ANALYSIS OF CROSS BORDER TRANSMISSION GAS TARIFFS BETWEEN PORTUGAL AND SPAIN
- PUBLIC HEARING –

Question 1: Would you agree with the analysis made on current market situation and on the major issues affecting cross border trade between Portugal and Spain?

We agree with the market situation analysis. However, it should be questioned the introduction of regasificaction toll and storage fee in a comparative study of natural gas cross border trade costs. We think LNG terminals use costs should be included as part of the natural gas costs imported in LNG form, in order to analyze the supply cost from one country to another, exclusively from the exporter country transmission grid.

Moreover, although we agree with the study analysis and conclusions about cross border tariffs (CBT), we note that the costs of LNG gasification and storage calculated on the assumption of 3 LNG ships / month are not representative of a typical supplier. This is because three vessels per month represent 50% of the Portuguese market, estimated at 5.5 bcm / year, and only one supplier has this quota in Portugal. In the study, the Sines LNG terminal cost appears to be lower than those of a Spanish LNG terminal, and this is only true for suppliers who have a high volume. In Spain there is little gasification cost differential between suppliers large and small, but in Portugal there is a high differential.

Question 2: How do you think that transmission network costs should be allocated at cross border IP (both in Spain and Portugal), taking into account the defined principles (coherence, transparency, cost recovery and cost reflectiveness, etc) and the starting situation of the regulatory tariff framework in both countries?

A priori we believe it would be very difficult to set the transmission cost in the cross border IP, as this price elasticity would be probably very large. To avoid imbalances between markets, we understand that the first step should be to equal this cost, regardless of the origin or destination of the natural gas. Obviously, to encourage integration between the two markets, the optimal would be a zero amount tariff in both sides of the frontier, but to take into account the cost recovery principle, there should be articulated a compensation mechanism between the two natural gas systems, the Portuguese and Spanish. We believe that in the Portuguese case, this compensation could be included in the UGS concept, which is paid proportional to all consumers' energy consumption. It would be probably appropriate to consider a similar system in the Spanish tariff structure, and it would need a proper development.

Additionally, to encourage cross-border energy transmission, the capacity reserve tariff (Spanish and Portuguese) should be assimilated as the entry transmission tariff, and there only should be a payment of capacity reserve in the whole Iberian gas natural transmission system; the entry tariff in the transmission system where the natural gas in introduced. Thus, the tolls that should pay a supplier who introduce natural gas in one country and it is consumed in the neighbor would be very similar to those that assume the rest of supplies: a single entry transmission, just one exit transmission tariff and, if applicable, underground storage and distribution network tariff in the country where that energy is consumed.

This no-cost cross border IP system, in which it's only paid the entry transmission tariff (capacity reserve) in the country where the natural gas is introduced and the exit transmission tariff in the country where energy is consumed, is similar to the currently prevailing electricity transmission system; this system has been implemented successfully for many years and has significantly facilitated the electricity exchange between different countries of the European Union. Among other advantages, strengthening trade between countries has encouraged the development of cross-border interconnections, that are needed to ensure stability and security of supply, and especially so in the electricity sector.

Question 3: Which do you feel are the most important aspects where harmonization (apart from the cross border tariffs harmonization) can contribute significantly to short term market integration?

In addition to tariff harmonization, we consider very important to coordinate all the logistics and energy balance rules between Spain and Portugal, so it could be possible a single trade management between the two countries. This, with zero cross-border transmission tariffs and a single payment at the entry and at the exit of the transmission network, could make possible consider the whole transmission network in the Iberian Peninsula as a single network for commercial activity. In this situation, after entering in this transmission network the natural gas could transit to the consumption point with the only cost of exit transmission tariff, and if appropriate, the distribution tariff.

Only a homogeneous transmission tariff structure with unique balance rules would make viable the implementation of entry-exit transmission tariff system for the Iberian Peninsula, so there were no restrictions on the energy transit beyond the signals of the market optimal logistics and the good use of transmission networks.

The energy balance rules unification, in addition to tariff harmonization, must have it consequence, even if it's an obvious repetition, in the unification of procedures and operational roles between different actors. The relationship between primary and secondary suppliers that exists in the Spanish market is an illustrative example of this situation; the primary owns the capacities / contracts at entry points and transmission network, and the secondary supplier is the owner of Third Party Access (TPA) contracts in distribution networks and delivers natural gas to final customers, thus making the switching process with distribution operators.

The unified energy balance and logistics management would, in addition to unifying rules and operators, force the adoption of unique protocols and communication formats with the integrated Iberian Technical System Operator (TSO), without which it wouldn't be able to perform all the tasks entrusted within an acceptable timeframe.

This model based on an entry/exit tariff system at regional level without transmission network costs allocated at cross border IP, and the creation of a single balance area would be in line with the goals proposed in the developments of the current European Regulation (Framework Guidelines and network Codes) and the Cross-Border Market Areas defined in the Gas Target Model European Working Group.

Question 4: How would you implement the proposed step-wise approach, aiming for a more integrated market in the longer term?

The first thing to do to achieve a greater integration between the two natural gas systems, it's a split of the current Spanish transmission and distribution tariff (conduction term) in two different tariffs; one for the use of exclusively transmission networks, which will consist of two terms (entry and exit), and another by the use of distribution networks (the entry term of the transmission tariff should be added to the capacity reserve tariff). This should not be a problem for the sector normal activity, and it should not affect economically to consumers as it would take an additive tariff structure, as it already is in Portugal, so the amount currently paid with the transmission and distribution tariff would be equal to the sum of transmission tariff and distribution tariff costs.

The first consequence of the Spanish transmission and distribution tariff split in two should be the automatic elimination of cross subsidies that currently exist between the different tariffs, produced after ten years without updating them. The appearance of two different tariffs, transmission (exit) and distribution, will not in itself be enough cause for the disappearance of these cross-subsidies, but the necessary creation of a stock compensation between the two transmission systems would be imperative for a tariff adequacy to operators real needs. For

example, in Spain this would increase the tariffs for the use of the LNG terminals, and conversely decrease transmission and distribution tariffs.

With these first two steps the basic transmission tariff structure could be homogenized between Spain and Portugal, which is considered essential to start the markets integration. It is not necessary to advance in a greater assimilation of transmission tariffs (their durations, flow estimations, tariffs costs), as this would add imbalances to be compensated, and their effects would be little more than aesthetic.

Immediately after or simultaneously, a zero cost natural gas exportation should be agreed between the two countries (zero cost transmission tariff at the international transmission network exit), and zero cost transmission tariff at the international transmission network entry.

With these mechanisms it could be achieved a costs balance in the natural gas transmission network, independent of the border crossing or not. But for an adequate long-term integration is also necessary to agree on unique balancing rules for the entire Iberian Peninsula natural gas system.

Logically, unified balancing rules would imply the appearance of a single TSO in the Iberian Peninsula, which would be necessary, along with transparency in its management, to provide security to the agents. These standards should be similar to those currently used in other European countries, solving imbalances through market mechanisms where any supplier could participate freely; imbalances would always have a cost, bringing transparency to the natural gas system management and giving economic signals to agents to increase their efforts and involvement in adequate supply logistics.

Question 5: Would you identify new issues you think are important to create a favourable cross border trade environment? How would you set the timing and prioritization for the discussion on these issues?

It is possible that during the two natural gas systems balance integration it could be desirable a unification of regulated TPA underground storage facilities management, and we would consider appropriate so. This would make necessary a tariff homogenization for its use, and also probably the creation of a new bag of compensation between systems or an extension of the already mentioned as necessary for the harmonization of transmission tariffs. An additional benefit of the underground storage facilities unified management would be the synergies that the two systems would provide because of a bigger bulk available.

Similarly, we consider desirable a harmonization on hydrocarbons strategic reserve storage capacity, as the underground storage facilities management and the technical management of the transmission system would be unique.

However, we understand that it wouldn't be necessary or appropriate to harmonize the regulation of the entry points that represent the LNG terminals, as they can provide natural gas to transmission networks as they actually do and simultaneously as do international gas pipelines.

Finally, we consider very convenient the use by distributors and suppliers on both sides of the border of the same formats and communication protocols in everything related to changes in supplier billing and other processes in the retail supply market, and this will facilitate greatly the natural gas suppliers to do so in either Portugal or Spain, and therefore generate greater cross-border trade of natural gas.