

EXPLANATORY MEMORANDUM TO
THE ENERGY SUPPLY COMPANY ADMINISTRATION RULES 2013

2013 No. 1046

1. This explanatory memorandum has been prepared by the Department of Energy and Climate Change and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. **Purpose of the instrument**

2.1 This explanatory memorandum has been prepared for the Energy Supply Company Administration Rules 2013, which implement provisions in the Energy Act 2011 for a special administration regime for energy supply companies in England and Wales.

3. **Matters of special interest to the Joint Committee on Statutory Instruments**

None.

4. **Legislative Context**

4.1 The Rules are made under the Insolvency Act 1986 ("the 1986 Act"), as applied by the Energy Act 2004 ("the 2004 Act") and the Energy Act 2011 ("the 2011 Act"). Section 411(1)(a) of the 1986 Act empowers the Lord Chancellor, with the concurrence of the Secretary of State, to make rules for the purpose of giving effect to Parts 1 to 7 of the 1986 Act. Schedule B1 to the 1986 Act provides for administration.

4.2 Chapter 3 of Part 3 of the 2004 Act provides for a special administration regime for gas transportation and electricity transmission and distribution companies facing actual or threatened insolvency. Section 159 of the 2004 Act applies the power to make rules conferred by section 411 of the 1986 Act to give effect to Chapter 3 as it applies for the purpose of giving effect to Parts 1 to 7 of the 1986 Act. Schedule 20 of the 2004 Act provides for certain provisions of Schedule B1 of the 1986 Act to have effect in relation to energy administration, Schedule 21 covers the content and effect of transfer schemes which can be made to ensure that the objective of the energy administration is met.

4.3 Chapter 5 of Part 2 of the 2011 Act applies much of Chapter 3 of Part 3 of the 2004 Act (and Schedules 20 and 21) with modifications.

4.4 The Rules mirror as far as possible the Insolvency Rules 1986 (S.I. 1986/1925) (as amended) and the Energy Administration Rules 2006 (S.I. 2005/2483) and depart from them only where necessary to accommodate the special provisions of energy supply company administration. The Department is also laying a separate set of Energy Supply Company Administration Rules for Scotland before Parliament.

5. Territorial Extent and Application

5.1 This instrument applies to England and Wales.

6. European Convention on Human Rights

6.1 As the instrument is subject to the negative resolution procedure, and does not amend primary legislation, no statement is required.

7. Policy background

7.1 The purpose of energy supply company administration is to ensure that if a large gas or electricity supply company is in financial difficulty, arrangements can be put in place to allow the company to continue operating until it is either rescued, sold, or its customers transferred to other suppliers. This will reduce the risk of financial failure spreading across the energy market, maintain market stability and therefore protect consumers.

7.2 Energy supply company administration is intended as a backstop to the supplier of last resort arrangements included in supply licences under the Electricity and Gas Acts, which allow Ofgem to revoke a supplier's licence if it becomes insolvent and appoint another supplier to take over its customer accounts. In order to protect other market participants from exposure to the failed supplier's debt, this process is generally completed within 48 hours of the company being declared insolvent. The failed supplier receives no payment for the customer accounts which are transferred.

7.3 Experience of small suppliers' insolvency has shown there is a significant risk the supplier of last resort arrangements would not be effective in dealing with the insolvency of large suppliers because of the large volume of customers involved. Other market participants would face increased exposure to the failed supplier's debt as its customers would continue to be supplied with energy through the industry's balancing and settlement arrangements, rather than under contract. If the supplier in financial distress defaults on the charges incurred through supplying customers through the balancing mechanisms, the charges are smeared across other market participants in line with the market trading arrangements. If a large supplier became financially distressed and its customers were supplied through the balancing mechanisms,

industry systems would be placed under a tremendous strain with the risk of financial failure spreading across the market.

7.4 The Government therefore judges it prudent to put in place a framework to ensure the continued operation of a large energy supply company experiencing financial distress, and for which no buyer can be found. It will allow the company to continue operating, potentially with financial assistance from the Government, if the company is unable to secure funding from commercial sources, until it is either rescued, sold or its customers transferred to other suppliers.

7.5 Under energy supply company administration the administrator's actions are constrained by the duty to continue to supply customers until the company is either rescued, sold or its customers transferred to other suppliers. This is likely to result in less favourable outcomes for creditors and shareholders than under ordinary administration.

8. Consultation Outcome

8.1 The Government consulted on the draft rules between June and September 2011. The consultation was intended to give interested parties an opportunity to comment on the draft technical rules of procedure, rather than the policy design. We received 7 responses. Respondents welcomed the introduction of energy supply company administration and agree that it will protect the gas and electricity markets from the risk of financial failure spreading in the event of a large supplier becoming insolvent.

8.2 Three respondents suggested that it was unfair that the Government envisaged applying for an energy supply company administration order only if a large supplier were in financial distress. They argued that all supply companies encountering financial difficulties should be given the opportunity of being rescued prior to Ofgem implementing its supplier of last resort process.

8.3 The Government believes that the restrictions placed on creditors' and shareholders' rights in an energy supply company administration can only be justified in order to ensure the continued operation of essential services. Therefore it is the Government's intention to apply for an energy supply company administration order only if it is not feasible for Ofgem to appoint a supplier of last resort, i.e. where a large supplier becomes, or is likely to become, financially insolvent (see section 7 above).

8.4. The Government also consulted the Lord Chancellor's Insolvency Rules Committee and reflected its comments in the rules.

9. Guidance

9.1 The Government does not intend to introduce guidance to accompany the rules. The rules, if used, would be followed by insolvency practitioners, who are already well versed in insolvency proceedings.

10. Impact

10.1 A full impact assessment has been prepared. There are no additional costs on business, charities or voluntary bodies. Government and Ofgem would experience some small administrative costs if the provisions were ever used.

11. Regulating small business

11.1 The legislation allows the Secretary of State to apply to the court for an energy supply company administration order in respect of all energy supply companies. However, in practice the Secretary of State will apply for an energy supply company administration order only if it is not feasible for Ofgem to appoint another supplier to take on the customers of the insolvent supplier, under its supplier of last resort process. The supplier of last resort process is likely to be feasible for all but the largest suppliers.

12. Monitoring & review

12.1 There are no formal monitoring or review requirements, as energy supply company administration is a contingency measure designed to deal with a low probability, but high impact event, and may never be used. If the Rules were used the Government would review them then.

13. Contact

13.1 **Dawn Armstrong** at the Department of Energy and Climate Change; Tel: 0300 068 6755 or email: dawn.armstrong @decc.gsi.gov.uk can answer any queries regarding the instrument.