



Comisión

Nacional

de Energía

SUMMARY OF THE SPANISH ANNUAL REPORT ON THE ELECTRICITY AND GAS MARKET SITUATION

(REPORT FOR DG TREN)

28 JULY 2005

1 THE SPANISH ELECTRICITY MARKET SITUATION.

The Spanish electricity market liberalization started in 1998. Electricity Act was published at the end of 1997, transposing the 1996 European Directive on common rules for the internal market and establishing the present structure of the electricity market. The start of functioning of an organised spot market in 1998, the introduction of a regulated Third Party Access regime; the definition of the different agents roles and, in particular, the figure of the eligible customer; the distinction between regulated and non-regulated activities and their unbundling and definitely, the introduction of competition, represented an important change in the electricity sector and the point of departure of the liberalization process.

In order to create a competitive market that works in practice, sufficient numbers of consumers have to be free to purchase electricity from the supplier of their choice. That means a lot of changes on trading systems that companies has to put in place. In practice and since 1998 eligibility thresholds have been progressively lowered to allow a greater number of consumers to benefit from liberalisation, and just only five years later, in 2003, any customer is able to choose their electricity supplier freely.

Nowadays, the main features of the Spanish Electricity Market can be summarized as follows:

1.1 Production Market.

The energy transaction negotiated by agents in the production markets correspond to the demand forecasts, group generation capacity and transportation grid availability.

This market is based on several interrelated processes:

- Daily Market: its purpose is to perform energy transactions for the following day. As the System Operator notifies the agents of its demand forecast, generation availability and transportation grid conditions. The Market Operator matches the various offers and determines the marginal price and the volume of energy that is

accepted for each buy and sell unit and each time period. Once energy buy and sell transactions are matched, the program is reviewed by the ISO, from a supply safety perspective and any technical restrictions have been resolved with other specific offers.

- Intra-daily Market: managed by the Market Operator. It is a market for adjustments on generation or demand deviations that can happen. This market is organized into six sessions and agents that have previously participated in the daily market can present new energy buy or sell offers. The transactions programme resulting from each intra-daily market is analysed by the ISO to assure compliance with safety criteria.
- Operations Markets: managed by the ISO as responsible for system operations. Consists of processes that resolve unbalances between production and demand. It is a group of competitive mechanisms that complement the production market.

1.2 *Transport and distribution, and others.*

- The investment decision planning is abandoned and replaced with indicative planning, except for transportation facilities that can help investment decisions of the various economic agents.
- Installation of new electricity generation plants is subject to a previous authorization to be granted by the Ministry of Industry.
- As for transportation and distribution activities, the use of grids is deregulated providing general access to third parties to the grids in return for payment of access tariffs. Ownership of the grid does not grant exclusive or preferential rights of usage to its owners.
- The price for transportation and distribution continues to be set by the Government. In order to ensure transparency of this payment, electricity companies are separated by law between regulated and deregulated activities.

- The electricity sector is set-up following the principles of objectivity, transparency and free competition. All without damaging the necessary regulation of the sector characteristics among which is the necessity of economic and technical coordination for its operation. In order to ensure proper operation of the system, the Market Operator function is created (responsible for the economic operation of the production market) and the System Operator (responsible for technical management of the electricity system). The ownership structure of the Transmission System Operator, is limited to 3 % for any agent, and 1 % if it is an agent in the electricity sector, with the date limit of 2008 for the accomplishment of that limit by disinvestment of excess shares.
- Concerning electricity infrastructures, transmission is developed mainly by REE, also acting as ISO, which owns most of transmission lines, and distribution activity is developed by five main distribution companies which belong to the 5 main holdings with interests also in the generation and supplying activities. Moreover, there exist 300 smaller local distribution companies, and all of this DISCOS perform as well the supply activity to tariff customers.

As the result of the liberalization process, it can be said that in the last year, the 40% of the internal demand has been supplied via the liberalized market. The 3 main incumbent companies were responsible for more or less 84 % of purchases of energy in the pool, and 11 other independent companies account for 9 % of the total purchases in the pool.

There is an increasing rate of customers changing from the conventional supplier to a new one, with a percentage of change of traditional supplier of 23 % (by energy volume) of the liberalised market in 2004.

2 THE SPANISH GAS MARKET SITUATION.

The Spanish gas market liberalization started in 1998. Hydrocarbons Law was published in 1998, transposing the European Directive on common rules for the internal market and establishing the present structure of the natural gas market. The introduction of a regulated Third Party Access regime; the definition of the different agents roles and, in particular, the figure of the eligible customer; the distinction between regulated and non-regulated activities and their unbundling and; definitely, the introduction of competence, supposed an important change in the natural gas sector and the point of departure of the liberalization process.

Taking into consideration the evolution of the process and after detecting some circumstances that hampered the way towards the liberalization, some additional measures had to be approved in order to achieve the target. In this sense, the limitation on the shareholding of the Transmission System Operator, the gas (and capacity) release program of the gas coming from Algeria by Maghreb pipeline, the reduction of the eligibility threshold, the provision of bails for the capacity reservation, the use it or lose it principle, or the partial capacity reserve for short term contracts, have been practical measures that have cleared the way.

Nowadays, the main features of the Spanish Gas Market can be summarized as follows. There is a regulated Third Party Access regime to the transmission and distribution infrastructures, which includes not only the pipelines, but also the LNG plants and the underground storages. Since 2003, any customer, with independence of its consumption, has the option to be supplied in the liberalized market, by himself or by the means of an authorized supplier. The reservation of capacity is subject to the *first come first served* principle, and it is necessary to establish a bail when the TPA contract is signed. The under use of the capacity reserved implies the respective loose of the proportional part of the capacity and the bail established. The participation on the Transmission System Operator shareholding, agent that is responsible for the technical management of the network, the security of supply and the coordination of the different players in the gas system, is limited to 5%. There is also a limitation on the maximum share of the wholesale market, so no agent is allowed to supply an amount of gas above the 70% of the national

consumption. Concerning the security of supply provisions, it is stated an obligation for the maintenance of minimum security stocks of 35 days of the firm consumption supplied, obligation that any agent that introduces gas in the system has to comply with. Also importers must diversify their supplies, in such a way that the share of them coming from the same country cannot exceed the 60%. Balancing tolerances are included in the TPA tariffs, 5 days of the contracted daily capacity in LNG tanks and 2 days of the contracted daily entry capacity in the transmission system.

Concerning gas infrastructures, there are six main entry points: four regasification plants, Barcelona (10.5 bcm/year), Bilbao (7 bcm/year), Cartagena (7.9 bcm/year) and Huelva (7.9 bcm/year), and two pipelines, Tarifa (10.9 bcm/year) and Larrau (2.5 bcm/year). The underground storage capacity is 2.1 bcm. LNG plants provide the system with a big degree of flexibility. The high degree of infrastructures integration with Portugal opens the possibility to a future real integration between both markets. Important increases of interconnection capacity are expected for the near future.

As the result of the liberalization process, it can be said that in the last year, the 80% of the market has been supplied via the liberalized market. The incumbent was responsible for more or less half the liberalized market, and the rest was supplied by other ten different companies, among which there are many foreign undertakings with significant shares. The three major companies account for the 76% of the retail market. There are four companies that have a share higher than the 5% in the wholesale market, in fact the three biggest ones represent jointly 73% of the supplies.

64% of gas supplies arrived as LNG in 2004, and the domestic production represented only 1.2%. Even if there is not an organized market, a significant volume of gas interchanges, based on bilateral agreements, has been detected. In 2004 the volume of gas traded within the system reached the 18% of annual demand, and last month in June, it supposed 45% of the gas demand. There is an increasing rate of customers changing from the conventional supplier to a new one. In the beginning of 2005, about 55% of the consumption in the liberalized market was supplied by companies different from the trading affiliate of the conventional gas supplier.



Even if a lot of progress has been achieved in the liberalization process, some provisions from the new gas Directive, that will enhance competition, must be transposed into National Law.