Opening Statement to Joint Oireachtas Committee on Climate and Environment on the Pre-Legislative Scrutiny of the General Scheme of the Energy (Windfall Gains in the Energy Sector) Bill 2023.

Department of the Environment, Climate and Communications

18 April 2023

Dear Chair and members of the Joint Oireachtas Committee on Climate and Environment, thank you for this invitation to this meeting of the Committee on the Pre-Legislative Scrutiny of the General Scheme of the Energy (Windfall Gains in the Energy Sector) Bill 2023.

My name is John Burke and I am Principal Officer in the Department of the Environment, Climate and Communications in the area of Energy Security. I have just taken over from Kevin Brady who briefed the Committee a couple of weeks ago on the General Scheme. I am joined today by

- Evan Walker, Economist Assistant Principal, (working on the cap on market revenues),
- Laurena Leacy, Senior Geologist, (working on the temporary solidarity contribution),
- Samuel McArdle, Economist, Administrative Officer
- Kevin Hagan, Manager, Wholesale Electricity Market at Commission for Regulation of Utilities, and
- Michael Kelly, Director, Eirgrid

The Energy (Windfall Gains in the Energy Sector) Bill 2023 will implement the temporary solidarity contribution and cap on market revenues of EU Council Regulation 2022/1854 in accordance with the Government decision on 22 November 2022.

High energy prices have had a significant impact on consumers and the revenues from this initiative will be available to Government to offer additional supports going forward.

Ireland, along with other EU Member States, is implementing measures to address windfall gains in the energy sector. The General Scheme aims to ensure the right balance between maximising the collection of windfall gains while minimising any negative impact in energy markets. So the prize is a strong revenue stream for the State but without introducing risk to our security of energy supply or a reduced appetite for future investments.

Background

Increased wholesale gas and oil prices have led to potential windfall gains for producers and refiners of these fuels where the costs of production have not increased to the same extent. In the electricity sector, there are also potential windfall gains with the wholesale price of gas being the key driver of the wholesale price of electricity. As a result, some electricity generators (such as wind and solar which have seen limited increase in production costs) may be realising windfall gains.

EU Council Regulation 2022/1854 is an emergency intervention to address high energy prices and came into force in early October 2022. Ireland was an active participant in the negotiation of this EU Council Regulation and successfully sought additions to the Proposal that would not constrain Ireland's ability to collect windfall gains in the energy sector and to address unique Irish concerns.

The EU Regulation seeks to address windfall gains in the energy sector through:

- a mandatory temporary solidarity contribution based on taxable profits in the fossil fuel production and refining sectors; and
- a mandatory cap on market revenues of specific generation technologies in the electricity sector.

On 22 November 2022, the Government approved the introduction of these measures which included:

- that the **Temporary Solidarity Contribution** will apply for both of the years 2022 and 2023 (the maximum permitted under the Council Regulation)
- losses from previous years would not be taken into account when calculating the Temporary Solidarity Contribution
- the rate of 75% would apply, and
- it would be administered by the Revenue Commissioners;

- that a **Cap on Market Revenues** of €120 per MWh would apply for wind and solar (reflecting their lower operating costs)
- a floating cap would apply to some technologies (such as oil and coal) based on their operating costs thus ensuring no impact on security of supply
- no cap would apply to small projects (up to 1MW), and
- that it would be administered by the Commission for Regulation of Utilities.

Stakeholder Engagement

The Department undertook stakeholder engagement on the implementation of the windfall measures with relevant Departments, agencies, companies and representative bodies within the scope of the temporary solidarity contribution and cap on market revenues.

Firstly, information sessions on the temporary solidarity contribution and cap on market revenues in the EU Council Regulation were hosted by the Department with stakeholders in October 2022 just weeks after the Regulation was published.

Following the Government decision in November 2022, further information sessions were held to inform stakeholders of the Government's decision on the implementation of the windfall measures. Additional meetings with stakeholders, including bilateral meetings, were held throughout December 2022 and the first quarter of 2023.

During this stakeholder engagement, concerns were raised by companies about the impact of these measures on their operations, ongoing viability, capital investments, and future investments. Stakeholders also submitted proposals to the Department on the implementation of the windfall measures.

As the Department was developing the general scheme for this Energy Bill, consideration was given to the concerns raised and the submissions received from various stakeholders on both the temporary solidarity contribution and cap on market revenues.

The General Scheme for the Energy (Windfall Gains in the Energy Sector) Bill, produced by the Department and approved by Government on 21 March 2023, is in accordance with the Government decision of 22 November 2022, including maintaining a 75% rate for the temporary solidarity contribution and a €120 per MWh cap for wind and solar electricity generators, with further provisions to avoid significant impacts on the energy sector. The General Scheme aims to balance the collection of windfall gains in the energy sector across a broad base and a high rate with consideration to impacts on Ireland's energy security.

Proceeds

Chair I would like to now discuss with you the estimates of proceeds from the wholesale gas market, and the uncertainties surrounding them.

In November 2022, an estimate of the proceeds was provided to the Government, indicating a range of €340 million to €1.9 billion. The wide range reflected the unprecedented uncertainty surrounding potential scenarios of wholesale gas price trajectories as of end October 2022.

In situations of extreme levels of uncertainty, such as +/- 10% volatility on a daily basis, it is technically appropriate to model with a focus on the range of possible outcomes, rather than the precision of the final number. This approach is supported by a consistent body of economic and statistical literature, which recommends the use of scenario analysis, sensitivity analysis, as well as forecast averaging. The economists present are available to comment further on this.

In February 2023 revised estimates of the proceeds ranged from approximately €280m to €600m.

The primary driver of the reduction in these estimates since end October 2022 is the significant reduction (approximately 70%) in futures prices. As such, the extreme scenarios that were anticipated in the futures markets for Q4 2022 did not materialize, and the range in the scenarios has abated for now.

It is important to note that the revised estimates remain highly sensitive to wholesale gas prices, which can be influenced by various unpredictable factors, such as weather, gas storage levels, and developments in the war in Ukraine.

External estimates, conducted separately from the Department by Aurora Energy Research in January 2023, indicate that the market cap could generate between €49m and €591m. Their similar use of an extremely wide range is acknowledged also.

The distribution of the proceeds collected from the temporary solidarity contribution and the cap on market revenues will be decided by Government. These proceeds are required to be distributed in accordance with measures set out in the Regulation, such as supports for energy customers.

General Scheme of the Energy (Windfall Gains in the Energy Sector) Bill 2023

The General Scheme of the Energy (Windfall Gains in the Energy Sector) Bill 2023 is divided into three Parts. Part One of the general scheme provides for the title of the Bill, its commencement and definitions which are used in the Bill, Part Two provides for the Temporary Solidarity Contribution and Part Three provides for the Cap on Market Revenues.

There are Four Chapters in Part 2 of the general scheme for the temporary solidarity contribution.

Chapter 1, Heads 3 to 4 sets out the methodology to calculate the Temporary Solidarity Contribution, the rate of the temporary solidarity contribution, and the definition of taxable profits and average taxable profits for the purposes of calculating the Temporary Solidarity Contribution.

Key Elements of the definition of taxable profits are that losses outside of the period 2018 to 2023 will not be carried forward/back, group relief will not be included, capital expenditure in the period 2018 to 2023 will be deductible and Temporary Solidarity Contribution will be deductible when calculating corporation tax.

Chapters Two and Three provide for the Revenue Commissioners to administer the Temporary Solidarity Contribution, provide the necessary powers to the Revenue Commissioners, and provide for the reporting obligations of companies to the Revenue Commissioners.

Chapter Four provides that the proceeds from the Temporary Solidarity Contribution will be distributed in accordance with Article 17 of the Regulation.

There are three chapters in part 3 of the general scheme for the cap on market revenues.

Chapter 1 provides for which entities and technologies are subject to the cap, the level of the cap, method by which the cap is calculated, calculation of preliminary surplus revenue and adjusted surplus revenue, payment obligation, hedging and company obligations to report to the Commission for Regulation of Utilities.

Chapter 2 provides for the administration of the Cap on Market Revenues by the Commission for Regulation of Utilities.

Chapter 3 provides that the proceeds collected from the Cap on Market Revenues will be distributed in accordance with Article 10 of the Regulation.

There is currently a large amount of work being undertaken at a very rapid pace to develop the Bill - by this Department, other Government Departments and agencies, the Office of the Parliamentary Counsel, the Revenue Commissioners, the Commission for Regulation of Utilities, Eirgrid, and the Irish Government Economic and Evaluation Service. It is a complex piece of legislation and this is a major collaborative effort on behalf of all those organisations.

We look forward to the recommendations from this Committee which will inform the development of the General Scheme as it moves towards being published as a Bill and then to it becoming enacted having completed its passage through the various stages of the House which will afford further opportunities for debate.

The Department, along with CRU and Eirgrid, will attempt to answer any questions from the Committee on the General Scheme, or alternatively can supply additional material after today's session as required.

Thank you.