EVERSHEDS SUTHERLAND

Sector Focus

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Turning out the lights? Implications of the rising cost of energy for corporates

KEY POINTS

- Of the many economic challenges facing the UK currently, one of the most striking, and critical, is the steep rise in energy prices.
- Whilst much has been written in the press and other media around the impact of rising energy prices on domestic users, there has not been as much focus on the implications for businesses.
- Sectors including heavy industrial manufacturing and hospitality may find themselves particularly exposed as traditionally high users of energy.
- Government support is being put in place through the Energy Prices Act 2022, though it is far from certain that this will, on its own, be sufficient to fend off insolvencies attributable to the high price of energy. This support is being put in place for an initial period of six months, and, having been implemented on 1 October 2022, will be subject to review prior to 1 April 2023.
- It seems inevitable that energy costs will be a major factor (though not of course the only one) in an anticipated uptick in the volume of corporate insolvencies in the coming months as the economy heads into a potentially prolonged recession.

A CHALLENGING WINTER AHEAD

'*Winter is coming*' is a phrase that will be familiar to fans of the *Game of Thrones* books and TV series – a phrase usually uttered to warn of impending difficult times. Whilst, given the time of year, it is a literal truth that winter is indeed coming, that phrase's use in the *Game of Thrones* context could also be seen as appropriate for the challenges facing the UK economy in the months ahead. Although a number of factors will bring challenges to businesses – another obvious one being rising interest rates, which increased to 3% on 3 November 2022, the highest level since 2008 – the focus of this article is on the problems likely to be encountered due to the current high levels of energy prices.

It is a fact that business insolvencies are on the rise. Whilst the level of corporate failures fell during the pandemic, largely due to government support put in place pursuant to the Corporate Insolvency and Governance Act 2020 and other legislation designed to assist businesses in surviving the COVID-19 pandemic, as that support has fallen away, so corporate insolvencies have increased. Insolvency Service statistics show that in the second quarter of 2022, company insolvencies were at their highest level since 2009, with a similar number being recorded in the third quarter of 2022 as compared to the previous quarter (Commentary – Company Insolvency Statistics July to September 2022 – GOV.UK (www.gov.uk)). This trend is only likely to continue.

SECTORS VULNERABLE TO HIGH ENERGY PRICES

The rise in energy prices is attributable to a combination of factors, including Russia restricting the supply of gas, a period of calmer weather in the UK impacting levels of wind-generated electricity, and a general increase in demand levels after lockdown restrictions lifted. One starkly illustrative statistic is contained in recently published research from the Office for National Statistics analysing '*rising business insolvencies in the UK at a time of persistently high energy prices*' (the 'ONS Report') which noted that in the first quarter of 2022 the gas price index rose 70% as compared to the corresponding quarter in 2021 (Rising business insolvencies and high energy prices – Office for National Statistics (www.ons.gov.uk)).

Amongst larger enterprises, industrial manufacturing businesses such as steel and concrete producers are high users of energy and will be just some examples of corporates impacted by the rise in energy prices. Companies which rely on gas as a raw material input – for example, manufacturers of glass and ceramics – will be particularly exposed given the heat required to be generated for the furnaces used in their processes. Petrochemical and fertiliser productions are also energy-intensive industries.

It is of course not just heavy-industry, large-scale businesses which will be exposed; there are innumerable other businesses which will also be stricken by the ongoing high energy prices. Indeed, the ONS Report notes that according to its research, businesses employing between 10 and 49 individuals are the most worried about energy prices. These may include hotels, restaurants and other hospitality businesses operating in the accommodation and food services sector. Even before the current economic turbulence this has been a fiercely competitive sector with a high number of business casualties.

Whilst the comments above have identified some of those sectors and business-types most at risk from the current level of energy prices, the impact of the high costs are not limited to any particular area of economic activity, and will be widespread. Regardless of the sector that they operate in, prudent businesses will be looking ahead to the winter and considering what steps they may be able to take to mitigate the impact of high energy costs on business viability. One step will be considering whether they can benefit from any government support offered, which we now turn to consider.

GOVERNMENT SUPPORT

As to whether businesses will be able to avail themselves of government help to weather this storm, the fast-moving political landscape has not helped business leaders feel certain about what lies ahead and what support schemes may be available. After the departure of Liz Truss and Kwasi Kwarteng as Prime Minister and Chancellor respectively,

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Biog box

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all eyes are now on their successors Rishi Sunak and Jeremy Hunt. They have confirmed that help is being made available to businesses in relation to energy prices, though this will be subject to review at an earlier stage than proposed by the previous government.

Energy bill relief for non-domestic customers will be provided via reductions being applied by suppliers directly to bills, with those suppliers then being compensated by the government. The amount of the reduction is calculated by comparing the estimated wholesale portion of the price that would be paid against a baseline 'government supported price', which is lower than the expected wholesale price (Energy Bill Relief Scheme: help for businesses and other non-domestic customers – GOV.UK (www.gov.uk)). The total bill will therefore still be dependent on levels of usage, so the high levels of energy costs will still impact some companies more than others, notwithstanding the government support.

The scheme is intended to last for an initial period of six months, and will be reviewed in time for a decision to be made as to what the position will be from 1 April 2023. The government has commented that this review '*will focus in particular on identifying the most vulnerable non-domestic customers and how the government will continue assisting them with energy costs*'.

The government has also noted, whilst not yet identifying any specifics, that '*[i]t is important that users who are less vulnerable to energy price increases (particularly large businesses that are not energy-intensive) use the 6 months support provided by the scheme to identify measures they can take to protect themselves against high energy prices*'.

Reading between the lines, it is arguable that this indicates that the government should not be viewed as being willing to continue providing support indefinitely, and any support measures, having initially been put in place quickly, may become more tailored over time towards energy users that are identified by government as being most vulnerable to the high level of energy costs. Users that are not identified as particularly vulnerable may have to help themselves as far as they can, and ultimately either sink or swim.

It is worth noting that it is not only businesses which will be able to access government support – the scheme will also be available to voluntary and public sector organisations such as charities, schools and hospitals. Whilst the criteria that the government will apply in assessing which energy users are most vulnerable are unknown, it will be interesting to see whether the approach of making such organisations eligible for support in the first place will inform the strategy of determining the most vulnerable users – for example, if hard choices had to be made, would priority be accorded to, say, hospitals over high-energy using businesses on the brink of failure? Time will tell.

In the corporate context, businesses are inevitably having to seek to be flexible and creative in terms of identifying optimal energy procurement strategies, efficiency improvements and targeted expenditure aimed at achieving long-term energy cost reductions (for example, investment in solar panels). However, such matters do not exist in a vacuum and are challenging to navigate in an ever-changing economic landscape, not least when available funds and time may already be limited.

Legislative implementation of this support comes in the form of the Energy Prices Act 2022, which contains the Energy Bill Relief Scheme in the context of non-domestic assistance, alongside measures aimed at supporting households in the domestic context. This Act received Royal Assent on 25 October 2022, with the Energy Bill Relief Scheme being in place for the initial period 1 October 2022-31 March 2023.

It remains to be seen whether this fairly short-term one-size-fits-all approach will provide meaningful assistance to companies that are struggling this winter. It is perhaps difficult to conclude that, if a company is teetering on the edge of collapse, such measures will save it, although they may assist that business in buying some time, which, in near-endgame scenarios, can be all-important.

A PROLONGED RECESSION

It appears that the UK economy is now in recession, with the Bank of England's Monetary Policy Committee ('MPC') noting in its minutes on 3 November 2022 that it was expected that this recession would last for a prolonged period. These were the minutes of the meeting at which the MPC voted to increase interest rates to 3% (see: bit.ly/3AivfOH).

Given that managing inflation is a central objective of the MPC (rather than management of the economy as a whole) it is clear that further interest rate rises may well be necessary as the MPC seeks to reduce inflation in accordance with its objective of preserving price stability in the UK monetary policy framework.

In the minutes cited above, the MPC noted that energy prices continue to be '*the key driver of high inflation*'; as the MPC seeks to reduce this inflation by increasing interest rates, this will in turn dampen economic activity. It can, therefore, be concluded that the rise in energy prices has most likely been a contributing factor to the UK economy falling into recession – in that sense having another (albeit less direct) impact on businesses over and above them having to find the funds to pay their own energy bills.

It should be noted that at the time of writing this article, the Chancellor's Autumn Statement has not yet been made, so it remains to be seen what measures will be put in place in this budget in an attempt to guide the economy through the times ahead.

CONCLUSION

Even prior to the current turbulent economic times, the autumn and winter months have often been a busy time for insolvency practitioners and other restructuring and insolvency professionals. This winter looks set to be even more so as a combination of issues, primary amongst which is the cost of energy, creates a perfect storm of challenges for businesses to attempt to navigate.

Further reading

- Energy Bill Relief Scheme: bit.ly/3FsZ3uU
- LexisPSL Restructuring & Insolvency; Key R&I law developments; Weekly highlights; Autumn Statement 2022–key Restructuring & Insolvency announcements
- LexisPSL Restructuring & Insolvency; Key R&I law developments; R&I cases; UK court provided clarity on issues affecting the insolvencies of failed energy companies