

ANNUAL REPORT ON THE STATE OF THE SERVICES AND THE ACTIVITY CARRIED OUT

Introduction by the President of the Authority

Rome, 4 July 2001

President of the Republic,
Presidents of the Senate and the Chamber of Deputies,
Ministers, Authorities, Ladies and Gentlemen,
The Authority for Electricity and Gas today presents its fourth Annual Report on the state of the services and the activity carried out.
On behalf also of the other members of the board, Prof. Giuseppe Ammassari and Prof. Sergio Garribba, I wish to express our gratitude to the President of the Republic for honouring us with his presence at this ceremony. This is a source of great support and encouragement to us in our work.

In accordance with the law establishing the Authority, the Report provides information on the state of the services, which are undergoing a radical transformation as a result of the opening up of the energy sectors to competition, and on the activities which the Authority has already carried out or which are currently in progress.

In the European Union electricity and gas markets are being progressively liberalised and integrated within the Single Market framework as the Directives adopted in 1996 and 1998 respectively, and subsequently transposed into legislation, are implemented. Progress within the EU has been uneven: in some countries the process has been taken much further than the levels required by the Directives, although this does not necessarily mean that conditions of true competitiveness have been achieved. In others, however, it is being held back, to the extent that some countries have still to transpose or fully implement the Directives. Difficulties and fears sometimes emerge that require prompt and appropriate responses from the institutions.

THE PROGRESS OF LIBERALISATION

The energy sectors are being liberalised in much of the industrialised world, and the process is proving beneficial to economic and social development and bringing clear advantages: greater competitiveness in the productive and industrial systems, the creation of new firms and businesses at both the national and international levels, and increased freedom of choice for consumers.

In Europe the price reductions we have witnessed over the last decade appear in general to be directly correlated with the degree of market opening in each country. The United Kingdom and the Scandinavian countries have experienced reductions in electricity prices of up to 35% in real terms since the early 1990s, when the liberalisation process was first launched. Since 1995 electricity prices have fallen by about 22% in countries where the markets have been fully opened to competition, and 13% in countries where market opening is less than 40%.

The benefits are even clearer if we look to the future: by its very nature, liberalisation operates on a long timescale, as is the case for all structural transformations.

The general public's attention has been captured by certain critical situations that have emerged. In areas where the demand for electricity is growing particularly fast, there are clear shortfalls in energy availability.

The case of California, where the electricity system has been thrown into a very serious crisis with interruptions in supply, large price increases, and the insolvency of energy suppliers, stands out in particular. The crisis originates from an imbalance in the

relationship between supply and demand and from a poorly designed and managed regulatory system that has increased the effects of this imbalance.

Electricity demand has been growing at an increasingly rapid pace in California as a result of the strong population flow into the State, the growth of the economy and of IT services in particular, and strong demand for air conditioning. Supply has been held back by strict environmental constraints and by the climate of uncertainty linked to the transition to a competitive framework that was introduced without the necessary degree of clarity in either the rules to be applied or the roles of the different public institutions involved in the process. The shortage of interconnection lines has prevented the local market from integrating with neighbouring ones. The exceptionally large rise in wholesale prices, fed in part by the concurrent rise in natural gas prices, has been exacerbated by short-term supply and demand rigidities.

The Californian regulatory system, based on free prices set in an electricity exchange system and tight tariff restrictions on retail sales, has prevented the market from sending out sufficiently clear signals to operators. Wholesale prices have grown as much as tenfold. The ceiling on retail prices has resulted in the financial crisis currently being experienced by the major distribution companies, which have been bailed out by public funds, which in turn has created a heavy burden on taxpayers. The belated adjustments to final prices have been concentrated in a short space of time and are producing strong price increases for consumers.

The Californian case should not be seen as an invitation to slow down the transition to a more competitive system. Rather, it invites us to draw up the liberalisation rules very carefully indeed and to avoid uncertainty and ambiguity. It underlines the efficacy of the mechanism for the transfer of wholesale prices to the tariffs applied to final consumers as drawn up by this Authority in recent years: a mechanism of moving averages that smoothes out short-term fluctuations in fuel prices. The Californian experience also confirms the advisability of creating a long-term capacity market and of the Authority retaining its power to intervene on the wholesale markets whenever insufficient competition gives rise to unacceptable behaviour.

In Europe, the opening of the electricity and gas markets to competition is making headway, albeit with some difficulties. Linkages between the national or regional energy markets are still poor: the transition to a continent-wide single market is being held back by physical interconnection shortcomings, by the differences between the various industrial and market structures, by weaknesses in the common rules set out in the European Directives and by the different speeds and rates with which the national systems are complying with these rules.

The bodies that manage the electricity transportation networks in Europe have not yet reached agreement on the introduction of a transparent cross-border tariff system, thus hindering the free circulation of electrical energy. Directive 98/30/EC on the natural gas market has not yet been transposed by some Member States, including France and Germany.

At the beginning of March 2001 the European Commission proposed a new directive to the European Council that would amend the electricity and gas market liberalisation directives currently in force in order to address the shortcomings that have emerged through practice and experience and accelerate the liberalisation process by bringing forward to 2005 the introduction of freedom of choice of supplier for all consumers. The proposed directive would create a clearer separation between the sale of energy to customers and the transportation of energy over national and local networks, in order to create equal network access conditions for competing companies. It also envisages the creation in all Member States of a regulatory Authority that would be independent of sectorial interests and would have wide-ranging autonomy and a regulatory role that

included, at the very least, the setting of the conditions for access to the networks and other essential facilities, including interconnection with neighbouring countries.

Along with the new directive, the Commission has also proposed a regulation to introduce tariff rules that would eliminate barriers to the flow of electricity. The European Council in Stockholm on 23 and 24 March decided to delay its examination of the proposals. This decision has held back and weakened the liberalisation process.

A greater degree of convergence by Member States on joint decisions, leading to complete liberalisation sooner rather than later, would reduce uncertainties and contribute to industrial and economic development. Greater uniformity in the transposition of the existing directives is required. The need for harmonisation is underscored by the prospect of an enlarged European Union. The candidate countries for accession are characterised both by strong real growth and by inefficient energy systems that will require considerable investment to develop and up-grade plants and curb emissions.

Security of supply, discussed in a recent Commission Green Paper, must be pursued through joint action. The creation of an integrated, liberalised European energy system will also make an effective contribution to security: by unifying the diverse systems, it will reduce the risks inherent in reliance on single sources of supply. Europe's links with the countries of the Mediterranean basin will need to be strengthened through greater cooperation and an up-grading of interconnection facilities. Liberalisation is a European choice that is not open to second thoughts. In terms of implementation, it has already passed the point of no return: we have no other choice but to continue along this path with determination and commitment.

THE ELECTRICITY MARKET

Electricity prices in Italy are high compared with European levels. Average Italian domestic tariffs exceed the European average by about 20%: Italian tariffs are considerably lower in the case of low consumption profiles, and considerably higher in the case of high consumption. The electricity tariffs applied to industrial users are between 25 and 50% higher than the corresponding European averages. On the free electricity market, which is developing rapidly, prices are 10-15% lower than the tariffs applied to captive customers. In many countries tariffs and prices have fallen in spite of the increases in the international prices of oil and natural gas; in Italy, however, tariffs rose by an average of 10% between the beginning of 2000 and mid-2001 as a result of our dependence on hydrocarbons for electricity generation. The gap between Italy and the rest of Europe has widened.

In the same period Italian electricity tariffs, if calculated net of fuel costs, actually fell by about 10%; a further decrease is envisaged in 2002. The Authority's provisions, which anticipate the expected effects of competition, have offset our weak currency and the inflationary effects of price trends in the world oil market. However, the cause of the high electricity prices in Italy is not only our strong reliance on oil, which equates to about 34% compared with a European Union average of 10%. Another contributing factor is the low efficiency of partly obsolete generation plants that produce only modest conversion yields.

The high level of general system costs also plays a part. These now account for 8% of the average unit cost.

One general system cost that is proving to be particularly burdensome is related to the support provided for plants using renewable and assimilated sources, on the basis of regulation enacted in 1991 and 1992.

As a result of a ministerial decree, since January of this year more than one tenth of Italy's entire national output has been produced from renewable and assimilated sources and has come onto the market by way of auctions. This production is remunerated at source by applying a purchase price defined by legislative provisions issued between 1991 and 1995. The auctions, which are partly reserved for customers willing to accept "interruptability" clauses, have resulted in prices that are much lower than those paid to generators. The difference is adding to the system costs applied to electricity consumers in general.

System costs also include the costs involved in the transition from a monopoly to a competitive framework; these include compensation for investments made and commitments undertaken by the former monopoly company and other production-distribution companies, which the competitive market might not amortize or honour: in other words, "non-recoverable" or stranded costs. In proposing the criteria for the definition and calculation of costs eligible for compensation, the Authority has only recognised those costs that are genuinely non-recoverable, so as to avoid placing an unjustified burden on consumers. The Authority must now implement government provisions, which under the terms of legislative decree 79/1999 it is bound to respect, that diverge from these criteria. If the total stranded costs did indeed amount to the maximum set out by the Government, 15,000 billion lire, and if these were spread out over the four remaining years of the transition process, this would produce an unacceptable increase in the prices charged to all consumers, the equivalent of 14 lire for each kilowatt-hour. The tariff structure is now consistent with the transition to market prices: the tariffs for supply to final customers are the sum of distinct components, each of which is to be replaced by market prices.

The tariff component corresponding to generation costs has been unified and the distinction based on type of plant eliminated. The incorporation in the tariff of the compensatory component for fuel costs, previously a separate item, has produced an increase in the returns on energy generated by hydro-electric plants: part of this is being levied (on a temporary basis) in order to offset the increased costs to consumers.

In the captive market too operators now have the faculty to offer their clients "tariff options": in this way a limited degree of flexibility has already been introduced to the tariff system during the early stages of liberalisation. Businesses have begun to take advantage of this greater freedom of choice, as high electricity prices are a significant cost factor for them and weaken their competitive position. The answer to the problem lies not in sectorial tariff systems, which would be the equivalent of subsidies, but in liberalisation, which must be speeded up.

Demand

A liberalised framework rests on three pillars: a demand side that has freedom of choice, a competitive supply side, and guaranteed access to networks for operators under equal and non-discriminatory conditions. The number of customers eligible to obtain their electricity on the free market has more than doubled in little over a year: in May 2001 there were 1,200, with over 8,000 off-take points, accounting for over a third of total demand. The number of customers will rise to about 150,000, accounting for about 60% of total consumption, when the access threshold for eligible status falls to 100,000 kWh per year, three months after the sell-off of Enel power stations has been completed. The small and medium-sized companies that are such a distinctive feature of the Italian industrial fabric, many of which already have access through purchasing consortia, will then enter of right into the free market.

An essential step for the exercise of true freedom of choice of supplier is the possibility for customers and their suppliers to have access to the local distribution networks without unjustified restrictions. Distribution, which is subject to exclusive licensing arrangements, therefore needs to be clearly separated from the sale of electricity, which is, on the contrary, a free activity carried out under competitive conditions: this is the solution adopted by the European Commission in the recent proposal for a review of the energy directives.

In Italy the Authority introduced a requirement for the accounting unbundling of distribution and sales activities as early as 1999. In accordance with the provisions of legislative decree 79/1999, the Minister for Industry has begun issuing distribution licences that extend until 2030. The Authority has proposed to the Government that the scope of the licence should be limited, by excluding from it the activities of selling and metering consumption. Meter-checking provides access to information that is of prime importance in sales activities. It is essential to ensure that the technical standards adopted for metering equipment cannot in future create an impediment to the entry of competitors to the sales sector or to customer freedom of choice.

The Authority has also proposed that a possible division into regional zones should be envisaged when the licensing system is drawn up, in order to encourage comparative competition, at the very least.

Many, but not all, of the Authority's proposals have been included in the licensing permits issued by the Ministry of Industry. In municipalities where more than one distributor operates, only one licence is being issued. The transfer of part of the Enel network to local distributors, as envisaged by legislative decree 79/1999, has only been carried out in a few cases. The protraction of this climate of uncertainty, which discourages investment, is a source of concern. In the absence of a consensus-based or arbitrated solution, it is envisaged that the local licence holder should **operate** in place of the network owner, to which it would pay a fee for the use of the network. The Authority will set this rental fee by applying the same criteria that are used to set the distribution tariffs.

Supply

The expansion of potential demand on the free market has not as yet been matched by a comparable development in supply.

The supply side is highly concentrated. None of the envisaged sales of Enel power plants has taken place, although more than half the available time envisaged by legislative decree 79/1999 has already gone by, causing the timescale for the formation of a competitive supply framework to slip badly.

There are no real prospects of this concentration of supply being remedied in the medium term. The principal operator will continue to hold a dominant position in the domestic production market, accounting for more than 50% of the total if self-production is excluded. This will be the case even after the sale of plants accounting for 15,000 MW envisaged by legislative decree 79/1999 and a further sale of 5,500 MW of generating capacity which the Competition Authority has imposed as a condition for the approval of the acquisition by the Enel Group of a company in the telecommunications sector. Many of the plants sold will have to be radically modernised, which means they will be out of service for not less than two years. With respect to supply as a whole, including imports, the Enel group seems likely to continue to hold a share of around 40% for a long time to come. The concentration of supply in the electricity market cannot be evaluated using the same criteria as are used for other markets. There is no possibility of recourse to stored capacity. The excess production capacity that emerges

in periods of low demand, night-time and holidays, does not influence price formation at times of high demand, when the dominant operator, which has marginal plants at its disposal, can set prices. Competition must be encouraged and safeguarded, not just against the potential exercise of market power by the dominant operator, but also against the possibility of a situation arising where a small number – as low as two – of major operators were able to discourage the entry and growth of competitors. The development of competition on the supply side also depends on the construction of new generating plants. These will increase the efficiency of the system and reduce the amount of fuel used for each unit of electricity produced. Greater efficiency in supply and service provision will be needed to cope with the probable continuation of high fossil fuel prices, especially for hydrocarbons.

Competition, both actual and expected, can strongly encourage new investment in generation. For intentions to be translated into action effective steps need to be taken to streamline the authorisation procedures that are still required for the construction of new power stations or the reconversion of existing ones: these changes have been announced but so far have not come to pass.

In redefining the division of powers between the state and the regional and local administrations it is important to remove any impediments to the development of generating capacity. The administration with responsibility for issuing permits must view the reinforcement of local electricity supply as a factor that can contribute to development and provide safeguards against possible costly network congestions. The single national tariff must not be used to burden the entire customer base with inconsistent decisions that affect the electricity demand and supply localisation process. Electricity imports, which at present cover about 15% of demand, contribute to supply and to the formation of a competitive framework. Insufficient interconnection capacity with other countries creates congestions: as a result, the prices of imported electricity are close to the average Italian market prices; this creates a form of rent that benefits sellers.

In August 2000 the Authority set up an auction-based system regulating the allocation of importation capacity for the free market in order to hive off and redistribute exporters' rent to the advantage of the system as a whole. Appeals were lodged against the provision with the Lombardy Regional Court; the Court's decision to cancel the provision was subsequently confirmed by the Council of State. Following the recommendations contained in this ruling, the Authority allocated the available capacity to all applicants in proportion to demand. Nearly 500 operators were allocated modestly sized "bands" of capacity, thus giving rise to a secondary market.

For 2002 the Authority is following the example of other European countries and drawing up a new set of regulations for this market, in collaboration with regulators from neighbouring countries.

The task of up-grading Italy's power plants has been made more urgent, and more attractive to investors, by the prospects for growth in demand. For the fourth year in a row the increase in electricity supply has exceeded GDP growth. International comparisons suggest that the potential for increased consumption exists: electricity consumption per household in Italy is just over 3,000 kWh a year, compared with 4,000 to 5,000 kWh in the other major European countries. Even considering the Authority's efforts to promote the rational use of energy, the prospect remains of a marked upwards trend in demand.

The network and the market

The network infrastructure, its management, and the regulation of the market for the transactions carried out in it are all factors that define the fulcrum of the electricity system, the point where balance is achieved.

The *Gestore della rete di trasmissione nazionale* (National Transmission System Operator, or GRTN) has now been operating for over a year. The legal framework in which it acts, the broad outlines of which are fundamentally in place, is developing continually to keep pace with the development of the free market: the wheeling tariff, the technical rules for the connection of generators and distributors to the national network, energy despatching conditions and metering devices have all been subjected to a series of interventions by the Authority and adjusted to create the right conditions for the system to develop in a much more complex context than was previously the case.

As envisaged by legislative decree 79/1999, the GRTN operates without owning the network. This first year has shown up difficulties, both in the definition of financial relations and, to an even greater extent, in the execution of necessary and urgent work on the network to remove internal congestion, increase interchange capacity with other countries, and connect new plants. The possibility of bringing ownership and management of the national transmission system together again under a single neutral business operator, with no interest in the production and sale of electricity, needs to be evaluated. The *Gestore del Mercato Elettrico* (Electricity Market Operator) has also been set up, with operating conditions drawn up by the Ministry of Industry. The Authority has also played a part in this process, not least to bring together in a single framework the power exchange, bilateral trading and the role of the Single Purchaser.

If the Italian electricity exchange is to function properly, complex technical instruments need to be developed and honed. Unlike some electricity exchanges operating in Europe at a solely commercial and financial level, the Italian electricity market is closely linked to the despatching of electricity by the network operator.

The launch of the exchange could be undermined by the highly concentrated supply structure of the industry. The Authority is aware of the problem, is keeping a watch on market trends and, where necessary, will use appropriate economic and administrative instruments to ensure that distortions do not arise.

THE GAS MARKET

Prices and tariffs

Legislative Decree 164 of 23 May 2000, implementing the European Directive for the single market for natural gas, lays the foundations for far-reaching changes to the sector. According to projections looking as far ahead as 2010, demand in Italy is expected to grow more than in any other European country. The growth in demand depends largely on the electricity sector, as a result of the need to diversify primary energy sources and the relatively more environmentally-friendly characteristics of methane. The timing and the instruments proposed and adopted for the liberalisation of the gas sector need to be compatible and consistent with the need to open up the electricity market and create a competitive supply system. Consistency between the gas and electricity markets should also be borne in mind in any decisions on the development of the networks and the organisation of local distribution and sales activities.

Gas prices and tariffs in Italy, both net and gross of taxes, are higher than average European prices. This gap is particularly wide for industrial users, compared with those countries where market liberalisation has already been completed or is in progress. The high tax burden on natural gas further widens this gap. Structural factors, such as easier

access to sources of supply and climatic differences that influence the efficiency of distribution, might explain some of the differences. The rest can be traced back to the absence of competitive pressures in the Italian gas market.

A reduction in these price differentials to the benefit of users and consumers should be seen as the most immediate and desirable result of liberalisation and the initiatives taken by the Authority. In a deliberation of December 2000 the Authority introduced a new system for the gas distribution and supply tariffs for the clients of the captive market. The Authority's reform separates distribution from sales so that when all consumers are able to choose their gas suppliers, supply companies will have access to their local networks on the basis of a tariff system that is already in place. The reform brings tariffs into line with the costs that are necessary to supply the service in the conditions of safety, quality and efficiency that the Authority has laid down for the whole country, where about 750 distributors currently operate, some of which are very small. Distribution accounts on average for about 20% of the final cost paid by users. Since 1 January 2001, the tariff reform has produced a first reduction in the average national price. For subsequent years, up to 2004, the reform envisages a ceiling for the reduction of revenue from distribution activities of 3% per year in real terms. To encourage the development of the networks in those parts of the country that are still not covered by the gas service, the reform also envisages a fee to cover the higher costs involved in creating new methane supply structures. The protection of the low-income sections of the population has been entrusted to the municipal authorities, who will receive subsidies amounting to 1%, for a total of about 50 billion lire per year. These will be covered by consumers as a whole.

In a deliberation of May 2001 the Authority laid down the criteria for the calculation of transportation and despatch fees on the national and regional networks by companies already engaged in transporting and despatching natural gas and those wishing to enter the market.

The Authority's provision puts the finishing touches to the tariff structure for transportation over the networks, whether these be high-, medium- or low-pressure, and makes it possible for existing wheeling contracts drawn up directly by the interested parties to be renegotiated. The new transportation tariffs, which come into force this coming October, are based on an "entry-exit" criterion, or fees for reserved capacity at entry points to the pipelines (international borders, fields and storage) and for booked capacity at interconnection points with the regional networks (grouped into 15 zones) and on a further fee for booked capacity on the regional network. This last fee is calculated on a "postage-stamp" basis, with discounts for operators with off-take points near exit nodes from the regional network.

Fees for booked capacity, which account for 70% of the overall tariff, are accompanied by a fee that varies according to the volumes of gas transported. This is designed to encourage the efficient use of pipelines. The Authority's tariff rules are innovative for Europe; only the United Kingdom has a similar system.

Rules for booking the transportation service to encourage exchanges of capacity are envisaged, as is a favourable return on new investments.

Similar methods to those followed in setting the transportation tariff have been adopted to encourage the use of regassification plants for liquefied natural gas. A return corresponding to the specific risk, which is higher than for transportation, has been allowed for this activity.

The Authority will complete the normative framework by drawing up a standard contract for distribution activities and by defining the network codes, tariffs and storage codes. The flexibility provided by the use of stockpiles could be increased if this activity were liberalised, albeit with the necessary degree of coordination. The

introduction of competition in the management of the service and the allocation of new storage licences should contribute to a more efficient use of the national transportation network.

Supply: towards a multiple supply system

Legislative Decree 164/2000 envisages that the supply of natural gas, both through long-term importation contracts limited by take or pay or similar obligations, and from national production, must be open to all operators, with due respect for the general aims of ensuring the safety of the gas service and the criteria for access to and use of the system.

However, the gas market as it stands is very far from competitive. The Authority is monitoring the situation. Its remit to cover the whole complex of different segments that go to make up the gas sector, independently of the existence of licences and the degree to which competition has been achieved, has been confirmed by recent rulings by the Regional Administrative Court of Lombardy and the Council of State.

The introduction of a plurality of operators capable of creating real competitiveness in the supply of gas is undoubtedly a difficult task. National energy security needs to be guaranteed by greater integration with the European gas system, by closer economic interdependence with the producing countries, and by the diversification of the areas of origin. A significant difference between market liberalisation for electricity and for gas lies in the fact that in the case of gas the centres of production are mainly located in countries outside the European Union and as such are not subject to EU legislation. On the other hand, we need to consider that the European Union is surrounded by gas producing countries; further opportunities and areas of supply could be activated and reached by creating new pipelines and regassification terminals.

To ensure the formation of competitive supply, obstacles and impediments of a political, ownership and contractual nature need to be dismantled. The decree issued by the Minister of Industry on 27 March 2001 on the importation of natural gas from countries outside the EU, which implemented Legislative Decree 164/2000, pursues the objective of security of supply through strict controls on the quality, provenance and reliability of the gas imported, but at the same time introduces technical and financial constraints that create barriers to the entry of new operators.

The market needs to develop in full respect of the principles of competitiveness and non-discrimination, both nationally and at the European level. Agreements between companies on the way they handle take or pay obligations are being examined by the European Commission, which is weighing up the question of their compatibility with the rules for the protection of competition and the overall requirements of the liberalisation of the internal market.

The application of a national ceiling on gas entering the network from the same company implies gas releases at national borders: the private negotiation method that Eni seems to have followed for gas of Libyan origin does not meet the requirements of transparency and non-discrimination for all potential competitors.

Access and control of the system

With the progressive opening of the gas market to competition, strategies for the acquisition of distribution companies are being developed, while mergers are favoured by the unbundling of sales activities and by the need to compete for licences, as envisaged by the market liberalisation decree.

The European gas industry, under the impetus of the deregulation of the national monopolies and privatisation processes, is moving towards structural changes brought about by alliances, mergers, holdings and demergers aimed at conquering new market shares and expanding into contiguous sectors, the scope of which often extends beyond the external borders of the Union. In this dynamic context it is in the country's interest for the gas market to be liberalised as quickly as possible, without prejudice to the conditions of reciprocity envisaged by European directives and treaties.

The company unbundling of the network of high-pressure gas pipelines under Eni ownership is a positive step towards liberalisation. Entrusting the network to a listed company poses the question of how to define the rules for managing the national gas system and governing the network in such a way that the new company is transparent and neutral. The Authority intends to press the interested parties to see to it that the necessary rules are put in place.

Natural gas is an energy source with features that lend themselves to real and financial trading. In this context the possibility of identifying hubs in Italy for the negotiation and trading of natural gas on a standardised basis needs to be evaluated. As already happens in the United Kingdom or the United States, it should be possible in these hubs to sell batches of gas purchased on the primary markets and develop a secondary market in capacity and access rights, once again with due respect for equal and non-discriminatory conditions for operators.

A necessary prerequisite of the promotion of competition is the administrative and accounting unbundling of companies operating in the gas sector. The Authority has submitted for consultation by the interested parties criteria to ensure that this separation does not involve crossed subsidies and other distortions, while keeping the administrative burdens falling on smaller operators as low as possible. Access to the local distribution networks, guaranteed by the Authority, has for the first time made it possible for eligible customers to withdraw from contracts with their habitual suppliers and obtain their supplies from other operators: in 2000 alone about 170 new contracts were drawn up. More than ten consortia for the purchase and sale of gas from abroad have been set up, and new trading companies have been created.

QUALITY OF SERVICE AND THE ENVIRONMENT

Protection of consumers and users

When services are provided in exclusive or monopoly conditions, the tariff structure needs to be supplemented by rules and standards to protect the rights of consumers and users. The liberalisation process must take place in such a way that competition between providers makes a positive contribution to improvements in services. Quality levels, which are obligatory for the captive market, provide an essential benchmark in defining the economic relations between service providers and clients on the free market also.

The initiatives to improve the quality of the service that have been put in place by the Authority since it was set up are beginning to bear fruit.

The new contractual conditions that have been introduced for all electricity customers have gradually replaced contractual clauses imposed unilaterally by operators that sometimes contained features that were unfair to customers; new rules have also been drawn up for gas sales contracts.

The Service Charters, which contained service quality standards decided unilaterally by operators, have been replaced by uniform national standards. If services are not provided within the envisaged timescale, customers are compensated automatically

through the billing system. In the second half of 2000, in the electricity sector alone, nearly 5,000 automatic compensation payments were made, compared with just a few dozen before the Authority's intervention. A similar system of standards and reimbursements has been introduced in the gas sector with effect from 2001.

The legal and administrative framework required to measure and improve the quality of the electricity service is well advanced; for the gas sector, where physical safety factors are of prime importance, work is still in progress.

The Authority has taken some innovative steps with regard to continuity of supply in the electricity service. Standardised methods have been drawn up for the measurement of service continuity and obligatory performance targets have been set, with required improvement rates of up to 16% a year.

The Authority's objective is to bring the continuity parameters of the Italian electricity service more into line with those of other European countries by the end of 2003. Italian users at present experience interruptions in the electricity service lasting a third more on average than those experienced in France or the United Kingdom.

Another target for the end of 2003 is to reduce the distance separating the South of Italy from the rest of the country, a distance which at present is unacceptable. The Regions lagging most dramatically behind are Campania, Calabria and Sicily, where interruptions amounted to an average 350 minutes per year in 2000, compared with 180 minutes for the rest of the country.

A system of economic incentives and disincentives has been designed to provide the impetus for improvements in the electricity service, on the basis of decisions taken by the Authority in December 1999. The data for 2000 show that the average duration of interruptions for which distribution companies were responsible was 10% lower that year than in 1999. Further interventions by the Authority will produce improvements in the quality of the gas service, with particular regard to the prevention of gas leaks. The percentage of local distribution network inspected annually by operators is about 30% at present for the low-pressure network, and 50% for the medium-pressure network: differences between one operator and another need to be reduced through measures to be implemented by the Authority.

Safety and continuity in the gas distribution service are the central concerns of a provision setting out obligatory requirements for the investigation of gas leaks from the networks, monitor the gas odourisation process and improve the emergency service. In subsequent provisions the Authority will regulate the safety of gas installations in homes and in "beyond-the-meter" activities, and will codify aspects of the service that were previously left to the voluntary initiative of operators.

Checks and controls

Wider availability of transparent information and comparisons of the services provided by producers and suppliers are important aspects of the regulatory process. Access to information enables users to interact responsibly with operators, which in turn provides an added impetus to the improvement of the quality and efficiency of the services.

The separation of distribution and sales activities, and a clearer definition of responsibilities, both play a part in this process. The numerous reports and comments sent in by consumers and users all contribute to the Authority's task of monitoring the implementation of the new Directives.

Improvements to service quality are also based on the monitoring activity carried out directly by the Authority. The agreement with the *Guardia di Finanza* (the Police **Tax Corps**), which will allow further checks and controls to be developed, is nearing completion. The Authority has carried out a formal investigation into Enel

Distribuzione for providing incorrect data on the number and duration of interruptions in the electricity service in Campania, Calabria and Sicily in 1998 and 1999. The fine imposed as a result of these proceedings takes into account the fact that the Authority bases its decisions on tariffs and service quality standards on data provided by companies, and that the effectiveness of the regulatory process depends essentially on the reliability and completeness of the data provided by operators. The fine also reflects the particularly vulnerable situation of the three regions in question.

The EU Commission has clarified that service obligations should be understood as guarantees of consumers' right to have access to energy services that have clearly defined and satisfactory quality standards, at reasonable and fair prices. These commitments should be viewed as an essential part of the harmonisation process that needs to be taken forward if the national markets are to be integrated within the internal market. However, the situation must not arise where the existence of public service obligations enables existing companies to maintain privileges that would impede the opening of the market.

Protection of the environment

The law setting up the Authority envisages that the tariff system should also encompass factors such as environmental protection and the efficient use of energy. In the Authority's opinion, the use of economic instruments to pursue these objectives effectively should be encouraged, a process that will foster the birth of new business initiatives and drive innovation. The envisaged market for green certificates will stimulate competition and efficiency in the technological solutions adopted for the generation of electricity from renewable sources.

The measures taken to implement Framework Law 36/2001, on the protection of public health from electromagnetic fields, will need to take into consideration the principles of prevention, proportionality, and graduality. Any allowance in tariffs of the costs incurred to up-grade power lines will need to take into account the balance between expected results and costs.

The Ministry of the Environment's programme for the installation of 10,000 photovoltaic roof systems is a practical example of the way the new renewable energy sources are being promoted. The Authority has developed rules on connection to the grid and trading contracts that enable users with photovoltaic installations to sell any excess energy they produce to the network on an equal footing.

The Ministry of the Environment and the Ministry of Industry jointly issued two decrees in April on the efficient use of energy in the electricity and gas sectors. As part of the implementation process the Authority is drawing up "guidelines" for the identification and selection of suitable projects and the monitoring of the results achieved.

The envisaged creation of a secondary market in energy efficiency certificates may well be the most effective economic instrument to keep costs down and maximise the benefits to users and operators alike.

REGULATION AND COMPETITION

In implementing the European Directives the Italian Parliament has set the electricity and gas sectors on the road to liberalisation. In some respects, and even in the face of difficulties that still need to be overcome, Italy has gone further along this road than some other major European countries.

It is customary, but not correct, to measure liberalisation using just one indicator: the percentage of customers who have been granted the right to choose their supplier. On the basis of this indicator Italy is in an intermediate position with respect to other

European countries. To exercise this right companies need to enjoy equal conditions of network access.

Italy has opted for regulated, rather than negotiated, access to the network infrastructure; she is already working towards independence between energy network operators and users. The regulated structure provides surer guarantees of free access under non-discriminatory conditions: the proposed new energy directive formulated by the European Commission takes this as its sole benchmark.

The up-grading of the network infrastructures will be encouraged by entrusting the task to companies specialising in this field, by tariff-based incentives and by service continuity requirements backed up by penalties in the case of failure to comply.

As an overall consequence of the decisions taken by Parliament, the Government, and, where appropriate, by the Authority, the conditions under which liberalisation is being achieved in Italy are favourable to the development of companies operating in the energy sectors. The transition has been structured in a way that definitely does not penalise the former monopoly companies. Sales of plants or branches of activity envisaged by the liberalisation legislation, or which are already taking place, are generating considerable flows of funds which companies can use for strategic reconversion purposes in order to engage in other activities that will compensate for the market space they are being required to give up.

Moreover, in keeping with the provisions of the law and the Government's Economic and Financial Planning Documents of the last few years, the rules governing tariffs and prices are being implemented in a gradual manner that ensures that operating costs will be kept within reasonable margins during the reorganisation, with additional costs for consumers during the transition phase.

The availability of financial resources enables repositioning strategies to be implemented: these strategies need to be taken forward without impeding or delaying the development of competitors on the national market, so that the benefits of competition will compensate consumers as soon as possible for any additional costs they are having to meet during the transition.

Eni has begun to seek out opportunities for growth as an energy company operating worldwide and specialising in the exploration, production and transportation of oil and natural gas.

Enel is looking for opportunities for diversification in related public utility sectors, along the lines of the multi-utility model. Diversification is intended to produce economies of scale and scope, and to enhance profitability. The success of the multi-utility model raises the issue of the need for better coordination in the regulation of the different services.

The development of competition and the protection of consumers' interests mean that diversification must take place in a context of full accounting, administrative and company unbundling and that no company still providing services to captive customers on an exclusive supplier basis can exploit this position to gain a competitive advantage.

Some aspects that emerged from the recent European expansion initiatives by Electricité de France raise serious concerns. Indeed, while under the legal monopoly system companies licensed to carry out public utility services may enjoy special conditions that reflect their service obligations without the interests of third parties being harmed, such conditions are not acceptable when these companies come to operate in competitive markets.

The conservation of public utility status and of a system of legal and *de facto* monopoly in the market of the country of origin is not compatible with expansion into the competitive markets that are taking shape in Europe, even when this takes place through indirect interests in other companies.

As in other sectors, in energy too the single market includes a wide range of companies of different nationalities and ownership profiles. The two-way match between national market and national company has been lost, as has the contraposition between publicly and privately owned companies, as long as both are subject to the same rules, including those regarding the ban on benefiting from state aid. The fostering of competition cannot be put off until that time when the European markets are in effect competitive and integrated: it is during this transition phase that the need is most pressing for all firms, existing and new, to compete on an equal footing. Under conditions of equal and fair competition, it is very much to be hoped that foreign companies enter the Italian market, and in so doing provide a competitive stimulus that is able to weaken certain privileged situations that still penalise our energy system. In its recent report on regulatory reform in Italy, the OECD acknowledged the progress made by the liberalisation process. The OECD report also calls for increased competition in the electricity and gas sectors, the removal of any barriers that might hamper the entry and formation of new companies and investments, and a reduction of the allowed transition costs. The Authority intends to take up the OECD's suggestion and to monitor the results of regulation very closely, and to carry out a comparative analysis and assessment of the costs and benefits involved.

The role of the regulators is being enhanced throughout Europe. In the energy sectors all European countries, with the sole exception of Germany, have set up independent regulatory bodies. New forms of coordination are coming into being for the regulators of the financial – as a result of the “Lamfalussy Report” – and telecommunications markets: the national regulatory authorities are being entrusted with an advisory role in the Community decision-making process. Similar provisions could be included in any resolution that the European Council adopts to supplement the existing electricity and gas directives.

Ever since it was set up, this Authority has worked alongside the regulatory bodies of the other European countries and has played an active part in the creation of the joint body, the Council of European Energy Regulators, in its work and in the preparation of its proposals. It also takes part in the activities promoted by the European Commission, such as the Florence Forum for electricity regulation and the Madrid Forum for gas regulation.

In a recent provision the Authority set out the guidelines for bills to be issued in euros with effect from July of this year, and the calculation procedures that are to be adopted to avoid distortions in rounding the amounts due.

To perform its tasks against this background of intense change the Authority currently operates with 70 employees. Vacancy notices have been published to fill permanent and temporary posts to address the shortfall in staffing levels. In view of the additional duties assigned to it by the liberalisation decrees, Law 422/2000 has raised the number of temporary staff the Authority can employ by 30.

I am very pleased to take this opportunity to thank the staff of the Authority for the great commitment, dedication and skill with which they carry out their tasks.

Mr President, Authorities, Ladies and Gentlemen, the requirements of liberalisation and those of the privatisation of the public utilities do not always coincide, as liberalisation can, in the very short term, reduce the market value of former monopoly companies. A reform process that is slow and incomplete might result in greater contrasts: this would create uncertainties, hold back the development of the sectors involved, and accentuate the inherent contraposition between the interests of users and those of shareholders. By taking a longer-term view, however, we can detect a convergence between the different interests of the community as a whole: it is therefore desirable for the liberalisation process to be implemented and brought to completion in a rapid and sure timescale. In

its four years of operations the Authority has enjoyed a fruitful and effective collaboration with the Government, the Competition Authority, and the other branches of the public administration. On numerous occasions it has provided Parliament with contributions to the evaluation of problems, and with observations and proposals.

The Authority continues to assure Parliament and the Government of its intense and attentive cooperation. It will continue to comply, in a spirit of deferential respect, with the laws and recommendations addressed to it by Parliament.