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# PEGAS Response to KAP+ Procedure – Second Consultation

08.11.2019  
Paris

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Powernext SAS

## Introduction

PEGAS welcomes the German Federal Network Agency's (BNetzA) efforts to bring together the discussions regarding the creation of additional gas transport capacities ("KAP+") among the different groups of interested parties by introducing an overbook and buy-back model (OSBB) in the framework of the German market area merger via a second consultation and to establish a final regulation on this basis.

PEGAS confirm that it prefers the use of market-based exchange instruments over internal instruments by the transmission system operators to cover the overbooking model. Only market-based instruments of the exchange ensure that as many market participants as possible can participate in a price- and quantity-transparent order book and, if applicable, provide the transmission system operators (TSO)/market area manager (MAM) with offers based on the commodity price for the long-term hedging of the desired capacity level in a non-discriminatory competition with each other.

PEGAS categorically reject price caps and, hence, any intervention in market-based pricing in line with supply and demand for the use of congestion management instruments since such distort the market. A qualified statement on the functionality, efficiency and profitability of congestion products as a market-based alternative to physical grid expansion is only possible if there is free pricing and, if applicable, a discontinuation of the temporary overbooking model can only be evaluated after the planned test phase.

Below, we comment on the further deliberations of the ruling body on the design of the oversell and buy-back system (OSBB) in the context of the market area merger as follows:

## General remarks on the transmission system operator's concept for an overbook and buy-back system

The experience gathered so far with the French market area merger shows that market-based exchange instruments can remove congestion in an effective and cost-efficient manner. Therefore, PEGAS primarily recommends these market **price**-based instruments to remedy congestion in the context of the German market area merger.

The congestion management instruments specified and described by the transmission system operators (TSO) can be divided into the following three groups and they should be used transparently in line with the sequence or Merit Order List (MOL) shown below:

1. Market **price**-based exchange products (Location Spreads), which are offered to the TSOs or MAM based on the commodity price.
2. Internal tools of the transmission system operators (VIP-wheeling, 3rd-party network use), which are used based on the commodity/working price, if the market participants do not submit any further offers to remedy the congestion via MOL 1.
3. Capacity buy-back products which are only used if congestions cannot be remedied via MOL 1 and MOL 2.

PEGAS support the Federal Network Agency's proposal that the German TSOs should consult the market participants for a better understanding of the functioning and the operating principle of the above-mentioned instruments, a comprehensive process description with detailed information on product characteristics and expected commodity prices and, subsequently, include such in the concept.

In designing the internal tools of the transmission system operators, care should be taken to ensure that their concept (e.g. regarding the lead time) and applicable costs (Would a trader pay the same amount?) does not have a market-distorting or even market-locking effect. Otherwise, the use of the market price-based MOL 1 products might be prevented and this market might be excluded from the outset. The TSOs/MAM should base deployment scheduling for the congestion management products on the primary use of as many MOL 1 products as possible with a lead time of, at least, three hours. The use of Internal TSO

instruments (such as wheeling), which do not provide for any inclusion of the trading market, should only be permitted after this with a shorter lead time.

All cost components (such as entry-exit fees, levies, service fees) should be made transparent for the internal instruments of the transmission system operators in advance, converted on the basis of the commodity price to ensure improved comparability, and consultation with the market should be effected.

### **Further remarks regarding specific proposals by the Federal Network Agency**

#### *Comments regarding 3.1.: Restriction of the period of application of the OSBB*

PEGAS welcomes the limited term of the OSBB under consideration of the points expressed by the Federal Network Agency. The determination of the “sufficient” extent of fixed freely allocable capacities (FAC) within the national German market area, the execution of successful tests of the functionality and efficiency of the congestion instruments proposed by the TSO, in particular, have to be mentioned in this context.

#### *Comments regarding 3.2.2.: Capacity products in the OSBB*

We support the requirement by the Federal Network Agency and the market’s desire to close the capacity gaps resulting from the market area merger with FAC marketed via OSBB in full or in part. However, at present, in our opinion, the need for the use of temperature-dependent entry capacities cannot be evaluated. We do not yet know in how far there is a demand for it from the market participants and whether, based on this, there will be a reduction of the use of congestion products.

#### *Comments regarding 3.2.4.: Market-based instruments and buy-back*

In order to strengthen transparency and acceptance, PEGAS supports demand for a detailed description of the congestion instruments and is also available for the TSO/MAM in preparing this detailed description of the Location Spreads.

*Comments regarding 3.2.4. (4): Price cap for congestion products*

PEGAS categorically rejects price caps and, hence, any intervention in market-based pricing in line with supply and demand for the use of congestion management instruments since such distort the market. A qualified statement on the functionality, efficiency and profitability of congestion products as a market-based alternative to grid expansion and, if applicable, on a discontinuation of the OSBB can only be provided if there is free pricing.

The potential cases of market abuse addressed by the TSO can easily be avoided by the following measures:

- Market-based design and deployment planning of congestion products
- The biggest possible number of trading participants that trade these congestion products in the corresponding congestion zones
- The public market surveillance of the exchange which monitors compliance with the market rules regarding the initiation and execution of trades as it already does in exchange balancing of the MAMs.

Furthermore, according to section 25 of the balancing group agreement, the MAMs/TSOs can be granted far-reaching ex-post rights of information by the exchange and the trading participants as in the case of balancing market on the exchange. By that they may monitor the physical effect of congestion products and to punish any possible violations.

*Comments regarding 3.2.5.: Suspension of short-term marketing*

We do not agree without reservations to the concept of the general suspension of short-term marketing of all and, hence, also the technical and freely allocable fixed entry capacities according to OSBB in the oversupplied zone during the deployment of congestion instruments. A general suspension of short-term marketing constitutes a significant intervention in the regular market activities and does profoundly harm the functioning of the market.

However, PEGAS agree to a limited suspension of short-term marketing provided that the extent of such is limited to the times and booking points at which an additional use might reinforce the congestion.

PEGAS supports the Federal Network Agency's proposal for transparency in the suspension of short-term marketing to ensure that the market participants are always aware of the grid points at which restrictions might be observed for which capacity products and to which extent.

### *Comments regarding 3.2.6.: Monitoring*

We welcome the monitoring proposed by the Federal Network Agency and will support the TSO/MAM as well as the regulatory authorities in establishing such provided this is desired and legally permissible.

### **Further remarks regarding the OSBB concept of the TSO**

At present, the concept of the transmission system operators does not sufficiently show the obligations and terms to which the market participants contributing to the elimination of congestion by trading exchange congestion management products are subject.

As in the case of quality-specific balancing, we also propose that safeguarding of the physical, congestion-remedying effect be transferred to the traders and that this should also be bindingly included in the balancing group agreement.

For many years, physical fulfilment has been mandatory in quality-specific balancing for Germany and it has been a decisive factor for its success. The market participants can decide from within their portfolio how the desired physical effect is to be achieved and they can provide evidence for this in specific individual cases upon a question to this end by the MAM.

### **Further remarks regarding the comments of BNetzA, mentioned during the 3<sup>rd</sup> market dialogue regarding the usage of location spreads for Germany**

As already shown during the 3<sup>rd</sup> market dialogue from the French TSO GRTgaz, the usage of market-price-based location spreads, which were traded on the exchange and used for removal of congestions in the merged French market area, has proven very good success in the first year of usage and should be even improved in a dialogue with the market.

Based on that and under consideration of the listed arguments below, concerns argued by Federal Network Agency regarding the usage of location spreads in the merged German market, could be devitalised. We are convinced location spreads in Germany will prove better results as in France with lower commodity prices. In the following we will elaborate on the reasons why we believe so.

*Criteria, to compare the usage of location spreads in France and Germany*

- Number of congestion management products:
  - In France there are eight (NS1, NS4, EO2, S1, SN1, SN3); in Germany only one (GPL→NCG).
  - Less congestion management products lead to a stronger bundling of trading interest in only one congestion management product, hence leads to an increase of liquidity, stronger competition and finally lower commodity prices.
- Number and layout of congestion zones:
  - In France there are five smaller ones; in Germany two bigger ones (GPL and NCG)
  - Less and thus larger congestion zones may comprise more interconnection points, which then could be used by market participants for physical fulfilment of location spreads.
- Number of registered trading participants for location spread trading with MAM/TSO
  - In France today there are forty (thereof 21 active); in Germany more than 100 are to be expected.
  - In Germany today more than 95 market participants are registered for quality-specific balancing with H-Gas at GPL and 113 at NCG, leading to the desired physical effect in the market area.
  - Trading participants on location spread trading can be those that are able to
    - Exclusively buy gas from the MAM/TSO in the upstream zone and commit to exit this gas out of the upstream zone physically, or
    - Exclusively sell gas to the MAM/TSO in the downstream zone and commit to entry this gas into the downstream zone physically, or
    - Both, buy gas from the MAM/TSO in the upstream zone and commit to exit this gas out of the upstream zone physically and sell gas to the MAM/TSO in the downstream zone and commit to entry this gas into the downstream zone physically.
  - A higher number of trading participants leads to increased competition and lower commodity prices.

- Availability, number, size and allocation of gas storages:
  - Allocation, size and number of gas storages across the single German gas market is just as well as in France.
  - Gas storages create fast physical effects on a large scale in the congestion zone and therefore contribute very efficiently and effectively to the removal of congestions.
- Level of historical price differences between the congestion zones:
  - In France price differences between the northern (PEG N) and the southern (TRS) market area amounted in the past for the current and the next gas delivery day a lot from more than 1 €/MWh until 15 €/MWh
  - In Germany price differences for current and the next gas delivery day amongst GPL and NCG are mainly smaller than 0.5 €/MWh and only in very rare cases bigger than 1 €/MWh.
  - Thereby the commodity price for location spreads in Germany are expected to be mainly lower than 0.50 €/MWh and thus below the French commodity price for location spreads (currently ca. 1.8 €/MWh).
- Liquidity for gas trading during night (between 18 and 8 CET) and on weekends
  - In France ca. 1% of day products respectively 8% of Within-Day products, traded on the exchange, were traded at night or on the weekend from ca. twenty companies.
  - In Germany ca. 10% of day products and more than 50% of Within-Day products, traded on the exchange, were traded at night or on the weekend from more than forty companies.
  - Hence, high liquidity and the huge number of active participants already today will also guarantee activity in location spread trading in Germany at night or on the weekend and thus lead to commodity prices formed by competition.
- Experiences of market participants for trading of products with physical effect:
  - For several years, less than 5% of exchange based balancing, traded from ca. 50 companies, has been done under obligatory physical fulfilment in France.
  - In Germany, however, at least 30% of exchanged based balancing, traded from ca. 100 companies, has been done under obligatory physical fulfilment



- Thus, many years of experience in trading products under obligatory physical fulfilment ease the launch of location spreads as congestion management product.

PEGAS is looking forward to its continued participation in the ongoing discussions on the way towards a successful market integration. Particularly, we would like to be involved in discussions on use and detailed design of market-based exchange congestion management instruments.

PEGAS do not see the usage of congestion management products as automatically and generally failed, once TSO/MAM have to buy back capacities in less and well-founded exceptional circumstances. Only a very few systems and processes run smoothly right from the start.

Instead, market parties and regulatory authorities will have to pass through a learning curve and agree on further improvements within a dialogue – as done in France.

In Germany the dialogue on balancing trading is already well established. We advise to also use this channel for congestion management products.

**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 Austrian, Belgian, Czech, Danish, 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, time spread, and options products on the Dutch TTF hub. This setup enables market harmonisation and forms the preferred pan-European natural gas market. For more information: [www.powernext.com/pegas-trading](http://www.powernext.com/pegas-trading).

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