Open Letter

to the Minister of Economy in Germany (Mr. Müller),
EU-Commission and the German Gas and Industry
Associations BGW, VKU, BDI and VIK. Development
of Gas-to-Gas competition in the German Gas Industry
EFET position paper – 25th February 2000

Introduction

The European Federation of Energy Traders (EFET) was set up in 1999. The group represents 42 energy companies across the European Union. Each company in EFET supports liberalised markets, in electricity and gas, in each country of the European Union.

General

The German gas market is characterised by a very complex structure involving more than three layers of gas business on a national, regional and local levels. Responsibilities for gas transport and gas deliveries are divided across these levels. The German gas market characteristic is an extremely long supply chain. EFET seeks to ensure that the natural development of the internal market is not distorted or constrained by barriers to competition, which result from undue application of subsidiary in the implementation of the Gas Directive. In order to realise the goal of liberalisation, EFET believes that the "Verbändevereinbarung" (Association Agreement) must fulfill certain minimum standards.

To develop competition it is essential that all eligible customers are in a position to participate in all levels at any time. This can be provided by:

a. Competition in production
b. Free choice of import
c. Easy and transparent gas network access
d. Easy and transparent access to storage facilities
e. Clear balancing rules and access to this service
f. Provision of quality management and conversion if necessary

If only one of these requirements are not fulfilled only limited customers will benefit from predictions, only part of the customers will participate in gas-to-gas competition and it will delay the pace of market development. The development of gas-to-gas competition is rather limited.

Germany has chosen negotiated third party access (nTPA) for networks instead of the EFET preferred way of regulated third party access (rTPA). We believe that also under this "second best solution" it is possible to develop competition, but the following minimum standards must be fulfilled in the most explicit manner.

1. Unbundling,

   has to be established in the most effective way! This is one of the most important mechanics for achieving a competitive market. Clearly, an independent pipeline company will have different incentives than a pipeline company that is affiliated with
a supply company. The early days of liberalised markets give clear evidence of that effect.

The Directive requires the preservation of confidentiality of information, and provides for unbundling of accounts of transportation and trading to achieve this. In practice, clear administrative separation or the erection of ‘Chinese Walls’ (more than accounting separation) will be absolutely necessary in order to prevent commercial information from a third party reaching the trading or marketing arm of a transportation company.

2. *Non discrimination*

has to be guaranteed by applying the same principle to the separation of transportation and storage. All market participants need access to the following information on a daily basis:

- clear, transparent and unambiguous tariff charges,
- short term tariff provisions,
- status of pipeline and storage capacities,
- all possible entry and exit points including corresponding level to which they apply,
- physical flow direction,
- injection and withdrawal rates as well as available working gas capacities for all storage facilities.

In addition, the current proposals require in a more complex system such as Germany, all companies have to define on which level they are acting – without exception. If a transport company is carrying gas from point A to B, the pipeline operator cannot choose if he is a local or a regional distributor on an arbitrary basis. It should not be possible that the incumbents are treating their customers in a different way than they treat a third party supplier, using the incumbents network.

3. *Tariff system*

EFET is strongly opposed to the use of "path based" charging systems. Path based charging systems will delay the development of a competitive market for the following reasons:

- Suppliers will have to obtain individual quotations for each separate customer. This will increase the complexity in pricing customers and hinder price transparency
- Path based systems reduce a suppliers flexibility to switch to alternative supply sources in response to market signals
- Anomalies in customer transit costs may occur as some large customers may be on lower pressure networks and smaller customers on high-pressure networks. Potentially this could lead to customers investing in new pipelines to link up to high- pressure lines.
As retail competition develops the transmission operators will struggle to respond to the requests for point to point charges.

EFET is looking for effective gas-to-gas competition in favour of a clear system, which is easy to understand and provides the lowest possible transaction costs. The ideal solution appears to be an Entry-Exit charge matrix, for the whole country, to avoid potential pancaking costs of moving from one transportation network to another.

If the chosen system is more complex, the calculation basis for tariffs has to be as close as possible to the above-described system. In any case it is unacceptable to create a system where a shipper has to negotiate with more than one transportation company. If transportation on the same pipeline is scheduled in opposite directions at the same time, resulting cost savings through avoided transportation must be shared among shippers.

1. **Cost reflective tariffs**

The tariff system has – in accordance with the EU-Directive – to be cost reflective at any time. The fixed and variable costs have to be reflected in appropriate charges to allow for an optimisation of the transport system.

The alternative "comparable market approach" wouldn’t be in accordance with the EU-Directive.

Tariffs for transportation contra the prevailing flow direction have to be much lower, as the effective costs for the shipper are negative. This is a benchmark for true cost reflective tariffs. A similar provision is also part of the German electricity Association Agreement.

As a consequence of cost reflection variable and fix costs have to be reflected in the tariff structure by a commodity charge as well as transport and network services charges.

5. **Trading of pipeline and storage capacity**

To allow the market participants to establish the most effective system with a minimum of sunk costs, the participants must be allowed to trade already booked capacities in pipelines and storage on the market and to transfer corresponding shipping and storage rights within a transparent system.

6. **Balancing regime**

Balancing is an important part of the complex gas business. It has to be provided by the transport and storage companies along with shipping and storage rights. The experience in developed markets has shown that monthly or daily balancing is possible and effective. EFET believes the same principle is applicable to the German market and EFET therefore seeks demands the establishment of a daily balancing (rather than hourly balancing) regime to support for a fair and competitive market.

If hourly balancing is chosen, the high pressure pipeline operator has to provide the participants with an "offer" from hourly to daily or monthly balancing at any time at every entry and exit point. The price and terms for this service must be the same for all
participants, including the unbundled company and must be available on a daily basis for each entry/exit point.

The smaller regional and/or local companies have to provide the same service if they are in a position to do so, as this will lead to the establishment of a competitive market for balancing services.

7. **Access to storage**

   a. Storage access is, as described in the introduction, a necessary precondition for most gas deals and for portfolio optimisation. To a large extent, the gas imported to Germany has to be structured through storage facilities in order to be marketable (seasonal storage).
   
   b. Security of supply (back up in case of interruption of deliveries) is the second reason that access to storage is necessary. The companies have to deliver gas at any time, except for interruptible contracts (backup storage).

This service has to be provided by the storage operator on clear, transparent and unbundled conditions, the same as the usage of the network itself.

8. **Quality conversion (Blending)**

   Two main gas qualities are supplied in Germany ("L" or low cal gas and "H" or high cal gas as described in the DVG-Guideline G 260). Some German companies are able to ensure the delivery of L gas to its customers by a combination of blending L gas with H gas, or by adding Nitrogen to H gas. Other quality descriptions are for accounting reasons.

   Trading and competition is only possible if the transportation company provides a blending service according to predefined transparent rules. This allows to provide customers with gas that corresponds to the "L"- and "H"-gas limits Transportation companies have to provide all relevant information about blending facilities.

**In conclusion:**

EFET, as the biggest Energy Trader community in Europe, firmly believes that the eight points described above need to be fulfilled by the German Verbände vereinbarung (VV) in order to meet minimum requirements necessary to give the minimum basis for the establishment of Gas-to-Gas competition. We strongly urge all parties involved in the negotiations to set up such a framework in Germany for the benefit of all gas customers and market participants.

For more information:

Secretary General EFET

Secretariat@efet.org