

Public Consultation issued by ERSE and CNMC on the “Models for Integration of the Spanish and Portuguese Gas Markets in a common Iberia Natural Gas Market”

Comments from Galp Energia

Galp Energia (GE), an integrated energy group with operations in both the Portuguese and Spanish Gas markets, welcomes this Public Consultation issued by the national regulators ERSE and CNMC, under the auspices of ACER, aimed at evaluating the preferred model for integration of the Iberia NG Market (MIBGAS), as well as assessing the most adequate measures to accelerate the process, considering the options put forward in the Gas Target Model adopted by ACER.

As a first remark, Galp Energia notes that it has previously expressed its support to the development of MIBGAS, provided that this goal is achieved through a step-by-step approach, that should consider not only the regulatory harmonization still to be done, but also the fundamental differences in market size, maturity, and structure of the two national markets. Therefore, immediate and unbalanced decisions could jeopardize the existing equilibrium and should be avoided.

We would therefore recommend that in establishing a roadmap for attaining the full integration of the Iberian Market, a detailed time schedule is agreed by the Regulators, National Authorities and relevant Stakeholders, identifying the major points to address and establishing credible milestones. Without limitation, we would note the regulation harmonization, operational procedures, and transparency on tariff and allowed revenues calculation. On this last point, GE expresses its strong opinion that each country's infrastructures should be sustainable, and therefore cross-subsidization between countries or activities should be avoided.

Notwithstanding the above, GE acknowledges that in the long term, a full market integration in the MIBGAS area would be the most consistent with the Common European Market objectives. Naturally this would correspond to the “Market Area Model” (MAM) described in the consultation papers. But saying this, the Iberian stakeholders should then be entitled to anticipate a full European Market Integration, which is still highly limited today, by the lack of an effective Pyrenees connection to the Northern European Markets. Otherwise the results coming from the Iberian integration would never allow the region to participate in the European Market, either as a potential door for LNG imports to Northern countries, or then so Portugal and Spain could access pipeline gas from gas producers outside the European Union.

Answers to the “Questions for the Stakeholders”:

Q1 Would you agree with the analysis made on current market situation and on the major issues affecting the creation of and Iberian market?

GE generally agrees with the analysis made on both issues, and considers that the most relevant aspects that may affect the implementation of the various integration models are correctly identified.

We would however present the following remarks:

- As a first major point, GE considers that any decision should take into account the fact that the existing physical interconnection between Portugal and Spain is sufficient, based on the data provided in the consultation document itself, which also shows a relevant infra-utilization of interconnection capacity in the recent years. As discussed in the reply to Q2, this finding is perhaps not entirely considered when comparing the “Trading Region Model” (TRM) with the “Implicit Allocation of Capacity Model” (IACM), since the former is recognized as being particularly adequate in cases of scarce available capacity in the interconnections, and we consider that this implicit allocation mechanism not being as transparent as the one resulting from explicit capacity contracts could not artificially create the need for CMP application (with a highly likely tariff increase) at Market Operator discretion;
 - Additionally, if some decision on development of further interconnection infra-structures is to be taken, that decision procedure must be subject to public consultation, supported by a cost benefit analysis identifying the economic impact on market stakeholders of the new infra-structure, and be based on market mechanisms, like open season;
- GE acknowledges that market integration is potentially positive for both countries: Portugal would not fulfill the minimum requirements in terms of size, sources and market players to implement a national organized market on its own and Spain has to gain in terms of market liquidity with the integration with the Portuguese market;
- Even though recently there has been some decrease in the contribution of the CCGTs in the natural consumption in Iberia, the installed capacity and its potential impact in the energy sector in the Iberian market is still very significant, and not comparable to any other region in Europe. So we would recommend this particular question to be taken into account, when market rules are established, in order to guarantee coherence between gas and electricity markets, namely in terms of gas/electricity day, renomination periods, capacity booking and balancing system, etc.

Q2 Do you agree with the implementation of the wholesale market with implicit allocation of capacity as a step for market integration, but aiming for an even more integrated market in the longer term?

As previously stated, GE acknowledges that full Iberian market integration, aimed at complying with the objectives of the Common European Gas Market through a methodology compatible to the Gas Target Model adopted by ACER, would be achieved by the MAM. In the above sense this should be the long term objective for the integration of the Spanish and Portuguese gas markets.

Having said this, we would agree that the adoption of the IACM could be a first step towards full integration. **However, we note that the IACM is not necessarily better or more adequate than the TRM**, being the analysis presented in the consultation documents somewhat biased towards the former: (i) since there are no capacity limitations at the border, in the end the supposedly fundamental advantage of the IACM is not relevant¹; (ii) the study reckons that in case of relevant differences in the national markets size (and we would add in their maturities) the IACM is not preferable; (iii) apart from keeping the two Balancing Zones, the TRM is closer to the ultimate desired MAM, so the global time schedule could even be shortened by adopting the TRM.

Apart from the consultation documents, there are other points that GE considers insufficiently discussed, whose clarification is deemed necessary for a more comprehensive analysis a decision:

- Even if accepting that some overcapacity exists in the Portuguese system, this problem is far more serious in the Spanish side. GE considers that in the present situation one of the obvious advantages of keeping some independence of the two national areas would be to guarantee that the respective consumers only support the cost of the infrastructures, without unjustified cross-subsidization;
- The consultation documents suggest that the IACM would be faster to implement than the TRM, since the level of regulatory harmonization to be achieved would be less relevant. We have reserves on this conclusion, since some of the main outstanding issues (as a major examples we note the interoperability rules and CAM-CMP – see Q3 below) must be clarified in both models. On the other hand the “Market Operator”, and its respective procedures, that would manage the IACM is still to be established;

¹ As an example, the comparison to the situation at “PEG North-PEG South” where capacity limitations are well known looks misplaced.

- A discussion on which of the models would be preferable to achieve the objective of GTM (trading hub-to-hub) in case of absence of physical connection. It is not obvious that the TRM with an explicit established virtual point would not be preferable;
- **Finally, in any case, an eventual adoption of the IACM could never create a contractual uncertainty on the existing capacity contracts.** Accordingly, we consider that only the available capacity should be considered for the implicit allocation mechanism.

The above reasoning would rather recommend the adoption of the TRM, so GE strongly suggests some additional evaluation.

Nevertheless, and in order to guarantee that further integration continues to be pursued, we consider to be fundamental the definition of a common timetable between Portugal and Spain, identifying the major milestones and corresponding implementation dates, towards the final implementation of a full integration solution. The chosen model and its main developments – be it the wholesale market with implicit allocation or the trading region model – are to be considered some of the fundamental milestones, towards the final goal.

Q3 What are the most important aspects to take into account and to harmonize from a regulatory point of view for the creation of the wholesale market with implicit allocation?

Should one of the discussed models (IACM or TRM) be adopted to accelerate the MIBGAS integration, there would always be a need for a previous regulatory harmonization. Naturally this harmonization has to be developed in accordance with the medium-long term objective of a Common Energy Market, so the European Directives and Regulations – notably the CAM, CMP, Tariffs, Balancing and Interoperability - should be considered whenever they are approved.

Finally, we also consider important to highlight that the regulatory harmonization between both countries, should aim at guaranteeing that the same best practices are applied, so as to guarantee absence of cross-subsidization between activities, transparent cost allocation and definition of additive tariffs per activity.

Under the above, we would consider that the following points are to be especially taken into account:

- a) Harmonized requirements for national licenses and acknowledgement of licenses issued by other countries for providing access to the system – one license for both countries;
- b) data exchange and settlement rules;
- c) interoperability rules:

- a. Units
 - b. Measurement principles of gas quantities and quality (notably the reference temperature of 25°C)
 - c. Odorisation
 - d. Capacity calculation
 - e. Data exchange
 - f. Rules for flow control
 - g. Gas day (6h-6h) and gas year
 - h. Matching
 - i. Rules for allocation of gas quantities
- d) Communications GTG/GTS-Shippers;
 - e) Adaptation of existing contract and agreements;
 - f) Operational procedures in an emergency;
 - g) Capacity-allocation and congestion-management rules;
 - h) Transparency rules;
 - i) Balancing rules including network-related rules on nominations procedure, rules for imbalance charges and rules for operational balancing between transmission system operators systems;
 - j) Rules regarding harmonized transmission tariff structures; and
 - k) Energy efficiency regarding gas networks.

Q4 Which is the best model for the integration of Iberia in the longer term? Market area model, trading region or others?

As previously indicated, GE acknowledges that in the long term the MAM is the model that more adequately satisfies the demands of the Energy Common Market. This could represent a fully functioning Iberian Gas Market, where shippers would be free to choose any of the entries in the Iberian system, paying the respective tariff, and take the gas in any of its exit/consumption points, also paying the corresponding tariff, operating in an integrated Iberian entry-exit system.

However, on a cautious note, GE recognizes that the full implementation of the MAM is very ambitious and would require a full alignment and engagement not only between market users and operators, but also between the governments and regulators.

Saying this, especially if the question on the allocation of the allowed revenues to the two systems is not satisfactorily settled, we consider that the TRM could be a valid solution, for as long as no significant capacity congestions at the interconnection point is present. GE also notes that the consultation documents reckon that this model is fully compatible with the elimination of the interconnection tariffs, which would even overcome the repeatedly discussed “pancaking” question², as long as an adequate redistribution of the lost revenues was performed.

In any case, the above discussed is clearly compatible with the step-by-step approach referred in the beginning of this document. Whatever the interim and final models are chosen, a detailed time schedule should be agreed with the stakeholders, with “in-built” revision mechanisms, that would allow for the development of a efficiently functioning MIBGAS.

Q5 When and how the Balancing Network Code and the Interoperability Network Code should be implemented to contribute to the goal of the Iberian Market?

The implementation of these Network Codes is of major relevance in order to obtain a fully operational MIBGAS. As referred to in answer to question 3, a timely implementation of the European NC would also help the future integration with Europe. As an example, upon implementation of the Interoperability NC, market access by shippers would be quite simplified, since it will harmonize basic operational concepts between the various markets – “gas day”, “gas year”, “combustion temperature”, nomination schedules, etc.

Regarding the Balancing NC, a similar implementation in both markets will ensure a common set of rules for balancing and corresponding penalties, and, since most of the correction mechanisms foreseen in this NC are market based mechanisms, it will also contribute for market liquidity.

Thus, we consider that both NC should be implemented as soon as possible and following a similar time frame in both countries. Noting that the Spanish regulators (Ministry/CNMC) have presented to the Iberian gas Hub Development Working Group an implementation plan with explicit milestones applied during 2015-2016, we would recommend that a common approach is agreed by the Spanish and Portuguese regulators in order to ensure coherence in contents and time schedule.

² Whose actual impact, more than once, GE has expressed to be negligible and not different from the situation noted at the Spanish-French border.

Q6 Identify any issue you think is important to achieve further integration. How would you set the timing and prioritization for the discussion/implementation on these issues?

Apart from an immediate alignment, mostly for practical operational purposes, between the regulatory framework of both countries, further integration requires a broader regulatory harmonization between regulatory models and tariffs rules, aiming at guaranteeing that the same best practices, like absence of cross-subsidization between activities, transparent cost allocation and definition of tariffs per activity, are applied.

Timing for discussion of these issues will depend on the time frame established by national authorities for the achievement of a more ambitious integration between the markets. Nevertheless we believe that regulators and stakeholders should first focus in the alignment of concepts and issues previously identified namely interoperability issues and simplification of interconnection capacity booking procedures, and in the complete implementation of the various network codes, ensuring once again alignment and coherence between both countries.

As a final major question, we again note that it could never be overemphasized the importance for the Iberian market of the improvement of market liquidity, which would be efficiently achieved by an effective interconnection with north European gas hubs like NBP, Zeebrugge, TTF, Peg Nord or NGC/Gaspool. In this sense, the need that decisive steps aimed at the reinforcement of the Spanish-French connection can never be understated.