



Autorità per l'energia elettrica e il gas

ANNUAL REPORT
ON REGULATORY ACTIVITIES
AND THE STATE OF SERVICES

*Introduction by the President
Alessandro Ortis*

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Authority for Electricity and Gas

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President of the Republic
President of the Chamber of Deputies
Prime Minister
Deputy President of the Senate
Authorities, Ladies and Gentlemen

In presenting the ninth “Annual Report by the Authority for Electricity and Gas on the State of the Services and the Activities Carried Out”, I have the honour of offering, together with my colleague Fanelli and on behalf of all our staff, our sincerest regards to you, as President of the Republic, and of expressing my very real gratitude for the privilege of your presence, which encourages us greatly as we renew and intensify our efforts to overcome the current, still unsatisfactory, situation in the energy sector.

I also have the pleasure of expressing our thanks to the President of the Chamber of Deputies for the distinguished hospitality he has extended to us, and for his readiness to further develop the dialogue between Parliament and the Authority. This intent is also to be found in the recent Bill presented by the Government which, together with a strengthening of the Authority's powers and independence, envisages a more intensive reporting activity by our organisation to the Parliamentary Committees. For this reason, and the ready attention they have devoted to energy matters, which are a key component in the country's development, I wish to thank the Prime Minister and the Minister for Economic Development.

I would also like to offer my best wishes to the new Parliament and new Government in their work, and my thanks to the preceding Parliament and Government for all that they have achieved, not least in energy matters.

INTRODUCTION

In 2005 and in the early months of this year, a number of critical issues, already highlighted in last year's Report, unfortunately became more acute. Energy costs for our country grew heavier. We were unable to prevent increases in prices and a number of tariffs. In the electricity system a number of reliability problems dating back to 2003 were overcome, but during the recent winter months we experienced a new and severe "gas emergency".

In addition to unfavourable weather conditions and geopolitical factors and the fact that the liberalisation process is still not complete, the most significant causes of these problems are the growing dependence of Italy's energy system on hydrocarbon imports and delays in the development of infrastructure for the procurement and storage of natural gas. These problems have built up over the years and require further, urgent solutions in addition to the measures already adopted through previous legislative and government initiatives.

With this in mind, and to ensure the necessary collaboration with Parliament and the Government, we have for some time now been increasing our reporting activity and reiterating a number of observations and proposals.

We are pleased to note that a good number of these have been taken into consideration, first by the 10th Committee of the Chamber in the *Concluding Document* of its latest inquiry, which was approved by a massive cross-party majority last February, and then in the recent Government Bill (the *Energy Bill*).

The Authority's founding law entrusts us with two fundamental objectives: to promote competition and to protect consumers. It follows that, while we take great satisfaction in the achievements gradually emerging from initiatives to save energy and foster continuing improvements in the quality of services for consumers, we also feel deep regret in occasionally having to make unpleasant, though unavoidable, decisions such as the recent tariff increases. These increases unfortunately overshadow the

positive results obtained in what are still only the initial stages of the as yet incomplete liberalisation process, the progress of which should be supported and accelerated to improve security of supply, ensure reasonably priced supplies, and safeguard the environment.

To this end, we will adopt every initiative that might help us in our efforts to overcome the problems experienced in these periods of intense and widespread energy crises which are affecting our own country, Europe and the international scenario as a whole.

INTERNATIONAL SCENARIO

The international energy scenario continues to be marked by rising and very volatile hydrocarbon fuel prices. The price of oil, on which our energy system still depends too heavily, has more than tripled with respect to the average for the 1990s.

Tensions on the international oil markets, which were particularly intense in the course of 2005, also continued into the early months of 2006. At the end of 2005 the reference price of crude oil was over \$57/barrel, an increase of 44% on the previous year, while in the second quarter of 2006 the average price was as high as \$70/barrel. To date, prices show no significant signs of cooling.

The recent international crises have accentuated our awareness of structural problems in the sector, such as the scarcity of spare capacity (that is, the difference between possible supply and actual demand) and the international shortage of production capacity and refining facilities. These structural problems are also being mirrored in futures contract prices, which are set to remain very high in coming years.

The sharp rise in oil prices has also influenced the natural gas market, which has experienced a particularly unfavourable trend connected with the emergence of marked shortages in transport capacity, including at the European level. Moreover, the extent of the price increases for gas – a raw material that is growing strongly in proportion to overall energy

consumption in Italy – is not altogether justified by the market itself, but can be explained in part by an undue dependence on oil prices.

EUROPEAN CONTEXT

In an international situation of this nature, Europe cannot resign itself to experiencing any and every increase in oil prices as being simply unavoidable, because the effects of such increases have already taken households and businesses to the limits of affordability.

The time therefore seems right to embark upon an in-depth reflection that also encompasses the possibility for Europe to play a new role on the global oil and gas markets, and in relations between consumer countries and supply countries.

In this respect, we have taken it upon ourselves to put forward a number of observations and proposals regarding the development of liberalisation and the integration of the markets.

Green Paper

The European Commission has recently opened the consultation process on the “Green Paper on a European Strategy for Sustainable, Competitive and Secure Energy”, a planning document concerning the completion of the single energy market, the promotion of common initiatives and a European energy policy, and measures to overcome the crises mentioned earlier.

Considering the nature and extent of the problems that need to be tackled, however, we see a need for more robust initiatives than those already outlined, in the areas of:

- European-level harmonisation of the various national legislative frameworks and operating conditions, which continue to have a highly diverse impact on supply costs;
- the process leading to complete integration of the single market, including through pragmatic, preliminary regional integration processes;

- capitalising on the collaborative approach which has already been adopted for some time by the various national regulatory authorities and promoting a harmonisation of their powers and levels of independence;
- defining shared EU-wide solutions for energy-intensive industries;
- a review of the objectives and mechanisms resulting from the Kyoto Protocol;
- the development of networks and storage facilities;
- unbundling;
- the diversification of supply infrastructure, sources and production technologies; and
- joint hydrocarbon procurement initiatives.

In Europe, a one-dollar increase on the barrel price of oil leads to over \$5 billion in increased annual costs, around a third of which reflect on the electricity and gas sectors. As a result of our heavy dependence on hydrocarbon imports, Italy is in proportionate terms the country hardest hit by these increases. This amplification of the effects of price rises can be explained by a twofold anomaly: the oil market operates largely on spot-market principles, while the gas market operates mainly through long-term contracts based on “baskets” of energy products, which in turn are influenced by the spot-prices of oil. And what is more, the gas market finds it hard to change, for reasons based more on infrastructure than on any commercial consideration: a large part of the infrastructure was built against a background of long-term contracts, and even increased storage facilities were planned more with a view to the modulation of internal demand for domestic heating than to international market strategies. All this is holding back the hoped-for competition by producer countries, even though at the global level there is a much wider availability of gas than of oil.

Because the global oil market is sensitive to variations in spare capacity in the order of a million barrels per day (b/d), no European country on its own can take effective action on the oil and gas markets. Nonetheless, a

joint strategy involving 25 European countries, which together represent a demand of over 15 million b/d of oil and 6 million b/d equivalent of gas, could well merit evaluation on both the supply and demand sides.

On the supply side, one objective that might be pursued would be to balance the oil market through a number of long-term contracts uncoupled from the spot market and, conversely, to introduce to the gas market a higher proportion of spot-contracts that are not tied to oil prices. Western companies do not invest sufficiently in seeking out new supplies from non-conventional oil fields in politically stable countries, in the fear that such medium- to long-term investments might be crowded out by the price-setting strategies of state companies in the traditional producer countries. This situation could perhaps be remedied by proposing long-term fixed-price contracts to these companies; prices which, while well below the current \$70/barrel, would certainly still be profitable.

With regard to gas, Europe should be aiming to create at least 2 or 3 hubs – one of which in Italy for the Centre-South of Europe – acting as nerve centres for the major supply infrastructure (gas pipelines, regassification and storage facilities) and in which spot prices could be established increasingly independently of oil prices.

On the demand side, various initiatives to restrict oil consumption have been developed thus far by individual countries. However, if these measures are to have any significant bearing on market expectations, they should be: sufficient in scope with respect to spare capacity projections; credible, because based on binding agreements spread across the member states of the European Union; and dynamically correlated to oil price levels.

Initiatives such as these, which, taking the supply and demand sides, together account for higher volumes than the current limited spare capacity, should provide good results in terms of the markets. Results which, with the possible participation of other countries in the OECD area, could certainly be built upon.

Opening and integration of the markets

With the second package of Directives and the introduction of two Regulations on the cross-border trading of gas and electricity, the European regulatory framework, which underlies the liberalisation of the markets and the creation of the European Single Market, is now well under way, at least on the demand side. In exactly one year all EU consumers will be free to choose their supplier.

With that date in mind, and with a view to evaluating possible new measures as promptly as possible, the European Commission has completed an initial analysis of the state of implementation of the existing rules, conducted in collaboration with the various national Authorities. The resulting "Report on progress in creating the internal gas and electricity market" (COM 2005/568), of November 2005, has brought to light a number of significant problems.

In spite of the considerable progress in the opening of the market, some critical issues remain unsolved. These include: a low level of integration owing to delays and imbalances in the implementation of the Directive by the countries concerned; continuing marked differences in energy prices in the various member states; and obstacles hindering the development of competitive frameworks and the opening of the markets to competition, which in turn limits the opportunities for consumer choice.

In February 2006, the European Commission also presented the first *Report on the State of Competition in the Electricity and Gas Markets*. This report highlighted the barriers to the entry of new operators, caused partly by inadequacies in the unbundling of infrastructure activities from the control of dominant operators owning vertically integrated supply chains. A further and by no means secondary reason appears to be the lack of cross-border competition, which results in fragmentation into national sub-markets, to the disadvantage of consumers.

International collaboration by the Authority

Our contribution to international collaboration focuses on the EU and the areas of greatest interest to the Italian energy system and to our consumers and industry. It includes: the difficult and on-going promotion of infrastructure and economically attractive cross-border trade for Italian importers; active participation in the *Council of European Energy Regulators* (CEER) and in the *Group of European Energy Regulators* (ERGEG) established with the European Commission; membership of the *Board of Regulators* envisaged by the recent Balkan Treaty; the follow-up to the twinning agreement with the Turkish Energy Authority; the recent opening, in Rome, of the Mediterranean Working Group on Electricity and Natural Gas Regulation (MEDREG); and support for the *European School of Regulation* in Florence, open to all foreign stakeholders and regulators.

LIBERALISATION, MARKETS AND COMPETITION IN ITALY

Electricity sector

1 January 2005 saw the completion of the launch of the electricity market, thus opening the way to the active participation of demand, albeit in indirect form for the captive market.

This introductory stage, although lengthy, has however produced significant results in terms of greater efficiency, new investments in production activity, new operators entering the market, and a stronger focus on customers' and consumers' rights.

These results have however been largely overshadowed by the concurrent large increases in fuel costs, while their effect on prices has been limited in extent as competition has still not gained a strong enough foothold.

The wholesale electricity market still shows a high degree of market power in the hands of dominant operators, led by Enel, who are able to control prices in certain periods, areas of the country and stages of the market. In view of this, and following the inquiry carried out together with the Antitrust Authority (the Authority with whom we are developing a fruitful and on-going collaboration), as well as our own investigations of June

2004 and January 2005 into Exchange prices, we have promoted a number of temporary actions aimed at encouraging more competitive market conditions. These measures, however, which are intended to smooth the transition towards a mature and truly competitive market capable of satisfying the legitimate expectations of consumers, are currently being examined by the Council of State after their annulment by the Regional Administrative Court (Italian acronym TAR) of Lombardy on the basis of an alleged lack of powers on the part of the Authority.

As we wait for these powers (which are indeed necessary to speed up the transition towards an efficient electricity market) to be clarified in the courts and for their definition to be revised and up-dated in legislative terms, our commitment to consumer protection and the development of competition is currently focused on the considerable changes that the market will be seeing over the coming year.

As envisaged by Directive 2003/54/EC, in July 2007 all customers, including household customers, will be free to choose their electricity supplier. This is a fundamental step in completing the liberalisation process, but it also calls for new forms of protection for customers to ensure that they have real options available to change to a new supplier who is able to provide all the guarantees they would expect in terms of service quality.

We therefore deem it necessary to: set out in detail the universal service obligations as envisaged by the Directive; define the conditions of supply for parties who have not chosen their supplier and who, at least in the first few years, are likely to include a large proportion of household users and a number of small firms; and establish a supplier of last resort and maintain a clear distinction, which is now guaranteed by the Single Buyer, between distribution on the one side and procurement and retail activities on the other, to avoid the risk of the new customers being "captured" by the integrated companies.

The development of these new services and the full participation of demand in the electricity market mean that further development of the

wholesale markets will be needed, with the definition of forward products or derivatives that provide suitable instruments to hedge price-related risk and manage the procurement portfolio. In anticipation of the establishment of organised forward markets, the Authority has drawn up a revised version of the rules for dispatching, which will come into force from 2007 onwards.

System costs – tariff components which are by no means negligible – are, as in the past, equally worthy of attention. These include the CIP 6/92 mechanism, for which we very recently adopted an initiative designed, where possible, to bring the incentive scheme as closely as possible into line with the avoided costs of the national electricity system.

A consultation document was published in this respect, amending the parameters on which the “avoided fuel cost” allowed for CIP 6/92 power stations is based by indexing them to a more easily adjusted basket of fuels while also safeguarding producers’ acquired rights. We will also be consulting on measures aimed at enhancing the operational efficiency of CIP 6/92 plants and their compatibility with market rules. These measures, together with the work already under way to intensify our work in supervising and monitoring compliance with the parameters giving entitlement to the incentive, will play a part in reducing the overall cost to consumers.

There is, however, a strong risk for consumers of increases deriving from the effects of the emission trading regulations. These effects can be equated this year in an increase of around 1% in prices and tariffs, compared with a relatively modest allocation deficit with respect to actual emissions. Were this deficit to become significant, the consequences for the electricity sector could be serious.

We have already pointed out to the Government and to Parliament the inconsistencies in both the Directive and the allocation method. These mainly derive from the absence of a correlation between the *ex ante* allocation mechanism and the price-forming mechanisms in the electricity

market, which creates the possibility of speculative conduct and strong discrimination against new entrants.

The effect on electricity prices could therefore be much higher than the actual purchase cost of emission rights. A review of these mechanisms, at the EU level also, would therefore seem timely, as there is a risk that they will create inefficiencies in the pursuit of just environmental objectives.

Gas sector

In the gas sector, in spite of the advances made on the regulatory and legislative framework, the situation is progressively worsening in competition terms as a result of insufficient infrastructure development, which has not kept up with demand, and of Eni's dominance of the market.

Demand for gas rose by 7.4% in 2005 compared with the previous year, from 79 billion m³ to around 85 billion m³. 40% of gas went towards electricity generation, while the remaining 60% was divided between the industrial sector, services and household consumption.

As in recent years, national production continued to decline, and is dominated by Eni, which controls 84%.

Italy's dependence on imports has been increasing noticeably from one year to the next, and in 2005 accounted for 85% of consumption. Procurement is based mainly on non-EU sources (37% from Algeria, 32% from Russia, 6% from Libya) and arrives via infrastructure (4 gas pipelines and one regassification facility) which is controlled by Eni or by its foreign subsidiaries. For the most part imports are based on long-term take or pay contracts; just under 50% of these are of over 30 years' duration. Spot-contracts of a year or slightly less in duration account for just under 5% of all imports. Eni also remains by far the dominant operator in import and storage activities.

As shown by the results of a survey we published at the beginning of this year, the final sales market is also still strongly influenced by Eni; the lack

of independent supplies from the international market in fact forces many companies to sell gas supplied by Eni.

Independence and development of infrastructure

Given this national situation, with acute problems in the competition sphere, the AEEG has on several occasions pointed out to Parliament and the Government the need to take prompt action in the gas sector, as has already been done in the electricity sector, to initiate a process of ownership unbundling by companies operating technical monopolies from those operating freely in a competitive environment, whether upstream or downstream in the supply chain.

Experience drawn from the specific nature of the Italian market and from the solutions adopted in other countries shows that corporate unbundling is not enough in itself to ensure full neutrality and transparency in transportation and storage activities. These are services to which all competitors must have access, without even the faintest suspicion of discrimination or competitive disadvantage. They cannot be concentrated in the hands of any one operator, far less the dominant one. Besides, Stogit, Snam Rete Gas and cross-border transit rights for supplying our country should have no part in, relation to or influence on any aspect whatsoever of the 88 billion m³ – a considerable amount – of gas which Eni sells each year in Europe. The transfer of these companies and rights to an ownership structure whose interests do not clash with the national interests and whose neutrality is guaranteed cannot therefore be presented as weakening Eni's position or growth potential. Indeed, such growth, in exploration, production, procurement, marketing and sales on the most extensive European and international markets is highly desirable and most certainly possible. These are growing markets, where international leaders are already growing even without adequate networks, and where national champions too can grow into European or international champions without dragging their feet by defending monopolies and privileges in the domestic market to the bitter end.

Parallel developments in the electricity sector show, in fact, that the unbundling of Terna (the national transmission grid operator) has in no way weakened Enel and its efforts to increase its share of markets outside Italy.

Moreover, the unbundled Snam Rete Gas and Stogit, which are still financed by tariff levies and are free from other influences, are capable of developing infrastructure which could also bolster our country's campaign to become the main hub for Southern Europe. This is a campaign in which we urgently need to surpass the other competing projects already launched to the advantage of the Balkans and the Iberian Peninsula. It is a campaign in which victory would provide Italy with a much needed surplus of supply capacity, that famous "bubble" which has, in the past, been feared as a hinderance to infrastructure development and capacity, but which is, in fact, highly necessary. It is needed to provide greater security; to play a part in providing all operators, new entrants included, with more opportunities for competition; and to ensure that each and every consumer has access to a more reasonably priced, free choice.

With regard to gas emergencies, both those in the past and those which we are taking firm steps to prevent and control, our attention should not be focused only on weather conditions, the reliability of Russian imports and transits across the Ukraine, the full operation of the pipeline from Libya, and increased demand (including from the thermoelectric sector). We should also be focusing on our ability to rapidly make up for the delays that have built up in the development of storage, the up-grading of existing pipelines and the construction of new ones, and the activation of new regassification facilities. These last named are particularly important and pressing elements of the system, not least in view of the diversification of procurement markets through sea connections with suppliers who can compete with those already providing us with coverage. Alongside its recommendations and proposals and its commitment to play a part in developing international collaboration, in all its work over the years and all its tariff regulation or network access provisions, the AEEG

has introduced clear mechanisms to promote efficient operation and new infrastructure investments.

As for the task of putting this infrastructure to correct use, the first investigations opened by the Authority into the improper use of storage facilities by a number of operators during the last gas emergency will soon be concluded, and penalties possibly imposed.

But all these measures taken together will not deliver the expected returns as long as the acute imbalances between operators on the national market and the asymmetries between the frameworks and regulatory systems of the energy systems of individual countries, the EU and supplier countries remain in place.

Local distribution networks

One problem specific to the downstream part of the gas sector emerged very clearly from our survey into the retail segment published in February of this year. In terms of structure, this segment is geographically fragmented, with operators mainly concentrating on consolidating their own local positions and belonging, in the majority of cases, to the same group as the distribution network operator, thus causing further difficulties for the entry of new operators. This is confirmed by the low rate of customer switching, the weak competitive marketing initiatives targeting small consumers, and by distribution network access conditions that are discriminatory and lacking in transparency, as evidenced by the high number of reports received by the Authority concerning denial of access.

We have therefore approved a Standard Distribution Network Code containing detailed rules designed to make relations between distribution plant operators and sales companies or wholesalers increasingly clear.

PRICES AND TARIFFS

As already mentioned, the past year, and recent months also, have seen a considerable increase in electricity and natural gas prices at both the national and international levels.

In the period from April to December 2005, wholesale electricity prices on the European power exchanges registered increases in the order of 70% (arithmetic average) on the same period of the previous year. Exceptions were the Scandinavian and Italian Exchanges, where price movements were much more modest, with increases of 8% and 13% respectively. In the first four months of 2006 the upwards trend in wholesale prices continued, with rises of over 50% in the exchanges of continental Europe, over 60% in the Netherlands and Scandinavia, and 32% in Italy and Spain.

Similarly, spot-prices in the European gas exchanges registered increases ranging from 40% to 70% from 2004 to 2005. The upwards trend continued into the first five months of 2006, with increases of 50-60% compared with the same period in 2005.

The trend in wholesale energy prices also reflected to some extent on the final prices of electricity and gas: for the main European countries, these prices were higher on average at the beginning of 2006 than they were a year earlier. The increases were more significant for commercial and industrial consumers than for household users.

Electricity

In the case of national final electricity prices, some signals of convergence at the European level emerged over the period 2003-2005. More specifically, for household consumption the price differential with the major EU countries was reduced, though it still remains wide. It should be noted, however, that Italian households with the lowest levels of consumption (between 600 and 1.2kWh annually) benefit from tariffs that are lower than the prices prevailing in Europe.

For Italian firms prices are higher than the European average, with a smaller differential for low consumption categories and a wider one for large-scale users.

For the captive market (small consumers and households) the average national tariff for the third quarter of 2006 is 13.8 eurocents/kWh net of

taxes, which account for 10% of the gross total. If we compare the current total tariff with that of the same period in 1999, the year the liberalisation process was launched, we find an increase of 41.1% in nominal terms and 22.3% in real terms, compared with a nominal increase of 269% in \$/barrel oil prices.

If we analyse the various tariff components for the captive market, the increases registered from the third quarter of 2004 onwards are mainly ascribable to a marked increase in the component for generating costs. This component represents 70.6% of the tariff net of taxes, and its growing incidence is a consequence partly of the still insufficient impact of competition in the market, but mainly of the rise in fuel costs, hydrocarbons in particular.

The increases in generating costs are also cancelling out the impact of the tariff reductions which the Authority has been gradually setting for transport and distribution services.

It should, however, be noted that the launch of the Power Exchange and the procurement arrangements adopted by the Single Buyer have helped to limit the impact of the tensions that have developed on international fuel markets and also, therefore, to protect the most vulnerable customers.

The effects of the liberalisation process, incomplete as it may be, have already resulted in lower prices and tariffs than would have been the case under the pre-liberalisation administrative regulation system. The need is, however, confirmed for an increasingly less oil-dependent production mix and for a sustained effort on everyone's part to uncouple gas and oil price trends as far as possible.

The activation of new, more efficient power stations using less expensive fuels (including clean coal) and technologies, together with the adoption of regulatory and legislative measures aimed at developing competition among producers, should provide future benefits for consumers.

Again with reference to the coverage mix, renewable sources too deserve a special effort, through measures designed and selected to foster

competitiveness, efficiency and system security. Renewables also present opportunities for innovation, environmental protection and new entrepreneurship.

For our own part, the Authority has been active throughout 2005 and the early months of 2006 both with provisions to promote electricity generation by smaller plants using renewable sources (in implementation of Legislative Decree 387 of 29 December 2003). It has also been engaged with the implementation, in collaboration with the Electricity System Operator (Italian acronym GSE, formerly GRTN), of the ministerial decree concerning incentives for photovoltaic generation (Decree of the Ministry for the Environment and the Ministry for Productive Activities (now the Ministry for Economic Development) of 28 July 2005). It should be noted that the incentivised tariffs adopted through these ministerial decrees are additional to the prices envisaged by Legislative Decree 387/2003 and by Authority Resolution 34/05.

Unlike generating costs, the costs for the component which is totally regulated by the Authority (for transmission, distribution and metering activities, which account for only 17.9% of the net tariff) have gone down significantly since the beginning of the liberalisation process and are already lower than the European average.

As regards the *system cost* component, which accounts for 11.5% of the net tariff, the Authority is constantly engaged in promoting actions of control, containment or reduction. *System charges* cover, *inter alia*: the fund for the promotion of renewable sources and for the CIP 6/92 mechanism mentioned earlier; the fund for the recovery of stranded costs by a number of producers, which recently had to be topped-up in order to curb the interest mounting on delayed repayments; the fund for nuclear decommissioning, the costs of which are to be optimised through efficiencies to be developed by Sogin S.p.A.; the research and development fund; and the fund covering special tariff schemes.

In reconsidering the tariff system as a whole, we will continue to promote time-of-use tariffs and we are also developing a restructuring proposal for

low-consumption users. This solution would reward the rational use of electricity and envisages a *social tariff* to protect the most vulnerable categories and users of energy-intensive life-saving medical apparatus. To introduce this *social tariff*, however, a preliminary political choice must be made, one which the Authority has already been pressing for and which would define which categories of users would qualify for the support. In this respect, the *Concluding Document* of the 10th Committee, as mentioned above, the content of which has been picked up in the Energy Bill, is deserving of merit. The Authority intends as of now to promote a consultation exercise, on those aspects falling within its sphere of competence, with a view to reducing as far as possible the implementation times for the measures determined by Parliament and the Government in this respect. The initiative under consultation might envisage: the recovery of the anomalous incentives which are now implicitly awarded to customers with low consumption and high income; incentives for the most vulnerable social categories, determined by household size and income level; the collaboration of local government bodies; and delivery of the incentives in a manner that does not interfere with the market – that is, which still gives subsidised customers the possibility of freely choosing their supplier.

Gas

With all natural gas customers already free to choose their supplier, the Authority has set a *benchmark price* which sales companies must offer to households and small consumers. For the third quarter of 2006, this price is 69.32 eurocents/m³ including taxes. Compared with the same period in 2000, the current price is 17.9% higher in nominal terms and 2.7% higher in real terms.

Over a third (33.6%) of this *benchmark price* is made up of raw material costs, and 23.3% of transport, storage, distribution and marketing costs. Containment of the tariff components (for the transport, distribution and storage services, which, however, benefit from significant incentives for

the development of investments) only partially counterbalanced the increase in the raw material component.

For the period 2004-2005, the increase in the *benchmark price* was more contained, net of taxes, than that found on average in other European countries.

This can be explained by the introduction of a new indexation mechanism for the raw material component, defined by Authority Resolution no. 248 of 29 December 2004 and designed to protect consumers and better reflect the actual costs of procuring gas, without curbing the potential of efficient operators in the sector.

The method established for calculating the raw material component was confirmed by a recent ruling of the Council of State (no. 217 of 21 March 2006).

We also recently adopted a provision to manage the reimbursements due to consumers on the basis of Resolution 248/04 for the excess amounts billed in 2005, and to adopt appropriate instruments to support the efficient operational capacity of smaller operators and their need for additional winter purchases with respect to those provided for by long-term contracts, purchases which have been necessary to cope with two particularly critical years from the point of view of security.

It should also be noted that the *benchmark price* includes a fiscal charge of 42%. With regard to the tax element, the Authority is ready to cooperate with Parliament and the Government in any review they might carry out of the structure of the tax burden (excise duties, VAT, regional surtaxes) weighing on the prices of gas and electricity, not least with a view to achieving greater transparency.

In Italy, prices for industrial consumers remain higher than the European average. It should however be pointed out that in the course of 2005 prices for Italian firms increased less than the European average did. The situation is different for the major Italian industrial customers, who have experienced a very substantial increase in prices – in some cases of more

than 25% – which is, however, in line with trends in other European countries.

QUALITY OF SERVICES

Alongside our commitment to help reduce the differentials between costs here in Italy and those of the main European countries, the Authority continues to be actively and intensively engaged in developing the quality of the services provided to consumers. This has allowed our country, in the space of just a few years, to make up ground on the international stage.

Technical quality

As an effect of a regulation introduced by the Authority (one which includes incentives and penalties) and the positive response from operators, electricity outages without notice (lasting more than three minutes) continued to see a reduction in terms of both average number (down to 2.3 outages per year per customer) and duration (down to 80 minutes of interruption per year per client, an improvement of 21% on 2004 and 58% on 1999). If we discount exceptional weather events, an analysis of these results shows that the initial gap between the regions of the North of the country and those of the Centre-South is continuing to narrow progressively.

In 2006 new standards, which are among the strictest in Europe, came into force concerning the maximum number of outages for medium-voltage customers. We have also opened a consultation with a view to introducing automatic compensation for household customers in cases of prolonged or extensive outages, such as blackouts or interruptions caused by exceptional weather events.

As regards the safety of the gas distribution service, the rules introduced by the Authority have led to a large increase in the portion of the grid inspected for possible gas leaks: this now averages over 40% per year.

Speed of response in the emergency call service remains good, with action being taken in less than 35 minutes in 2005.

2006 saw the entry into force of a new incentive mechanism for distributors aimed at reducing gas leaks and increasing checks on gas odourisation levels, again with a view to improving the safety of all citizens.

Commercial quality

The mechanism envisaging single national quality standards (activation and disactivation times and estimates for executing works; contractual arrangements) continues to be effective, with automatic compensation for consumers. This instrument was originally introduced to replace the rules set out in the of Service Charter. In 2005 over €4.3 million were paid out in compensation to customers of the electricity service and over €2.4m to customers of the gas service. Altogether there have been over 93,000 compensatory payments for failure to comply with the standards introduced by the Authority.

In 2005 the average times for the delivery of services were again kept below the maximum timeframes established by the Authority.

Code of commercial conduct

In view of the completion of the liberalisation process with the extension of eligible status to household customers on the electricity market with effect from 1 July 2007, we are now bringing the various consumer protection instruments into line with the new market conditions. Our objective here is to introduce measures that enable consumers to make informed choices and give them an opportunity to take advantage of the new competitive conditions. As regards the retail segment in the electricity market, our consumer protection activity focused on two areas.

Transparency of electricity bills. The proposals that we have drawn up also envisage more easily understood bills. These represent a key channel of communication between suppliers and consumers, as well as the main

means of checking consumption and spending data. Bills, which will include more, and more easily readable, information, will therefore provide an information base that consumers can use to compare the offers made by suppliers and check their consumption patterns.

Code of commercial conduct. Published last May, this is a valuable tool that will make it easier for consumers to select the most reasonable supplier. The Code sets out rules on fairness and transparency that sales companies must comply with in promoting offers, concluding contracts and amending contracts already under way.

A similar initiative had already been carried out in 2004, with the adoption of the code of commercial conduct for the sale of natural gas. We are at present carrying out an assessment of the commercial conduct of operators on the gas sales market.

RATIONAL USE OF ENERGY

2005 was the year the “white certificates” mechanism came into force. This scheme was introduced through the ministerial decrees of July 2004 and is governed by technical and economic rules defined by the Authority, which is also responsible for implementing the scheme and monitoring the results achieved. In the course of 2005 the Authority received and evaluated applications for energy savings certificates relating to over 1,000 initiatives carried out by consumers. Compared with an annual savings objective of 156,000 tonnes of oil equivalent (*toe*) for 2005, over 280,000 *toe* of savings were actually certified. These savings, in electricity, gas and other energy types, produce benefits for final consumers, the trade balance of the country as a whole, the competitiveness of our economy, and the containment of atmospheric emissions. The savings achieved are equivalent to the annual electricity production of a 160MW power station, or the annual domestic consumption of a city with around 380,000 inhabitants. And thanks to the certified initiatives, the emission of 750,000 tonnes of carbon dioxide into the atmosphere was avoided.

These initial results are a positive signal that we should be setting more and increasingly challenging objectives which could also play an important part in helping our county achieve the primary energy savings objectives established by the recent European Directive on the promotion of energy end-use efficiency and energy services (2006/32/EC).

CONTROLS, INSPECTIONS AND DISPUTES

The Authority has stepped up its supervisory and control activities, especially as regards prevention. Our commitment to closer monitoring of the energy market is confirmed by the allocation of additional resources to our new department specifically dedicated to these activities, the increasing number of requests for collaboration by the Electricity Equalisation Fund and the Transmission System Operator (GSE), and the Protocol of Understanding reinforcing our collaboration with the *Nucleo Speciale Tutela Mercati* (Special Team for Market Protection), a section of the *Guardia di Finanza* (tax police). Indeed, to the *Guardia di Finanza* go our most sincere thanks for the much appreciated – and growing – commitment and utmost professionalism they have dedicated to us. The provisions adopted in connection with our supervisory activities have increased by 10% on last year, and the number of inspections and checks on operators by 87%.

On the matter of disputes, in its first nine years (1997-2006) of operation, and taking into consideration decisions that did not go to judgement, only a small proportion of rulings, just over 1%, have been totally or partially quashed; if we consider only those rulings that have been challenged, the rate is around 10%.

In this context, I would like to express my warmest thanks to the Government Lawyers for the considerable attention and support they provide, both through their advisory services and through their advocacy in the administrative courts.

The Authority considers judicial control as an essential counterweight to its own independence: a check that is naturally in keeping with the nature

and scope of the powers it exercises, which, as envisaged by its founding law, are distinguished by a marked degree of technical discretionary power.

In this respect, we intend to grasp every possible opportunity to increase the clarity and accessibility of our deliberations and help develop an increasingly widespread yet in-depth technical and economic awareness of the issues at stake, including in the courts. This would help to increase the stability and reliability of the regulatory framework, by reducing the number of appeals in the medium-term and discouraging initiatives that are often put forward merely as delaying tactics.

Moreover, the options contained in the Energy Bill with regard to a revised and up-dated definition of the powers and prerogatives of the Authority would also make it possible to focus decisions, which for the moment mainly revolve around an abstract compliance with the aims that the Authority is required to achieve, on procedural rules (a key instrument for the protection of third-party interests) and on the rationality and proportionality of the technical and economic content of the rules which the Authority adopts.

ORGANISATION AND OPERATIONS

The new organisational framework facilitated the efficiency gains we achieved in 2005, and while the number of provisions adopted increased by 20%, we employed fewer economic resources than in 2004.

The category of provisions that in 2005 saw the greatest increase were *consultation procedures* (up by 67%), which account for more than one quarter of the total; the average number of days dedicated to consultation also rose significantly, from 28 to 38. With a view to making our actions increasingly foreseeable and transparent, we also adopted and published, with the first resolution of the year, a "*Three-Year Plan for 2006-2008*" which will be up-dated periodically on the basis of annual public consultation exercises. The first of these is already scheduled for early July and will also concern our Report, the subject of this presentation.

All of this is a very real confirmation of the concern and commitment that we devote to our efforts to enhance our dialogue with operators, consumers, their associations, trades unions, and all stakeholders in the sector. In the same vein can be set the trial being conducted on the new *Regulatory Impact Analysis* methodology, launched in September 2005 and already playing a role in five provisions, two of which have now been completed with a resolution. A *modus operandi* is thus becoming ever-more firmly established, one which is intended to make the regulatory framework increasingly clear and reliable, to the benefit of institutions, consumers and operators.

The demanding activities I have referred to in this presentation have at all times been supported by the focused and highly professional commitment of all our staff, to whom I would like to address, on behalf also of my colleague Fanelli, my warmest thanks.

We would also like to express our appreciation of the cooperation provided by the Board of Auditors, the experts, the *Cassa Conguaglio per il Settore Elettrico* (Electricity Equalisation Fund), and the National Consumers' Council.

OUTLOOK FOR FUTURE ACTION

The Authority intends in future: to ensure that our independent administrative action becomes increasingly transparent, effective and efficient; to help achieve closer dialogue by and between the institutions; to continue to outline clearly and in good time the main objectives and timeframes for our activities, within the dynamically evolving framework established progressively by European and national rules; to provide institutions, consumers and operators with a planned, coherent and flexible framework for our future initiatives; and to adopt, promptly and with due respect for consultation processes, each and every provision that will contribute to consumer protection and the promotion of competition, with a view also to strengthening the competitiveness of our companies and of the country as a whole.

Mr. President, we intend in this way to contribute to the very best of our ability to the overall effort to achieve a rapid and timely improvement in the safety, cost-effectiveness and sustainability of our energy system.