



Autorità per l'energia elettrica e il gas

ANNUAL REPORT
TO THE EUROPEAN COMMISSION
ON REGULATORY ACTIVITIES AND THE STATE OF
SERVICES IN THE ELECTRICITY AND GAS SECTORS

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SUMMARY

SUMMARY/DEVELOPMENTS IN THE LAST YEAR

Legislative developments

The Government, in power since the national political elections of 9 and 10 April presented, in July, the economic policy guidelines for the period 2007-2011 in the Economic and Financial Planning Document (DPEF). In a specific chapter of the DPEF dedicated to energy, Parliament and the Government lay down strategic guidelines for the decisions of the Authority. Highlighting and insufficient level of competition in the electricity and natural gas sectors, the policy emphasised the need to: diversify the supply and provide adequate infrastructures; guarantee non discrimination in access to the grids, also, where necessary with forms of separation of ownership and limits on shareholdings in electricity transmission grid and natural gas storage and transport companies; to assure non discriminatory access conditions also to electricity metering activities, in view of the full liberalisation of the electricity market with effect from 1 July 2007; define public service obligations in the sectors liberalised and review the “social tariff” (i.e. tariffs for vulnerable customers); adapt the energy mix to reduce dependence on foreign supplies, through the efficient promotion of renewable resources, aiming at advanced, low environmental impact technologies. The DPEF, for the first time, also dedicated a section to the obligations stemming from the Kyoto Protocol.

The 2007 Finance Bill (27 December 2006, No. 296) paid particular attention to energy matters, defining significant incentives to promote energy efficiency (solar panel installation, energy re-qualification of buildings, renewal of domestic appliances and industrial motors, use of bio fuels). The same Bill re-defined the date by which Eni S.p.A. must proceed to alienation of its shareholding, over the limit of 20%, in the capital of Snam Rete Gas S.p.A. (within 2 years of the expected Snam Rete Gas privatisation decree) and ordered a review of the CIP6¹ regulations aimed at reducing the costs born by end users and implementing Article 2 of Directive 2001/77/EC (limits on new incentives to the so-called “assimilated” energy sources and incentives allowed only to renewable plants authorised and whose construction was already started).

Among the draft laws, whose content is expected to have a major impact on the structure of the energy sector and the activities of this Authority, is the draft *Government powers to complete the liberalisation of the electricity and natural gas sectors and to re-launch energy savings and renewable resources, in application of EC Directives 2003/54/EC, 2003/55/EC and 2004/67/EC (AS 691)* bill, issued in July 2006 shortly after the new Government took office and illustrated in the *2006 Annual Report*. The draft bill is still pending in Parliament, however part of its measures were anticipated by the afore mentioned 2007 Finance Bill (energy taxation, energy saving, renewable resources). Moreover the rulings referring to the duties and competences of the Authority, contained in the draft bill AS. 691, might be superseded by a new draft law, issued in Spring 2007, which completely overhauls the entire discipline of independent authorities (*Dispositions in matters of market regulation and vigilance and of the function of the independent administrative authorities* (AS 1366). Finally, the

¹ In 1992 the CIP6 regulation introduced an incentive system in favour of electricity production from renewable and “assimilated” (i.e. similar) resources. The incentives, specific to production technologies, are of variable, limited duration over time.

imminence of the full liberalisation of the markets on 1 July 2007, rendered legislative intervention urgent in June 2007 (full implementation of Directives 55 and 54 of 2003 and new competences of the Authority (see Chapter 6).

Developments in the electricity market

In 2006 electricity demand rose by 2.2% against the previous year settling at 337.8 TWh. The growth in demand for electricity, driven by good overall performance in the Italian economy, is associated with a continuative positive trend in electrical intensity (0.5%). The mean growth of 2.2% derives from differentiated increases of consumption across sectors. On the basis of the provisional data published by TERNA (the national grid company) the most significant increase, of 3.7%, was recorded by the service sector, while industrial consumption rose by 2%. Increase in domestic and agricultural consumption was rather less significant: with respect to 2005, they recorded variations of 0.5% and 0.7% respectively.

Net national production available for consumption registered a growth of 4.2%, settling at 293.1 TWh, while net imports fell significantly with respect to 2005 (-9.0%), at 44.7 TWh. Following this decrease, derived both by falling imports (-7.8%) and an increase in exports (44.5%) and largely due to the "gas shortage and emergency" (described in the *2006 Annual Report*) of winter of 2005-2006, the share of demand covered by net imports fell from 14.9% in 2005 to 13.2% in 2006.

During 2006, gross thermo-electric generation rose by 4.1%, at approximately 257 TWh. There was a slight consequent increase in the share of thermo-electric generation on total generation (from 81.3% in 2005, to 81.6%), to the detriment of production from pumping.

With reference to the mix of thermo-electric generation, despite a reduction of 2.1% in total natural gas consumption due substantially to the mild temperatures in the later months of 2006, natural gas consumption for electricity production rose by 6.1% during the year. This may be attributed to the start up of new combined cycle plants, which counter-balanced the effects of the imposition of fuel oil operation on *dual fuel* thermo-electric plants foreseen among the emergency measures adopted by the Government in the early months of the year, in order to contrast premature exhaustion of gas stocks. One effect of the emergency measures was a significant slowdown in the substitution of oil as an energy source: electricity generation from oil products did, indeed, fall by 1.8%, while over the last three years the use of oil as a generation source fell on average slightly less than 20% per year. Production from renewable resources rose in line with the overall increase in generation (3.6% over 2005), albeit notably below the value reached in 2004 (-7.2%) due to a natural hydro-electric supply significantly below the average of the last decade (36.7 against 41.8 TWh). 2006 was distinguished by a significant increase in wind power, at 0.9 TWh, which brought this source to contribute to over 6% of overall generation from renewable resources. The increase in geothermal production was also above the average (3.8%). In terms of generation market shares, in line with the trend in recent years, there was a further contraction of the ENEL group market share (some -4%) mainly in favour of Edison, which reached a market share of almost 13%. The rises in the market shares of the other major companies, ENI, Endesa Italia and Edipower, were less significant. During the year new gross efficient capacity for approximately 4,500 MW, mainly constituted by thermo-electric plant, was started up.

With reference to the performance of the regulated market operated by GME S.p.A. (the electrical market operator company), the transactions on the Power Exchange reached 196.5 TWh, falling by 3.2% with respect to 2005. The reduction in demand on the Power Exchange derived mainly from a significant reduction in demand from the Single Buyer company, of approximately 7.0 TWh, due to a contraction in the captive market, for which the Single Buyer procures on the Exchange. By contrast, demand through bilateral contracts rose by almost 11% over 2005, following a rise in demand of over 17 TWh from the national operators other than the Single Buyer.

The average purchase price (PUN) on the Italian Power Exchange was 74.75 €/MWh, rising by 16.17 €/MWh over 2005 (27.6%). The increase reflects, among other components, the input price trend, in particular in Brent oil, rising by approximately 19% on the European markets, and natural gas, whose average import price in Italy rose by approximately 30% over 2005. A significant differential in prices (17-26 €/MWh) between the Italian Power Exchange and the major foreign exchanges, particularly high in peak hours, was recorded also in 2006.

With reference to the retail market, at 31 December 2006 the eligible clients were 7.6 million and they consumed, during the year, 221.5 TWh of electricity (net of consumption by users benefiting from special tariff regimes). With respect to the previous year, the volume of energy withdrawn by the same group of clients fell by approximately 1.7 TWh. At 31 December 2006, the eligible clients effectively supplying on the free market, were, by contrast, around 700,000, with a total consumption of 149.7 TWh, corresponding to 67.7% share of the potentially free market. Energy consumption on the captive market in 2006 settled at approximately 138.5 TWh, of which 61.6 TWh for domestic consumption.

The standards of continuity of service in the electricity distribution grids were improved also in 2006. Indeed, the duration of interruptions without warning for low voltage clients fell from 80 minutes per client in 2005, to 64 minutes in 2006, considering all interruptions. However, with reference to commercial quality, data supplied to the Authority by the operators evidence that in 2006 both the number of cases of failure to respect the specific quality standards subject to reimbursement and the number of indemnities paid to clients rose.

Developments in the gas market

2006 was a troubled year for natural gas consumption: beginning with the tension caused by the gas shortage and emergency of the winter months, there were then worries in the opposite sense in the autumn and winter seasons, much warmer than the average in the preceding years. Overall, according to the preliminary data issued by the Economic Development Ministry, gas consumption in Italy fell from 86.3 to 84.5 G(m³). Also on the basis of the data provided by the operators in the annual survey conducted by the Authority, gas consumption in Italy appears to be falling with respect to the previous year: adding to sales, which reached 77.3 G(m³) and self-consumption, 7 G(m³), we obtain a total estimated consumption of 84.3 G(m³). Consumption was covered by national production of 10.4 G(m³) and the remainder by imports, which reached 77.4 G(m³). Part of the gas acquired remained in storage: storage variations show a negative value, at -3.7 G(m³). National production saw another fall (-9.1%), following the decreasing trend which has now lasted for more than a decade. The national production quota of total consumption

fell further to 12.5% (it was 33.6% in 1997). Italian dependence on foreign supplies rose, consequently, year by year: in 2006 a further 5.4% of gas was imported than in 2005, reaching 87.5% of the gas distributed.

With respect to 2005 the balance of gas operators in 2006 appears to be substantially unchanged. On the procurement side, there was an appreciable effort by minor operators who increased both production and imports, although the latter were mainly cross-border purchases from Eni S.p.A. The excess stock accumulated in expectation of a cold winter was significantly less for the major wholesalers (Eni excluded) perhaps as they are more specialised in sales for large industrial consumers and electricity generation. Similarly, climatic conditions determined a fall in purchases and sales, albeit differentiated across the diverse categories of national operators. The fall was higher for retailers, specialising in the domestic sector, than for wholesalers; it also heavily impacted on purchases at the border. On the other hand, there was a general increase in transactions at the VTP (Virtual Trading Point), particularly important to the sales and purchases of the minor wholesalers and the purchases of retailers.

The split of sales between the free and protected markets did not change substantially with respect to preceding years: from the 77,3 G(m³) sold (the data excludes self-consumption), approximately 69% was purchased by the free market, against 31% by the protected market.

Organisation and mandate of the regulator

The need to respond to the changing conditions of the market, prompted the Authority to complete the process of reorganisation of its' offices begun in the second half of 2004 and addressing progressive regulatory harmonisation in the gas and electricity sectors, more coherent with full liberalisation of the markets, foreseen for 1 July 2007. From 1 January 2007, the objective of "convergence" of regulation in the two sectors pushed the reorganisation towards the creation of a single Markets Direction dedicated to the technical-economic regulation of the electricity and gas markets. The new organisation thus foresees three regulatory Directions horizontal to the electricity and gas sectors (Markets; Tariffs; Quality and Consumers' Affairs) and four service/support Directions (Strategies, Research and Documentation; Human Resources, Administration and Finance; Legislation and Legal; Vigilance and Control). The new structure of the General Secretariat which, in the new reorganisation, further to programming, planning and strategic control, also includes institutional relations - national and international - and communications, aims to give further space to *advisory* activities and the dialogue with all the *stakeholders*.

There were no changes in the competences of the Authority in 2006. It must however be noted that the energy sector restructuring Bill (AS. 691), in discussion in Parliament, is oriented to restore the fullness of the Authority's original powers (in particular in matters of electricity imports and tariff control), and confirming others not explicitly foreseen in the founding law (extension of competency to all phases of the chain and not solely those in natural monopoly conditions), foreseeing augmenting the control function of Parliament over the activities undertaken by the Authority itself, and redefining the composition of the Board.

Main developments common to both sectors

Among the regulatory activities common to both sectors, particular attention, in view of full liberalisation in July 2007, was paid in 2006 to those relative to consumer protection (transparency of billing documentation, commercial codes of conduct and price comparison instruments) alongside the normal handling of complaints and queries from both individual customers and from the consumer associations.

2006 was the second year of full application of the mechanism of energy efficiency promotion based on a system of individual energy saving obligations on the operators and on trading system of efficiency certificates (white certificates) started in 2004. Further the review of the regulations increasing the efficiency of the mechanism, the Authority, during the year, developed an important collaboration with ENEA² to evaluate, verify and certify projects. In October 2006 the first *Annual Report on the White Certificates Mechanism* was on the basis of the results of the first 17 months of operation published; the *Report* documents a system which, after three years of building up, shows an overall positive performance.

The experimental phase of Regulatory Impact Analysis (RIA)³ started in 2005 (see last year's Annual Report), was carried on in 2006 and four dispositions subject to RIA were adopted on: storage tariffs, electricity dispatching discipline, the hourly bands for delivery of electricity and standards for communications between the distributors and retailers of natural gas.

Monitoring and vigilance over the effective implementation of regulation, also addressing improvement of the same, are to assume growing importance among the Regulator's activities. Thanks to the definition of collaboration agreements with the Finance Police, the Italian National Agency for New Technologies, Energy and the Environment (ENEA) and other technical support institutions, in 2006, the offices of the Authority undertook over 100 inspections and controls on operators and plants, over half of which dedicated to technical and commercial quality and the safety of service.

Activity in the electricity sector

Tariff regulation activities concentrated on: a review of the protection mechanism for disadvantaged and vulnerable consumers; modification of the criteria for updating of the "Avoided Fuel Cost" in the incentive prices for renewable and assimilated energies (CIP 6 disposition); the re-determination of the tariff costs connected with the dismantling of nuclear power stations and with *stranded costs*; the start up of activities for the definition of the transmission, distribution and measurement tariffs for the third regulatory period (2008 - 2011).

Among the measures to *promote competition* adopted in 2006: the revision of the rules for the allocation of interconnection capacity undertaken within the European regional market integration programme promoted by ERGEG; the proposal of measures to promote competition and transparency in the retail market in view of the opening of the domestic market on 1 July 2007; the simplification of the hourly bands for electricity distribution

² ENEA is a public body that promotes and undertakes basic and applied research and technological innovation activities in the energy field.

³ Mandatory in Italy for independent administrative authorities as indicated by Article 12 of Law No. 22 of 29 July 2003.

and sale driven by criteria of homogeneous prices. Finally, in January 2007, the Authority modified the regulation of *unbundling*, adopting the criteria of functional separation of the activities essential to the liberalisation foreseen by the European directives.

With reference to *technical-economic regulation*, the main measures adopted in 2006 are: a review of dispatching discipline, of *load profiling* and of the remuneration of interruptibility. Particular attention was paid, in the regulation of metering, to the application of the progressive obligation, from 2008 to 2011, to provide all consumers with remotely controlled electricity meters.

The regulation of *quality* of service during the year, focussed on: the application of the rulings established for the regulatory period 2004-2007 by the *Electricity Service Quality Code*; the introduction of new dispositions relative to detection of low voltage clients supplied effectively affected by power cuts; the simplification obligations of medium voltage clients; the proposals for regulation in matters relative to *extended and prolonged power cuts* and *commercial telephone service quality*, matters which will be merged into the new regulation for the third regulatory period, whose study began in September 2006.

Activity in the gas sector

In 2006 the activity undertaken in matters of *tariff regulation* referred principally to completion of the discipline of the transport tariff (metering charges for the re-delivery points, tariffs and conferral of capacity at the interconnection gas pipe points and incentives for interruptible supplies), the modification and integration of the distribution tariff discipline rendered necessary after the prolonged legal dispute and the determination of the storage tariffs for the 2006-2010 regulatory period.

In the activities addressing the *promotion of competition*, the Authority adopted a series of measures intended both to guarantee the adequacy of the gas supply and to prevent the repetition of a gas emergency and shortage similar to that which occurred in the thermal year 2005-2006. Further to foreseeing a transitory balancing regime to facilitate the reintegration of storages, measures were adopted to favour the interruptible supplies of consumption and the release of unused capacity. On the retail side, a change of the economic conditions for the supply of natural gas and of the cost component of the raw material was necessary in order to take into account the high and consistent rises in fuel prices, the definition of new storage tariffs and the update of the transport related component. Finally, in January 2007, the Authority modified the regulation of *unbundling* adopting the criteria of functional separation of the activities essential to the liberalisation foreseen by the European directive.

With reference to *regulation of the infrastructures*, various measures of technical nature intended to regulate access to the sector's *essential facilities* were adopted. Among these: the approval of the Standard Grid-Distribution Code and the Storage Code, of the changes to the Transport Code of Snam Rete Gas and the Società Gasdotti Italia, the predisposition of the criteria for allocation of transport capacity at the entry points of the regassification terminals, for which there was an exemption from the third party access obligations. Further the provision of standard withdrawals for the diverse gas usage categories were defined. Finally, in July 2007 the introduction of infra-annual allocations with effect from 1 October 2007, in compliance with EC Regulation No. 1775/2005 was completed.

Regarding the *quality of service* the activities were mainly devoted to the monitoring of the regulation of safety, continuity and commercial quality standards of gas distribution that brought, in some cases, to adjustments in rulings and implementation procedures. In the regulation of post metering safety standards, some simplification and further information guarantees for consumers to the norms that regulate control obligations were introduced. Better information standards about the minimum national insurance for gas end users were also introduced. In 2006 new proposals to regulate standards for quality, safety and continuity also for natural gas transport were also defined.