



Autorità per l'energia elettrica il gas  
e il sistema idrico



# ANNUAL REPORT ON THE STATE OF SERVICES AND ON REGULATORY ACTIVITIES

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*Presentation by the President  
Guido Bortoni*

*Rome, 24 June 2015*



The Regulatory Authority for  
Electricity Gas and Water



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Gas and Water

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Guido Bortoni, President

Alberto Biancardi, Commissioner

Luigi Carbone, Commissioner

Rocco Colicchio, Commissioner

Valeria Termini, Commissioner

“...QUO EIUS CAPAX EST, EIUSQUE ESSE PARTICEPS  
POTEST”

[Aurelius Augustinus, *De Trinitate* XIV, 8, 11]

“... IN THAT IT IS CAPABLE OF HIM, AND MAY BE PARTAKER OF HIM”

[Saint Augustine of Hippo, *On the  
Trinity* 14, 8, 11]

Authorities, Ladies and Gentlemen,

On behalf of the Authority's Board and Organisation, I would like to welcome and thank all of those present and everybody interested in our *Annual Report* on the state of services and regulatory activities.

We would like to begin this 2015 *Annual Report*, recalling from last year, the **European energy/environment debate**. Hence, *heri dicebamus*, or as we were saying: we were both critical and perplexed, as Europe's institutions seemed to have let the meaning and momentum of energy policies slide, having lavished reams of words and texts on them, instead of developing effective action. At the time we were asking for a “new Europe for energy”, when Italy was inaugurating its six-month Presidency of the Council of the European Union, on the eve of the elections which would have given rise to a new Parliament and a new Commission. We were proposing a genuine commitment to Europe's energy and environmental future by building **solid, cohesive** relations between national policies by channelling them within a single market, as well as European energy management policies that were no longer governed by bureaucratic and technocratic considerations but rather by concrete, effective policy choices. At the beginning of the year, the new Commission commenced its term by publishing its Communications on the Energy Union Package in order to put their renewed vision before Europe's citizens. The strategic framework outlined therein, which mainly sets out the same aspects recommended by this Authority in 2014, aims to create a **resilient Europe**, which guarantees secure, competitive, sustainable, affordable energy. It refers several times to the concept of solidarity and trust between countries. With the framework in place, our hope is that the Commission keeps abreast with pragmatism and determination in the direction it has decided to pursue.

In the European context, Italy, despite needing to update its national strategic framework, unlike what already done by the Germans with their *Energiewende*, the United Kingdom with its *Energy Transition* and Paris with its own *Transition Énergétique*, is recognised as having

implemented or launched – certainly at regulatory level – **several far-reaching reforms** in support of the energy and environment developments currently underway. Whereas the strategic frameworks of the aforementioned countries promise epoch-making transitions from the current situation to clearly identified future settings, **Italy's transition**, more pragmatically, reforms and transforms the context, well knowing that we are in a transition which surely overcomes the present setting, but whose processes and outcomes are largely still flexible. This flexibility is also shaped by regulatory instruments. The Italian transition, in addition, does not limit itself to dealing with the **new mix of energy sources towards decarbonisation**, but in a noteworthy contrast exercises also choices with regard to various energy carriers, as I shall mention in my conclusions.

The end of our current term of office is a thousand days away: a period that may still be fruitfully employed given the **forward-planning capability** that has always been our strength. Therefore, this *Annual Report*, like the last, focuses on policy issues in the sectors of energy (electricity, gas and district heating) and the environment (water), illustrating only the most significant prospective activities given the current context.

As the third year of water regulation by this Authority comes to an end, so the series of conferences on national water regulation held in Milan for three years will end, as the **water service takes its place among the Authority's mature activities of regulation** and makes room for **district heating in its new regulations "incubator"**. Regulation of district heating was partly assigned to us during last year, and so we wish to announce here that a similar event will be held, once again in Milan, next winter.

As well as being the location of our organisation's permanent headquarters, Milan, with its Metropolitan City, is hosting a series of events in the energy field in 2015. Most of these events are taking place during the 2015 Milan Universal Exposition, which, with its central theme "Feeding the Planet, Energy for Life", echoes our two regulatory themes of **energy and environment** on which this *Annual Report* itself is extraordinarily closely based, giving them global visibility and offering a shared commitment to dealing with the many critical issues still present. Our thanks go to Expo 2015 for granting its free patronage for the 2015 *Annual Report*, testimony to the synergy between the international bodies present at Expo and the interlinked issues of energy and the environment dealt with by this Authority.

An important event, which we would like to mark with an international conference in Milan, is the twentieth anniversary of the legislative institution of **independent regulation**

**for utilities** in our country (Law no. 481 of 14 November 1995 – known in Europe as *The Italian Regulatory Act* – which acted as a precursor for similar legislation in the European Union).

Turning to the Authority's activities, we should mention here a newly coined term that has been used around Italian energy regulation since 2011: “**empowerment**”, a principle that has shaped the Authority's action since the beginning of this term. This principle, which we hold dear, does not apply only to pro-consumer regulation but also to very many segments of the energy and water supply chains.

I shall transform *capax est* into an epigraph, reducing it – not without trepidation – from an absolute reference to our small fractal field. It is the consequence of being “**empowered**” in turn that makes market players “**participants**” in the market – whether consumers or producers – and makes them responsible for seeking answers to their own needs. Except for the original case referred to by Saint Augustine, we are however not capable by nature; thus in the energy market and water sector the capacity to act responsibly, orienting one's own behaviour in the market, has to be dynamically constructed for everyone. Hence the need to raise the level of capability of each individual person through initiatives of “empowerment”. And regulation is the enabling instrument, as there is no need to make everybody conform to standard forms of behaviour, but rather to help everybody to acquire, to contain within themselves – the original etymology of *capax* – the background that is necessary and sufficient for them to be free agents in the market, in accordance with their own personal paradigms.

The work entrusted to the empowering regulation for different market players is a huge, challenging task: huge with regard to consumers – particularly small consumers – and sophisticated and specialised with regard to operators.

Indeed, empowerment also regards the Regulatory Authority, which is not capable by investiture of performing its role, but rather “feels” responsible for making choices in the general interest of the market and for the common good, particularly in those areas in which the market struggles to achieve general objectives such as social protection and infrastructure.

Regulation based on empowerment is called for by several parties. Take, for example, a sector such as public procurement. Recent assessments, including the one expressed by the President of the Italian National Anti-Corruption Authority, point out that it is unsatisfactory to have recourse to repressive or pecuniary measures alone, which are essential but by their very nature destructive,

in order to clear the conduct in this sector. The other extreme, *ex ante* hyper-regulation of all possible cases and behaviour – virtuous or otherwise – of the individuals and parties involved is an equally vain exercise. The best “medicine” consists in adding a dose of so-called “cooperative monitoring” which, for the public procurement sector, closely resembles our own regulation based on empowerment.

Empowerment assumes even greater value, given Italy’s current macroeconomic context, after six years of severe economic recession, perhaps mitigated by a number of finally positive indicators regarding industrial output and exports. Energy consumption in 2014 did not show any reversing trends. Electricity demand has not yet recovered after the falls recorded over the last few years: -3% in 2014, after -3.9% in 2013 and -3% in 2012, with consumption declining in all sectors. Gross domestic consumption of gas fell by another 8 billion cubic metres to 62 billion during the year going back to 1997 levels.

## **ENERGY: electricity, gas and district heating**

Considering the energy, electricity and gas sector, this year we begin with the retail markets. We insist on beginning with final consumers, not just because the Regulator is their champion, but also because of their crucial role in the energy evolution underway. During the first part of this term, in accordance with the 2012-2014 Strategic Plan that has just come to an end, the Authority chose to monitor the **price protection mechanisms** in free market context in order to measure the capacity of the average final customer. With the adoption of the 2015-2018 Strategic Framework it was deemed important to review price protection mechanisms for domestic customers and small businesses to speed up the empowerment process among these customers and enable the maturation of a mass retail market over a three-year horizon.

After eight years of well-functioning, the current protection mechanisms of the retail market anchoring prices to in the evolution of wholesale markets, continue to represent an important point of reference and to act at the same time as a parachute (universal service principle) also for customers who choose the free market. The current protection mechanism, which has passed several tests of compliance with the principles of European liberalisation, may be gradually phased out. The present mechanism should evolve towards a major reform stage (2.0 protection), which in any case will have to be applied starting from the most empowered protected customers: firstly from 2016 non-domestic electricity users followed, in a second phase by the domestic segment. The non-domestic market segment – especially

low-voltage, high-consumption customers – according to monitoring activity conducted by the Authority, show similarities with the medium-voltage customers, who have been acting in a competitive setting for several years. The Authority's proposals for the reform, which we shall soon submit for consultation, call for price protection mechanisms to be gradually reduced instead of being fully cancelled on a set date, to avoid any rushed processes which could have the undesirable effect of shifting wealth from consumers to service providers.

With regard to current price protection mechanisms, which are characterized by a certain rigidity and a structural alternation with the free market, we envisage a new "protection 2.0" structure, which will be "liquid" in several respects. Liquid in that it will have features very similar to those of the free market, without entering into direct competition with it. Liquid in that it will encourage protected customers according to the current universal system to abandon it while at the same time respecting those consumers who are not yet ready to choose for the free market. Liquid in that it provides for a large number of operators who could compete also in offering the "2.0 protection", albeit temporarily as it is destined to be faded away into the free market. Liquid, finally, as regards the permanent links with market parameters without however needing the Authority's quarterly updates, although a strict monitoring of "2.0 contracts" by the Authority will remain in place.

In parallel to the price protection reform process, the Authority is monitoring the current legislative process regarding the competition draft law ("Disegno di legge concorrenza") concerning the possible full phase out of price controls in the future, allowing also in the 3.0 phase small consumers to still count on ordinary *non-price* protection mechanisms guaranteed by the Regulator, as it is already today in the free market.

With a view to the full establishment of a mass market in the energy sectors in the future, regulatory action continues to ensure the **neutral role of the distribution system operator(DSO)** in energy retail market processes. For several years now, regulation has ensured that the only contact with the final customer in the energy retail market is with the retailer, who is authorised in the name and on behalf of the final customer to manage contractual relations with other operators in the energy supply chain, "disintermediating" the DSO, who is almost always part of an integrated group with its own retailer.

There are at least four sensitive areas with regard to full neutrality of DSOs in the retail market; for each one, the Authority is implementing ever more effective regulatory measures or legislative provisions.



The first area regards the so-called **debranding**, that is, the separation of communication and branding policies between the distribution and sales channels in vertically integrated undertakings. Under a European impulse, already acknowledged by Legislative Decree no. 93 of 1 June 2011 – which the European Commission urged again to implement – a further step is also being taken in Italy, by means of regulation, to remove any risk of brand confusion in the mind of the final customer with regard to the operators of last-mile delivery; the aim is to limit the competitive advantage the established or local supplier structurally has by from having a DSO. The Authority's recent provision, taken following a new, consultation process opposed by vertically integrated operators, will make it possible to remove any risks for final customers of confusing among the different companies of an integrated group by introducing the obligation to separate the branding and communication policies (including the company name) of the energy DSO from the retail suppliers and among the latter, in line with the European law and with the specific functions assigned to the Authority by the legislative decree implementing it. The obligation will not impact on the reputation of the established supplier with the final customer, as its intrinsic value will in all likelihood be retained by the retailer on the free market of the integrated group.

The second consists in providing for the gradual yet permanent exclusion of distribution companies from commercial and administrative processes, in particular those involving switching and transfers of contracts. This will soon be possible with the full launch of the **Integrated Information System (*Sistema informativo integrato*)** dealing with mass switching of electricity customers, which will guarantee impartiality in the implementation of such processes. The Integrated Information System, in its forthcoming stages of development, will host the measurement and the validation of customers' consumption data for both the electricity and gas sectors so that actual consumption figures can be used to a greater extent in the billing process.

The third line of action has to do with the supplier-DSO **relationship** in the retail electricity market. Since 2013, regulation has been investing intensively in developing a standard distribution contract, which will need to set out in detail the reciprocal rights and obligations of the supplier and the DSO. The first rules referring to contractual guarantees and provisions relating to billing for distribution and transport services, have recently been approved. This contract will allow DSOs' contacts with the retail market to be fully regulated, thus preventing any discrimination between operators or practices that

distort or harm competition in the market, including functions involving the collection of financial charges, including general system charges in particular. Greater accountability of DSOs towards contractual performance will also make it possible to introduce automatic compensations for failure to fulfil contractual obligations on the part of the DSO, to protect final customers through their energy supplier. In addition, it would be equally advisable to provide for specific authorisations for retail activities to be suitably issued in line with best practices in other European countries, to prevent any breaches of contract or inappropriate behaviour on suppliers' part, thus increasing final customers' trust in the market.

The fourth line of action, the so-called final customers' **Energy Footprint**, is geared towards their empowerment, just as the first three are focused on empowerment of operators in the energy supply chain and responding to the need to effectively separate DSOs from market processes.

With the Energy Footprint, in line with Legislative Decree no. 102 of 4 July 2014 implementing the European Energy Efficiency Directive, we have sought to increase awareness, simply and effectively, among the large family of final electricity customers, of their offtake, consumption and self-consumption characteristics: in other words, their "final overall" behaviour at home or in the workplace. This project which can no longer be postponed intends to give greater awareness to over 30 million customers so that they can freely develop their individual understanding of their way of producing/consuming energy, including simple energy audits combined with practical suggestions.

The Authority is working in order to provide shortly low-voltage final customers with both information about their historical consumption according to billing data and the maximum capacity actually used by each customer, enabling them to make an informed choice with regard to the type of contract.

With regard to data management of consumption profiles according to time band, the Authority aims to ensure a neutral approach to innovative technological solutions for measuring such information from meters. This initiative encourages a wide range of devices, with a market-based approach which is consistent with the entry into the market of new providers of technological services: in the "post-metering" sector, telecommunications operators, software applications developers, domestic appliance retailers, suppliers of furnishing or home automation systems and energy service companies can provide customers with appliances and offer them integrated solutions.

In coherence with this approach, forthcoming investments to replace existing electricity meters will also need to be adopted with a selective approach and on the basis of careful cost-benefit analysis. In this regard, they will fulfil several functions, from making data available to promoting customer awareness and contrasting arrears.

In the now not-so-distant future, trials promoted by the Authority show that it will be possible to design and develop devices that can dialogue directly not only with electricity but also gas and water meters.

One of the new potential areas of development in the electricity sector is active **demand response**, which can provide the flexibility services demanded by a system characterised by extensive production from renewables with high intermittence in generation. Starting from the results of the smart distribution grid pilot projects, the Authority is oriented towards developing smart distribution systems, in other words infrastructure which allows dispersed resources (for example distributed generation) to play a genuine part in dispatching services, thus achieving the integration of renewable energy sources.

The Energy Footprint project in this sense is the first step in an innovative process which aims to incorporate new functions such as those offered by dynamic pricing to encourage the emergence of new market actors capable of aggregating customers, including small customers, and encouraging their active participation in the market. This is why the Authority evaluates the possibility of introducing for all customers the option of requesting hourly metering.

Empowerment of the final customer is also achieved by providing appropriate price signals for their energy choices. To this end, the Authority is currently committed to implementing **reforms of network tariffs and of tariff components covering general system charges** for domestic electricity customers. It is an epoch-making reform, the purpose of which is to make the electricity system more efficient by providing incentives for consumers to behave virtuously and making the tariff system fairer.

Last year, the Italian legislator took a particularly important step with regard to domestic electricity tariffs. The Italian legislation implementing the European Energy Efficiency Directive, set the goal of moving beyond the progressive domestic network tariffs introduced after the oil price shock of

1973 with the aim – a worthy one at the time – of discouraging high consumption levels among residential domestic users and reducing spending for low-consumption households, who were imagined to be the neediest. We were in a completely different world. More recently the so-called “social bonus”, a means of identifying households in difficulty (for financial or health reasons), was introduced. Furthermore, and above all today, new uses are available for electricity which were inconceivable just a few years ago – for instance, heat pumps which use renewable heat energy sources efficiently for heating and air conditioning, or electric vehicles on a large scale – and which are strongly discouraged by the current progressive tariff, especially with a 3 kW electricity connection capacity limit. These new uses, on the other hand, make a significant contribution to environmental sustainability and reducing overall primary energy use.

Following the reform, for the first time ever, the final customer may make use of the connection capacity parameter to optimise their own electricity supply.

What is more, the improve of efficiency in electricity consumption attributed over time to the progressive structure of domestic tariffs has never been borne out by empirical evidence. On the contrary, the reverse may be true. Faced with a complex tariff structure such as a progressive one based on consumption bands, the domestic consumer normally does not adopt consumption and investment decisions based on the price of the final band (the most expensive) but rather on the average billed cost. This leads to a weakening of the presumed economic signal which should derive from a marginal price that increases with consumption. The final result is that under the current system, which we have been seeking to overcome since 2000, large households and households that choose an efficient, sustainable energy carrier are charged more for electricity! And that is not all. The progressive tariff slows the implementation and dissemination of innovations in electrical technologies and delays scenarios of smart energy, smart cities and widespread home automation. Lastly, it does not encourage the expansion of diffuse energy solutions, which use geographically decentralised renewables and which have always been easier to integrate with electricity than with other energy carriers.

The legislative degree consolidates the principle already contained in Law no. 481 of 1995 that the components of the new non-progressive tariff structure must be cost-related. Such an approach may not be transferred to tariff components covering general system charges, as these cannot be related to an underlying cost structure. Nevertheless, the choice of criteria for attributing charges to customers in accordance with their electricity system usage parameters has

major implications not just for income distribution but also for the efficiency of the national energy system. In this regard, it is debatable whether the artificial increase in prices – including general system charges – for high-consumption households would lead to the development of environmentally sustainable consumption patterns. For example, efficient systems for domestic and other non-industrial customers need explicit support instruments which are transparent and commensurate with their incremental costs and the benefits that they may bring in the transition towards the energy system of the future. The reformed tariff structure must not be used as an implicit incentive.

In a context of radical and wide-ranging – albeit gradual – reforms underway in the retail energy market, the instrument of the **electricity and gas bonus** is taking on an increasingly key role as a social safety net for customers suffering economic hardship or users of electro medical equipment. On the one hand, a process to reduce price protections is underway: when completed, it may see all consumers, including economically disadvantaged consumers in possession of the bonus, obliged to choose among the various offers on the free market. On the other, the concurrent launch of domestic network tariff reforms, with the elimination of progressive bands and cross-subsidisation of low-consumption customers, may have the effect of increasing energy expenditure for some bonus holders, particularly for single-member households, while it will reduce spending for large households or residents in areas of the country that are not served by the gas network.

For these reasons, together with the persistent effects of the deep economic crisis on the phenomenon of energy poverty, the Authority, along the lines of the proposals already made last year with regard to reinforcing the bonus, is putting forward additional actions to amend the rules regarding granting of the bonus, through a variety of measures communicated to the Government and Parliament. In this regard, additional measures to protect bonus holders are to be introduced, such as tools to help them choose the offer with the lowest yearly cost or the opportunity to pay outstanding electricity and gas bills in instalments at favourable conditions compared to those currently applicable.

In addition, as part of the network tariff reform, alternative proposals for increasing bonuses have been put forward, with the aim – as provided for at primary regulation level – of offsetting the effects in terms of increased spending for customers benefiting from the bonus mechanism.

Consumer protection is not limited to economic terms and conditions of supply. In this prestigious venue, I must point out the measures that are implemented thanks to

the active cooperation between this regulatory authority and the competition authority.

In this regard, the combined action of this authority and the Antitrust Authority (AGCM) with regard to consumer protection received an additional boost in accordance with the new Consumer Code in the sectors we regulate, in particular in the fight against **unfair commercial practices**. The formula adopted for collaboration is based on a memorandum of understanding which is already at its second issue and is shaped accordingly by the joint action of the two authorities.

The typical structure of a regulated sector, where regulation is also effective in the retail market to protect the consumer/user, as has been the case for years for the energy sector and more recently for the integrated water sector, foresees the definition of a set of rules to safeguard and preventively protect consumers by filling at least partly, the information gap as well as the gap in contractual power between consumers and operators. Clearly the mesh of this regulatory net is not so fine – nor should it be – in order to leave sufficient flexibility to the market. Nor it is unchanging, as it is impossible to prevent all possible unfair commercial practices on an *ex ante* basis.

The strength of *ex ante* and *erga omnes* regulation assisted by enforcement and the repressive action necessarily taken in individual cases by the AGCM is one of the main results of the combined action of the collaboration between the two authorities, in the interest of regulated markets and above all consumer protection.

Of the many ongoing enforcement activities promoted by the Authority, we would make particular mention of two: the development of the resolution service and the first results of the inquiry into billing for low-consumption customers.

The resolution **service**, established by the Authority and managed by the Single Buyer (Acquirente Unico, AU) in parallel with the Regulator's support for joint conciliation procedures promoted by associations and companies goes towards the enablement of consumers as a fundamental step in the customer empowerment process. The conciliation service, which has been from the outset fully compliant with the EU Directive for alternative dispute resolution (ADR) is rapidly coming at its full operation speed. Indeed, figures for the first two trial years demonstrate the maturity of the instrument, with over 2,500 activation requests from final domestic customers or small businesses, an annual increase of 50%, while showing a success rate of 88% for procedures concluded and an average time of 62 days to reach an agreement.

The Authority has taken steps to consolidate the strengths of this service it by extending

its scope of application to include the so-called “prosumers” (producer-consumers), and the participation of operators in procedures (compulsory for all the suppliers of the protected market and DSOs). For the purposes of developing the service, an important signal is expected in this direction from the entering into force, also for the energy and water sectors, of the decree transposing the aforementioned directive, which aims at the harmonisation with other sectors in which resolution procedures are compulsory.

In the medium term, developments will also regard the symmetrical availability of the resolution service for operators in relation to customers. This development will also regard the water system: indeed, a recent fact-finding investigation revealed the need for ADR instruments in this sector too.

With regard to enforcement, mention should be made of the **fact-finding investigation into billing** of small customers launched by this Authority, the results of which will be published shortly. This investigation has revealed the existence of a number of critical aspects, both in the whole sector and in specific local contexts, which risk damaging trust in the free market.

The Authority considers it of strategic importance to take further specific measures with regard to billing to increase the use of actual consumption data, including through the use of customer meter self-readings. In the area of information gathered during the fact-finding investigation, it was found that often, especially in the gas sector, customer meter self-readings partly make up for an essential lack of remotely-managed electronic meters in the sector, as well as large numbers of meters which are not directly accessible. However, also in this case, active cooperation by consumers is often undervalued by suppliers in the billing process. Incentivising billing based on actual consumption or customers’ meter self-readings constitutes a further instrument, in addition to those already implemented such as the new “Bill 2.0”, designed to provide clear, adequate information on energy consumption and costs with a view to increasing customer empowerment.

As I mentioned at the beginning of this *Annual Report*, empowerment pervades the entire supply chain of the regulated sectors: this means that infrastructure operators are affected too.

With the current year, the fourth **regulatory period for infrastructure services** in the electricity sector (transmission, distribution and metering) comes to an end. Documents have been published which illustrate the general policy guidelines and the



investments necessary to modernise distribution systems, bringing them in line with new needs for flexibility implied by the renewables revolution, as well as further improvements in quality of service, with special attention to the vulnerability of the electricity system to exceptional events.

The defining feature of the Authority's new regulation will be the ability to promote efficient behaviour among service providers as well as users. In addition to this, regulation will have to guarantee not only a sufficient boost in efficiency but also particularly favourable conditions for investments creating "useful value" for the electricity system, ultimately in the interest of end customers of the service. These are the reasons that have led us to propose – in keeping with developments in international regulatory best practices – the gradual introduction of schemes that can combine recent incentive regulation approaches with infrastructure development requirements, based on principles of recognition of the costs relating to the service and based on total expenditure (operating costs plus investments, i.e. totex).

The project is an ambitious one, requiring a profound change in infrastructure regulation, which this Board is determined to introduce, albeit sufficiently gradually.

Mechanisms to incentivise infrastructure development need to change too. We have already shared our thoughts in this regard, starting from the excellent results of the pilot projects started in 2011 in order to trial active distribution networks (so-called **smart grids**). The regulatory mechanism supporting this process of smart grid deployment will change compared with the past, evolving from a system based on increased return on invested capital – an area which has exhibited several critical aspects – to selective mechanisms based on the achievement of a set of goals aimed to foster value creation for users of the service.

Italy's electricity distribution sector still has a high number of small and medium-sized companies operating in very small areas which do not allow them to reach an optimum size and imply also disproportionate administrative costs for the Regulator. In this respect, the Authority considers that costs for companies must be based solely on "efficient" costs and that, consequently, extra costs for inefficiencies of scale cannot be acknowledged for tariff purposes.

For distribution and transmission, we have already formulated proposals for developing regulation of **quality of service**, and have opened a debate



on the matter – one which concerns us greatly – of the vulnerability of the electricity system to exceptional events, such as the recent heavy snowfalls in the Emilia Romagna, Lombardy and Abruzzo regions. In recent years, regulation has provided effective incentives for the improvement of the service; according to our study on costs and benefits, one billion euros of net incentives (subtracting fines issued) was distributed over 12 years to distribution operators has yielded benefits for consumers in terms of reduced costs due to outages totalling around five billion over the same period. The issue regards finding solutions that are cost-effective in terms of benefits to render networks more robust where they are most fragile.

In parallel, the Authority is carrying out an important **reform of the methods for calculating and updating the rate of return on invested capital in infrastructure**, for both the electricity and gas sectors. On this front, the Authority is committed to drawing up a new regulatory framework that responds efficiently and consistently to the turbulence that continues to characterise financial markets, guaranteeing conditions of predictable certainty needed to foster the development of investment – and therefore infrastructure – and at the same time limits risk, and thus the cost of capital invested too, always in the ultimate interest of end consumers.

Empowerment of market players is based on objective assumptions; these are the existence of adequate infrastructure on the one hand and an appropriate shared framework of rules for the efficient operation of markets on the other. Neither can be left exclusively to market evaluations; they must instead be developed from a coordinated point of view, taking into account the externalities which individual considerations based on price signals only would not be able to value correctly. In both cases the role of the Regulator is central. Specifically, with regard to **major national and cross-border infrastructure**, efforts are being made in coordination with ACER and with the other European regulatory authorities in CEER (we shall take the opportunity to mention the proactive work conducted by the Authority in the ACER working groups and in **CEER**, an association in which the Authority holds the vice-presidency to establish the new single European regulatory framework) and together with network operators to draw up shared and transparent methods for determining the value of investments. The methods in question are still immature and untested, with large margins for improvement, particularly in the gas sector.

Nevertheless, the path towards selectivity based on facts and on quantitative analyses is already marked out.

This will ultimately benefit all consumers. Work is currently underway on the second list of projects of common interest (PCIs) as part of the Infrastructure Package, which is due to be finalised in autumn 2015. In that this process leads to true virtuous coordination of infrastructure development in the European Union, however, it is necessary to overcome the complexity and non-linearity of the decision-making process, ensuring that decisions on the advisability of implementing specific infrastructure developments are taken by the party that subsequently ensures that the costs are covered, passing on costs to consumers as a last resort. This party is the national regulator in coordination with regulators in other countries.

With regard to the **gas sector**, in particular **distribution**, public tenders for the allocation of the service by area are forthcoming. Reform of the service and associated expected efficiency gains in the sector are nevertheless running into yet further delays. These can be attributed on the one hand to persistent uncertainty regarding pending appeals, and on the other to claimed difficulties on the part of local authorities in organising the tender procedures, based on the complexity of the fact-finding activities for which they are responsible and the behaviour of DSOs which is not always proactive.

The need for a new gas distribution structure, with a smaller number of operators, has never been more keenly felt in this sector too, in light of the increasing use of sources of local renewable gas. The focus is first and foremost on the injection of **biomethane** into the grid; despite the persistent European standstill which prevents the publication of national norms and technical regulations concerning quality specifications, an initial general framework on the subject has been drawn up in order to foster and facilitate its development. It is the view of this Authority that in the gas sector, too, only operators of a certain size can deal with the innovation challenges posed by the development of renewable energy sources in an effective, efficient manner – challenges that can no longer be ignored, and which may lead to the role of DSOs themselves being reviewed in the next few years.

Already in last year's *Annual Report* an account was given of the work underway, both in Europe and Italy, to proceed swiftly with the integration of wholesale markets and complete a harmonised framework of rules. With regard to the wholesale gas market, the means of implementing the European Regulation on **gas balancing** are currently being established. The reform is an important one, its main strengths being the implementation of additional

resources for system flexibility and the fully mature role given to parties involved in balancing activities, meaning not only users but also the gas transport network operator, which will need to change its *modus operandi*. In implementing this reform, which will need to include an appropriate testing period, it will be necessary to ensure that it brings about concrete improvements in the overall efficiency of the system to the benefit of final customers. This means that the new system must genuinely expand available resources for balancing and for market liquidity. To this end, it is necessary to keep in place effective mechanisms for gas storage congestion management and additional resources (linepack, storage subject to replenishment obligations) which can be used under the current balancing system, introduced at the end of 2011 and subsequently amended.

In order to foster broader, more stable competition in both the wholesale and retail market, one of the challenges faced by this Authority is to redraw the rules governing **how to allocate the rights to use the natural gas transport and distribution networks**, building on successful experiences gained in the electricity sector. The aim is to enable the wholesale gas market by moving beyond a structure that has become obsolete.

In order to promote system security, competition and liquidity in the wholesale market, it would be necessary – overcoming the critical issues emerging at the European level with regard to the entry-exit model – to consider introducing additional methods that would enable capacity to be allocated on a hub-to-hub basis. This would make the Italian and European markets more attractive, preventing gas supplies from being potentially diverted towards other markets.

Remaining on the subject of future developments in the wholesale natural gas market, the Authority recently integrated the rules for the management of physical markets, in consideration of the cooperation agreements with the main European power exchanges, in order to allow the physical delivery of natural gas in the Italian system according to contracts – including forward contracts – traded on these exchanges.

These agreements, in accordance with the national legislative and regulatory framework, allow the vast expertise acquired by the Gestore dei Mercati Energetici to be deployed in the Italian gas market and to reduce trading costs for financial products involving the physical delivery of natural gas on the Italian hub, thus contributing to an increase in trades in Italy too and in the final analysis reducing costs for customers.

With regard to the integration of the Italian electricity market with that of the other European countries, 2015 marked an important step in this direction for Italy. In full compliance with the European commitments, since February Italy has integrated its wholesale electricity market with that of the other European countries by means of so-called **market coupling**. The coupling of our market, which for now regards the electricity borders with France, Austria and Slovenia and which will be extended to the border with Greece as soon as it is technically feasible, has allowed trading to become more efficient. The results can already be seen. The process of integration is not complete, however. It will be necessary in this respect to bring integration up to European standards in terms of current price limits and full harmonisation of payment terms. The temporary solution, which was adopted to enable a swift launch, will give way to the permanent one over the course of 2016. Market coupling has posed a very real challenge to the harmonisation, requiring close coordination of a very large number of players. The next highly challenging step is the integration of the intra-day and balancing markets.

The Network Code on **Electricity Balancing** is being finalised and will be submitted for approval by the European Commission to the Member States by Comitology decisions over the course of 2016. Judging from the current debate, it seems clear that the matter is still relatively immature and far from being fully shared at the European level. The definition of a harmonised taxonomy has itself proved a far from straightforward exercise. The purpose of the Authority's efforts in this area is to keep the flame of debate alive in Europe with regard to the Authority's strategic vision of a new functioning of the dispatching markets, for which Italy, in view of high production characterised by uncertainty, represents an advanced country. Overly simplifying the organisation of the physical market, delaying action on the dynamic constraints of the system, unjustifiably aggregating demand or generation, as other countries intend to do, would lead to inefficient use of resources, with an ensuing increase in costs for the system.

With regard to the integration of markets, the Authority remains committed on the one hand to cooperating with the association of Balkan countries in the Energy Community (**ECRB**) and on the other strengthening cooperation with other Mediterranean countries through the **MEDREG**, the Association of Mediterranean Energy Regulators.

In the area of integration of wholesale energy markets, it should be pointed out that 2015 is also the launching year of the market monitoring

and surveillance system provided for by the REMIT regulation, for which the Authority – in accordance with other European regulators – has drawn up a specific register available to operators since March.

The true challenge now regards the enforcement tasks assigned by the REMIT regulation to national regulation authorities, which are given specific investigation and sanction powers to deal with suspicious operations reported by ACER or by regulators themselves during the monitoring stage.

Considering the structure of the markets, the capacity market is connected to the subject of electricity market flexibility.

Here I wish to mention three basic reasons, among the many of general interest, which would call for the immediate enforceability of the Italian capacity market model, setup after our consultation documents and provisions, with a Ministerial Decree in June of last year.

The first reason is cast in a European mould. The European Commission plans to act upon the structure of capacity markets, fearing that the various Member States will introduce markets that are incompatible with each other creating a true obstacle to the achievement of a single market. As we have already pointed out, we believe that our flexible model, open to the participation of producers of other countries in the Union, as to renewable energy sources and demand, places Italy at the forefront in Europe in the implementation of mechanisms which do not distort competition. Thus the Authority hopes that the Commission may make of the Italian model, with its neutrality with respect to the various production technologies and based on market procedures, a blueprint for continental electricity systems.

The second reason specifically regards empowerment of the markets. The energy-only markets – which we well know as they have been operating for over a decade in Italy – have become inadequate to express prices which are representative of the economic fundamentals underlying the energy production sources that participate in them. Renewable sources with zero variable costs are now predominant on the wholesale market (over 40% of domestic production in 2014) and erode the importance of price. In these conditions an energy only market implies extremely high price volatility, with major uncertainties regarding both the profitability of facilities in the market and the predictability and reasonableness of price for the demand. The capacity market thus represents a solution which offers an “insurance” above all for the consumer and does not allow easy market speculation on high volatility which would inevitably mean higher costs for the final consumer.

The third reason lies in the fact that today (not tomorrow) we need to tackle the problem of overcapacity which, also in the field of large renewable energy power plants, will very soon

be absorbed. The launch of the capacity market would help the market to give visibility and transparency to the value of generation capacity required by the system over a longer time period, thereby avoiding inefficient “exit and re-entry” dynamics in production capacity. Specifically, it is undesirable for certain more efficient power generation plants to fall under the control of concentrated companies, who would tend to use them in a less competitive manner, to the detriment of prices for final customers.

Without a capacity market, Italy’s future electricity market will be subject to greater costs, greater uncertainty and increased speculation.

To conclude the part of the report dedicated to energy, I shall now offer some considerations on the sector of **district heating and cooling**, after the Legislator has assigned the Authority *ad hoc* regulatory duties, with enforcement powers provided for by the law governing the creation and operation of our Authority.

The Authority, on the potential *ex ante* competition front, will establish a regulation to ensure the transparency of the economic conditions of supply of the service applied by operators so that the final consumer has complete, clear information about the terms and conditions of supply of the service of district heating and can make a real, effective comparison with any available, feasible alternatives. In cases where no choice between alternative heating systems is available to the consumer who must therefore be connected to the district heating network, the Authority will establish heat supply tariffs, in line with the principles which have already inspired action in other regulated services.

On the consumer protection front, during both the pre- and post-contract stage, we will be committed to establishing the regulatory framework relating to quality of service, an aspect of the sector which is characterised by a rather heterogeneous and generally inadequate situation. In terms of promoting the development of efficient district heating, our action will be initially aimed at developing a framework of rules for access to district heating networks of third-party heat generation plants, in order to give priority to recovering waste heat and using locally available renewable sources as part of an integrated energy system.

## **ENVIRONMENT: integrated water service**

The current year is one of the most significant in terms of water sector regulation in Italy. Over the course of 2015, in fact, a number of particularly important provisions have been established for the sector: we need only to mention the new tariff-setting methodology for the next regulatory period and the standard agreement for the assignment and management of integrated water services.

To these we should add the introduction, for the first time in Italy, of nationwide tariff equalisation systems, with the involvement of the Electricity Equalisation Fund (CCSE, Cassa Conguaglio per il Settore Elettrico), which has already been used for the first time for a specific case characterised by urgent needs, without compromising the social sustainability of the tariffs.

Other particularly important aspects concern ongoing work to regulate contractual quality, establish environmental and resource costs, revise the structure of charges applied to users – which has not been updated for several years – and set tariffs for collection and treatment of industrial waste.

Within the limits of its remit, to date the Authority has worked to establish an **innovative regulatory framework** to take account of the **multiplicity** and **specificity** of the aspects that characterise the sector, while at the same time setting out regulation designed to bring the regulatory certainty and stability necessary for the development of the water sector, which in many areas of the country is still characterised by a significant lack of infrastructure.

At the end of last May, tariffs approved by the Authority for 2014-2015 regarded over 1,700 local entities managing the service, affecting around 49 million Italians. It is from this significant result – the updating of tariffs with a single, consistent method for the entire country and with final approval on the Authority's part for 83% of the population – that inspiration should be taken for a number of considerations regarding planning in the water sector.

Despite starting from a situation characterised by a number of problematic issues which still have not been completely addressed, the water sector has nonetheless embarked once again on a path of development, helped by the impetus given by the regulatory initiatives of this Authority in three years of operation in the sector. In view, therefore, of a certain legislative and regulatory context and a macroeconomic context which is showing the first tentative signs of recovery, favourable conditions would seem to have been created for a **renewed series of investments** in the sector; an opportunity that the nation must seize and take advantage of by continuing along the path on which it has set out.

As we have reiterated several times, water service tariffs paid by end users cannot be the only instrument for financing investments. Nevertheless, they may stimulate and support them if they are approved as part of a consistent, clear, reliable approach. While the average change in payments on the previous year was just over 4% in 2014 and 4.5%



in 2015, investments (net of public contributions) for the same years (2014-2015) show particularly strong growth (compared with the corresponding period for 2012, in 2015 an increase of 55% has been recorded), with total investments amounting to approximately 5.5 billion euros during the four years from 2014 to 2017. This value of investments (taking in two thirds of the population) – as we have already pointed out at the last Conference on the regulation of water services – means that investments in this period were equal to the total value of the related Regulatory Asset Base (RAB): it can therefore be stated that the competent authorities and management entities have committed themselves during the four-year period 2014-2017 to investments equal to the value of the entire existing infrastructure prior to 2013.

The aim of encouraging the development of investments, especially in water purification – a department in which Italy is still behind in terms of infrastructure, as evidenced, unfortunately, by infringement proceedings still pending against Italy – remains a priority in the course of regulatory activity. This need is poorly understood by customers who, unlike in the energy sectors, find themselves at an intermediate level in respect of the services that make up the sector's supply chain as a whole. Often customers are aware of services that are upstream from supply, such as water captation, aqueduct management and distribution, but unaware of those downstream from it such as sewage treatment and purification, even though these may be to dispose of and purify the users' own waste water. Tariff regulation, with the establishment of sewage and purification charges forthcoming, must therefore also take into account the adequacy of these collective services which are so essential to sustainable environmental development. The **water tariff method for the second regulatory period**, which may be longer than four years, will seek to guarantee the necessary stability and consistency with the framework set out hitherto, by integrating and developing the asymmetrical, innovative regulation already adopted. The Authority intends to step up the selective, goal- and action-based approach demanded of the competent administrations and gradual convergence between the various areas of the country characterised by extremely divergent management situations and levels of service.

To this end, while continuing to focus on protecting users, with particular reference to more vulnerable sectors, the Authority plans to develop solidarity-based **equalisation measures** between the various *Ambiti territoriali ottimali* (ATOs, Integrated Water Districts) present in the various regions and establish conditions for their application. We are referring to measures for which consultations have just been held which, in consideration of the guidelines formulated by the Prime Minister's Office, will make it possible to introduce equalisation systems



in the water sector too, by developing solidarity-based systems for equalisation and for advancing sums using the integrated water tariffs on the national as well as the local scale, thus always guaranteeing its social sustainability.

Specifically, the provision of planned equalisation measures stems from the need to respond to the progressive application of the provisions of the “Sblocca Italia” decree relating to the management and organisation of the integrated water service, making it possible to encourage business restructuring processes that may derive from it and to implement investments the size of which cannot be sustained within a short timeframe in the specific ATO.

Regulation will be completed, therefore, with a further set of instruments, in addition to specifically tariff-based instruments, including the establishment of model schemes for management agreements, so that relations between local government authorities and the integrated water service management entities can be regulated in a consistent manner throughout Italy. Indeed, the establishment of a consistent, coherent framework for drawing up management agreements, combined with provisions to simplify the sector and make it more efficient introduced by recent legislation – in particular the “Sblocca Italia” decree and the 2015 “Stability law”, represents a key element in the completion and harmonisation of the new system of rules.

The “Sblocca Italia” decree also gives the Authority the task of **monitoring** the state of reform in the sector and to present it to the Parliament. The volume which accompanies this *Annual Report* illustrates the first results, which show, among other things, that the decisions taken so far at the regional level with regard to the rationalising of the number of ATOs have not yet fully led to models with the desired characteristics of uniformity and consistency throughout Italy, that there is still a high number of management entities for particularly small catchment areas, and that there are still cases in which the service has not yet been assigned.

In order to foster the process of management reform, the Authority plans – under the tariff regulation for the second regulatory period – to introduce rules that take into account the process underway, thereby giving additional impetus to the development of the sector towards a more efficient and effective structure. Ongoing activities to define procedures for the accounting **unbundling** in the water sector will form part of the necessary completion of tariff regulation, which is an essential factor in the drawing up of a new method for charging the industrial waste which has been authorised to discharge into the public sewage system, in accordance with the recommendations already made

by the Authority in specific consultations, in line with European Union guidelines.

Stimulus for improving the quality of the service provided to users will not come from tariff rules alone, but also from completion of the regulation concerning **contractual quality** of the water service, which aims to strengthen the protection of end users and iron out local differences by introducing minimum quality standards, recognising additional costs from improvements in quality beyond the minimum standards, and introducing an incentive mechanism based on compensation, penalties and bonuses.

In this area, the role of local authorities (*Enti d'ambito*) is fundamental to the orientation of the Authority, as they possess greater information regarding the contexts which they oversee, thus allowing them to identify the wishes of local communities, thus helping to achieve a higher quality level than the minimum national quality level, with an ensuing reward mechanism for the management entities concerned, at the expense of the users benefiting from the service. I should also mention that the Italian Authority has recently been elected to the Presidency of **WAREG**, the network of European water service regulators, with the responsibility of fostering cooperation between regulators in the sector and strengthening dialogue with institutions and stakeholders at the European and international level. Finally, it should also be pointed out that since 2014 the Authority has also presided over the Network of Economic Regulators (**NER**), the first network of independent, non-governmental regulators under the aegis of the OECD.



One of our many **accountability** initiatives, the **Permanent Observatory on Energy, Water and District Heating Regulation** was launched in May. With its various working groups currently being formed, the Observatory is a relevant part of the Authority accountability process and boosts stakeholders participation in a context of multilateral interaction.

Finally before conclusions, a number of considerations with regard to the work done to follow up on legislation (Decree Law no. 90 of 24 June 2014), introduced for the **rationalisation of independent authorities**.

This Authority, in implementing the legislative provisions, has sought to interpret their spirit beyond mere compliance with them, with a view to interacting more closely with other independent authorities and where possible reducing its own operating costs and improving its efficiency.

In this regard, since July 2014 it has cut additional payments to staff - including management and executive staff - by 20% compared with last year, and has further reduced spending by 50% on external consultants and researchers (whose services were already used relatively sparingly). In December 2014 the Authority signed an agreement with two other independent authorities, Autorità per le Garanzie nelle Comunicazioni (AGCOM) and Garante per la Protezione dei Dati Personali (the Italian Data Protection Authority), to share the management of a series of major instrumental services. In March 2015 it drew up a framework agreement with the other independent authorities to share the management of staff selection and recruitment procedures. The first procedure is currently getting under way, at the initiative of this very Authority.

With regard to the building for our headquarters in Milan, after the entering into force of the aforementioned legislation, the Authority verified with the State property department that no vacant premises were available and confirmed that staff would be distributed as follows: 80% at our Milan headquarters (a minimum of 70% by law) and 20% at our Rome offices. In view of this, the Authority is agreeing with the Metropolitan City of Milan, which has been operational since 2015, upon the potential transfer of our headquarters from the current building, which is rented from private owners at market rent, to a publicly owned building.



Authorities, Ladies and Gentlemen,

at the beginning we briefly mentioned the **transition underway**: a profound change in the fundamentals and in ways of producing/consuming energy which we need to constantly be able to interpret and steer in terms, not just of the mix of energy sources, but also and above all, energy carriers.

The near future will see the surging role of the **diffuse electricity carrier** which, as a pure energy carrier (never having been a primary energy source) has become, in the space of a decade, *the* enabling factor for the environmental sustainability of energy, as it can be integrated with all modern primary energy sources that can be converted into electricity, especially decarbonised ones. It is an energy-efficient carrier which even permits energy-efficiency applications and savings in domestic uses. It is not liable to energy waste as it must in any case be transformed into other forms of useful energy by means of today's extremely efficient devices. It is a formidable tool for the emancipation of energy demand, as it is easily manageable even without a high degree of specialisation

on both the production (including *in situ* self-consumption) and consumption side. It boasts a high degree of “integrability” with all of the new information and communication technologies applied to energy and energy consumption. It is an energy carrier which, as it can be wholly integrated with distributed generation – particularly that based on renewables – it places value on the “native” resources of an area, reducing dependence on primary energy imported from abroad. It facilitates the integration of national markets with mixes of different energy sources, thus widening the market and rendering it more secure by means of interconnections. It is, therefore, the most resilient, modern and flexible energy carrier, as a result of its openness and universality. The energy transition countries wisely aim to electrify their energy sectors still further.

However, the real equation to solve is how to organise the electricity carrier for the future, especially with regard to distributed and urbanised users, with respect to the current structure with low electricity consumption per capita and currently unable to face a future which will be characterised by high electricity use. This world is upon us, it is at our fingertips, and the various elements which will furnish it are already here and are taking up important positions. A few examples. Distributed generation – that is, generation connected to the energy distribution networks – from almost exclusively renewable energy sources rose to over 64 billion kWh in 2013, a figure equal to total electricity consumption by Italian households, and is growing annually at double-digit rates. User efficient systems, that is, electricity solutions installed on the final consumer’s property which encourage consumption or self-consumption from high-efficiency renewable or cogenerated sources and which represent the cornerstone for the new paradigm of environmental sustainability, are increasing very rapidly in number. Dispersed electricity storage solutions are rapidly taking root, while cost barriers, too, seem ready to crumble very soon. Activities to involve consumers in evaluating and optimising their energy footprint are ready for take-off thanks to various Authority provisions and concrete actions in this regard. The process of rendering electricity grids smart has shown that there are significant margins for optimisation, for example exhibiting a generous 15% of additional hosting capacity for energy flows with assets remaining equal. Lastly, there is the development of electric mobility, which constitutes an important driver in the effort to decarbonise the traditional transport sector which is still so dependent on fossil fuels.

All of this is possible, as can be seen, only thanks to the energy carrier of tomorrow: electricity. In terms of instruments, especially in a context such as the current one, characterised by extremely rapid changes, it is never wise to cling to rigid goals *a priori*: it is better to foster innovation and enjoying tasters of it

(pilot projects), easing the metamorphosis without losing sight of its sense or direction.

All of this also influences the gas sector, which, after the market reforms and alignment with European prices carried out by this Authority in since 2012, is undergoing significant redeployments in terms of supply towards environmental sustainability: the example of new biomethane developments shall suffice. We believe that **gas** is a **source-carrier**; it is the cleanest and most abundant of the fossil fuels and is destined to remain a part of the nation's energy mix for a long time to come. It will gradually change role, due to developments in electricity: it will become more a source and less a dispersed carrier. We too – at least on the regulation side – wish to support the transition not by laying down one single frame but rather by implementing individual reforms that are consistent with one another and which dispose regulation to foster market “integrability” and stability of efficient investments in renewable sources and energy efficiency in the world of electricity, as environmentally and economically sustainable growth factors for the companies and citizens of today, without irreversibly impoverishing resources or too easily placing charges on those of tomorrow.

The same logic applies to the **water sector**, which has to bridge the infrastructure gaps of the past and invest today in order not to compromise the service of the future.

I wish to take this opportunity to express my personal thanks, which are echoed by those of my Colleagues and departments, the following organisations and institutions: the Regional Administrative Court of Lombardy, the Council of State, the Avvocatura dello Stato (Attorney General), the Consiglio Nazionale Consumatori ed Utenti, Gestore dei Servizi Energetici (Energy Services Manager), the Acquirente Unico (Single Buyer), Gestore dei Mercati Energetici, Ricerca di Sistema Energetico, ENEA, Cassa conguaglio per il settore elettrico (Electricity Industry Equalisation Fund), the Guardia di Finanza (Finance Police), our Board of Auditors and Evaluation and Strategic Control Unit, as well as all the other institutions to which this Authority has always been bound by loyal and effective cooperation.

I should like to thank in particular all of the staff of this institution, women and men, whose daily work and commitment make the proper functioning of the Authority itself possible.

On behalf of myself and my colleagues I thank everybody present for their attention.

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