



Study about models for integration of the Spanish and Portuguese gas markets in a common Iberian Natural Gas Market

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1. General comments and executive summary

1. Enagás welcomes the opportunity to provide comments on the public consultation about the models for integration of the Spanish and Portuguese markets.
2. Enagás is an advocate of further market integration between Portugal and Spain and has worked, and is working, actively within its competencies as certified TSO and Technical System Manager to achieve a high degree of harmonization between both gas markets.
3. It must be noted that this consultation by NRAs is running in parallel to an initiative by the Spanish Ministry to establish a functional hub at Spanish or Iberian level, where the Portuguese Ministry, NRAs and other selected stakeholders are invited. It is of the utmost importance for the success of the process, and for the credibility of the CNMC and ERSE, that both initiatives are coordinated and the opinions obtained from this consultation are taken into account.
4. Enagás favours the implementation of a Trading Region model, performing a technical, regulatory and legal assessment of the possibilities of establishing in the longer term a Market Area.
5. For a number of reasons, the company disagrees that implicit allocation is an appropriate model for the creation of an organized wholesale market or as an interim step towards a proper form of market integration between Portugal and Spain. It must be noted that the model has only been tried within France as a residual, complementary mechanism, to enhance capacity allocation between existing hubs, not to create a common wholesale market from scratch, and under very different conditions.
6. There is a risk that the implicit allocation model will result in inefficiencies, superfluous (regulated?) costs and, more importantly, that it will retard the establishment of a liquid hub in Spain and the implementation of a veritable integration of the areas.
7. Enagás is concerned that the public consultation does not seem to provide a fair view of possible market integration options; it seems to be biased towards the implicit allocation model.
8. Enagás recommends Iberian NRAs and Ministries to wait until the issue of the reviewed Gas Target Model (GTM2) before adopting any irrevocable decision. The proposal of integrating markets through implicit allocation could be disregarded in the GTM2.
9. Furthermore, a Cost-Benefit Analysis should be performed before deciding on the implementation of this non-proven model.

2. Questions

Question 1: Would you agree with the analysis made on current market situation and on the major issues affecting the creation of an Iberian market?

10. The document provides a **fair description of the current situation of the natural gas market in Portugal and Spain** as regards infrastructures, capacities and supply and demand, as well as some information on the evolution of markets and natural gas hubs in the EU, **but is a far cry from a deep analysis on the relevant issues affecting the creation of an Iberian market.** Strikingly, the document provides a second-hand analysis of most of the topics by copying and pasting fragments from the original Gas Target Model documents, studies performed by consultants for the European Commission (KEMA, DNV), and market analysis and descriptions from a number of regulators, but lacks an original and focused analysis.
11. Surprisingly enough, **the document does not offer a detailed insight on the regulatory harmonization between Portugal and Spain, in particular on the implementation of NCs** (existing and under development) **in both countries** (in the areas of Transparency, CAM, CMP, Balancing, Tariff and Interoperability), reviewing in detail what has already been achieved and its impact, the following steps already planned and the timeline, and what is missing.¹ Nor does it present a roadmap with the necessary detailed actions to implement each of the models. Therefore, **from the information presented, it is difficult to come to any conclusion** on what is the best way to go, since the current harmonization status and the steps planned are required are simply ignored.
12. Nevertheless, **the conclusions are biased in favour of the so-called “Wholesale market with implicit allocation of capacity”** on the grounds that *detailed rules of functioning of the Trading Region model can be complex and that the establishment of a single Market Area would require a full alignment of national legislations and the creation of a single entity to perform the balancing of the system, and any form of implementation of the cross-border market area model for the Iberian gas system will need much time and resources from Governments, regulators and TSOs.*

Question 2: 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?

13. **No**, Enagás disagrees that this is an appropriate model for the creation of an organized wholesale market or as an interim step towards a proper form of market integration between Portugal and Spain. NRAs should aim at

¹ The only mentions to the implementation of Codes in Portugal and Spain are in sections 4.1. “Stakeholder expectations from Iberian gas market integration and progress report” and 4.2. “Way forward”, and do not offer any insights on the contents, but mentions what codes have been or are being implementing, or what pieces of regulation have been passed at national level, without commenting on specific measures and their impact.

establishing a Trading Region, performing an assessment of the possibilities of establishing in the longer term a Market Area.

14. **The proposal of implicit auctions merely mimics the rules applied in the electricity market**, where very different conditions prevail. **NRAs underestimate (i) the consequences it may have on the development of the market, (ii) the legal and regulatory hurdles** to implement implicit capacity auctions (including the management of transit contracts, which are being adapted in 2014 to have identical conditions to TPA contracts), and **(iii) the opportunity cost incurred by TSOs, NRAs and Governments** if time and efforts are devoted to such projects instead of focusing on a veritable integration of the areas.
15. While the proposal builds on the models included in the Gas Target Model (GTM),² Enagás believes that the consultation by **NRAs misunderstands the GTM Conclusions Paper issued in December 2011**, where the Trading Region and Market Area models are mentioned as part of the first recommendation (“Enabling functioning wholesale markets”) and **implicit allocation is mentioned in the second recommendation (“Connecting functioning wholesale markets”)**. The GTM does not regard market coupling as a way of creating a common, organized hub from scratch, but as a way of integrating already existing markets. It would be, if anything, a tool to *fine tune* two already established markets which fulfilled a number of conditions.
16. Moreover, it must be noted that the original GTM is under review, and **the proposal of integrating markets through implicit allocation could be disregarded in the reviewed Gas Target Model (GTM2)**, since it has failed to deliver any meaningful result since 2011 and the review has not included any further discussion on the model so far. On the contrary, the “satellite hub” concept has sparked a lot of debate since the GTM2 was launched, and would deserve more attention from Iberian regulators. **Enagás recommends Iberian NRAs and Ministries to wait until the issue of the GTM2** before adopting any irrevocable decision.
17. Enagás fears that **the proposed development will result on illiquidity leading to inefficient price signals. It may also hamper continuous trading**, which is essential in gas markets.
18. A large share of natural gas imports to Portugal come from Algeria via the interconnection with Spain, on the basis of **long-term supply contracts related to the transit contracts in Spain. This makes it difficult to implement the Implicit Allocation Model successfully before 2021.**
19. **The proposal is partially justified because the model can be applied with limited interconnection capacity** (in fact the model is appropriate in

² Note that the consultation includes a number of quotes *highlighting the benefits of an implicit capacity allocation*, in particular in pages 25 and 26, taken from a draft paper on the GTM issued in 2011 (being the second one referred as a “recent quote”), not from the GTM conclusions paper issued in December 2011, which do not necessarily reflect the final understanding of NRAs. Enagás understanding is that the Dec 2011 conclusions paper adopts a more cautious approach to implicit allocation.

that case, not in the case of sufficient capacity). However, as shown in the study, **for around four years and a half now nominal capacity has consistently been every single day higher than the flow at Badajoz/Campo Maior** (even leaving aside capacity at Tuy).

20. **Implicit allocation in the gas sector received harsh criticism from many stakeholders when a public consultation was run in late 2012 in the NWE region.**³
21. The conclusions by NRAs of the NWE region, presented at the 23rd Madrid Forum,⁴ were that *implicit allocation can have added value, but its feasibility should be assessed once CAM and CMP are up and running*:
 - *Implicit allocation is useful if price difference is sufficient, it can lower transaction costs, improve use of capacity (thus solves several identified allocation issues)*
 - *However, CAM and CMP are likely to also solve these issues: feasibility of implicit allocation should thus be re-evaluated once CAM and CMP are up and running*
 - *RCC considers – but stakeholders question – that a coordination problem will effectuate due to profiled booking: effect difficult to predict (await CAM and CMP)*
 - *But: implicit allocation could have added value between two adjacent Member States: In case of positive cost/benefit analysis, pilot projects to be considered.*
22. **Unlike NWE NRAs, Iberian NRAs do not even recommend making a proper Cost-Benefit Analysis before deciding on the implementation of the model.**
23. **Enagás believes that the implicit allocation model would not live up to a Cost-Benefit Analysis**, given that price differentials between Portugal and Spain are not likely to be large enough as to offset implementation costs. The analysis presented is not providing any estimate of implementation costs, and in particular it is not mentioning if the implementation would entail new regulated costs.
24. The analysis of the so-called “Wholesale market with implicit allocation of capacity” does not build on any real experience in the EU. The overall analysis performed in the document seems to be biased towards the conclusion that the “Wholesale market with implicit allocation of capacity” is the only possible

³ GRI NW, “Draft position paper for consultation Exploring the feasibility of implicit allocation in the (North West) European gas market”, 1 October 2012, Available at:

http://www.acer.europa.eu/Gas/Regional_%20Initiatives/North_West_GRI/Documents/RCC%20position%20paper%20on%20feasibility%20of%20implicit%20allocation%20in%20the%20gas%20market.pdf

⁴ “Progress report on key projects - GRI North West”, 23rd Madrid Forum, 17-18 April 2013. Available at:

http://ec.europa.eu/energy/gas_electricity/gas/doc-23/11.02_mf23_presentation_by_acer_-_progress_report_on_key_projects_-_gas_regional_initiatives_-_north.pdf

model to make progress in the short-term, since any other model would entail a high level on harmonization of national legislations.

25. It is worth noting that as of June 2014, while this is a model that has been successfully applied between a number of electricity markets, **experience in natural gas markets is limited to France**.⁵ Only one pilot project has been carried out in Europe, between the North and South areas of GRTgaz, **with very different conditions prevailing**, as described below.

26. The project carried out by GRTgaz has the following characteristics:

- it was implemented between areas of the same TSO,
- it was implemented within the same country,
- it was only implemented for day-ahead capacity,
- explicit allocation of capacity is the only mechanism for monthly, quarterly and annual products, and was kept in parallel to implicit allocation also for short-term products
- the two areas connected already had established hubs, enjoying the Northern one reasonable degree of liquidity, i.e., it was established to enhance market integration, not to create a market.
- there was contractual, and frequently physical, congestion, and
- the exchange does not receive any regulated revenue, it was created as a private initiative of GRTgaz and Powernext.





















27. The implementation of implicit allocation in the case of Iberia would have remarkably different characteristics:

- it would be implemented between areas of different TSOs, still in the process of harmonising CAM and CMP rules,
- it would be implemented between countries with different legal and regulatory regimes,
- the proposal is not clear on the products and suggests that every kind of explicit allocation could even be ruled out,

⁵ The GTM Conclusions paper advocated for conducting pilot projects, and said that “the experience gained in these pilot projects shall be used to agree on a common understanding of the meaning of implicit capacity allocation for gas markets”. **NRAs proposal does not acknowledge the conditions prevailing in the French case; in fact NRAs do not even acknowledge the French case even in the section addressing France’s experience in market integration**, which is devoted to describing a different set of actions. The consultation mentions the GRTgaz case only in page 27 to say that “As an example, GRTgaz have found that their implicit allocation project had increased the volume of trading in the PEG Sud zone. The system automatically generates offers for PEG Sud based on the more liquid PEG Nord zone and the price of inter-zone transportation”, but does not provide any information on the only implicit allocation model ever implemented in a natural gas market model. It does not even comment on the existence of this project in pages 40-41 when describing the French natural gas market.

- does not clarify if explicit allocation would be kept in parallel in case it continued existing,
- it would be established to create a market, not to enhance market integration between already existing organized markets, since the two areas connected do not have organised hubs, and there are doubts that any of them would enjoy at the beginning a reasonable degree of liquidity, and
- there is no contractual or physical congestion at all, not in a single day throughout the year, as a figure included in the consultation document shows.
- It is likely that the exchange claimed the right of receiving regulated revenues for it.

Table 1: Comparison of the characteristics of the only existing implicit allocation project in the EU (GRTgaz North – South) and the project proposed between Spain and Portugal

	 ES-PT 	 GRTgaz 
Balancing zone	 Two countries with different legal and regulatory regimes	 Implemented within the same country
TSOs in the project	 Different TSOs  	 Same TSO 
Capacity products	 Not defined (explicit allocation could even be ruled out)	 Day-ahead products exclusively, maintaining explicit allocation in parallel
Objective	 Creation of a common, organised hubs, creating a market from scratch	 Better integration between areas with already-established hubs, increasing liquidity in the South
Liquidity of the market	 None of them is likely to enjoy a reasonable degree of liquidity	 One of the areas enjoys reasonable degree of liquidity
Contractual congestion	 There is no contractual or physical congestion at all	 There is contractual congestion
Physical congestion		 There is FREQUENTLY physical congestion
Regulated cost	 Unknown	 No cost, private initiative of GRTgaz and Powernext

28. In summary, **prioritizing works on implicit allocation may lead to an inefficient and costly outcome while distracting from the objective of achieving veritable integration** of the Portuguese and Spanish gas markets. Implicit allocation should be ruled out as an alternative to other forms of market integration, or as an interim step, and be considered, if anything, as a residual, complementary mechanism to be implemented once hubs are up and running.

29. **The establishment of an organised market in Spain that allows for the proper implementation of the BAL NC and provides a price reference for gas traded on the wholesale market is an urgent matter.** Given that for the time being there are no capacity constraints between Spain and Portugal, **if works on the Trading Region model were judged by regulators as complex, time and resource consuming, Enagás would advocate for a parallel development of hubs in each market, allowing Portugal to function as a “satellite hub” until the conditions for a veritable integration were met.** This would be positive for consumers located in both markets. For the good or the bad, the conditions prevailing in Spain for the development of a hub do not differ substantially from those that would prevail if Iberian markets were integrated, so there is no point on working in integration if it means delaying or putting at risk the development of a liquid hub.

Question 3: 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?

30. For the reasons already explained, Enagás considers that no further work should be done for the implementation of implicit auctions. TSOs and NRAs should focus their efforts in harmonizing the national regulatory framework in each country in order to implement the already approved network codes in a timely manner.
31. Enagás shares ACER's view that "Gas wholesale markets are also becoming more integrated as a consequence of the implementation of the provisions in the network codes and greater cross-border cooperation."⁶ CMP and Transparency provisions in Regulation 715/2009, and the NC on CAM (Regulation 984/2013) are clearly contributing to the completion of the IEM.
32. Enagás would encourage to continue working on the implementation of the full NC on CAM, including auctions for daily and with-day capacity products as from 1 November 2015.
33. NRAs should allow for the extra-costs incurred by TSOs due to the implementation of NCs. The lack of determination of TSOs has not facilitated a decision about the booking platform where Enagás and REN will offer capacity at the VIP IBERICO. During 2014 Enagás and REN have carried out a pilot project with PRISMA but the decision from 2015 onwards is still pending. This decision should be taken in coordination with all TSOs in the S-GRI. TIGF has already joined PRISMA as a shareholder.
34. Besides, there are also some areas where work is still to be done if NRAs aim at integrating the markets.
- The harmonisation of the gas day is mandatory as from 1 November 2015 in order to comply with the NC on CAM.

⁶ ACER, "European Energy Regulation: A Bridge to 2025 - Public Consultation Paper". 29 April 2014. Available at:

http://www.acer.europa.eu/Official_documents/Public_consultations/Documents/PC_2014_O_01%20-%20A%20Bridge%20to%202025%20-%20Public%20Consultation%20Paper.pdf

- The implementation of the nomination and renomination scheme included in the NC on BAL also needs to be implemented by 1 November 2015. Enagás, in coordination with REN, has already started working on this issue and will comply with the deadline. However, some regulatory changes at national level need to be approved by the NRAs as soon as possible.
- The CAM NC and Circular 1/2014 require that the secondary market is performed at the same booking platform than the primary allocation. Further harmonization needs to be done by November 2015 in order to comply with the deadline of CAM NC implementation.
- The harmonisation of the reference temperature in the Spanish system deserves further consideration if a veritable integration is to be achieved. Currently on the Portuguese system all the gas value chain is calculated at a reference temperature of 25°C, in accordance with the INT NC; on contrary on the Spanish system it is calculated at 0°C. This situation may not only create inefficiencies in the allocation of capacities, but also in the nomination and renomination processes, in particular in the case of bundled capacities. Harmonising the reference temperature in the whole Spanish system in line with the Portuguese system, according to the Interoperability Code, should be studied within the scope of the Trading Region

Question 4: Which is the best model for the integration of Iberia in the longer term? Market area model, trading region or others?

35. The **analysis contained in the consultation is insufficient to answer to this question.**
36. **Enagás view is that NRAs should aim at implementing a trading region while performing a technical, regulatory and legal analysis of the possibility of merging zones in the long-term.** Political barriers should not be underestimated.
37. Enagás has noted a conceptual mistake in the description of the trading region and market area models as regards implications on tariff calculation; while these models would require the elimination of the tariff between Spain and Portugal (and in principle and inter-TSO compensation mechanism to transfer from one TSO to the other the lost income), from a regulatory point of view there is no need to establish a common tariff methodology. The draft TAR NC allows to set tariffs at TSO level.⁷ Moreover, it is the current practice in some countries such as Germany. German TSOs within the same balancing zone set tariffs individually. That said, it is obvious that tariff methodologies not only

⁷ ENTSOG's draft TAR NC states that in *an entry-exit system where more than one transmission system operator is active [...] each of those transmission system operators shall apply the cost allocation methodology separately.*

ENTSOG, Initial Draft Network Code on Harmonised Transmission Tariff Structures for Gas for Public Consultation. Approved by the ENTSOG Board on 28 May 2014. Available at:

http://www.entsoq.eu/public/uploads/files/publications/Tariffs/2014/TAR200-14_Initial%20Draft%20TAR%20NC_for%20consultation.pdf

for transmission, but also for LNG terminals and storages, would need to be consistent to avoid inefficiencies.

Question 5: When and how the Balancing Network Code and the Interoperability Network Code should be implemented to contribute to the goal of the Iberian market?

38. Enagás and REN are working to ensure a timely implementation of NCs. Enagás view is, again, that gas wholesale markets become integrated as a consequence of the implementation of the provisions in the network codes and greater cross-border cooperation, as long as there is enough interconnection capacity.
39. Enagás has started to take the first steps to implement the Balancing Network Code:
 - Enagás, in coordination with REN, will implement the nomination, renomination and matching procedures included in Regulation 312/2014 on 1 November 2015. This is key to carry out the daily and within-day capacity auctions included in the CAM NC.
 - Enagás in coordination with CNMC and the MINETUR has analysed the current status of the Spanish gas market and it has been decided that by 1 October 2016 the remaining parts of the Balancing Network Code shall be implemented in the Spanish system.
40. However, for the proper implementation of the BAL NC what is needed is the establishment of an organised wholesale market. It seems more appropriate to first implement the BAL NC at national level, on a coordinated manner with the adjacent system, and then integrate markets, than attempting at integrating markets through a non-proven formula before balancing systems are consistent.
41. The binding application date of the Interoperability Network code is foreseen by 31 March 2016, as included in the latest comitology version of the Code. Enagás has also started to take some steps towards its early implementation:
 - The provisions related to data exchange between TSOs have already been implemented between Enagás and REN.
 - As regards the provisions of data exchange between TSOs and network users, Enagás and REN are already working on their implementation.

Question 6: 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?

42. Enagás would like to comment on the market integration progress between Spain and Portugal achieved since 2012 described in pages 30 o 32 of the public consultation:
 - Licensing procedures. Enagás would like to note that stakeholders are still waiting for a decision on this point. Network users need to be registered in each country in order to book capacity in each country, as

it is stated in Circular 1/2014 of CNMC and in the Information Memorandum issued in February 2014 by Enagás and REN, which was validated by ERSE.

- Secondary market. The CAM NC and Circular 1/2014 require that the secondary market is performed at the same booking platform than the primary allocation. Thus, although Enagás has a bulletin board and REN a secondary platform, this issue has not been solved yet. Further harmonization needs to be done by November 2015 in order to comply with the deadline of CAM NC implementation.
 - Harmonised gas year. It is worth noting that Enagás and REN have not implemented a common gas year yet, work still need to be done on this point.
 - Capacity booking through an IT platform. Contrary to what is suggested in the consultation document, neither Enagás nor REN have yet decided to join PRISMA. The lack of commitment of authorities to allow for this implementation cost is not facilitating progress.
43. Enagás strongly believes that efforts should be focused on continuing the implementation of the EU Codes rather than deviating the attention to other alternatives, not included in EU Regulation and thus, not binding for Member States, that might provide little or no added value, which is the case of implicit auctions.