: 115 061 375
100%
AGL ACT Retail Investments Pty Limited
ACN: 093 631 586
Victorian Energy Pty Limited
ACN: 069 892 379
AGL HP2 Pty Limited
ACN: 080 810 546
AGL HP1 Pty Limited
ACN: 080 429 901
SHP3 Holdings Pty Ltd
ACN: 080 783 053
50%
100%
100%
ActewAGL Retail Partnership
ABN: 46 221 314 841
• Market Customer
AGL South Australia Pty Limited
ACN: 091 105 092
• Market Customer
AGL Sales Pty Limited
ACN: 090 538 337
• Market Customer
100%
100%
AGL Hydro Partnership
ABN: 86 076 691 481
• Generator Market – Scheduled
• Generator Market Non-Scheduled
• Generator Market Semi-Scheduled
• Generator Non-Market Non-Scheduled
• Market Customer
AGL Southern Hydro (NSW) Pty Limited
ACN: 056 452 601
• Generator Non-Market Non-Scheduled
AGL Loy Yang Marketing Pty Ltd
ACN: 105 758 316
• Generator Market-Scheduled
AGL SA Generation Pty Limited
ACN: 081 074 204
• Generator Market – Scheduled
AGL Sales (Queensland Electricity) Pty Limited
ACN: 078 875 902
• Generator Market Non-Scheduled
• Market Customer

## Schedule 3 – Overview of the role of traditional external administrators

## 1. Introduction

When a company becomes insolvent it may be placed in one of the forms of external administration whereby the directors of the company relinquish control to an insolvency practitioner who conducts the affairs of the company. There are three main forms of external administration available to such companies:

**(1) voluntary administration** (***VA***):

VA is a process begun by the appointment of an administrator to a company which is in financial difficulties (but could possibly be saved), during which the administrator investigates its affairs to recommend to creditors whether it should enter into a Deed of Company Arrangement (***DOCA***) (if one is proposed), be wound up or revert to normal operation by its directors. The methods by which a company can go into VA are set out in section 2 below, but the most common method is for the company's board of directors to resolve that, in the opinion of the directors voting for the resolution, the company is insolvent, or is likely to become insolvent at some future time and that an administrator should be appointed.

**(2) receivership**:

Receivership is usually instituted by a secured creditor appointing a receiver to enforce a security. The right to appoint is contractual so that there may be a range of triggers to permit the secured creditor to exercise its entitlements – actual insolvency, deemed insolvency under the *Corporations Act 2001* (the ***Act***), the appointment of an external administrator to some or all of the assets of the company and material adverse change are some common triggers.

**(3) liquidation**:

This refers to a winding up of a company wherein the company ceases trading and a liquidator is appointed for the purpose of realising its assets, discharging its liabilities (or a percentage of them when the liabilities outweigh the assets) and dividing any surplus assets to its members.

## 2. Voluntary Administration

### 2.1 Overview

VA is by far the most common method of reorganisation in Australia, primarily because of the speed and ease by which it can be commenced.

VA is a procedure designed to salvage companies which are either insolvent or likely to become insolvent so that the company can return to trading or provide a better return for creditors than would be available in liquidation. It is the only formal process in Australia with rehabilitation as one of its express goals. The objects of part 5.3 of the Act (which deals with VAs) are set out in section 435A as follows:

The object of this part is to provide for the business, property and affairs of an insolvent company to be administered in a way that:

(a) maximises the chances of the company or as much as possible of its business, continuing in existence; or

(b) if it is not possible for the company or its business to continue in existence – results in a better return for the company's creditors and members than would result from an immediate winding up of the company.

There are two stages to the VA process. The first is the administration phase in which the company comes under control of an insolvency practitioner who must investigate the company's affairs and then recommend to the company's creditors whether the company should be:

- salvaged under a DOCA;
- wound up; or
- returned to the control of those who controlled it prior to administration.

The second stage, if the creditors so decide, is the period after a DOCA is entered into, which is known as 'deed administration'.

### 2.2 Requirements

There are three ways in which a voluntary administrator can be appointed to a company:

1. the company itself at the instigation of the directors, if the board has resolved to the effect that in the opinion of the directors voting for the resolution, the company is insolvent, or is likely to become insolvent at some future time;
2. a liquidator or provisional liquidator appointed to the company, if he or she thinks that the company is insolvent, or is likely to become insolvent at some future time; or
3. a secured creditor with security over the whole, or substantially the whole of the company's property if the security has become and is still enforceable.

### 2.3 Effects

While a company is under administration it cannot be wound up and legal proceedings and enforcement processes cannot be started or continued unless the administrator or the court agrees.

Secured creditors cannot enforce their security except in limited circumstances. Secured creditors who have a security interest over all or substantially all of the company's property must enforce their security within 13 business days of the appointment of the administrator or they are prohibited from enforcing their security during the administration phase without the administrator's consent or the leave of the court. Creditors with a security interest over perishable property are allowed to enforce their security. Similarly, creditors who have begun enforcement prior to the commencement of the administration are allowed to enforce their security.

If a DOCA is executed, the DOCA is binding on all creditors (secured creditors who did not vote for the deed are not barred from enforcing their security), the company, its officers and members, and the administrator of the DOCA. Anyone who is bound by the DOCA cannot, without court permission:

- apply to have the company wound up;
- start legal proceedings against the company; or
- prosecute any enforcement process against the company's property.

### 2.4 The Powers and Role of the Voluntary Administrator

The voluntary administrator has a duty to conduct the VA in the best interests of creditors and for the purpose of achieving the objectives of section 435A as set out in section 2.1 above.

The powers of administrators are set out in the Act and allow for the carrying on of the business. An administrator acts as an agent of the company and is thereby able to bind the company during the administration period. The creditors do not have a role in the day to day management of the company during VA but will be called upon to decide the fate of the company at the end of the administration phase as described in section 2.1 above. Where a company is operating under a DOCA, the terms of the DOCA will govern the extent to which the deed administrator can carry on the business of the company and the approvals that are required.

Unlike liquidators, voluntary administrators do not have power to seek court relief in relation to insolvent trading, unfair preferences, uncommercial transactions or other statutory voidable transactions.

### 2.5 Stays of Proceedings/Moratoriums

When a company is in VA:

- No proceeding in a court against the company or in relation to property of the company can begin or proceed except with the administrator's consent or the leave of the court.
- No enforcement process in relation to property of the company can begin or proceed except with leave of the court.
- A security interest cannot be enforced on property of the company except with the administrator's written consent or with the leave of the court, unless the secured creditor holds security over the whole or substantially the whole of the company's property and enforces its security within 13 business days of the administrator's appointment, or the secured creditor has commenced enforcement of the security prior to the administrator's appointment.
- A secured creditor who has security over perishable property can enforce its security.

- The owner or lessor of property that is used or occupied by, or is in the possession of the company cannot take possession or otherwise recover it, except with the administrator's written consent or with the leave of the court.
- Suppliers of essential services (electricity, gas, water and telecommunications) cannot refuse services to a company under administration by reason only of there being a debt owing to them and they cannot make further supply conditional on payment of outstanding debt.
- An officer of the court, upon receiving written notice of the fact that the company is under administration is restricted from taking action under an execution or attachment process.
- A guarantee of a liability of the company cannot be enforced against a director of the company who is a natural person, or a spouse, de facto or relative of such a director.
- The courts may grant leave allowing the commencement or continuation of proceedings against a company under administration if the claim has a solid foundation and gives rise to a serious dispute. However, generally, the courts will refuse leave to proceed, so as to prevent the unnecessary hindrance to the administrator of the need to defend legal proceedings.

Importantly, there is no stay on the ability of contracting parties to exercise their rights to terminate contracts of supply or purchase of goods or service when a company is under administration. Many contracts give counter-parties the right to terminate on the actual insolvency or deemed insolvency of the other contracting party or on the appointment of an external administrator. For some companies the major value of the company resides in its contracts. The appointment of an administrator can see that value rapidly disappear.

### 2.6 Personal Liability of Administrator

The administration phase of VA is intended to be an interim administration which generally results in either a DOCA or a winding-up occurring. During the administration phase, an administrator has power to obtain credit or take loans on behalf of the company. The administrator of a company under VA is personally liable for debts he or she incurs in the performance or exercise, or purported performance or exercise, of any of his or her functions as administrator for:

- services rendered;
- goods bought;
- property hired, leased, used or occupied;
- the repayment of money borrowed;
- interest in respect of money borrowed; or
- borrowing costs.

In exchange, the administrator has an indemnity out of the company's assets for the payment of such liabilities. This indemnity has priority over all unsecured debts and security interests over circulating assets of the company.

## 3. Receivership

### 3.1 Overview

A receiver is appointed in respect of a corporation to take control of specific property, or to get it in, so as to protect the rights of a party entitled to that property. Receivers may be appointed privately by a secured creditor in accordance with the terms of a security document or by a court on application of a party seeking to protect its interests.

### 3.2 Privately-appointed receivers

The private appointment of receivers pursuant to the terms of a debenture is the most common form of receivership appointment. No involvement of the court is necessary for such an appointment to be made.

(a) Manner of appointment

The manner of a receiver's appointment will depend on the terms of the debenture under which they are appointed. There is no mandatory form imposed on secured creditors in respect of a receiver's appointment.

In order for the appointment to be effective, the receiver must accept the appointment made by the secured creditor. Although not always necessary pursuant to the terms of the debenture, it is best practice for a formal written demand for payment to be made of the debtor prior to the appointment of a receiver.

(b) Powers and role of the privately-appointed receiver

Depending on the extent of the assets securing the debtor's obligation and the terms of the debenture, the secured lender will usually have the ability to appoint either a receiver or a receiver and manager. A receiver is charged with the realisation or management of the secured asset over which they have been appointed. A receiver and manager is empowered to take control of the debtor's business as a going concern for the purpose of repayment of the secured debt, either through realisation of the debtor's assets or through the income generated by the debtor's business.

A receiver's powers are determined by the terms of the debenture under which they are appointed. Generally, receivers' powers are very broad and will usually include the power to enter into possession and control of the secured property, lease or sell the property, and, in the case of a receiver and manager, to carry on the business of the debtor and do all things which the debtor is normally empowered to do. In carrying on the business of the debtor the receiver and manager acts as agent of the company.

A receiver owes their primary duty to the secured creditor who appointed them. The Act also imposes certain statutory duties on receivers in the conduct of their administration of the debtor's assets. Of primary importance within these duties is that imposed by section 420A of the Act, which obliges receivers to take reasonable care to ensure that, if sold, the secured assets are sold for market value or, if there is no market value, for the best price reasonably obtainable. This is a significant duty that goes beyond the duties imposed on other forms of insolvency appointments in their dealings with the property of the debtor.

While the directors and officers of the debtor are not formally displaced by the appointment of a receiver or receiver and manager, the powers of the receiver supersede those of the existing company management and will usually result in the directors and officers being left without an active role in the operation of the company. The directors may be required to provide the receiver with reports as to the company's affairs and to cooperate with the receiver to the extent necessary to achieve the purposes of the receivership.

(c) Conclusion of receivership

In the normal course, a privately-appointed receivership will terminate on the purpose for which the receiver was appointed having been achieved. This will usually be the repayment of the debt owed to the secured creditor. If there are insufficient assets held by the debtor to fully retire the secured debt, the receivership will terminate when the receiver exhausts all of the available assets of the debtor and retires.

On termination of the receivership, control of the debtor and all of its remaining assets are returned to the debtor's directors and officers.

### 3.3 Court-appointed receivers

(a) When will the court appoint a receiver?

A receiver may be appointed by the court as an equitable remedy whenever it is just and convenient to do so. A receiver can be sought by any party to a cause or matter involving the court's jurisdiction. In practice, applicants are usually mortgagees or debenture-holders, but the appointment could be sought in unusual circumstances by ordinary creditors and even by the company itself. For example, a receiver may be appointed by the court:

- during the course of a protracted litigation to settle a dispute between parties or to protect the "public interest";
- under the Act where ASIC is conducting an investigation and it is necessary to freeze the assets of companies or ASIC may apply to the court for an order appointing a receiver of the property owned by or held by a securities industry dealer; or
- at the request of a liquidator or provisional liquidator, to an officer's or related entities property in circumstances where the officer or related entity may otherwise avoid liability to the company.

The distinction between a privately appointed receiver and a court appointed receiver was summed up in the case of *Duffy v Super Centre Development Corp Ltd*[64]*:*

[64] (1967) 1 NSWR 382, per Street J at 383 to 384.

> There is some contrast to be borne in mind between the function of a privately appointed receiver and the function of a court appointed receiver, and I use the word `receiver' as a compendious word encompassing a receiver and manager. *To some extent*, the privately appointed receiver, particularly in current commercial practice, makes an effort to restore the financial prosperity of the company whose affairs he has been appointed to administer by a debenture holder. A court appointed receiver does not fill the same position. He is not what might be described as a company doctor, but rather his function is that of company caretaker.

(b) Procedure

Persons may seek a court-appointed receiver where there are difficulties in appointing a receiver by another mode, or where they have no power to appoint a receiver except by application to the court

The actual procedure for securing a court order will depend upon the circumstances in which the order is sought. In a court appointment, the court will always exercise a discretion as to whether a receiver should be appointed.

The requirements for notification by the receiver and by the person appointing him or her are the same as for a receiver appointed from powers arising out of a document.

(c) Conclusion of receivership

The appointment of a receiver does not prevent creditors or the company itself from seeking to initiate liquidation, administration, provisional liquidation, proposing a scheme of arrangement, or even appointing a receiver under a mortgage deed with prior rights. In this way other reorganisation processes can be taken advantage of so as to rehabilitate the company, however, whether this ultimately benefits the rehabilitation is dependent upon the parties that seek the alternate process (for example secured creditors may enforce their security thereby making rehabilitation difficult or impossible).

(d) Powers and role of the court-appointed receiver

A court appointed receiver has a limited role which is reflected in the limitations to his/her powers, for example, a court-appointed receiver often has no power of sale, except with the permission of the court. In addition, the fact that a moratorium does not exist when a court appoints a receiver means that while the court-appointed receiver may be working towards resolving protracted litigation to settle a dispute between parties or to protect the "public interest", a creditor of all or substantially all of the company's assets may step in and destroy any hope of rehabilitation. Court-appointed receivers are not normally appointed to arrange or facilitate a restructuring. A court could give a court-appointed receiver power to act in that way but this is not the normal role of a court-appointed receiver.

## 4. Liquidation

### 4.1 Court-ordered winding up

(a) Requirements

A compulsory winding-up in insolvency is a winding-up of an insolvent company that begins with a court order. A company is insolvent when it is unable to pay all its debts as and when they become due and payable. Any one of the following may apply to the court for a company to be wound up in insolvency:

- the company;
- a creditor;
- a contributory;
- a director;
- a liquidator or provisional liquidator of the company;
- ASIC; or
- a prescribed agency.

A court will make an order to commence winding-up of a company if it is proved that the company is insolvent. The Court may also order that a company be wound up in a number of other circumstances, including where it is just and equitable for the company to be wound up and where the members have passed a resolution that the company be wound up.

Most commonly, insolvency is proven by failure to comply with a statutory demand which may be served on a company by a creditor owed at least A$2,000. A company is presumed insolvent if it fails to comply with a statutory demand within 21 days of service unless within that period it has commenced proceedings to have the demand set aside or it has paid or compromised the claim. The most common basis on which such demands are set aside in that there is a genuine dispute about the debt or that the debtor has a counterclaim against the creditor sufficient to reduce its indebtedness to the creditor to less than A$2,000.

A court liquidation may be used because:

- a voluntary liquidation while available to any corporation, might, because of large or opposed membership, be too slow or too cumbersome as an alternative to court liquidation; and
- schemes of arrangement and DOCAs require the voting sanction of creditors and their voting preference may need to be sought before proposing such administrations.

The liquidator has the power to bring a wide range of proceedings in the name of, and on behalf of the company including specific statutory rights of recovery such as insolvent trading and voidable transactions including unfair loans, unfair preference, uncommercial transactions, improper director benefits and related party transactions. In the course of controlling a liquidator's exercise of power, the court may make an order authorising another person, such as a creditor or contributory, to sue in the company's name upon giving the liquidator and the company an indemnity.

A liquidator may assign the proceeds of an action for recovery or sell a bare right of action to another party. The ability of a company's external administrator to do this represents an exception to the general law doctrine against maintenance and champerty.

A liquidator also has a statutory power to breach contracts without the risk of being ordered to specifically perform them. This power is called disclaimer. A liquidator can disclaim an unprofitable contract without leave of the Court and can disclaim a profitable contract with Court leave. Contracts which require the company to incur costs and provide goods and services are likely candidates for disclaimer.

(b) Need for consent

In the process of winding up, a liquidator's broad powers are subject to obtaining certain consents where:

- the liquidator compromises a debt owed to the company where that amount is greater than A$20,000; or
- the liquidator enters into an agreement on the company's behalf if the term of that agreement or the obligations of a party under that agreement extend for more than three months after the agreement is entered into.

For a liquidator to enter into an agreement exceeding those thresholds he or she requires consent in the form of either:

- approval of the court;
- approval of the committee of inspection; or
- a resolution of the creditors in favour of the action.

(c) Set-off

The Act specifically provides for a set-off of debts and credits arising from mutual dealings, mutual credits or mutual debts between the insolvent company and a creditor. The effect of this section is that it is only the balance that remains a provable debt against the company (or is owed to the company depending on the result of the netting).

The right to set-off is specifically excluded, however, if at the time of giving credit to the company, or receiving credit, the creditor had notice of the fact that the company was insolvent. For example the appointment of a liquidator would prevent the creditor from setting off mutual debts or mutual credits arising under mutual dealings entered into after knowledge of such appointment.

(d) Stays of proceedings/moratoriums

When a company is being wound up:

- individual claimants lose the right to litigate their claims in court and instead must lodge a proof of debt with the liquidator. In order to achieve this, a stay is imposed to prevent the assets of the company being wasted by litigation;
- the leave of the court must be obtained in order to bring or continue proceedings against a company, or in relation to the property of the company;

- factors which the courts will take into account when considering whether to grant leave include the potential disruption to the orderly liquidation of the company, the extent to which other creditors of the company may be prejudiced by the grant of leave and the seriousness of any question to be tried;
- enforcement processes in relation to the property of the company cannot be begun or continued against a company;
- an applicant, seeking leave to obtain a remedy against a company that is being wound up, must prove to the court that there is some good reason why its claim against the company should be pursued by a court action rather than by lodging a proof of debt with the liquidator;
- a secured creditor does not require the leave of the court to deal with the collateral of its security interest; and
- any disposition of company property other than by the liquidator is void.

On liquidation, unsecured creditors have no rights to specific items of the company's assets; they have a right to have a fund of assets protected and properly administered.

(e) Distributions

After collecting the assets and the time fixed for the proving of claims has expired, the liquidator can distribute to creditors. Depending upon the complexity and size of the company, liquidation can last for several years and the liquidator may make several payments over that time. In an insolvent company there is a prescribed order of payment of debts as described above. Even in a company which appears to be solvent, a liquidator should follow the statutory order.

(f) Conclusion of winding-up

In the case of winding-up, the final step to be taken in the process is the deregistration of the company. The steps for deregistration are governed by the Act and once deregistered the company ceases to exist and the liquidator's role comes to an end.

(g) Powers and role of the court-appointed liquidator

The powers of the liquidator are broad and are set out in the Act. The liquidator must exercise those powers in furtherance of his primary purpose, which is to facilitate the distribution of the assets of an insolvent company to its creditors. Like receivership, liquidation is not a process designed to facilitate the restructuring of a company's business. Unlike receivership, it would be very unusual for a liquidator, once appointed, to continue to trade on the company's business for any significant length of time. In some liquidations, the liquidator may be successful in identifying some profitable business of the company which can be sold and continue in operation under another company's guidance. However, the aim of liquidation is not rehabilitation of the company or its business and, like receivership, if the business of the company or any part thereof is able to be saved it is a subsidiary benefit to the liquidator's primary purpose of realising the company's assets for the maximum benefit possible for its creditors and other stakeholders.

### 4.2 Voluntary winding up

(a) Commencement

A voluntary winding-up may be commenced by the company's members or creditors.

A voluntary winding-up may be undertaken by a resolution of the members in general meeting if the company is solvent. The directors are required to make a written declaration of the company's solvency before sending out the notice of meeting.

A creditors' voluntary winding-up is similar to a members' voluntary winding-up, except that the directors have not made a solvency declaration and the company is insolvent. Creditors' voluntary winding-up occurs infrequently, other than as a result of the creditors voting in favour of liquidation at the second creditors' or decision-making meeting in a VA.

(b) Effects

The liquidator assumes control of the company and proceedings against the company cannot be continued or begun except with the leave of the court. The powers of the directors are suspended; they do not lose office but they can only act with the written approval of the liquidator or the approval of the court.

An order for winding up a company operates in favour of all of the creditors and contributories of the company. A secured creditor does not require leave of the court to deal with the collateral of their security. Unsecured creditors have no rights to specific items of the company's assets other than pursuant to retention of title or other rights if applicable.

Transfers of shares after the date of the order are void as against the company unless the court orders otherwise. There can be no change in the status of a member unless the court orders otherwise. Members who hold partly-paid shares will be called upon the pay the unpaid part.

(c) Powers and role of the voluntary liquidator

Like court-ordered liquidation, voluntary winding up is a process designed to achieve the selling up and distribution of a company's assets. It is not a tool designed for or to be proffered for reorganisation other than the deregistration of non-operating companies. As a result, it would be very unusual for a liquidator, once appointed, to continue to trade on the company's business for any significant length of time.

## Schedule 4 – Examples of electricity industry levies

Set out below is a brief description of levies imposed by various State governments on participants in the electricity industry.

(a) **Levy on network services providers – Energy Safety Levy (WA)**

The *Energy Safety Levy Act 2006* (WA) allows for a levy to be imposed each year of varying amounts and on differing industry participants.

The Act provides for the Minister to specify, by notice published in the gazette:

- the total amount to be raised by levy for a financial year;
- the method of determining which energy industry participants are liable for the levy;
- the method for assessing the amount to be paid by each energy industry participant; and
- when the levy is payable.

The Energy Safety Levy Notice 2012 imposed liability for the levy on certain gas distributors and on electricity transmission companies and distribution companies (other than those with less than 500 connections). Liability was imposed on a proportional basis, by reference to the number of consumer sites with connections to the relevant network. Notices for previous years imposed liability on a similar basis.

The advantage of this approach is the flexibility that it provides, both in terms of the amount of the levy and the appropriate entity liable for the levy. Each of these aspects can be altered each year by way of notice.

(b) **Levy on distributors and retailers – Recovery of regulatory costs (ACT)**

The *Utilities Act 2000* (ACT) provides for electricity and gas distributors and retailers to pay a levy to recover the Territory's regulatory costs relating to the energy industry for each year. The total amount of the levy to be collected by all participants is determined by an appointed administrator.

The division of responsibility for payment of the levy between industry participants is determined in accordance with a formula set out in the legislation. This depends in part on the amount of electricity (in MWh) distributed or sold by the industry participants in the year prior to the relevant levy year.

(c) **Levy on retailers – Smelter Reduction Amount (Vic)**

Until mid 2004, the Victorian government collected a levy from Victorian retailers. This levy was designed to fund the costs of providing cheaper electricity to Alcoa in connection with the operation of the Point Henry and Portland aluminium smelters. This levy was calculated on the basis of energy consumed. The amount was collected by NEMMCO under provisions set out in chapter 9 of the National Electricity Code.

In 2003, these payments were challenged in the High Court on the basis that they were unconstitutional. Although the case did not proceed, in light of the uncertainty created by the legal proceedings, the Victorian government discontinued the arrangements, replacing them with a new land tax on electricity easements owned by electricity transmission companies.

(d) **Levy on customers – Ambulance levy (Qld)**

A levy on all electricity customers was imposed by the Queensland government to recover the costs of provision of ambulance services in Queensland. This was structured as a fixed daily payment imposed on standard electricity supply contracts (certain exemptions applied). The amount to be paid was not linked to the amount of electricity consumed but was payable for every day that the electricity supply contract was in place, even if no electricity was supplied during that period. The levy was discontinued in July 2011

## Schedule 5 – Examples of alternative forms of external administration

## 1. Judicial management regime (Australia)

### 1.1 Introduction

Following the collapse of HIH Insurance in 2001, judicial management in relation to general insurers was introduced in October 2008 by Part VB of the *Insurance Act 1975* (Cth) (the ***Insurance Act***). A similar regime has applied in relation to life insurers since 1945 under the *Life Insurance Act 1945* (Cth) and then the *Life Insurance Act 1995* (Cth).

### 1.2 Judicial management versus other forms of external administration

Judicial management is a form of external administration which takes into account the interests of policyholders and financial system stability when determining what actions should be taken. This can be contrasted with the usual forms of insolvency related external administration under the *Corporations Act 2001* (Cth) (the ***Corporations Act***), in which the interests of creditors and / or members are paramount.

Judicial management is not a regime for the distribution of assets in the manner of most other forms of external administration. Rather, it is more like a provisional liquidation or a court appointed receivership. Under judicial management an external party is inserted by the court to take control of the insurer, investigate its state of affairs and determine what course of action would best serve the interests of policyholders and the stability of the financial system in Australia.

### 1.3 Appointment of a judicial manager

Either APRA or the general insurer can apply to the Federal Court of Australia to have a judicial manager appointed.[65] The insurer does not need to be insolvent for there to be an appointment. An appointment may be made if the court is satisfied, among other things, that:

- it is in the interests of the policyholders that the order be made, having regard to the findings of an investigation by APRA under Part V of the Insurance Act;
- the general insurer is, or is likely to become, unable to meet its liabilities; or
- there are reasonable grounds for believing that the financial position or management of the insurance business may be unsatisfactory.

### 1.4 Consequences of a judicial management

Judicial management takes precedence over all other forms of external administration. No other appointment can be made without prior notice to APRA and if it is, it is invalid

[65] *Insurance Act 1975* (Cth), section 62K.

and ineffective. When a judicial manager is appointed, the appointment of any other external administrator is terminated.[66]

While under judicial management, court proceedings cannot be commenced or continued against the general insurer, except with the written consent of the judicial manager or the leave of the court.[67]

On appointment, management of the business of the general insurer in Australia vests in the judicial manager and the powers of the directors of the insurer are displaced. Therefore, after the appointment of the judicial manager, and during the period of the management, the directors will not be exposed to liability for acts done by the judicial manager, including insolvent trading.

Contractual counterparties are prohibited from:

- denying any obligations under the contract;
- accelerating any debt under the contract; or
- closing out any transaction relating to that contract[68]

based on the appointment of a judicial manager. A prohibition of this type does not exist for other forms of external administration in Australia. The wording of the prohibition is however quite specific, which means that a counterparty could still potentially rely on an event of default other than the appointment of a judicial manager (such as insolvency) to deny obligations under a contract, accelerate a debt under the contract or close out any transaction relating to the contract.

A judicial manager can exercise numerous powers during a judicial management including:

- bringing or defending legal proceedings;
- selling or otherwise disposing of all or any of the property of the general insurer; and
- proving in the bankruptcy of any debtor of the general insurer.[69]

A judicial manager is required to conduct the judicial management as efficiently and economically as possible.[70] They must submit a report to the court as soon as possible recommending a course of action which is, in their opinion, the most advantageous to the general interest of the policyholders of the general insurer while promoting financial system stability in Australia.[71] Courses of action can include one or more of the following steps:

- transferring the business of the insurer to another insurer;

[66] *Insurance Act 1975* (Cth), section 62U.

[67] *Insurance Act 1975* (Cth), section 62P,

[68] *Insurance Act 1975* (Cth), subsection 62V(2).

[69] *Insurance Act 1975* (Cth), section 62Y.

[70] *Insurance Act 1975* (Cth), section 62ZG.

[71] *Insurance Act 1975* (Cth), subsection 62ZI(1).

- allowing the insurer to carry on its business after judicial management;
- winding up the insurer; or
- taking steps to alter the constitution, rules or other arrangements for the governance of the insurer.[72]

The court may make an order giving effect to one or more of the recommended courses of action if it considers it to be most advantageous to the general interest of the policyholders of the general insurer while promoting financial system stability in Australia.[73]

## 2. United Kingdom special administration regime for energy supply companies

### 2.1 Key differences between the proposed UK special administration regime and the current Australian insolvency regime

The most common forms of external administration under the Australian Corporations Act are receivership, voluntary administration and liquidation. The purpose of each of these forms of external administration is different, as are the specific duties of an insolvency practitioner appointed in the role of receiver, administrator or liquidator and the powers at their disposal to continue to operate the business. In general terms, however, the role of each of a receiver, administrator and liquidator appointed in an insolvency scenario is to take steps to maximise the financial return to relevant creditors of the company to which they have been appointed. One underlying premise to the duties of external administrators in the usual forms of external administration is that they should not continue to trade a business where that will not confer a benefit to creditors. Special insolvency regimes, including Australia's judicial management regime for insurers and the UK special administration regime for energy supply companies, are most often implemented where there is a state interest in overriding this underlying premise. To protect the state interest in ensuring that an insurance company failure does not have a cascading effect on the rest of the Australian financial system, the purpose of judicial management is said to be primarily ensuring the protection of the interests of policyholders and the stability of the national financial system. Similarly, to protect the state interest in ensuring the continuity of energy supply and the integrity of the industry, the UK special administration regime for energy supply companies has the explicit objective of ensuring that the supply of gas and electricity to customers is continued until the distressed company is either rescued as a going concern or, if this is not possible, its business is able to be transferred to one or more other companies.

While one object of the voluntary administration regime in Australia is to provide for the management of the business, property and affairs of the insolvent company in a way that maximises the chances of the company, or as much as possible of its business, continuing in existence, if this is not possible the administrator must seek to maximise the financial

[72] *Insurance Act 1975* (Cth), subsection 62ZI(2).

[73] *Insurance Act 1975* (Cth), subsection 62ZJ(1).

return to creditors. Where a business is unprofitable, this will often require an administrator to cease trading the business so as to avoid incurring further financial losses. It would be a breach of duty for a receiver, administrator or liquidator under the Corporations Act insolvency regimes to continue to trade a business at the expense of the company's creditors, notwithstanding the fact that ceasing to trade could have harmful consequences for other industry participants or the interests of the state.

This issue is overcome in both the Australian judicial management regime for insurance companies and the UK special administration regime for energy supply companies by imposing a requirement that the relevant regulatory body be notified prior to any move to put the regulated company into a traditional form of external administration. This allows the regulatory body the opportunity to consider whether it wishes to apply to court to instead put the company into the special administration regime.

If no such application is made within the mandated time period, the regulatory body is taken to have concluded that the protection of state interests does not require that the regulated company be dealt with outside of the traditional processes.

If the regulated company is put into the special administration regime, that regime will apply and creditors (or other stakeholders) are prohibited from then seeking to have a receiver, administrator or liquidator appointed.

Under the UK special administration regime, the Secretary of State is explicitly empowered to make grants and loans to the company in energy supply company administration and may also give guarantees in respect of any sum borrowed by the energy supply company while it is in energy supply company administration. Further, the UK *Energy Act 2011* (the ***Energy Act***) allows for the recovery from the company of any financial assistance provided by the government. It is recognised that any company entering energy supply company administration may not be in a position to repay some, or all of the funding it receives, so further provisions are included in the Energy Act to allow for any government funding to be recovered through charges other industry participants are required to pay the system operator as a condition of their licenses.

### 2.2 Likely advantages and disadvantages of the proposed special administration regime and its likely usefulness in the UK context

The perceived benefits and costs of the proposed energy supply company special administration regime include:

**Benefits**

- if a large gas or electricity supply company is in financial difficulty, it is able to continue operating normally until it is either rescued, sold or its customers transferred to other suppliers;
- there is a reduction in the risk of financial failure spreading across the energy market (contagion), which maintains stability in the market and protects consumers;
- government funding would allow the company to continue to supply customers through normal contracting arrangements with generators and

gas suppliers (acts as a sort of 'insurance policy' in the event of a low probability, high impact event);

- there would be lower short run balancing costs (compared to the regime which would otherwise apply). Additional costs would not occur if a large supplier became insolvent with a special administration regime in place as the company would not require use of the balancing mechanism above usual operations; and
- a reduction in the impact of transfer of costs from the insolvent supplier to other industry participants. Costs would be transferred between the insolvent supplier and other market participants under both an ordinary administration and a special administration regime. However, the impact of these transfers under a special administration regime is expected to be reduced due to 1) a reduction in the level or transfers, by reducing the costs of supplying customers with electricity; and 2) greater predictability in the flow of transfers.

**Costs**

- the direct costs of establishing a special administration regime, which primarily fall on the government in the form of officials' and parliamentary counsel's time in defining and drafting the requisite enabling powers / rules, administrative costs etc.;
- the perception that a special administration regime will encourage excessive risk taking. However, this will be mitigated by the potential for a Supplier of Last Resort (***SoLR***) process to still be invoked (special administration regime is a backstop to SoLR) during special administration with the result that the special administration regime could be terminated by a transfer of customers to other companies for which the failing company will receive no payment; and
- an argument that if a company were in difficulty, its directors may be tempted to accelerate its failure knowing that it may be underwritten by the government, although:
  - the UK legislation allows for investigations into the conduct of directors in same way as ordinary administration rules do; and
  - there is no guarantee that the government will elect to exercise its power to put the company into the energy supply company special administration regime.