2nd Statement in the Proceedings for the Amendment of the Specification for the Introduction of a Conversion System in Quality-Overlapping Gas Market Areas

Summary

PEGAS welcomes the renewed opportunity to submit a statement in the consultation procedure initiated by the Federal Network Agency with regard to the amendment of the specification regarding the introduction of a conversion system in quality-overlapping gas market areas.

In this statement, PEGAS will show options as to how the versions proposed by the German Federal Network Agency (BNetzA) (ex-ante, ex-post conversion fee) for the determination, design, establishment and distribution of the conversion costs incurred at the Market Area Manager (MAM) can have the smallest negative effects on the competitiveness of the German gas market in an international context and the market participants operating within it.

Without doubt, both versions will attain the objective of prompt coverage of all costs incurred at MAM in connection with the conversion as desired by MAM and BNetzA and, as a result, they prevent arbitrage towards the MAM. Nonetheless, because of the design of both versions, there will still be sufficient arbitrage opportunities for traders that operate rationally and use both the virtual conversion service of the MAM and participate in quality-specific control energy trading with the MAM towards market participants that exclusively use the virtual conversion service. If these arbitrage options are consistently used, the costs for commercial conversion at the MAM might increase further and, as a result, the costs for the conversion fee and levy might rise further for all market participants compared with the last winter.

Statement

Below, PEGAS wishes to submit proposals regarding the different versions in order to limit the disadvantages resulting from the current drafts, such as the loss of competitiveness and reputation of the German market areas at an international level.

Predictability, reliability and sustainability of regulation

The general extension of the period of validity of the conversion fee and levy from 6 to 12 months under both versions in order to increase predictability for the market participants operating in gas trading and distribution is welcomed. A conversion fee which is known in advance (ex-ante) is also conducive to this end, while a conversion fee that is only established subsequently (ex-post) makes predictability in the competition even more complicated. Any possibility – even if only by way of exception – to adjust the conversion fee during the year should be prevented and covered by a sufficient liquidity buffer in order to avoid ex-post elements in the conversion fee which cannot be planned. In general, the continuation of a system with which the market is familiar and consisting of a conversion fee and a conversion levy (ex-ante version) is useful.

As in the past, BNetzA should assign specific times to change paths which are also possible in adjusting the conversion system and desired from a regulatory perspective in order to ensure planning reliability of more than one year for the trading and distribution portfolio, prevent any further weakening of the German derivatives market and facilitate the opening of the market through the entry of new market participants on the basis of reliable framework conditions. If, in
contrast to the original provision in Konni Gas, BNetzA, however, intends to preserve the long-term price separation between H-gas and L-gas in the German market areas, this needs to be communicated consistently so that the market participants can adjust their business model to this in the medium to long term.

**One market price per market area and, as a result, bundled liquidity for H-gas and L-gas**

Both versions prevent a quality-overlapping bundling of the liquidity of supply and demand and, as a result, one market price per market area. Hence, they reduce the competitiveness of German market areas, e.g., towards the TTF because the permanent preservation of the conversion fee cements the separation of the L-gas market from the H-gas market.

**Limitation of the commercial conversion costs at the MAM**

Under both versions, a limitation of the MAM’s commercial conversion costs compared with the last winter is not possible.

For as long as gas traders use their booked transport capacities between German market areas and the Dutch TTF market area in a profit-maximising manner, there is a strong financial incentive for these traders to sell the imported L-gas at high prices in quality-specific control energy trading rather than using it directly for a possible L-gas delivery obligation at lower prices. As an alternative, this delivery obligation can be fulfilled via the MAM’s virtual conversion service. On account of the existing market structure in the German L-gas market areas, the conversion costs incurred in this process, a possible profit margin and, if applicable, a security surcharge (e.g. in the event of uncertainty regarding the amount of the conversion fee as applicable in the case of the ex-post approach) can also be included in the L-gas prices in quality-specific gas trading with the MAM. Moreover, traders exporting H-gas will also try, at least, to include their transport costs to the neighbouring market area and, if a applicable, a profit margin in the H-gas price in quality-specific control energy trading with the MAM even though this is more difficult than in the L-gas market because of the market structure prevailing on the H-gas market. As a result, the MAM’s costs for the commercial conversion can spiral up. The commercial incentive for traders to predominantly use L-gas for control energy trading might only cease to apply once the revenue from quality-specific control energy trading can be distributed to more and other market participants than the conversion costs of the MAM.

However, the consistent limitation and safe predictability of the MAM’s conversion costs are possible if the MAM is granted direct access to the TTF market – as has already been the case so far for quality-specific control energy trading (L-gas purchase and H-gas sales); however, in addition, the costs required for the technical conversion on the TTF (transport costs) also need to be refunded to it via the conversion levy. In this case, the MAM could take its trading decision regarding the purchase of L-gas and the sale of H-gas on the basis of the pure commodity prices at the NCG-L, NCG-H and TTF VTP and the price difference between the L-gas purchase and the H-gas sale corresponds to, at a maximum, the bid-ask spread in the TTF order book (€ 0.1 - € 0.25 per MWh). The current price differences between the purchase of L-gas and the sale of H-gas, which were caused, in particular, by costs of transport but also by profit mark-ups and
security surcharges of the L-gas importing and H-gas exporting traders that have taken part in quality-specific control energy trading with the MAM cease to apply and the conversion fee reaches the conversion-friendly level of the bid-ask spread of the TTF order book (€ 0.1 to € 0.25 per MWh).

Arbitrage options towards other market participants through the virtual conversion service

Both versions prevent the MAM from being arbitrated out by trading participants because all conversion costs are passed on to the market participants. However, they permit arbitrage by traders taking part in quality-specific control energy trading with the MAM at the expense of market participants that only use the virtual conversion service with the MAM.

All users of the virtual conversion service from H-gas to L-gas have to pay the corresponding conversion fees to the MAM. The users taking part in the virtual conversion service that also trade quality-specific control energy with the MAM in their own market area can generate revenue that is above the conversion fee on account of the market structure. And, for rational reasons, these traders will have a low interest in dispensing with such in future. However, the additional costs that this causes for commercial conversion at the MAM are not only assumed by these traders but also by those traders that only use the virtual conversion service with the additional revenue from control energy trading remaining exclusively with this trader.

All possibilities for arbitrage among market participants brought about by the virtual conversion service of the MAM can be remedied as described in the lower part of the section entitled “Limitation of the commercial conversion costs at the MAM”.

Control function for the L-gas entry for the direct customer supply

Both of these versions will not prevent some market actors from using their transport capacities into the Netherlands for quality-specific control energy trading with the MAM rather than for the direct supply of final customers with L-gas for as long as higher revenue can be generated through the sale of L-gas to the MAM than in the direct final customer supply with L-gas (see example above under “Limitation of commercial conversion costs at the MAM”).

Sufficient liquidity buffer

The liquidity buffer envisaged for both versions should be dimensioned so that unexpected fluctuations in the conversion fee and the conversion levy in the course of the year as well as temporal asymmetries in the payment flows are covered.

Integration of German gas storage facilities in quality-specific control energy trading

Germany has the highest gas storage capacities in Europe; however, a large part of the flexibility of quality-specific control energy trading comes from abroad. As regards the security of supply and liquidity on the German L-gas market, neither of the two versions creates incentives for an increased use of the German storage facilities in the
conversion system. Therefore, it appears logical for German gas storage facilities in both versions to:

a. Permit within-day transport capacity bookings and
b. Abolish entry transport fees at the storage facility (in particular regarding L-gas)

so that L-gas from German gas storages facilities can be offered to the MAM in a fair pricing competition with quality-specific flexibility from abroad. In this case, users of German storage facilities would be able to take part in quality-specific control energy trading both in terms of operations and financially (avoidance of the double burden of entry fees if L-gas imported from NL is temporarily held in a storage facility).

**Accompanying PEGAS measures**

Irrespective of the selection of the versions provided by BNetzA, PEGAS can support the market participants in the implementation, e.g. with the help of the following measures, if required:

1. Introduction of an exchange L-gas derivatives market for GASPOOL and NCG – if BNetzA communicates a price separation between H-gas and L-gas (through the open-ended preservation of the conversion fee), the market participants can trade L-gas on the derivatives market via the exchange.
2. Centralised publication of transparency information of both MAM at PEGAS/EEX – Harmonised prompt publication of preliminary and final GASPOOL and NCG data regarding the conversion and publication of daily balancing volumes for each conversion direction (preliminary and final volumes).

Based on the proposals and measures specified, we are pleased to support the Federal Network Agency and the market participants in adjusting and designing the conversion system and are, of course, available in case you have any questions.
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About PEGAS

PEGAS is the central gas trading platform of EEX Group operated by Powernext. PEGAS provides its members with access to all products on one single platform and allows them to trade natural gas contracts in the Belgian, Dutch, French, German, Italian and UK market areas. The product range of PEGAS covers spot and derivatives contracts for the major European gas hubs as well as trading in location spread products between these market areas. This setup enables market harmonisation and forms the preferred pan-European natural gas market. For more information visit: www.pegas-trading.com