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Consultation response of Gazprom Marketing & Trading Ltd. to the Kap+ procedure for additional capacity in the single German market area: BK7-19-037.

To whom it may concern

Gazprom Marketing & Trading (GM&T) is a UK registered wholly-owned subsidiary of the Gazprom Group active in the marketing and trading of energy commodities worldwide, including power, gas, oil, LNG and carbon allowances. In Germany, GM&T is particularly present in the supply and wholesale markets and it has therefore an active interest on the current discussion on the future establishment of the German market merger.

We have provided our thoughts and recommendations on the different chapters below and would like to ask the Ruling Chamber to carefully consider these in their final decision.

We hope the comments above prove helpful. Please do not hesitate to contact me on [REDACTED] or at [REDACTED] in the first instance should you have any questions.

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1. Oversubscription

We would like to take this opportunity to express our appreciation to be able to share our views on the Kap+ consultation, as well as the concept for an oversubscription and buy-back scheme in the common market area provided by the Transmission System Operators (TSOs). It is our belief that the market merger offers the chance to achieve the establishment of an attractive and liquid German trading hub, which will be in the benefit of suppliers and end-customers alike. Yet, the setting of the necessary firm capacity level into the new market area as well as the design of the facilitating instruments have to be chosen with the greatest care, as it might otherwise negatively disrupt market dynamics and liquidity.

Therefore, we welcome the started consultation process, which has been initiated by the Federal Network Agency (BNetzA) in recent weeks and has requested a conceptualization of the intended oversubscription and buy-back mechanism. As an active wholesale trader, we support BNetzA's general acknowledgement that more than 22% (based on current NDP levels) of firm entry capacity (FZK) is needed to maintain at least current liquidity levels of the German gas market. This will allow the development of stronger price signals, lead to greater market efficiency and welfare gains. Moreover, we believe that the chosen test-phase of three years offers the right timeframe to strengthen previous assumptions on basis of statistical analysis and will help to identify the economic benefits of the merger. We also believe that it is the right approach to estimate the future firm entry capacity on basis of historic and real demand and agree that the three years will offer a good reference period to achieve this. Lastly, it has to be emphasised that all impacted stakeholders should be interested in a cost-efficient tariff system. Thus, aiming to couple historical bookings and binding capacity requests as the base for future capacity levels is the right way to go forward.

Besides the above-mentioned positive observations within the consultation document, GM&T sees the need for additional adjustments and clarifications on the generation of additional capacities (via over-subscription). In the published documents, it becomes apparent that the decision of how much capacity is offered at specific grid points, and in which quality (capacity product), is solely within the decision of the TSOs. The Network Development Plan 2018-2028 will serve as a capacity maximum. Two points that we would like to emphasize in this regard:

1. Substitution of firm with temperature dependent capacity

We want to underline strongly that the increase of temperature dependent capacity at all grid points is not the right instrument to decrease costs and will have negative impacts on market liquidity. While we understand that storage points might indicate a statistical

correlation between capacity bookings and temperature levels, it is wrong to assume that temperature dependent capacities achieve the same effects to firm entry capacity. The offering of temperature dependent capacity will push more uncertainty to the shippers as volume hedges become more difficult. This will ultimately worsen the economics of storages and creates welfare losses. Also, having in mind the published EUR 30 million worst-case scenario in annual costs for the congestion management, we believe that the intended savings to substitute firm with temperature dependent is not significant enough to create risk premia for transportation bookings.

2. Beyond oversubscription and buy-back: creating a diversion service

Besides the generation of additional capacities via the possibility of over-subscribing, we would like to ask BNetzA and TSOs to consider the possibility of introducing a diversion service for contracts similar to the Dutch GTS offering. This would allow a more flexible use of existing capacity contracts between different points of the grid. Given the fact that the three-year test phase intends to create a reference period for the future German capacity demand, introducing a diversion service would help shippers to adapt their portfolios in light of the market changes.

Lastly, we want to stress that we support the Federal Network Agency in fostering the development of market-based instrument as a more cost-efficient way to maintain an acceptable capacity level into the new market area. The retrospect benchmarking between the costs of market-based instruments and construction of new infrastructure within the bi-annual process of the Network Development Plan will ensure an efficient cost-structure over the next years. However, in order to establish real cost comparability between network extension and market-based instruments we believe that the Ruling Chamber will need to ensure that full costs need to be applied to the TSO-related market-based instruments, namely Wheeling and Third-Grid Use. The intention of this rationale will be presented in more detail in the next paragraphs.

2. Facilitating measures: market-based instruments

GM&T welcomes the competitive use of the proposed market-based instruments (MBIs) in one merit-order list (MOL). This will ensure the future comparability of costs between MBIs and infrastructure developments and will keep the system costs of the congestion management as low as possible. However, the comparability and efficiency of the MBIs can only be evaluated subsequently when network-based MBIs (Wheeling and Third-Grid Use) are designed according

to market-related criteria. This includes that the cost basis of these products should not be artificially reduced, for example by excluding German capacity costs. We would see two main issues with latter variant:

1. Transparency and comparability of costs

A reduced cost basis for MBIs would obscure much of the real system cost. It might seem at first that the reduction will positively impact the system-costs of managing the congestion. Yet, since the TSOs operate under a regulated revenue cap, it is effectively not making the instruments cheaper but instead it hides significant parts of the costs within the German tariff structure - through already booked capacities. Hence, it is beneficial that all capacity costs are included when applying Wheeling and Third-Grid Use as: (1) it will increase transparency; and (2) by including the costs will create additional capacity demand, which in turn will decrease tariff levels.

It is, moreover, wrong to assume that MBI costs including German tariffs would automatically incentivise traders to increase their locational spread bids and therefore increase the system costs. But these bids will always be derived on basis of market fundamentals and given the expected competitiveness of the market, it will reach low price levels. Also, it is wrong to assume that set prices for MBIs will automatically create an economic price ceiling. This works only when seen in market isolation. Yet, given the connectivity of the German grid to neighbouring markets, market spreads and storage levels will play a more significant part in the sourcing of gas to manage the congestion.

2. Distortion of capacity and wholesale markets

Another impact of artificially reduced MBI costs is their potential to distort both, capacity and wholesale market signals. Capacity market signals on PRISMA are distorted, as TSOs would assume different costs for flowing gas cross-border to ease the congestions. This will place market participants automatically at a disadvantage since it would potentially reduce capacity levels between hubs prior to the physical route becoming profitable for shippers. Undeniably, this reduction of capacity will have an impact on the price signals between both markets and, hence, will distort the respective wholesale markets equally.

Given the presented arguments, we believe it would be more beneficial for the functioning of cross-border markets, if the design of the MBIs include the entire capacity costs of the intended routes for both, Wheeling and Third-Grid Use.

Moreover, the TSO concept for an oversubscription and buy-back scheme in the common market area also proposes the introduction of a price limit for MBIs. We share the Ruling Chambers concerns in this regard and consequently reject the proposal. Giving the geographical position of Germany with its many adjacent markets and storages, it can be anticipated that the tenders will generate a favourable market outcome – with low average prices for spread products. Moreover, in order to generate real cost comparability between MBIs and grid extension within the framework of the NDP, a restriction should not be introduced as it will distort the results and prevent the evaluation on basis of cost-efficiency.

Lastly, we would like to comment on the TSOs recommendation to place interruptions on the first level of the MOL. While, we understand the intend of such proposal, we would like the Ruling Chamber to consider that managing congestions through interruptible capacities (or interruptible parts, e.g. DZK) will add another layer of uncertainty on these capacities. A shipper will now not only need to assess the probability of interruption based on locational grid constraints but will also need to include the likeliness of inner-German congestions due to the merger. This seems particularly burdening for grid points where only fully or partly interruptible capacities are available.

3. Restriction of short-term capacity auctions

The TSO concept for an oversubscription and buy-back scheme in the common market area proposes to restrict short-term capacity auctions in case the market is experiencing a congestion. We believe that this restriction is not needed as the decision to book additional short-term capacity by shippers is based on market fundamentals and not on the anticipation of potential calls for congestion products. In this regard, it is our belief that functioning market signals will give no incentive to shippers to book short-term capacities, which will worsen the congestion. Moreover, and in order to create trust in the German market, it is of utmost important to ensure that the unsold capacity of the annual auction is made available throughout all remaining within-year capacity auctions (quarterly, monthly, day-ahead and within-day).