127 Baggot Street Lwr.

Dublin, D02 F634

31st March 2022

By email to:

Mike Brennan – Permanent Secretary DfE
Richard Rodgers – DfE
John French – URNI
Colin Broomfield – URNI

Re: Request for coordinated response to current energy crisis addressing consumer issues, financial liquidity /collateral concerns and gas storage

Dear Mike, Richard, John and Colin

I write to you on behalf of the Electricity Association of Ireland (EAI) in the context of the extreme and volatile prices in the energy market, driven by the war in Ukraine. Our thoughts are with the people of Ukraine and our hope is for a quick resolution of the conflict.

EAI represents the electricity sector on the Island of Ireland from generation through to retail. On behalf of our members, we have already engaged with the regulatory authorities (RAs) on the possible impacts of the current situation in the markets and we are aware that some of our members have raised similar concerns directly with the RAs.

In this letter we outline key issues that are driving increased costs for consumers and make suggestions to enable continued trading by participants in gas and electricity markets. The points that our EAI committees holistically wish to raise for discussion with you relate to impacts on electricity customers, collateral and security of supply considerations for the SEM market.

We request urgent consideration of the matters outlined below and collaboration with industry in addressing the issues and determining the optimum way forward for consumers and industry as a whole. As this is a quickly developing policy space, the EAI will continue to evaluate proposals as they emerge and or evolve. We hope to be given the opportunity to engage fully with policymakers and regulatory authorities on the Island of Ireland to find and implement solutions in a proactive and timely manner. In that respect, we would ask that a government led Energy group is stood up to respond to this quickly evolving situation and that key energy market participant are represented.

We note and welcome that the EU Council has asked the EU Commission "as a matter of urgency to reach out to energy stakeholders to discuss short term options which, contribute to reducing gas prices and address contagion effect on electricity markets, **taking into account national circumstances**"[1]

It is important to ensure that any intervention(s) have the desired effect, without unintended consequences and without disrupting investor confidence. It is also important that differences between European markets are recognised. Such an evaluation should, and can only be made at the Member State level taking its specific circumstances into account[2].

The implications of high prices for consumers are rightly recognised as a problem that needs to be addressed. We support measures taken to date but further support for consumers is needed. We outline below some further suggestions including VAT linked considerations for offering additional consumer supports and addressing retrofit challenges. In addition, we outline how collateral, liquidity and working capital concerns can negatively impact end consumers in terms of market disruption, and higher costs. Finally, we comment on the recent EU proposals on gas storage.

Collateral, liquidity and working capital considerations

The threat posed by Europe's energy crisis also extends to the market as a whole, where collateral and financial liquidity issues associated with high and volatile prices need to be addressed. This is because markets need to be funded, and must have certainty of future funding, long before customer receipts and hedges pay out. A failure to address this issue puts security of electricity supply at risk and could further increase costs for consumers. Our proposals below include, for example:

- the potential need for emergency liquidity measures/ government guarantees
- addressing the dual collateralisation effect and

[1] European Council conclusions - Concilium (europa.eu)

[2] By design, the SEM requires market participants to trade in the fully collateralised Day Ahead and Intra-Day Markets and the fully collateralised Balancing Market, as opposed to trading bilaterally as seen in other European countries.

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- letter of credit approval timelines in SEM.

It is important to note that even well hedged, profitable and prudently managed energy companies have the potential to be severely affected by the current crisis. Some of Europe's largest utilities have already received some form of government support, not because they are badly run but because of extreme market conditions[3]. Nobody knows how high gas prices might go, when or how soon future increases might happen or how long high prices might persist. Neither does anyone know the tipping point for triggering systemic failures.

Financial liquidity pressures and collateral requirements associated with extreme wholesale gas pricing on international markets and related volatility have the potential to abruptly disrupt the functioning of energy markets, including the all-island Single Electricity Market (SEM). Some of these effects will be reminiscent of the immediate and significant events that unfolded around the banking / financial crisis, albeit the cause in this case is external events rather than excessive risk taking. Urgent measures may be needed to avoid the domino effect that any failure (in SEM or beyond) can have.

From a liquidity perspective, you may be aware of the enclosed position paper from the European Federation of Energy Traders. This paper calls for emergency liquidity support to ensure that wholesale energy markets continue to function, thus highlighting the gravity of the problem and the kind of assistance that may be needed. In addition, the proposed measure may also need to apply directly to market participants and not just the clearing members/banks of the Exchanges, otherwise there is a risk that the liquidity support will not flow through to those that need it to keep the lights on and the gas flowing.

A range of measures should be considered and progressed in tandem, and at pace over the coming days and weeks, to protect the functioning of our market and the continuation of electricity and gas supply to customers in Northern Ireland. In that respect, we would welcome direct engagement so that we can provide insight into any measures considered.

It will be crucial to improve collateral arrangements in the electricity market which will help to reduce the likelihood of emergency liquidity measures/government guarantees having to be utilised (albeit they are still needed to be put in place). Notably, collateral requirements in the SEM are unnecessarily

[3] German state bank KfW stepping in to provide billions of euros in liquidity support to German utilities to cope with the unprecedented volatility in energy markets, including €2bn for Uniper (one of Europe's largest energy companies) alongside €8bn from its state owned Finnish parent company Fortum, €5.5bn for another unnamed German utility, and most recently VNG is understood to be seeking state support to cope with the energy crisis[3]

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onerous due to a requirement for market participants to effectively dual-collateralise the market. Removing this unnecessary requirement could reduce SEM collateral requirements at current prices by almost €300m. Further details included in the annex to this letter. Other improvements should also be explored in tandem. For example, reducing SEMO's approval times for Letters of Credit (currently 5 working days), would be helpful in responding quickly to high prices and market volatility. EAI intends to engage further on this matter with the RAs in the coming days, given its significance to our members.

The impacts on electricity and gas customers

EAI fully recognises the challenges customers face in the context of current energy market conditions and our members continue to engage with customers who are experiencing difficulty. We are supportive of the positive steps taken by Government towards protecting customers, in particular those who are or may be at risk of energy poverty.

While we anticipate that further measures will be needed in the coming months to support customers. We believe additional actions would be effective in the current environment, including:

- **Further targeted government supports**- Ensuring that those who cannot afford their energy needs or cannot change their behaviour are targeted with greater supports. Increased VAT revenue can be used by government to fund additional energy allowances." More targeted delivery, e.g. to those in receipt of social welfare with a means test being applied to extend support to individuals on lower incomes who are not in receipt of benefits, should be considered.
- **Improve identification of the most affected customers**- Improvements are needed to identify more comprehensively those who are experiencing fuel poverty, such as those that are in employment. Census data can provide useful insight.
- **Address retrofit challenges-** While we welcome the UK government's announcement on 23rd March of the time-limited zero-rate of VAT for the installation of certain Energy Saving Materials in residential accommodation , further work is needed to address additional challenges especially for the rising number of fuel poor customers. To help make adoption of energy saving measures more affordable consideration a low-cost loan scheme should be expedited so customers can access necessary finance to fund retrofits.

A clawback of high rents- This proposal would disrupt investor confidence at a time when investment of tens of billions of Euro is needed to deliver the climate transition and at a time when security of electricity supply in Ireland is currently at risk. Whereas we recognise the need to look at all options to help customers in this time of great volatility, we do not believe that in the long run this type of

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retrospective action will deliver the fundamental shift that is needed to reduce dependence on Russian fossil fuels. It undermines typical market cycles and raises regulatory risk –with overall negative implications for existing and future investments.

A price cap on wholesale gas prices/ and or electricity prices – To achieve decarbonisation ambitions in an accelerated fashion Governments should not seek to interfere with the markets that will underpin investments. We believe there are numerous avenues to help customers through this time of volatility and uncertainty and suggest that we map out our ambitions and actions needed to achieve them before we look to unravel the regulatory certainty that we have strived to achieve over the past number of decades to attract largescale investment.

Gas Storage Policy and Regulation

Recent events have highlighted fragilities in the depth of the Europe's gas security of supply, and we note the proposals to review EU gas storage policy through recent regulation proposals. These are focussed on shorter term measures to maximise gas in storage with the EU with complimenting medium term proposals to boost gas independence within the EU in a manner consistent with decarbonisation objectives.

- We would welcome engagement with DfE regarding security of supply Maintaining security of supply is incredibly important and the SEM does not have significant energy storage facilities .
- Striving to reduce dependence on fossil gas in the medium term is an area Northern Ireland should focus on, especially given increased urgency from events in Ukraine. In addition, efforts should be redoubled in the area of renewables deployment, removal of administrative bottlenecks and the development of a net zero strategy for Northern Ireland that places security of supply as a central objective.

EAI members stand ready to work with Government and regulators on the above and would appreciate an early engagement.

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Finally, we request a meeting to discuss with regulators and government the development and implementation of a coordinated response to the current energy crisis. We will be in touch with your respective offices to set up a suitable date for such a meeting. In the meantime, if you have any questions or require any additional information, please do not hesitate to contact me.

Yours Sincerely

Dara Lynott
CEO
Electricity Association of Ireland
Encs.

- JEAG Position Paper on Liquidity

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Annex – Worked Example of European Commodity Clearing (ECC) Collateralisation

By design, the SEM requires market participants to trade in the Day Ahead and Intra-Day Markets and the Balancing Market, as opposed to trading bilaterally as is permissible in other European wholesale electricity markets.

Collateral requirements in the SEM are unnecessarily onerous by a requirement for market participants to individually collateralise European Commodity Clearing (ECC) in the Ex-ante Markets and to also collateralise the Single Electricity Market Operator (SEMO) in the Balancing Market.

This effectively duplicates collateral requirements in the SEM which is unnecessary and could be avoided by having SEMO, which is part of EirGrid Group, collateralise the Ex-ante Markets[4]. This would allow the efficient netting of generation and demand across the entire market for the purpose of collateral calculations and would reduce the likelihood of emergency liquidity measures / government guarantees having to be utilised (albeit they are still needed). We have provided a worked example below calculating the Ex-Ante collateral requirements[5] that could be displaced if we had an efficient wholistic collateralisation of the SEM wholesale markets. As shown in table 1 below, SEM collateral requirements for an example supplier with 20% market share could be reduced by c€59m based on average wholesale prices during the month of March 2022, without any adverse effect on the collateralisation of the market as a whole. This would be equivalent to collateral savings for the whole market of almost €300m, which would be even greater at higher wholesale prices.

For comparison, we have included calculations in table 2 below showing the collateral savings based on average prices in March 2021 (i.e., €13m for the supplier and €65m for the market). Clearly, the benefits of reforming collateral arrangements in the SEM increase markedly at higher prices.

Table 1: ECC collateral requirements based on March-22 prices

Euro Price (Average Mar 22)	326.95	
	Ex-ante Daily Volume (MWh)	Peak ECC Margin (€)
Example Supplier (20% Market Volume)	**(26,316)**	**(58,507,594)**
Average Market Volume (Mar 22)	**(131,579)**	**(292,537,971)**

Table 2: ECC collateral requirements based on March-21 prices

[4] This could potentially be done a number of ways, including by SEMO conducting the clearing of all the markets or by SEMO appointing a clearing bank to collateralise ECC.
[5] This calculation is based on peak ex ante volumes x 4 days x price x 1.7.

Euro Price (Average Mar 21)	72.79	
	Ex-ante Daily Volume (MWh)	Peak ECC Margin (€)
Example Supplier (20% Market Volume)	(26,316)	(13,026,123)
Average Market Volume (Mar 22)	(131,579)	(65,130,613)

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