

**Gas Natural comments to ERGEG Public Consultation on ERGEG Regional Initiatives
Progress Report - November 2009**

A. ERGEG Gas Regional Initiative

A.1. From your point of view, what is the main achievement of the Gas Regional Initiative process?

Gas Natural-Unión Fenosa evaluation of the Gas Regional Initiatives (GRI) is positive.

GRI has allowed to identify barriers to market integration. In addition, some practical improvements have been reached although it is arguable whether the results are enough to satisfy market needs.

The S-GRI has allowed the launch of an open season between Spain and France to allocate capacity in 2013. The need of further investments in interconnections has been identified as priority one for the South Gas Regional Initiative. Therefore, the launch of the open season can be considered an important step forward for the South Gas Region and a concrete achievement of this Initiative. Nevertheless, it should be noted that it has taken three years of discussions and even after this long period it was launched despite the concerns raised by most of the stakeholders with the conditions imposed in the Information Memorandum of the open season. As a result, just Larrau interconnection has been decided but not the Irún/Biriatou one even though there was sufficient market interest and will contribute to enhance market integration and security of supply.

In this regard, Gas Natural-Unión Fenosa considers that the voice of the stakeholders is not properly taken into account. NRAs (National Regulatory Authorities) as well as TSOs (Transmission System Operators) are the ones which take the main decisions, define the process and the rules, leaving very little room for the opinion of the stakeholders. More stakeholder meetings should be envisaged and their comments should be taken into account.

CONCLUSION: Gas Natural-Unión Fenosa evaluation of the Gas Regional Initiatives is positive. GRI main achievement has allowed to identify barriers to market integration. Some practical improvements have been reached although it is arguable whether the results are enough to satisfy market needs.

Investment in new infrastructure

A.2. Do you consider that Gas Regional Initiative (GRI) projects have effectively contributed to cross-border investment processes? What kind of improvements would you expect?

The priority I identified for the South GRI was investment in interconnection capacity. As mentioned before, the S-GRI has allowed the launch of the OS and has implied an investment

decision of Larrau which is an important step forward. Nonetheless, Irún-Biriatou interconnection was not decided.

Gas Natural-Unión Fenosa considers that the Irún-Biriatou interconnection should have been approved and built based on the following reasons:

- The great interest showed by market agents. Shippers and traders requested 200% of the capacity offered from Spain to France, and 58% in reverse flow. In average, allocated capacity would be approximately 84% of the total capacity offered in both interconnections and in both directions.
- The requirement, imposed by the CRE (*Test of the CRE to validate the capacity allocation in France*) included in the Information Memorandum, that 90% of the capacity has to be booked in both directions of the interconnection for its approval, do not reflect the real European market needs. The success of the South-North allocation capacity should not be limited by the lower interest North-South. In addition, there is no transparency on how this test and the thresholds have been set by the CRE.

According to EFET, letter of 18 December 2009, even a requirement of 80-90% of capacity pre-booked in one direction might be disproportionate: *“Arbitrary prerequisites should be avoided. For example a requirement that 80% or 90% of capacity pre-booked, even in just one direction, may be unreasonable and an undue barrier that prevents implementation of the best economic option.”* However, the OS was launched asking for 90% of capacity pre-booked in both directions.

- The rule included in the *Test of the CRE to validate the capacity allocation in France* to discuss on Irún-Biriatou validation, was not fulfilled by just 1 GWh/day, only 0,4% of the total capacity allocation required.
- The investment costs have raised continuously compared to the initial estimations provided by TSOs and no adjustment has been made at a time when steel, labour and even land costs are static or falling. No transparency and justification has been provided so as to check whether TSOs costs are efficiently incurred. If TSOs cost were checked, the results of the open season could be different.

Regarding Irún-Biriatou project we would like to highlight that:

- It would enter into commercial operation in 2013.
- It is a reinforcement of an existing interconnection that should not face significant difficulties (ie. Environmental impact, expropriations, etc.).
- It is a marginal investment 78M€¹ (Arcangues-Coudure II and III pipelines, 98 km, 24”) that would provide 32% of the capacity offered in the OS.

¹ Development of existing interconnections by 2010/11 and proposal for a new one between France and Spain by 2013/15. July 2007.

- The European Commission, recognizing the importance of this project for the creation of a single European energy market and for the security of supply of the European Union, has granted European funds by the European Energy Programme for Recovery. In particular, it has granted 200 M€ to France for investing in the interconnection between Spain and France which makes the project more attractive for TSOs, implying that less market requests are needed to recover the investment. However, according to the information provided in last SG meeting (13.11.2009) just Larrau project (2013) and MIDCAT project (2015) have requested part of these European funds; but not Biriadou (2013). No reasons were expressed.

CONCLUSION: The priority I identified for the South GRI was investment in interconnection capacity. S-GRI has allowed the launch of the OS and has implied an investment decision of Larrau which is an important step forward. Nonetheless, Irún-Biriadou interconnection was not decided even though there was market interest and the project would have contributed to the improve market integration and security of supply of the region.

Capacity allocation and congestion management

A.3. What lessons do you draw from GRI projects in the area of access to cross-border capacity? Do the current GRI projects on capacity allocation harmonization meet your expectations?

A.4. Would there be real benefits if, at this stage, the GRI tried to seek better coordination at a cross-regional level? How do you value the experience acquired with the capacity projects in the regions? What type of projects should be developed in the future?

For the South GRI, efforts should concentrate on the development of the open seasons to develop further interconnection capacity.

Better coordination at cross-regional level would improve market integration. For the future, we would propose to apply UIOLI when TSOs are vertically integrated, there is congestion and no further investments are developed.

CONCLUSION: For the South GRI and at this stage, efforts should concentrate on the development of the open seasons to develop further interconnection.

Transparency

A.5. What would you expect to be the contribution of the GRI to transparency going forward? Do the current projects in the three regions meet your expectations?

The open season was launched without having enough transparency on the following issues:

- Economic test

- Investment costs
- Tariffs

A second open season would be launched in 2010. It is of mayor importance that this lack of transparency is solved before it is launched for stakeholders to have confident in the process.

CONCLUSION: For the South GRI, more transparency should be envisaged when launching the next open seasons, mainly regarding the economic test, the investment costs and the access tariffs.

A.6. How could this work help to ensure that the requirements of the 3rd Package are met in a consistent way across the three gas regions?

Interoperability and Hub development

A.7. What further actions would you expect from the GRI in this area in order to contribute to interoperability and hub development?

Gas Natural-Unión Fenosa considers that hubs should be developed with the objective of facilitating regional trading in mind. In this regard, ERGEG in the context of the Gas Regional Initiatives has encouraged regions to develop regional hubs rather than focusing on national ones as a way to reach an internal European gas market.

The South GRI has identified four priorities:

- Priority I: Interconnection Capacity
- Priority II: Interoperability
- Priority III: Transparency
- Priority IV: Hubs

Gas Natural-Unión Fenosa considers that the priorities order is relevant and to have solutions in a previous priority before tackling the next one it is necessary. Therefore, hub development at regional level will not become a reality unless there is sufficient interconnection capacity.

A number of elements are needed to develop regional trading: sufficient transmission capacity between hubs, access to such capacity; easy and timely access to the information participants need to access and trade in each network as well as information on the overall status of the networks; TSO processes that facilitate trading of commodity and capacity; fair and non-discriminatory processes for access to and use of the relevant networks; appropriate streamlining of processes such as balancing regimes to remove undue barriers to trade and access to flexibility services.

CONCLUSION: For hub development to become a reality at regional level certain prerequisites have to be reached: such as sufficient interconnection capacity. The priorities order identified in ERGEG action plan is relevant and to have solutions in a previous priority before tackling the next one it is necessary.

A.8. From your experience with the Regional Initiatives, what are the main obstacles to reach harmonization regarding interoperability at a regional level?

Security of Supply

A.9. Should security of supply be more clearly considered as a main driver within the GRI? Should specific actions be developed in this area?

Yes.

Security of supply is of mayor importance. The recent gas crisis has shown that the European market did not have a lack of gas but a lack of transmission capacity. This is the case of the SW region, where the lack of transmission capacity prevented additional gas flows to continental Europe, even though LNG regasification capacity was available and local demand was dipping during the gas dispute (~20%).

In addition, in the current situation of financial crisis, it is important to prioritize those projects that provide more benefit the soonest and at a lesser cost and the GRI can contribute to identify those projects.

In the case of the interconnection between France and Spain, a marginal investment at Irún-Biriadou (not approved) would provide important benefits to the European market compared to other projects. An increase in the interconnection between those two countries would act as a “diversified-corridor” and provide the European market with Algerian and LNG gas increasing both security of supply and competition among producers and suppliers.

Specific actions could include: The development of new investments, and therefore the economic test of the new investments should include security of supply criteria, monitoring the level of interconnection capacity between Member States and/or balancing areas, monitoring the development of the interconnections projects included in the Recovery Plan and present a regional risk assessment and a regional emergency plan.

CONCLUSION: Security of supply should be included in the GRI. The recent gas crisis has shown that infrastructure development has an impact on security of supply.

Specific action: the development of new investments, and therefore the economic test of the new investments should include security of supply criteria.

A.10. How can the regions of the GRI take into account and develop measures contained in the European Commission's proposal for a Regulation concerning measures to safeguard security of gas supply?

The proposal for a Regulation on gas security of supply establishes that the Relevant Authority should prepare a Risk Assessment and an Emergency Plan.

Gas Natural-Unión Fenosa would like to propose that both the Risk Assessment and the Emergency Plan of each Member state is presented to the GRI participants and that a Regional Risk Assessment and a Regional Emergency Plan is prepared taking into account the priorities and the weak points identified by the GRI participants.

CONCLUSION: National Risk Assessment and Emergency Plans should be presented to GRI participants. In addition a Regional Risk Assessment and a Regional Emergency Plan should be developed.

B. ERGEG Electricity Regional Initiative

B.1. From your point of view, what is the main achievement of the Electricity Regional Initiatives process?

From Gas Natural – Union Fenosa point of view the Electricity Regional Initiatives process have brought a positive contribution to the implementation of the Congestion Management Guidelines into the regions. In this issue, it is remarkable the establishment of the auction offices.

Capacity calculation

B.2. What should be the framework conditions for having flow-based capacity calculation based on a common grid model implemented in practice?

The flow-based method requires a strong co-operation among TSOs and would therefore contribute to the objective of regional integration. With this method, TSOs should adopt on a regional basis the same standards for calculating reserve grid capacity in each control zone, the same procedures and assumptions and the same regional grid model.

Establishment of a common grid model will require the same level of information and coordination between TSOs with regard to reliability assessment, security analysis, and measures to guarantee firmness.

In order to have a common European grid model, TSOs will need to harmonize the data used for calculating the base cases; the development of a single set of standards for grid calculations (including security standards like for example: the n-1 rule and transmission reliability margin); and the development of one regional grid model.

B.3. What do you believe should be the short- and long-term goals for a regional approach to capacity allocation?

Short term

- Reaching consensus over a target model for the EU capacity allocation and congestion management framework
- Increase coordination between different projects and regions on the EU/interregional level

Long term

- Ensure close and robust cooperation between TSOs and Power Exchanges, which primarily depends on agreement on the governance framework and definition of new functions, roles and responsibilities against the background of the adoption of the 3rd Energy Package.
- Market coupling within and between the regions as a way to achieve an European integrated spot market.

B.4. Do you consider transparency requirements for capacity calculation sufficient? If not, what do you need additional data/information for?

Most of TSOs do not provide enough information to market parties about how the capacities are calculated. To ensure transparency and market's trust in the values defined by TSOs, they should clearly explain how assumptions are made, how different drivers/factors are included in the calculation and how final results are calculated.

Due to this lack of transparency, market agents often have the impression that capacity amounts offered to the market are too conservative and exceed what is required for network security margins.

Capacity allocation

B.5. What practical steps should be taken at an interregional level to ensure an efficient and harmonised approach to capacity allocation in the 1) long-term; 2) day-ahead; and 3) intraday markets?

Long term

We believe that a single negotiation platform is a step forward in order to achieve a successful and fully integration between different markets.

Aspects like firmness and reliability of transactions, flexible and robust secondary markets, so that they can provide enough liquidity are also essential to market participants.

Non discriminatory treatment should be applied to any market participants unless there are clearly justified reasons. These measures should be based on public and detailed market analysis and Regulators should evaluate the effectiveness of them after a reasonable period of

time. The present limitations applied to several Iberian market participants are not based in these principles and should be removed immediately.

Day-ahead

We support the Single Price Coupling all over Europe as the target model (as agreed in the PCG project).

The further work on the target model should comprise two major elements:

- Development of a single matching algorithm that will enable the establishment of prices and volumes across all borders between the “PX market areas” and/or bidding areas compatible with capacity calculation.
- Agreement on a governance model – clear definition of the functions and responsibilities between power exchanges and TSOs. Market stakeholders should be consulted and their support should be an important factor in making final choice between various alternatives of governance arrangements.

Intraday

The proposal of a continuous trading platform seems to be the best solution. It is important for market agents to have the opportunity to trade as close as possible to delivery, hence liquidity and firmness of capacity are key issues involved in this process. The fact of centralizes intraday markets for the different borders could also help to improve some of the aforementioned aspects.

B.6. What are the future challenges in ensuring that allocation mechanisms across all timeframes can work together?

We would like to highlight the following issues:

- Subjects related to the implementation of a unique negotiation platform for the different timeframes.
- Technical challenges in order to change from ATC to Flow base model.
- Fully coordination between TSO and PX.
- Harmonization of regulatory issues between different regions.
- Non discriminatory treatment to any market participants unless there are clearly justified reasons.

B.7. Do you consider that achievements by different regions towards a harmonised set of rules at regional level for long-term capacity allocation merit further work or should there be more emphasis put on inter-regional harmonisation (considering that this may impede short-term regional progress)?

We believe that progress should be made in parallel inside the regions and between regions.

Harmonisation of products (multi annual, annual, quarterly, monthly, etc.), auction rules and procedures inside regions and between regions are crucial to speed up market integration: this process has to be made consistent EU-wide, be based on best practices already in place in certain regions and further evolve towards one single agreed model.

B.8. Do you think that extending the geographical scope of existing auction offices is advisable/feasible?

We believe that the existing auction offices should progress in a harmonisation of structures and auction rules. The extending of geographical scope should be done at the same time of market integration without creating new entities if them already exist.

B.9. Do you agree with price market coupling as the target model for day-ahead capacity allocation?

The market coupling is an effective and feasible solution to join markets. Market Coupling project in the CWE is a clear example of that. So we fully support price coupling as the target model for day-ahead capacity allocation.

Balancing

B.10. How important do you consider further development of cross-border balancing solutions? Which model do you consider appropriate and efficient?

In our opinion, TSO-TSO scheme seems to be the best model to follow. We think there is a relationship between intra-day markets and balancing, therefore an efficient intra-day market scheme should help to increase the performance of balancing markets.

Transparency

B.11. Do you share ERGEG's view that significant progress in transparency has been reached thanks to the ERGEG Regional Initiatives? What steps should be taken in order to enhance transparency further?

We consider ERGEG Regional Initiatives have given the main driver for enhancing transparency in the European Power Market in the last years. The ERIs have been a very useful way to discuss among the market participants on the information needs to guarantee a sound market.

The first step to take in this matter should be the harmonization of the information provided by different TSO in the different countries/regions. We consider these differences are not justified and this would be unacceptable in the target model.

On the other hand, we think ERGEG should establish as soon as possible, the Power System information requirements to be published by TSO's and these entities should have the responsibility for collecting the information from the different companies (Gen Co, Dist Co, ...) applying the corresponding technical procedures. The owners of generation, transmission or consumption facilities would have to make its best endeavors to provide all the relevant data required.