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BK7-16-050; FNA consultation aiming to amend ruling BK7-11-002 ("Konni Gas") on the conversion scheme in multiple gas quality market areas

Dear Sir/Madam,

The market area managers (MAMs) GASPOOL and NetConnect Germany have proposed to amend the FNA Ruling BK7-11-002 issued March 27, 2012 ("Konni Gas") with the aim to continue the gas quality conversion fee scheme beyond March 31, 2017. The MAMs claim that changes in the market environment have occurred or are expected to occur which were not foreseeable when the ruling was issued in 2012 and which, in their view, require the continuation of the conversion fee scheme. Explaining the market changes, the MAMs list the below developments:

1) Gas production from the Groningen area in the Netherlands has – in conjunction with earth tremors - about halved compared to 2013. They expect L-Gas supplies from the Netherlands to further decline and are concerned that these supplies will not be sufficient to meet end-consumer demand and that hence supply security may be at risk;
2) Domestic L-gas production is declining more than assumed at the time of the ruling;
3) The decline in gas supply capacity (from production in the Netherlands and in Germany) is not sufficiently compensated by a reduction of (peak) capacity demand;
4) Long-term L-gas import contracts may be terminated early if economic incentives (arguably established by the conversion fee scheme) are reduced for individual shippers to procure gas in a quality corresponding to its demand; this in turn would – in the view of the MAMs - accelerate the reduction of L-gas production in the Netherlands.
5) NetConnect Germany (NCG) has stated recently increased control energy (CE) purchases at high prices as supporting reason for the need to amend Konni Gas.

We question whether the changes in the market environment stated by the MAMs are of such a relevance or nature that they justify the amendment of the ruling. We also question whether they were not foreseeable at the time of Konni Gas:

Ref. (1): A decision to continue or discontinue the conversion fee scheme in Germany does not alter the physical availability of L-gas supplies for German consumers and hence does not impact security of supply levels. However, earth tremors in the Netherlands have led to political decisions to limit the *annual* L-gas production volumes from the Groningen cluster in 2014, 2015 and 2016. A decision about future production levels is planned for October this year. Our understanding is,

- that (maximum) L-gas flows across the border from the Netherlands to Germany have not been and are not expected to be affected by the aforementioned political decisions;

- that a significant share of the maximum L-gas capacity generated to enable exports to Germany has been generated by blending Nitrogen (N_2) into H-gas flows and that the corresponding N_2 blending plant capacities have not been subject to the political decisions (which limited the annual L-gas volumes from the Groningen cluster only) but have been utilized at a higher rate as a consequence;
- that reduced production from the Groningen field can be compensated by N_2 blending in the Netherlands and that the construction of additional N_2 blending capacity is being planned by the transmission system operator, Gas Transportation Services B.V. (GTS), in the Netherlands;
- that GTS, which is state owned, has not changed its communication to the German gas transmission system operators about the available L-gas transportation capacity at the border points; GTS has consistently communicated since 2012 (and reaffirmed this publically in the TSO Workshop on the Grid Development on February 25, 2016) constant available L-gas capacities up to the year 2020 and a reduction by 10%-pts. p.a. thereafter until 2030.

Hence, we question whether there have been fundamental changes in the availability of L-gas supplies from the Netherlands to the German market and therefore whether the security of L-gas supplies to consumers in Germany is at risk.

Ref. (2): Domestic L-gas production capacity in Germany was forecast in the NEP 2012 to represent about 14% of total L-gas supply capacity by 2016/17. In the NEP 2016 that share turned out to be 11%, which is 3%-points lower than forecast. The relevance of this development to a decision on the continuation of the conversion fee seems limited.

Ref. (3): The reduction of available L-gas supply capacity from the Netherlands to the German gas market beyond 2020 has been known in 2012 and has not changed since then. The German TSOs manage the reduction in L-gas supply capacity through a well-coordinated and consulted process as part of the annual grid conversion planning: based on these plans L-gas peak capacity demand has been reduced year baxely year by connecting L-gas consumers to the H-gas grid. It is noteworthy that the German TSOs have not proposed significant changes or even accelerated grid conversion in their recently published draft grid development plan (NEP 2016). Neither does the NEP 2016 differ significantly compared with the NEP 2012 with regard to the anticipated L-gas capacity availability.

Ref. (4): The duration of bilateral L-gas procurement contracts tends to be a result of multiple market dynamics and each supplier will have its own reasoning. As long as the physical supply capacities are available, supplies will find their way to consumers through multiple commercial arrangements.

Ref. (5): The procurement of CE by TSOs to perform quality conversion services is foreseen under Konni Gas and an increase does in our view not constitute a fundamental change in the market environment. Price volatility is a fundamental element of gas commodity price formation and allows for market signals (e.g. providing incentives to store L-gas). However, we understand that the market may need some time to develop efficiently including more efficient CE procurement processes by MAMs (e.g. reducing CE purchases during out of trading hours and/or concluding longer term CE arrangements) and an increased number of market participants in the L-gas CE market. We understand that over the past months the market has become more efficient already. Allow us also to point out, that - following dialogue with the regulator in 2015 - we entered into discussions with Gasunie Deutschland, GASPOOL and Netconnect Germany about L-gas CE supply agreements and made offers but no interest existed to enter into binding arrangements. Hence, it seems that there are sufficient supply alternatives offered in the market.

Allow us to also point out in this context that increased CE purchases by MAMs do not constitute an increase of overall L-gas demand (as total physical L-gas demand by endconsumers does not change) but are merely a (partial) shift of the management of L-gas supplies from longer term to shorter term (including within-day / CE purchases by TSOs) commercial arrangements. This mechanism is foreseen by Konni Gas aiming at the creation of larger market areas with no distinction between gas qualities. Such a larger market yields the general economic benefits of improved market functioning with corresponding market efficiency gains.

In conclusion, we believe that changes in the market environment are not of such a significance, that they alone would justify the amendment of Konni Gas. Furthermore, consideration must be given to the amendment of Konni Gas constituting an unexpected intervention into the market framework: shippers will have already entered into commercial arrangements in anticipation of the phase out of the conversion fee.

Notwithstanding the above, a careful analysis should be conducted, market parties consulted and the root causes for the recent increase in cost for CE identified. If it is determined that the elimination of the conversion fee may lead to opportunistic trading that could result in significantly higher than anticipated CE cost, then further consideration should be given to how best to prevent this. Any analysis should also include establishing a framework that fosters CE market efficiency and transparency.

Please let us know if you wish to discuss the above stated in more detail.

With kind regards,

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