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Darren Jones MP
Chair, Business, Energy & Industrial Strategy Committee
House of Commons
London
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By email: beiscom@parliament.uk

Dear Darren

I was grateful for the opportunity to appear at the Committee's session on energy pricing and the future of the energy market last month. Given the nature, and unpredictability, of the ongoing issues that we are navigating, I of course stand ready to provide any further evidence to the Committee which may support its work. Given pressure on time at Tuesday's session, I also wanted to follow up on a number of points that the Committee may wish to consider.

Support for households going into Autumn

With millions of households already feeling the pain of increased living costs, the prospect of a further Autumn increase to the price cap weighs heavily on all our minds. I am acutely aware of the impact that this will have on many of our customers.

While energy consumption reduces in the summer, once we experience colder weather in Autumn alongside a further likely increase in the price cap, we will expect to see the real impact on consumers' bills. Without further intervention from the Government, I fear things will get substantially worse for households. Ultimately, it is down to Government and policymakers how to do this, but a targeted and straightforward option may be expansion of Warm Homes Discount, as well as suspending VAT, temporarily moving policy costs into general taxation. I believe this would be simple package to implement and would have a real impact – potentially worth almost £500 to households.

As I mentioned to the Committee, as well as our £6 million customer support fund, the British Gas Energy Trust has, in the last year, provided £1.8 million of debt relief – including for the customers of other energy companies – as well as emergency fuel vouchers, and grants to replace boilers. A further £3.6 million in funding has supported 49 frontline charity organisations who support debt and energy advice. The Committee would be very welcome to visit one of the frontline advice centres being funded through the Trust, to see first-hand the vital work that they are doing.

Regulatory reform

In our written evidence to the Committee, and during my appearance this week, we urge Ofgem to bring forward a package of financial resilience measures.

I think it was plain from the later evidence that the Committee heard from Bulb and Avro Energy, that it is essential the sector is subject to stricter regulation which promotes market stability, incentivises prudent risk management by suppliers and minimises socialisation of the costs of supplier failure. This already exists in the financial services sector and can easily be replicated. We believe this can be achieved through the adoption of the following four measures by Government and Ofgem, which should be implemented as soon as possible:

1. ***Fit and Proper Person Testing***. It was extraordinary to hear from Jake Brown during the Committee session that he had never undertaken a fit and proper test with Ofgem, or in the case of Hayden Wood, that Bulb had apparently been able to self-certify this for executives. I would strongly argue for an authorisation regime that creates sufficient accountability for the most senior executives through personal liability for failures to manage systemic failures and/or consumer harm.
2. ***Proper Monitoring of Risk Management (including hedging).*** The provision of additional resources to the sectoral regulator to support enhanced supervisory and enforcement capability.
3. ***Capital Adequacy.*** Mandatory capital adequacy requirements for all suppliers to ensure suppliers have appropriate capital to make good customer commitments, which take into account both market and weather stress testing, discounted only where suppliers are effectively hedged; and
4. ***Ability to refund Customer Credit Balances.*** Again, it was extraordinary during the Committee's session with Jake Brown to hear of a company founder who has injected £250,000 to start up the business, trading off customer balances to grow the business, and then paying a management company £250,000 a month to run the business. This situation reinforces why maintenance of sufficient capital to refund all customer deposits on demand should be a requirement. Customer deposits are in effect short term prepayments for energy and should be repayable on demand, not used to fund day to day operations. I welcome recent steps by Ofgem which indicate they are looking seriously at this, but I would reiterate the point that there should be no transitional provision if we are to avoid further market failures – time is of the essence as companies will be building up substantial credit balances over this summer and I fear there is a very real risk that companies could once again go out of business in the second half of the year taking hundreds of millions of pounds of customer money with them.

I particularly welcome the valuable work that the Committee is doing to examine the conduct of management linked to supplier failures. Given some of the testimony heard, it is frankly surprising that no-one has yet been prosecuted or disqualified months after a catalogue of failures. We have again written to the Insolvency Service to urge them to act and create the necessary deterrent effect in light of the mounting evidence that has emerged. I enclose a copy of our letter. I would also urge the Committee to look at how the role that administrators play in ensuring a smooth and speedy transition for customers through the Supplier of Last Resort (SoLR) process can be improved. As mentioned to the Committee, amongst of the most difficult SoLR transitions that we have been involved in related to PFP and People's Energy, where it took three months to negotiate a transitional service agreement. This causes unacceptable distress for customers, and frustration for energy suppliers with customer service badly impacted. There is often little incentive for administrators to conclude these process speedily, but for households who need certainty about their utility bills, we need a streamlined and swift arrangement put in place. We would urge the Committee to consider recommending changes to the duties and obligations of administrators in a SoLR scenario under the Insolvency Act and suggest, in the interim, that the Insolvency Service could promptly issue guidance to practitioners as to the expectations of their conduct.

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Fundamentally, the core policy objective of the energy supply retail market should be to protect current and future consumers, including the reduction of greenhouse gas emissions. This objective can be delivered by building a resilient market made up of well-capitalised suppliers; encouraging vigorous and responsible competition between suppliers; developing a stable and predictable regulatory and policy framework that will encourage investment; and ensuring help is targeted at those most in need.

It is important that action now undertaken by Government and Ofgem to reform the retail energy market and resolve the energy price crisis does not impact the move to net zero. If we are to achieve net zero by 2050 the UK needs a strong energy market where suppliers are financially resilient, there is adequate infrastructure and a robust supply chain to meet net zero, and customers have transparency about what the journey to net zero will mean for them. Net zero brings significant opportunities for consumers, investment and jobs. Earlier this week I was pleased to announce plans to recruit an additional 500 customer agents to help improve our customer service and ensure we can better support our customers through a difficult period. This is in addition to our commitment to hire 3,500 apprentices by 2030 as we upskill our engineers for the green transition, so they have the skills to install, for example, heat pumps and Electric Vehicle charging points.

UK energy resilience and storage

One final point, which may be of interest to the Committee in the context of its wider inquiries, is in relation to energy resilience and how we can best support the Government's recently published British Energy Security Strategy.

Energy security is a vital part of a healthy and robust energy market and the greatest resilience is achieved through diversity of supply. The UK has a strong track record in this respect. Understandably, many of the initiatives set out in the Government's plan will take time to implement. However, one possible option to boost security and resilience in the short term is increasing storage capacity.

We believe it would be prudent for the UK to invest in additional gas storage as an additional buffer to help make the supply chain more robust and reduce the impact of further price volatility. The flexible nature our Rough storage facility means it could be used as methane gas storage to help ease some volatility in prices as the UK transitions to low carbon fuels such as hydrogen. The Rough reservoir could be returned to a storage facility in c.6 months, ready for the winter, with the ability to store 30bcf of gas, or the equivalent of 10 LNG tankers. This would increase the UK's gas storage by 50%, providing vital resilience in these uncertain times. Longer term, we could further increase the capacity of Rough to over 100bcf with a view to converting it to hydrogen storage in the late-2020s, so it can play a key role in the transition to net zero. We are currently in discussion with Government on these options but would be pleased to provide further information on the potential role Rough could play.

I hope that this information is helpful, but please let me know if there is any further information that we can share with the Committee meantime.

Yours Aye

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Tuesday, 26 April 2022

Dear Keith

Energy supplier failures – Insolvency Service enforcement action

I refer to my previous letter to the Insolvency Service dated 11 October 2021 and your subsequent response dated 18 October 2021 (both of which are attached) regarding our material concerns about the underlying causes of energy supplier failures, the very significant adverse consequences for UK energy consumers and the need for effective enforcement action by the Insolvency Service to deter future misconduct and mismanagement by directors of energy suppliers.

The level of our concern has been heightened by the failure of a further 19 energy supply companies, which have entered into administration (or, in the case of Bulb Energy, special administration) since my letter of 11 October. This takes the number of energy suppliers which have failed since January 2021 to 31 (and since January 2018 to 51).

I noted in my original letter that the underlying causes of these failures were: (a) irresponsible and reckless practices pursued by directors of the companies involved; and (b) a regulatory regime that has failed to provide for rigorous licensing or robust safeguards or sanctions against such behaviour on the part of these directors. Our analysis has been further reinforced by the evidence provided to the BEIS Parliamentary Select Committee on 19 April 2022 by the CEOs of two of the failed suppliers, Bulb and Avro.

Whilst you may have reviewed the evidence provided by these individuals to the BEIS Select Committee, I wanted to highlight specific aspects of that evidence which engage the provisions of the insolvency regime and invite further questions, scrutiny and action on the part of the Insolvency Service:

- **Potential wrongful/fraudulent trading -** both CEOs clearly did not understand the importance of a prudent hedging policy to running an energy supply company. Although Hayden Wood of Bulb acknowledged that the price cap required Bulb to hedge out for 12 to 14 months, he went on to explain that the company continued to expand despite not being able to provide sufficient collateral in order to access the seven to 14 month hedging markets. Still more concerning was the explanation by Jake Brown of Avro where it was not clear that Avro had considered at all how it would operate in circumstances where prices rose rather than fell. This generates two critical questions:

- In failing to appreciate the fundamental importance of hedging, particularly in circumstances where the price cap limits the amount which can be charged to customers and that hedging is an inherent cost of operating in this industry, did the directors of Bulb and Avro comply with their duty to exercise reasonable care, skill and diligence?;
- By continuing to take on new customers and accepting customer deposits in circumstances where there was a clear risk that the suppliers in question would be unable to withstand the scenario of rising wholesale costs, were the directors of both companies guilty of wrongful and/or fraudulent trading?

- **Failure to act in the interests of the company's creditors** - Mr Brown returned throughout the session to the fact that Avro had made a profit for four of the five years prior to its collapse. His thinking appears to have been that, so long as the company was turning a profit, there was no limit on the amount which could be extracted by way of management fees and loans to connected parties. Avro's profits appear to have come, however, at the expense of protecting against downside risks. By prioritising short term profit and financial gain above a proper hedging policy and the ring-fencing of customer money, leaving customers critically exposed to a rise in commodity prices, did the directors of Avro Energy comply with their duty to act in the interests of the company's creditors when a company's solvency is in question?

- **Unwinding of transactions prior to insolvency –** given that the only directors of Avro Energy were Mr Brown and his father, and taking account of their duty to avoid conflicts of interest, was a proper and independent process followed by Avro Energy in agreeing the payment of management fees of £250,000 per month to the management company? The same consideration applies to the loans which were made by Avro Energy to companies owned by Mr Brown and his father, apparently for the purpose of allowing them to invest in other opportunities – what corporate benefit did Avro Energy receive for making these loans and how were they approved given the clear conflict of interest that existed? Now that Avro Energy has entered administration, are those transactions capable of being unwound?

It is clear that a detailed and forensic investigation, with the benefit of appropriate financial and legal advice, is needed in order to consider these questions and to properly unpick the conduct of these individuals and their fellow directors. As you noted in your letter, primary responsibility for investigation lies with the insolvency practitioners appointed as administrators of the relevant company, who are required to submit to the Insolvency Service a factual assessment of the conduct of the directors of that company within three months of the onset of insolvency. Accordingly, we assume that the Insolvency Service has now received those initial reports for almost all of these failures.

Whilst we understand that those documents are confidential to you, we have been able to access (through Companies House) the administrators' reports for a number of the failures. I regret to say that they do not give us any confidence that a thorough and proper investigation is being carried out by the relevant administrators. By way of example, we have identified that for at least seven of the companies (PfP Energy, Utility Point, People's Energy, Avro Energy, Green Supplier, Igloo Energy and Neon Reef) the administrators have included identical explanations (almost word for word in terms of the actual drafting) for the failure of the companies in question.

After watching the evidence provided by Mr Brown to the Committee, it is simply not plausible that the reasons for Avro's collapse could be deemed to be identical to those of the six other energy suppliers

mentioned above. Similarly, the special administrators of Bulb included two sentences in their report on the causes of Bulb's failure, neither of which refers to the inadequacies of its hedging policy or strategy despite Mr Wood himself identifying this as a key driver of Bulb's failure in his evidence to the Select Committee.

We are left with the inescapable conclusion that, rather than carrying out rigorous and exhaustive investigations, administrators see this part of their role as little more than a perfunctory and box-ticking exercise. Given the materiality of the impact of these failures on UK energy consumers of these supplier failures, this cannot be an acceptable position.

If the system for investigation relies on insolvency practitioners who – on the face of the available evidence – are not carrying out robust investigations, then the misconduct of directors will not come to light or be addressed. There are at least three consequences to this omission:

(1) Reckless and irresponsible commercial behaviour goes unchecked, and directors who have mismanaged businesses into insolvency are free to start afresh and with no adverse personal consequences;

(2) any prospect of unwinding pre-insolvency transactions with shareholders and connected parties, and thereby potentially enhancing recoveries to creditors (including customers), will be lost;

(3) most importantly, the opportunity to deter further wrongdoing and mismanagement, with the consequential costs that are then borne by UK energy consumers, is missed. On this last point, we note that Ofgem is currently consulting on various proposals to reform the regulatory framework applicable to energy suppliers – it seems to us that evidence regarding mismanagement by individual directors will be very relevant to this exercise.

Accordingly, and as things stand, we have little confidence that the process you described in your letter will result in meaningful action being taken in respect of the failures that have happened to date. The level of our concern has been reinforced by the fact, to date, no enforcement action has been initiated against any individual involved in the running of a failed energy supplier.

We had, in my original letter, suggested a number of constructive steps which the Insolvency Service might proactively take in response to the wave of energy supplier failures, which included disqualification and/or compensation proceedings against individual directors. We would again ask the Insolvency Service, before it is too late, to take clear and decisive action that will help to mitigate the effect of the current energy supply market crisis or avoid a similar crisis from occurring in the future.

If it should be helpful, we remain available to meet at the earliest opportunity to discuss our concerns in more detail, and to answer any questions that you might have.

Yours sincerely,

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Group General Counsel & Company Secretary

cc: Dean Beale, CEO, Insolvency Service

Sarah Munby, Permanent Secretary, Department for BEIS

Eoin Parker, Director of Business Frameworks, Department for BEIS

Neil Lawrence, Director of Retail, Ofgem

Sinead Murray, General Counsel, Ofgem