"You'll never walk alone"? Germany's Lifeline

Michael Thierhoff and Niklas Franke write about the German government's efforts to maintain critical energy supply and keep struggling companies in the industry trading

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Once upon a time natural gas, being the "cleanest" fossil fuel available, was considered in Germany as the sample solution bridging supply required for the transition from nuclear energy, coal and lignite to renewable, green energy. At the same time, the history of gas supply by Russian state-controlled entities was marked by growth and steady relations for decades, undisturbed by foreign policy crises.

Already at the end of the 1980s, Western Germany purchased about half of its natural gas from the Soviet Union. By 2020, Germany was procuring 55% of its natural gas needs from the Russian Federation. State-owned companies there, such as Gazprom, supplied reliably and with reasonable conditions, leading to a general lack of concern about the availability of this critical resource. The entire infrastructure, from production facilities and transit to the largest natural gas storage facility in Germany, was owned by Russian-controlled entities. This dependence was barely questioned critically. By the end of 2021, winds changed and the European energy markets experienced disruption, with prices rising by 4.2%: a foreshadowing of events to come.

The turning point

Russia's continuing aggression against Ukraine was the turning point. To counter well deserved sanctions imposed by the international community resulted in a reduction of gas deliveries through pipelines to Germany. If the conflict intensifies, Russian gas deliveries are expected to come to a complete stop. The use of control valves on pipelines to enforce geopolitical goals has led to a historic disruption in already tense energy markets.

The Federal Government seems determined to maintain gas supplies for industry and consumers for as long as possible and to stabilise companies along the supply chain economically by all means. To this end, the German Ministry for Economic Affairs and Climate Action implemented a whole series of measures at record speed, all with one clear goal: to avoid insolvencies along the supply chain at all costs to prevent potential damage to the manufacturing industry and bitter consequences for consumers in winter. Of the numerous legal changes enacted by the Federal Government, the amendment to the Energy Security of Supply Act of 12 July 2022 can be highlighted.

Energy pricing issues

The legislator thus reacted to a dilemma which some gas supply companies find themselves in in view of the troubled energy markets. In order to be able to meet their obligations, even with reduced supply volumes from Russia, they have to buy their gas on the soaring spot markets. While the price per megawatt hour used to be less than €20, current prices are up to ten times that amount. However, they cannot pass these prices on to end customers because they are bound to long-term contracts on fixed terms. This situation results in considerable insolvency risks, especially for those who have procured all or large parts of their gas supplies from Russia.

Current prices have the potential to kill, where guaranteed prices or the typically long-term customer commitments leave no room to pass on increased prices. Here profits are slashed, turning into losses, while liquidity is under stress. Both can instantly result in imminent insolvency and a negative going concern. Other importers have long since diversified their sources of supply and buy most of their natural gas from Norway, the Netherlands or the few domestic gas producers. In this respect, they are also affected by increased purchase prices, if no long-term agreements are in place, but at the same time they are less dependent on replacement purchases. This makes them more robust in the current crisis.

In response, the government has passed a regulation, according to which the collectively increased gas prices can be passed on uniformly to all end customers from 1 October 2022 until April 2024. However, the amount of the gas levy is set centrally and adjusted every three months by Trading Hub Europe, initially at 2.419 cents per kilowatt hour, plus VAT, which will be reduced from the regular 19% to a reduced 7% rate, as Germany was not allowed to waive VAT under EU law. In addition, gas suppliers can also exercise a right to refuse performance if they cannot procure the required gas quantities on the markets. However, they need permission from the regulator (*Bundesnetzagentur*) to do so.

Equity investments and state trusteeship

Ways for the Federal Government to invest in equity or otherwise financially support ailing enterprises upon request have been facilitated and have already been applied in practice. *Uniper SE*, a large energy supply company with an annual turnover of almost €164 billion, was also in crisis. To stabilise it, the Federal Republic took a 30% equity stake by increasing capital. In addition, the company's credit facility was increased by €7bn by KFW, the state development bank, and *Uniper SE* was provided with a further €7.7bn via convertible bonds, bringing the total for the financial aid package to €15bn.

In the decision process, there was also an initiative to adapt the insolvency law. An early draft bill also catered for the insolvency option, guiding insolvency administrators to assure a seamless supply. However, the draft did not make it into the final version of the Energy Security of Supply Act. This clearly shows that the legislator is looking for crisis management and stabilisation for the market avoiding insolvency law and/or preventive restructuring.

As part of the critical supply infrastructure, the Energy Security of Supply Act also provides for the possibility of placing a company in the gas supply industry under state trusteeship, a process that has also already been used. *Gazprom Germania*, a German wholly-owned subsidiary of the Russian state-owned *Gazprom*, has been under the trusteeship of the Federal Network Agency since early April 2022. The background to this was that, by shareholder resolution, the company was to be liquidated. As a result of the trust administration, voting rights for the shares were transferred to the *Bundesnetzagentur*, which is closely supervising trading and has also appointed a managing director of choice. Due to Russia's economic sanctions against *Gazprom Germania*, its liquidity situation also had to be secured by KFW. However, the use of these funds is restricted for use only for the business and to maintain gas supplies, in order to prevent a drain to Russia. Since June, the company has been trading as *SEFE Securing Energy for Europe GmbH*.

Resilience for Winter

The Federal Government has also enacted the Gas Storage Act, according to which all gas storage facilities in Germany must have attained specified charging levels by 1 October 2022, in order to assure appropriate supply for the coming winter. Finally, the public sector has also pushed ahead with the expansion of LNG terminals on the coast by issuing the necessary permits to be able to obtain liquefied gas from ships in the future. Floating LNG terminals have been chartered to bridge the construction period.

With *Uniper SE* and *SEFE Securing Energy for Europe GmbH*, the German government has stabilised the main pillars of the national natural gas supply. However, there are countless other businesses along the supply chain that are also essential for the supply situation in Germany. They can also make use of the new price adjustment rights and rights to refuse performance. In addition, there are state funded credit and guarantee programmes. Additionally, there are plans for subsidies to mitigate losses.

If the last stage of the gas emergency plan, the alert stage, is declared, the gas still available in gas storage facilities and obtained through replacement procurement will be allocated by the *Bundesnetzagentur*. Combined with orders for conservation measures, this is intended to give priority to defined consumer groups, e.g., households with gas heating, social institutions such as hospitals, but also gas-fired power plants, which also serve to generate heat for households. Gas-intensive industries are currently not included. At the moment, however, there are discussions about softening this clear prioritisation in favour of businesses.

At the same time, the European Union's Gas Emergency Plan also came into force on 9 August 2022. Within the EU, 15% of gas consumption is to be saved by March 2023. This corresponds to 45 billion cubic metres. This savings target is non-binding and there are numerous exceptions, for example for extremely gas-dependent states such as Spain or Italy. Only if it is missed could binding savings targets be adopted with the consent of 15 EU states.

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Energy allowances and further steps

For the people, a taxable "energy allowance" of €300 is to be paid out in September to account for income differences. But the government has assured the public that this is just the start. Further aid is currently subject to intense cabinet discussions. Whether these measures will be sufficient to avoid major collateral damage and a state of emergency in energy supply in the event of a complete cessation of Russian gas supply remains open. Measures taken so far show that Germany does not shy away from substantial financial aid to ensure security of supply. Or, to conclude with Chancellor Scholz's promise: "*You'll never walk alone*." ■