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The status of energy liberalization and why the process remains incomplete

A comment on the opening of energy markets at the annual Aiget conference

The process of liberalization of the electrical energy and gas market in Italy, is at a more advanced stage, after eight years, than in other European countries. While it has unquestionably produced some interesting results, it still has a way to go before becoming truly competitive. There is general consensus on this point, but a wide range of opinions as to the modalities and times required for the achievement of this goal.

It is fundamental to bring the process to a successful outcome in order to make the electrical energy system more efficient and thus boost the competitivity of the entire national economy. Furthermore, this has been made especially complex today, in consideration of the recent environmental policy decisions, with Europe deciding to take the lead through a series of policy initiatives that have a direct impact on the production system, and thus on the ability of Europe, and of Italy in particular, to compete on the global market.

These were some of the strategic issues concerning the Italian and European energy markets addressed by AIGET's President, Luca Alippi, in his opening presentation at the last AIGET annual conference, held this past May in Rome at the Chamber of Deputies, Palazzo Marini, with the participation of leading political and business figures. The message launched by AIGET's president during the course of the event was that the liberalization of the Italian energy markets must be completed: "while it is true that the initial steps in the liberalization process have achieved important results, it is increasingly evident that the process, once begun, must be brought to completion."

Giovanni Apa, Vice Chairman & Director Area Gas AIGET
Raffaele Chiulli, Vice Chairman & Director Area Energy & Environment AIGET

The following summarizes some of the principal points brought out during the course of the conference, which AIGET brought to the attention of the many institutional figures present, in addition to the various energy businesses and associations and the information companies also in attendance.

The electrical energy market

Paolo Grossi, Vice President of AIGET and Director of the Electrical Energy Area, delivers a brief overview of the current status of the national electrical market, providing some suggestions for future steps in the liberalization process.

Liberalization is further along in the electrical sector than in gas:

- the network is largely independent of producers of electrical energy (although ENEL still holds a small stake in Terna and the Cassa Depositi e Prestiti holds sizable shares of both ENEL and TERNA)
- there is an exchange for the spot market that works both for the day before and, from May 1st , for futures, through the Piattaforma Conti Energia
- the dominant operator's capacity is less than 50% of the overall national capacity, and there have been important investments in electrical production in recent years. This has led to an increment in the total capacity of the system, widening the gap between supply and demand and lowering the risk of peaks in spot prices for energy.

In any case, there are ample margins

AIGET
Italian Association of Energy Traders and Suppliers (www.aiget.org)

Mission: to promote all initiatives, economic, financial, technical or scientific, in the interest of the Italian energy sector, its liberalization and its competitivity.

Founded in 2000 with the start of the liberalization of the Italian energy markets, the association represents the new sector operators: suppliers, wholesalers, traders and shippers working in the natural gas and electrical energy sectors.

The purpose of the Association is the following:

- to promote competition and transparency in the energy markets
- to favor the development and standardization of primary energy products and derivatives
- to stimulate reciprocal consultation and communication with member companies, to better serve their interests at the national, European and global level
- to analyze the issues that affect the supply and trading of energy products and to promote initiatives designed to resolve them
- to promote the application of information technology to energy trading
- to edit and publish the Association's documentation and to promote its activities with the mass media.

for improvement in terms of market efficiency.

An initial step, already established for some time, is the complete opening of the market from the demand end as well, starting from July 1st . In fact, this deadline served to underscore one of the main problems in this market: legislative and regulatory uncertainty.

It was only a few days before the opening of the new market that the modalities for the transition stage were announced: a stage that might last for a longer period than initially envisioned, during which the Authority for electrical energy and natural gas will play a leading role. In addition, in a liberalized market with a specific oversight authority, it is difficult to imagine what role should be assigned to the AU (Acquirente Unico, or Single Buyer), a body that has been very important in the demand for electrical energy until now. It would be instead very useful to identify a Single Supplier of last resort, to whom industrial and residential customers could refer, but only in extraordinary cases and in modalities that are not "economical", especially for industrial operators, who would only recur to the Single Supplier when other supplies were unavailable. Furthermore, the proposed "social" rate is a practical instrument for the protection of the weaker segments from market turbulence, and poses no risk to the market itself, unless it develops into an excessively bureaucratic procedure. In this case, the natural gas market presents a good example to follow: the townships set a tax on consumption and utilize the funds to cover the consumption of the most disadvantaged customers, though it will not be easy to determine who is really in need and who isn't.

Uncertainty thus reigns, and at a crucial moment for the electrical system in our country.

Some of the steps needed to complete the liberalization of the market can be summed up as follows:

- consolidation of futures markets
- efficiency and simplification in the communication of information between the various segments of the supply chain (in particular between distributors and retailers)
- simplification of bureaucracy involved with customer management.

The natural gas market

Giovanni Apa, Vice President of AIGET and Director of the Natural Gas Area, has outlined the status of the natural gas market and made some suggestions as to how to overcome the obstacles that block the completion of the liberalization process.

The market's immaturity is made evident by its "schizophrenia", having moved from the "gas bubble" in 2004 to the "gas emergency" of 2005 to the "blackout" of 2006 to the "oversupply of gas" of 2007, without any apparent rhyme or reason.

Bruno Tabacci, Chairman V Comm. Chamber of Deputies

The market is still characterized by the presence of an incumbent, active all along the supply chain, from upstream (imports and in-house production) to transport, storage and sales, and this conditions the actions of all the operators along the line.

In addition, today ENI is engaged in the production of electrical energy, so it can decide to use gas to sell electricity, or sell natural gas directly, and is launching integrated offers on the retail market, following the total deregulation of demand.

The corporate division of ENI, Snam Rete Gas and Stogit, along with the guarantee of access to the network, have increased the level of competition, but the benefits expected from liberalization are still a long way off. It is indubitably true that SRG, as well as Stogit, guarantee access rights to the network and the existing stock to everyone, but it is difficult to envision them making investments aimed at further opening the market.

As of today, there are three main factors slowing down a true liberalization process:

- low liquidity
- lack of an exchange for natural gas and a futures market
- the "raw material natural gas dispute"

Liquidity is low mainly because there is a lack of "flexible" infrastructures, such as re-gassifiers and storage facilities, just when the demand for natural gas is rising rapidly from producers of electrical energy. In addition, access modalities for international networks not operated by SRG remain to be defined.

All of this makes it difficult to formulate efficient supply policies, because the risk is too high, so the Virtual Exchange Point (PSV) is in fact simply a point of "consignment", despite the fairly large volumes (about 7% of the total natural gas exchanged). Last winter, the low liquidity led to a natural gas blackout and the subsequent creation of a provisional Wholesale Supplier of Last Resort (FGUI), while the auction to become the permanent FGUI was held without bidders.

In addition, an adequate level of liquidity is also blocked by concentration upstream, which has always been dealt with extemporaneously rather than structurally.

A tool that would favor liquidity in the natural gas system is the so-called

Luca Alippi, Chairman AIGET **Alessandro Ovi**, Counselor, Council of Ministers

"open season" mechanism for unblocking bottlenecks: the idea is that transporters should "execute" market demands rather than setting the capacities beforehand, deciding year by year, or over the long term, how much it is "necessary/opportune" to load into the system. A sufficiently liquid market is a basic condition for a Natural Gas Exchange, which, in turn, would contribute to increasing liquidity even more. A Natural Gas Exchange would provide the system with the price signals needed to guide investments and would allow sector operators to draw their supplies, at least in part, from a real spot market, which, thanks to the efficiency and transparency of the exchange mechanisms, should result in average prices lower than those obtainable with long-term supply contracts. The German experience is relevant to this question, now that, as of July 1st , the natural Gas Exchange has been opened there. This result was made possible by some clear and decisive choices:

- the 5 leading operators are obligated to act as "market makers"
- flexible transport system (Entrix)
- possibility of cross-border exchanges (with the possibility of export flows).

Another, but not the last, obstacle to the development of the natural gas market is the continued and serious uncertainty linked to the "Raw material natural gas dispute", introduced by the AEEG decree 248/04. This dispute threatens the very survival of several sector operators, who were forced to sell natural gas at prices higher than those set by the Authority in order to obtain even a minimal profit margin.

This dispute is unfortunately not the only one; the elevated number of legal suits costs the system considerably, and it is a result of the uncertainty about regulations and legislation that is often tardy and unclear and sometimes contradictory.

Competitivity and the environmental challenge

Raffaele Chiulli, Vice President of AIGET and Director of the Energy & Environment Area then highlighted the growing correlation between energy policy and environmental policy and how this latter is strongly influencing sector development.

Europe is second to no one in environmental protection, and the European Commission recently set new goals for its member states with the "Energy for a changing world" program, outlining a new energy strategy for Europe, reacting to climate change, increasing competitivity and guaranteeing supply security for the EU. The targets to be achieved by EU countries by 2020 are the following: reduction of 20% in greenhouse gas emissions (30% in the case of ulterior international accords); a 20% increase in energy efficiency; 20% of the energy mix provided for by renewable sources, including at least 10% biomass. These goals do not, however, seem easily attainable: moreover, they seem almost certain to result in burdens that will have repercussions on the entire national production system.

In particular, the Emissions Trading Scheme (ETS), involving some of the most energy-intensive sectors, which therefore emit relatively high amounts of CO_2, while based on market mechanisms, risks having a distorting effect on competition, both between sectors and between countries, and is thus an issue of some concern to the companies that would be affected. Today, the cost of emissions quotas is partly included in the price of electrical energy, and the high volatility of prices tends to generate uncertainty and discourage investment, forming a de facto barrier to would-be new entrants. The European Commission has reduced the emissions quotas cap requested in the National Allocation Plans (NAP) submitted by various EU countries, in an attempt to avoid the over-allocation that characterized the first phase of the ETS, with a consequent dramatic drop in the price of CO_2. In particular, Italy saw its proposed plan cut by 6.3%, and it was requested to add some industrial facilities to those subject to emissions quota limits and to specify the criteria of allocation for new entrants, another delicate aspect of the ETS norm. Meanwhile, the Authority for electrical energy and natural gas has evaluated the impact of the first phase of the ETS (2005-2007) at 0.53 €/MWh, but it foresees that the cost may rise to over 5 €/MWh for the second phase (2008-2012). Furthermore, it projects that the total cost of incentives for just the "energy account" for photovoltaic power may reach 10 billion euro over the next 20 years. If these figures are accurate, Italy not only must reduce insecurity and unpredictability of the regulatory context, but also develop a "realistic" renewable resource initiative, clearly explaining that these sources of energy involve a cost that the system must bear. It is thus important to open a discussion about the efficacy of the various types of incentives for the different kinds of renewable resources, which appear to have different requirements and characteristics. This is the only strategy for transforming the challenge posed by climate change into an opportunity for development. Finally, Europe must succeed in involving the other great nations in this effort, or risk remaining out on a limb, isolated by its choices and without having achieved results that make a difference at the global level. ■