



The Italian Regulatory Authority for Electricity and Gas

# ANNUAL REPORT ON THE STATE OF SERVICES AND REGULATORY ACTIVITIES

*Presentation by the President  
Guido Bortoni*

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## **The Italian Regulatory Authority for Electricity and Gas**

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*«Nulla lex sibi soli conscientiam iustitiæ suæ debet, sed eis, a quibus obsequium exspectat. Ceterum suspecta lex est, quæ probari se non vult, improba autem, si non probata dominetur.»*  
*Quintus SF Tertullianus, Apologeticus, Caput IV, 13*

Knowledge is not reflected in the law itself, but in those who shall respect it. An unjustified law becomes suspect, even unjust, if it is imposed without deeper consideration.

[*Ante litteram*, well applies to Regulation: editor's note]

## **Authorities, Ladies and Gentlemen,**

Greetings and thank you, on behalf of myself as well as my colleagues, to everyone here and all of those who show an interest in the work and future activities of this institution, which regulates and controls the energy market as well as, for several months now, water services. I will be commenting on the newly-instituted water regulations shortly before coming to a close.

The Regulatory Authority for Electricity and Gas sets forth its considerations today, halfway through 2012, in this hall where both branches of Parliament are represented, before the authoritative members of Government, numerous civil and military authorities and an audience of qualified public utility operators, as well as various exponent associations.

Our thoughts span well beyond the confines of this hall to consumers, businesses and families alike. We would like to express a special empathy for the individuals burdened by the shadow of the earthquake, to whom we extend our wholehearted solidarity. This solidarity is materializing in our continued commitment to measures designed to foster a rapid and courageous recovery from the results of this grave situation.

Our message today reaches out to Europe as well, as we lay our hopes in the resurgence of a widespread awareness that a united Europe is advantageous to everyone, both collectively and individually. To achieve this, we exhort everyone (ourselves, first and foremost) to look beyond our own short-term interests.

The period we have witnessed since the last Annual Report (06<sup>th</sup> July 2011), a few short months after the appointment of the third Board of the Authority (16<sup>th</sup> February 2011), has been unparalleled in terms of the intensity and rapidity of the fundamental changes taking place.

Since 2009 there have been crises on a variety of fronts that have braked and slowed down the national economy in extraordinary ways, with deep reverberations in the energy sectors as well. This also shows in the trend of the energy demand, among many other indicators. Two of these indicators are most emblematic of how the Country has lost ground with the protraction of the crisis: the total gross domestic consumption of energy for 2011 resembles the levels witnessed in 1999. On the social side, an even more worrying fact is witnessed in the level of expired credits and late payments for electricity and gas services. In the two-year period of 2010-11, in fact, approximately 10% of the families were behind on their payments. This percentage increases to 19% for small- and medium-sized enterprises. Since last summer, new tensions have involved the public debt of various European Countries, including Italy. The understandable reaction of our Government has been to strengthen the austerity of its policies, austerity from which the energy sector cannot and must not be excluded.

Alongside the crisis phenomena, as just mentioned, we have also witnessed exceptional structural changes in both the electricity and the gas markets over the last year.

The change in the electricity sector was so deep and sudden that the nascent changes revealed in the Authority's previous Annual Report have already been transformed into predominant and overbearing realities, and to handle them calls on us to reflect deeply upon our framework of rules, which are not always suitable to accompany the coming developments.

In the gas sector, the change forecasted in the 2011 Report as a scenario for the next few years is already knocking at the door, pushed forward by the evolution of the European regulatory framework. Everyone's eyes are on the first elements, such as the convergence of Italian prices with those of other European markets, at least in terms of spot prices. In the case of gas, the regulatory instruments are still awaiting the completion of the reforms we began in 2011.

These new paradigms, unfortunately, are intervening at a time when the construction of a single European market, one with a real capacity to confront these new demands, is still incomplete. Even worse, these changing paradigms have different impacts on different member states, which

threatens a divergence in national interests and makes the energy market even more challenging at the level of the European Union.

On the other hand, it is critical to translate the problems associated with these structural changes into a constructive impetus to rediscover the genuine spirit of government, especially of the changes that are under way, with full awareness of the dictum that "nothing is constant except change itself," according to the ancient philosophical wisdom (Heraclites), so that our constructions of today need to prepare ourselves to accommodate the tomorrows to come. This change, for all of us, serves the maieutic function that "does not teach" senselessly but instead "helps us to find" the right path forward.

## **ENERGY**

### **Regulation: regulating the change**

Last year it seemed necessary to concentrate the Report's presentation on the guidelines that the new Board intended to adhere to during its term in office. At that time we highlighted, *in primis*, how the only way to provide full protection for the interests of consumers and users in the electricity and gas sectors would be through the promotion of competition and efficiency. We went on: «...regulation, therefore, needs to avoid the paternalistic temptation to substitute for the market.»

In this direction, we committed ourselves to crafting a new set of rules with the admittedly complex aim of investing the various actors in the market with responsibility (capacity-building regulation) and bringing their own pursuit of legitimate individual objectives into alignment with the general interests of the system as a whole and the relevant subset of consumers - this defined the main institutional goal of this Authority.

Infrastructural development was pinpointed as being an effective tool for national economy recovery while anticipating, at that time, the intention to continue the incentivized regulation of infrastructure investments<sup>6</sup> with regulated compensation. We sensed how the goal of sustainable environmental development could transform itself into formidable leverage for a rapid economic turnaround for national growth and its maintenance well beyond the first 2020 horizon, should the impulse for

investing in the *green economy* (or *white–green economy*, if one considers an optimal mix of renewable resources and energy efficiency) could succeed in inducing regular, non-chaotic and, most importantly, balanced growth through the economic sustainability of the incentives.

While these programming guidelines have been regulation up to now and have been confirmed into the future as well, they still need to be fine-tuned to the specific context that characterizes the regulated sectors and, as suggested, the significant changes that are under way.

Times of economic crisis and the efforts to overcome them, as many have said, require a combination of austerity and growth. But the dual concept of austerity-growth cannot be configured haphazardly by simply pairing them together. On the contrary, while resources need to be freed up by reducing inefficiencies, the most important element actually concerns how these freshly available resources (and selectively available resources in general) are then applied in favor of interventions that are more effective and efficient. The balanced mixture of austerity and growth proceeds therefore from the selectivity criterion, and this applies to the regulation field too.

Selectivity, for instance, has already guided our efforts towards the end of 2011 to define the regulation of power distribution and transmission activities for the period of 2012-2105 by promoting investments on the basis of their "figure of merit" for reducing congestion in the networks and increasing the security and quality of the supply. Anticipating, at the same time, that the so-called *smart* interventions are backed up by clear evidence of their effectiveness and efficiency. As a further guarantee that the proposed investments by grid operators meet these criteria in full, this Authority has opened the ten-year national power grid development Plan to a public consultation - in the spirit of the European directives - in order to formulate its opinion by taking into account the observations of the many different subjects who have an interest in the Plan.

The regulation of gas facilities and infrastructures will also be based on the selectivity criterion during the new regulatory period. The figure of merit will be higher for

interventions that increase the security of the supply, as well as the level of competition on the supply side and full integration within the European market, in addition to developing gas transport in a flexible manner according to our own Country's multiple directives.

Selectivity - according to the Regulator's presentation - once again served as the justification for the Authority's actions in regard to renewable energy sources for electric power in their own fields of competence.

The Authority is firmly convinced - and has repeatedly asserted - that renewable energy represents a fundamental pillar for enabling environmentally-sustainable development in our economy as well as reducing our strategic and economic dependence on foreign energy. As confirmation of its conviction, this Authority considers correct for everyone to share the burden of these incentives, under the condition that these charges be contained at sustainable levels and remain efficiently commensurate with energetic-environmental externalities. This level would be unreasonable to exceed for political industrial and employment-related reasons. Other tools that lie beyond the powers of the Regulator can be used to do this, such as general or special taxation. The importance of renewable energy sources, in fact, must not be allowed to result in the negation of the principles of efficiency and correct attribution of responsibility, leading to distortions in the allocations of the costs borne by the electric system as a consequence of their peculiar development. To avoid that the consumers of electricity must pay the costs related to grid imbalances, the Authority introduced its first selective measures for producers who employ renewable energy sources in order to increase their responsibility in terms of the programming of the power being fed in to the grid.

These interventions form part of a general revision of the current dispatching rules that accommodates the new structural and market context, which is undergoing rapid transformation, and of the greater and greater need for flexibility, which is also necessary to maintain the security of the system.

As for making producers who employ renewable energy resources more responsible, the Authority also introduced prescriptions on medium and low voltage generation plants in order to reduce possible problems on the power grid

beginning this summer. The grid operators, at the same time, will need to proceed with the creation of the grid infrastructures of the essence for the new productive scenario and make up for delays and inefficiencies.

On the energy policy front, the latest ministerial measures related to renewable energy resources for the production of electric power have reduced the incentives, even if, while awaiting their zeroing following the achievement of the so-called *grid parity*, these peaks are at a level even higher than that of many other European Countries. It is the first clear step but other actions are still required, that will be inserted in the context of the austerity-growth binomial just cited. In the context of scarce resources, like today, only a resizing of future "electric" incentives can make it possible to transfer resources to the development of renewable thermal resources and energy efficiency, in the hope of thus being able to seize also the strong points of the Italian industry in these sectors. And that is not all: the few resources that are still available need be allocated precisely where the performance capacity is greatest, according to the selectivity criterion, by reason of their efficiency. As an example, through the mechanism of energy efficiency Credits - the so-called "white certificates" - over 14 million tons of oil equivalent have been saved from 2005 to the present.

To manage the general needs and coordinate these complexities, it appears more opportune than ever to define a National Energy Strategy (or however it might be called), that defines the objectives, also for environmental sustainability, according to medium-long term time horizon, ensuring the information needed for the market and identifying priorities based on selective criteria. On this matter, we might recall the numerous reports by the Authority on this issue as well as those filed within the context of the fact-finding investigations and proceedings of the competent Commissions of the Senate of the Republic and the House of Deputies, who I thank here publicly, also in the name of the Board, for the great attention always paid to our argumentations.

Once defined, however the energy strategy then needs to be implemented and respected without, however, overlooking any modifications that might be necessary due



to the emergence of technological innovations, for instance, as the scenario unfolds into the future. Innovations that could be fueled by the results of the *pilot projects* under way for the integration of renewable energy resources. The promotion of research and innovation, for instance, could lead to a reduction of the IRES hike (the *Robin Hood Tax*, which was introduced last August for the profits of bigger companies in terms of revenue and assets in the renewable energy resources sector and their depressive effect on investing, as already suggested) for the initiatives in research projects. Analogously, some of this tax yield could be designated to compensate for a VAT reduction on parafiscal components of the charges to consumers.

The pressing and accelerating development of power generation from renewable energy resources that are not (economically) controllable is otherwise one of the main causes of the radical change that is afflicting the wholesale electricity market. During last year's presentation of the Annual Report, we showed how new instruments might need to be introduced in order to increase the level of coordination between power plant investments by reducing informational asymmetries in order to overcome certain market failures. For this very reason, some time ago we set forth the criteria that should be driving the new market for production capacity (*capacity payment*) to ensure the security of the system for final consumers without excess costs. To achieve this, it is critical to have an operational recommendation from the grid operator.

As the Authority has indicated on more than one occasion, the developments under way in the wholesale market have led to an abrupt departure from past trends, with the price on the Power Exchange exhibiting unique new patterns and being used as the basis for defining the hourly bands and fees per kilowatt-hour for customers of the protection service. This points to the need to review the price structures (the consultation for which was just concluded) in order to guarantee that each domestic consumer receives the correct allocation of electricity value at the times when it is actually used.

Special care needs to be taken with the inescapable reform of the bi-hourly pricing of kilowatt-hours, since these

consumption procedures apply to roughly 30 million domestic consumers. This consultation and the various *focus groups* with consumer associations also led the Authority to determine that the level of "empowerment" needs to be increased even more in this issue-area. In specific, consumers need to be consulted to learn more about the *ratio* underlying the market change and the criteria for possible shifts in consumption across hourly bands, and statistics on wholesale market prices during summertime need to be gathered to conduct additional simulations. To do this, the Authority is planning further consultations and comparisons before making its final decision.

Turning our attention to the wholesale gas market, recent months have witnessed significant events that are destined to modify the paradigm of the market itself.

The balancing market (which was launched last December 01<sup>st</sup> before entering its normal configuration in April), along with a set of rules for regulating the recently reformed physical and economic entries (*settlement*), has made it possible to overcome numerous hurdles in the wholesale market so far and has been accompanied by an unexpected increase in the liquidity of the *spot* transactions for gas sales. The existence of an organized, liquid and transparent market characterized by a representative price is an essential condition for promoting both wholesale competition among importers, and enabling a full deployment of competitive forces in the retail market, thus reducing the impact of the transaction costs and risks that would otherwise be different for operators who are not integrated vertically - new entrants, typically.

The results of the balancing market have so far been particularly significant and have shown, after gas transport costs have been cut, a tendency to line up with the *spot* prices registered in Europe's other primary (*hub*) markets.

This tendency, which is also observable in the *forward* quotations for products, serves as evidence of the radical changes under way in the gas supply structure as a result of developments in the European rules, with regard to the allocation of cross-border transport capacity and congestion management. A change that resolves the contractual congestion problem for the transport facilities and infrastructures and that is destined to heighten the

price convergence among different European markets, and even more so with the support of upgrades of the facilities themselves. A change, on the other hand, that brings not only the market's role into serious question, but also the economic stability of the long-term contracts themselves (*take or pay*).

These contracts have for some time been reflecting prices (after correcting for transport costs) that are higher on average than the prevailing prices for spot transactions - which are now well represented by the results of the balancing market - are required to make unused transport capacity available and thus are destined to be exposed to greater and greater competitive pressures from other importers as well as other operators in non-European producer Countries.

Lastly, we cannot forget - recalling Europe's wave of bad weather and cold last winter and how it revealed the unavailability of certain supply sources - that the issue of supply security is one of the most timely issues for our Nation.

The profoundly-changing world of gas is in need of a legislative - regulatory context that is capable of meeting these new demands. It is therefore a primary concern the introduction of European new regulation on *congestion management* and *capacity allocation*, to be accompanied by both appropriate infrastructural developments to support the efficient exploitation of the *shale-gas* scenario and by truly innovative tools, apt to promote the competition and liquidity of the wholesale market, while complying - at system level management- with market dynamics, in order to guarantee the security of supply (at reasonable prices for final consumers). Tools such as, insurance against specific price risks created on the spot and balancing markets, or mechanisms that make the operators more responsible for the consequences of their actions in terms of increasing or decreasing the security of the system. It is equally important to expand the set of tools to be put at the disposal of grid operators during times of crisis, and to provide management during such times that is better aligned with market-based logics and to strengthen the rules on the utilization of imbalances. A veritable

"construction site" for new regulatory tools that is just as essential, in any case, for restructuring the market and keeping up to speed with neighboring markets.

Our system has evolved this very year by affirming the ownership unbundling model for the new Snam group in accordance with the *unbundling* project of the latest European Directive; consistency with European criteria, as this Board has indicated more than once.

As a result of the ownership unbundling, Snam, acquires impartiality as system manager (transport, storage and regassifiers), and can be entrusted an even more active role in the definition of functional system management mechanisms based on market-driven logics. Our hopes are that this new manager, accompanied by the innovative regulations we are introducing, will focus on infrastructural investments and support new and more expansive strategy in Europe and other areas of priority interest for Italy.

Another issue (in no sense secondary) raised by the structural changes in the gas market concerns a more complete and efficient reform of the current mechanism, known as the QE, being used to determine and update the value of raw materials in the protected market segment, or the main share of the gas price for families and small- and medium-sized enterprises.

Part of the reform has already been launched by decree law no. 1/12 and by our latest measure for next October. The process of QE reform is likely to consist in a radical transformation, beginning in 2013, in the development of the coverage tools cited earlier.

The reform will also depend on the findings from a special study with which the Authority intends to examine the supply conditions for retailers, with the goal being to overcome problems with a regulation from 2010 that is becoming less and less appropriate. The need to combine the goal of transferring the benefits of favorable developments in the *spot* market to the customers with the goal of protecting them from any unfavorable consequences now requires the QE calculation to employ spot market prices that are weighted to reflect the costs entailed by long-term import contracts.

This must not be allowed to translate, however, into unjustifiable extra profits for the retailers. Extra profits that would be circumscribed, more specifically, by the retailers' *spot* market purchases of gas at prices significantly lower than the costs of long-term import contracts, but without making any contribution to ensuring the security of supply at reasonable prices by bearing the risks associated with such contracts.

The European dimension of the wholesale markets for electric power and gas continues to grow. Developments in market design, the strategies and infrastructure choices and the tools for ensuring security and promoting competition must conform to, or at least be consistent with, European level decisions, at the risk of poor national level functionality as well. A Europe-wide vision, in fact, is the only way to guarantee the efficiency and effectiveness of national decisions. Inside our Country, therefore, there is a greater need than before for a stronger and more expansive energy *governance* that defines the strategies with which Italy can make an effective contribution to defining a European energy policy that accounts for its own needs and makes it possible to make the best of its own circumstances and realities. All of this is possible with the contributions and commitments of manifold actors, institutions as well as operators.

Since 2011, the Authority's activities in the international context have been more and more oriented towards a more technical-regulatory approach. The Authority, with increasingly active and informed multilevel participation (at the highest policy-making levels and among working groups), is committed to identifying the problematic issues and defining potential solutions. Our commitment is not aimed at Europe alone, but also towards other areas of particular interest for our Nation, such as the Mediterranean and the Balkans.

In order for the process of change that is under way in the wholesale markets to lead effectively to a new functional paradigm for the energy sectors, it must be accompanied by consistent developments in the retail markets, where consumers are steadily becoming more knowledgeable and active: this is a key to the transition to the new structure.

Smaller consumers, including families, have been free to choose their own supplier for over 5 years in the electricity sector and over 9 years in the gas sector. This market segment, however, has yet to achieve the predicted levels of maturity: although recent years have proven to be more dynamic, at the end of 2011 only 13% of the families (including condominiums) being supplied natural gas were enjoying market conditions that differed in any way from the protected conditions. This figure is 18% in the electricity sector.

The challenges to be faced now extend beyond what the 2011 Annual Report labeled as the "empowerment" of the consumer to include the definition of a framework of rules for the promotion of healthy competition. What I am referring to here, for example, is the need to prevent pathological market phenomena, such as unrequested contracts, from undermining public confidence in the functionality of the contracts themselves. In 2011, a wide-ranging consultation was held among the interested parties, and since June 01<sup>st</sup> the results have shown in regulations that pursue a reasonable balance between the reinforcement of protection, the construction of a "satisfactory" protection to accompany the sanction-based protections, and the safeguarding of trust in the market.

A regulation we might think of as "surgical," in that it began to eradicate the remaining pathology that the self-regulation of retailers alone had been unable to eliminate. The Authority developed several new interventions, in fact: a preventive one, in which the tools that were deployed give the retailer the burden of verifying the consumer's actual willingness to conclude the free market contract; a corrective one that aims to restore the *conditio qua ante* in cases (very few in number, let's hope) of unwanted contracts that are still in effect, but also to extend the sanctions beyond the damages to the final consumer's own interests to include the undermining of trust in the market that alters its physiological functioning.

It also places a strong emphasis on punishing the retailer's reputation, in terms of unrequested contracts that can be ascribed to them, by broadcasting this reputation to potential customers (*black list* of retailers). Last of all, it promotes self-regulation protocols for the actions of the retailers themselves. In other words: self-regulation,

preventive and corrective regulations, lists of reliable vendors and *enforcement* by sanctions. We feel confident, at this point, that the pathology will be eradicated.

The Regulator's role in this activity, which might be thought of as "extraordinary maintenance" of the rules and mechanisms that support competition, has been and will continue to be especially important in the *retail* market.

Starting up competition in a mass market, in fact, presents specific critical elements that are intrinsic to the transition from a regulated system to a market-based one. What comes to mind, for instance, is the management of the information and data required for the *retail* market to function, including sampling measures. This element has been problematic ever since liberalization began, and not just in Italy. The problems it generated have had transverse repercussions across every phase of the supply chain. In the retail market, it has created problems with the proper periodic billing of final consumers, especially in cases of *switching*. In the wholesale market, it has caused problems with the correct and timely allocation of economic balancing entries among multiple operators.

Those just described are the minimum enabling conditions needed to allow the appropriate competitive dynamics to develop. Their effectiveness, however, inevitably depends on the propensity of the consumers to step up and actually engage the market itself. An informed consumer is not necessarily an "empowered" consumer. On this point, the preliminary findings from *retail* monitoring activities that were initiated in 2011 have revealed several disconcerting elements that, according to the Authority, require further study, especially given the importance of cultivating the free market for energy. It concerns a comparison between the economic conditions of the electricity supply applied to domestic customers in the free market and those being applied to families under protected conditions. From this comparison, which is still preliminary, it appears that the suppliers are applying unit prices in the free market that are higher, in a variety of cases, than the prices on the protected market, i.e., by passing the price of a reasonable basket purchased in the wholesale market on to the customer. This cannot be attributed to the methods used to calculate the protection

basket, being based on wholesale prices and market conditions where the Authority limits itself to simply turning over the costs associated with the basket each quarter. The initial input has revealed an increase of the free market price for the component covering supply costs, which seem to reach noticeably higher levels than the service with more protection.

The analysis of the supply side of the free market has greater difficulty accounting for certain factors correctly, such as the value attributed by final consumers to *non-price* components of the chosen offer (including, for instance, any bonus points or add-on services awarded to the customer or higher level guarantees of commercial quality). The comparison, overall, seems to suggest margins for more affordable offers in terms of price, all in the interest of more dynamic development for the free market. The additional analysis conducted by the Authority to determine customer needs, on the other hand, still confirms poorly-informed decision making and the continuous demand for greater transparency and simplicity, even in relation to consumers' own effective capacity to make correct assessments of the relative economic convenience of different options in the free market for energy. Many consumers, whether families or small businesses, still feel insufficiently prepared to operate inside a market it perceives as being too complex.

Having noted the low levels of consumer awareness and determining that the consumers' capacity to gauge the relative economic convenience of the offers was noticeably constrained by the highly diversified and complicated fee structures, the English Regulator (Ofgem) recently offered to intervene by requiring all sales offers for smaller-sized customers in the electricity sector to utilize the same fee structure, differentiating among themselves through variations in the size of the fee applied on the basis of consumption. The intervention by the English Regulator - with whom we remain in constant contact within the context of the *Council of European Energy Regulators (CEER)* – tends more towards restricting the market than promoting empowerment, and it justifies itself in terms of consumer behavior assessments, such as disorientation when faced with large quantities of information and the preference for the *status quo*.



Even while no interventions similar to the one proposed by Ofgem are currently being studied, the Authority still feels duty-bound to open a fact-finding investigation to uncover the reasons underlying the price differentials noted in the Italian *retail* market and to expand this study to include the gas sector as well. Furthermore, the study will be designed to build our understanding of the barriers that are slowing down the maturation of the *retail* market. In specific, we need to reflect upon competition in the *retail* market and the specific elements it could influence. At present, in fact, the suppliers seem uninterested in supporting the price comparison. Considerations like these have not generated any conclusive findings yet, not even in the international context.

Along with the demands for simplicity and transparency, therefore, consumers and operators throughout the supply chain are also experiencing a growing need for faster and more efficient procedures. Regulation must be oriented towards effectiveness in its own right by employing a sort of “regulatory *review*” that is oriented towards the selectivity principle and designed to simplify and rationalize the procedures by eliminating any constraints that are not strictly necessary for optimal functioning of the processes.

### **Enforcement: the insurance for better regulation**

The day after this Board took office we announced that *ex ante* regulation, to work effectively, must be accompanied by an *ex post* monitoring phase and *enforcement* activities capable of guaranteeing that the rules would be respected. This is how we have set our sights for the action. It has also served as our guide for the new organizational articulation of the Authority itself.

With the objective being to promote the market, *enforcement* took the form of two different guidelines: one to protect the consumers, and the other vis-a-vis the operators. The first, in parallel with the needs for simplicity and transparency, manifests itself in the speed and efficiency of the problem-solving procedures applied to customer-operator relationships. The availability of a wide range of free and effective tools to use for resolving problems that come up in the energy market increases the trust of final customers in its functionality while simultaneously promoting competition. This context

includes an idea to be introduced concerning the readability of the bills as well as the activities of the consumer desk, which receives over 1,300 calls per day and represents a useful tool for promotion of the free market.

With the confirmation of the orientation towards greater efficiency in complaint management, the Authority's activities are striving to lay the foundation for making it easier for consumers to access the extra-judicial procedures for dispute resolution. After many initiatives designed specifically to promote conciliation procedures (based on the joint conciliation model) had been adopted within voluntary memorandums of understanding between businesses and consumer groups - a positive experience to be encouraged further, although still in the development phase - the Authority also defined a set of rules for activating a conciliation office for energy customers that will soon be operative, thereby instantiating a concrete application of legislative decree no. 93/11, which incorporates the third package of European Directives, as well as the measures envisaged in the Authority's own founding law.

Regardless, the remediation and solution of consumer disputes in regard to energy services need not be limited to these instruments alone, i.e., joint Memorandums and the conciliation Office. In reference to the Community-wide and national legislative framework, therefore, the Authority intends to do its best to implement a wider variety of alternative dispute resolution procedures. These would include, for instance, a procedure for handling operators' complaints concerning the managers of the facilities and infrastructures with respect to the European guidelines on accessibility, impartiality, efficiency, cost-effectiveness and independence.

The ordinary daily management of complaints must focus more and more on the timely handling of any demands and problems that arise on the demand side. A new approach oriented by a regulatory *review* (as already suggested), involving the selective simplification of the same obligations that characterize the different processes, particularly those of more dubious utility for final customers, should also help reduce the causes that generate the complaints in the first place. In this sense, *ex ante* and *ex post* regulations come

together in the common objective to protect the final customer, thus allowing the market to express its full potential as derived from supporting competition itself.

The second guideline that the Authority's *enforcement* is focusing on concerns the sanctions and prescriptive provisions directed at the operators. The guiding principle for defining the recently-approved Rules for regulating the sanction procedures and the procedural methods for assessing commitments combines this instrument's typical afflictive function with general guarantees for adhering to the rules as well as controls of the effectiveness of regulatory actions.

The Rules regulate the institution of commitments, which represent one of the primary activities employed in *enforcement*, enabling the Authority to protect (even more effectively than sanctions, in some cases) damaged interests and guarantee, in addition, a more complete realization of the overall interests of regulation. In this domain, significant new developments were introduced by decree law no. 5/12, which, in addition for providing for the introduction of simplified procedures for imposing pecuniary administrative sanctions, entitles the Authority to adopt precautionary measures prior to the initiation of proceedings, given due cause and in cases of particular urgency.

As announced one year ago, the *enforcement* activity envisioned by this Board - constructive *enforcement* – also began to lay the foundation for continuous improvements in the completeness, simplification and effectiveness of the rules and regulations by studying and verifying different experiences with regulation in practice. This is the activity that inspired the recent fact-finding investigation that was designed to assess and update the definition of auxiliary generation services.

The recently-introduced monitoring and surveillance of the effects generated by regulatory measures also falls within this context.

## **WATER SERVICES**

I did not leave the water sector for last because it is any less important, but instead because this fall we would like

to dedicate a special session to the "General State of water regulation." Recent legislation has entrusted the Authority with a task of utmost relevance and responsibility, one that we have no intention of shirking. The water sector today, in fact, nearly twenty years since the reforms initiated by the Galli law, presents significant problems in terms of providing quality assurance for final customers and protecting the environment and the territory as a whole.

The legislature's decision to innervate the regulatory and control functions (decree-law no. 70/11), which were transferred to the Authority in accordance with the powers derived from its founding law (law no. 481/95), gives us the confidence to face this challenge positively, having at our disposal the entire regulatory repertoire that has already met with considerable success in the energy sector.

Our activity will set out, most of all, to provide the regulatory framework with greater stability, a condition which is essential for promoting the massive investment programs that are so critical and indispensable for the adequate protection of our environment and for guaranteeing the best ecological state for water as a resource and the security of supply. In specific, we would be satisfied if our institutional contribution were able to count itself as one of the more concrete referendum decisions, one with the capacity to activate real investments. Otherwise it will be impossible to confront and dissolve the knots that have tied up this sector. The amount of investments required in this sector leads us in the context of this session to note the opportunity to introduce Italy, in the wake of the efforts taking place in other European contexts, to legislative mechanisms designed for the centralized collection of funds in the water sector. This would make it possible lines of subsidized financing to be dedicated to the attraction of investments, which would in turn lower the fees borne by final customers.

For our part, the action will be focused on consumer protection through a regulation that provides incentives for effectiveness and quality of service, promotes investments without recognizing the costs until the works have effectively entered into service and takes into account their effectiveness and efficiency. A regulation that overall, will consider the high social content of this essential service,

and that requires a special tariff structure and a specific form of assistance to protect families and the needier social strata.

## **THE ORGANIZATION**

As anticipated in the last Report and right on schedule, the new organizational structure of the Authority became operational on January 01<sup>st</sup>, 2012. The reorganization of the energy-related structures was guided by the concept of specializing and selecting the functions by identifying the specific areas of strategic coordination (of regulation and of *enforcement*) in which each of the different Directorates would operate. In this session last year, we also announced our willingness and availability, according to the logic of loyal institutional collaboration, to cooperate in the creation of the Water Agency. As already mentioned, the legislature subsequently decided to entrust the regulatory and control functions for water services directly to our Authority. After the legislative *passage* was completed early this year, the Authority set up its very first activities right away in order to take immediate control of the new functions by defining (consistently with the general organizational criteria for energy, which I mentioned earlier) a strategic coordination area for the water sector with dedicated departments. At the managerial level - always in accordance with procedures characterized by the principles of merit and specialization - specific competitions were announced for the hiring of fixed-term personnel and a *performance* assessment and organizational behavior evaluation was begun for all Authority personnel. From a logic of internal efficiency and human resources development, the new organization also subjected itself to a significant internal mobility operation through an innovative procedure designed to promote the periodic creation of a healthy exchange and flow of experiences and professional skills across the different strategic Areas of the Authority.

Austerity policies for containing expenditures - including limits on salaries - were applied during this period and equally rigorous monitoring and analysis activities are under way in search of additional margins for improvement in terms of managerial performance (*managerial spending review*) as well as, more ambitiously, the procedures and

results of the regulatory activities being applied to operators in the sector and the "national system" more generally (regulatory *review*). These demanding challenges have also attracted the interest and involvement of the Unions who, despite their differing roles, continue to embrace a positive style of relations characterized by interaction and open, transparent dialogue, while the daily announcements and disclosures addressed to all personnel continues thanks to the improvements in internal communications tools.

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Authorities, Ladies and Gentlemen,

Today's meeting also gives me the opportunity to express my personal gratitude as well as that of my Colleagues, to the Lombardy Regional Administrative Court, the Council of State, the State Advocates (Avvocatura dello Stato), the CNEL, the National Council of Consumers and Users, the ENEA and the Electric Sector Compensation Fund, the Tax Police (Guardia di Finanza), who have collaborated closely with us for some time now, and our own Board of Auditors, not to mention all of the other institutions with which the Authority always benefits from loyal and pragmatic collaboration.

The Board expresses a special thanks to all of the women and men who work in and for the Authority with an unwavering commitment, day after day, both at our headquarters in Milan and our offices in Rome with a smaller staff.

In conclusion, I feel that an important investment we are making in ourselves is worthy of brief mention, an intangible investment that will heighten the technical credibility and *accountability* of the Regulator's own decisions: we intend to strengthen the *notice & comment* process, which emphasizes consultation and participation in regulatory decision-making. While we are already very progressive, most of our documents are currently addressed towards the technicians working in the regulated sectors, the operators and the associations. We would like to add at least two guidelines to our *notice & comment*

process without necessarily increasing the overall paperwork. Extended segments of final customers, first of all, mostly domestic consumers and small- and medium-sized enterprises have yet to be heard because they have no access (at not fault of their own) to the *notice & comment* process, leaving them with *no comment* at all and unable to participate in regulatory decisions, even ones of very close concern to them. The empowerment of consumers to make use of the rules, as discussed earlier, can be extended from more active participation by individuals and associations to include the definition of the rules for tomorrow.

Secondly, an innovative *notice & comment* process that contains more regulatory impact analysis will help with illustrating the problems, debating the potential solutions and evaluating the pros and cons of each option.

To summarize - drawing on the full gamut of stakeholders to foster the most comprehensive "justification" of the Regulator's conceptual and factual *decisions*, in other words, provides a concise epigraph for this Presentation. Furthermore, this will increase the credibility and *accountability* of the Authority in the eyes of the consumers, values synonymous with the reliability of this institution and the practicality of its actions. We hope that it will be said - within the limited world of energy and water regulation, at least - that the regulatory solutions being adopted represent the fruit of a more participatory and knowledgeable process, and that they bear less and less resemblance to the "acts of the prince." We also hope - in a genuine Socratic spirit - that the regulatory actions of the Authority are more focused on winning by force of reasoning and reflection than by imposing its own decisions by force of violence. We believe this to be fundamental part of our mission, which, at present, is to regulate changes with special attention to their social effects.

Thank you once again for your kind attention, and thank you on behalf of my colleagues Alberto Biancardi, Luigi Carbone, Rocco Colicchio, and Valeria Termini, as well as the entire structure of the Regulatory Authority for Energy and Water.