OBSERVATORY ON COMPETITION LAW ENFORCEMENT

THE PORTUGUESE COMPETITION AUTHORITY IDENTIFIES BARRIERS TO ENTRY AND EXPANSION IN THE NATURAL GAS MARKET

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On October 25th, 2017, the Portuguese Competition Authority (Autoridade da Concorrência – AdC) issued a press release announcing it had identified barriers to entry and expansion in the natural gas market likely to have an impact on the competitive conditions of industrial consumers and on the offer of more competitive prices. Between 2010 and 2016, natural gas prices, before taxes and levies, paid by Portuguese industrial consumers were consistently among the highest of the 28 Member States of the European Union (EU-28). Despite a decline towards the EU-28 average price level for the higher consumption bands in 2016, prices remain amongst the highest for industrial clients with a lower consumption. The relevance of this analysis is due to the high share of natural gas in the cost structure of several Portuguese industries.

The AdC highlighted several factors likely to compromise market efficiency:

- The high degree of concentration of the industrial consumers segment of the natural gas market, with its two main operators (Galp, followed by EDP) accounting for more than 70% of the market. Galp holds a dominant position both as the historic importer of natural gas (by pipeline and by terminal) and in the secondary market for this commodity, maintaining wholesale contractual ties with some of its competitors in the retail market. This barrier results from factors inherited from the pre-liberalization market context;
- The insufficient integration of Iberian markets (Iberian Natural Gas Market, MIBGAS), the double application of transmission network access tariffs in the cross-border trade between Portugal and Spain (tariff pancaking) and the high access costs to the Liquified Natural Gas (LNG) Terminal in Sines for small-scale operators. These barriers restrict the ability of retailers to import natural gas through pipeline at competitive prices, limit the use of the Terminal and penalize the competitiveness of the Portuguese National Natural Gas System (SNGN);
- The increase in network access costs, particularly for the medium and low pressure networks. This evolution is related to the combined effect of the sharp contraction of

natural gas demand as of 2011, but also to the increase in the remuneration rates of network assets in the period under review;

- The increase in import costs in 2013/2014, which occurred alongside with the strengthening of Galp's trading activity following the Fukushima nuclear disaster in 2011 (the international reseller strategy followed by this company triggered prices and demand for natural gas in Asian markets) and with a change in the management of its supply portfolio in respect of take-or-pay[1] contracts with Algeria and Nigeria (sale of Nigerian LNG in the international markets where the price was higher and strengthening of the contribution of the – more expensive – Imports of gas coming particularly from Algeria).

In order to foster competition and reduce barriers to entry and expansion in the natural gas market, the AdC has proposed to the Government and the Sectoral Regulator (the Energy Services Regulatory Authority, ERSE):

- The strengthening of intergovernmental cooperation between Portugal and Spain, promoting the effective development of MIBGAS and eliminating the double application of transmission network access tariffs on imports by pipeline in Campo Maior (Spain-Portugal direction). The AdC argues that this would allow for a more competitive natural gas price-setting, an increase in the number of players active in the SNGN and a greater diversification of the sources of natural gas supply in the country;
- The adoption of market-based LNG auctions with a delivery point at the Sines LNG Terminal, granting small-scale competitors the opportunity to acquire LNG at competitive conditions. Although in the past natural gas auctions did not arouse great interest from market players, this proposal settles a specific delivery point (the Sines LNG Terminal, which may increase the number of its users), with such auctions taking place under a market context marked by an increase of the consumption of natural gas and by a greater number of players acting in the SNGN;

[1] The long-term contracts concluded by GALP with Nigeria and Algeria provide for the existence of minimum quantities to be consumed, ensuring the right of the seller to claim payment of this quantity. The risk of non-compliance with the contractual minimum consumption is transferred to the consumer (either the natural gas consumer or, indirectly, the consumer of electricity).

- The adoption of regulatory solutions that allow natural gas exchanges between different delivery points of the SNGN (swaps between locations), namely between the Sines LNG Terminal and the pipeline interconnection between Portugal and Spain, at Campo Maior, providing smaller competitors with one more options regarding the destination for the LNG received at the Terminal, without having to bear its high storage costs.