



Pamela Taylor  
Associate Partner  
GB and EU Gas Wholesale Policy  
Ofgem

Dominique Woitrin  
Director  
Technical Operation of the Market  
CREG

Robert Spencer  
Head of Unit  
Gas Markets and Regulation  
NMa

**MCM-D**

Your ref.	
Your letter	
Our ref.	
Contact	Stephen Rose
Phone	+ 44 (0)1793 892068
Fax	+ 44 (0)1793 892118
Email	Stephen.rose@rwe.com

Swindon, 20/12/2012

**Call for evidence on the use of the gas interconnectors on GB's borders and on possible barriers to trade**

Dear Pamela, Dominique and Robert

RWE Supply & Trading GmbH (RWEST) welcomes the opportunity to respond to the above joint call for evidence by Ofgem, CREG and NMa (the Regulators).

RWEST is a primary capacity holder in the Interconnector UK Pipeline (IUK). Its current registered capacity is [ ] in a forward flow direction (GB to Belgium) and [ ] of capacity in a reverse flow direction (Belgium to GB). This capacity is contracted until 30<sup>th</sup> September 2018 and represents an amalgamation of:

- original primary capacity acquired by National Power Plc in 1998 as an IUK shareholder (subsequently transferred on change of name/ownership); and
- additional enhanced reverse flow capacity acquired when technical import capacity in IUK was upgraded in 2007.

In addition, [ ] of forward flow capacity and [ ] of reverse flow capacity has recently been novated to RWEST from RWE Supply and Trading Netherlands B.V. (RWEST BV). RWEST BV is the new name for Essent Energy Trading B.V and this capacity comprises both primary and sublet capacity<sup>1</sup> owned and operated by RWEST BV prior to the ongoing corporate reorganisation to concentrate RWE's trading activities within RWEST.

RWEST acquires interruptible and UIOLI capacity in IUK from time to time, when available and commercially beneficial to do so.

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<sup>1</sup> [ ]

As regards BBL, RWEST is a registered shipper in this pipeline and is able to participate in the auctions for quarterly, monthly and daily interruptible reverse flow capacity from GB to the Netherlands, when available and commercially beneficial to do so.

RWEST uses its capacity in IUK to maximise profits in its GB and continental gas trading books. The capacity is used to support spread trading along the NBP and ZEE forward curves and at the day ahead nomination stage we calculate a break even price applicable for forward (GB exports) and reverse (GB imports) flows through IUK. This is based on the marginal costs of flowing gas in either direction and is described further in Appendix 1. To the extent the relevant price at the NBP or at ZEE exceeds the break even price, we nominate flows in IUK to optimise any residual short or long position in our trading books. We also seek to sell as much extra volume in either market as liquidity allows. Where the relevant price at the NBP or ZEE is less than the break even price we do not nominate any flows in IUK and balance any residual short or long position in our trading books by trading in the respective markets.

Ex-post analysis of the efficiency of flows through IUK is inherently problematic and can at best only be a broad approximation. In this instance the Regulators' analysis compares end of day actual physical flows against price quotations for NBP and ZEE day-ahead trades, as published by Bloomberg. As they readily point out, this fails to capture market the dynamics of day-ahead price formation within the trading day, which are significant. To demonstrate this we have included in Appendix 2 a record of the high, low, closing and opening day-ahead NBP and ZEE prices which are derived from OTC trades we have captured in our trade reporting systems for each GB business day during the period 1<sup>st</sup> January 2009 – 30<sup>th</sup> June 2012<sup>2</sup>. Aggregate day-ahead trading volumes captured for each business day are also shown. Analysis of this data shows that in 33% of cases the absolute spread between NBP closing and opening prices is > 1p/therm and in 69% of cases the spread between NBP high and low prices is > 1p/therm, with a median spread of 1.4 p/therm. In the case of ZEE, the equivalent figures are 32%, 62% and 1.25 p/therm respectively.

Using day-ahead quotations also fails to take account of within day price dynamics, which again are significant. Also, using them as a proxy for weekend prices, or prices applying on public holidays, is not necessarily a fair reflection of the price drivers influencing IUK Shippers flows. RWEST, along with most other IUK Shippers, operates a 24/7 gas trading and operations capability and will adjust its flow nominations out of office hours in response to changes in GB and Belgium imbalance prices.

As IUK demonstrated in its presentation at the public workshop on the 21<sup>st</sup> November, using quotes from different price reporting organisations can result in different efficiency outcomes, as each reporting organisation uses different methodologies for reporting prices. Heren's price reporting is widely recognised throughout European gas markets as being comprehensive and credible and is,

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<sup>2</sup> Missing data and obvious data errors are highlighted in red. These have been excluded from our data analysis.

in our opinion, a more robust basis for assessing the efficiency of IUK flows than Bloomberg data. Indeed, when attempting to download day-ahead NBP and ZEE price data from the Bloomberg ticker (which we subscribe to) for the period in question, we noticed there were considerable gaps in the ZEE price data on certain business days which we couldn't explain based on public holidays alone. When querying this with Bloomberg we were told that "the ticker {ZEEBDAHD Index DES<GO>} contains data from a third party source, and it is not uncommon for the brokers who contribute this data to elect not to do so on a given day. This is generally due to lack of volatility in the index, but is ultimately up to the discretion of the contributor." Assuming this ticker is capturing the same ZEE data used by the Regulators in their analysis, we are unsure what assumptions the Regulators have made in relation to this missing data. We have included a list of the dates in question in Appendix 3.

Appendix 4 lists RWEST's daily allocated end of day flows over the period in question. These are the result of nominations and trades made in light of the circumstances described above. Whilst it is clearly not possible now for us to justify these retrospectively for each, or any, specific day, we are confident these flows are commercially logical and efficient in the vast majority of cases. Whilst we cannot comment on the actions of other IUK Shippers, evidence presented by IUK suggests that aggregated flows are equally logical and efficient. In our opinion IUK flows represent by far the most economically efficient gas flows through any interconnection point in Europe.

Our responses to the specific questions raised in the call for evidence are included in the attached Appendix 5. These relate only to IUK, where we have extensive experience of maximising the commercial benefits arising from our primary capacity holdings. We do not comment specifically on BBL as we have no forward flow capacity in this pipeline, although the analysis is complicated by ever changing FX rates which also affect the flow decision<sup>3</sup>. Instead we rely on primary capacity holders flowing gas inefficiently to exploit arbitrage opportunities, although these opportunities are becoming noticeably less frequent than before<sup>4</sup>.

Yours sincerely,

RWE Supply & Trading GmbH



Steve Rose  
Head of Gas Market Design



Kevin Alger  
Head of Gas Trading

RWE Supply & Trading GmbH  
Swindon Branch

Windmill Hill Business Park  
Whitehill Way  
Swindon SN5 6PB  
United Kingdom

T +44(0)1793/87 77 77  
F +44(0)1793/89 25 25  
I www.rwe.com

Registered No. BR 7373

VAT Registration No.  
GB 524 921354

Supervisory Board:  
Dr. Leonhard Birnbaum  
(Chairman)

Board of Directors:  
Stefan Judisch (CEO)  
Dr Markus Krebber  
Alan Robinson

Head Office:  
Essen, Germany  
Registered at:  
Local District Court, Essen  
Registered No.  
HR B 14327

Bank details:  
Deutsche Bank Essen  
Bank Code 360 700 50  
Account No. 105 127 500  
SWIFT: DEUTDEDE  
IBAN: DE05 3607 0050 0105  
1275 00

<sup>3</sup> As the NBP and TTF markets which BBL connects operate in different currencies, gas market arbitrage is also influenced by currency deviations as well as gas supply/demand dynamics in these markets.

<sup>4</sup> [ ]