THE PORTUGUESE NATURAL GAS MARKETPLACE

A regulatory and market overview| November 2020

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1. Overview

In 1993, Portugal had no backbone high pressure natural gas pipeline, storage and other infrastructures. From 1993 onwards, such infrastructures were built, and natural gas became one of the most important sources of energy used in Portugal.

According to 2020's most recent data, the natural gas market has been witnessing an increase in consumption of 7.2% since last year.

Until 2006 the promotion of natural gas and the development of the system's main infrastructures were handled by the Galp group companies, Transgás – Sociedade Portuguesa de Gás Natural, S.A. ("Transgás") and GDP – Gás de Portugal, SGPS, S.A. ("GDP"), under concession agreements entered into with the Portuguese State.

The public service concession for the import, transmission and supply of natural gas through the high-pressure pipeline, was granted to Transgás, and the public service concession for the distribution of natural gas through regional pipeline networks, was granted to six different companies, held by the GDP group.

Most importantly, Decree-Law no. 30/2006 of 15 February 2006 ("Gas System Law") transposed Directive 2003/55/EC, implementing in Portugal the common rules for the EU internal market.

The Gas System Law established (i) a National Natural Gas Distribution Network (RNDGN), licensed or licensed to several operators, to guarantee non-discriminatory and transparent access to the network infrastructures of Liquid Natural Gas (LNG) and RNDGN terminals, (ii) the legal unbundling between the network and infrastructure operators of the National Natural Gas System (SNGN) and the marketers, and (iii) the natural gas supplier and the last resort supplier.

The Gas System Law principles were specified by Decree-Law 140/2006, of 26 July 2006 ("Gas Regulatory Law"), with new rules regarding transmission, LNG facilities' storage, and distribution and supply services.

As a result of these changes, the natural gas sector was unbundled, and is currently divided into several activities, each one with different operators. Thus, the sector is structured in (i) reception, (ii) storage and regasification, (iii) underground storage, (iv) transmission, (v) distribution, and (vi) supply.

With this briefing, we intend to present an overview on the functioning and organization of the different activities of the Portuguese Natural Gas Sector, as well as on the main players that operate on the market.

2. Gas reception, storage and regasification

There are no natural gas deposits in Portugal, so there is no gas output in our country. The Portuguese market natural gas supply is carried into the national gas system via the interconnection with Spain and the Port of Sines' Container Terminal (responsible for 80% of the Natural Gas consumed in Portugal).

At the Sines terminal, the gas is received in liquid form. After unloading the methane carriers, the LNG is sent to intermediate storage tanks where it waits until the gas owner issues a regasification order. At the end of this process the natural gas (already in gaseous form) is compressed and injected into the high-pressure network at the terminal delivery point.

Following the Sector's liberalization policy in 2006, the Government established the unbundling between the operation of facilities and supply activities and compelled Galp to sell the high-pressure pipeline, the underground storage facilities and the LNG terminal to REN – Rede Eléctrica Nacional, S.A ("REN"), currently a private company.

REN then incorporated new companies for the operation of major gas facilities (high-pressure pipeline, underground storage facilities and LNG terminal, respectively). REN SGPS, S.A. was also incorporated as the holding company of the group.

The National Gas System is currently based on public service concession contracts entered into with the Portuguese State, as a general rule, after a public tender or restricted procedure, in accordance with the Gas System Law.

The concession is granted for a period of forty years, and cannot be transferred, sold or otherwise charged by the concessionaire, without the Government's permission.

The concession of the activity in the LNG terminal of Sines was awarded to REN Atlântico, Terminal de GNL, SA, to carry out the following activities:

- Reception, storage, treatment and regasification of liquefied natural gas discharged from methane ships in the Port of Sines;
- The injection of high-pressure natural gas into the National Natural Gas Transmission Network, or its dispatch through trucks designed for this purpose; and
- The construction, use, maintenance and expansion of LNG terminal infrastructures (buildings, tanks, pipelines, etc.).

3. Transmission network and underground storage

Transmission network

Natural gas is received at the Portuguese border with Spain (Campo Maior e Valença), or at the LNG Terminal and then transmissioned through the high-pressure gas pipelines of the National Natural Gas transmission Network, which are connected through pressure and metering stations to the medium pressure gas pipelines operated by the distribution companies.

Prior to 2006, Transgás was the entity responsible for the transmissionation and storage of natural gas. With the sector unbundling, these activities began to be performed by REN in exchange for the 18.3% stake held by it in Galp.

The concession to use the National Natural Gas transmission Network (RNTGN) was assigned by the Portuguese State to REN - Gasodutos, S.A., with the purpose of:

- Management of the National Natural Gas System (SNGN);
- Operation of the gas transmission network under high pressure; and
- Development of the necessary infrastructures, under the regime of public service provision.

Underground storage

The operation of the underground storage facilities is located at Carriço, Pombal, and was awarded under public service concessions to REN Armazenagem, S.A. and Transgás Armazenagem, S.A., a subsidiary of Transgás.

However, in 2014 REN bought from Galp the rights to use and manage the concession for the underground storage of natural gas at Carriço for €72 million euros. Today REN owns all existing infrastructures of this kind in Portugal.

In underground storage facilities (Pombal), high-pressure natural gas is stored in gaseous form in wells created inside a salt mass, at depths greater than 1.000 meters. The construction of new cavities is expected and, with it, the storage capacity expansion.

The underground storage activity comprises the following activities:

- Direction, injection, underground storage, extraction, treatment and delivery of natural gas in order to create or maintain natural gas safety reserves or for delivery to the RNTGN; and
- Construction, use, maintenance and expansion of underground storage chambers.

4. Natural gas distribution network

The distribution activity is carried out by the exploitation of the infrastructures that, as a whole, make up the National Network of Natural Gas Distribution.

Gas distribution is carried out under public service concessions and under public service licenses granted by the Government. The entities responsible for the distribution must be legally unbundled, and cannot carry out other activities within the sector.

Natural gas from high-pressure pipelines is transferred to medium pressure branches through regulation and metering stations, that are granted to distribution companies under concession contracts entered with the Portuguese State, which grants the final consumer's natural gas supply.

The natural gas distribution activity is carried out in one of two ways:

- Concessions of regional distribution networks executed exclusively and under public service; and
- Distribution licenses in autonomous local networks, not linked to the interconnected system of pipelines and networks, also exercised exclusively and on a public service basis.

The public service concessions for regional distribution of gas have been granted to eleven concessionaires, each one with its exclusive distribution area.

These companies are: Beiragás, Dianagás, Duriensegás, Lisboagás, Lusitaniagás, Medigás, Paxgás, RENPortgás, Setgás, Sonorgás, and Tagusgás.

Recently, Galp sold Allianz Capital Partners, for €368 million, 75,01% of the capital of Galp Gás Natural Distribuição, which holds nine of the above concessionaires for regional and local distribution of gas in 106 Portuguese counties.

In regions where the local distribution is not connected with the high-pressure pipeline, the natural gas supply to the grid is truck transmissioned from the LNG terminal to autonomous regasifying units. The supply of natural gas to these regions is made equally through concessions of local distribution, in this case.

There are currently five licensed companies operating in local distribution. Those companies are: Dianagás, Duriensegás, Medigás, Paxgás, and Sonorgás.

5. Natural gas supply

The natural gas supply activity is fully liberalized and subject to a competitive market, only requiring a license granting by the Portuguese State, in accordance with the Gas System Law.

Licensed suppliers, in the exercise of their activity, can freely buy and sell natural gas. To this end, and upon payment of a regulated tariff, they have the right to access (i) storage facilities and LNG terminals, and (ii) transmission and distribution networks.

The commercial relationship with the clients derives from the conclusion of a contract for the purchase and sale of natural gas, that has its content subject to the provisions of the Commercial Relations Regulation of the natural gas sector and to the provisions of article 39 of the Gas Regulatory Law.

Consumers have the right to freely choose their natural gas supplier, without any charge, in the event of a contractual change. For this to be possible, the Logistics Trader Change Operator (OLMC) was created, and is currently exercised by the Energy Agency (ADENE), an independent entity focused on ensuring that the change of the natural gas marketer demanded by the consumer is executed quickly and is free of charge, with simple, transparent, standardized and dematerialized rules and procedures carried out through a digital platform, by a simple process called "switching“.

There are currently thirty-one entities operating in natural gas supply in Portugal.

According to the latest data published by ERSE, concerning 2019, EDP continues to be the main market operator regarding the number of customers with a 53% market share, while Galp and Goldenergy came second and third with a market share of 24% and 11%, respectively. Nevertheless, Galp came first, presenting the largest share of gas consumption (60%), while both EDP and Endesa rank third with 11%, just behind Fenosa, in second place, with a 13% consumption share.

There is also the last resort marketer figure, who ensures the natural gas supply to vulnerable customers, or in areas or market segments where there are no offers for supply on the free market.

The last resort marketer license is currently attributed to the current holders of twelve distribution licenses. Under Portaria no. 83/2020 of 1 April 2020, consumers who are still being supplied by a last resort supplier have a transitional period until December 31, 2025, to secure the supply of natural gas by a market supplier.

6. The Energy Regulator

The Regulatory Entity for Energy Services (ERSE) is the entity responsible for regulating the natural gas and electricity sectors at national level.

ERSE is a legal person governed by public law, with administrative and financial autonomy and its own assets, governed by its articles of association approved by Decree-Law no. 97/2002, of 12 April 2002.

It has the duty to ensure that operators in the natural gas and electricity sectors comply with public service obligations and other obligations laid down in laws and regulations, as well as in the concession contracts.

It is an independent entity in the exercise of its functions, without prejudice to the guiding principles of energy policy established by the Government in legal terms, and of acts subject to ministerial approval.

In the course of its activity, it has to protect adequately the interests of consumers, particularly economically vulnerable consumers, regarding prices, service quality, access to information and security of supply.

ERSE also aims to promote competition between market players, particularly in the internal energy market, by ensuring that the companies in the sector perform public service functions, and maintain, at the same time, the economic and financial balance of an adequate and efficient management.

Finally, it contributes to the progressive improvement of economic and environmental conditions, and arbitrates and resolves litigation by encouraging the extra-judicial resolution of disputes.

Regarding the natural gas sector, ERSE has the following attributions:

- To ensure the existence of conditions to meet the demand for natural gas efficiently; and

- To guarantee concessionaires and licensed entities the existence of conditions that allow them, within an adequate and efficient management, to obtain the economic and financial balance necessary to fulfill the obligations set forth in the concession agreement and in the respective licenses.

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