CNMC public consultation on the proposed new regulation of services provided by the LNG regasification plants

EFET comments – 31 October 2018

Introduction

The European Federation of Energy Traders (EFET\(^1\)) welcomes the opportunity to respond to this consultation and looks favourably on the initiative of CNMC to review and update the current model of services provided by LNG regasification plants in Spain. In our view this consultation represents a positive first step in achieving the objectives of allowing shippers greater access to the flexibility inherent in the Spanish gas infrastructure, encouraging greater and more efficient LNG terminal utilisation and generating greater liquidity at the PVB. Realising these objectives will promote gas market competition, contributing to the development of the Spanish wholesale gas market.

CNMC proposes a direct implementation of the ‘single tank and regasification contract model’, for reasons of effectiveness. We believe the transition towards this should be first based on a thorough impact assessment of the regulatory change requirements and associated operational needs to minimise the risk of unintended and unforeseen consequences.

Therefore, we would like to suggest a considered and sequential implementation of the overall reform. In general, we believe that any attempt to reform the regulation of LNG services in Spain should be first and foremost a response to the challenges we identified in our discussion paper\(^2\) published on 27 September 2018. The paper highlighted a number of improvements that could be implemented, as a matter of priority, in the short-term: these regards transparency, access to flexibility, congestion management and market-based balancing to facilitate the economic and efficient operation of the LNG market.

General comments on Model 4:

EFET acknowledges that Model 4 is a reasonable target model: it envisages aggregated storage and regasification capacity being allocated on a bundled basis with terminal specific LNG capacity, along with the option of acquiring it separately on an aggregated unbundled basis. We support this approach and believe that aggregated unbundled storage and regasification capacity, in combination with efficient secondary trading, will provide shippers with ample opportunities to optimise their LNG portfolios and exploit opportunities in the wholesale gas market. Moreover, it may help creating a bigger market for LNG trading and it may encourage cargoes to be delivered to less utilised terminals.

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\(^1\) The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent and liquid wholesale markets, unhindered by national borders or other undue obstacles. EFET currently represents more than 100 energy trading companies, active in over 27 European countries. For more information: www.efet.org

\(^2\) EFET IGG discussion paper: “Improving LNG logistics in Spain”
However, the implementation of this model could be particularly challenging and would require a significant degree of coordination by the System Operator, which creates the risk of limited transparency and/or inefficient operations. Mitigating the transparency challenge should be part of any implementation plan. We have highlighted below a number of issues that ought to be clarified, before any final decision is taken.

**Capacity allocation**

Determination of vessel unloading slots at each terminal and the subsequent allocation of LNG capacity is a complex process and, to an extent, reflects current processes, except for the possibility of auctioning capacity in the event of there being congestion.

EFET agrees with the capacity allocation mechanism developed by CNMC with annually, quarterly and monthly procedures. However, the interaction with other capacity products need to be taken into account and preferably the flexibility provided by the existing rolling annual allocating mechanism should not be lost.

For unallocated capacity between the aforementioned procedures, a “First Come First Serve” (FCFS) allocation mechanism could be implemented. This mechanism does not detract from market competition and would instead help to provide more flexibility to the system. The introduction of auctions should not cause delays in the implementation of the reform and it should not occur to the detriment of necessary flexibility for booking arrangements as the global LNG market is not aligned to the CAM auction calendar. We agree that auctions should only be implemented when capacity demand exceeds what is available.

As pointed out in the consultation document, the current process of allocating entry capacity from the LNG terminal to the national transmission system is not consistent with model 4. The most obvious way of addressing this is to treat transport entry capacity to the PVB as an implicit product which is allocated on a one-to-one basis with contracted regasification capacity, but questions related to correct revenue allocation and invoicing will need to be addressed.

**Loss of locational signals and role of Enagas in system management**

Though Model 4 would enhance flexibility, one of the concerns we have is that it removes some locational signals, moving to a more interventionist management of the system by the TSO rather than a market-based solution (i.e. local balancing actions or balancing services). Also, it may pose some challenges to availability of gas for ancillary services which require gas at a specific location, such as those for bunkering and truck loading.

This raises a number of questions:

- If, due to TSO mismanagement of the system, gas at (e.g.) Barcelona was not available for reloading as capacity was already taken, would the TSO or another party compensate market participants for any additional costs?

- For services which cannot be virtualised and require a physical location, such as truck loading and reloading – how can the non-flexible characteristics be accounted for and guaranteed?
- What mechanisms would be in place to ensure that this would not discriminate between pipeline entry, storage withdrawal entry and LNG terminal entry capacity?

Overall, since the responsibility to balance the system will fall more squarely on the TSO, we believe it is necessary to clarify and design a strong transparent governance system with highly detailed operating terms and conditions for the TSO. This is also relevant to define how importers would be compensated for any costs arising in case of redirections, should this prove necessary.

**Tariff setting**

How tariffs are set for bundled LNG capacity and aggregate regasification and storage capacity will also need careful consideration to ensure they are consistent with achieving the desired objectives and it does not increase the unbundled cost products. We acknowledge the CNMC aim to reduce the overall tariff levels of operation, in order to increase the competitiveness of the Spanish LNG market. Existing tariffs, in particular for reloading, are high by comparison with competing North West European terminals. Overall, the review of the LNG model should be based on a detailed assessment of the impact of any solution on tariffs.

Penalties for capacity overruns and excess storage as outlined in Ministerial Order IET/2446/2013 should also be reviewed against the objectives.

**Final recommendations**

Whilst model 4 may be the most suitable, it is also more challenging to implement in a single step compared to other models, since it requires significant changes to regulations, access rules and tariffs etc. These will need to strike a careful balance between ensuring TSO neutrality, promoting liquidity and enabling LNG terminal operators to offer services that market participants value. All market participants should have equal access to capacity and be able to avoid material risks arising from congestion and reduced liquidity, regardless of their size.

A diverse mix of market participants from small to large, Spanish and non-Spanish, should be actively encouraged as this is the best way to ensure strong LNG competition and a deeply liquid Spanish wholesale market. The future competitiveness of the Spanish LNG market will rely on the offer of more competitive terms and conditions. So this needs to be addressed through the proposed redesign with a combination of tariff reductions, increased operational and commercial flexibility and incentives to new entrants reducing the entry barriers.

Therefore, we recommend adopting a considered and sequential approach delivering the below improvements:

- Implementation of Royal Decree 335/2018:
  - Regulated tariff setting of all unbundled products therein identified
  - Marketing of such products via competitive procedures, possibly having auctions as allocation method
- Modifications to current capacity allocation procedures should be introduced with sufficient notice, without extra costs on captive shippers
- Introduction of effective congestion management mechanisms at all terminals
- Establishment of a secondary capacity market for all services offered at LNG terminals

Priority should hence be given to the above improvements. Once these materialise, we consider that the full implementation of model 4 will still take time to develop and implement, however it should be done in full consultation with stakeholders. CNMC and Enagas should also publish a detailed implementation roadmap and project plan, in the Spanish and English languages. This will provide greater clarity to all stakeholders about the timescales and the extent to which they are able to engage in the project and evaluate its impact on their business operations. It would also be helpful to establish a discussion forum where market participants (including those not based in Spain) can discuss relevant issues and be kept informed about the project’s progress, as was the case with the implementation of the PVB. Finally, to ensure high levels of certainty on reform we consider that a back-stop date for full implementation of the new design should be defined.