

Energy Supply Crisis – refresher on possible outcomes

Market context

- Rise in wholesale prices (in both electricity and gas).
- Cap on consumer energy prices at a level below the cost to serve new customers, with only a small increase approved from October 2021.
- Renewable obligations deadlines.
- Thirteen energy supply companies (ESCs) have collapsed since August 2021, with most of the sector now loss-making.
- Emergency talks with the Government did not result in any solutions to the issues the industry is facing.
- Industry experts expect a significant number of challenger energy suppliers to fail over the autumn / winter season.



**Will existing suppliers be capable to take on customers of failed energy suppliers?
What are the possible outcomes and how do they work?**



Is the ESC unable to pay its debts or has an insolvency event occurred in relation to it¹?

- **obliged to notify** the Gas and Electricity Markets Authority (GEMA)
- ideally the ESC is sold by way of a **trade sale**
- failing that, GEMA can **revoke the company's supply licence** on 24 hours' notice and exercise one of the two options below.

¹ For these purposes 'unable to pay its debts' is defined by reference to section 123(1) and (2) of the Insolvency Act 1986 and includes both cashflow and balance sheet insolvency. The relevant insolvency events include a CVA being proposed, entering into a scheme of arrangement, appointment of a receiver, an administration order being made, a resolution for winding-up being passed or becoming subject to a winding-up order.

Possible Outcomes²

| | Supplier of Last Resort ('SoLR') | Energy supply company special administration |
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| What is it? | <p>Not an insolvency process, but one whereby Ofgem³ appoints a SoLR to take over the supply of gas and/or electricity to the insolvent supplier's customers.</p> <p>Usually a competitive process where other suppliers bid to be appointed as SoLR but in the current market context, it has become more likely that Ofgem will have to direct suppliers to take over the insolvent supplier's customers. Such suppliers will have to comply with Ofgem's last resort supply direction unless very specific circumstances apply.⁴</p> | <p>One of a number of special administration regimes under English law for industries which involve a wider public interest. Similar to the administration regime under the Insolvency Act 1986, with certain modified objectives and powers.</p> <p>Objective is to secure:</p> <ul style="list-style-type: none"> — that energy supplies are continued at the lowest cost which it is reasonably practicable to incur; and — rescuing the business as a going concern or transfer of the business / parts of it as a going concern to another company or companies, so that it is unnecessary for the ESC administration order to remain in force. |
| Practical uses | Ofgem's preferred option to ensure continuity of supply , if it is achievable. It has been used in relation to ten ESCs since August 2021 ⁵ . | Only if SoLR cannot be appointed. It has not been used to date, and in any event would be more suited for large ESCs. |
| Appointment and conditions | <p>Ofgem asks suppliers of their willingness to be considered as SoLRs and proposed terms. Ofgem will ideally appoint a SoLR who has volunteered for the role but can direct a supplier to take over supply to insolvent ESC's customers.</p> <p>Ofgem will look at factors such as the ability to provide the increased credit</p> | <p>Application for ESC administration order either by the Secretary of State or with the consent of the Secretary of State.</p> <p>The court can only make an ESC administration order if it is satisfied that the supplier is unable to pay its debts, likely to be unable to pay its debts, or on a petition from the Secretary of State, it would be just and equitable (considering the objective set out</p> |

² Relevant legislation and materials: Energy Act 2004, Energy Act 2011, Energy Supply Company Administration Rules 2013, Guidance on supplier of last resort and energy supply company administration orders.

³ In practice, Ofgem acts on behalf of GEMA.

⁴ The supplier may refuse the supply on grounds of safety, or because it would not be reasonably practicable in all the circumstances to make the supply, or if the supplier is not a Green Deal Licensee but the direction would require the supplier to supply Green Deal Premises.

⁵ Up to date as at the date of this note.

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| | <p>cover required under industry arrangements to supply the additional customers⁶, capacity to source additional gas and electricity, ability to transition customers promptly and without disruption, ability to continue to supply to existing customers, whether a Last Resort Supply Payment would be sought, etc.</p> <p>When SoLR is appointed, licence of insolvent ESC is revoked, so that ESC can be placed into an ordinary insolvency process (administration or liquidation).</p> | <p>above) to wind up the company in the public interest</p> <p>Other administration or winding-up applications to be dismissed by the court if ESC administration order made (even if not yet effective).</p> <p>Energy supply administrator is an officer of the court and exercises and performs duties on behalf of the ESC as the company's agent. The energy supply administrator is required to continue to contract to supply gas and electricity to customers until the company is rescued, sold or its supply activities are transferred to another company.</p> |
| <p>Funding and related issues</p> | <p>SoLR may make a claim for a Last Resort Supply Payment, being the difference between:</p> <ul style="list-style-type: none"> — SoLR's costs reasonably incurred in supplying electricity or gas to the relevant premises under the supply direction + reasonable profit + sums paid or debts assumed by the licensee to compensate any customer in respect of any pre-existing customer credit balances, and — total amounts recovered by SoLR from the relevant customers it supplied under the supply direction. <p>Once approved by Ofgem, such claims to be paid by relevant network operators dependent on location of premises supplied under the supply direction.</p> | <p>Government funding is available to finance the ESC's activities. Accordingly, the Secretary of State may (subject to HM Treasury consent):</p> <ul style="list-style-type: none"> — make grants or loans to the ESC of any appropriate amounts (and subject to such repayment and interest terms as the Secretary of State may direct) for the purposes of achieving the objective of the ESC administration; — agree to indemnify persons in respect of liabilities incurred in connection with the exercise and performance by the energy administrator of his powers and duties, and any related loss or damage; — guarantee the repayment of any sum borrowed by the company while the ESC administration order is in force, payment of interest on such a sum, and the discharge of any other financial obligation in connection with the borrowing of such a sum. <p>Any government funding will be recovered from the company, or otherwise through a cost recovery mechanism with the cost being borne by the industry.</p> |

⁶ Bearing in mind that credit balances of customers are absorbed by the SoLR.

Other restructuring and insolvency options?

- **SoLR and special administration regimes will in practice have priority and other restructuring (such as a scheme or restructuring plan) and insolvency processes are unlikely to be used.**
- Any other winding-up or administration application or enforcement of security in relation to an ESC subject to a notice of intention to the Secretary of State and GEMA and 14 days having elapsed. GEMA will in practice decide during such 14 day period whether to apply for an ESC administration order.
- However, compulsory liquidation has been used in recent years to provide quasi-state aid to significant companies (Carillion, British Steel, etc.) and so theoretically could be used as an alternative, although such funding would not be recoverable in the same manner as in special administration.
- The directors of the ESC will also have to notify the Secretary of State and GEMA when seeking a Part A1 moratorium and when such moratorium is obtained. The Secretary of State and GEMA can still apply for a special administration order while the company is subject to a Part A1 moratorium.

Special regimes – wider context

- The ESC special administration regime has to be looked at in the context of other 'special regimes'. Since the early 1990s when the first 'special' regimes were introduced for railways and water, there has been a proliferation of 'special' insolvency regimes in the UK (see below for detail on key 'special regimes').
- A usual regime has as its guiding principle the interests of creditors and their rights to recover value; commercial promises and other types of interest are disregarded. The key difference is that a **'special' regime recognises that in certain sectors and situations, the rights of creditors are not paramount. The 'special' purpose and achieving that special purpose are the key outcomes.**
- **Railways** – the special administration regime was created in 1993 and used in 2001 for Railtrack plc (the UK rail infrastructure owner). Its purpose is '(a) the transfer to another company, or to two or more different companies, as a going concern, of so much of the company's undertaking as it is necessary to transfer in order to ensure that the relevant activities may be properly carried on; and (b) the carrying on of those relevant activities pending the making of the transfer.' Essentially, Railtrack could continue to operate as usual while a solution was found, notwithstanding the interests of creditors.
- **Energy Networks**⁷ – the regime's special purpose is that 'the company's system is and continues to be maintained and developed as an efficient and economical system' and to achieve this that either the company is rescued or a transfer is effected of all or relevant parts of its business. Similar provisions apply to water and sewage companies.

⁷ There is a separate special administration regime for protected energy companies – which is different from the regime for ESCs.

- **Banks** – following the 2008 banking crisis, and the ‘usual’ administration of Lehman Brothers International (Europe), the UK government introduced ‘bank insolvency’ and ‘bank administration’ for deposit-taking financial institutions where the principal purpose of the process was to maintain the rights of depositors and ensure the integrity of the banking system. These were coupled with government powers to effect ‘partial property transfers’, which could be used forcibly to transfer parts of a UK deposit-taking financial institution to a third party. Similar regimes were introduced for building societies.
- **Investment banks** – ‘special’ insolvency regimes have created mechanisms to ensure that clients of investment banks can access client monies and client assets as soon as possible and also provide a regime to permit a fair distribution where there are insufficient client monies and client assets for a full distribution following irregularities.

Practical considerations

- Collapse of further ESCs in short order may lead to **Ofgem having to direct larger suppliers to take over insolvent suppliers’ customers**, increasing pressure on larger suppliers.
- **Other stakeholders in the supply chain, such as gas shippers, may also be impacted** by the current market conditions and collapses. Gas shippers who shipped gas to a failed supplier’s customers will have to comply with any directions given by Ofgem to facilitate a SoLR supplying gas. If a gas shipper fails, there is no ability to appoint a shipper of last resort.

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