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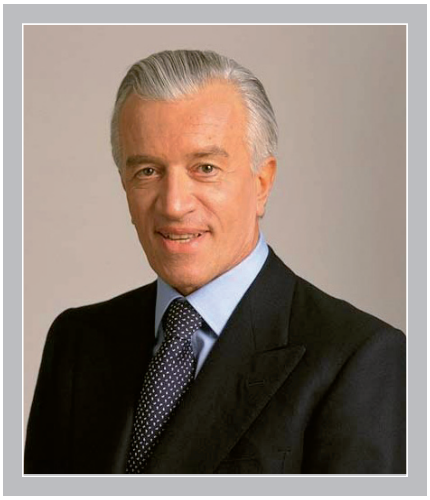
AU - ACQUIRENTE UNICO

The role of Acquirente Unico in the electricity market

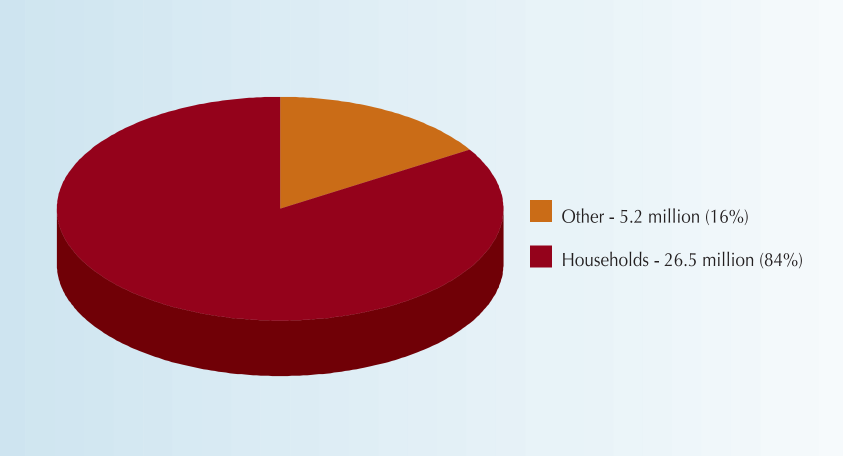


In the mid-2009, the attention of participants in the Italian electricity market was focused on two issues: i) in international markets, the erratic pattern of oil prices, which nearly doubled from their minimum levels at the start of the year, in spite of harsh worldwide recession and contraction of energy usage; ii) at home, the continuing of the debate on the reform of the electricity market, namely the modalities, timescales and pre-requisites for the take-off of GME's regulated forward market as per Law No. 2/2009.
Both issues are crucial to Acquirente Unico (AU), the publicly-owned company which has been active since 2004 and in charge of the servizio di maggior tutela (universal service) since 1 July 2007. This service is provided to all customers who, after full electricity market liberalisation (July 2007), did not migrate to the "open market" or who decided to switch back to the universal-service market. In compliance with Directive No. 2003/54/EC, the Italian universal-service market includes low-voltage-connected final household customers and small businesses (with less than 50 employees and a yearly volume of sales not exceeding 10 million euro). AU has the task of guaranteeing electricity supply to these customers at competitive prices and on the contractual and economic terms and conditions established by Autorità per l'energia elettrica e il gas (AEEG, the Italian electricity & gas regulator). This task is one of those with which AU was vested under Law No. 125 of 3 August 2007.
In March 2007, the universal-service market included about 32 million customers: almost 27 million households and over 5 million small businesses. Since July 2008, about 3 million customers (approximately 1,800,000 households and 1,200,000 small businesses) have opted for the open market. AU's role is to enter into purchase contracts with Italian and foreign producers and wholesalers and, after hedging for the price risk, to make spot purchases on the power exchange.
AU sells the electricity so purchased to *esercenti di maggior tutela* (universal-service suppliers), i.e. companies specially created after 1 July 2007 to sell electricity to the final customers served by AU.

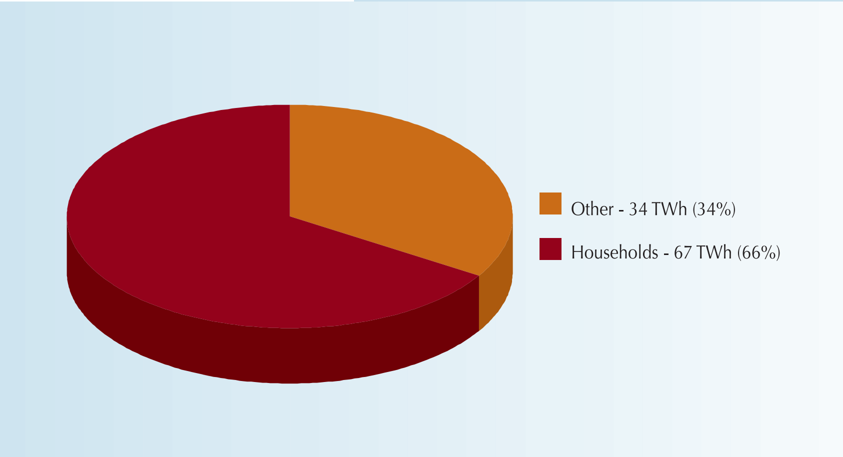
ELECTRICITY PRICES

It is worth recalling that the price per kWh that final electricity customers (universal-service market and open market) pay has the following key components:

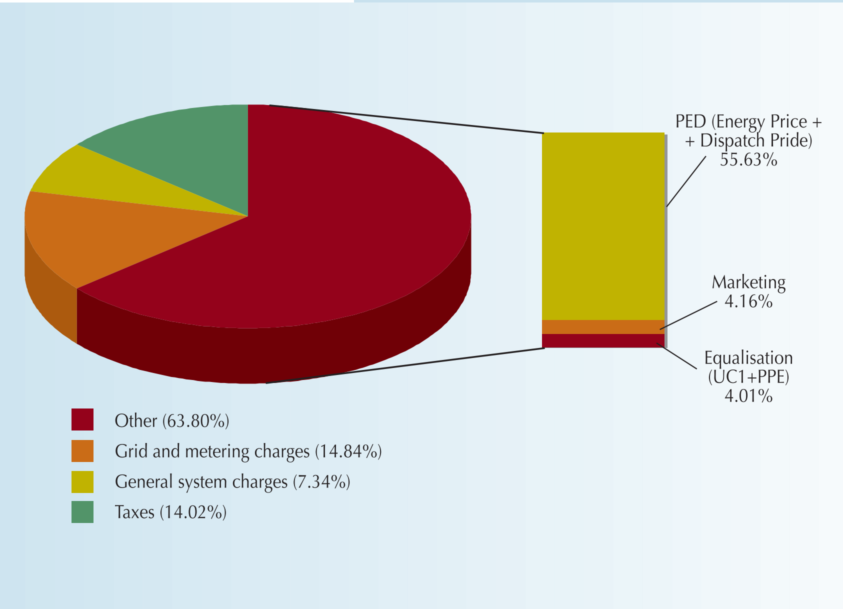
- the cost of procurement of electricity (PUN or other index of the cost of electricity generation and ancillary services);
- the cost of transmission, distribution and metering;
- the cost of marketing and sale;
- the general system charges (support to renewables and other items);
- taxes.



Universal-service market: number of customers as of 30th April 2009



Universal-service market: usage as of 30th April 2009



Components of the electricity bill - 2nd quarter of 2009

The efficiency of AU (buying at competitive prices) has an impact on the main component of the above electricity bill, i.e. the cost of procurement of electricity. For the universal-service market, AEEG updates this component, as well as the general system charges, on a quarterly basis.

In the 2nd quarter of 2009, the bill of a typical universal-market household customer included: i) the energy component (63.80% of the gross expense); ii) grid and metering charges (14.84%); iii) taxes (14.02%; and iv) general system charges (7.34%).

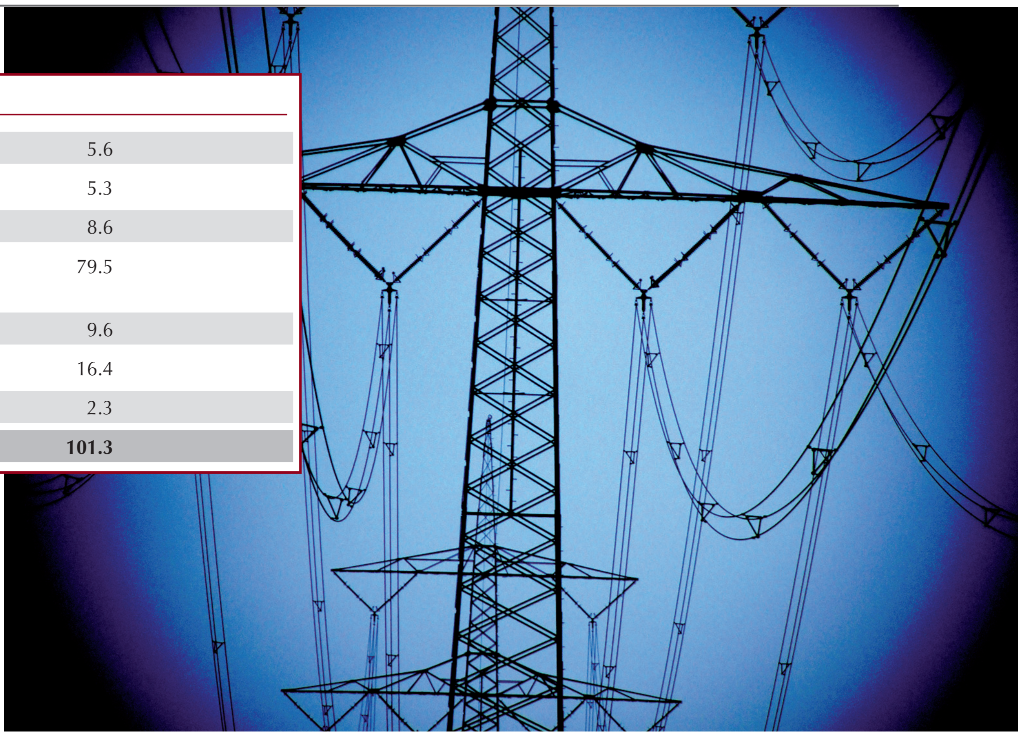
A typical household has a yearly average usage of 2,700 kWh and a subscribed demand of 3 kWh. Low-income households and users of life-saving devices may file an application for an "electricity bonus" with the Municipality where they reside.

COST OF PROCUREMENT OF ELECTRICITY

The chief indicator of the cost of procurement of electricity (regardless of dispatch charges, i.e. the component remunerating the generation/consumption balancing service) is the PUN ("Prezzo Unico Nazionale", National Single Price). The trend of the PUN is, among others, also taken as reference in bilateral transactions between producers, wholesalers and large industrial customers. So far, the average level of the PUN has been structurally higher than the one of foreign prices, even if its spread has been declining in the past few years. Additionally, it has shown to reflect the dynamics of international prices of the main raw materials used for electricity (oil, coal, natural gas) with a lag of a few months.

In the past 18 months, crude oil prices hit 150 $/bbl in July 2008, then fell to below 35-40 $/bbl in the first months of 2009 and finally doubled in a little less than two months, April and May. Italy is particularly exposed to the risk of oil price (to which gas supply contracts are pegged) and the situation worsened in the past few years.

In the last decade, as a result of lib-



AU's procurement in 2008 (billion kWh)

Yearly imports	5.6
Multi-year imports	5.3
OTCs	8.6
Ipex (Day-Ahead Market) of which:	79.5
CIP-6 bands	9.6
CfDs	16.4
Imbalances	2.3
Total requirements	**101.3**

eralisation, our electricity generating mix made progressive and strong reliance on natural gas. The process was favoured by low capital costs of combined-cycle power plants, ease of obtaining siting permits and low environmental impact. As a consequence, Italy's current generation costs are on average higher than those of other European countries, which benefit not only of nuclear energy but also of significant contributions from coal.

Some observers pointed out that liberalisation of electricity generation failed, especially in Italy, to steer investments towards long-term supply security. It follows that we should depart from this short-term approach, while meeting the targets that the European Union has set to counter the effects of global climate change and without thinking of centrally-planned-economy measures.

The need thus arises for combining market mechanisms with long-term strategies and policies. The latter fall under the responsibility of Governments, which should draw the forward energy scenarios to be achieved and establish a framework of rules and incentives for operators. Operators, who bear the cost of investments, need a regulatory and legislative framework that is stable over time. In this connection, numerous legislative initiatives have been taken to define the scope of public intervention, the energy targets to be attained, as well as the implementing instruments and roles of institutions and operators.

FORWARD MARKETS

In the past few years, large customers, wholesalers and, obviously, also AU (in its role of protection of small consumers) have developed growing awareness of the fact that they should make their purchasing choices while managing the market risk connected with the unpredictability of the international prices of energy products.

The basic concept is to apply portfolio management approaches and techniques and risk mitigation measures to energy procurement, first of all by allocating purchases over time and diversifying contract maturities (daily, quarterly or multi-quarterly, with or without indexing).

As is known, in the Italian electricity sector, physical and financial instruments have been recently made available in regulated markets: physical in GME's MTE and financial on Borsa Italiana's IDEX. AU deems it very interesting to have a broader range of trading instruments, with longer maturities and adequate liquidity.

Indeed, to fulfil its mission, AU must secure reasonable and stable costs of procurement of electricity, making purchases and price risk hedging actions based on competitive bidding among the largest possible number of operators and over different maturities. In this regard, longer-term contracts are an important element. This is why AU, just as all operators, looks with interest to the development of both physical and financial forward contracts, in line with the reform of the electricity market introduced by Law No. 2/2009.

The end goal is to increase the number of trading instruments.

So far, AU has set its own rules to trade in forward markets. Since 2004, AU has held auctions to select counterparties with which to conclude physical and financial contracts with different maturities, in order to hedge the price risk.

Thanks to its specific role and traded volumes, AU has set from time to time: i) trading rules (price determination rule, number of bids/offers which may be submitted, number of sessions, participation criteria, etc.); ii) types of contracts (base-load, peak-load, off-peak; physical, financial; fixed and variable prices; monthly, quarterly and yearly maturities, etc.); and iii) contractual clauses (maturity extension option, termination option, etc.). The results achieved substantiate that, in the past few years, AU acquired forward contracts at low transaction costs and with wide flexibility. ■