

## **Delta Gas and Power Ltd**

### **Notice of Reasons under section 25(2) of the Electricity Act 1989 and section 28(2) of the Gas Act 1986**

To: Delta Gas and Power Ltd ("Delta"), company number 09933244, whose registered office is situated at 344-354 Gray's Inn Road, London, England, WC1X 8BP.

1. This Notice sets out the reasons why, on 7 November 2022, the Gas and Electricity Markets Authority ("the Authority") made a Provisional Order in respect of contraventions and likely contraventions of Standard Licence Condition (SLC)s 4A (Operational Capability Principle) and 4B (Financial Responsibility Principle).
2. Delta is the holder of gas and electricity supply licences granted by the Authority and is subject to the usual conditions thereunder, which are "relevant conditions" for the purposes of the Electricity Act 1989 ("EA89") and the Gas Act 1986 ("EA86") (together, "the Acts");
3. The Provisional Order was made as it appeared to the Authority that Delta was contravening and likely to continue to contravene relevant conditions and requirements by virtue of the following:
  - a. The Authority has recently conducted financial stress-testing exercises of non-domestic gas and electricity suppliers, with the purpose of ensuring ongoing compliance with SLC 4B. The information<sup>1</sup> provided by Delta to the Authority in response to the Financial Stress-Testing Request for Information ("RFI") has forecast that in stress-test scenarios 3 and 4<sup>2</sup>, Delta's available shareholder funding limit would be significantly exceeded this winter (Nov/Dec 2022). The reasons set out by Delta as to how the potential funding shortfalls would be met by way of an increase in revenue strategy are not considered by the Authority to be realistic or accurate, raising doubts

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<sup>1</sup> Provided to the Authority on 20 September 2022, in response to the Financial Stress-Testing RFI initially issued by the Authority dated 11 July 2022.

<sup>2</sup> The stress test scenarios require Delta to provide forecasts in respect of certain financial metrics in four key price scenarios (central, low, high and very high, with a requirement to meet low, central and high scenarios). The Authority has provided detail of the financial metrics and pricing scenarios in the Stress Testing RFI.

that Delta's forecasts are fit for purpose. By failing to secure sufficient financing to cover the required stress-test scenarios set by the Authority, and by failing to provide sufficient explanations as to how enough funding can be generated to cover said scenarios, Delta is contravening, and is likely to continue to contravene, SLC 4B.

- b. Delta has not procured a sufficiently hedged position<sup>3</sup> in the wholesale market and does not appear to have sufficient funding under certain stress-test scenarios. Delta purchases a certain amount of its gas and electricity on the open market, exposing it to volatile prices and putting it at risk of insolvency should prices increase further before it can improve its hedged position. Given the current market and geopolitical circumstances, this constitutes a considerable risk to Delta, which should be mitigated appropriately. Failure to procure a sufficiently hedged position combined with Delta's current cash position and the correspondent risk of insolvency, amount to a failure to manage costs responsibly that could be mutualised<sup>4</sup>. This is because, upon insolvency, Delta's costs including its outstanding Renewables Obligation ("RO") liability<sup>5</sup> and any liability it has in respect of any other industry schemes, will be mutualised and therefore borne by other market participants and therefore, ultimately, by consumers. By not securing a sufficiently hedged position whilst forecasting potential funding shortfalls under certain stress-test scenarios set by the Authority, and having failed to date to meet its outstanding RO obligation, Delta is contravening, and is likely to continue to contravene, SLC 4B.
- c. Delta's submissions to the Stress-Testing RFI have been insufficient in quality and accuracy. Delta's first response, received by the Authority on 8 August 2022, contained multiple errors and omissions of data. The Authority highlighted to Delta the errors and requested a response to a set of queries relating to the RFI. On 20 September 2022, Delta submitted a revised

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<sup>3</sup> A hedged position enables a supplier to purchase energy on the wholesale market for a fixed price over time, protecting it from volatility.

<sup>4</sup> Has the meaning given to it as SLC 1 of the gas and electricity supply licences: "*means one or more market participants other than the licensee bearing costs incurred by the licensee, which may include Customer Credit Balances and costs incurred by the licensee under government environmental and social schemes, by virtue of regulatory mechanisms;*"

<sup>5</sup> The Renewables Obligation is a Government Support scheme for large-scale renewable generation which places an obligation on suppliers to present to the Authority a certain number of Renewables Obligation Certificates (ROCs) in proportion to the amount of electricity they supply to consumers. As an alternative, suppliers can make a payment to the Authority in lieu of ROCs.

Stress-Testing RFI and set of responses to the queries set out by the Authority. However, the second submission still contained numerous errors, therefore casting doubts on the reliability of the information provided by Delta and undermining the Authority's ability to accurately assess financial reliability and risk. By failing to provide robust and reliable information to the Authority, Delta is contravening, and is likely to continue to contravene, SLC 4A.

4. The Authority considers that it is essential to uphold compliance with SLCs 4A and 4B. Failure to comply with SLC 4B risks significant consumer harm in the event of a supplier entering insolvency or defaulting on payments due. This is because insolvency and/or payment default would result in costs being mutualised across other market participants who will ultimately pass those costs on to consumers through increased bills, as explained in paragraph 3 above. Given the current market circumstances and cost to consumers of gas and electricity, further increase could be highly detrimental to customers, particularly those in a vulnerable situation<sup>6</sup>. Failure to comply with SLC 4A compromises the Authority's ability to intervene to prevent and/or mitigate the harm likely to be caused by a failure to comply with SLC 4B.
5. The Authority considers it requisite to issue a Provisional Order (rather than consulting on a final order) because the information obtained by the Authority indicates that Delta must immediately take steps to begin improving its financial position to realistically reduce the risk of insolvency and/or defaulting on payments due. If the Authority delays requiring Delta to make improvements by virtue of this Provisional Order and instead consults on a final order, it is more likely that Delta will find itself in serious financial difficulty and at risk of insolvency and/or default on payments triggering cost mutualisation and resultant harm to consumers.
6. The Provisional Order also prohibits Delta from engaging in sales, marketing and customer acquisition activity until it provides a report to the Authority confirming its compliance with the Provisional Order. The Authority has considered this provision (commonly referred to as a 'sales ban') very carefully, mindful of its impact on Delta's business. The Authority considers it requisite on this occasion to prohibit Delta

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<sup>6</sup> Has the meaning given to at SLC 0.9 of the gas and electricity supply licences.

acquiring new customers until it can satisfy the Authority it is in compliance with SLCs 4A and 4B. Where Delta acquires new customers, its RO liability and hedging requirements increase. This in turn increases the costs at risk of being mutualised. The Authority therefore considers the 'sales ban' to be reasonable and proportionate in the circumstances to limit loss to consumers should Delta enter insolvency or default on payments due and trigger cost mutualisation. The Authority also notes that the 'sales ban' will only apply until Delta can provide a satisfactory report evidencing that it is meeting the requirements of the Provisional Order and is therefore in compliance with SLCs 4A and 4B.

7. The Provisional Order also prohibits Delta from making any payment, providing any loan or transferring any asset to any third party unless that payment, loan or transfer is essential to Delta's supply operation, is (with the approval of the Authority) required to be made by virtue of a legal requirement or is otherwise approved by the Authority in writing (i.e. a 'ban on non-essential payments'). The Authority has also carefully considered this provision, again mindful of its potential impact on Delta's business. If Delta makes non-essential payments this will prevent it from improving its finances such that it has a realistic chance of reducing the risk of insolvency. Also, making non-essential payments is likely to decrease the sums available to meet its RO liability and liability under other industry schemes, therefore increasing the costs at risk of being mutualised. The Authority therefore considers that this requirement is reasonable and proportionate in the circumstances, again noting that it will apply for a short period of time, as set out at paragraph 6 above.
8. The Authority has had regard to the matters in sections 25(3), (4A), (4B), (5), (5A) and 26 EA89 and the equivalent provisions in GA86<sup>7</sup>. In particular:
  - a. It does not consider it would be appropriate to proceed under the Competition Act 1998 (that Act has no application to the present circumstances);
  - b. It is satisfied that the duties imposed on the Authority by sections 3A to 3C of EA89 and 4AA to 4A GA86 do not preclude the Authority from making

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<sup>7</sup> Sections 28 (3), 28 (4A), 28 (4B), 28 (5), 28 (5A) and 29 GA86.

the Provisional Order (on the contrary, it considers that its duties require it to make the Provisional Order);

- c. It does not consider that the contraventions are trivial.

9. For the above reasons, the Authority decided to make the Provisional Order requiring Delta to do the following:

- a. Not to act in contravention of SLCs 4A and 4B;
- b. By 5 December take steps to improve its operational capability such that it can respond accurately and on time to any Requests for Information from the Authority in relation to its financial position and arrangements or otherwise.
- c. By 5 December improve its financial position such that it can operate effectively under low, central and high stress-test scenarios set out in the Stress-Testing RFI.
- d. By not later than 5pm on 7 December 2022 provide the Authority with a report confirming Delta's compliance with paragraphs a, b and c above. Said report must be accompanied by supporting documentation to evidence the assertions made by Delta in the report.
- e. Until the terms of the order are met:
  - a. Refrain from all sales, marketing and customer acquisition activity, including the acquisition of any new non-domestic customers or upgrading of all existing non-domestic customers to dual fuel;
  - b. Refrain from making any payment, providing any loan or transferring any asset to any third party unless that payment, loan or transfer is one that Delta: i) is required to make by virtue of a legal requirement and said payment is approved in writing by the Authority; ii) is essential to Delta's operation as a supplier of gas and electricity to consumers; or iii) is otherwise approved in writing by the Authority.

10. The Authority will in due course consider whether to consult on confirming the Provisional Order (with or without modifications). Unless earlier confirmed or revoked by the Authority, the Provisional Order will lapse on 7 February 2023.

Dated: 10 November 2022

Signed

Charles Hargreaves

Deputy Director, Enforcement

Duly Authorised on behalf of the Gas and Electricity Markets Authority