EFET European Federation of Energy Traders
SO YOU CAN RELY ON THE MARKET

EFET[1] Position Paper

Capacity Conversion Service

Key Points:

- The speed of introduction of a Capacity Conversion service is important. Many capacity contracts are already unusable, and more can become so as, following the entry into force of the amended NC CAM, single-sided interruptible products will no longer be allocated.
- The service is likely to be most useful for daily capacity on a day-ahead (and ideally within-day) basis, although this is not mandated in the network code. A simplified design that could speedily be extended to daily products is preferred.
- An *ex post* regime where successful bidders can return surplus capacity following an auction will be most effective, although later development of an *ex ante* option may still be offered if a need is identified and it can be delivered economically.
- Access to the service should be available for holders of primary and secondary capacity (i.e. capacity that has been assigned or transferred) as well as for capacity booked by different legal entities belonging to the same group. Common procedures should be developed.
- In any given auction, the offer of capacity (bundled + unbundled) at one side of an IP should be at least big enough to match the capacity booked on an unbundled basis at the other side of the IP. Booked unbundled capacity would otherwise become unusable.
- In the current market environment, the cost of transportation capacity frequently exceeds the price differential between the connected virtual trading points, which will not be changed by this mechanism. Therefore, take-up may well be low, but a conversion mechanism is still an important tool to ensure that capacity can be used.

Capacity mismatch in Europe is widespread. It can be caused by:

- technical mismatch (especially when TSOs are dynamically setting their technical capacity level on an individual basis and without coordination);
- different booking levels on both sides of an IP (e.g. at German IPs because of rights under German law to terminate affected contracts under specific circumstances, but also present elsewhere);
- different shippers who own the capacity on each side of an IP (including different legal entities in the same Group) and who are unable to exchange mismatched capacity;
- deficiencies in the secondary market including the terms for trading capacity in some systems.

Restrictions on the sale of single-sided firm capacity may render some of these contracts unusable, where complementary capacity remains unutilised, but is not offered in an accessible way.

[1] The European Federation of Energy Traders (EFET) promotes competition, transparency and open access in the European energy sector. We build trust in power and gas markets across Europe, so that they may underpin a sustainable and secure energy supply and a competitive economy. We currently represent more than 100 energy trading companies, active in over 27 European countries. For more information: www.efet.org.

The characteristics of a useful conversion service

- Where a shipper books bundled capacity to match singled-sided capacity it already holds and is committed to pay for, the conversion mechanism should ensure that no extra charge is applied for the same-sided element of bundled capacity it cannot avoid booking (except the relevant share of any auction premium). The revenue of the TSO is thereby maintained, but not artificially increased through double-selling of capacity.
- The service should be made available for daily capacity on a day-ahead and within-day basis. Because of both demand and supply volatility and the consequent impact on prices, it is not possible to anticipate accurately when the conversion of monthly capacity will be economic. A network user faces the choice of converting a monthly product which may lead to the holding of excess capacity on many days, or of buying bundled capacity on a daily basis without using the conversion mechanism. In the latter case, the cap on the price spread will be set at a higher level (based on the full price of bundled capacity) rather than only the incremental cost of buying complementary capacity. Without a daily service, there will therefore be more occasions where a price differential exists and capacity is available, but without the incentive to flow gas.
- The service should be free, as specified in NC CAM.
- Access to the service should be available for both primary and secondary capacity (i.e. including capacity that has been assigned or transferred) without additional operational complexity. There should be common procedures for these cases.
- The service should be available to separate legal entities controlled by the same beneficial owner or belonging to the same capital group holding unbundled capacity at two sides of an IP.
- In order to accommodate the early introduction of the service and its extension to daily products, EFET is happy to support a simplified design, such as the sacrifice of capacity on an *ex post* basis when a network user acquires *bundled* capacity where they already hold *unbundled* capacity. The advantages of a more complex *ex ante* service are considered to be limited, and do not justify a delayed implementation. If the benefits of an *ex* ante system are subsequently found to be greater, or it can be introduced quickly and economically, then this could be introduced later.
- The offer of capacity (bundled + unbundled) on one side of an IP in any given auction should be at least big enough to match the unbundled capacity booked on the other side. Where this is not possible, (e.g. if unbundled capacity has been sold on one side of an IP and matching capacity cannot be made available on the other side because of a lower technical maximum,) then the unmatched capacity is unusable and the holder should be permitted to terminate the holding.
- The National Regulatory Authority and TSOs in France asked for a suspension of the conversion mechanism in case of congestion, arguing that it could raise the capacity auction price. First, this effect depends on the configuration of the auction: an *ex ante* mechanism can increase the available bundled capacity offered and therefore reduce the spread. More importantly, a conversion mechanism always increases the options offered to shippers, thus allowing a more efficient management of the IP and a reduction of price spreads. Finally, it means that a shipper would not be able to use its previously booked unbundled capacity when it has a market value.
- In theory, shippers with unbundled capacity should not pay the full premium of an auction (if any), but only the share linked to the capacity they book on the other side of the IP. However, it is difficult to split fairly the premium between the two sides. Therefore, even if it represents a loss on their existing bookings, mismatched shippers may need to pay the full premium. This issue is not regarded as critical, if terms are clearly defined in advance of any auctions.

Timing

The conversion mechanism can and should be applied immediately. Discussions on how to use existing unbundled capacities have been ongoing almost since the concept of bundling was first proposed, and numerous exchanges between EFET and ENTSOG have taken place. While TSOs have initially seemed reluctant to implement such a mechanism, EFET believes they should engage with shippers to design and implement a useful conversion mechanism at the earliest opportunity.