



Autorità per l'energia elettrica e il gas

ANNUAL REPORT ON THE STATE OF SERVICES AND REGULATORY ACTIVITIES

*Presentation by the President
Guido Bortoni*

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Autorità per l'energia elettrica e il gas

Guido Bortoni	President
Alberto Biancardi	Commissioner
Luigi Carbone	Commissioner
Rocco Colicchio	Commissioner
Valeria Termini	Commissioner

QVID ENIM PRODEST STREPITVS ORIS, MVTO CORDE?

S.Aurelius Augustinus, In Evangelium Ioannis Tractatus CXXIV – Tr. 9, 13

Freely translated:

"What use are exterior acts which do not express what one thinks and feels?"

Authorities, Ladies and Gentlemen,

I would like to draw upon the inspired wisdom of Augustine's sentence to open the 2013 Report of the Italian Regulatory Authority for Electricity and Gas in this Chamber of Parliament which is hosting, for the third time, the annual presentation for this Board. That warning wisdom we would like, above all, to mark the action of this Energy and Water Utilities Regulatory Authority and, at the same time, the hallmark of this speech. It is not for us to provide judgements of our work. Yet there is no doubt that it is up to us to offer broad accountability in relation to our core service.

On behalf of the Board and the Organisation of this Authority, I wish to thank our illustrious guests, whose presence is testimony to the attention given to regulation. Today, too – like one year ago – our gratitude goes to all of those who listen to or read today's considerations and observations regarding the state of our services and activities which are collected and summarised in our digital volumes, or extracts from them published in the press.

This month sees the Board complete one third of its term (a maximum of seven years). We will not bore you with what "has already been done", except in order to illustrate developments underway. Instead, what concerns us here is to show what we feel to be the essence of regulation: making projects with regard to the things to do, which has grown even further today in energy regulation given 16 years of activity, and which is already quite keen after just 16 months of activity in relation to new competences concerning water.

Making projects is essential in the field of regulation, just as it is in the more general field of energy and environmental policy. It also becomes positive forward planning if it forms part of a responsible approach to regulation which does not allow us to imagine - not least out of respect for generations to come – a future world which is an easy dumping ground for

problems which remain unsolved or are put off today.

Responsible regulation which gives no leeway to those who believe – from a divisive perspective – that it is, selfishly, only the present which should be regulated – better still if restricted to the domestic context. As if problems and solutions, including those in the field of energy, were not European in scope and significance.

With regard to this latter point we may draw an effective lesson from the recent past. Do we really wish to provide individual, domestic responses, such as those chosen after the oil price shocks of the 1970s, which have left us the legacy of a Europe with high explicit and implicit costs and clear energy and environmental imbalances in its various Member States? It may be said that today's "Europe of energy" struggles to provide valid solutions; yet recourse to a reckless energy *jingoism* is a losing path for everyone, just as sceptical statements by individual figures regarding Italy's governability made last month in Brussels should not discourage us from being European. I can assure you that the assessment of our Country among those Europeans with whom we deal in our daily work is absolutely not in agreement with those statements, which have in any case already been officially retracted.

Striving towards forward planning in regulation which is both responsible and fosters responsibility on the part of the various parties may appear today to be threatened by the acute instability of the Italian context. I am referring, first and foremost, to the extraordinarily difficult ongoing economic situation, with a recession that has lasted for almost two years and a marked credit crunch which continues to affect not only capacity to invest but the performance of the production system itself. For citizens the picture is no better. Labour market conditions have deteriorated dramatically, not to mention the choking off of Italian households' income and their savings capacity. The fall-off in economic activity, indicated by a contraction of no less than 7 per cent in GDP since 2008, is also reflected in the sharp decrease in the Country's energy demand, which in 2012 fell to 1998 levels and shows no sign of an upturn.

ENERGY: MARKETS, INCENTIVES AND INFRASTRUCTURES

In the gas sector, 2012 saw a further severe contraction in domestic demand, around 3.5% lower than in 2011, after the 6.3% fall recorded the

previous year. Major developments were seen on the global supply side of which, as Europeans, we have not yet been able to take full advantage. The widening gap between USA and European gas prices, which has come about among other things as a result of American shale gas development, is an obstacle to the competitiveness of European – and consequently Italian – industry, particularly in the sectors most exposed to international competition. It would be illusory to imagine that US gas prices might be simply exported to Europe, considering moreover the high prices on Asian markets and their increase in demand.

By now accustomed to observing financial phenomena in terms of the "spread" between ourselves and others, we are faced with a veritable structural gap which is opening up between the United States and Europe. On the other hand, within the "Europe of gas", it is precisely forward planning in regulation which has enabled Italy to achieve a significant and far from certain result, ensuring that it is at least in line with its own continent, starting at the end of 2011 with Italian wholesale gas prices much higher than those in other European Countries.

The aforementioned contraction in demand, the potential increase in supply and the change in the regulatory framework both at the European and domestic level (with the balancing market based on criteria of economic merit drawn up by the Authority coming fully online), have enabled a wholesale spot market to develop in Italy too, with prices in line with those in other European markets. Indeed, from the beginning of 2012, the spread between the Italian spot market and that of other European markets finally began to decrease, being cancelled out from autumn 2012 onwards. Greater regulatory integration with other central European markets has also been able to spark competition for volumes of gas which are not purchased on the Italian spot market but based on long-term contracts. This, coupled with the formation of an Italian price uncoupled from price trends in petroleum products, has led to holders of these contracts to embark upon a positive and still ongoing renegotiation phase with regard to prices and quantities.

The Authority's project to reform the economic terms for the "*servizio di tutela gas*" ("enhanced protection service" for domestic and small business consumers) finds its origin within this structural change in markets and renewed European cohesion. The project's main aim is to pass on the benefits deriving from wholesale spot commodity prices aligned with European prices. The expected price reduction for domestic customers benefiting from this enhanced protection service between 01st April and

01st October 2013 is 7%, incorporating also the initial 4.2% reduction decided last April, and will be applied to consumption over the winter quarter. This percentage reduction over the entire price was determined by the decrease of nearly twenty percent in the price of raw gas over the same period and will make it possible to turn back the clock in terms of tariffs by no less than two years over the six months between April and September 2013, cancelling out all of the increases which had taken effect in the meantime as a result of the means of calculating the price of raw gas prior to the reform. Such a result testifies to the effectiveness of the initial project to develop regulation in the Italian gas market which commenced in 2011, achieved by leveraging the best means of protecting consumers: market competitiveness.

This alignment of wholesale gas prices with current prices in Europe improves the competitiveness of our firms and, considering the predominance of gas in Italian power generation, entails a reduction in the price of electricity. It is now necessary to work in order to consolidate this alignment of European prices structurally, not least in view of the hoped-for exit from the current economic crisis.

In the electricity market, alongside a sharp contraction in demand, in the second half of 2012 wholesale recorded a fall, thanks to lower gas prices and the entry of renewable production at nil variable cost. Electricity prices subsequently reached, in the second quarter of 2013, a level comparable with mid-2009, when Brent prices were around half today's level. We have therefore significantly reduced the price spread compared with other European markets, despite continuing differences in the electricity production mix which have always been highly disadvantageous for Italy.

Nevertheless, an analysis of prices currently paid by consumers in Italy's retail market shows a worrying upward trend. Domestic customers currently pay around 10% more per kilowatt-hour compared with 2009 as a result of the fiscal and parafiscal increase. On the other hand, the European Commission itself, looking at a decade-long timeframe, in its Green Paper on EU climate change and energy policies published last March, points out that while on the one hand the increase in wholesale energy prices in the European Union has been moderate, on the other final electricity prices, in real terms by various sectors and for households, have increased significantly.

The main contribution to price increases for Italian consumers has come from tariff components of a fiscal or parafiscal nature (stranded costs).

Such patterns also emerge clearly from a percentage breakdown. The share of consumer prices accounted for by what we might term "market" components – that is, those components determined by trends in the wholesale and dispatching markets – is falling significantly. Around half of the typical household's electricity bill is currently determined by market trends, around one third by taxes and general stranded costs and the remaining 15% by charges for regulated services, such as transport and metering. In four years, the space left to the play of market forces has contracted by no less than ten percentage points, and has been taken up by components of a fiscal or parafiscal nature. This signals a worrying return to more heavily administered frameworks.

Management of the transition towards environmentally sustainable energy paradigms is proving more difficult at the European level than had been realised as recently as one year ago and the difficulty of drawing up efficient market mechanisms, combined with requirements of a distributive nature, leads to instruments of the "command and control" type being preferred. The same consumer price protection mechanisms may be seen as a limitation on the markets themselves. In this regard it is important to note that, in Italy, such protection mechanisms already reflect wholesale market price trends (even more so from now on in the gas market, as a result of the aforementioned reform relating to raw gas prices).

It is nonetheless true that the market itself will need to be the main consumer price protection instrument: this, however, will be in proportion to their average level of empowerment. It will therefore be necessary to trace out a temporal path in order to move beyond price protection systems, while reinforcing social protection mechanisms. The Authority is concerned with this issue and will take a leading role in fostering in-depth, inclusive debate in this regard.

Remaining in the domestic segment, the Authority has initiated a reform which had been awaiting completion for years. I am referring to the plan to realign the structure of electricity tariffs applied to domestic customers for grid services and the structure of costs produced by them with related consumption patterns. Consumers themselves will be broadly engaged in the consultation process pertaining to this reform plan, which aims to move beyond the outmoded logic of tariff subsidies between domestic clients in the electricity sector. Such logic is becoming increasingly unsustainable, as it introduces distortions into consumption choices, in some cases even penalising choices which would be the most efficient in terms of energy

and utilisation of renewable sources (without implementing new monetary incentives) such as the dissemination of new electrically-powered technologies.

What has always been demanded of the Regulator is a certain, stable framework; never more than at this exceptional juncture, however, has the Authority been asked to combine the certainty of rules with rapidly evolving fundamentals. In order to deal with this apparent paradox, the Regulator must constantly review its interpretation of what things and conditions are to be regulated. And its interpretation must be in-depth and pragmatic. To borrow an apposite Latin concept, it might be said that what is required today is *contuitus*, in other words a vision which is at once concise and able to penetrate a situation undergoing rapid change in order to be able to deal with and regulate it with realism.

A concrete example of how approaches which are perhaps overly ideological, the result of an insufficiently in-depth interpretation, may produce far-from-ideal outcomes is the system of rules and incentives for the transition to an environmentally sustainable energy system.

The imbalance is clear in Italy with reference to renewable electricity – incentives for which will be worth 12.5 billion euros on bills in 2015 – especially if we compare how much (or little) has been done to date with the costs and benefits obtainable on the energy efficiency and renewable thermal energy fronts. The system of white certificates alone, over the last two years, has enabled energy consumption to be reduced – beyond the reduction attributable to the crisis – by 2.7%. These savings were achieved with extremely modest average incentives, consistently below 2 euro cents per kilowatt-hour and more than justified by the benefits both to the energy system overall and directly to consumers and the Italian economy.

Faced with choices that have such significant economic repercussions on the community as a whole – just as are choices relating to renewables and to energy efficiency, increased transparency and selectivity of the system of incentives and for evaluating the impact of public choices becomes of paramount value. This is all particularly true when faced with the granting of more "opaque" forms of incentive, which all too often have come to be of an implicit and indirect nature.

Implicit incentives, which are equivalent in every respect to direct grants for the promoting bodies, may include a number of cases relating to simple production and consumption systems or efficient consumer systems, which currently enjoy exemption from a number of tariff components (in particular

those relating to costs). Recognition of the value added to the system by the development of efficient, sustainable production and consumption solutions constitutes the right stimulus for positively restructuring the sector in the direction of an efficient decentralisation of the electricity paradigm. Nevertheless, exemption from payment of parafiscal components, such as general costs, pulls in the opposite direction: in other words, towards adoption of certain frameworks for the purpose of avoiding the parafiscal burden irrespective of whether the principle of efficiency and sustainability has been met. The cost is borne entirely by other consumers who are not covered by the subsidised system and, as has already been remarked, may be transformed into an unsustainable cost for certain types of customer, particularly during this period of economic crisis. It should be pointed out that the restructuring of the parafiscal items in electricity bills, in order not to penalise the competitiveness of firms for which energy represents a large share of costs (article 39, Decree Law no. 83 of 22nd June 2012), is an action which deserves our attention and support, if accompanied by adequate selectivity.

The size of implicit incentives threatens to spiral out of control and may lead to inefficient initiatives being implemented for future generations, too. This "extra charge" is currently estimated at approximately 1.2 billion euros per year. We are not proposing here that these mechanisms be reset, but rather that they be adapted with a view to allocation efficiency and environmental sustainability goals. Nevertheless, in order to adapt them, it is necessary that any implicit incentives be made explicit and unbundled from any grid assets or at least limited to the level of the respective explicit incentives as applied by this Authority to the new on-the-spot trading service.

More generally, in the current context, no one must give in to the easy temptation of asking for additional public money or tariff subsidies, even if motivated by their own legitimate interest. What instead needs to be asked of government institutions is sound rules for attracting investment, labour and innovation, which are the true drivers of development. In a Country such as our own, with scarce natural resources utilisable in production activities, at an economic and social juncture which is the cause of recessions and depressions for many, it is necessary to bring to bear – in the words of President of the Republic, Giorgio Napolitano – the wealth connected to the "*vast reserves of human, moral, intellectual and labour resources which Italy has at its disposal*"; in other words, our positive

creativity.

It is abundantly clear that the main quality of good regulation must be the utmost realism and an enhanced sense of the limit of one's action. The independence of the Authority – which is a State institution – from any other power must not degenerate into a sort of self-referential separation from the rest of the State. What needs to be sought instead is inter-institutional cohesion in order to achieve general ends, while respecting each other's specific tasks.

This is even more important during a phase such as this one, in which a new equilibrium between energy policy, environmental policy, regulation and markets is being sought, within a context in which the environmental sustainability of energy systems takes on ever greater importance and intersects with industrial policy and income redistribution goals.

The Authority's previous address to Parliament had already indicated selectivity as the keystone to the new regulation paradigm. Today we wish to reaffirm the validity of that concept, while elaborating further upon it: an effort needs to be made to base selectivity on merit, accountability, transparency and above all on investing all parties with responsibility.

In this connection, last year the Authority worked on a number of projects which will continue to play a key role over the next few years relating to the full implementation of the criterion of selectivity in the regulation of infrastructure. It is a particularly important area of intervention. Over the coming years, in fact, the system will need to be able to dedicate substantial resources to investments in infrastructure, for example to renew natural gas metering systems and reinforcing connections between the Italian energy system and the rest of Europe, as well as upgrading electricity distribution grids. Hence the need for infrastructure regulation that is capable of providing incentives by rewarding collective utility, that is, in a selective manner. Using the same approach, the Authority promotes a form of "smart" regulation which, with the experimental introduction of efficient technologies will make its widespread application possible in the future.

In the case of the electricity transmission grid, at the beginning of this year the Authority, after technical discussions with Terna, identified strategic infrastructure items subject to incentives. With regard to these infrastructure items, a commitment was undertaken entailing that, for the first time in Italy, any failure to meet deadlines would lead to a penalty being imposed on the transmission system operator. The aim is twofold: on

the one hand to improve work planning and scheduling and compliance with timescales in grid developments, and, on the other, to support experimentation with innovative solutions, such as energy storage systems. More specifically, with regard to investments in storage systems, under the incentive system the Authority gave the go-ahead to pilot projects for the development of 35 MW of so-called "energy-intensive" batteries – in other words mainly designed to reduce the amount of energy produced from renewable sources locked in by grid constraints – and 16 MW of so-called "power-intensive" batteries in order to support grid security.

Other work in progress through which the Authority is transforming the concept of selectivity into new rules regards new regulatory periods for natural gas distribution, transportation and regasification. Specifically, the Authority is evaluating the transition – gradual, if necessary – from regulation based on incentives relating to the level of return on investments to regulation focusing more on the return on the service provided. A further process for improving efficiency is in the distribution of natural gas with the implementation of tendering procedures for concession of the service. In the evaluation of the invitations to tender which legislation assigns to the Authority, particular attention will be given to evaluating development plans for the areas.

With regard to tariff regulation, the Authority has already implemented – from a forward-planning perspective to foster selectivity – another major vein of innovation aimed at convergence towards consistent procedures for calculating the rate of return on capital invested in grid-based energy services. Such procedures require not only methodological consistency – a goal which can be considered to have already been achieved – but also the alignment of times for updating parameters. The aim is to guarantee the elimination of potential distortions between operators in obtaining sources of financing (whether equity or debt) due to the different times at which the respective parameters, such as the risk-free asset rate of return and inflation, are updated.

In the final detailing of the regulatory framework to be applied to infrastructure items, the question of the choice of new investments takes on particular importance. To this end, it is necessary to put into effect instruments which make it possible to identify what is most useful, measured against a common yardstick at both the domestic and European level. What is much more important in this phase of the cycle during which,

unlike the past, investments in infrastructure are largely driven by environmental policy or security-of-supply goals, rather than growth in demand. All in a context of great uncertainty concerning energy scenarios, and all of which places on the shoulders of the "institutions" – including the Regulator – the responsibility of planning and recompensing any additional investments which operators would not be willing to make. It is a great responsibility, which needs to be faced with awareness and transparency. If a certain form of infrastructure development is not attractive for the market, first of all it is necessary to understand the reasons why before implementing mechanisms entailing the socialisation of costs. It is perfectly true, nevertheless, that there are many situations in which the market by itself struggles to ensure optimal development. It is here that the Regulator must intervene. A thorough analysis of the benefits connected with the new infrastructure and a comparison with the respective costs thus becomes a necessary precondition for quantifying their value for the system and establishing consistent economic regulation.

The recent European regulation concerning infrastructure is a step in this direction, as it requires not only that Projects of Common Interest (PCIs) in infrastructure be based on cost-benefit analysis, but also that the related costs be attributed to the various Countries in accordance with the benefits that they derive from the new infrastructure, with a dual selectivity: time and space. However, it must be acknowledged that quantifying the value of infrastructure items is an extremely complex task and does not always yield a single result, because the growing integration of energy markets renders infrastructure projects increasingly transnational in scope. In gas and in electricity, Italy has the best credentials, thanks to the ownership unbundling of its transmission grids, to deal with trans-European infrastructure developments.

For our Country, therefore, it is very important on the one hand to converge towards a methodology which is shared at the European level, and on the other to step up cooperation with other Mediterranean countries. Our leadership role in the association of Regulators (Mediterranean Energy Regulators – MEDREG) in this geographical area is also geared towards supporting the consolidation of a regulation which is favourable to shared infrastructure development, and more generally promoting the integration of these markets within a harmonious, stable and transparent regulatory framework.

The exemption of new infrastructure from mandatory third-party access

(TPA) is one of the instruments set by the Third Package to provide room for a number of investments which would not be made on a tariff basis, for example because they are too risky. Indeed, in Europe the most important transnational infrastructure projects, particularly in the gas sector, have applied for exemption. In this case, too, the Regulator is responsible for evaluating whether the new infrastructure, although exempt, has a positive impact on competition and as a result for consumers. As provided for by the Third Package, this evaluation must be transnational in scope, through close coordination among the institutions concerned, including regulatory authorities in first place. An example of best practice in this respect is certainly the recent decision to exempt the Trans Adriatic Pipeline (TAP), a coordinated decision which for the first time involved regulators in the European Union and the Energy Community (specifically Albania).

Selectivity has also concerned two major public stock corporations which perform activities characterised by a high level of responsibility: Sogin and GSE. With regard to Sogin, the Authority, with the technical collaboration of ISPRA, for the first time has introduced a bonus/penalty mechanism aimed at speeding up the decommissioning process by increasing operational efficiency. With regard to GSE, specific disciplinary measures have been introduced concerning accounting (unbundling), an essential prerequisite to move beyond "refund of expenses" costs and assign such costs to those who induce them.

As already announced in last year's report, and perhaps to an even larger extent than was expected, the change in the operating paradigm for the electricity sector is imposing the maintenance, and where necessary, a review of rules for market operation. In an increasingly complex system with growing needs for flexibility, combined with simplifications and imperfections in mechanisms which up until a short time ago did not have significant economic impacts, today urgent corrective measures are demanded. An example of this has emerged in Sardinia. The Authority's fact-finding investigation revealed how a number of parties had introduced conduct which led them to increase their profits not through healthy competition in the dispatching market but instead by exploiting a number of weaknesses in rules regarding imbalances. As soon as the problem emerged, the Authority acted, on a precautionary basis, to prevent further increases in imbalance charges. Over the next few months it will be necessary to strengthen rules governing imbalances.

Rendering operators responsible thus becomes even more important. To this end it is necessary to prevent the market design from diverging too far from the actual physical transmission and generation system. Interventions carried out on essential facilities have been a move in this direction for safeguarding system security and flexibility services. With regard to the latter point, the Authority is working on a project to revise market architecture for dispatching services with the aim of enabling efficient selection and remuneration – on an opt-in basis – of the primary regulation service; that is, of one of the main flexibility services. This revision of market rules cannot ignore the goal of creating a single electricity market in Europe. The integration process is advancing rapidly. By 2014, Italy must extend to France and, it is hoped to Austria, the market coupling arrangement with Slovenia already in operation. In parallel, it will be necessary to work on integrating intraday markets, which are deemed strategic, in order to enable intermittent renewable energy sources to participate efficiently in the market. European integration is also moving ahead rapidly with regard to market oversight and monitoring activities, particularly with the implementation of the European Regulation on wholesale energy market transparency and integrity, also known as the REMIT Regulation.

The transaction reporting system should in fact become operational as of the first six months of 2014. The assumption underpinning this important, innovative regulation – with regard to which the 18-month term set for its legislative implementation at the national level as required to provide Regulators with new investigative and disciplinary powers is coming to a close as we speak – is that wholesale markets in the European Union are vulnerable to specific forms of manipulation and abuse which may damage consumers' very trust in the market. Regulation considers, among other things, abuses of a cross-border nature, which require new forms of coordination between national Regulators and the Agency for the Cooperation of Energy Regulators (ACER), who we thank.

Over the last ten years we have witnessed two cycles of investment in electricity generation: both of them legitimate and significant, but born to different parents. The first cycle, of investment in modern, conventional generating capacity, stems from the need to increase and make generating facilities more efficient by following market principles. This cycle has led to a clear increase in the average efficiency of generating capacity but at the same time has led to overdevelopment of capacity. The second cycle

concerns renewables, which stems from the new environmental sustainability and decarbonisation targets. These two cycles come together today in an approach which is only apparently competitive. Indeed, a closer analysis reveals that the approach is rather self-validating, with each seeking its own return, following a logic which is more corporative than market-based. It is a divisive, losing development model, focused on the partitioning of the (few) existing resources.

Now, in order not to burden consumers with further costs, the only prospect is for the two investment cycles to be positively integrated, "cohabiting" on the same electricity market. Renewable energy sources are asked to take responsibility for high induced system costs, while on the part of conventional energy sources innovation, in other words flexibility, is asked, as well as a broadening of horizons in terms of opening onto the European market. As we have just seen, with regard to the two potentially conflicting investment cycles in electricity generation, there is a need to pursue the goal of adequacy and optimal composition of electricity generating facilities in terms of technology and energy sources over the medium term, in order to take into account the highly cyclical nature of investments in generating capacity and uncertainties relating to investments in grid capacity. The electricity market is not always able to pursue such an objective on its own.

The Authority's approach is not to enter into a logic of subsidies for generators no longer remunerated by today's market, but rather to provide responses to a profound change in the fundamentals and to genuinely foster the aforementioned "cohabitation": responses built upon the logic of competition, through the introduction of capacity-driven market segments which do not distort existing price-setting mechanisms.

Italy, along with Germany, is one of the European Countries most affected by this concern, in view of the high percentage of intermittent energy sources in both Countries. The capacity market scheme developed by the Italian Regulator in 2011-2012 appears to be a sound solution, in terms of compatibility with the target model for electricity currently in the implementation phase at the European level.

CONSUMERS AND ENFORCEMENT

In the market context outlined hitherto, consumers have a decisive role, as they are themselves active players. With regard to consumers, too,

regulation must pursue an approach which by making them responsible of their behaviour, is capable of achieving the primary goal of protecting them.

Last year, in our annual report, we pointed out the damaging effect of the so-called "paternalistic" approach which tends to lead to the Regulator taking the place of the consumer, especially small-scale consumers, taking upon itself unilaterally the various choices "on their behalf". We expressed our wish – which we reaffirm today – that an increase in the level of "empowerment" on the part of the end consumer should be at the root of the solution sought. The Authority believes that the right approach to protecting consumers of energy or water can be summed up in three words beginning with P; two to be avoided and one at which to aim. The first negative "P" is certainly represented by the temptation to aim at "paternalistic" regulation, the results of which we have already illustrated; the second harmful "P" – we must not be shy of saying – is one in which the Regulator drifts, perhaps unknowingly, into forms of protection which comply with "populist" trends, designed to drag consumers in order to acquire unnecessary consent with regard to their action. The best "P" in terms of consumer protection consists in "proximity" to consumers, which is best encapsulated by the Greek term *παράκλητος*, "called to the side of" the consumer or by the consumer.

The negative "Ps" imply a concept of exercising the role of protection not as a service for consumers but rather as a limitation of their freedom: it is assumed that consumers are not aware of their role in the market. The model of proximity reverses this assumption. It is characterised by the utmost respect for their freedoms and is confident that it can induce an adequate level of capability on the part of the consumer which generates responsible awareness. What is important is that consumers are able to make aware, responsible choices: in other words that they are free and can exercise their freedom. Yet is such a model achievable for the average consumer? Over what timescale? Fundamental questions which this Authority is seeking to answer, by measuring the various facets of the level of awareness among different types of consumer.

The initial findings of the preliminary investigation – which is still underway – into the retail markets would appear to point to a still-high degree of information asymmetry between sellers and customers. Although overall knowledge of energy markets is increasing, the final customer, on average, often displays an inadequate capacity to choose and behaviour

that is not oriented towards seeking market opportunities. The Authority's effort to overcome this information asymmetry, which to date has held back customer empowerment, lies in its proximity-gearred approach, with the purpose of ensuring maximum transparency. This is the context within which actions aimed at monitoring the market in its various aspects (wholesale, retail, etc.) are conducted, in addition to improving instruments available to customers, such as the Consumer Desk, which has seen its service expanded and improved. Specifically, the Consumer Desk has been tasked with managing unrequested contracts and the indemnity system. Initial data would appear to show that the number of unrequested contracts is decreasing, compared with the period prior to the introduction of regulatory measures in this regard. During the last half of 2012 such contracts represented 0.13% of all customers served on only the free market in electricity and 0.02% on the entire gas market; complaints concerning unsolicited contracts represented 11% and 4%, respectively, of all complaints. The most significant figure is however that regulation led sellers to act promptly in almost all cases reported by end customers. Mention should also be made of positive self-regulation initiatives on the part of operators. The Regulator plans to continue its action to counter the hateful phenomenon, which undermines trust in the market, by completing the respective monitoring system.

I would also briefly like to mention the indemnity system. It is an instrument for countering any opportunistic behaviour inherent in arrearage by a number of customers, with negative repercussions on the development of competition in the retail market and in terms of possible price rises for other end customers. During its two years of operation, the system has enabled around 2.5 million euros a month in unsettled bills to be recovered in both the free and enhanced protection markets. Arrearage remains a worrying issue – a tangible sign of the current economic situation – on which the Regulator continues to focus through various provisions. To mention one figure, in the electricity sector requests to suspend the service have reached 5% of the total number of delivery points for domestic customers and 9% for small enterprises. Initiatives adopted by the Regulator in 2012 include a consultation process regarding guidelines for regulating the database of breaches of contract on the part of final customers, initially with lists regarding arrearages; a possibility which, following observations made by consumer associations has been superseded and is being studied with a view to potentially being implemented for small and medium-sized enterprises, whose associations

have stated that they can test it.

In keeping with the principle of proximity about which I spoke earlier, the Authority is also acting to increase consumer empowerment through specific institutional communication campaigns. After the campaign conducted in conjunction with the office of the President of the Council of Ministers and the Ministry of Economic Development on the *Numero verde per il consumatore di energia: 800.166654* (free phone number for energy consumers: 800.166654) in the form of radio, television and Internet spots, in 2013 a new project devised to spread basis awareness of energy and free market issues was developed through various television slots: results in terms of audience share are positive.

2012 saw a reduction in the overall number of complaints to the Consumer Desk, the result above all of the solution through appropriate measures – to which we continue to be committed – to a number of problems relating to the social bonus. Since 01st January 2013 the mechanism, renewed by the Authority, of the electricity bonus for physical hardship, that is, the bonus for patients dependent on electromedical equipment to keep them alive, which can be combined with the bonus for low-income households, using an ISEE (*Indicatore di Stato Economico Equivalente*, Equivalent Economic Status Indicator) for access to the bonus, and for large families. At the end of 2012, over two million families were eligible for the bonus for electricity, and one million families for gas.

In last year's report we pointed out that promotion of the market is achieved through rapid, efficient procedures for solving problems in the relationship between customer and provider. Among these we mentioned the promotion of dispute resolution procedures, to be placed alongside the already effective joint dispute resolution procedure protocols. The Authority's *Servizio Conciliazione Clienti Energia* (Energy Customer Conciliation Service) is a reality (it is in an initial, experimental phase) and is one of the out-of-court dispute resolution procedures to which customers may have recourse in order to solve any problems which may have arisen with their provider. The Conciliation Service is provided completely online, and provides for a third-party conciliator who is independent of the two parties with expertise in mediation and energy. Its scope of application is extremely broad, both with regard to potential users of the service and disputes covered by the procedure. For these reasons it is in line with regulatory developments at the EU level in terms of Alternative Dispute

Resolution (ADR) to the benefit of consumers, and has been welcomed by stakeholders as a system of reference for dispute resolution.

Remaining on the topic of disputes, over the last year regulations have been implemented for dealing with complaints submitted by providers about infrastructure operators, with 24 complaints being dealt with (part of a larger number of cases received). The mere introduction of the regulation – and this is an important result – would appear in itself to have produced a deterrent, encouraging parties to settle disputes directly. To return to the subject of information: although it is true that information for consumers does not constitute a sufficient condition for their empowerment, it is nonetheless a necessary condition.

With regard to improving the information for consumers provided by invoicing – that is, by bills – we have awaited approval of European Directive 27/2012 (currently being transposed into Italian law) dedicated to increasing demand-side participation in the market and the drive towards energy efficiency, to launch a new, renewed project to simplify and rationalise the document known as the "bill".

A combined initial reading of the first results of our investigation into the retail market just mentioned and of the guiding criteria of European legislation designed to ensure that consumers are provided with exhaustive, clear information about their consumption and energy costs on which they may base their free market choices has led to the "*bolletta 2.0*" project as an aid to consumer awareness.

Current regulatory provisions regarding the legibility and transparency of energy bills were deemed unsatisfactory by the average customer consulted by us in 2012, who did not feel that current bills help them to understand their own behaviour and energy needs.

The project will take an innovative approach with a high degree of participation on the part of consumers and providers through their respective associations, which will produce reconnaissance documentation drawn up by the parties involved (supply and demand). From the end of 2013 onwards, this will be followed by *ad hoc* regulation on the part of the Authority, which will implement – we hope – joint, shared solutions; already today, it can be said that our goal is concise information in summary form and greater use of modern computerised procedures.

It should be pointed out that, as part of this Authority's action, the focus on disseminating information to customers and ever wider monitoring of markets and the various activities of the energy supply chain has

developed in parallel with a project to simplify and reduce administrative charges stemming from obligation on regulated parties to provide information, requiring among other things the adoption of Guidelines to be introduced by 2013 regarding the measurement of such charges and designed to reduce them.

Usability of information data for operators for the complete opening up of the market, to the benefit of end customers, is also attributable to the continuation of regulatory activities focused on the upcoming operational start-up of the Integrated Information System (*Sistema Informativo Integrato*, SII), with the purpose of managing information flows relating to the electricity and gas markets, based on a centralised database of delivery points and end customer identification data.

As mentioned previously, it is opportune to debate whether the average level of empowerment of domestic customers or small enterprises is such as to enable individual customers to operate completely independently on the free market with only the protection of rules (and no longer prices) on the part of the Authority. Following, that is, the classic pattern of individual switching adopted by large customers from the very initial stages of liberalisation, which as of 30th April 2012 had led almost 24% of domestic customers and 41% of small enterprises into the free market. In this context, the Regulator is observing with keen interest the recent initiative to set up a buying group on a national scale for domestic customers – based on models similar to those already trialled in other European countries such as the UK, the Netherlands and Portugal – in order to identify, through competition procedures, the best conditions for electricity and gas supply and encourage so-called switching on a collective basis on the part of thousands of members of the buying group. The challenge of such models is whether they will make it possible to effectively offset the information and bargaining power gap between supplier and customer or will be models which are appreciated only by those customers who have already seized the opportunity offered by liberalisation of their own accord.

On the consumer side, the results achieved thanks to bonus/penalty mechanisms introduced in relation to the quality of distribution services are also deserving of mention. Following the establishment of obligations and the gradual extension of participation in the mechanisms also to smaller firms for both the electricity and gas sectors, increasingly positive trends were recorded in 2012. To mention just a couple by way of example, I

would mention that electricity service outages ascribable to distribution companies, which currently stand at 43 minutes per customer per year, have decreased by one third since 2000, while standard gas leakages fell by one third between 2009 and 2012. During the 9 years from 2004 to 2012, the reduction in the length of electricity outages led to overall bonuses of around 740 million euros being paid out, with approximately 3.5 billion euros of extra economic output. These results will make it possible to introduce additional, increasingly selective elements over the coming regulatory periods which reward particularly efficient, effective behaviours aimed at creating value for the end customer.

Until now we have spoken about the activities of the Authority as an institution with the purpose of establishing regulation to promote competition and efficiency in the sectors under its remit, based on an approach which places the emphasis on proximity to the customer. This approach is completed – or rather its effectiveness is guaranteed – only through activities to oversee and monitor regulatory compliance (enforcement). Enforcement which we develop by means of investigations, which can – in cases of proven non-compliance with or violations of legislation – lead to penalties, which are today partly supplemented by the institution of commitments, in addition to the important – as it leads to a reduction to the charges contained in energy bills – recovery of sums unduly received. With specific reference to incentive mechanisms for renewable energy sources or their equivalents, the total amount expected to be recovered from 2005 until today is around 300 million euros.

Against this background the Authority has launched a number of well-known investigations which are now in their closing stages, such as the investigation into electrical imbalances, into the provision of the gas balancing service in relation to the failure of a number of defaulting users to pay sizeable sums invoiced for quantities of gas transported and to the Authority's oversight and monitoring activity, conducted by means of inspections (130 in 2012 alone), with the invaluable support of the Guardia di Finanza (Italian Tax Police).

Another activity related to this context is the Authority's monitoring of compliance with the prohibition against passing the charge arising from the increase in IRES (the so-called "Robin Hood Tax") on to consumer prices, for which the Authority has reporting powers, a task we fulfil every year by submitting a report to Parliament concerning our activity. In this regard I must also point out the positive effects of this monitoring activity, once

again performed with the Guardia di Finanza, in terms of possible recovered national tax revenue from 2008 to 2012.

We would like, in addition, to offer an assessment – a very positive one – of the year of application of regulations regarding the reinstatement commitments added to the Authority's sanctioning powers without detracting in any way from the appropriate deterrent signal inherent in the imposition of regulatory penalties. The implementation of this regulation, which became final in June 2012, has seen operators submit 10 proposals (of which 6 were approved and made compulsory, 3 rejected and 1 declared admissible and published for comment by third parties), showing that reinstatement commitments are taking on an increasingly important role in the system of enforcement. Indeed, they make it possible not only to conclude proceedings more rapidly but also to benefit those consumers subjected to the violation directly and immediately.

It is also positive that the subject of these commitments is the obligation on the part of companies to comply with quality standards which are higher than those set by the regulation itself, with resulting improvements in services provided to end customers. This regulation, too, is proof of the effectiveness of an approach characterised by proximity to the consumer, which truly guides our action.

WATER SERVICES

Like last year, I have left until last a number of considerations on the water sector, not because they are "left over". On the contrary! We intend to give the same importance to the water sector as to energy, by dedicating specific attention to this sector and organising, once again in Milan, the 2nd National Conference on Water Services Regulation, an opportunity for dialogue and debate with all parties concerned: the second edition of what in 2012 was an important experience for us in terms of contributions received on which to build.

Last year in setting out upon the task of water regulation, we stated that we were "*confident in facing this challenge positively*", the challenge laid down by the legislator to strengthen regulation and monitoring functions for the integrated water sector with the powers which we derive from our founding law. One year is an extremely short period of time. However, this brief period saw the Regulator's activities commence in four areas of

intervention: tariff regulation, regulation of quality of service, consumer protection and regulation of the service's assets. It is the first time since the "Galli Law" that topics relating to water services have been dealt with a structured manner.

Our action, geared first and foremost to protecting users, has been guided by the responsibility of creating, by regulation and other means, the preconditions for the development of the sector: development which is necessary so that "the primary resource of water" can become not just a "common good" but a "common good of high quality" for all consumers. All this in the knowledge that our Country needs – and it is the European Commission itself which asks it of us – massive investment in infrastructure, which is essential for future generations. The goal of restarting investment can only be achieved with certain rules, by overcoming the uncertainty that has characterised the sector in the last twenty years – which does not mean cancelling out those specific aspects that characterise the various contexts of water services – and with the identification of traditional and innovative financial instruments which make it possible not to obtain funds exclusively through consumer charges. In the current economic climate, which shows signs of structural crisis, it is not even possible to pass the onus of obtaining funding to close the Country's negative gap infrastructure and environmental terms to general taxation, which has been subject to constraints for some time. Additional finance instruments therefore need to be considered, such as revolving funds, or hydrobonds and project bonds, which can have strong ethical connotations; they constitute solutions to the goal of making capital available to invest in the sector, also as a driving force for reviving our economy in crisis.

With the approval of the current provisional tariff method, that is, the criteria for setting tariffs for 2012 and 2013, the Authority has identified a number of aspects (such as the transparent correspondence between efficient costs borne and prices charged) which take on the value of founding principles and are confirmed in the tariff provisions to be issued shortly. Thus a break has been made with the past by setting out plans for the future. The upcoming tariff measures make provision for the stabilisation of what has been established to date, also with a view to conciliating critical issues identified as a result of appeals in relation to the provisional tariff method. They form part of the completion of the regulatory framework both by placing value on planning choices which are consistent with European, national and local priorities, and

through their guidelines concerning accounting separation reporting obligations, in compliance with the outcome of the referendum.

We would like to consider several aspects of consumer protection in regulation plans. However, we feel that particular importance should be attached to the social sustainability of water tariffs: in other words, the issue of offsetting the expense borne by domestic users in need of support with regard to vital goods. The fact that Italian tariffs are among the lowest in Europe does not exempt us from tackling, together with the Government and Parliament, the issue of complete protection for disadvantaged users and users who cannot be disconnected from the service.

ORGANISATION

On the first of June the new regulation concerning the organisation, operation and the new set-up of the organisational structure of the Authority came into effect. It represents the completion of a process which began in 2011, continued in gradual stages and subsequent refinements for participatory purposes, with consultation with managers and our trade union organisations.

The reorganisation confirms the choice regarding departments, which has gradually formed over time, moreover without increasing the number of existing departments, inspired by principles of selectivity, specialisation and process efficiency and geared towards optimal cross-departmental and strategic coordination of activities. The Authority deemed it necessary to supplement these guiding reorganisation criteria with a tangible contribution to the general requirements of the nation and the need to rein in government expenditure, arriving at the current organisation through a painful but substantial reduction in the number of organisational Units (-15%) compared with 2011.

The new organisational structure aims to achieve maturer, more consistent integration of the energy and water sectors, thus internalising within the overall organisation of the Authority the competences and functions assigned to it by the legislator with regard to water services, to perform which an initial "start-up" organisational supervisory unit was set up.

While selection procedures are underway to fill 40 new staff positions in order to deal with water regulation issues, over the next few months a procedure of extraordinary internal mobility will be implemented. Currently exactly half of the Authority's staff (with an average age of 43) is women.

Constant discussions continue with trade union organisations, not just on the subject of reorganisation, in a two-way dialogue which is often tough with regard to individual issues but always positive insofar as it takes place within a framework of shared values, of *idem sentire* in relation to the primary resource represented by our institution and its staff.

As has already been said in previous years with regard to comparable situations, on this occasion we can only reaffirm our institution's complete readiness to cooperate in order to spread the culture and best practices of regulation to other sectors of the economy too.

In the energy sector the need has emerged to extend the scope of regulation to a number of sectors in which it is still lacking, especially ones in which it is essential to provide a solid framework for developing investments in energy distribution networks and introduce at the same time adequate protection for consumers and users. I am thinking in particular of district heating services for domestic and other non-industrial customers: it is time regulations were implemented for such services. This Authority can take on this commitment with a minimal use of new resources, thanks to strong synergies with other sectors which are already regulated.

Authorities, Ladies and Gentlemen,

The Regulator's work up until now and its plans for the future could not exist without the work and contribution of the people who provide their professional know-how at and for the Authority in its Milan headquarters and Rome offices. Our mentioning them at this time equates to our most heartfelt thanks.

Today I would like to take this opportunity to express my own personal thanks, which are echoed by those of my colleagues, to the Lombardy Regional Court (TAR Lombardia), the Council of State (*Consiglio di Stato*), the State Legal Advisory Service (*Avvocatura dello Stato*), CNEL, Consiglio Nazionale Consumatori ed Utenti, ENEA and the Compensation Fund for the Electricity Sector (*Cassa conguaglio per il settore elettrico*), the *Guardia di Finanza* (Italian Tax Police) who have been at our side for a long time, our own Board of Auditors, as well as all of the other institutions with which the Authority has always shared ties of loyal, active cooperation: in particular the Antitrust Authority.

In conclusion, we feel that it is appropriate to dedicate a short reflection once again to an intangible investment which will feature in our next year of activity, to which I referred at the beginning. It regards an innovative accountability project concerning the Regulator's decisions. The issue of the Authority's complete independence from operators and from the executive is a well known one, and one upon which we have already touched. It is guaranteed by a founding law which is, still today, one of the most highly appreciated and innovative laws in Europe. Independence means not having to respond to or receive instructions from anyone in order to carry out one's activities. Yet in order to guarantee that this technical discretion does not tailspin into a regressive, self-referential spiral, the Regulator must arm itself with transparent forms of accountability: accounting for its activities, a *Rationem Reddere*, in the original and not the peremptory meaning of transparency. Various contributory aspects have already been ascribed to the accountability of the Regulator: justification of its actions so that they stand up to administrative and judicial examination, intense dialogue with parliamentary committees, consultation on an almost daily basis with parties affected by its provisions, an ongoing process of notice-and-comment rulemaking extended to broad sectors of society. Nevertheless, investment in increased accountability over the next few months will consist in the organisation of regular, topic-based sessions on an *ad hoc* basis with experts representing the categories of those stakeholders whose interests the Authority represents and whom it protects. We are referring to representatives of consumers and domestic users of energy and water, associations of small and medium-sized firms, representatives of the interests of large and mid-sized end customers in the energy sector to whom the Regulator will address a special *Rationem Reddere*.

Last year's report ended with an appeal to the Socratic spirit of "convincing" on the strength of one's arguments rather than "conquering" by imposing one's decisions by force. This year we have chosen to repeat the notion, in confirming the commitment of this Authority to continue on this path with renewed energy. To paraphrase the writer Samuel Smiles we could say that without the will to labour energetically and perseveringly, no matter how the conscience speaks loudly, it will speak in vain.

I would like to thank you also on behalf of my colleagues for your attention.