ASSESSING THE CHANGES OF THE ITALIAN GAS MARKET IN THE EUROPEAN CONTEXT

by Sergio F. Garribba, Commissioner

The Regulatory Authority for Electricity and Gas, Italy

www.autorita.energia.it

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OUTLINE

A. BACKGROUND

B. LIBERALISING THE GAS MARKET

C. CONCLUSION: EMERGING CHALLENGES AND NEXT STEPS

A. BACKGROUND: THE LEGAL FRAMEWORK

- **The Regulatory Authority** - law no. 481 of November 14, 1995
- **New electricity market** - legislative decree no. 79 of March 16, 1999, implementin the European directive 96/92/CE
- **New gas market** - legislative decree no. 164 of May 19, 2000, implementing the European directive 98/30/CE
- **Local (energy) services** - law no.142 of June 8, 1990 considered for amendment a in article 35 of the national draft budget law for the year 2002

A1. BACKGROUND: THE REGULATORY AUTHORITY FOR ELECTRICITY AND GAS OF ITALY

- **Established** under law no. 481 of November 14, 1995
- Fully **operational** since April 23, 1997
- **Independent entity** with three Commissioners
- Defining its own organisation and **procedures** fo decision-making
- **Self-financed** by contributions from regulated companies and entities
- **Member** to the Council of European Energy Regulators since March 7, 2000

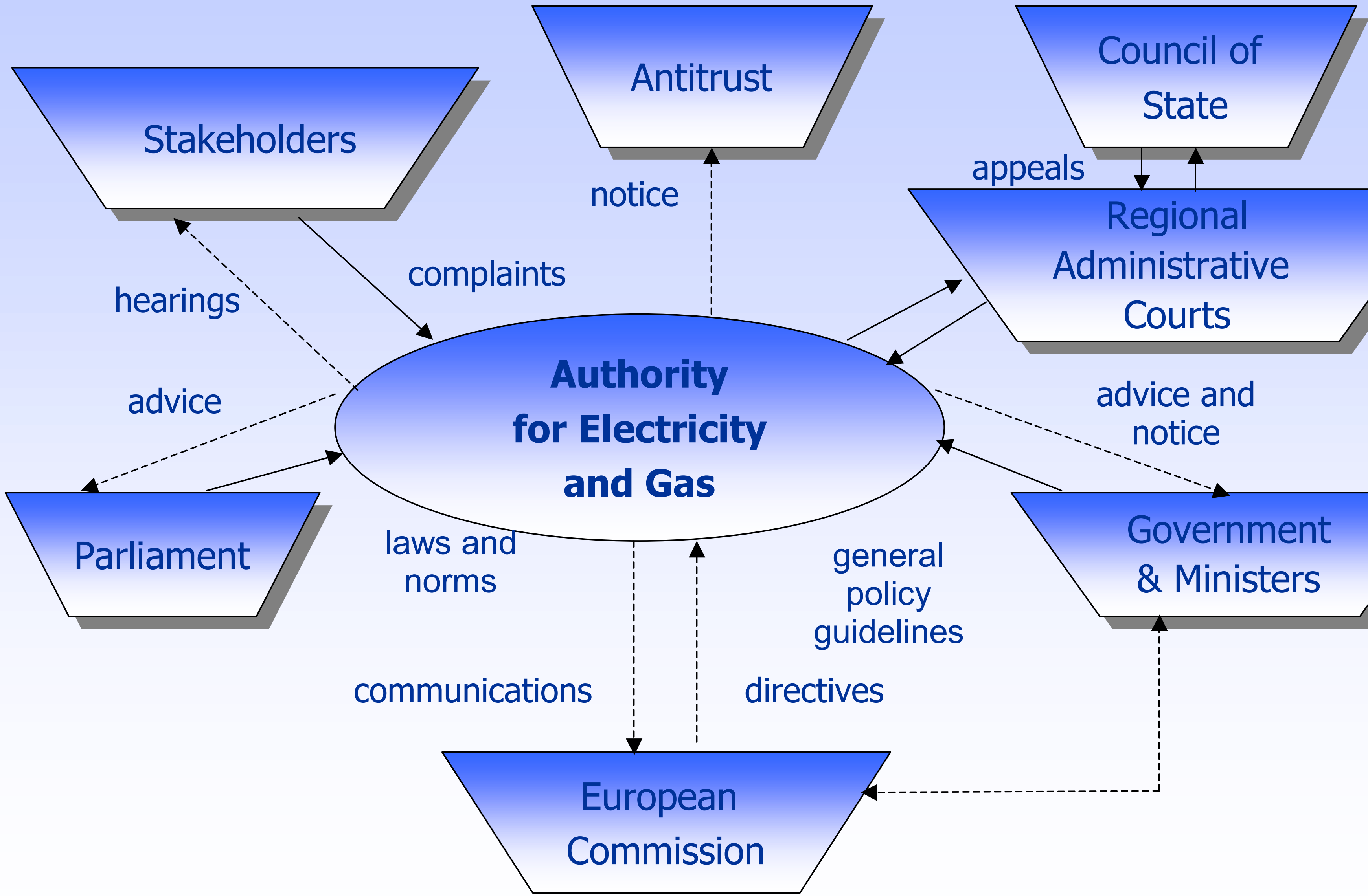
A2. BACKGROUND: THE POWERSPA OF THE REGULATORY AUTHORITY

- **Tariff** setting (level and price-cap) and **price** monitoring
- **Quality of service** (minimum requirements and sanctions)
- Directives on **activity unbundling**
- Advice to Government and Parliament on **marke structure** and **promotion of competition**
- **Overviewing** electricity and gas service supply and contracts
- **Settlement** of disputes and complaints

A3. BACKGROUND:ACCOUNTABILIT OF THE REGULATORY AUTHORITY

- **Annual report** on the state of electricity and ga services delivered to the Parliament and Prime Minister
- **Compliance** with general economic policy goals as determined by the Government and the Parliament
- **Hearings** with stakeholders (companies, consumers, environmentalists, trade unions and business groups)
- **Appeals** against Authority's decisions before the Regional Administrative Courts and Council of State

A4. ACCOUNTABILITY OF THE REGULATORY AUTHORITY

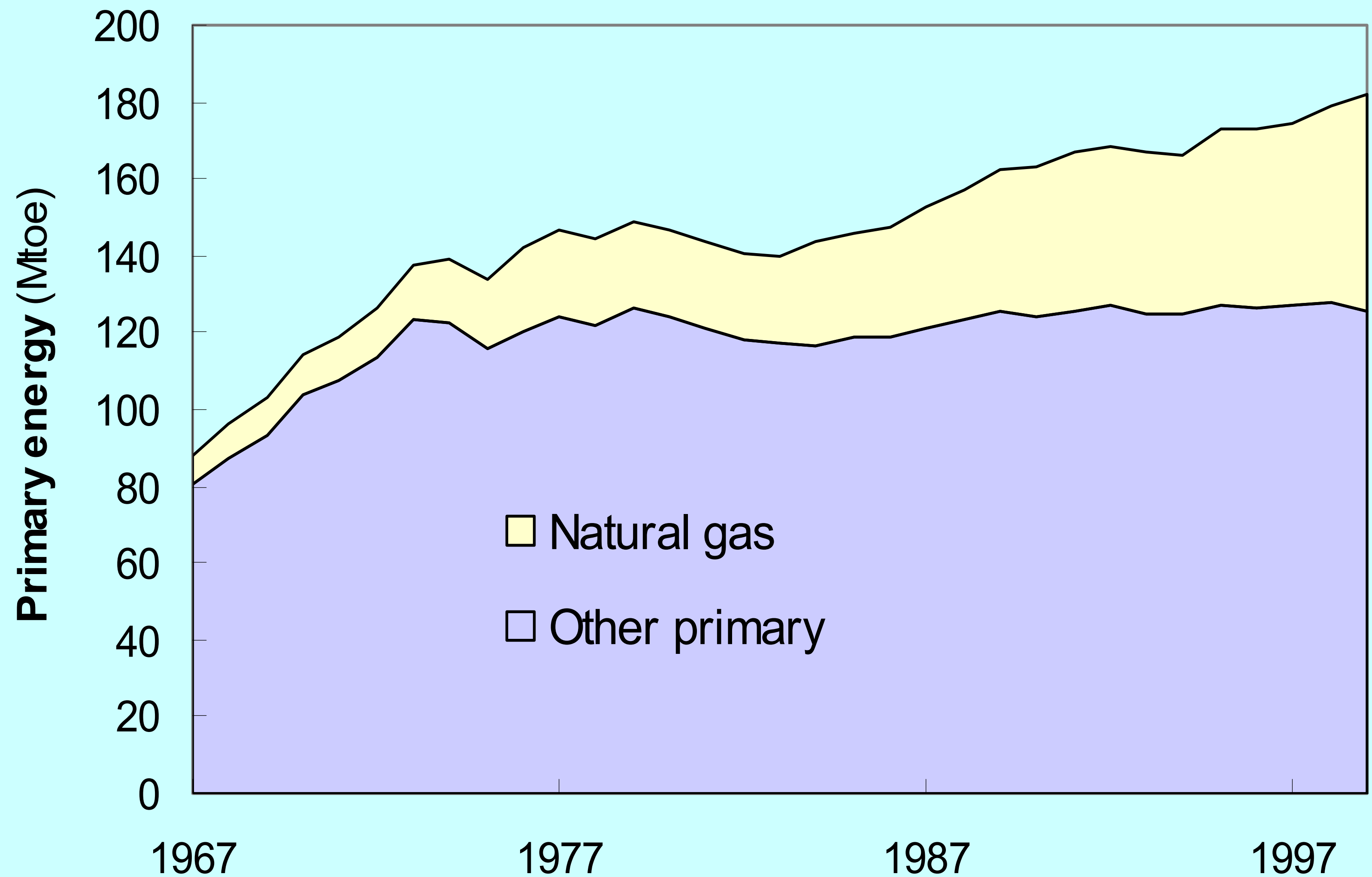


B. LIBERALISING THE GAS MARKET

- Structure of the Italian natural gas sector
- Liberalisation and privatisation issues
- Current and expected developments (legislative decree no. 164/00)
- The new gas market organisation

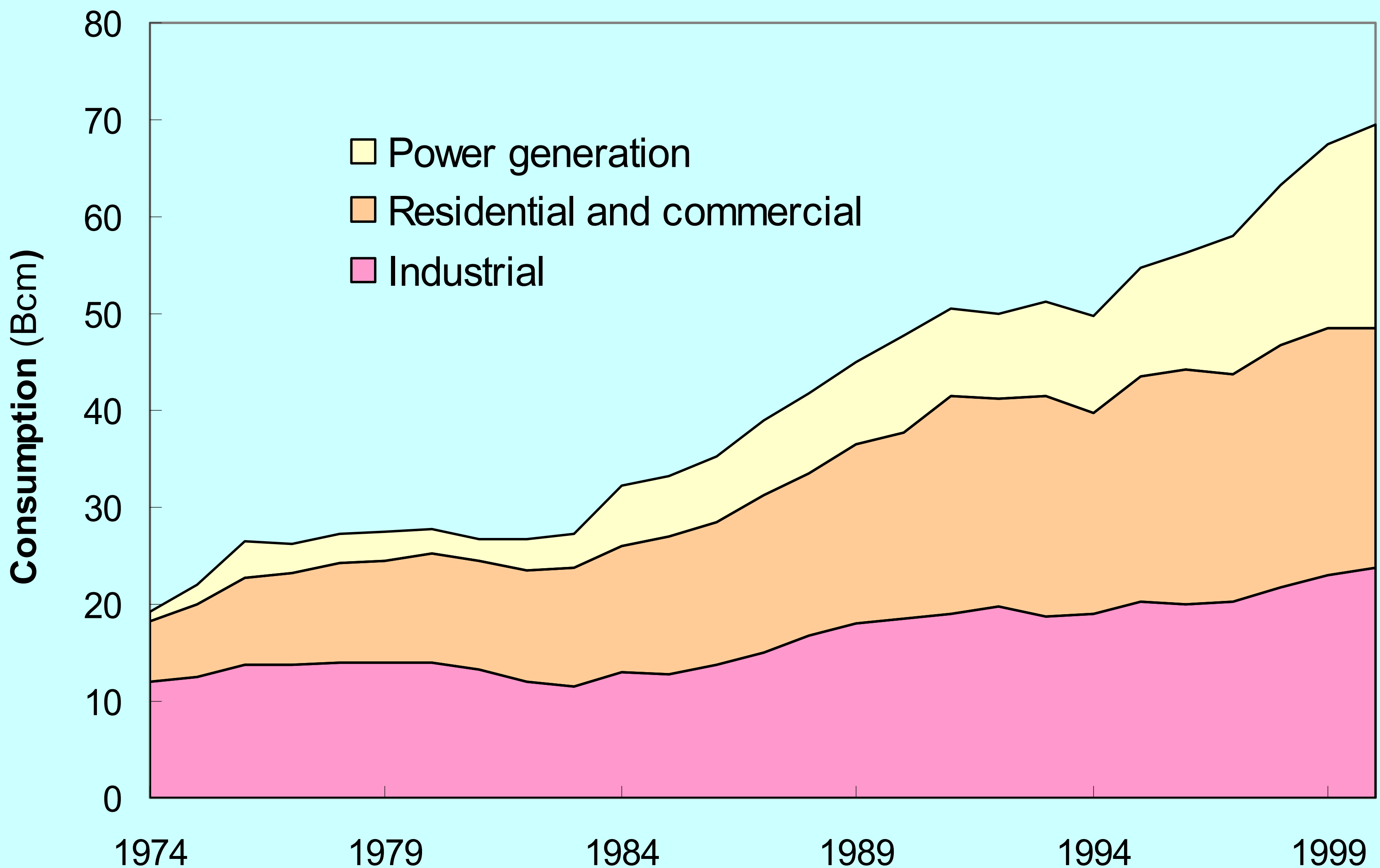
B1. THE NATURAL GAS SECTOR (I)

Natural gas in Italy's energy economy 1967 -2000



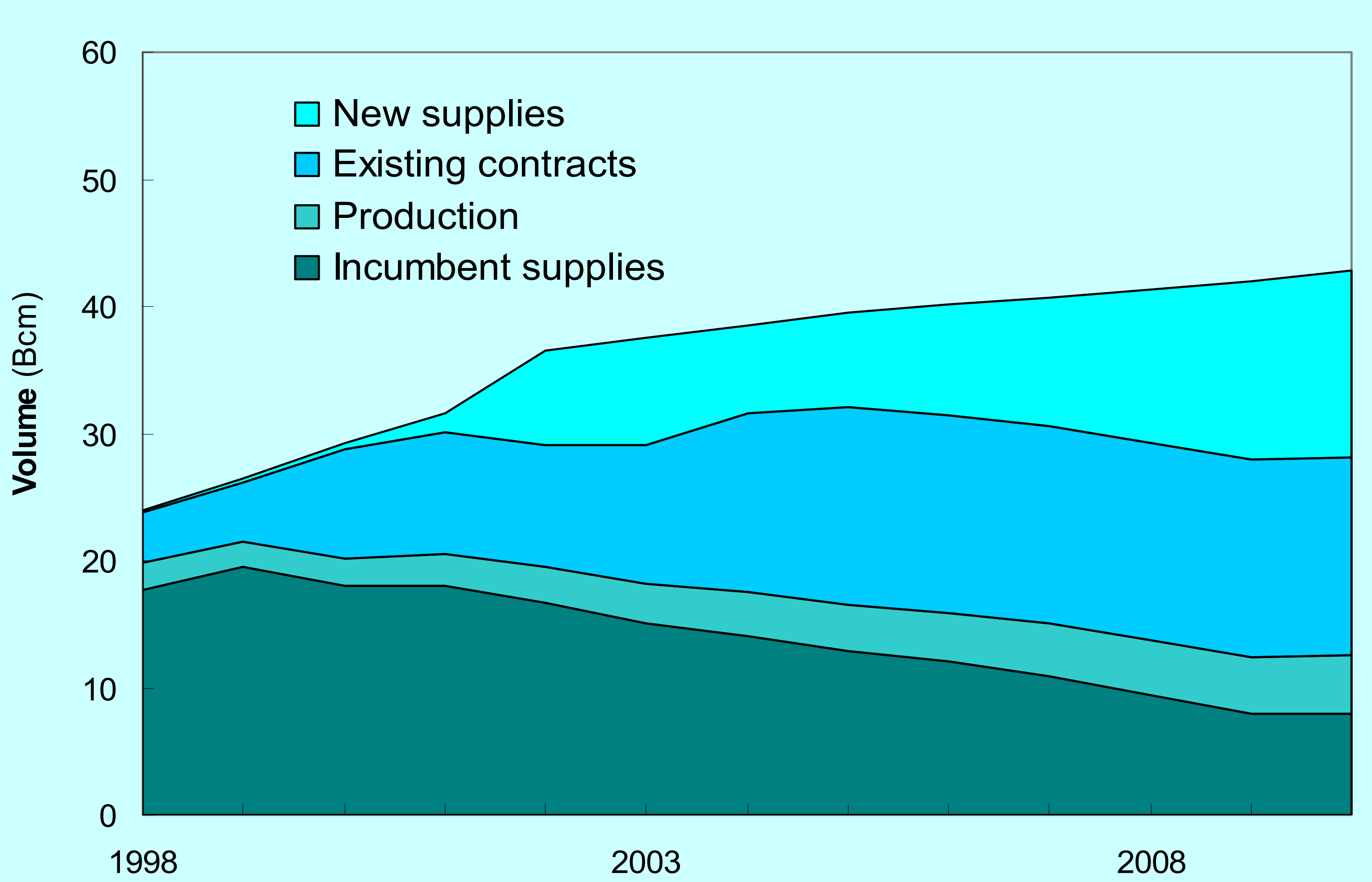
B1. THE NATURAL GAS SECTOR (II)

The increasing prominence of power generation in gas use



B1. THE NATURAL GAS SECTOR (III)

Sources of competing final sales for power generation (Bcm)



B2. THE NATURAL GAS SECTOR OF ITALY: PROBLEM AREAS

1. Level of prices and tariffs	High compared with EU average
2. Supply organisation and security	Lack of competition; domestic production 20%, LNG terminals 3%, pipeline imports 77% (Alger The Netherlands, Norway, Russia
3. Pipeline infrastructure and quality	About 70% grid outreach; new power plants driving expansion
4. Distribution(and retail) organisation	Fragmented distribution with ove 700 (local) companies; 40% demand increase by year 2010

B3. THE NATURAL GAS SECTOR: HOW ELECTRICITY AND GAS MARKET INTERACT AND CONVERGE

Electricity market		Gas market
1. Power generation →	**gas combined cycle**	← Primary gas supply
2. Electricity distribution →	**electricity vs gas transport** (embedded generation & microgeneration)	← Gas distribution
3. Electricity supply →	**separation between distribution and retail** (identification of retailers, metering and billing)	← Gas supply
4. Beyond the meter →	**DSM & other public service obligations**	← Beyond the meter

B4. THE LEGISLATIVE DECREE NO. 164/00 OF MAY 23, 2000

- **Liberalised activities:**
  - Pipeline construction and operation (subject to permits)
  - Storage (subject to permits)
  - Supply, measurement and retail to final customers

- **Activities subject to licensing (or authorisation):**
  - Domestic production
  - Distribution
  - Shipping

- **Legal unbundling:**
  - Pipeline transport and LNG terminals
  - Gas storage
  - Supply, measurement and retail

B5. THE (OLD) GAS MARKET: BEFORE THE LEGISLATIVE DECREE NO. 164/00

1. Import, national production, storage, regasification	• Negotiated price
2. Integrated activities of primary supply and transport (wholesale supply to large customers)	• Monitored price
3. Integrated activities of distribution and retail supply to residential and commercial customers	• Regulated tariff

B6. LIBERALISING THE GAS MARKET: MARKET SHARES & NEW COMPANIES

January 1, 2000				January 1, 2004 (development prospects)			
ENI-SNAM MONOLITHIC (35% state-owned)		**COMPETITORS**		**ENI HOLDING** (private)		**COMPETITORS**	
• Imports	90%	• Enel and others	10%	• Snam Gas Import and Shipping (?)	~ 60%	• Others (& Gas release)	
• Domestic production	95%	• Others	5%	• Agip (Hydrocarbon Production) Division (?)	~ 90%	• Others	
• Storage	100%		—	• Stoccaggio Gas Italia Co	~ 90%	• Others	
• Transport	98%	• Others	2%	• Snam Rete Gas Co	~ 90%	• Others	
• Distribution & Retail (Italgas)	~ 65%	• Enel & Municipalities	~ 35%	• Distribution & Retail Co	< 50	• Distributors and retailers	

Special regime above 200,000 cm/yr

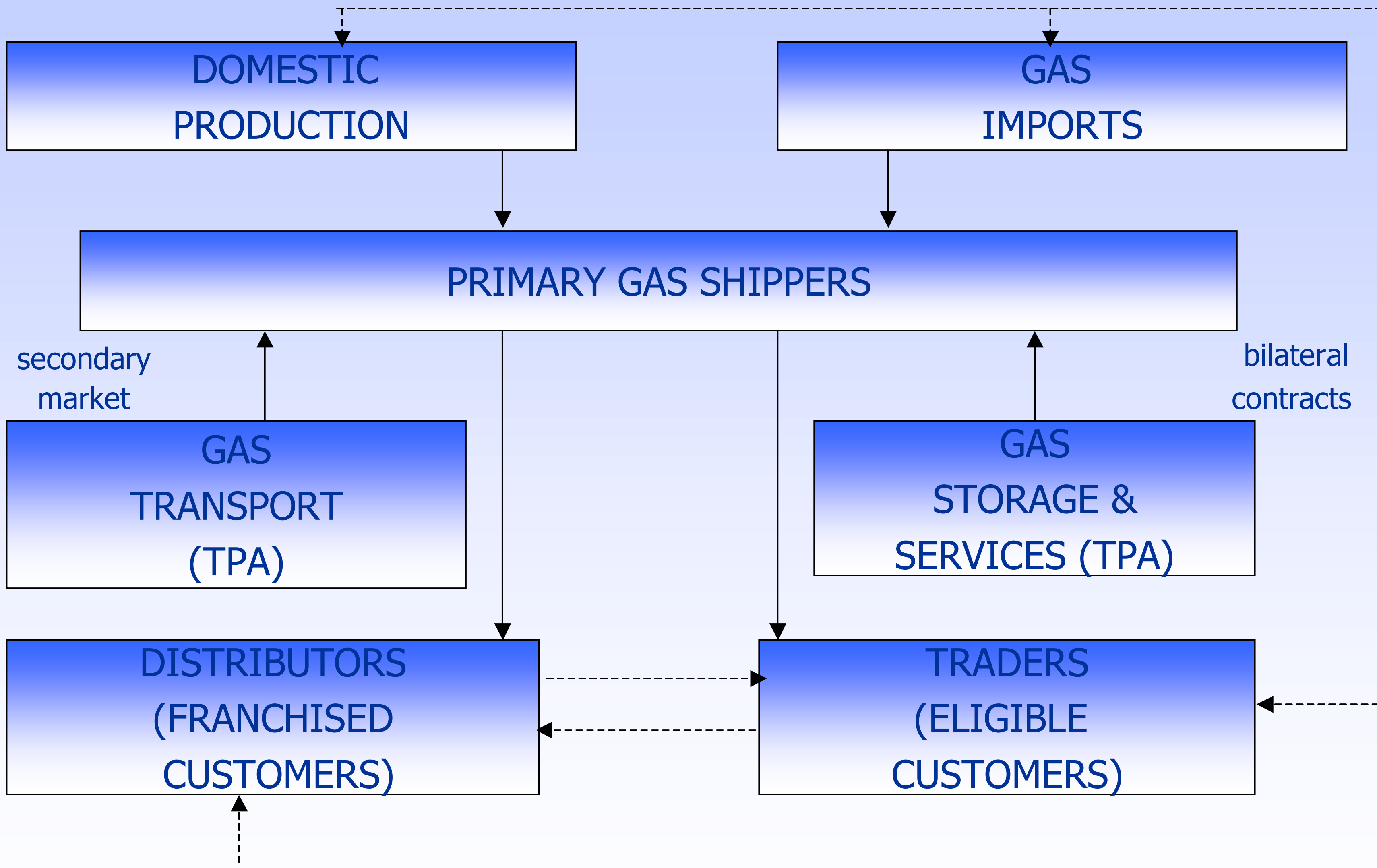
Eligible market ~ 10%

Eligible market 100% by Jan. 2003

B7. RESTRUCTURING ENI-SNAM, THE NATIONAL GAS MONOPOLY: MILESTONE

• National hydrocarbon act		1948	• ENI as a public entity SNAM as a subsidiary
• Corporatisation	August	1992	• ENI as a state-owned holding (Eni Spa)
• Privatisation		1993	• IPO on 65% of Eni Spa shares (& golden share)
	through	1999	
• Unbundling	January	2002	• gas storage, GNL • pipeline activities
	January	2003	• supply and retail
• Divestments	years	2002-2003(?)	• high-pressure gas transport (40% private)
	2000 through	2010(?)	• take-or-pay contracts
•Thresholds	January	2002	< 75% (to 61%) of national gas production and import
	January	2003	< 50% of national gas supply

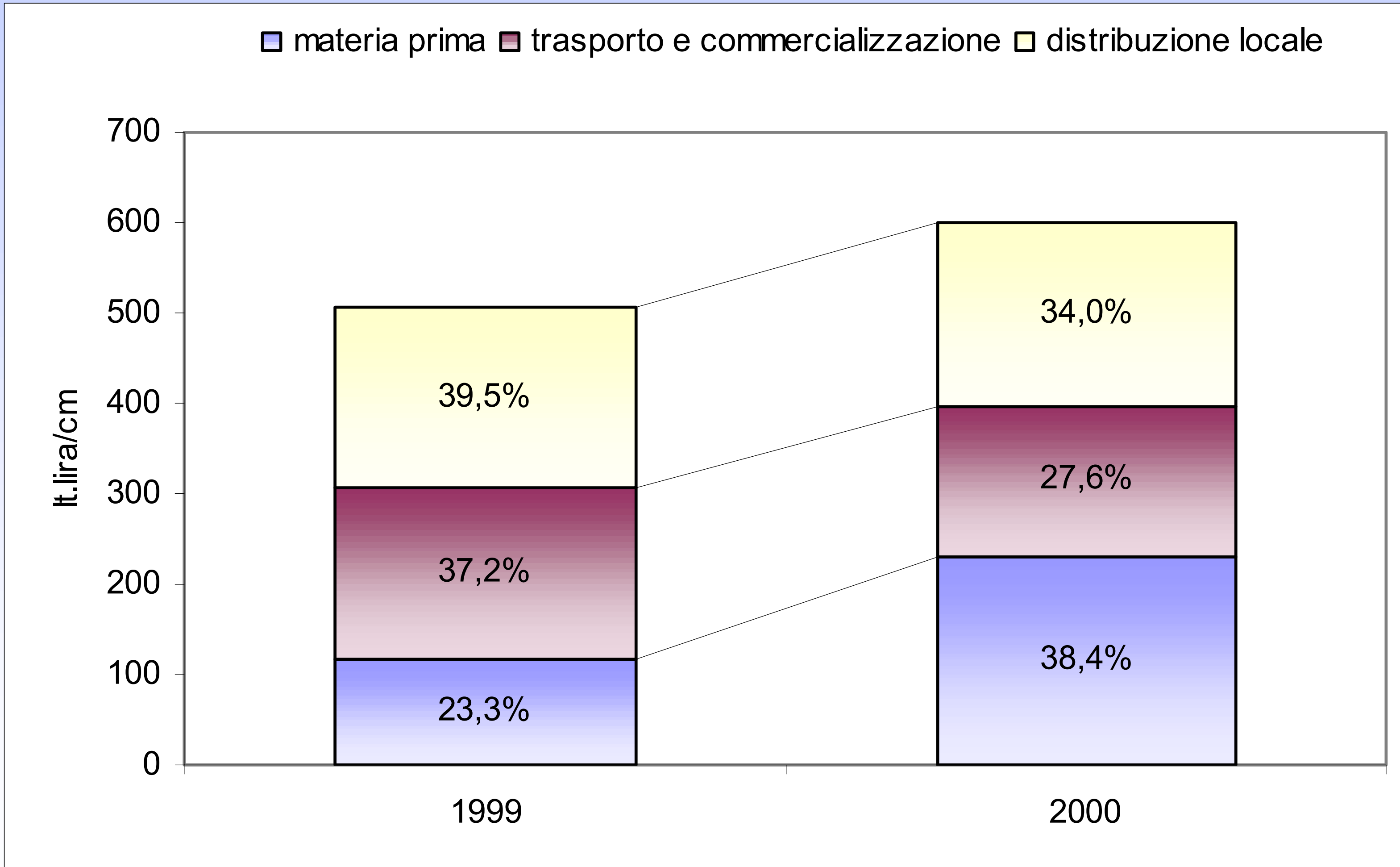
B8. THE NEW GAS MARKET IN ITALY



B9. LIBERALISING THE GAS MARKET (I)
GAS TARIFF(tax free, July 2000,It.lira/cm

	Residential use		Industrial use	
	It.lira/cm	added fiscal charges %	It.lira/cm	added fiscal charges %
Italy	622.5	42.2	307.5	21.8
EU (weighted average)	583.4	22.7	288.0	24.9

B10. LIBERALISING THE GAS MARKET(I: COMPONENTS OF GAS TARIFF (before taxes, It.lira/cm)



B11. THE NEW GAS MARKET: THE TARIF AND PRICE SYSTEM (I)

1. Import and national production	• Negotiated prices and take- pay contracts (monitored by the Regulatory Authority and Competition Authority)
2. National (and main) regional pipelines	• Regulated TPA and transport tariff (determined by the Regulatory Authority)
3. Storage, LNG, tech services	• Regulated TPA and use tarif (determined by the Regulato Authority)

B12. THE NEW GAS MARKET: THE TARIF AND PRICE SYSTEM (II)

4. Local pipelines	• Regulated TPA and transport tariff (determined by the Regulatory Authority)
5a. Retail supply to franchised customers (until Dec. 31, 2002)	• Regulated retail tariff (determined by the Regulatory Authority)
5b. Retail supply to eligible customers, and to franchised customers (since Jan. 1, 2003)	• Negotiated price (monitored by the Regulatory Authority

B13. THE NEW GAS MARKET: CRITICAL DECISIONS

- Identification of the **national and regional gas pipeline grid** (Ministry of Industry **by January 2001**)
- **New tariffs** for national and regional pipeline gas transport, dispatching, storage and LNG terminal use, distribution and retail supply (Regulatory Authority **by Spring 2002)**
- **Access** to the national gas system and its facilities: conditions and rules (Regulatory Authority **by end 2002**)
- **Gas system and grid interoperability codes** (national companies with supervision by the Regulatory Authority **by end 2002**)

B14. TARIFF FOR GAS DISTRIBUTION THROUGH LOCAL GRIDS (I): ORDER NO. 237/00 OF DECEMBER 28, 2000

- Separated tariffs for distribution and retail supply
- Fair rate of return on capital
- Revenue cap adjustment with 3% annual productivity recovery rate set for 4-year regulatory period (until June 30, 2004)
- Gradual tariff adjustment towards allowed revenue

B14. TARIFF FOR GAS DISTRIBUTION THROUGH LOCAL GRIDS (II): ORDER NO. 237/00 OF DECEMBER 28, 2000

- **Allowed revenue set by standard costs taking into account the characteristics of the main distribution areas**
- **National cost coefficients reflecting cost elements controlled by distributors**
- **Cost elements coherent with current cost of service of efficient distributors including adequate service quality standards**

B15. TARIFF FOR GAS TRANSPORT AND DISPATCHING, AND USE OF LNG TERMINALS (I)
ORDER NO. 120/01 OF MAY 30, 2001

- **National pipeline grid (NTG) and regiona pipelines (RTG) tariff based upon:**
  - capacity
  - distance
  - shipped volume

- **Tariff:**
  - set for a 4-year regulation period
  - subject to price-cap on allowed revenue

B15. TARIFF FOR GAS TRANSPORT AND DISPATCHING, AND USE OF LNG TERMINALS (II) ORDER NO. 120/01 OF MAY 30, 2001

- Rate of return from Capital Asset Pricin[g] Model
- Allowance for new investments
- NTG:entry-exit capacity tariffs wit[h] consideration of distance to smoot[h] regional differences
- RTG: exit capacity tariff, distance-relate[d] with distance cap

B15. TARIFF FOR GAS TRANSPORT AND DISPATCHING, AND USE OF LNG TERMINALS (III) ORDER NO. 120/01 OF MAY 30, 2001

- **Capacity booking regime:**
  - path-based booking to avoid capacity hoarding
  - annual or six-month booking, with tradable capacity
  - capacity linked to final customers
  - daily balancing with hourly ceiling

- **Interruptible service:**
  - reduced capacity components TE*, TU*, TR*

B16. QUALITY OF DISTRIBUTION SERVICE: TECHNICAL REQUIREMENTS ORDER NO. 236/00 OF DECEMBER 28, 2000

- **Continuity of supply:**

  - enhancement overall level of continuity

  - adoption of (European) benchmark and reduction of regional gaps

  - pipeline inspections and safety

  - emergencies and accident recovery

B17. QUALITY OF SUPPLY SERVICE: COMMERCIAL REQUIREMENTS ORDER NO. 229/01 OF OCTOBER 18, 2001

- **Contractual conditions of supply:**
  - billing and payment procedures
  - meters reading
  - penalties for delays on payments
  - procedures in case of disconnection
- **Quality standards:**
  - time required for new connections
  - repair practice
  - reply to consumers’ complaints

B18. QUALITY OF SUPPLY SERVICE: TRANSPARENT BILLING ORDER NO. 42/99 OF APRIL 14, 1999

- **Billing practice and content:**

  - transparency

  - completeness

  - information to the customer

C1. CONCLUSION: EMERGING (UNRESOLVED) REGULATOR’S CHALLENGES

- New Government’s drive to accelerate gas market liberalisation and to complete companies’ privatisation of gas companiers

- Progress towards the single European gas market setting the framework (while raising concern regarding regional asymmetries in the build-up of th single European gas market)

- Need for new infrastructure investment and codes o conduct for gas grid governance (while coping with national security)

- Recognition of synergies between the electricity anc gas sector

C2. CONCLUSION: EMERGING (UNRESOLVED) EUROPEAN CHALLENGES

- Management of take-or-pay contracts to achieve supply-side competition

- Regulated/negotiated third party access and use while promoti new infrastructure investment

- Cross-border gas trading and tarification for the internal market

- Security of gas supply:
  - concern on long-term security of supply
  - capacity allocation and congestion management
  - role of storage and equivalent flexibility instruments

C3. CONCLUSION: REGULATOR'S NEXT STEPS

- Promoting competition in gas imports, production and supply
- Defining rules for the access to national gas pipeline grid and congestion management, while adjusting for long-term (take o pay) contracts
- Introducing tariffs and access rules for gas storage
- Monitoring operation of the growing national gas hub and derivatives' market
- Enacting legal separation and physical security standards in gas distribution, measurement and retail activities