18 October 2022

Re: President of the European Commission Ursula von der Leyen's letter addressed to the Members of the European Council regarding energy markets

Dear Minister,

We, the undersigned, have been closely following political developments around European energy markets. We represent a broad cross-section of market participants involved in this market and other connected energy markets. Our members understand the concerns that the European Institutions have about the impact the current crisis is having on European citizens and industry. We appreciate that the EU Member States Governments are ready to work with the European institutions to introduce a package of measures which would alleviate the burden stemming from the unprecedented situation. We also read with great interest the letter dated 5th October from the President of the European Commission to the European Council proposing, among other measures, an intervention in the gas market to cap the price.

The undersigned strongly agree with the President's point that recent market developments, and in particular the price of gas, are caused by the geo-political situation. In fact, the price of gas in Europe is high because of an imbalance between demand and supply caused by reductions in the usual quantities of natural gas imported into Europe by pipeline from Russia. The current high prices reflect this difficult reality.

We also share the President's point of view that EU Member States Governments can work together to bring down energy costs for families and businesses, and provide energy security by, for instance, introducing new sources of gas supply to the European network. However, we have serious concerns regarding the proposal for a mechanical intervention to set prices artificially in the natural gas market. Such an approach would bring about a number of unintended negative effects, with undesired implications for commodity and financial markets.

First, it should be noted that artificially lowering the price of gas – imports of which the EU needs to attract from the international markets – is likely to worsen the supply shortage in the EU which would, ultimately, end up increasing the real price European importers may need to pay. In fact, a price cap would further widen the gap between supply and demand thereby exacerbating EU difficulties in obtaining access to gas deliveries from the international market. In this context, while we support measures taken to ameliorate the impact of the crisis on those consumers at greatest risk, we do not believe this can be best achieved by interfering in the functioning of physical markets and undermining the behavioural change and investment incentives that market pricing encourages.

Second, and in parallel to the above, the implementation of such measures to artificially cap natural gas prices would entail a significant impact on the financial markets and businesses' ability trading in physical commodities to hedge risks through the use of derivatives. Derivatives trading is guaranteed by clearing houses using collateral supplied by market participants. A price cap mechanism could lead to significant changes in prices as the market adjust to the new capped level which will impede the orderly functioning of the market and risk distorting gas flows into and within the EU. It will also likely exacerbate the existing liquidity issues faced by the energy sector as the ensuing volatility may occasion even higher margin requirements than those they have already experienced over the last 12 months as a result of high and volatile energy prices.

It is vital that any measures taken to address the current energy crisis and its knock-on effects focus on providing solutions to specific problems and that these measures will, in a timely manner, directly alleviate issues faced by the market, and, by extension, end consumers. In this respect, we would note that a number of other jurisdictions have used other mechanisms to lower energy prices for certain types of consumers and have not chosen mechanical interventions to set market prices artificially.

We would be very pleased to further discuss the issue and to provide any clarifications you may need.

Yours sincerely,
CMCE
EACH

About Commodity Markets Council Europe (CMCE)
CMCE is the only association in Europe representing the range of commodity market participants - agriculture, energy, metals and other commodity market participants, benchmark providers, price reporting agencies, and trading venues operating in the EU, EEA, Switzerland and neighbouring countries. The majority of CMCE members use commodity derivative markets to hedge the risks related to their physical activities and assets. CMCE's key purpose is to engage with policy-makers and regulators to promote liquid and well-functioning commodity derivative markets in Europe.

About EACH
The European Association of CCP Clearing Houses (EACH) represents the interests of Central Counterparties Clearing Houses (CCPs) in Europe since 1992. EACH currently has 18 members from 14 different European countries and is registered in the European Union Transparency Register with the number 36897011311-96.