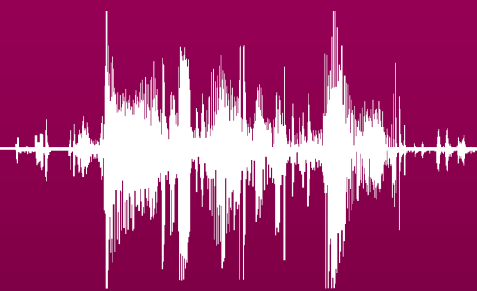


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SPECIAL REPORT: ITALY

Bridging the power and gas gap

Winter 2012

By Beatrice Bedeschi



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Italy: Bridging the price gap

A combination of Italy's location, geography, limited natural resource and policy trajectory has saddled it with the dubious distinction of being west Europe's most expensive energy market.

As a near-island system with limited interconnection and negligible indigenous production of hydrocarbons, Italy has struggled to access international oil, gas and power markets on the same terms as its European partners. Improving this through infrastructure (terminals, pipelines, HV lines, power stations) is a tortuous process involving the country's maze of local, regional and national planning laws, and the field is littered with abandoned projects.

Having spurned nuclear, for years Italy's power market was pulled and pushed around by global oil prices. A dash-for-gas in the 1990s and 2000s reduced Italy's dependence on oil, but it was a case of out of the frying pan and into the fire. In the words of Enel chief executive Fulvio Conti, firing a CCGT in Italy had become as expensive as burning champagne.

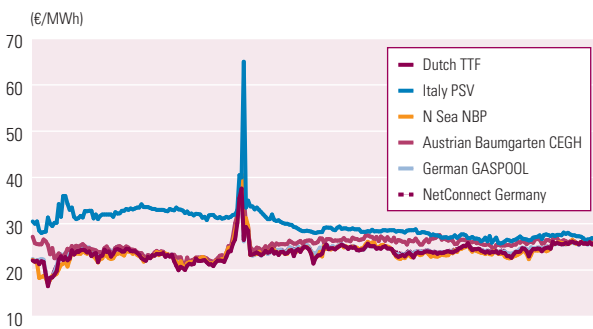
Like Germany and France, Italy has very little of its own gas to call on. Unlike Germany and France, Italy has very little coal and no nuclear plant with which to diversify its gas-heavy power mix. In short, the country is uniquely exposed to global hydrocarbon prices at a time of intense national economic stress.

In response, the government has proposed a new policy strategy to reduce its 84% reliance on energy imports. The plan is out for consultation to November 30, 2012, and will then be discussed by a National Conference in December before going forward for final approval.

The strategy sets ambitious 2020 targets to bridge the price gap to cheaper European markets, boost national production of hydrocarbons, develop a regional gas hub, extend renewables' reach and accelerate energy efficiency efforts. The framework proposals are ambitious and there is time pressure given the strong likelihood of a general election in April 2013.

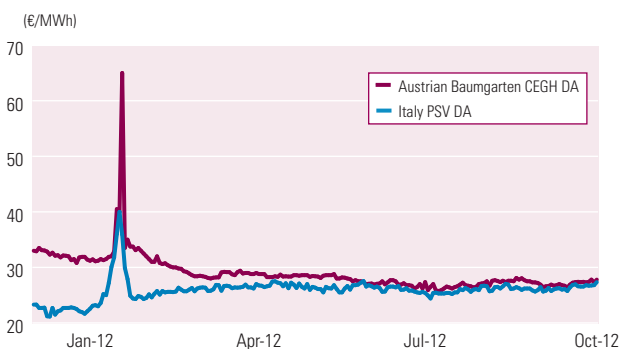
Even if successful, many of the much-needed projects resulting from the proposals are likely to run in to a planning brick wall unless the government can succeed in its attempts to streamline the permitting process. There is a precedent - Law 55/02 of April 2002 was designed to accelerate permit procedures for power plants over 300 MW in size. The industry ministry was required to pass on an application within six months from filing of a project and an environmental impact study. Very few projects met the six month deadline but the law did result in a boom in CCGT construction. Now Italy needs the offshore exploration, LNG terminals, oil-to-coal conversions, wind farms and new HV transmission lines to balance the CCGT boom - and getting these projects permitted has proved much harder.

PSV vs European day-ahead



Source: Platts

PSV vs Baumgarten day-ahead



Source: Platts

DEFINING THE GAP

Through much of 2012 the gap between day-ahead spot gas prices on the Italian PSV trading hub and the Dutch TTF, the most liquid Continental European gas market, has been around Eur10.00/MWh, although recently the spread has narrowed.

While dominant gas supplier Eni has been renegotiating its contracts, most Italian gas is still linked to oil. Moreover, third-party access to transport capacity on the pipelines bringing gas to Italy is limited, with a few operators controlling most of the capacity, only 70% of which is used on average, according to Italian energy authority AEEG.

In a report on the gas and electricity markets in March 2012, AEEG said expensive gas prices were among the main reasons for a strong Italian premium in Europe's wholesale electricity market. The spread between Italian and French electricity prices reached Eur23.30/MWh in 2011, while the spread with Germany was Eur21.10/MWh and with Spain Eur22.30/MWh, with the regulator attributing the differential to a 25% price gap between the PSV and the Dutch and Belgian gas hubs.

Platts' assessments of Italian baseload electricity, launched in September, showed on October 30 a premium to the German power benchmark of Eur24.90/MWh for 2013 delivery. Italy was the most expensive of the ten forward electricity markets Platts assesses.

DIVERSITY OF GAS IMPORTS

One of the aims of Italy's new energy strategy is to increase national gas production by 24 million boe/year, and increase and diversify gas import capacity. Gas demand in Italy has decreased from 85 billion cubic meters in 2008 to 78 Bcm in 2011. The outlook for the years through 2020 is uncertain – forecasts vary from modest growth to further retraction – depending on economic recovery and the success or otherwise of the strategy's renewables and efficiency strands.

At the same time, companies that import gas on long-term, oil-indexed take-or-pay contracts are facing the challenge of weak demand combined with increased competition from the spot market. This has led some of the major energy companies in the country, such as Edison and Eni, to renegotiate their contracts with key suppliers, namely Russia's Gazprom and Qatar's RasGas.

The strategy stresses that a further increase in gas import capacity is needed, for two main reasons: to diversify sources, with most gas currently being imported from Algeria and Russia, and to increase imports in order for Italy to then become an exporter to northern Europe.

While around 90% of national demand is currently covered by imports, the strategy aims to turn Italy into a southern European gas hub and transit route, integrating Italy's gas market with other European hubs, promoting price convergence and improving security of supply.

Snam Rete Gas would play a key role in the process. The grid operator, which achieved the status of independent transmission system operator in October following its unbundling from the vertically integrated Eni, is aiming to complete a reverse flow system on the grid by 2016 between Italy and northern Europe, which would allow Italy to export around 40 million cubic meters/day.

Snam's network would be more integrated with the rest of the European grid, while operators would have increasing access to capacity on the Transgas and TAG pipelines on Italy's northern border.

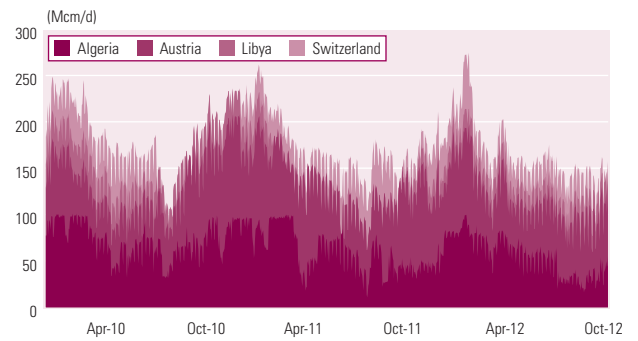
More import capacity into Italy being available in the short term to operators has already shown its effect on prices since March 2012, when interruptible day-ahead transport capacity began to be auctioned on the TAG pipeline. The price differential between the PSV and the Austrian Baumgarten market reduced from around Eur10/MWh to 1-2/MWh, Platts data show.

THE GAS MARKET

Policymakers can take some comfort from the fact that in 2012 there has been a marked convergence of price between Italy's PSV market with those on other European hubs. Since the end of February, a month in which European gas prices spiked following a cold snap, the day-ahead contract on the PSV has been falling.

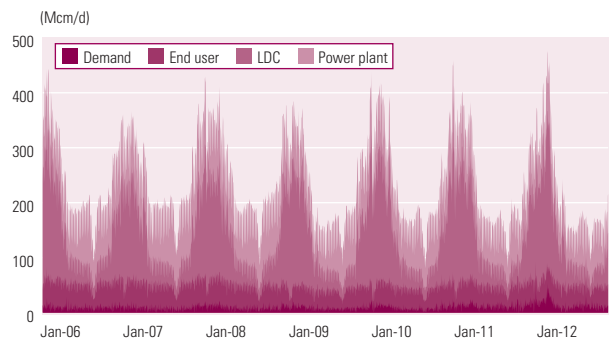
Traders see one reason for this as the opening up of import capacity on Italy's northern border. Since March 2012, the Trans Austria

2010-12 imports



Source: Bentek Energy

2006-2012 gas demand



Source: Bentek Energy

Gasleitung company, which operates the TAG pipeline, has started to auction day-ahead capacity on its website.

This came after Eni, the main importer, in December 2011 sold to Cassa Depositi e Prestiti its 89% share in TAG as part of commitments taken with the European Commission in September 2010. However, Eni's ship-or-pay contract with TAG remained in place.

According to a June 2012 report by the Oxford Institute for Energy Studies, of about 50 million to 60 million cubic meters of transport capacity on TAG, about 15 million cu m/day were bought. This helped contribute to a price convergence between the Baumgarten and PSV hubs, with the spread down to less than Eur1 since the end of September.

IMPORTS

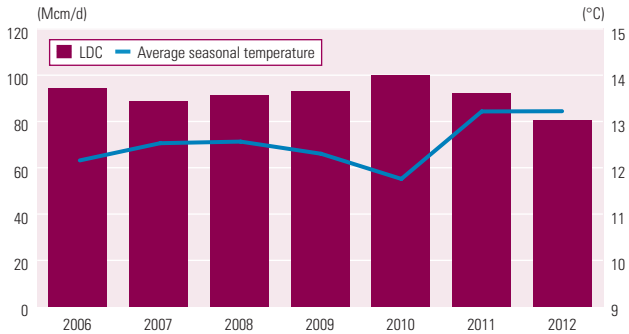
Snam Rete Gas data show imports of Russian gas through the TAG pipeline covered 34% of national demand in 2011, with an average flow of 119 million cubic meters/day. Gas coming from Algeria through the Transmed pipeline to the Mazara del Vallo entry point covered 28% of the demand, with 105 million cu m/day; 14% of the demand was covered by gas coming through Passo Gries from northern Europe, with 65 million cu m/day imported; 3% came from Libya's Green stream pipeline through Gela, with 38 million cu m/day.

The two LNG terminals of Panigaglia and Cavarzere covered 2% and 9% of the total demand respectively, corresponding to 13 million and 26.4 million cu m/day.

DEMAND

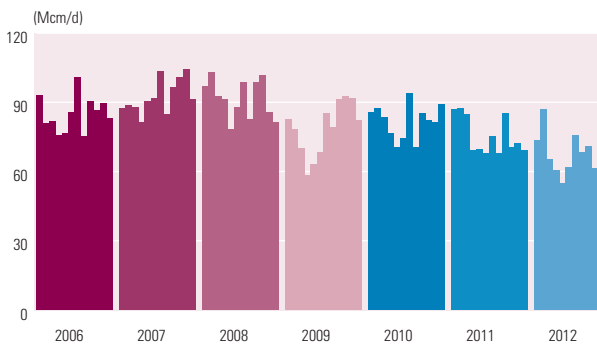
Demand in 2011 was 77.4 Bcm, according to Snam Rete Gas, compared with 83 Bcm for 2010. Industrial demand was 13.5 Bcm, demand from power plants was 27.7 Bcm and demand from local grids was 33.6 Bcm. Network consumption and exports accounted for 2.5 Bcm.

2006-12 local grids demand



Source: Bentek Energy

2006-12 power plants demand



Source: Platts

Import pipelines



Source: Platts PowerVision

Of the total demand, 70.3 Bcm were covered by imports, 8 Bcm by national production and 896 million cubic meters by storage outage. Data from Platts unit Bentek Energy show that Italian demand has a seasonal trend, dominated by local distribution grids in winter and power generation in summer.

Bentek Energy data also show that although it has maintained a seasonal trend, demand for heating between 2006 and 2012 has fallen by 3%, in line with warmer weather.

Demand from power plants has also fallen during the same period, partly because of the increase in generation from renewables.

Eni's transport capacity auctions

A further improvement in third-party access to transport capacity came in September, when the Italian antitrust authority (AGCM) decided to shelve a probe into Eni's market power and accepted the company's proposal to free 5 Bcm/year of transport capacity on the TAG and TENP/Transitgas pipelines through 2017.

Some 3.4 Bcm/year will be auctioned on the TENP/Transitgas pipeline, and 1.6 Bcm/year on the TAG pipeline. The first auctions were held in September for the period October 2012-September 2013.

According to analysis by industrial gas user association Gas Intensive--which had prompted the probe--based on AEEG and Industry Ministry data, the utilization rate of the TAG and Transitgas pipelines between March and September 2011 was 60% and 56% respectively, while the utilization of transport capacity on all import pipelines--including Greenstream and Transmed--was 58%.

Households TTF indexation

A further development of the market came with an AEEG regulation on household gas tariffs. The AEEG ruled that an increasing percentage--5% from October onwards--of the formula on which household tariffs are calculated should be based on Dutch TTF spot gas prices.

In September, the AEEG reported that because of this measure, it was increasing gas tariffs by 1.1% for the last quarter of 2012, instead of 1.7%.

The AEEG said the long-term objective for household gas tariffs was to take Italian exchange prices as a benchmark.

The idea of developing an integrated gas exchange was also included in the new energy strategy. In line with that, on October 19 the GME opened a consultation on the launch of a forward regulated gas platform (MT-gas), which would allow companies to trade balance-of-month, monthly, quarterly and seasonal contracts under a continuous trading mechanism.

MT-gas would complement the existing day-ahead (MGP-gas) and intraday (Mlgas) platforms, which took off in 2010.

A development in the liquidity of the regulated platforms came in December 2011 with the inception of the PB-gas, a balancing mechanism in which grid operator Snam acted as the central counterparty of all transactions. Since April 2012 operators have also been able to trade stored gas between them.

Volumes traded on PB-gas have increased from 160 million cu m (1.7 million MWh) in December 2011 to 266 million cubic meters in September 2012, thus contributing to an increase in the overall liquidity of spot transactions, but also “to seriously challenge not just the role but the economic sustainability itself of long-term take-or-pay contracts,” according to the president of the AEEG, Guido Bortoni.

PB-gas is also increasingly representing a price signal for prompt contracts on the PSV. PB-gas showed average prices in line with the day-ahead on the PSV. In September, the average day-ahead price on the PSV was Eur27.32/MWh against Eur27.57/MWh of the PB-gas platform, according to GME data. The average price on MGPGas was Eur28.00/MWh, while on MI-gas it was Eur27.90/MWh.

There were also major regulatory changes in 2012. In January the Italian government approved a package of liberalization measures that included the full unbundling of Italy’s incumbent Eni from its gas transmission operator Snam.

In March, the government said Eni had to sell at least 25.1% of its stakes in Snam to Cassa Depositi e Prestiti, a financing company 70%-owned by the Italian government. On October 15, CDP completed the acquisition of 30% less one share of the voting capital of Snam held by Eni.

In August Snam, together with Belgian gas network operator Fluxys, completed the joint acquisition of the equity interests held by Eni in Interconnector UK, Interconnector Zeebrugge Terminal and Huberator.

On the same date, Snam and Fluxys signed a memorandum of understanding to develop reverse flow capacities from Italy to the UK.

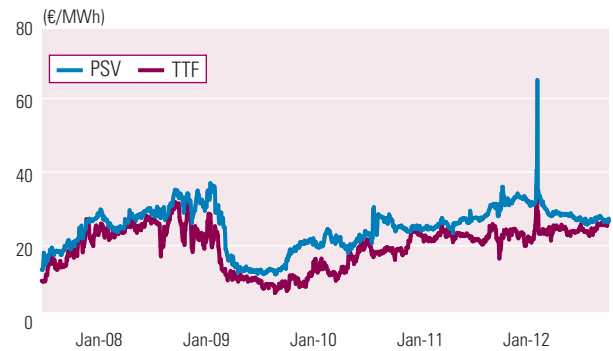
In September, Snam and Fluxys also completed the joint acquisition of a 15.09% equity interest held by E.ON in Interconnector UK.

Italy is looking at developing its LNG capacity (recently approved LNG terminal projects include those of Porto Empedocle, Gioia Tauro and Falconara) and improve its interconnection with foreign countries through new pipeline projects such as TAP, which could bring gas from Azerbaijan to Europe through Italy, as well as developing existing pipelines--Transitgas in particular--in order to diversify supplies.

THE COLD SNAP

Italy’s energy strategy noted that the question of security of supply rose up the agenda in February 2012, when for about two weeks Italy, along with most of Europe, was hit by a cold snap, with temperatures plummeting to 10-12 degrees Celsius below zero.

TTF vs PSV day-ahead



Source: Platts

Italy experienced a shortage of gas supplies, which led the government to declare a state of emergency and to re-start some oil-fired power plants in order to save gas.

The shortage was due to a number of factors: an increase in internal gas demand in Russia due to the drop in temperatures prevented it from meeting increased demand from countries like Italy, although Russian exports did not fall below obligations.

At the same time, imports from Northern Europe and Algeria increased to full capacity.

As Italy was facing an increase in demand to around 440 million cu m/day, rough seas in the Adriatic were also preventing LNG cargoes from docking.

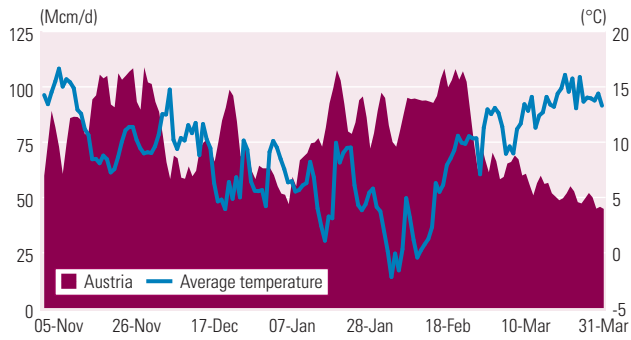
The regasification terminal of Cavarzere--in the Adriatic--is crucial for Italy’s LNG flows: looking at the period 2010-2012, it covered 80% of monthly LNG sendouts.

Under the pressure of increased demand, lower supplies and persisting cold weather, on Wednesday, February 8 day-ahead spiked up to Eur65.00/MWh, the highest price recorded by Platts for that contract since starting assessments in 2007.

Some market players, such as Eni, see long-term gas supply contracts as important for security of supply. Moving away from long-term contracts does not seem to be the priority for Italian regulators. The government seems rather to be aiming at reaching a balance between the spot market and more flexible long-term contracts. The energy strategy says that “although it favors an increase of spot supplies, for the necessary alignment of prices, it recognizes the contribution to security of supply given by long-term import contracts.”

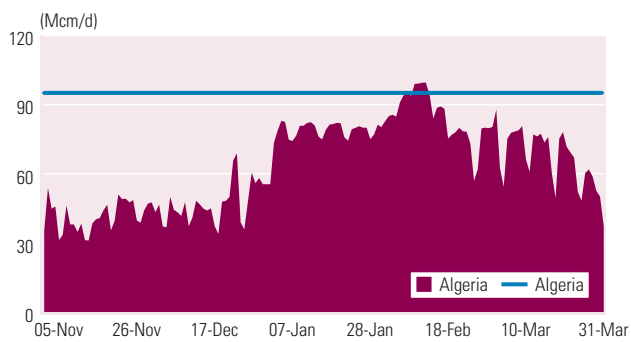
In order to increase the percentage of supplies based on spot gas prices, the government “intends to favor the gradual redefinition of existing import contracts” through “mechanisms of price adjustment linked to the effective dynamics of gas.” This would mean hub indexation clauses in contracts.

Russian gas imports Winter 2011-12



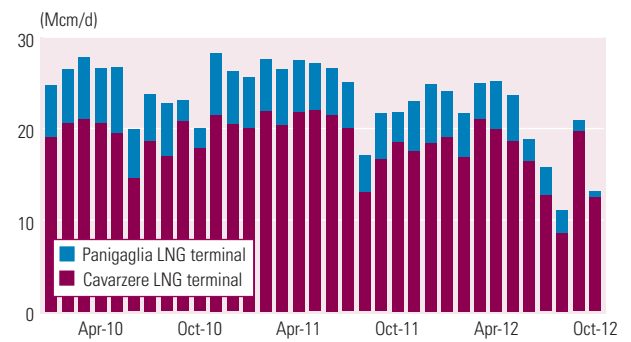
Source: Bentek Energy

Algerian gas imports Winter 2011-12



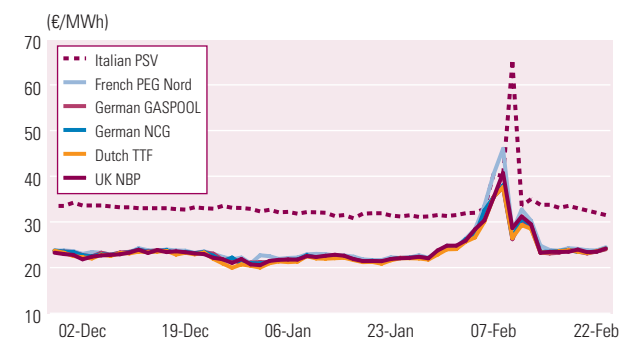
Source: Bentek Energy

LNG sendouts 2012-12



Source: Bentek Energy

European day-ahead gas during cold snap



Source: Platts

In line with all major European utilities, Italian companies have been renegotiating their long-term gas contracts. In September, utility Edison obtained a ruling adjusting the price of LNG supplied by Qatari RasGas for the period 2011-2012.

In October, Edison also obtained a renegotiation of its long-term contract with Eni for its Libyan gas. The arbitration of the company for its Algerian gas is still pending. And earlier in the year Eni itself renegotiated its long-term contract with Russia's Gazprom.

THE POWER MARKET

Hampered by a reliance on expensive gas, network inefficiencies and limited access to cheaper imports, Italian wholesale power is markedly more expensive than anywhere else in Western Europe.

A dash-for-gas in the power sector, prompted by the Bersani Decree's introduction of competition in 1999, saw the country transform itself from a deficit market with a heavy dependence on oil-fired generation to one burdened by a large surplus of gas-fired generation -- much of it tethered to uncompetitive oil-linked gas contracts.

Attempts to diversify conventional generation have largely failed. Twice Italy has rejected nuclear, while efforts to build coal-fired power stations or convert oil to coal have had only limited success.

The resulting dominance of gas-fired power plants has done nothing to reduce the high cost of electricity. It is ironic that although Italy has greatly reduced its generation from oil-fired units, the price of electricity is still closely linked to that of oil.

Despite some of the highest wholesale power prices in Europe, however, Italy's relatively new fleet of combined cycle gas turbine power stations are struggling to make ends meet.

While fossil fuel costs drove Italy's time-weighted day-ahead national power price (PUN TWA) up to Eur77.50/MWh in the first half of 2012, spark spreads (indicating gas plant profitability) have come under severe pressure.

Platts 50% month-ahead Italian clean spark spread shows relatively healthy margins of profitability, with Eur8.58/MWh on October 30 compared with minus Eur9.56/MWh on the German market.

However, utility Edison reported an average spark spread of minus Eur0.9/MWh for first-half 2012, compared with Eur9.90/MWh for the first half of 2011.

A structural decrease in gas demand coupled with the availability of large quantities of spot gas on European hubs has produced "a growing, drastic misalignment between the price of spot gas and the cost paid under long-term procurement contracts," Edison said.

Falling demand for electricity has compounded the problems facing central plant operators. Gross demand in 2008 exceeded 336 TWh, dipping to below 330 TWh in 2011. The trend continues. At 245.7 TWh, nine-month 2012 consumption is down 2.3% on the same period of 2011.

Then there is the headline-grabbing solar power boom to factor in. This development, initiated to a great extent by new entrants, has served to flatten the summer midday peak, depriving the gas fleet of a key source of income.

In 2011 the differential between peak and off-peak prices fell to 1.29, the lowest level seen on the market. The average peak price was Eur82.71/MWh while off-peak was Eur66.71/MWh. As solar capacity has built – and it is approaching 17 GW installed – so summer peak prices have fallen, even to sub-baseload levels, a phenomenon also observed in Germany.

For utilities that missed the photovoltaic boom, there is some consolation to be had from the fact that the race to install PV panels is drawing to a close, having racked up an annual subsidy bill approaching Eur6.7 billion.

THE TRADED MARKET

The clearest indication of Italy's price disparity is to be found in the PUN – Prezzo Unico Nazionale, or single day-ahead national price – produced by market supervisor Gestore dei Mercati Energetici (GME).

GME organizes and manages the wholesale electricity market in Italy. Producers, consumers and wholesalers use GME's power exchange platforms to trade day-ahead and, since 2008, have traded electricity blocks for forward physical delivery. GME also organizes and manages Italy's environmental markets, enabling trade in Green Certificates, Energy Efficiency Certificates and Emission Allowances.

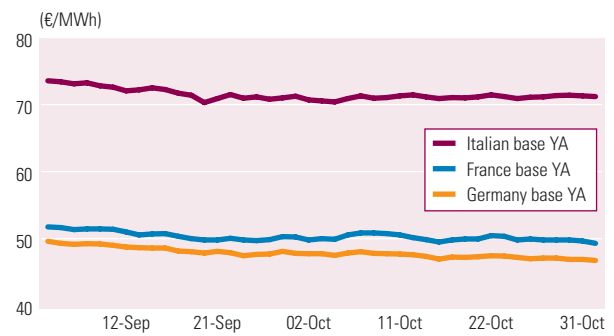
The baseload PUN, reflecting trade on GME's day-ahead market, maintained a premium of Eur20.00/MWh over German day-ahead power last year, averaging Eur72/MWh for 2011 compared with Eur51/MWh in Germany.

In terms of volumes, most prompt power trading is concluded through GME's regulated platforms, while forward trading is focused in over-the-counter trade. On GME's day-ahead market (the MGP), traded volumes in 2011 stood at 180 TWh, down 10% from 2010.

Forward contracts can be traded on GME's Mercato a Termine (MTE) platform. There are additional platforms for intraday trade (Mercato Infragiornaliero, MI, composed of four sessions) and ancillary services (Mercato dei Servizi di Dispacciamento, MSD). GME lists 192 participants admitted to trade on its IPEX power exchange.

Volumes exchanged on the regulated forward market MTE went from 6.3 TWh in 2010 to 31.7 TWh in 2011. On the intraday market MI, traded volumes in 2011 were 22 TWh, up by 50% year-on-year. On the ancillary services market MSD, exchanged volumes decreased by 56% to 9.6 TWh: GME said this was partly due to an incentive

Italian vs German, French Cal 13 power



Source: Platts

introduced by regulator the AEEG to prompt Terna to reduce volumes traded on MSD to balance the grid.

Over-the-counter contracts for physical delivery of power have to be registered on GME's Piattaforma Conti Energia a Termine (PCE). GME lists 208 participants admitted to trade on PCE. OTC forward trade registered on PCE increased in volume by 23% year-on-year to 290.9 TWh in 2011. Prompt trades registered on PCE also went up by 10% to 131 TWh.

INFLATIONARY COMPONENTS

In addition to Italy's exposure to high gas prices, the spread between Italian and continental European power prices is accentuated by network/interconnection inefficiencies between the country's various zones.

Transmission system operator Terna's zonal divisions are based on geographical location (North, Center-North, Center-South, South, Sicily, Sardinia), areas of limited production (Foggia, Rossano, Brindisi and Priolo) and import/export markets (France, Switzerland, Corsica, Austria, Slovenia and Greece).

Prices in the Sardinia and Sicily zones have been considerably higher than in the rest of Italy, inflating the weighted average PUN price. In late 2011, however, the SAPEI cable connecting Sardinia to continental Italy entered operation, bringing Sardinian prices in line with those of the continent for the last three months of the year.

Under the existing zonal pricing system, producers are paid by Terna at the zonal price, while buyers pay on the basis of the PUN price. Although no details were given, the government's energy strategy proposals raise the possibility of adapting the zonal system to reflect tightening spreads between the zones and accommodate a key aim of the strategy – market coupling with the rest of Europe, leading to price convergence.

Terna operates some 63,500 km of high voltage Italian grid and is the country's dominant TSO. Its 10-year, Eur8 billion investment plan targets reductions in energy losses of 1.2 TWh/year, reductions in congestion of at least 5 GW and an increase in cross border capacity of around 3 GW.

Power interconnectors with foreign countries



Source: Platts PowerVision

Interconnection developments include the MON.ITA line to Montenegro (Villanova-Tivat, Eur777 million capital cost); a new Italy-France link (Piosasco-Grand'Île, Eur365 million); and the Sorgente-Rizziconi link to Sicily (Eur735 million).

Terna's key internal projects include upgrading the networks of Milan, Naples, Rome, Genova, Palermo, Turin and Firenze (total capex Eur925 million); Trino-Lacchiarella (Eur350 million); Dolo-Camin (Eur326 million); Foggia-Gissi-Villanova (Eur254 million); Paterno-Pantano-Priolo (Eur213 million); and Colunga-Calenzano (Eur176 million).

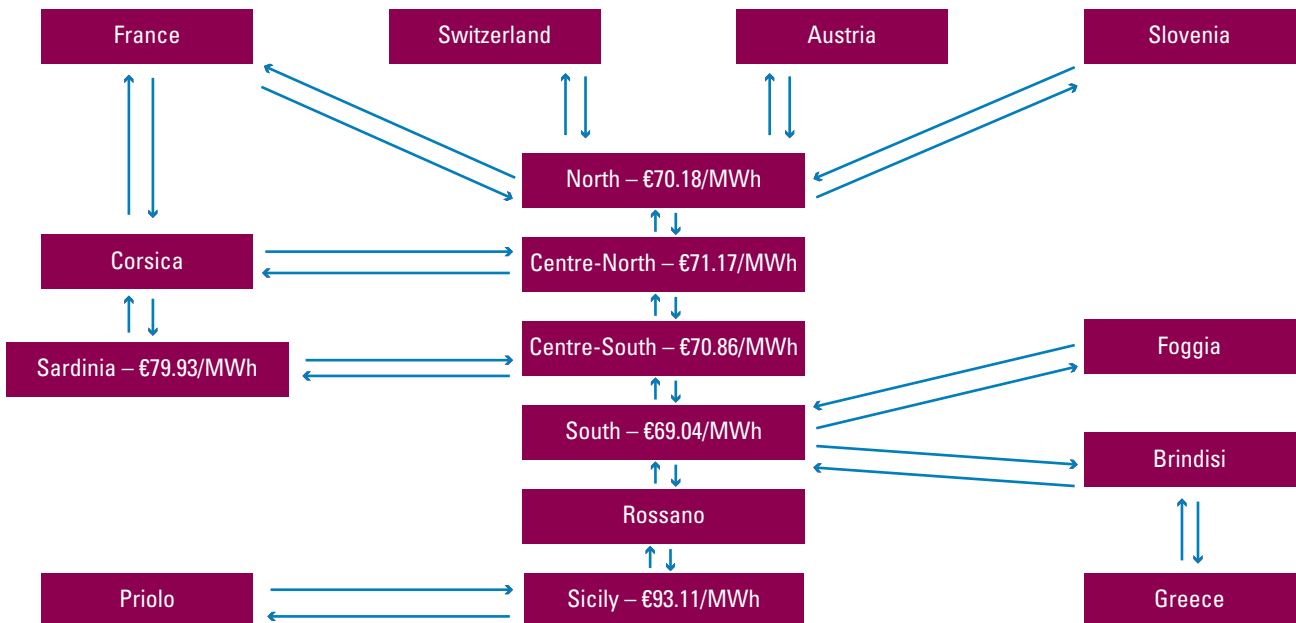
Italy has 22 interconnection lines -- four with France, 12 with Switzerland, one with Austria, two with Slovenia, two DC connections, one cable with Greece, one cable connecting Sardinia to the mainland through Corsica (SACOI) and one additional AC cable between Sardinia and Corsica. Through its Northern border links, seven lines at 380 kV and nine lines at 220 kV, Italy imports around 14% of its requirement every year.

At distribution level, Enel Distribuzione is responsible for around 86% of volumes (246 TWh in 2011) delivered at sub-high voltage level, dwarfing its fellow distributors A2A Reti Elettriche (3.9%), Acea Distribuzione (3.2%) and AEM Torino Distribuzione (1.4%).

MARKET COUPLING

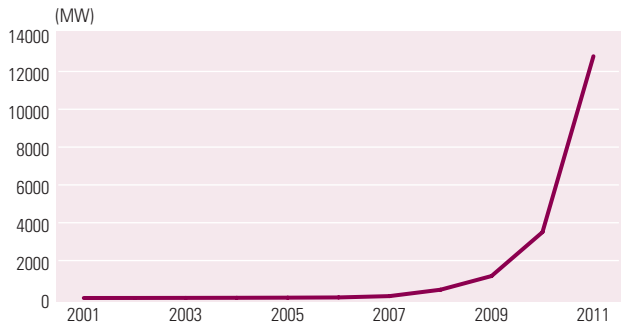
Given Italy's relatively high dependence on imports, integration of Italy's power market with the rest of Europe is a central proposal in the government's recent energy strategy. GME has been working with other power exchanges to develop a continental European Price Coupling of Regions initiative.

Zones and corresponding average prices 2011



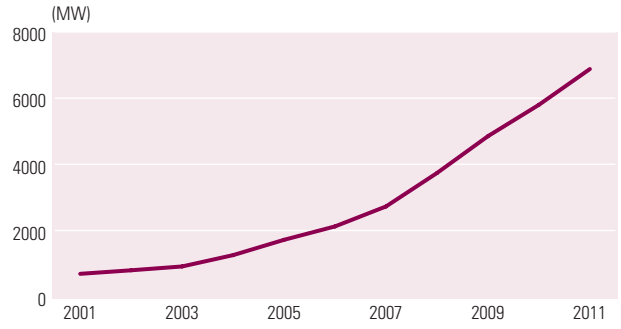
Source: GME 2011 report

Installed solar capacity



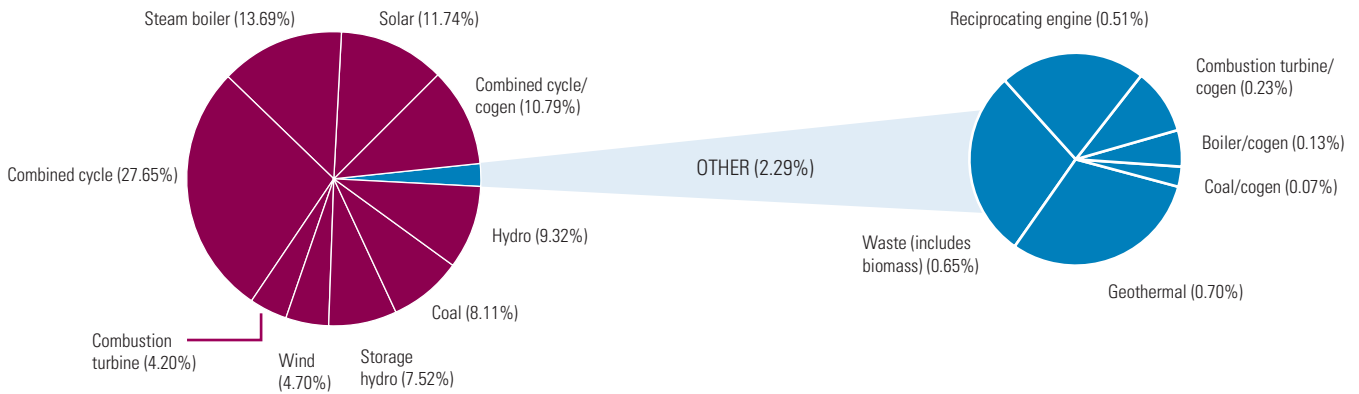
Source: Platts PowerVision

Installed wind capacity



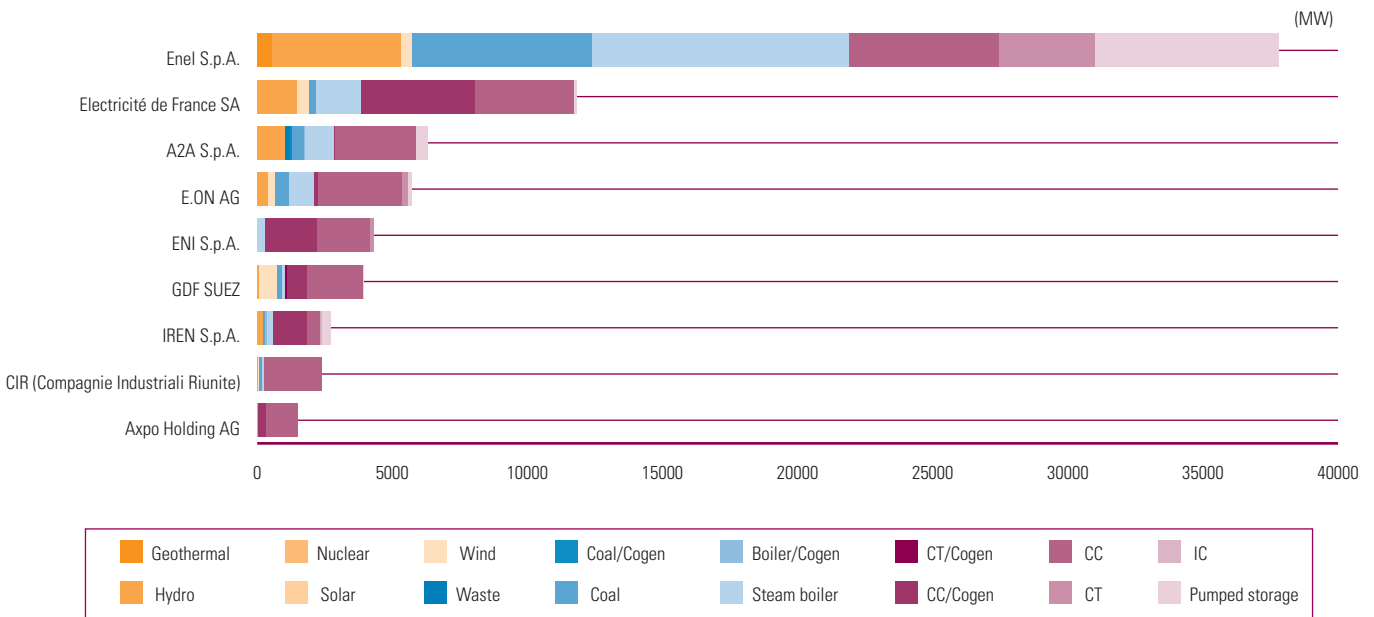
Source: Platts PowerVision

Existing capacity by fuel



Source: Platts PowerVision

Existing capacity by holding



Source: Platts PowerVision

The initiative is focused on the delivery of a common European price coupling solution with associated algorithms, systems, procedures and inter-exchange arrangements, where this solution can potentially be implemented in a variety of local regulatory/governance settings. Its philosophy is to build on the existing contractual, regulatory and operational solutions, setting at the European level the needed harmonization and governance principles. As part of the central south block of countries as defined by European energy regulatory group ERGEG, Italy, along with Austria, France, Germany, Greece and Slovenia, have a first-quarter 2014 goal for final integration of borders.

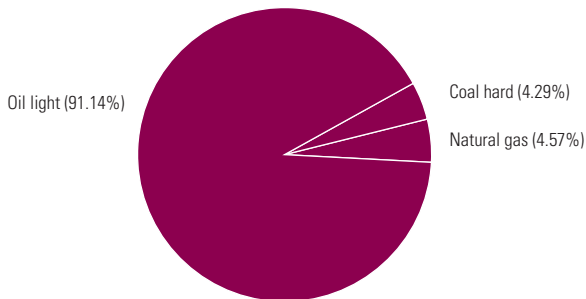
In December 2010 market coupling between the Italian and Slovenian power exchanges began. The system allocates capacity from the market with the lowest price to the market with the highest price through implicit auctions.

GME has seen strong growth in volumes allocated and traded volumes between the markets. In October 2012 alone some 423 MW were allocated, all for imports into Italy -- the spread between the two markets was Eur26.30/MWh in 2011, with Italy averaging Eur76.03/MWh compared with Eur49.70/MWh in Slovenia.

GENERATION

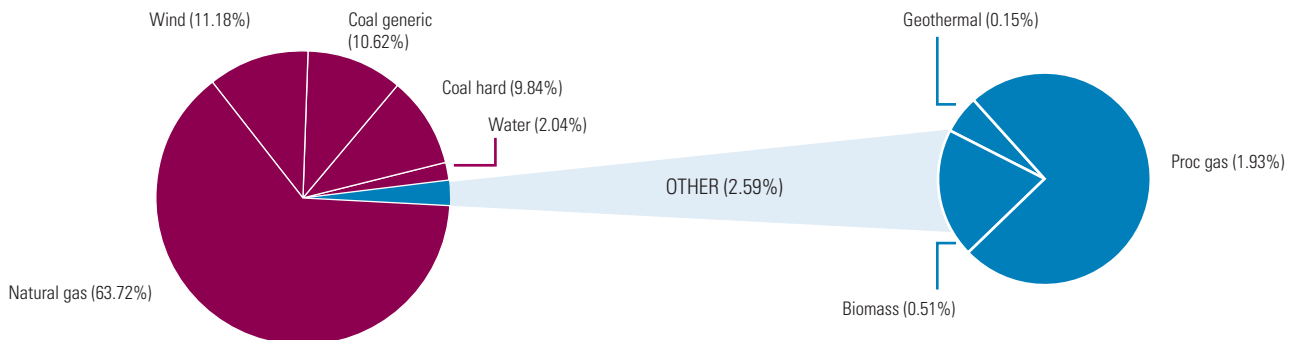
At around 300 TWh, Italian power production was static in 2011 from 2010. At 142 TWh, gas-fired power dominates as a generation source, followed by renewables, hydro and coal.

Future retirement by fuel



Source: Platts PowerVision

Future capacity by fuel



Source: Platts PowerVision

Of the operators, Enel's generation market share last year was 26.4% (down from 29.8% in 2010), followed by Eni (9.4%), Edison (8.4%, owned by EDF), E.ON (5.2%), Edipower (5.1%) and GDF Suez (3.1%), Erg (2.5%), Sorgenia (2%), Iren (2%), Axpo (1.6%), Saras (1.5%), other (autoproduction, decentralized renewables etc., 25.8%).

The most recent data from Terna illustrates how volatile Italy's generation mix is. Solar photovoltaic output was up 91% year-on-year in the nine months to the end of September 2012. At 15.379 TWh for the 2012 period, solar output was almost double the 8 TWh produced in the first nine months of 2011. Italian wind has also enjoyed strong growth in the first nine months of 2012, up 37.2% at 9.1 TWh from 6.63 TWh in the same period of 2011. Hydro conditions have been poor, meanwhile, with nine-month 2012 output down 16.2% at 31.5 TWh, while conventional thermal was down 4.3% at 157.6 TWh. Geothermal was stable at 3.9 TWh for the January-September period. Overall production was down 1.6% at 217.5 TWh. At 26.4 TWh, gross demand in September was down 9.6% on September 2011 (29.2 TWh). Adjusted for working days and temperature, demand was down 7.3%.

Peak demand in September reached 48,207 MW for hour 12, Wednesday, September 12 – down 8% on peak demand in September 2011.

Italy's Conto Energia solar support mechanism is now in its fifth decree phase, having begun in 2005. This latest phase is designed to run to the end of the first half of 2013, when the government forecasts that PV will have reached grid parity in Italy. Total funding for PV has been capped at Eur6.7 billion/year, however, and funds have been draining away quickly as developers rush to complete. As such, the country's subsidized PV era had less than 1.5 GW of capacity left to run as of October 2012, taking total capacity to around 17 GW.

In July 2012, meanwhile, the government approved new incentives to non-solar renewables, establishing a system of auctions for plants with capacity greater than 10 MW for hydro, 20 MW for geothermal and 5 MW for all other sources. For smaller plants it established

registers and feed-in tariffs. The new Eur5.8 billion/year scheme will come into effect from January 1, 2013, and remain in place until the programmed budget cap for 2020 is reached.

THE STRATEGY IN DETAIL

On October 16, 2012, the government opened a public consultation on a new national energy strategy. The consultation is set to run to the end of November, with a public debate in December and finalization thereafter. With elections expected in spring 2013, however, the strategy is facing a tight political deadline.

In its broadest form, the strategy seeks to reduce energy costs, ensure sustainability and guarantee security of supply. Taking 2020 as the main reference date for achievement of the strategy, the government has put forward the following goals:

- alignment of wholesale prices to lower European levels for all energy sources: electricity, gas and liquid fuel;
- a reduction of Eur14 billion/year in Italy's imported energy bill (which currently stands at Eur62 billion/year), with a reduction from 84% to 67% of dependence thanks to energy efficiency, renewables production, reduced imports of electricity and greater production of domestic resources;
- investment of Eur180 billion by 2020, in the white (energy saving) and green (renewables) sectors, and in the conventional energy sectors (electricity and gas networks, LNG terminals, storage facilities, development of hydrocarbons). This refers to private investment encouraged by incentives, with projections of Eur70 billion investment in renewables, Eur60 billion in energy efficiency and Eur50 billion in conventional energy;
- a reduction of around 19% in greenhouse gas emissions, surpassing Italy's European goals for an 18% reduction on 2005 GHG emissions levels;
- a 23% contribution from renewable energy towards primary energy consumption (compared with 11% in 2010), thereby reducing fossil fuels' contribution from 86% to 76%. In addition, renewables are expected to become the premier source of electricity generation, equal to or greater than gas and accounting for 36-38% of consumption (compared with 23% in 2010);
- a reduction of 24% in primary consumption to 2020, surpassing European objectives of a 20% cut, mainly due to energy efficiency measures.
- The strategy is divided into seven specific priorities for policy action. These are defined as:
 - the promotion of energy efficiency;
 - promotion of a competitive gas market, "with the opportunity to become the main hub for southern Europe";

Italy's 2011 electricity bill (excluding taxes, € billion)

Sales	1
Networks	7
Dispatch	2
Energy	21
Renewable incentives	9
Other system operating expenses	1
Total	42

Source: Ministero dello Sviluppo Economico

Power market - generation mix evolution (%)

	2010	2020
Gas	44	35-38
Renewables	22	36-38
Coal	16	15-16
Imports	13	7-10
Fuel oil	3	1
Other	1	2
Total (TWh)	346	345-360

Source: Ministero dello Sviluppo Economico

Primary energy consumption evolution (%)

	2010	2020
Gas	41	35-37
Gasoline	37	30-32
Renewables	11	23
Coal	9	8-9
Power imports	2	1
Total (Mtoe)	165	155-160

Source: Ministero dello Sviluppo Economico

- sustainable development of renewables, surpassing 20-20-20 goals while containing costs;
- development of a fully-integrated European electricity market in terms of competitive pricing and renewables' integration;
- restructuring of the refining and fuel distribution network;
- the sustainable development of national hydrocarbon production, bringing economic and employment benefits;
- and modernization of governance in the energy sector, "with the aim of making more effective and efficient our decision-making processes," the government said.

Finally, the proposals call for the prioritization of research and development into advanced technologies to aid energy efficiency, renewables and the sustainable use of fossil fuels.

For power, the ministry referred to initiatives (beyond those on gas costs and renewables) that reduce the Eur1 billion/year of "other

operating costs" (noting actions already taken on CIP6 renewable energy contracts and accelerated nuclear decommissioning); improve network efficiency and remove congestion between market zones (e.g. Sicily); review specific customer segment subsidies and special tariff schemes (SMEs are disadvantaged, it said); review the allocation of capacity on the Swiss border; and seek to boost cross-border capacity.

The threat of over-production would be pre-empted by limiting green power incentives and applying performance standards, the ministry said. If there is still an oversupply problem in the short term, imports and renewables would be curtailed. In the medium term, network

strengthening would help. Longer term, advanced smart grid network controls and emerging storage options would solve the problem.

With regard to ensuring system stability in the face of growing intermittency, a revamped capacity mechanism based on competitive auctions "may be desirable" in the medium to long term, the ministry said (i.e. from 2017). Auctions would be in line with EC recommendations. Persistent overcapacity could force the need for restructuring/downsizing of the thermal power plant fleet. The ministry would be alert to the threat of supply re-concentration, it said.



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