

Insolvent Energy Supply Companies: Treatment of Certain Creditors and Potential Dilution in Recoveries for Unsecured Creditors Following Latest High Court Ruling

Mark Fine, Partner, and Ryan Clarke, Associate, McDermott Will & Emery UK LLP, London, UK

Synopsis

On 11 November 2022, the High Court handed down an important judgment which clarified several issues arising in relation to the insolvencies of energy supply companies. In the case, the administrators and liquidators of several insolvent energy supply companies asked the court to rule on: (i) whether outstanding sums (actual and contingent) relating to the obligation of energy supply companies to evidence their use of renewable sources of energy were provable; and (ii) whether a supplier of last resort (SoLR) could pursue an unjust enrichment claim in particular circumstances.

In relation to the first issue, Mr Justice Zacaroli held that the liabilities (actual and contingent) arising in connection with the above were provable; the Court concluded that an energy supply company which failed to discharge its renewables obligation had a contingent liability to make a payment in lieu before 1 September and thereafter it became an actual liability which continued beyond 31 October despite the existence of the mutualization scheme from that date.

In relation to the second issue, Mr Justice Zacaroli held that the relevant energy supply companies had been enriched by the SoLR's satisfaction of their customer balances and that this enrichment was unjust. The SoLR's payment of the energy supply companies outstanding customer debts were held to enrich the insolvent energy supply companies on the basis that payments were implicitly requested / ratified or paid under legal compulsion, and that enrichment was at the expense of a SoLR. Whilst the liquidators and administrators of the insolvent energy supply companies pursued the claim in order to gain clarity on how sums should be correctly and fairly distributed on an insolvency – the ruling is also of particular interest to unsecured creditors whose returns could be diluted if similar circumstances are faced.

On 11 November 2022, the High Court handed down judgment in *Re Utility Point Limited and Ors [2022] EWHC 2826 (Ch)* – in a time of increased market volatility, this decision has far-reaching consequences for distressed energy suppliers, especially those that

participate or have participated in the 'Supplier of Last Resort' process.

Background

The case was brought by several liquidators and administrators (the 'Applicants') of certain insolvent energy supply companies ('ESCs') (including the likes of Utility Point) that had previously been authorised, under the Electricity Act 1989 ('EA 1989') and the Gas Act 1986 ('GA 1986'), to supply electricity and gas to domestic customers in the UK. Following Court declarations that these ESCs could no longer pay their debts as they fell due (and were therefore insolvent), their licences were revoked by the Gas and Electricity Markets Authority (the 'Authority') and their respective customer bases were transferred to third party providers of gas and electricity, otherwise referred to (each individually) as a 'supplier of last resort' ('SoLR').

The Applicants asked the Court to broadly consider two issues within the context of the SoLR statutory regime:

The renewables obligation

The renewables obligation requires certain ESCs to issue certificates ('ROCs'), stating the extent to which they have acquired electricity from renewable sources of energy. The Authority informs the relevant ESCs of the number of ROCs they are required to provide and the relevant ESCs have until 1 September of that relevant year (the 'Specified Day') to provide the ROCs, accounting for and with reference to an obligation period running from 1 April to 31 March of the relevant year (the 'Obligation Period'). If the requisite ROCs are not provided by the Specified Day, ESCs are required to make a 'buyout payment' to the Authority which, subject to a one-month grace period, should be paid before the Specified Day in the following Obligation Period.

It's within this statutory context that the Applicants asked the Court to determine whether the Authority

has a provable claim in cases where an ESC was yet to provide the requisite ROCs prior to entering insolvency.

Unjust enrichment

The Applicants further sought a second determination, asking the Court to determine if a SoLR was able to pursue a claim in equity against an insolvent ESC on the basis that a SoLR is compelled, by statute, to honour the outstanding credit balances of an insolvent ESC. It was argued that this legislative obligation would temporarily extinguish any insolvent ESCs' liabilities owed to previous customers (and in turn unjustly enrich the insolvent ESC). Such circumstances would arise when, for example, ex-customers of the insolvent ESC had paid for their energy supply upfront and by direct debit in the time immediately preceding the insolvency of the ESC.

Mr Justice Zacaroli handed down judgment.

Decision

Renewables obligation

The Court considered the scope of the renewables obligation, confirming its split nature. On the one hand, there was a primary obligation to provide ROCs to the Authority, demonstrating the renewable outlets sourced by the ESC and, on the other, a secondary, contingent obligation to pay an amount in lieu to the Authority if the renewables obligation was not met when required. Notwithstanding the statutory *mutualisation scheme* (a scheme designed to protect any extensive liabilities arising in connection with the renewables obligation), due to the dual nature of the renewables obligation, the Court confirmed that a contingent payment liability arose (contingent on whether the ESC would meet the ROCs) before such payment was crystallised and constitutes a liability and, as such, is attributable to the estate of an ESC on insolvency.

Unjust enrichment

On the second claim (and within the regulatory and legislative context of the current application), the Court considered the limbs that would traditionally be

needed to meet an unjust enrichment claim. This included questions as to whether the insolvent ESC had been enriched by the SoLR's satisfaction of their previous customer balances and if so, whether this enrichment was unjust.

The Court confirmed that both limbs were satisfied: an insolvent ESC is enriched by the SoLR's payment of its customer debts and, within the context of the legislative framework i.e., the process by which a failing ESC is replaced by a SoLR, there was an implicit request / ratification by the ESC for its customer balances to be honoured. The Court determined that this gave rise to a right in equity for the SoLR to be subrogated to the customers' claims against the failed ESC in the absence of a direct contractual relationship.

Citing the inevitable complexities of the matter, the Court refused to grapple with the question of whether previous customers of an insolvent ESC would have a claim against the insolvent ESC potentially arising when debit payments were made but before the transfer of any credit balances to the SoLR. Such position remains unclear but will undoubtedly be tested at a later date.

Comment

This decision is useful in clarifying a number of legal questions that were previously unanswered in the context of organising and arranging the liabilities of insolvent ESCs. In practice, it provides helpful guidance for insolvency practitioners tasked with arranging such liabilities, namely (i) that amounts (or contingent liabilities) due to the Authority under the renewables obligation are treated as liabilities, (ii) clarity on the point at which these liabilities crystallise and form part of an insolvent ESC's estate, and (iii) where these liabilities fall within the wider context of a restructuring.

Importantly, unsecured lenders will be wary of this decision given it ultimately dilutes the returns they can expect from an ESC's estate – now, not only will an unsecured lender have to share returns with shareholders and other common unsecured lenders, but potentially also the Authority and/or a SoLR.

The written judgment for *Re Utility Point Limited and Ors* [2022] EWHC 2826 (Ch) can be found on the British and Irish Legal Information Institute website.¹

Notes

¹ <https://www.bailii.org/ew/cases/EWHC/Ch/2022/2826.pdf>.