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Gas Market Insolvencies in Great Britain: Legal, Regulatory and Insolvency Issues

Over the past decade there has been an influx of small- and medium-sized entrants to the U.K. gas supplier market, which is supervised by Great Britain's[1] independent energy regulator, the Office of Gas and Electricity Markets (Ofgem).[2] According to Ofgem, this market development had the effect of increasing price competition and putting pressure on incumbent suppliers to improve customer service for consumers.[3]

Price volatility and increased prices, linked to the consequences of Russia's invasion of Ukraine and the ongoing war there, have put many gas companies under strain, as well as impacting consumer prices.

This note updates our 4 October 2021 publication on these issues. It highlights U.K. gas regulatory and financial markets issues arising out of the current crisis that create challenges for participants. We expect this note to be of interest to trading companies in the gas supply chain, participants in the gas financial markets and their clearing firms, insolvency officials and practitioners, and even consumers.

We predicted in our 2021 publication that gas price increases would prove to be a longstanding and important issue. Following Russia's invasion of Ukraine, this has become perhaps the greatest economic and political challenge facing Europe. As set out in the below table, 31 energy suppliers have failed in the U.K. since January 2021. To put both the rapid rate of new entries to the market and the number of firms that have failed into context, in December 2010 there were only 12 domestic energy suppliers. This hit a peak of 70 suppliers in mid-2018. By May 2022, only 23 suppliers remained.[4]

RECENT GAS SUPPLIER EXITS

DATE	OLD SUPPLIER	CUSTOMER BASE	NEW SUPPLIER
9 July 2022	UK Incubator Hub (UKEIH)	c. 3000 domestic	Octopus Energy
18 February 2022	Whoop Energy	50 domestic 212 non-domestic	Yü Energy
18 February 2022	Xcel Power Ltd	274 non-domestic	Yü Energy
18 January 2022	Together Energy Retail Ltd	c. 176, 000 domestic 1 non-domestic	British Gas
1 December 2021	Zog Energy Limited	c. 11,700 domestic	EDF
25 November 2021	Orbit Energy Limited	c. 65,000 domestic	Scottish Power
25 November 2021	Entice Energy	c. 5,400 domestic	Scottish Power
16 November 2021	Neon Reef Limited	c. 30,000 domestic	British Gas
16 November 2021	Social Energy Supply Limited	c. 5,500 domestic	British Gas

3 November 2021	CNG Energy Limited	c. 41,000 non-domestic	Pozitive Energy
2 November 2021	Omni Energy Limited	c. 6,000 domestic	Utilita
2 November 2021	MA Energy Limited	c. 300 non-domestic	SmartestEnergy
2 November 2021	Zebra Power Limited	c. 14,800 domestic	British Gas
2 November 2021	AmpowerUK Ltd	c. 600 domestic c. 2,000 non-domestic	Yü Energy
1 November 2021	Bluegreen Energy Services Limited	c. 5,900 domestic	British Gas
18 October 2021	GOTO Energy	c. 22,000 domestic	Shell Energy
14 October 2021	Daligas	c. 9,000 domestic and non-domestic	Shell Energy
13 October 2021	Pure Planet	c. 235,000 domestic	Shell Energy
13 October 2021	Colorado Energy	c. 15,000 domestic	Shell Energy
29 September 2021	Symbio	c. 48,000 domestic	E.ON Next
29 September 2021	ENSTROGA	c. 6,000 domestic	E.ON Next
29 September 2021	Igloo	c. 179,000 domestic	E.ON Next
22 September 2021	Avro Energy	c. 580,000 domestic	Octopus Energy
22 September 2021	Green Supplier Limited	c. 255,000 domestic	Shell Energy
14 September 2021	People's Energy	c. 350,000 domestic c. 1,000 non-domestic	British Gas
14 September 2021	Utility Point	c. 220,000 non-domestic	EDF
07 September 2021	PFP Energy	82,000 domestic 5,600 non-domestic	British Gas
07 September 2021	MoneyPlus Energy	c. 9,000 domestic	British Gas
09 August 2021	Hub Energy	c. 6,000 domestic c. 9,000 non-domestic	E.ON Next
27 January 2021	Green Network Energy	c. 360,000 domestic Non-domestic	EDF
27 January 2021	Simplicity Energy	c. 50,000 domestic	British Gas Evolve

Source: Ofgem

Downstream Gas – Key Entities

Gas Suppliers

Gas suppliers sell gas to an end consumer. They require a gas supplier licence under the Gas Act 1986, unless they benefit from an exemption. Gas suppliers only have a retail relationship with the end consumer and do not own or operate the local pipelines used to deliver the gas. They do not own the gas while it is transported in the pipeline systems, nor do they arrange for the transportation of gas through those networks. That role is performed by a gas shipper, which may be (but is not necessarily) a separately licensed firm within the same group.

Gas Shippers

Gas shippers buy and sell gas and arrange for the transportation of gas through the pipeline networks owned by gas transporters. Gas shippers must be licensed under the Gas Act 1986 unless an exemption applies.

Gas shippers may buy gas from producers—the entities who extract gas from the ground—in one of four ways:

- Under a long-term, bespoke bilateral agreement with a producer;
- Through bilateral "over the counter" (OTC) physically delivered futures contracts;
- Through exchange traded physically delivered futures contracts; or
- By buying gas in the "on the day" spot market. Spot transactions may be exchange traded or OTC.

Financial participants in the gas markets—i.e., traders that do not form part of the gas supply chain that have no intention of ever taking physical delivery of gas—may also invest in, hedge or seek financial exposures to gas contracts either by trading in cash settled derivatives or closing out their trades in physically delivered derivatives before the final settlement date.

Entities that only trade in gas, but do not ship it,[5] do not need to obtain a gas shipper licence from Ofgem for trading on U.K. markets such as ICE Futures Europe (IFEU). Traders and shippers trading gas on an exchange will be subject to regulation by the Financial Conduct Authority, including for compliance with market abuse regulations and derivatives trading requirements, and activities must be carried out in accordance with the rules of the relevant market. The role of exchanges and clearing houses in the gas industry is discussed below.

Several commentators have observed that part of the reason new entrant, smaller suppliers were able to undercut established names such as British Gas and EDF is that they have been able to deal with shippers who buy gas primarily unhedged on the spot market. New entrants also, by nature, tend not to be burdened with the same levels of administrative overhead, governance, compliance, real estate and pension costs as larger companies, making lower-cost models a possibility. Furthermore, suppliers who purchase gas from unhedged shippers do not need to price in the cost of hedging arrangements, so—provided the spot price stays well below the consumer price cap and fixed rates—lower prices can ultimately be offered to the consumer. However, if the spot price rises significantly, unhedged suppliers cannot pass the price rise to consumers, eroding or eliminating the suppliers' margin. This dynamic has contributed towards the failure of smaller suppliers, particularly during the final quarter of 2021. Since then, the rate of failures at energy suppliers has slowed significantly. This may be partly explained by the remaining suppliers having adequate hedging arrangements in place, as well as by the two subsequent increases in the price cap.

Gas Transporters

Gas transporters own pipelines in the gas distribution network. Transporters must be licensed under the Gas Act 1986 unless exempted. In Great Britain, National Grid Gas plc (National Grid) operates the high pressure national transmission system (NTS); for the most part, consumer and some industrial gas is taken off the NTS by transporters operating the "gas distribution networks" (GDN), which are local lower-pressure pipeline networks. While historically gas trading was primarily deemed to be traded at the "beach"—the physical shoreline locations at which producers input gas into the pipeline network—trading and delivery is now primarily deemed to take place at the National Balancing Point, a notional (i.e., virtual) point of delivery.

National Grid also plays a role in gas balancing, discussed below.

Ofgem

Ofgem regulates the electricity and downstream gas sector in Great Britain, acting on behalf of the Gas and Electricity Markets Authority.[6] Its roles include capping prices to consumers, issuing price control regulation for companies in the gas network, granting, modifying and enforcing licenses and approving significant changes to the "industry documents," the collection of codes and agreements that govern the conduct of licensed gas industry entities (and, in limited circumstances, unlicensed entities).

Among Ofgem's principal objectives is the protection of consumers' interests. This covers a wide range of interests, including the reduction of greenhouse gases, fair treatment of consumers and security of receiving gas. With several of the smaller gas suppliers exiting the market within a short timeframe, Ofgem's focus has been ensuring continuity of gas supply by requiring the transfer of customers from the exiting companies to other suppliers.

Gas Trading – Exchanges and Clearing Houses

As noted above, gas shippers may buy gas on exchange, either with physically delivered futures or OTC contracts. Intercontinental Exchange hosts the physical futures contract[7] (through IFEU) and operates the market for spot contracts[8] (through ICE Endex Gas Spot UK) that deliver at the National Balancing Point. Both contracts are cleared by ICE Clear Europe.

Exchanges

As discussed above, gas shippers may buy and sell gas on an exchange, either on a same-day or close-to-same-day basis under spot contracts or using physically delivered futures. At the moment, the pain point in the gas supply chain is at supplier level. It is not generally suggested that companies engaging exclusively in gas shipping are at imminent risk of failure. However, companies and groups that engage in both gas supply and gas shipping may be at risk in the current crisis—for example Enstroga Limited, which failed in September 2021, was licensed for both gas supply and gas shipping.

Therefore, the consequences of the failure of a gas shipper that is a member of an exchange under the exchange's rules should be considered. There are a number of companies licensed to both supply and ship gas that are members of major exchanges.

Insolvency of an exchange member will be an event of default under the rules of an exchange. If an exchange member defaults, e.g., due to an insolvency or similar event, the exchange would usually suspend its access to stop further trading and work with other participants to ensure a smooth process for any outstanding or upcoming deliveries.

In addition, even if the current crisis does not result in insolvencies of exchange members, participants in the gas markets—both physical and cash-settled—should recognise that increased price volatility will usually result in a higher cost of trading as a result of, e.g., increased collateral contribution obligations in respect of trades assessed as more risky. Higher volatility, of course, means scope for larger trading losses, as well as gains.

Clearing Houses

Exchange traded contracts are required to be cleared by a clearing house. Clearing house members are usually financial institutions who may not trade gas themselves. However, many of these members will clear contracts on behalf of customers who are active in the gas supply chain. Insolvency or administration at the customer of a clearing member is not generally dealt with under the rules of the relevant clearing house, but rather this will be governed by the documentation between the clearing member and its customer. Common clearing member-customer documentation are those forms published by the Futures Industry Association with the International Swaps and Derivatives Association (FIA-ISDA).

If a customer defaults under its agreement with the clearing member, the clearing member usually has extensive rights to liquidate the customer's open contracts. For example, the FIA-ISDA Cleared Derivatives Addendum[9] (Addendum)[10] allows the clearing member to enter close-out transactions in respect of the customer's account. The clearing member will close out the transactions either by entering into offsetting contracts on the customer's account (i.e., by entering into opposite positions to the customer's existing positions) or by assigning or novating the customer's positions to a third party (or most likely both).[11] In connection with closing out the customer's transactions, the clearing member will be entitled to apply margin and other collateral provided by the customer ("Credit Support" as defined in the Addendum) to meet amounts resulting from the close out of the underlying positions between the clearing member and clearing house ("Termination Amounts" under the Addendum).

On a customer insolvency or administration, a clearing member will request the assistance of the clearing house to carry out the necessary steps at clearing level (e.g., entering into the necessary offsetting contracts and recording assignments and novations). For contracts that go to physical delivery, the clearing member will work with the clearing house and the exchange to ensure that deliveries are effected to the substitute parties.

Generally, in the U.K. and EU, netting transactions entered into to close out a customer's positions are protected from the effect of national insolvency law that may otherwise prevent or inhibit such transactions, for instance, the general moratorium on new contracts imposed by an administration. These protections are provided for by, primarily, the Financial Collateral Directive, the European Market Infrastructure Regulation, and (if the clearing house is a "system" for these purposes) the Settlement Finality Directive and local law and regulations implementing this legislation (including as these regimes apply in the U.K. under the Financial Collateral Arrangements (No. 2) Regulations 2003, the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 and U.K. EMIR).

Gas Balancing

Any gas that enters the NTS must be balanced to ensure its safe operation. The NTS is the high-pressure system for transporting gas and refers to the process whereby the levels of gas in the NTS are maintained within safe limits. Gas shippers are encouraged to put in as much gas as they take out of the system each day. The terms of the Uniform Network Code establish incentives for gas shippers to flow gas on and off the NTS in a reliable and predictable manner. The National Grid, which operates the NTS and is also a regulated entity, acts as the residual balancer. It will only act if it considers that the system will not stay within the safe range. The National Grid will only intervene in balancing as a last resort because of the effect its balancing actions are likely to have on gas prices.

United Kingdom Energy Crisis Response

The U.K. Government has implemented measures to address issues arising from the energy price cap and put in place schemes for gas market participants and consumers. Ofgem has also taken steps to mitigate the challenges arising from the current environment.

UK Energy Markets Financing Scheme

On 8 September 2022, HM Treasury and the Bank of England announced a joint scheme designed "to address the extraordinary liquidity requirements faced by energy firms operating in the U.K. wholesale gas and/or electricity markets."[12] The Energy Markets Financing Scheme (EMFS)[13] will support electricity generators, suppliers and shippers that:

- Hold an Ofgem licence, or are part of a group where another entity is Ofgem-licensed;
- Make a material contribution to the U.K. energy markets, even if their parent is not incorporated in the U.K.; and
- Are of "good credit quality," i.e., there is a viable business in operation.

The EMFS is not available to state-owned firms or energy firms owned by financial institutions and commodity trading houses.

Eligible firms can apply for government-backed guarantees to secure commercial financing for:

- meeting collateral requirements resulting from hedging activity in over-the-counter (OTC) and exchange-traded markets; and
- reducing the risk or costs of contractual commitments related to the purchase or sale of electricity or gas intended to supply the U.K. domestic market.

Firms using the EMFS will be required to comply with certain conditions, such as restrictions on the use of funds, executive pay, and capital distributions.

The gas price cap

The price gas suppliers can charge domestic consumers on a standard (variable) or default tariff is capped by Ofgem. The price cap protects approximately 24 million U.K. domestic customers. The cap—established pursuant to the Domestic Gas and Electricity (Tariff Cap) Act 2018—sets the maximum price per kilowatt hour of gas and electricity a supplier can charge a consumer on a capped tariff, and also sets the maximum daily "standing charge" for each energy source. Many domestic consumers purchase gas at a fixed rate from their suppliers, which is not subject to the price cap. Commercial end users of energy are not protected by the price cap at all. Ofgem has used its power to increase the cap on consumer gas prices, which it hoped would mitigate some of the financial issues pressuring gas suppliers and limit further exits.

Temporary Energy Price Guarantee

In September, the U.K. government announced the Energy Price Guarantee (EPG), which replaces the price cap as of 1 October 2022 for a period of six months. The Energy Act 2022 amends the Domestic Gas and Electricity (Tariff Cap) Act 2018 to give effect to the EPG by empowering the Secretary of State to give notice that the default tariff cap will cease to have effect at a specified time. The EPG seeks to reduce the impact of the Ofgem price cap rise and hold down the annual cost of energy for a typical household at £2,500. The EPG scheme introduces a limit on the amount customers can be charged per unit of gas or electricity. Energy firms are then compensated for the difference between the wholesale price of gas and the amount chargeable to customers.[14] In practice, this means that each additional £1 that households spend on energy will be matched by 75p from the taxpayer. Shortly prior to the collapse of Liz Truss's premiership, the new Chancellor Jeremy Hunt curtailed the EPG from two years to six months, meaning it will end in April 2023.[15] A Treasury-led review will decide the scope of future support but concrete details are yet to be released. The revised program is expected to target lower-income households and will cost "significantly less" according to Hunt.[16]

Back to the gas price cap

When the EPG ends in April 2023, it is intended that the price cap will again be in effect. Ofgem calculates the prevailing price cap by reference to a number of factors, by far the largest of which is the wholesale energy price. The cap also takes into account a so-called "normal rate of return on capital" for suppliers, i.e., a maximum profit margin. The cap is designed to limit the profit a supplier can make on capped tariffs to 1.9%, which is applied as a flat margin within the cap calculations.[17] On 26 August 2022, Ofgem launched a consultation[18] on reform of the profit component of the price cap, identifying that a margin allowance applied as a flat rate results in higher profits for suppliers in a high-cost, high-price environment, since the margin allowance scales in line with the overall cap level. That large energy suppliers have posted record profits at a time when many consumers are struggling to afford their energy bills has, unsurprisingly, become a political issue. It remains to be seen how a reformed cap may affect suppliers: one plausible result is that a tighter profit allowance may cause further consolidation of the sector, with the few small suppliers that remain facing further financial pressures. In response to rapidly rising wholesale prices, Ofgem has also increased the frequency of price cap reviews from twice-yearly to quarterly.[19]

Energy Bill Relief Scheme for Great Britain

The Energy Bill Relief Scheme (EBRS) is set up to reduce the energy bills for all eligible non-domestic U.K. consumers and businesses for six months from October 2022. It provides for the reimbursement of licensed non-domestic energy suppliers that apply price reductions on customers' bills representing the wholesale energy price element of the bill. The Energy Bill Relief Scheme Regulations 2022 provide for the operation and the delivery of the EBRS, under powers granted to the Secretary of State by the Energy Prices Act 2022. Related 'pass-through' requirements will apply to intermediary firms which receive energy price support, mandating them to pass the benefit they have obtained to end users.

Gas Supplier Failure

Ofgem Action Plan

In response to supplier failures, Ofgem published, in December 2021, its "Building Energy Market Resilience"[20] action plan of regulatory reform. Measures in the package include:

- Increasing and refining the scope of information gathered from and disclosures made by suppliers in connection with financial resilience;
- Effective January 2022, launching a new financial stress testing process of suppliers;

- Launching a self-assessment exercise in early 2022 under which suppliers must demonstrate the adequacy of their systems, controls and governance; and
- The introduction of additional "fit and proper" requirements for senior personnel.

In the next stage of this action plan, Ofgem introduced a further series of supplier-related measures in February 2022.[21] These aim to reinforce earlier reforms on financial resilience and include:

- Strengthening the framework governing milestone assessments;
- Additional reporting obligations for significant commercial developments; and
- New notification requirements for senior personnel changes.

Gas Supplier Exits

When a gas supplier exits the market, Ofgem's preferred option is for that supplier to arrange for its customers to be transferred to another supplier through a trade sale. However, this takes time and is unlikely to be a realistic option during a fast-moving crisis. If this private market solution is unavailable, Ofgem will consider two options for regulatory intervention: the Supplier of Last Resort (SoLR) framework and the energy supply company special administration regime (esc SAR). From the consumer's perspective, the objective and outcome are largely the same: the continued supply of gas. However, for the supplier, the interventions are different in several important ways, not least that the SoLR means the exiting supplier will go through the normal insolvency process once its customers are transferred and its licence revoked, whereas a supplier under esc SAR administration will be subject to a special insolvency regime.

Supplier of last resort

What is it?

Under the SoLR framework Ofgem may appoint another energy company as supplier of last resort to whom the customers of a failing supplier will be transferred. The transfer is not itself an insolvency but a procedure the SoLR in question is compelled to comply with under the terms of its license.

Procedure

The selection process begins when a gas supplier is experiencing financial difficulties and notifies Ofgem of the circumstances.[22] Ofgem will then obtain relevant information from that supplier and will send requests to other licence holders for information on whether they are able to take on the customers under the terms set. Crucially, Ofgem must ensure that the chosen supplier is able to supply gas to the additional customers without impinging on its ability to service its existing customers.

The insolvency process of a failed supplier is separate from the SoLR procedure. Under the Gas Supply Licence Standard Conditions, if a licensee is unable to pay its debts (within the meaning of the Insolvency Act 1986), has a receiver appointed, has an administration order made in relation to it or is subject to winding-up, Ofgem may revoke its licence on 24 hours' notice.[23] Once Ofgem has revoked the licence of the exiting supplier, it will no longer be licensed under the Gas Act 1986 and the statutory restrictions on the normal administration or insolvency process applying to regulated gas industry entities fall away. The ordinary insolvency process will then begin.

Objective

The SoLR regulatory regime, set out in the Gas Supply Licence Standard Conditions, aims to protect customers by ensuring continued gas supply within a short time frame. The continuous supply of energy is ensured through the simultaneous revocation of the existing supplier's licence[24] and granting of the SoLR's licence.

Duties

Aside from the requirement to supply the customers of the failed supplier, the SoLR does not incur any other responsibilities.

Ofgem approach and use

The SoLR framework is best suited to market exits of smaller suppliers whose customer base is more likely be capable of being absorbed by a larger supplier at short notice. Its use has led to significant consolidation of the energy supply market, as illustrated in the table above.

Ofgem's preference is to appoint a SoLR that has consented to the role.[25] However, Ofgem has powers to appoint a supplier as SoLR without the supplier's consent, which it will consider exercising if no suitable supplier agrees to act as SoLR. This can be contrasted to transfer schemes under an esc SAR (discussed below), which do require the transferee's consent.

Current Developments

With gas prices remaining high, some commentators have suggested that many more suppliers will exit the market in the coming months. This has raised concerns about how even the larger suppliers will be able to provide gas to customers on fixed tariffs or on variable tariffs (which are subject to the gas price cap) on a commercially viable basis given the current high spot prices, especially if current hedging strategies are insufficient to cover customers transferred under SoLR.

If large suppliers cannot take on any more customers under SoLR arrangements, or indeed if large suppliers themselves come under pressure, the esc SAR may come into more widespread use.

There is no equivalent to the SoLR regime for gas shippers. SoLR applies only to gas suppliers.

Energy Supply Company Special Administration Regime

The esc SAR is provided for in the Energy Act 2011, which sets out when and how an energy supply company administration is put into place. It should be noted that the Energy Act 2011 incorporates the broad statutory transfer scheme provisions that exist for energy companies under the Energy Act 2004, which means that a transfer of the business could be achieved through the protection of an esc SAR.

What is it?

An esc SAR is a type of insolvency process with altered objectives that allows Ofgem to maintain the supply of energy from a failed supplier.

Procedure

Ofgem must obtain the consent of the Secretary of State to make an application to court for the appointment of an energy administrator. The Secretary of State may also make such an application itself.[26] A court will grant an esc administration order when it is satisfied either that: (i) the gas supplier is, or is likely to be, unable to pay its debts; or (ii) grounds exist for the Secretary of State to apply under the Insolvency Act 1986 to wind up the company on public interest grounds.[27]

When an esc SAR order is in place for a gas supplier, the Secretary of State may also provide financial support, guarantees or indemnities.[28] The Secretary of State has wide power to define the terms and conditions of any such support. The Secretary of State also has the power to modify the conditions of a gas (or electricity) licence or their standard conditions[29] and to modify licence conditions to secure funding of the esc SAR.[30]

Objective

The energy administrator must manage the supplier to achieve the objectives set out in the Energy Act 2011,[31] which are to (i) continue to supply gas at the lowest cost which it is reasonably practicable to incur; and (ii) secure the rescue of the supplier as a going concern, and where that is not possible, to transfer the supplier as a going concern to another company or companies.[32]

This changes the statutory objectives that would otherwise apply to an ordinary administration (where the objectives are principally focused on requiring the administrator to perform his functions for the benefit of the creditors as a whole or if that cannot be achieved, to perform his functions in a manner that does not unnecessarily harm the interests of the creditors as a whole). The esc SAR objectives clearly prioritise the interests of the consumer over creditors and, potentially, achieving a transfer of the supplier as a going concern. If a business has been transferred, either through a SoLR process or transfer scheme under the esc SAR, the objective for an esc SAR will have been fulfilled and the remaining supplier would no longer be an energy supply company, such that technically, any administration over what remains of the company should proceed on the basis of a normal administration, pursuant to which the administrator will be focused on collecting in the assets for the benefit of the remaining unsecured creditors (and, it applicable, secured creditors) having regard to his duties to those creditors.

Duties

A significant point of difference between the SoLR regime and the esc SAR process is that while Ofgem can direct a supplier to take on an exiting supplier’s customers under SoLR, transfer of customers to a new supplier under an esc SAR requires the transferee’s consent. While in the ordinary course suppliers would tend to welcome taking on new customers in an esc SAR process, in an unsettled market with difficult economics, it may prove difficult to find willing transferees.

Ofgem approach and use

The esc SAR process will be used where a SoLR is not possible or practicable. The regime is intended primarily for the failure of large gas suppliers where Ofgem does not believe that another supplier could take on the additional customers without prejudicing its ability to serve its existing customers. The esc SAR is relevant only to gas suppliers and not also to, e.g., gas shippers (although a broadly equivalent regime exists for gas transporters as “protected energy companies” under the Energy Act 2004). Gas shippers would be subject to the ordinary insolvency regime.

Current Developments

Over this recent period of volatility, Bulb Energy Ltd (Bulb) is the only company to be placed in special administration. There are various reasons why Ofgem opted for an esc SAR process here:

- Bulb was the U.K.'s seventh-largest energy supplier with approximately 1.7 million domestic customers. A SoLR transfer of this size would have been difficult for another supplier;
- The likelihood of high mutualisation costs to the market and resultant burden on consumers; and
- Existing suppliers were already in difficulty having taken on customers from over 20 other energy suppliers that had failed before Bulb.[33]

In October 2022, the U.K. government approved a deal agreed by the special administrators of Bulb to transfer the business' 1.5 million customers to Octopus Energy. The acquisition price per customer is reportedly the highest paid by any supplier to take on the customers of a failed competitor since the onset of supplier insolvencies in September 2021.[34] Octopus conceded they paid the government "above market value" for Bulb's customers.

The sale will be carried out through a statutory process called an Energy Transfer Scheme (ETS) that will see "the relevant assets of Bulb [placed] into a new separate entity that will protect consumers during the transfer process."[35] The procedure requires authorization from the Business and Energy Secretary and will commence following an order from the High Court, anticipated by the end of November.

Gas-fired power stations

Ofgem recently agreed to proceed with changing the industry rules governing electricity supply penalties payable by gas-fired power stations on an urgent basis.[36] A potential energy emergency raises the prospect of gas supplies being cut to gas-fired power stations which, if they have sold power by forward trading, would leave them unable to deliver. Under current industry rules, significant fines are levied upon power plants that fail to deliver promised electricity supplies. SSE, which has a gas-fired power station and supplies electricity, estimates that some companies could incur daily penalties of up to £276 million.[37] Ofgem has therefore accelerated the review of the penalty rules to stave off potential insolvencies of gas-fired generators.

European Union Energy Crisis Response

Russia's invasion of Ukraine has given rise to a sharp increase in energy prices across the EU and exceptional volatility on gas and electricity derivative markets. The situation is more troublesome than in the U.K.: the U.K. essentially does not rely on Russia for gas, producing its own and importing some from Scandinavia. The U.K.'s difficulties are in large part a result of changes to regional supply and demand. In contrast, much of continental Europe directly relies on Russia for gas supply. The average expenditure among EU Member States on energy has increased by more than one-third from 2019 to 2022 and it has recently been claimed that 8% of EU citizens now live in energy poverty.[38] The EU faces the challenge of meeting demand, as well as pricing issues. As regards pricing issues, the European Commission has set out a draft package of measures to address the high price of gas and protect consumers against the external shock of further increases.[39] However, these remain subject to political agreement. The main elements of the proposed package are set out below.

Action on gas price levels

New Complementary Benchmark for LNG

The price of front-month gas on the Dutch Title Transfer Facility (TTF) currently serves as an EU wide benchmark and therefore impacts price levels in long-term contracts across the EU including LNG transactions. The index is sensitive to pipeline infrastructure bottlenecks in North-Western Europe caused by Russian manipulation of natural gas supplies. In August 2022, the price of gas reached an all-time high of €340 per megawatt following Russia's temporary suspension of exports.[40] The Commission is considering introducing a new complementary price benchmark for LNG. Under the proposed regulation, the Agency for the Cooperation of Energy Regulators (ACER) would first create an objective price assessment tool so that it is operational for the 2022/2023 winter season. The price assessment tool would be complemented by the publication of a benchmark of the EU's LNG imports by 31 March 2023 at the latest.[41]

Gas Market Correction Mechanism

Another EU proposal to limit gas prices is the so-called gas market correction mechanism. This would empower the Commission to trigger, when needed, a maximum dynamic price for natural gas spot market transactions on the TFF.[42] Other EU trading hubs could be connected to the corrected spot through a "dynamic price corridor." The Commission stated the mechanism would be used as a last resort to avoid "extreme volatility and excessive prices."[43] Appetite for such a measure however is not universal among Member States. Germany and the Netherlands have cautioned that a dynamic price cap may put security of supply at risk if it prompts LNG tankers to sail to Asia instead. Moreover, as a practical point, it is not clear why any seller of gas would trade on-exchange TTF, if that price was capped and they could therefore achieve higher prices on the OTC market. So far, stalemate at a national level and falling gas prices off the back of unseasonably mild weather have slowed the impetus for an agreement. Regardless, advocates of the cap such as the Czech Republic continue to emphasize the need for a mechanism against future price spikes.[44]

Intra-day volatility management mechanism

It is also proposed to require trading venues, on which energy-related commodity derivatives are traded, to set up temporary intra-day volatility management mechanisms, based on an upper and lower price boundary that defines the prices above and below which orders cannot be executed. Trading venues would need to adopt price boundaries taking into account the attributes of each front-month energy-related commodity derivative as well as the liquidity and volatility of the market. Trading venues would need to ensure that their intra-day volatility management mechanisms prevent excessive price movements in a trading day. Such mechanisms would be required to be in place by 31 January 2023, however, preliminary mechanisms that broadly accomplish price stability would be required to be put in place before then.

The intra-day volatility management mechanism will not replace, but be in addition to, any circuit breakers already established by trading venues under the Markets in Financial Instruments Directive.[45]

Gas Price Cap

Out of scope of the proposal is a gas price cap. The European Council has called on the Commission to submit proposals on a cap for the price of gas in electricity generation.[46] Although a price cap of this kind is currently in place in Spain and Portugal, Brussels has expressed reservations about a Union-wide roll out of the mechanism. In particular, the Commission warned that a cap could cause an increase in gas usage and greater exports of EU-subsidized electricity to countries with higher prices such as the U.K. and Switzerland.[47] While the European Council emphasized that any concrete decision on a cap should include measures to prevent a spike in gas consumption, these matters have yet to be addressed by the Commission and no proposal has been put forward.

Joint purchasing and efficient operation of gas infrastructure

The Commission also proposes to introduce a temporary joint purchasing tool which would involve the establishment of, among other things, governance arrangements for demand aggregation of natural gas and potentially, joint purchasing under the Energy Platform. In addition, the proposal would aim to make the operation of pipelines and LNG terminals efficient given the change to gas flow patterns in the EU as a result of Russia's actions.

Security of supply

In addition, it is proposed to extend the solidarity protection obligation to critical gas fired power plants by allowing Member States to make a solidarity request, under certain conditions, if gas-fired power plants needed to ensure the electricity system's adequacy are at risk of not being supplied with critical gas volumes. The proposed Regulation also sets out the rules and procedures that will automatically apply between Member States which have not agreed on bilateral solidarity arrangements. Finally, it is proposed that, in extraordinary circumstances, the Council would be empowered to make efficient allocation of the gas capacities available to those Member States affected by a regional or EU emergency.

Recent press reports indicate that Germany has raised the possibility of a solidarity agreement between Germany and the U.K. to secure the supply of natural gas over the coming winter.[48]

[1] Downstream gas and electricity is regulated in Northern Ireland by the Northern Ireland Authority for Utility Regulation (the "Utility Regulator") (https://www.uregni.gov.uk/).

[2] According to Ofgem, around 30% of customers obtain gas from small to medium-sized suppliers.

[3] Letter from Ofgem dated 3 March 2021 appointing British Gas Trading Limited as Supplier of Last Resort for Simplicity Energy Limited.

[4] ICAEW Insights, 'Energy supplier collapses highlight bigger sector crisis' (22 August 2022).

[5] Historically, entities that only traded gas had to obtain a gas shippers licence. That is no longer the case, although there are some traders that still have their licences.

[6] Many of the powers contained in the relevant legislation are conferred on the Gas and Electricity Markets Authority. These are generally exercised by Ofgem.

[7] See ICE Futures Europe's site for physical futures contracts, available at https://www.theice.com/products/910/UK-Natural-Gas-Futures.

[8] See ICE Endex Gas Spot UK's site for UK OCM Gas Spot contracts, available at https://www.theice.com/products/43396041/UK-OCM-Gas-Spot.

[9] At clause 7(a) of the FIA-ISDA Cleared Derivatives Addendum.

[10] "Offsetting Transactions" and "Sale/Novation Transactions" under the Addendum, respectively.

[11] Bank of England, 'HM Treasury and Bank of England to launch the Energy Markets Financing Scheme (EMFS)' (News Release, 8 September 2022).

[12] Joint HM Treasury and Bank of England Energy Markets Financing Scheme (EMFS) (Market Notice, 17 October 2022).

[13] https://www.eonnext.com/electricity-and-gas/energy-price-guarantee

[14] HM Treasury, 'Chancellor brings forward further Medium-Term Fiscal Plan measures' (17 October 2022).

[15] Claer Barrett, David Sheppard and Jim Pickard, 'UK household energy bills to rise as Hunt redraws support scheme' *Financial Times* (London, 17 October 2022).

[16] Profit is calculated on an earnings before interest and tax (EBIT) basis. This figure was set on the introduction of the cap by reference to the Competition and Markets Authority's estimate of the EBIT margin of the so-called "big six" energy suppliers, during a time when energy supply was a generally low-cost, low-price market - Ofgem, 'Default Tariff Cap: Policy Consultation' (25 May 2021).

[17] Ofgem, 'Consultation on amending the methodology for setting the Earnings Before Interest and Tax (EBIT) allowance' (26 August 2022).

[18] Ofgem, 'Ofgem confirms changes to the price cap methodology and frequency ahead of new rate to be announced later this month' (Press release, 4 August 2022).

[19] Ofgem, 'Call for Input: Action plan on retail financial resilience' (15 December 2021).

[20] Ofgem, 'Decision on strengthening milestone assessments and additional reporting requirements' (4 February 2022).

[21] Under the Gas Supply Licence Standard Conditions, gas suppliers are under an obligation to provide Ofgem with certain information and must be open and co-operative with Ofgem.

[22] “Unable to pay its debts” has the meaning given in section 123(1) or (2) of the Insolvency Act 1986. Ofgem will make an application to the court for a declaration that a gas supplier is unable to pay its debts.

[23] Gas supplier licences are granted under the Gas Act 1986, which provides that it is an offence to supply gas, ship gas or provide a smart meter communication without a licence to do so.

[24] Paragraph 2.12, Ofgem’s guidance on SoLR, 2016.

[25] The Secretary of State’s involvement in esc administration orders is provided for by the Energy Supply Company Administration Rules 2013.

[26] Energy Act 2004, section 157(2), as applied by section 96 of the Energy Act 2011.

[27] Energy Act 2004, sections 165 to 167, as applied by section 96 of the Energy Act 2011. Certain of these measures require the consent of Treasury.

[28] Energy Act 2011, section 98.

[29] Energy Act 2011, section 99.

[30] Energy Act 2011, section 95.

[31] Energy Act 2004, Schedule 21, applied to energy supply companies under Energy Act 2011, section 96.

[32] Emily Davis, '(UK) Keeping the (light) Bulb on special energy administrations – what will happen next to Bulb ?' *Restructuring GlobalView* (London, 15 December 2021).

[33] Megan Baynes, 'Octopus Energy seals bid to take over 1.5 million Bulb customers' (*Sky News*, 29 October 2022).

[34] Department for Business, Energy & Industrial Strategy and The Rt Hon Grant Shapps MP, 'U.K. government approves agreement between Bulb and Octopus Energy, providing certainty to 1.5 million customers' (Press Release, 29 October 2022).

[35] Letter from Grendon Thompson, Ofgem, to Michael Gibbons, BSC Panel Chair (30 September 2022).

[36] See GC0160 - Grid Code Changes for BSC Mod P448: "Protecting Generators subject to Firm Load Shedding during a Gas Supply Emergency from excessive Imbalance Charges."

[37] Commission, 'Report on the State of the Energy Union' COM (2022) 547 final.

[38] Commission, ‘Proposal for a Council Regulation on enhancing solidarity through better coordination of gas purchases, exchanges of gas across borders and reliable price benchmarks' COM (2022) 549 final.

[39] Andy Bounds, Javier Espinoza and David Sheppard, 'EU leaders hail breakthrough in gas cap plan to tackle energy crisis' *Financial Times* (London, 21 October 2022).

[40] Commission, 'Questions and Answers on proposals to fight high energy prices and ensure security of supply' (Questions and Answers, 18 October 2022).

[41] *Ibid*.

[42] Commission, 'Energy Emergency - preparing, purchasing and protecting the EU together' (Communication) COM (2022) 553 final.

[43] Kate Abnett, 'EU edges towards gas price cap with more emergency talks' (*Reuters*, 25 October 2022).

[44] Directive 2014/65/EU on markets in financial instruments.

[45] European Council, 'Note: European Council meeting (20 and 21 October 2022)
– Conclusions' (EUCO 31/22, 21 October 2022).
[46] Kate Abnett, 'EU cautions against gas price cap for electricity – document' (*Reuters*, 24 October 2022).
[47] Philip Oltermann, 'Germany keen to discuss natural gas pact with UK amid supply risk' (The Guardian, 8 November 2022).

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