Position Paper regarding the Description and Further Development of the German Gas Market Areas in the Framework of the Market Dialogue with BNetzA

Leipzig/Paris, 22nd November 2016

Summary

PEGAS welcomes the possibility to comment on the market dialogue regarding the further development of the German gas market areas initiated by the German Federal Network Agency.

PEGAS shares the assessment in the underlying expert report of WECOM regarding market indicators. The liquidity inside the German gas futures market was seen at a critical point.
The highly liquid Dutch futures market at TTF is now an alternative for price risk hedging for market participants active in the German gas futures market. Therefore, liquid gas futures markets in Germany are not necessary as long as there are no bottlenecks for gas transportation between the markets GASPOOL/TTF and NCG/TTF.

The expert report discusses internal market and cross market measures to increase liquidity and competitiveness in German market areas.

With the exception of mandatory Market Making and, eventually, a restriction of possibilities to connect balancing accounts, the impact on the liquidity in Germany with the remaining market internal measures will be small. However, an obligation for Market Making is rejected.

Cross-market measure scenarios for market integration were also considered.
We share the conclusion that only market integration involving TTF will have a significant impact on liquidity in Germany. Both full market integration as well as trading region constitute significant regulatory interventions into the current regulatory regime, the market design and market processes. Those measures, therefore, appear to be very expensive in comparison to the expected benefit.

In this position paper PEGAS, as a partner of the gas industry, will submit its own proposal for a resolution which can contribute to a prompt enhancement of the competitiveness of natural gas as a commodity and to an increase in liquidity on the VTP of the German gas markets.

Statement

Below PEGAS wants to answer the catalogue of questions prepared by BNetzA to describe the status quo of the two German market areas as well as internal measures within the market areas and measures across market areas.

1. Status quo of the two German market areas

a) *Do you see any further indicators which should be used with regard to the assessment of the wholesale markets, in addition to the indicators of the Gas Target Model II (GTM II)?*

The indicators used to analyse are fundamentally correct and largely sufficient to measure the functioning of wholesale markets. Nevertheless, the methodology does not consider gas trading via location spreads, i.e. via standardised products in specific location spread order books which show the price difference between two geographically separate gas markets (e.g. NCG and TTF) and make it tradable. The consideration of location spread order books is required because more than 50% of the trading volume on the German gas derivatives market (across all trading platforms – brokers, exchange and bilateral) are generated via location spreads to the TTF.

The analysed database is restricted to order books of broker platforms, but order books of exchanges are not considered. A solitary analysis of exchange deals is not sufficient for assessing liquidity because up to 30% of the market share of exchanges depend on the product and market.

In addition to this, bilateral off-exchange trades were not considered, although they account for a significant share in gas trading.

In sum, the specified restrictions regarding methodology and data base leads to an undervaluation of liquidity.

b) *How do you assess the competition and liquidity situation in the two German market areas with regard to the different market segments of the spot, prompt and forward market? In as far as you see deficits in individual market segments, which obstacles for a higher intensity of competition and liquidity would have to be removed?*

PEGAS shares the assessment expressed in the expert report that, at present, liquidity on the German spot and prompt markets is high. However, if the conversion fee is maintained, access to the liquidity of spot and prompt markets could be considerably more expensive.

PEGAS also shares the statement in the expert report that the liquidity of the NCG and Gaspool Futures markets is currently very low.

c) *As seen from your perspective, in how far is a liquid prompt and forward market in the neighbouring country/neighbouring market area sufficient as an alternative provided there are sufficient fixed interconnection capacities?*

If sufficient transport capacities between the markets are available, then it is neither necessary nor realistic to develop a liquid futures market in each market area.

TTF as a liquid neighbouring market enables market participants' hedging at very low transaction costs and operative efforts. Transaction costs which have to be considered are, amongst others, transportation fees with intra-year factors, conversion fees and any possible levies on market area transfer points. Any uncertainty within the transaction cost is a risk for the trader.

2. Internal measures within market areas

Implementation by market participants, such as MAM, producers/importers, exchanges and associations

a) *More transparency regarding the various accesses to the organised trading market*

There are no signs that existing transparency regarding several kinds of access to the organised trading market is a barrier to entry.

Upon the introduction of MAM for the German gas market areas, the transparency already increased in so far that any further increase will only have minimal impact on the competition and liquidity situation in all market segments.

b) *Improved transparency regarding aggregated gas consumption and the condition of the system within the market area*

This measure should be welcomed in general because it provides all market participants and, in particular, the traders operating on the gas balancing market with the information and price signals necessary for a trading decision through the MAM. However, this cannot be expected to lead to an improvement of the competition and liquidity situation on the spot market.

c) *Creating a simplified set of agreements (only VTP access) for "pure traders"*

Should the present rules (e.g. in the standard balancing agreement) complicate VTP access for market participants that are not interested in the physical settlement of the trading transactions, this measure is to be welcomed and implemented by the MAM. A significant impact on liquidity is not expected.

d) *Obligation/incentives for market makers on the exchanges*

Market makers undertake to provide bid-ask spreads in return for financial compensation and under consideration of their own trading interest on exchanges but also on over-the-counter platforms and, therefore, ensure an increase in liquidity. Depending on the financial incentive, the gain in liquidity could be more or less significant.

PEGAS rejects obligations for Market Making. Each market participant should be able to freely decide whether to act as a Market Maker.

e) *Regular execution of gas auctions on the organised market (VTP as the place of performance)*

It is unclear whether gas auctions will increase liquidity on the future market. PEGAS does not see the demand for auctions in the future market. Principally, the product design has to follow market demands and should not follow regulatory specifications. Furthermore, it has to be considered that the gas price formation depends on other commodities which are traded continuously. As a result, market participants only accept auctions if the auction product is independent of other continuously traded developments.

If the market participants voluntarily carry out gas auctions on the VTP of a German market area out of self-interest, this can be done via gas exchanges.

Implementation through more or less significant regulatory interventions

f) *In principle, at least, interruptible VTP access for all capacity products*

Capacity products which do not exclude access to the VTP of the German market area permit gas trading on the VTP. Therefore – and in as far as this is not precluded by network topology reasons – additional capacity products with VTP access offered by the TSO might promote liquidity in all market segments to some degree.

g) *Possibility for intraday capacity booking at points of production, LNG and storage as well as at final consumer points*

In the position papers on the assessment procedure for Konni Gas, PEGAS has repeatedly referred to this measure which increases liquidity in all market segments and can be implemented by the TSO on a voluntary basis or ordered on a regulatory basis. Because of the increase in liquidity to be expected following the implementation of this measure, PEGAS has already introduced corresponding trading products (with the respective next 24 delivery hours being individually tradeable) since the spring of 2016.

As a result of the possibility to carry out intraday transport capacity booking transactions at costs which are lower than the costs for booking a day, trading participants can bring together the flexibility of gas storage facilities and gas-fired power plants and the volatility and liquidity coming from the balancing energy market for gas and power. In addition, hedging of fluctuations in power from renewable energy carriers (e.g. wind and solar power) can be effected with to-the-hour precision via gas-fired power stations which can be controlled flexibly. As a result, a contribution can be made to increasing liquidity at the VTP as well as to the security of supply regarding both gas and power. If, in future, intraday transport capacity booking is permitted at lower fees than the daily fee, the customers' portfolios will be aligned to that in the medium to long term.

h) *Exclusive fuel gas procurement by German Transmission system operators on the exchange*

PEGAS welcomes the proposed measure because it increases liquidity on the gas market of the German market areas. The effect will only be marginal because of the traded fuel gas volumes.

For the purpose of operational implementation, both German MAM that are already exchange members can on behalf of German TSO and without additional fixed costs procure fuel gas centralised in the gas futures market (year, season, quarter or month products) or/and as day periods on the spot market.

i) Restriction in the possibility for connecting balancing accounts

Shifting of trading in gas volumes at the VTP of the German market areas, to avoid balancing energy costs in the individual balancing accounts, could permit a significant gain in liquidity at the VTP in all market segments.

The multilateral bundling/pooling of balancing accounts in diverse balancing group structures, such as sub-balancing groups or balancing group cooperations, which is practiced by a large part of the German balancing group managers at present:

- on the one hand, prevents centralised balancing of gas volumes at the VTP to avoid balancing energy costs in the individual balancing areas, and
- on the other hand, like former gas supply contracts with City- or Regiogate as the place of delivery, it reduces the incentive for municipalities or end-customers to manage their own balancing account directly at the VTP and to contribute to an increase in liquidity there.

On the contrary, a restriction of possibilities for connecting balancing accounts can also limit flexible procurement and eventually be counterproductive for the creation of more liquidity, if the market participant without own trading activities would be squeezed out of the market, because he can no longer use any possibilities for connecting balancing accounts.

j) Reduction of the VTP fee

Because of its amount, the current VTP fee does not constitute a significant cost item of the transaction costs for the execution of trading transactions at the VTP.
A reduction would not contribute to an improvement in liquidity on the gas market.

k) Improved planning reliability for the "overall transport costs" (grid charge and levies)

This measure can be welcomed in general; however, the impact on liquidity for German gas future markets is unclear in terms of its direction and strength.

3. Cross-market measures

a) How do you assess possible national or border-crossing market area integrations?

The application of measures across market areas which lead to a complete integration of market areas or the formation of joint trading zones is assessed as being sensible if the following aspects are considered in the implementation:

- The welfare gain (benefit) is bigger than the costs which the final consumer has to assume as the result of this measure.
- Harmonised regulatory requirements apply equally to all market participants affected by this measure – also across borders.
- Transparent communication with regard to the fact that the transaction costs incurred between the market areas in the past, such as transport fees and other levies, do not cease to apply but are passed on to remaining entry and exit fees and other levies.
- Only the smallest possible adjustments of laws and ordinances are effected in the course of regulatory harmonisation in order not to jeopardise established market processes and minimise additional costs for the market participants.

After consultation with the market and under consideration of the above mentioned premises it might perhaps be sensible to implement less severe regulatory measures for market integration which might provide the same advantages but fewer disadvantages.

As seen from the perspective of PEGAS, the objective can be reached via the exchange through joint (implicit) trading in gas and transport capacities at the virtual trading hubs of the market areas to be connected (e.g. NCG/TTF). This proposal complies with the European Network Code for Capacity Management (NC CAM Art. 2 (4)), according to which transport capacities can also be allocated jointly with gas by the TSO according to the requirements of the national regulatory authority. This model has already been used successfully by the French GRTGaz TSO for coupling of the northern French market area (PEG Nord) with the southern French market area (TRS) in cooperation with PEGAS for several years and, in the process, it has been granted unrestricted support by the traders operating on the French gas market.

This proposal provides the following advantages for the involved market participants:

- The liquidity of a neighbouring market (e.g. TTF) can also be used within the German market area through the joint trading of gas and transport capacities via a trade in the location spread order book for as long as transport capacities are available.

Implementation is promptly possible because both European and national regulations do not have to be adjusted, market area-specific balancing zones remain unchanged, the current distribution of roles on the market and the market design are not affected, market area-transcending harmonisation of market processes and regulations is not required and the corresponding location spread order books have been actively traded on the exchange for years.

b) *In your opinion, integration with which neighbouring markets provides potential for a significant improvement in the competition and liquidity situation?*

In the case of the German market areas, only market integration with TTF would result in a significant improvement in the competition and liquidity situation.

c) *Which of the models of market integration (full integration or trading region) described in the expert opinion or in the GTM II do you prefer?*

Under consideration of the premises listed above, both models constitute fairly extensive regulatory interventions, in the case of which it is, at least, uncertain that the expected end-customer benefit will be higher than the costs of prompt implementation.

Therefore, we prefer the joint allocation of cross-market area gas transport capacities and gas as described in 3. a).

d) *How do you assess the restrictions which might appear in the offer of fixed, freely allocable capacities with a view to the future competition and liquidity situation?*

A merger of market areas in the framework of full integration or a trading region leads to implicit management of the transport capacity which used to be explicit before. If this implicit management leads to reduced, fixed, freely allocable capacities, inefficiencies might arise.

e) *In your opinion, will the integration of market areas have positive or negative effects on the security of supply of the German market areas?*

Any influence of market area integration on the security of supply is not certain.

f) *After weighing the advantages and disadvantages outlined above, where do you see the bigger overall benefit for the German market?*

We believe that the added value of further market integration is low, while the effort required is high. Hence, we support a prompt switch in gas qualities inside the market areas to remove L-Gas problems and, until further notice, advocate the maintenance of the gas market areas NCG, GASPOOL and TTF. With the application of the joint allocation of cross-market gas transport capacities and gas across the market areas, as described above under 3.a), a faster and more efficient welfare increase is possible.

g) *Which essential (legal, regulatory, etc.) obstacles to implementation do you see for integration projects?*

In the framework of the discussion in the run-up to as well as at the workshop of BNetzA regarding the subject of market area integration in terms of full integration or a trading region, the market participants predominantly illustrated the challenges regarding:

- Required harmonisation of the balancing and regulatory system
- Cooperation among the national regulators
- Possible additional costs which might possibly be higher than the additional benefit for the final consumer
- Type and manner of cost and revenue forwarding at the TSO if former market area interconnections are managed internally after integration
- Scope of and need for adjustments of the existing contracts
- Speed and time of the implementation of market area integrations
- Maintenance of fair balancing of interests between parties benefitting from market integration and parties placed at a disadvantage because of it
- Changed competitive situation for gas infrastructure operators (e.g. storage facility operators, producers, transmission system operators) affected by the market area integration mentioned.

A final assessment cannot be provided by us.

h) *How can possible solutions be designed in terms of operations and timing so that, e.g., different access systems can be harmonised?*

In the answer which was provided regarding question 3.a) and contains a proposal for the joint allocation of gas transport capacities and gas across market areas in order to increase liquidity in the German gas market areas, operative solutions, designs in terms of timing as well as the need to harmonise various access and balancing systems have already been discussed in detail. Moreover, the advantageousness as against other measures for market area integration across market areas can be expected to provide similar positive effects on liquidity and competitiveness at the VTP.

i) *Question regarding alternative approach: As a further possibility to strengthen EU gas market, a shifting of fees on cross-border points between EU countries to entry-points into the EU and/or domestic exit points is being discussed. In how far do you see such an approach as an alternative or supplement to the possible integration of market areas discussed in the GTM II?*

A detailed evaluation of these alternative approaches was not possible due to the limited consultation timeline. The proposed approach could lead to a market merger and to a potential increase in liquidity. However, it could also lead to a dilution in the principle of cost causation and to changes at the level of freely allocable transport capacities, with the result that a complex regulation for forwarding of cost and revenues can be assumed.

Regardless of the selection and further pursuit of the measures outlined above by market participants and the German Federal Network Agency, PEGAS is pleased to support the discussion with the market and regulators regarding the further development of the German gas markets and is, of course, at your disposal in case you have any questions with regard to this.

Contact

Sirko Beidatsch
Senior Expert Gas Markets
Phone: +49 341 2156-223
sirko.beidatsch@eex.com

European Energy Exchange AG
Augustusplatz 9
04109 Leipzig
www.eex.com

Dr Jan Richter
Head of Regulatory Affairs & Communications
Phone: +33 173 03-7639
j.richter@powernext.com

Powernext SA
5 Boulevard Montmartre
75015 Paris
www.powernext.com

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, UK and Danish 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. Further information: www.pegas-trading.com