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**Subject: BP response to CRE Consultation on the evolution gas hubs in France.**

BP is pleased to follow up its initial contribution to the debate on the future of PEG balancing zones with its response the CRE public consultation on the matter. Our comments are non confidential.

## 1 – Do you consider the consolidation of PEGs desirable? Do you consider imaginable to maintain the current PEG structure?

On paper, all options to consolidate PEG offer benefits to the market design and therefore look desirable. BP therefore considers that choosing the right way forward is a matter of identifying which target is more effective. This process should comprehensively consider all the conditions which have to be met to make PEGs consolidation effective, as no option on the table is implementable at all costs.

The direct costs of developing each option should be considered. A transition roadmap should also optimize synergy with existing regulatory developments, and achieve a more integrated approach around what needs to be changed to achieve a well developed gas wholesale market. Most importantly, and less obviously, each outcome should be evaluated in terms of ensuring that a levelled competitive environment will develop as a result.

In terms of direct costs and benefits CRE has identified the key uncertainties and some way forward to overcome issues of certain way forward.. In terms of integrated approach, CRE has also identified some key processes to coordinate with, although we see some opportunities for improving the coordination and therefore the desirability of all options. Finally, we consider CRE should focus more its analytical effort on the impact which some way forward have on the level of competitive push, as well as on ensuring that the competitive environment is levelled for all market players.

Our concern regards especially the impact of flow commitments on a levelled competitive environment, as it could favour dominant players. As we discuss in question 8, we think some constraining terms attached to the usage of LNG and storage, currently give a competitive edge to dominant players, by requiring a stronger market presence to use

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flexibility efficiently. This distortion could reduce or possibly nullify the impact on liquidity and market opening of even the most radical consolidation option, such as the single PEG. As a consequence, even the option which we consider in the highest regard such as a single PEG, should be approved as long as it does not require distortive measures. This remark fundamentally implies that we consider a physical investment as the only way forward which, if beneficial, could deliver a desirable consolidated hub, by eliminating the need to rely on expensive commercial contracts.

As to the current structure, we consider that it should not be maintained. We consider that in the long term at least the lowest cost options should be progressed, should options like a single PEG through physical investment not pass all the financial and market testing. This would mean chiefly to allow PEG S-TIGF to merge and then join the Iberian market, as in the long term BP expects the southern hubs developing only if becoming part of a greater hub with liquidity potential. This view implies that should a physical investment on the PEG N-S direction be approved, in the long term we would consider desirable to have a TIGF operating in an integrated manner with GRTGaz.

By maintaining the current three PEG structure, only EU-driven changes around capacity allocation, balancing, transparency and other fundamental aspects would improve market design. However BP expects these changes would more likely maintain the status quo. As a consequence we expect there would be minor changes in the current competitive environment, with at best few new entrants occupying marginal positions and dominant players consolidating at wholesale and retail level. These consequences could be very costly especially if France will scale up the importance of gas in its energy policy mix. We expect that having only dominant players to offer additional gas supplies could mean that higher premiums would be commanded.

### 2 – Do you favour the convergence of GRTGaz and TIGF procedures and information systems linked to the implementation of the EU Third Package? Do you consider desirable that both GRTGaz and TIGF join the common platform for capacity booking?

BP supports both CRE proposals.

BP would particularly welcome the coordination between EU Network Code implementation procedures and other initiatives, namely the implementation of the new balancing regime and the new capacity booking platform.

We particularly see opportunities to rely on the capacity platform as a blue print to extend to other countries. Similarly we would welcome a balancing platform

### 3 – What do you think of KEMA study conclusions? Do you support CRE analysis?

We do not have a strong basis to challenge or agree in detail with KEMA study conclusions. However we can provide two general comments on KEMA views and CRE analysis. The first one is that BP shares CRE views on the fact that network constraints are identifiable but their magnitude and financial impact is never easily predictable. Our second comment is that KEMA conclusions point at the impossibility to design a perfect market design *a priori*, as dynamic market forces require System operation needs to be adaptable.

More specifically, BP considers the KEMA a fairly comprehensive scenario analysis, which adds up to the available evidence showing the congestion between the North and the South of France. We consider that the main take of the exercise is that the effective amount of congestion is highly volatile and dependent on market dynamics. In this sense the contrasting comments from GRTGaz, TIGF and shippers like GDFSuez provide good evidence as to the uncertainty around the congestion magnitude.

We have mixed views about CRE approach to address the constraints of a merged hub. While we agree with CRE that a merged hub will remove certain locational signals, we think that some of the solutions which CRE suggested to address constraints of a merged PEG could have a limited effectiveness. Like CRE we expect that a merged hub could possibly lower the attractiveness to fill in storage in PEG South. However we think an obligation to fill in storage sites in PEG South, would likely affect in the long term the costs of flexibility. Similarly, we consider ineffective to oblige shippers with import capacity to offer gas for a flow commitment tendering process. Our experience with most regulatory solutions dictating solutions or obliging participation is that they can raise costs by generating artificial demand on certain sources of flexibility. This consequence affects especially non-dominant players with less diversified supply and flexibility portfolio, and in turn affects competition.

We think the market could rather benefit from a wider consideration of regulatory tools such as locational signals. For instance the costs of withdrawing gas in the South could be increased to account for the greater transportation and storage costs. Similarly CRE could review the tariffs and the terms for accessing LNG facilities, boosting their contribution to the balancing system. Another solution which we consider more effective is to allow GRTGaz to tender for storage capacity to be used as operating margin or to design an effective regulation to conduct local balancing actions. The advantage of such solutions is that would allow a more direct competition between sources of flexibility, push for a more dynamic approach to manage the GRTGaz portfolio, and possibly target more effectively parties which cause imbalance.

### 4 - In the current context, do you consider appropriate to commit such levels of investment in light of the expected benefits?

### 5 - What is your view about the mixed investment-contracts solution which GRTGaz proposed?

BP broadly supports CRE rationale and preliminary conclusions regarding the three investment options necessary to address the physical constraint between PEG North and South.

Specifically, we support CRE approach to the challenge of selecting the optimal asset-investment mix. Our understanding of the rule of thumb applying to infrastructure investment is that pipeline upgrades are the most efficient way to supply the most predictable and steady part of gas transportation needs. The costs of pipeline, storage or LNG should instead be evaluated in a comparative manner to supply more volatile or peak transportation needs.

More specifically, we make below comments on GRTGaz three main investment scenarios:

- A full physical infrastructure upgrade would certainly make sure that also Southern France can access the cheapest gas sources depending on the market context. Also, it would probably increase PEG hub firmness and improve tradability at PEG, as supply emergencies could be handled more easily. However BP shares the concern around the impact on tariffs of an excessive level of investment, especially in light of the conflicting views which emerged in the workshop regarding the effective degree of congestion between the PEG North and South zones. More specifically, there would be a risk that peak supply scenarios would be addressed with costly pipeline upgrades, rather than with possibly more cost effective flexibility tools.
- A PEG merger based only on flow commitments would increase the risks arising from structural internal congestion. BP concern goes to the fact that once merged, a single PEG could hide the right signals to bring new investment to solve the structural shortness, incentivizing exploitative bidding or gaming behaviour. In addition, a structurally congested network could force GRTGaz (or a common system operator) in costly gas redispatch, which could be especially high in light of the expected tightness around LNG pricing in the coming years. These factors would add up to the impact on effective competition we discuss in Question 1
- The mixed investment solution seems to offer a reasonable compromise between the above issues, as well as a more methodologically sound approach. Specifically, the fact that the Bourgogne pipeline upgrade would address most of the structural congestion is likely to offer cost effective gas flows to Southern France, as well as increased gas supply to the region. These benefits would add up to the additional liquidity and

operational efficiency. The reduction of expected flow commitments costs to €10m/ similarly adds up to the convenience of the investment. Finally, a reduced physical congestion would also make distorted bidding practice more risky and therefore less likely. The system operator could be incentivised to minimise use of flow payments (e.g. through flexible operation of the system) to reduce further opportunities for distortion.

BP considers that the decision around the optimal design could be improved with some tools to both identify and operate the most effective market design. In terms of evaluating the full benefits of network investments, we think CRE could benefit from including tools such as social discount rates in the investment appraisal. This would better allow estimating a wider set of benefits, such as security of supply. We think this tool could help estimating more accurately the financial threshold under which a physical investment would be justifiable.

Another solution to achieve a more effective reliance on flexibility tools as a bridge arrangement is to use locational signals to attract LNG into FOS rather than Montoir. Accessibility of the LNG terminals would also need to be improved so that cargoes could be competitively brought in (terminal sharing arrangements, balancing, access to more flexible storage products). This would be a means of broadening flow commitments to avoid a single party from benefiting in a way that might harm the development of competition.

### 6 – Do you agree with CRE analysis regarding the creation of a common GRTGaz South and TIGF hub?

We support the fundamental conclusions of CRE analysis.

We think that GRTGaz South- TIGF scenario would possibly generate the lowest level of costs and improvement in the design of France gas market. The main reason for our view is that we expect a Southern France hub providing reasonable improvements only in the operational functioning, while we expect limited improvements in liquidity and security of supply. As we discuss more extensively in answering questions 9 and 10, we do see the southern hubs either joining PEG North or becoming part of the Iberia regional hub, depending on the PEG North - South physical investment being feasible.

A southern hub would represent limited improvements as it would maintain a limited connection to pipeline gas import routes. In addition to this, we do not expect that 18 bcma of yearly demand provide a compelling case for predicting a significant improvement in market participation. Most of the demand would be located in the current PEG South, which at the moment has been able to develop some liquidity only at the spot level. We consider plausible to argue that adding up 3 bcma of TIGF consumption would hardly provide a breakthrough to the current market performance.

As to the complexity of achieving a common southern hub, we support CRE concerns on the separate ownership of TIGF. We consider this concern especially relevant in light of the explicit opposition to the merger which TIGF showed in the last workshop. These factors could generate time consuming negotiations and costly solutions to avoid deadlock in agreeing a combined operation of the merged Southern hub.

### 7- Do you think that market coupling can really be an alternative to the full merger of PEG North and PEG South? Do you think that market coupling can really be an alternative to the full merger of PEG South and TIGF or just an intermediate step? If the case, how should the coexistence be between a zero cost price for short term capacity and the price of long term firm capacity booked on the GRTGaz Sud – TIGF?

We support CRE conclusion on the limited impact of a coupling mechanism in terms of contributing to an integrated French market. Market coupling is not a substitute for a complete merger, as demonstrated by recent price divergence between PEGs N and S.

Our understanding is that market coupling is principally a tool for short term optimization of capacity usage between hubs. Among the drivers of effective coupling, there is an assumption that sufficient interconnection capacity exists between the areas. The effectiveness of the tool is then determined by the method of sale of the coupled capacity and the pricing applied.

On the basis of our understanding we conclude that with regard to both PEG N-S and PEG S-TIGF, CRE could rely on market coupling to optimize the use of capacity in order to achieve max usage of the pipe and improve the pricing convergence of the hubs. Conversely, as CRE correctly discuss in the consultation, we consider that a market coupling solution is not adequate to promote full hub integration.

With specific reference to the PEG N-S, the physical congestion between PEG-N and PEG-S limits the effectiveness of market coupling. As to the method of sale, the fact that so far CRE has been constraining the sale of coupled capacity to a band of hub pricing spread limits the effective functioning of the mechanism.

The lack of physical congestion makes market coupling potentially effective in the GRTGaz S - TIGF interface. However we express concern as to the implications of having a PEG S-TIGF coupling mechanism allocating capacity at €0. The lower pricing of short term capacity would interact with the pricing of long term capacity. Shippers would likely tend to reduce long term bookings, on the basis that short term capacity at €0 could be accessible. As we expect that 0 price could be the dominant price, this would disincentivize long term bookings. Additionally, CRE might need to allow shippers to walk away from existing long term bookings to compensate their losses, and to socialise the resulting under-recovery.

An alternative solution could be to couple the market, but to price capacity according to the LRMC. Such aspect could limit the risks of underrecovery, by limiting the differential between long term and short term pricing.

### 8 - Do you agree with CRE Comparative analysis of the alternative options for the evolution of PEGs?

We broadly support CRE views around the options to consolidate PEGs. Specifically, we agree on the general trade off between effectiveness of solution and investment costs on one side and timing to achieve it.

With specific reference to the mixed investment solution, which appears the most effective solution available, there is an uncertainty over the costs of the “bridge” arrangement, which will fundamentally depends on the differential between pricing of pipeline gas from Russia and North Sea on one side, and LNG marginal pricing. This cost can evidently reduce the net benefits which the French market can benefit from anticipating the merger.

Building on our previous comments, BP thinks that this uncertainty provides further evidence on the importance of setting efficient system operation incentives on GRTGaz. Experience across other EU hubs shows that with the right incentives, TSOs may find new ways to operate the system once they gain greater experience of running it. These efficiencies guarantee lower operational costs and therefore lower transportation tariffs increases. Secondly, TSO can solve congestion problems with a lower need to build additional capacity. We note that the reduction in the number of trading hubs in Germany was achieved creatively, without the need for excessive investment in pipeline capacity

### 9 - Do you agree with CRE analysis? Do you think that a separate TIGF can be desirable in the long term? Do you think that approaching TIGF to the Spanish market is a realistic option in the short or long term?

### 10 - Do you agree with CRE analysis on the target options available? Which of the three targets do you prefer?

As discussed in Question 1, we think that the way forward to the target hub will depend on the desirability but also on to the respect of fundamental conditions regarding cost/benefits, coordination and impact on the competitive environment. In any possible scenario we see TIGF independence as undesirable, and we see it joining either the Iberian hub or the single PEG hub.

From our framework we conclude that the single PEG target model is the most desirable model in the case the mixed physical investment looks economically feasible. This solution would guarantee the creation of a single market price across France, a more liquid hub, greater security of supply for the southern hubs, and set the right foundation for a levelled competitive environment. We see TIGF becoming part of GRTGaz in the long term as – taking for granted the separate ownership issue, gas market rules and overall legal arrangements would be much closer.

In case no physical investment is built to link PEG N and PEG S, we consider unfeasible to progress a single PEG merger based on flow commitments, for its distortive impact on the competitive environment which we discussed. This scenario would make a separate Southern hubs and a long term integration around the Iberian regional market look like the most desirable target. As discussed in question 6, we consider unfeasible that the joined PEG Southern hubs could constitute a stand-alone hub in the long term. The fundamental difference between this target and a single PEG is that there would be higher risks of having southern France developing different pricing when LNG is not the marginal price setter in Europe. We understand this could be a less desirable result for CRE, although we obviously consider it less damaging than a merger based on commercial contracts.

Linking TIGF and PEG with the Iberian market was the envisaged solution by a number of players, though French shippers indicated a preference for a merger of PEGs N and S. We conversely believe this remains a feasible solution.

We are aware that no way forward involving change is easy for TIGF. However we think that a separate TIGF is not feasible in the long term. At the moment, apart from the small market size, the separate ownership of TIGF constitutes an artificial border, delinked from the physical flows of gas demand and supply. As a conclusion we consider that in the long term the only feasible hub border can be the PEG N-S border (if NO physical investment is in place) or the France Spain border (if a physical investment is feasible)

### 11 - Do you agree with CRE analysis regarding the need to evolve de market structure rapidly ? Do you consider necessary to start changes from 2015?

We think that measures to address governance and to improve convergence between TIGF and PEG-S could be started immediately, while further analysis is carried out on reinforcement in Bourgogne. This would allow some benefits to be brought from 2015, and continued improvement thereafter.

### 12 - Do you agree with CRE Analysis on the evolution achievable as of 1 April 2015 ? Which of the two options you prefer? In case a single PEG N-S hub is achieved, should it be necessary to simultaneously put in place a market coupling between GRTGaz and TIGF? In case a single PEG S – PEG SW hub is achieved, do you consider necessary to simultaneously analyze the feasibility of Bourgogne pipeline doubling?

If the long term objective is to create a single PEG France, we are neutral between merging PEGs N+S then adding TIGF later, or merging PEG-S and TIGF then adding PEG-N later. However we agree that the latter could be started more quickly.

We hope that this response is helpful. Please do not hesitate to contact me should you wish to discuss in more detail any of the aspects we introduced.

Kind Regards,

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