

## **EFET Position on proposals by Trading Hub Europe (THE) regarding product design of SSBO**

### **Introduction**

The "Act to Amend the Energy Industry Act on the Introduction of Filling Requirements for Gas Storage Facilities" ("Gas Storage Act") is expected to enter into force on 1 May this year. With the "Strategic Storage Based Options" (SSBOs), a tool has been developed to achieve concrete minimum storage levels throughout Germany. We welcome the fact that THE has already published the first [key points](#) for the design of the SSBO product on 4 April 2022 and thus at an early stage. We would like to comment on these because the proposed design would lead to significant avoidable additional costs and therefore urgently needs to be corrected. With the two contract components (storage with level verification; retrieval option) two products are combined in one, which would drive up the cost of the proposed product without added value.

### **In detail**

The aim would be to develop a simply structured product SSBO in order to ensure the efficient and predictable filling of gas storage facilities in Germany in winter 22/23.

**SSBOs** are to be distinguished from the proven product of LTOs by the product characteristics in that they focus on a **level with working gas volume** at certain **points in time** for the purpose of security of supply, whereas **LTOs** as a balancing energy product for the purpose of grid stability are based on the **provision of capacity** for a certain **period of time**.

Thus, **SSBOs ensure cost-optimized storage of working gas volumes** for the winter period, and the proven **LTOs ensure the cost-optimized provision of capacity** during the winter. While LTOs require a retrieval mechanism, as the use is linked to the need for balancing energy, SSBOs can dispense with a retrieval because they are only aimed at ensuring a minimum level related to the cut-off date.

The following requirements will make the SSBO product unnecessarily more expensive:

- The retrieval option envisaged by THE for the call quantity (40% of the SSBO contract) at a fixed commodity price will unnecessarily increase the risk on the part of the providers for an SSBO contract and will be priced in by the providers.
- In addition, there is the further deadline of 1<sup>st</sup> March with a minimum level proposed by THE, which goes beyond the legally defined cut-off dates. The resulting limitation of the provider's flexibility further increases its risk. In addition, the fact that a complete emptying of some storage systems by the end of the

storage year and thus within the typical contract period on some storage systems would then no longer be technically feasible further restricts the provider field.

- A retrieval mechanism is associated with higher administrative costs and much more complex to implement, since each provider would have to qualify for a retrieval mechanism and corresponding communication channels would have to be set up.

The above restrictions will be priced in by the providers. The individual risk premiums are briefly outlined below:

- By means of a fixed commodity price, the provider has to bear the risk of being called up in high-price phases above the agreed commodity price. This severely restricts its own market-optimized operation and creates opportunity costs that would need to be priced in. In addition, in such phases would be withdrawn anyway, completely without a previously agreed retrieval option. The market would therefore be provided with the necessary liquidity even without this retrieval mechanism in the first place, but without the commodity price surcharge to be priced in by the providers.
- At the same time, the retrieval risk reduces the extrinsic value of the storage booking because the provider can no longer freely dispatch the storage content, both in terms of time and in terms of the amount of storage. The provider would not know when he would still have what amount in the storage for flexible use for his own optimization, since a retrieval by THE would be unpredictable. This, too, will be priced in by the providers.
- The additional base on 01.03. further restricts the flexibility, as it deprives the provider of optimization potential after 01.02. In combination with the guaranteed retrieval volume of 40%, in the worst case there would be no flexibility for the provider to use the storage in a market rational way and temporarily empty it below 40% in order to fill it again in time.

The above risk premiums can add up to 15-30 EUR per MWh, which with a retrievable volume of up to approx. 90TWh at avoidable additional costs of up to 2.7 billion EUR (90 TWh x 30 EUR).

The advantage of a pure filling-level product would be that at the time of the auction the provider can fully hedge on the futures market against price changes (price of injection, withdrawal and the storage-booking itself) without unnecessarily restricting storage flexibility.

We cannot understand the claim that the Gas Storage Act requires the introduction of an activation mechanism with a working price due to the phrase "exercise an option". In our opinion, the "exercise" could also consist only of the reduction or cancellation of the level obligation on the next cut-off date. In this case, in phases of scarcity, which could be commercially represented by the market area manager with local balancing energy purchasing if necessary, storage would be expected anyway.

## Rationale

In our opinion, this is a product that should leave the market based usage and optimization with the storage customer and at the same time guarantee the legally induced security of sufficient filling of the storage systems. This combination would offer the greatest possible economic cost efficiency with few restrictions.

Within the framework of the objectives of the overarching Gas Storage Act and taking into account the UOIL regulations, SSBOs should be divided into categories and put out to tender throughout Germany. According to the law, German storage systems should have the following filling levels:

- on 01 October 80%,
- on 01 November 90%,
- on February 1st 40%.

With regard to SSBO products, this means at the example of a 1TWh lot:

- Filling level as of 01 Nov. 90%/90% of 1 TWh,
- Level as of 01 Oct. 80%/90% of 1 TWh = 0.89 TWh and
- Level as of Feb. 01 40%/90% of 1 TWh = 0.44 TWh.

The following SSBO products should be put out to tender throughout German market area and at the earliest possible date so that the provider of the option has enough time to be able to provide the committed filling levels:

1. SSBO (I)
  - a. SSBO (Ia): Filling level auctions for previously booked storage capacities can take place all year round
  - b. SSBO (Ib): Filling level auctions for storage capacities that affect storage capacities that have not yet been marketed, could be tendered either as a combination product (bidders only submit a bid that includes both the cost of the min-fill restrictions and the associated storage capacity that is automatically assigned to them) or, just like SSBO (Ia), separately from the storage booking. Here the advantages and disadvantages would have to be discussed further.

2. SSBO (II): Volume incl. storage capacity, which are remarketed by UIOLI measures (combined product).
3. SSBO (III): if the filling level auctions SSBO (I) and (II) do not show the desired success, the market area manager (MAM, Trading Hub Europe) can carry out gas procurement auctions for its own injection in the period from 1 October to 1 February as a last option and to avoid manipulative market behaviour. This can also be done if beforehand Germany-wide tenders of SSBO (I) and (II) have not ensured sufficient filling levels in certain local zones (to avoid local gas shortages)  
*Note: SSBO (III) could be closely interlinked with the procurement of LTOs by the MAM, whereby in particular attention must be paid to the intended use of the products. LTOs serve as balancing energy for grid stabilization and the avoidance of grid bottlenecks and are therefore also put out to tender for certain bottleneck zones, SSBOs should serve solely for security of supply and are put out to tender throughout Germany. The product SSBO (III) should be procured in a transparent, competitive and non-discriminatory manner.*

## Specifically, SSBOs should meet the following requirements

1. **Transparent and cost-efficient handling** by the MAM, SSO and storage customers via the simplest possible structure, e.g. **Auctions with only an absolute fixed price for a volume** without a commodity price. The necessity of a retrieval mechanism can be dispensed with, because only the fulfillment of the product must be proven on the deadline promised in the contract. This can also be proven by the totals of the fill levels of different storage capacity in the respective advertised zone. The SSO can easily track and verify the respective storage status.
2. Germany-wide tenders minimize the costs for the product and still allow zonal storage monitoring. The product SSBO(III) can then be used locally if necessary.
3. **High flexibility for storage customers** over the timeline and storage capacities. This minimizes the **cost of the product**, e.g. the storage customer should determine himself which German storage of his portfolio he provides the committed quantities at (e.g. slow storage first).
4. In **the case of SSBO (I) and (II)**, the ownership **of the gas should remain with the storage customer**. This ensures the market-rational use of storage in the respective market, as market participants can react directly and immediately to fluctuations in supply and demand. **Before and after the cut-off dates**, the **buyers of the SSBOs** may deviate from the contractually guaranteed **minimum level quantities** in a market rational manner (see SSBA's timeline above) provided that they can guarantee the level to be achieved on the following key

dates. Such flexibility increases cost efficiency and prevents the extrinsic value of the storage booking from being lost. Failure to comply with the required levels must be subject to sensitive penalties.

5. For a **quick implementation**, the product SSBO (Ia) and (Ib) should first be **tendered** as early as possible in April. The tender for the product should be carried out via as many **tranches** possible with smaller volumes (approx. 1-5 TWh per tender) in order to prevent price fluctuations through concentrated hedging transactions of the storage customers.

**Small lot sizes** with e.g. 10 GWh/lot, which may be offered in multiples, expand the group of participants, as it is then also possible for smaller participants to participate.

Short time intervals between binding bidding and award lead to lower risk premiums, as they enable **market-compatible covering** without the risk of high price volatility.

There is still to be clarified **an effective penalization** in case of **non-fulfillment** of the SSBO product. For example, how to deal with providers who fall below the contracted min-fill commitment. These are (proportionately) responsible for the additional costs of a new auction or in the case of self-covering by THE.

## **Ways to alleviate the negative effects of the THE model:**

We recommend using SSBOs instead of as a combination product (storage with level verification; Retrieval option) as a pure filling level product. Should THE nevertheless and despite the additional costs stick to the design with the two contract components, following steps would be conceivable that would at least partially reduce unnecessary negative effects:

- It would be possible to limit the negative effects somewhat by conducting tenders with indexed commodity prices. It would be conceivable that the working price would not be named by the provider, but would be set to an index (e.g. day-ahead price) before the tender. However, it is unlikely to be possible to compare indexed with non-indexed bids. However, it would be conceivable to carry out both tender tranches with indexation and tender tranches without indexation at other times.
- Another helpful step would be to ensure that activation would be announced the day before and not at night or during the delivery day. This would reduce the risks associated with fulfilment.

- The amount of the released quantity (THE proposal: 40%) determines the unnecessary additional costs. A reduction in the call quantity could therefore have a cost-reducing effect.
- The removal of the cut-off date 1.3. would reduce the cost of the product.

## Contact

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