

ARE THE LIGHTS GOING OUT FOR SME ENERGY SUPPLIERS?



**WITH A WAVE OF COLLAPSES
ACROSS THE SECTOR IN RECENT
YEARS AND SURVIVING OPERATORS
FACING AN INCREASINGLY DIFFICULT
TRADING ENVIRONMENT, OUR
RESTRUCTURING TEAM TAKE A LOOK
AT THE ENERGY SUPPLY MARKET
AND IN PARTICULAR THE RAFT OF
CHALLENGES FACING THE MANY SMES
FIGHTING TO KEEP THE LIGHTS ON.**



The energy industry is one that has long been dominated by a 'big six' of established firms: British Gas; EDF Energy; E.ON, Npower; Scottish Power; and SSE. However, over the past few years there has been an explosion of 'challenger' companies entering the market, seeking to break the dominance of the incumbents. Initially, it appeared that this shake up of the market was a success: the market share of the 'big six' dropped to around 80%, with small and medium firms (SMEs) wrestling away around one fifth of the UK energy accounts. However, the lights may not be shining quite-so-brightly as it would appear.

On Tuesday of this week (14 September 2021), Dorset based Utility Point and Edinburgh-based People's Energy, two of the newer SME challengers in the UK's energy supply market, both announced they had ceased trading. Earlier in the month, two other suppliers – PfP Energy and MoneyPlus Energy, also closed their doors. Altogether, the four companies accounted for energy supply to over 600,000 homes across the UK.

Regrettably, they are just the latest in a long list of casualties in the sector: since 2016, the sector has witnessed a flurry of collapses, including GB Energy (November 2016); Future Energy (January 2018); GEN4U (July 2018); Iresa Energy (July 2018); National Gas & Power (July 2018); Ephase Energy (August 2018); Usio Energy (October 2018); Extra Energy (November 2018); and Spark Energy (November 2018); and Economy Energy, Our Power and Brilliant Energy (all 2019).

THE CONCERNING DOMINO EFFECT OF THESE FAILURES IS A SURE SIGN THAT THIS IS A MARKET FACING CONSISTENTLY TOUGH TRADING CONDITIONS. UNSURPRISINGLY, THERE ARE SEVERAL FACTORS FEEDING THIS:

1

Firstly, the industry has seen a sharp rise in wholesale costs, which is particularly difficult to shoulder for smaller players;

2

Secondly, there is now a price cap on energy prices, which was introduced by the UK's energy regulator, Ofgem. It caps prices at £1,137 a year for an average dual-fuel customer who pays by direct debit;

3

Thirdly, companies operating in the sector are facing ever-more onerous renewable energy obligations, including payments due under government-backed schemes:

- In 2018 it was estimated that £58.6 million of payments due to the regulator under the Government's 'Renewables Obligation' schemes were outstanding. Such payments are required from all energy supply companies that do not source the required proportion of electricity from renewable sources.
- Ofgem has also previously stated that several unnamed suppliers have missed payments under another green energy scheme, the 'feed-in tariff', leading to a £4.2 million shortfall in the correlative Ofgem-administered fund.

All of these factors means that while the cost of energy prices for consumers has dropped, the cost of supplying energy has increased dramatically and is threatening to price SME challengers out of the market. The 'big six', on the other hand, continue to leverage their size and position in the market to buy huge amounts of energy at wholesale and competitive rates.



WHAT HAPPENS WHEN AN ENERGY SUPPLY COMPANY IS FINANCIALLY DISTRESSED?

With little sign of anything in the pipeline to provide relief to the challenges faced by SME energy suppliers, we can expect to see further insolvencies across the sector.

Once an energy company considers that it can no longer continue trading, it can enter either administration or liquidation. However, given the vital importance of the supply of energy to households and businesses, there are unique procedures in place for this, as prescribed by the Energy Act 2004 (**the 2004 Act**) and the Energy Act 2011 (**the 2011 Act**) (together, **the Energy Acts**). These procedures need to be followed carefully to maximise returns to stakeholders.

Section 94(5) of the 2011 Act defines an energy supply company as a company which is the holder of a 'relevant licence'.

A 'relevant licence' is a licence granted under section 7A(1)(a) or (b) of the Gas Act 1996, or a licence granted under section 6(1)(d) of the Electricity Act 1989 to supply electricity.

Crucially, under section 163 of the 2004 Act, an energy supplier company, as defined by way of the above legislative provisions, is prevented from being put in administration or liquidation unless 14 days' notice has first been given to Ofgem and to the Secretary of State.

The rationale for this notice period is to allow Ofgem time to appoint an 'energy supply company administrator' (ESC Administrator) to handle the affairs of the failed company and to arrange for the transfer of customer accounts. It is extremely rare that such an appointment will be made at this stage of the process: of the nine companies that have ceased trading since 2016, only one - Ephase Energy - entered administration in this way.

The more common procedure by which an energy company ceases trading is a transfer mechanic known as the 'supplier of last resort' (**SoLR**) process. By using this alternative to administration or liquidation, Ofgem facilitates the transfer of customer accounts away from a failed energy supplier to a competitor in the market, who bids for the customer base of the failing supplier. The SoLR process is essentially four-steps:

- 1 Terminal financial distress is recognised, at which point Ofgem advertise to other energy suppliers the availability of the failing supplier's customer base;
- 2 Competitor suppliers 'bid' for the customer base. In reality, because the majority of domestic energy customers pay by direct debit, and so there is often an element of pre-payment which represents a credit owing by the energy supplier to the customer at the point of failure/insolvency, the 'bid' is the percentage of the customer credit balances that the incoming supplier will agree to honour;
- 3 Once the bids 'are in', Ofgem selects a winning bidder and serves notice on the failed supplier to revoke their energy supplier licences; and
- 4 Once the failing supplier's licenses have been revoked, it ceases to be the holder of a 'relevant licence', customer accounts are deemed transferred to the winning bidder and therefore ceases to be an 'energy supply company' for the purposes of the legislative framework set out above.

THE SOLR HAS BEEN, AND LOOKS SET TO CONTINUE TO BE, THE MOST FAVOURED OPTION FOR A FAILING ENERGY SUPPLY COMPANY, LARGELY BECAUSE IT IS BOTH EFFICIENT AND COST-EFFECTIVE. ONCE THE PROCESS IS COMPLETE, THE FAILING SUPPLIER CAN BE PUT INTO EITHER LIQUIDATION OR ADMINISTRATION FREELY, AS THE COMPANY IS NO LONGER BOUND BY THE PROVISIONS OF THE ENERGY ACTS AS A LICENCE HOLDER.

IT REMAINS TO BE SEEN IF THE CURRENT INDUSTRY TREND WILL CONTINUE - EVIDENCE TO DATE SUGGESTS IT WILL.



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