

Annual Report on the state of services and on the regulatory activities

Summary and excerpts from the presentation by the President Guido Bortoni

21st June 2016

- The presentation of the Annual Report covers both activities in progress and projects to come in the energy (electricity and gas) and the environment (integrated water service and district heating) sectors.
- **Action of the Regulator** – A regulatory design, in which the Regulator will carry out its action in three areas (energy, the environment and the grids) is under completion. Such a framework points also to transformation and growth for Italy. Transformation, as the energy-environment partnership will be implemented in regulation; growth, namely more tangible and intangible investments in services. The energy sector faces “*elegant failures*” (according to the jargon of the recent literature on resilience), that is to say, failures that are not disruptive for the system, but which lead to specific reforming actions adapting to a changing context. The action of the Authority in this respect is developed in a context of mutual independence between planning and regulation.
- **The participation of society in regulation** - In the ascending/designing regulation phase, the Authority has consolidated the practice and the procedures of consultation and increased the participation of stakeholders. In the descending/implementing regulation phase the Authority has created a fully operational Observatory: an innovative tool that allows a permanent dialogue among the over sixty major associations of stakeholders in a context of multilateral interaction and active participation. Transparency not only as a “*glass house*”, but also transparency “*explained*” is another guiding principle of participation.

Energy: electricity

- **Network tariff reform for household customers** – It is a reform process which will develop over a two year period (2016/2017) to overcome the critical issues related to the progressive structure of the grid tariff. A reform that will enable the electricity carrier to “free itself” from past constraints, thus allowing for the optimisation of supplies and the exploitation of renewable sources in households. The “free” electricity carrier may also significantly support the development of electric vehicles, which may be considered in all respects as *mobile efficient user systems*. In this context, it will lead to a situation (which is, according to many observers, paradoxical today) where, the more we aim at an almost completely *carbon-free* electricity market, energy efficiency will take on an unequivocal meaning: KWh will be saved with the sole purpose of reducing electricity spending, without the current additional concern of reducing the CO2 environmental externalities.
- **Wholesale markets** – Today, in an “*almost green*” scenario, also the signs of difficulty in wholesale markets shall be addressed. Provided we face two investment cycles in electricity generation (gas turbine and renewable plants), the market design needs to be adapted to the benefit of all. The Italian capacity market model, which is not a substitute for energy markets, acknowledged by the European Commission in its *Interim Report*, shall now get the green light from Brussels for implementation. The *ratio* of the Authority’s action in this area is: on the one hand, designing and introducing schemes aimed to enable the promotion of a mature competition and the development of new renewable sources in the medium term, without invoking new incentives which should instead be directed towards limited

and really innovative and advanced renewables and to electrical storage systems only; on the other, integrating renewable sources in the short term markets of the services provided to the grid operator, aimed at the overall system security, as we are doing with the multiple-stage dispatching reform (and with the timely reform of imbalance rules).

- **Electricity grids** – The adequacy of investments in the grids is a prerequisite to comply with the future methods of transmitting and distributing electricity. At the end of last year we introduced a new method with a steering function for infrastructures: their value in terms of usefulness /sobriety/ participation incorporated into an output-based tool based on the total expenditure method or TOTEX (recently trialled in the United Kingdom) which aims to a regulation based on mandatory results in terms of performance. Nevertheless, three years will be required for the full implementation of the new method. At the same time, from 2016, a reform of the input-based methodology has been put in operation, to promote to the widest extent possible a regulation based on expected results. In such a context, the Authority has transferred significant benefits to consumers too, in terms of reduction in network tariffs, acting on the remuneration of the investments needed for the proper operation of the system with a reform that combines investment attractiveness and protection of final customers.

Energy: gas

- **The reform of the balancing service** – The reform of the balancing service is being completed with the implementation of the European Regulation 312/2014. In particular, the transport network operator will be required to bring about a marked change in attitude, since it should increasingly act as a market operator. The last mile of an efficient gas market will make of Italy a market platform not only *with* Europe but also *for* and *in* Europe, thus becoming the liquid platform in Southern Europe to the benefit of the entire continent.
- **Gas metering**– Facing the difficulties emerged in metering the off-take of gas by customers, it will be necessary to envisage also incentives to the remuneration of the service aiming to increase the number of metered data made available, and to the correct allocation of consumption to the various players in the supply chain (wholesalers – sellers – customers). Another area for intervention will be the definition of a new regulatory framework for commercial grid losses. The envisaged reforms (as well as the development of bio-methane and pipeline distribution networks supplied with liquefied natural gas) should take into account that critical issues still remain with reference to the procedures for allocating distribution services.

Energy: retail markets

In the retail markets there are very clear signs to be addressed by timely structural reforms.

- **Second generation smart meter project (2G meters)** – It will soon be possible to progressively install the 2G meters with no significant tariff increase for customers or risks of double meter payments, introducing however a leap in performance in terms of metering, billing and awareness of personal consumption by means of the “*Energy Footprint*”, enabling many applications in the field of energy efficiency, sustainable consumption and home automation. This will allow billing on the basis of certain actual consumption, as well as the flourishing of innovative supply offers on the free market, including prepayment.

- **Contractual protections** – With the end of price standard offers (during 2018) new tools supporting consumers, in particular in the contractual negotiation, will be developed. These will be characterised by “increasing protections levels” regarding different contractual elements in the free energy market. All of this will lead to the definition of a specific standard offer for the free market, which will contain mandatory contractual clauses without penalising the creativity of the free market itself in any way.
- **“Tutela simile” standard offer** – It is nearly time to implement *Tutela simile* standard offer (standard offer with a structure, but not levels, of prices defined by the Authority) that will represent a real bridge that can accompany customers, who voluntarily subscribe it, towards offers and suppliers which are typical of the free market.
- **Dispute resolution** – We are meanwhile pursuing another structural reform that has been widely consulted: the resolution of disputes between consumers and energy operators in the retail market. The *leitmotif* of the reform is increasing and rationalising consumer protection. The legislative background is to be found in the European regulations already transposed into Italian law, which makes it mandatory to make at least one attempt at extra-judicial resolution of disputes, the so-called “conciliation”, before referring matters to the ordinary judiciary system. The reform identifies a model structured on three levels, assigning a central role to the institution of conciliation to the detriment of the current complaint system. The model includes the involvement of consumer associations, performing their traditional territorial front end role for consumers, accompanied by specialist support provided by the National Consumer Help Desk (*Sportello del consumatore*).

Environment: integrated water system

- With regard to the water service, the Authority’s vision of the future can only start from the results of its action during its first years of operation, to continue to promote the growth of the sector. The leading features of the “water package” adopted last December (new **Tariff method** for the second regulatory period, **standard** framework contract for the assignment and management of services, regulation of **contractual quality**) are here taken into account, with particular reference to the increased degree of responsibility of the various players promoted by regulation.
- **Tariffs approved** for the years 2014-2015, within the frame of a single homogenous tariff methodology established for the whole country, regarded 1,971 service managements and more than 53 million Italians, and implied an increase in charges compared to the previous year of just over 4.3% in 2014 and 4.5% in 2015, and an increased growth in **investments** (compared to 2012, an increase of 55% was reported) for an overall total of approximately 5.8 billion euros in the four year period 2014-2017. A significant result reversing a trend for a long time expected, but that today still falls short of what appear to be the effective demand of modernisation and development of the Italian water infrastructure. To encourage this process, as part of the new regulatory period 2016-2019 the Authority has introduced a new formulation of the interventions to be integrated into the regulatory framework. In this context, the Authority intends to provide operators with the possibility of reporting the main infrastructural and environmental issues to be addressed and to be able to combine them, with maximum efficiency, with the availability of resources needed for the implementation of priority interventions. In other terms: develop tariff selectivity according to

critical issues and priorities. Furthermore specific ad hoc measures intended to overcome critical issues related to the economic and social sustainability of certain interventions are foreseen.

- In terms of regulation, this means also implementing more effective actions of **enforcement**, surveillance and control, in order to complete the framework of measures with the definition, for example, of the technical quality of the service. Early this year, reforms relating to water **unbundling** and metering were approved.

Environment: district heating

- In 2015 the Authority, implementing the Italian legislative decree no. 102 of 2014, launched its regulation and control of the district heating and cooling sector. The current year, in which the first measures were defined and the dialogue with the stakeholders on the future guidelines to be pursued developed, can be considered the kick-off year of regulation. The first actions focused on the **mapping** and the **analysis of the sector**. The Authority's work will continue with the purpose of guiding prices to reflect the efficient costs of the service, as it is the case for customers/users of other regulated sectors. Both the measures being developed on **metering** and those aimed at improving the **quality of service** move in that direction.

The organisation of the Authority

- Although the ARERA¹ season has not yet started, we have preventively started a new **organisational reform process** to prepare ourselves for the enlargement of the sectors to be regulated. Within this context, we are evaluating “network” organisational models that are able to ensure coordinated inter-connection between sectoral regulation functions, which are typically vertical, and functions of control or enforcement and consumer/user protection functions, which are typically horizontal.
- If the extension of competences to new sectors and the growing organisational synthesis are easy to foresee with pen strokes on organisational diagrams, reality will meet expectations only if at the same time the Authority's resources will be accordingly strengthened in the draft legislative decree on local public services. I am referring here to **human resources**, which are essential to ensure expertise, and therefore effectiveness and independence, even in the new sector. This will be crucial – as we point it out to the Government – for carrying out the tasks that the same decree assigns to the Regulator, including the definition of tariff criteria for the **waste sector**.

Final remarks

- A final remark from a purely technical and regulatory point of view refers to the **institutional governance** of the system of tangible and intangible infrastructure – such as markets in their various forms are – of the Italian energy sector. The fifteen years' experience of the State-Region governance on energy, provided for by the current Chapter V of the Italian Constitution, highlights the need to overcome the “concurrent-based competence structure” to supersede a context marked by the mutual distrust among institutional parties, from which disagreements arise.

¹ ARERA is the new acronym for Authority for the Regulation of Energy Networks and Environment as defined by art. 16 of the draft legislative decree on local public services attributing to the Authority new competences in the waste disposal sector.

- Finally, this should be an opportunity to articulate **competition matter** in line with its two distinct but cooperative objectives: promotion and protection of competition. This in order to confirm a virtuous pair: promotion/regulation and protection/antitrust, ex ante and ex post intervention, law no. 481 of 1995 and law no. 287 of 1990. All this in the sole interest of the consumer and national growth.