17/02/2012

Dear Sirs,

In the name of Galpenergia, we are pleased to send our coments about the "Analysis of Cross Border Tariffs between Portugal and Spain", in the framework of the Public Hearing which is taking place.

Before answering the specific questions that have been adressed we would like to thank the promoters of this Public Hearing for the oportunitty given to all the stakeholders to give their view on this important matter, in such a transparent manner.

Best regards

PEdro Ricardo
Galpenergia
Director de Aprovisionamento, Trading e Regulação

ANSWERS TO THE PUBLIC CONSULTATION QUESTIONS

Q1 Major Issues

The recent approval of the *Gas Target Model*, that foresees the implementation of the single European gas market by 2014, having the creation of regional market areas as the preferred arrangement, with virtual trading points and *hub-to-hub* competition, makes the present consultation a welcomed development, which Galp Energia (GE) appreciates and comments hereafter.

As a first major comment, contrary to some statements in the Document, we do not agree that *Pancaking* – in the sense that there are different Transport Exit Tariffs at the PT-ESP border - is the “major issue” on the suggested reduced liquidity observed in the Iberian Gas Market. Actually, we note that the document fails to recognize an obvious conclusion that using two transport networks must be more expensive than using only one, and also that similar situations are observed throughout Europe, being the transport tariffs at the Spain-France border the most immediate one:

In the above sense, GE wonders if it should be expected, notwithstanding the South Gas Regional Initiative, that gas unloaded at Sines Terminal and delivered to a customer in the Bordeaux area (that Is, using three transport networks), should bear the same transport tariff as if the gas was unloaded at Fos Terminal …
GE considers that other relevant questions are to be considered in the implementation of a truly functioning MIBGAS, the most obvious one is the need for a comprehensive Regulatory Harmonization between the two countries that would create a level playing field for integrating the national markets. Namely, without limitation, GE notes the differences between the Capacity Reservation and Congestion Management mechanisms, Tariff Structure (including their additive and cost-reflexive nature, as well as the existence of cross-subsidies), and Regulator independence. These points are hereinafter discussed, and without a common approach for them in both countries, the Iberian market would

always suffer from insufficient liquidity.

Finally, we note that in the analysis presented in the Public Consultation, a significant effort is made on the comparison of the situation of cross-borders tariff levels, without analyzing the “single country tariff”, particularly taking into account the different levels of investment and infrastructures utilization.

Q2 Establishing Transmission Network Costs

As referred above, GE considers that the first step to be implemented should be the necessary Regulatory Harmonization, especially in what refers the Capacity Reservation Mechanism and Congestion Management Procedures (incorporating the results of the ongoing approval processes in the European Union for both CAM and CMP), which directly affect the Tariff Structure. As for the latter, any tariff system must follow the principles of transparency and non-discrimination, and be established in a cost reflexive manner, preventing cross-subsidization between countries, infrastructures and/or consumers.
In this sense, GE recommend that the two national balancing zones are kept, being the allowed revenues recovery for each TSO made through the tariffs applied to the users of each infrastructure. With this principle, the national tariff structure would more adequately account for the intrinsic features of each country, also avoiding discretionary arrangements. Namely, GE notes the following:

a) In Portugal the tariffs are additive contrary to Spain, being the approval process in Portugal already made according to the Gas Directive, whereas in Spain the tariffs are still approved by the Government;

b) The Spanish infrastructures have a comparatively lower load factor as compared to the Portuguese ones (especially the LNG Terminals), which create a upward trend in the tariff levels;

c) In both countries the tariffs include past revenues of different nature under recovery, which are not linked to transportation costs;

d) No cross-subsidies between countries should apply in order that:

i. The tariffs should reflect the costs of each gas system, in order to guarantee their respective economic independence;

ii. Eventual unnecessary investments are born by the consumers of that country and not by the neighbors;

iii. The tariffs are established by infrastructure, without cross-subsidization between transport, LNG and/or Storage, and the Allowed Revenues calculation should prevent any deficit development that would impact costs in future years, damaging transparency;

iv. The Shippers should be given adequate price signals for the most adequate utilization of the infrastructures, preventing hoarding and/or congestion.

For clarity, GE considers that the need for transparency and objectivity in the tariff calculation became the more obvious, with the most recent tariff publications(ERSE for Gas Year 2011-12 and CNE for FY2012). In fact, for both systems, a “reduced exporting tariff” was approved (30% discount ESP->PT; 50% discount PT->ESP). However, these “discounts” were fixed at the Regulators’ discretion, without an adequate economic justification, and in this sense they should always be considered “provisional and subject to change”. Therefore, GE strongly recommends that any future regulatory arrangement must allow for tariff calculation principles that are stable, transparent, non-discriminatory and foreseeable.

GE admits that different methodologies could be considered for minimizing the noted tariff differential at cross-border, namely by “transferring” costs to the Entry Tariffs. However, we note again that such “migration” should not lead to a situation where the adequate signs of infrastructure utilization are not given, such as minimizing the transportation route, or avoiding the most congestioned entry points.

In this point “a word of caution” is needed on an eventual essay to replicate in the gas market the procedure established in MIBEL that eliminated the cross-border tariff. GE notes the fundamental difference between the two markets, in the sense that whereas in the electrical market there is a two-way physical transit at the border (depending on the power production), in the gas market Portugal would always be a net importer from Spain, due to the imports through the Maghreb pipeline. This structural imbalance, if not properly taken into account, could create a burden to the Portuguese consumers that we deem inadequate.

The before said should also lead to the conclusion that “zeroing” the cross-border tariffs would most likely be a deceptive if not erroneous option. Taking into consideration the different cost structure of the national systems, the amounts now recovered at the “Border Entry Tariffs” would have to be computed either in the “Country Entry Tariff” and/or in the “Country Exit Tariffs”. However, in both cases, as compared to the existing situation, the consumers of that country would be penalized with higher tariffs. If, to avoid such development, a “cost socialization” between the systems is agreed, then this would be the exact opposite to what GE considers the desirable scenario, without transparent cost-reflexive tariffs, and implying TSOs compensations. Naturally, incorporating those “transferred costs” into the “Exporting Entry Tariff” would only represent a name change… GE would therefore recommend that in order to smooth the observed border price differential a careful analysis is made on the reasonable allowed revenues recovery that could be transferred to the “Country Entry Tariff” and/or to the “Country Exit Tariffs”. This “transference” should be established in both countries under the same objective and transparent principles in order that a correct cost allocation is achieved.

Q3 Most important aspects of Harmonization

In order to create a level-playing field in the Iberian market it is essential that decisive steps in regulatory harmonization are taken. Without limitation, we note:

a) Capacity Reservation arrangements (PT applies the 12-month daily maximum; in ESP the classical yearly capacity reservation) and Balancing Incentives; for clarification GE considers the Spanish model the most adequate, in line with the common European practice;

b) A similar tariff structure and calculation methodology, based on additive cost reflexive tariffs, without cross-subsidization between activities, market segments and/or countries;

c) Fully transposition of the 3rd Gas Directive in both countries, creating an identical legal framework for both the tariff approval process and Regulators' powers;

d) Adoption of common CAM and CMP Procedures, derived from the ACER approved Guidelines. This comment naturally also applies for other legislation still in a more immature approval process, such as the announced Tariffication Guidelines;

e) Similar procedures for approval of new investments, particularly those linked to the capacity at cross-border interconnection points. In this point, GE expressly defends the need for a previous process of Open Season, that would identify the actual market interest in those investments, preventing costly developments of infraused facilities;

f) Unique Shipper licensing procedures recognized in both countries, allowing for a single nomination procedure at both sides of border.

Adding to the above, GE considers that this harmonization process has to be done anticipating the development of the common European market, and not be limited to the Iberian area integration. Considering the on-going developments at the SGRI, we would suggest that in order to give an added consistency to this Regional Initiative, harmonization measures are properly synchronized in the different countries of this Region. In this sense, regulatory decisions, especially those that affect the medium and long term implementation of the "European Model", should be synchronized and approved between Portugal, Spain and France.

Q4 Step-wise approach

GE favors a methodology that takes a "step at a time", in order that no decisive options are taken with insufficient evidences gathered. Also, we consider that the on-going legislation preparation in the European Union resulting from the 3rd Gas Directive implementation has to be taken into account, to avoid future incompatibilities (namely the Framework Guidelines on Balancing and Tariffication, under preparation).

Q5 New Issues

- GE is aware of the ongoing analysis for the establishment of an "Iberian hub" in Spain. We consider that in order that such developments are interesting to MIBGAS, from its inception such hub must have a truly "Iberian" nature, and not only reflect options from the Spanish market.

- Notwithstanding the note on the electrical market on Q2 above, GE considers that the close relationship between the gas and electrical markets in the Iberian Peninsula should be taken into account. However this can not lead to the conclusion that it is necessary to apply the same principles to both electrical and gas sector.