



“Analysis of Cross Border Transmission Gas Tariffs between Portugal and Spain”

- Public Hearing -

- EDP Gás and Naturgas Energia Comercializadora Comments –

EDP Gás and Naturgás Energia, both shipper companies belonging to EDP Group, operating on a daily basis at the gas interconnections between Spain and Portugal, welcome this initiative from the regulators as we believe that this study, along with the consultation process involved, will represent a major contribution for the elimination of the existing obstacles to the development of an Iberian gas market - MIBGÁS.

Prior to our answer to the questions proposed in the consultation document, we would like to identify some key issues that we consider to be fundamental for a successful construction of the Iberian gas market. We would also like to take this opportunity to highlight some of the aspects that we consider that have not been so well addressed or pointed out in the study.

Case Studies

We consider that case studies could have been used for more ambitious purposes and conclusions and not just for the identification of the interconnection costs between Spain and Portugal, in both ways.

As an example, the reasons why the interconnection from Portugal to Spain is not so used as in the opposite direction, in spite of being cheaper, could have been addressed and analyzed. As could have been the fact that shippers still prefer to use the interconnection rather than the Sines LNG terminal as an entry point in the Portuguese system.

In fact, we believe that the main reason for these issues, apart from the fact that the Spanish market is larger and more mature and thus has a larger number of players with stable portfolios that can be extended to Portugal via the interconnection, is the fact that the Portuguese market has still some operational issues to improve, related both with the rules of access to the transmission system and the conditions of access and utilization of the LNG terminal at Sines.



Reviewing of those aspects is fundamental for the shippers acting in the Portuguese market to opt away from the interconnection, especially in Campo Maior/Badajoz as the main entry door in the Portuguese gas grid. Thus, one of the conclusions that could have been withdrawn from a wider scope case study analysis would be the need for access and operational improvement and harmonization along with tariff harmonization in both countries.

Furthermore, as we will detail ahead in this response, the real issue to be approached should not just be the difference between interconnection costs and if and how it should be eliminated, as the case studies seem to point out, but also the reasons why this difference exists and what can be done to reduce or eliminate it.

Also, and although this does not affect the comparison between the various scenarios, we do not agree with the “reference supplier” profile used for the calculation of regasification and entry costs and their respective transmission to the final customers, industrial client and CCGTs, for two main reasons: on one hand, the “reference supplier” profile corresponds to a very large shipper and does not apply to the average new entrant with activities in the Portuguese or Spanish market, especially in the former. On the other hand, the direct transmission of these costs to the customers is also very subjective since it disregards issues like the impact of each client profile in the portfolio of the supplier and could thus be misleading.

MIBGÁS Organization –the objective

In our opinion, the major goal to be achieved with the MIBGÁS development process is the completion of a fully functioning Iberian Gas Market, where, ideally, shippers are free to choose any of the entries in the Iberian system, paying the respective tariff, and take the gas in any of its exit/consumption points, also paying the corresponding tariff, operating in an integrated Iberian entry-exit system.

In fact, as mentioned in the study, the Gas Target Model recently approved proposes that the way to achieve a European internal gas market is through the construction and further integration of fully functioning regional markets.



Furthermore, and in terms of timing, as referred in the first recommendation included in the “Conclusion Paper” of CEER on its “Vision for a European Gas Target Model” published last December, the assessment by stakeholders - including NRA’s, TSO’s and other interested market agents - of the possible integration solutions as well as the “development of options to bring about functioning and integrated wholesale markets”, shall be concluded by the end of the year 2012.

Moreover, we also agree that in order for this to be achieved at the Iberian level, “cross border tariffs between Portugal and Spain shall not exist neither capacity booking at these IPS”, which will result in the development of a single “market area” with a single commercial balancing point.

Regulation harmonization, including regulatory concepts, tariffs and operational procedures, transparency and absence of cross-subsidization between activities and countries, sustainability of each country infra-structures are, in our opinion, the major stepping-stones of this process of Iberian integration.

Opportunities

Currently, the legal framework of both the Portuguese and the Spanish markets is changing, mainly due to the necessity of the transposition of the “third energy package” into our national laws.

In Portugal the first step was already taken last year with the modification of Decree-Law 30/2006, dated 15th February, by Decree-Law 77/2011, dated 20th June. Also, the “Memorandum of Understanding” signed between the Portuguese government and the European Union, the European Central Bank and the International Monetary Fund in 2011 defines some priorities related with the opening and promotion of a competitive and liquid gas market through a stronger interconnection with Spain. In Spain, on the other hand, the transposition process is still underway.

Either way, in both countries there is still a lot to be done in what concerns the adaptation of the regulation and legislation to the new European rules. We believe that this is an excellent opportunity to ensure that both countries are provided from now on with a legal and regulatory framework that promotes the development of a fully integrated Iberian gas market.



Moreover, we believe that, in order to avoid any type of distortion and to guarantee a successful market integration, NRA's and TSO's of both adjacent systems should establish a common implementation plan, minimizing differences between balancing regimens (during possible interim periods), defining common criteria regarding flexibility tools, products or services, tolerances, information provision, obligations, etc.

Answer to the “Questions for the Stakeholders”:

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?

The data presented in the document is generally correct.

In fact, the study undertaken by the regulators highlights the major differences between the existing regulation in both countries and concludes that harmonization is not only necessary but crucial.

Furthermore and as also mentioned in the study, the required regulation harmonization process should be performed following the major principles and guidelines already established, or currently being set, at an European level.

However, other equally important issues like the conditions of access to the Portuguese Gas System (inexistence of short term cost-reflective access tariffs, year-average peak capacity payments), the conditions of access to the Sines LNG terminal, in particular the analysis of the reasons why it is still not used by new entrants, or anti-hoarding measures at the interconnection (on both sides of the border) should also have been dealt with.

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?

First of all, we would like to stress once again that, in our opinion, the major goal to be achieved is the completion of a fully functioning Iberian Gas Market, MIBGAS, where, ideally, shippers are free to choose any of the entries in the Iberian system, paying the respective tariff, and take the gas in any of its exit/consumption points, also paying the



corresponding tariff, operating in an integrated Iberian entry-exit system. This organization would have no “economic interconnection points”.

Nevertheless, and as an intermediary step, an allocation of costs at cross border IP's could be made provided that this allocation is based on the following fundamental principles:

- Harmonization of regulation principles between both countries, guaranteeing coherence and transparency in the definition and identification of the capacities and costs to be allocated at cross border IP's in both countries;
- Absence of cross-subsidization between activities and especially between countries, assuring that each country is self-sufficient in the recovery of its regulated costs;
- Ideally, if possible, harmonization of the interconnection cost and access rules together with congestion management procedures at both sides of the border, which currently does not happen.

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?

We strongly believe that the “pancaking effect” existing at cross border IPs, and also between Spain and Portugal, is not just of an economic nature, related with tariffs applied at those IPs, but also, and with the same relevance, of an operational and administrative nature, related with nominations schedules, capacity reservation concepts, balancing rules or allocations.

Thus, and in order to promote short term market integration, we consider fundamental that the harmonization at operational, administrative and regulatory level is also ensured.

Rules being currently set at an European level for procedures like congestion management, capacity allocation and balancing, to mention the guidelines further developed at present, should be taken into account and applied, provided that the Iberian specificities are considered in the adaptation.



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

First of all, we consider that regulatory harmonization between both countries, guaranteeing, as previously mentioned, that the same best practices, like absence of cross-subsidization between activities, transparent cost allocation and definition of tariffs per activity, are applied, is fundamental and constitutes a steppingstone of the integration process.

Likewise, regulatory concepts and procedures, such as capacity reservation methods, capacity allocation, anti-hoarding mechanisms, congestion management and balancing rules, should also be harmonized, taking into account the calendar of development of the corresponding framework guidelines and network codes at an European level.

Once a clear regulatory framework is set, in what concerns both tariffs principles and operational procedures, we believe that the development of a fully integrated Iberian entry-exit system could be started. Of course, the involvement of the stakeholders should be guaranteed so that the development process can be assessed and approved by all parties involved.

Moreover, such good practices could contribute for a more balanced access to the systems from the several entry possibilities and thus reducing congestion possibilities at the interconnection points.

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

We consider that the development of an Iberian trading hub together with the definition of a single commercial balancing zone can strongly contribute to the creation of a favorable cross border trade environment, providing shippers with an additional trading tool.

This issue should be analyzed and discussed along all other subjects, especially because, on the one hand, a trading hub is already being foreseen in the balancing framework guidelines and network codes defined or being defined at European level, and, on the other hand, because it should be ensured that any solution to be



implemented covers the Iberian market and not just the Portuguese or the Spanish market.

In what concerns the development of a single balancing point in the Iberian peninsula, and as foreseen in the Framework Guideline on Balancing, we believe that in the short term "cross-border cooperation" measures should be applied in order to encourage and facilitate cross border flows between both systems, namely:

- Shipper-led cross-border portfolio balancing: allowing network users to net their imbalances between cross-border neighbouring balancing zones.
- Cross-border TSO balancing: allowing TSOs to act as intermediaries to facilitate access to flexible gas in neighbouring markets
- A joint balancing platform for TSOs in neighbouring balancing zones to buy and sell gas balancing gas, where sufficient interconnection exist.

Finally, together with the ongoing tasks (CAM, CMP and Pancaking), we believe that the following issues should also be analyzed and/or developed:

- TSOs should study the possibility to establish a Virtual interconnection point between both systems (Tuy/Valença and Badajoz/Campo Maior), as a mechanism to increase/maximize the interconnection capacity between Spain and Portugal.
- Coordinated tools to maximize the use of the physically available capacity and also to manage possible congestion should be developed, as already being foreseen at European level (framework guidelines, network codes, etc):
 - Oversubscription and capacity buyback
 - Interruptible capacity
 - Backhaul capacity
 - Secondary market: incentives for UIOSI mechanism
- An unique point of communication should be established between adjacent systems' TSOs. In this way, shippers could communicate with just one TSO for all issues related with its gas flows along different balance zones.
- Nominations and confirmation processes and schedules across both countries should be harmonized in order to facilitate cross-border trading by traders and shippers
- Data format and communication processes applied should also be harmonized.
- Operational constraints should be dealt in the same way on both sides of an IP, otherwise it becomes very difficult for a shipper to manage its flows at cross-



border points and furthermore it could create distortions in the wholesale market.

- Standard procedures to solve operational constraints should be identified and established.
- A common interconnection agreement should be established since these are the documents that rule nomination and matching processes on cross border points.