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Subject
Assumptions for the determination of the required Groningen production

OPENBAAR

Dear Sir/Madam,

GasTerra appreciates the opportunity to comment on the consultation on the planning assumptions for the determination of the required production from the Groningen field for gas year 2019/2020. We understand that GTS has been requested by the Minister of EZK to provide an advise on measures to reach a level of 12 bcm. We are concerned about the fact that GTS intends to advise the Minister to base the Groningen production limit on a 100% nitrogen utilization, that translates into the degree day formula which forms the basis on which GasTerra conducts its operations. GTS' intention is based on an analysis of a few months (October 2018 – May 2019) and lacks a proper analysis of the consequences this might have for the functioning of the quality neutral gas market. Please, find below our comments.

Assumptions

GTS bases its advice on multiple assumptions and measures. To start with, GTS bases its preliminary evaluation on the last 8 months of realizations. Based on this very limited analysis GTS continues to conclude that its modelling is fit for purpose (accurate demand-side forecasting) for all temperature profiles of the last 30 years which are the basis for the determination of the degree day formula.

Furthermore, GTS states that it is able to facilitate the market with 100% nitrogen on average. GTS seems to assert that it can guarantee the base load capacity in gas year 2019/2020. GTS does not describe or explain how it underpins this assumption, taking into consideration that capacity (base load and back-up) will be unavailable as a result of planned maintenance or unplanned outage. GTS seems to extrapolate the realisations of nitrogen utilization in the current gas year (until May) to represent a whole gas year, whilst the major unavailability of nitrogen capacity is planned to occur in June and September 2019. As a result we expect in the coming months, like in December 2018 and January 2019, a large utilisation of the Heiligerlee cavern. This will probably result in Heiligerlee cavern being empty at the beginning of the gas year 2019/2020 and therefore hardly any spare capacity being available for the first two months of the next gas year. It is our

opinion that it will not be possible for the market to pursue a 100% nitrogen utilization in those months as flow orders will be expected frequently as there is hardly any spare capacity.

GTS does not provide any insight into the consequences if one or more of their assumptions turn out to be incorrect or do not materialize. Therefore the robustness of GTS' proposal is unclear.

Furthermore, it is not clear how GTS will monitor the realization of these assumptions and what GTS will do when the assumptions turn out to be incorrect or do not materialize.

Impact on the market

GTS states, based on their judgement, that "the market is able to reach 100% average utilization of nitrogen". On the basis of its current observation of the market, GTS assumes no change in behaviour of market participants. However, GTS is not a market participant and does not have sufficient knowledge of the market in order to make such statements. Neither has GTS obtained an advice from a third party to that regard. GTS completely disregards the analysis of ACM and other parties of 2015¹ concluding against 100% average utilization of nitrogen. The latter analysis confirmed 85% average utilization of nitrogen as an acceptable level for the functioning of the quality neutral gas market. Any other level (currently 92,5% and possibly 100% in the future) seems random and posts a risk to the functioning of the quality neutral gas market. In a recent legal procedure by the Raad van State² the Minister explained that 100% nitrogen utilization is not possible as GTS will then lose its instrument to maintain the quality neutral gas market. The Raad van State confirmed that the motivation of the Minister is sound. Now the Minister seems to suggest that this might be different as the market share of GasTerra becomes smaller³. However, the market share of GasTerra is not a relevant factor in regard to the negative consequences of 100% nitrogen utilization for the functioning of the market.

Flow orders

In our opinion it is inevitable that the number of requests and flow orders from GTS will increase as a consequence of 100% nitrogen utilization. Already in the current situation of 92,5% nitrogen utilization there have been numerous REMIT messages (more than 300 in the current gas year), requests to decrease nitrogen utilization (on about 50 days during the current gas year), warnings of possible flow orders (on about 15 days during the current gas year) and flow orders to GasTerra.

Although the messages and requests are directed at all market parties, GasTerra is the only market participant who actually acts in response. The concrete requests and flow orders of GTS are always directed at GasTerra. Although most of the physical L-gas instruments in the market are in GasTerra's portfolio, GasTerra is not the only party with access to such instruments. It is not clear to us why, for instance, the L-gas cavern users are not also approached by GTS to help solving quality conversion issues.

¹ "Onderzoek andere benadering van de gaswinning"

² Raad van State, Uitspraak 201810054/1/A1, ro. 56

³ Brief van Minister Wiebes aan de Tweede Kamer "Beëindiging gaswinning Groningenveld: stikstofinzet en GasTerra", p. 5

Unfortunately, we have actually evidenced situations with flow orders to increase the production of the Groningen field while L-gas caverns are being filled up in the meantime. We are of the opinion that GTS should monitor the activities of such caverns and give flow orders to prevent production from the Groningen field which is not necessary.

Currently GasTerra is forced to take balancing measures regarding its H gas portfolio when it is requested/ordered by GTS to increase flow from its L-gas portfolio. This is, however, not necessary and not logical as there are multiple market participants capable of solving H-gas related issues. In this regard we welcome GTS' suggestion in its preliminary advice to the Minister for a market based approach ultimately substituting the flow orders. We would like to emphasize the importance of such an approach and urge GTS to develop, consult and implement such an approach as soon as possible and in any case before an eventual implementation of 100% nitrogen utilization.

If GTS nevertheless advises the Minister that 100% nitrogen utilization is achievable, GasTerra proposes that GTS then also commits to not issuing more flow orders than it has done until now during the current gas year, in line with GTS' own expectation.

Within Day (WD) market

GTS states that with same behavior of market participants it does not expect to issue more instructions. GTS hereby ignores the fact that it is not possible for GasTerra to behave in the same way if GasTerra is not able to rely on a certain amount of nitrogen flexibility. By 100% nitrogen utilization GasTerra will be forced to lean more heavily on the Within Day market to balance its portfolio due to insufficient physical instruments. It is GasTerra's assessment that the liquidity of the WD market is currently insufficient to deal with 100% nitrogen utilisation and that the limits of the WD market could more easily and more often be reached. This could disturb the normal price formation based on supply and demand and thus deteriorate market parties' trust in the market. An illiquid market, particularly in combination with the predictable behaviour of one of the market participants (see below) is more prone to market manipulation which could also lead to deterioration of market participants' trust in the market.

Possible market manipulation

By 100% nitrogen utilization GasTerra's behavior will be predictable for other market participants which will make it vulnerable to manipulation. It will be clear for all market participants based on the actual nitrogen utilization information provided by GTS what GasTerra's position is with respect to gas purchases or sales.

In the particular case of a flow order, when GTS requires that the shipper nevertheless maintains its own balance position, GasTerra will have to solve its imbalance caused by the GTS flow order which again makes GasTerra vulnerable to possible manipulative behaviour of other market participants.

Lessons learnt from Germany

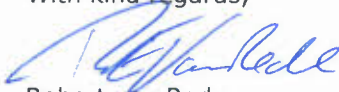
In this respect there are lessons to be learnt from the German Within Day market. There seem to have been situations in 2016 with extremely high prices due to a relatively illiquid market combined with high demand for the balancing of the system. Market parties seem to have been able to profit from the circumstances while NCG has suffered losses up to 50 million Euro.

Conclusions

GTS' proposal to plan on a basis of an average of 100% nitrogen utilization is based on a very limited analysis and raises serious concerns as described above.

It is our opinion that GTS should not advise the Minister to increase the average nitrogen utilization to 100% instead of 92,5%. In case GTS does advise the Minister such, this can only be justified if the functioning of the quality neutral gas market is guaranteed and efforts to solve gas quality conversion issues are shared by all market participants on a transparent market based approach.

With kind regards,



Robert van Rede

Chief Commercial Officer