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LOMBARD

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THE TOP 50 OF THE ITALIAN ELITE



**Rankings:
Unicredit
Still At
The Top**



**UK Banks
Back To
The Lead
In Italy**



**Power
Industry:
Italenergy's
Balkan Bet**



**Italian Blue
Chips'
Hidden
Values**

Sharing the Re-Power

The chairman of the **Italian electricity exchange** is promoting a **juicy opportunity** among **Italian banks** and industry players: rebuilding **generation systems** in the **Balkans**. It is raising strong interest

The European Bank for Reconstruction and Development (EBRD) recently stated that the potential value of the electric systems that need to be rebuilt in the Southern part of the Balkan Peninsula (i.e. countries like Romania, Bulgaria, Albania) can total up to EUR 7 bn. "The business is there, up for grabs. Italian companies just need to go in and get it," says Giorgio Szegö, chairman of the Italian Power Exchange. Szegö, who is also a professor of Financial Markets Theory at La Sapienza University in Rome, contributed largely to the incorporation of ItEnergy, a partnership, sponsored by the Italian government, that groups leading Italian banks, the operator of the transmission network, the power exchange and the Single Buyer (Acquirente Unico), which acquires power on the ex-

change on behalf of small retail consumers.

Lombard: Can you explain more in detail what the purpose of ItEnergy is and how the agency will work?

Szegö: ItEnergy is an association recently founded by the GRTN, the GME and the AU (all of them bodies in charge of the distribution of power and of the operation of the power market) under the sponsorship of the Ministries of Productive Activities and Foreign Affairs. The major players in the energy sector have also expressed their interest in joining. ItEnergy's goal is to create an alliance between the Italian government, financial institutions and industries with the purpose of helping Italian companies operate in Eastern Europe. The reconstruction of infrastructures in the Balkan Peninsula and throughout all of



Eastern Europe is big business. Some of these countries recently joined the European Union and need to renew their power generation systems entirely. Others, like Croatia, have been growing very fast over the last few years and are on the waiting list to become members of EU. It is a situation that reminds me of Italy



60 years ago. There are countries to rebuild, but competition is fierce. German, French and Austrian companies are also interested. For this reason, companies should not be left alone in their efforts. They need the intervention of the Italian government and of domestic banks.

Lombard: In which way?

Szegö: Banks are the first to know when a local government is preparing to launch an infrastructure project, since it needs financing. In this respect, Italian companies are lucky. Some of our major institutions, Unicredit Italiano and Banca Intesa in particular, have built a widespread network in those re-

gions that entrepreneurs can take advantage of. When government authorities contact local banks for financial support, the institutions owned by Italian banking groups are among the first to know. Those groups in turn can inform ItalEnergy, which will line up Italian companies interested in bidding for the

contracts. Correct intelligence and timing are fundamental.

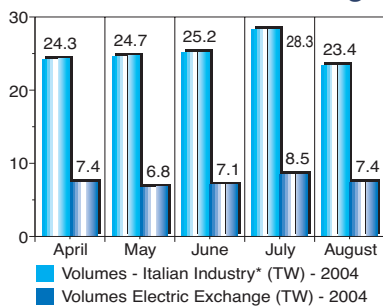
Lombard: Have you already discussed this with Italian banks? What kind of feedback did you get?

Szegő: I mentioned the issue to Banca Intesa. I contacted them because it owns one of Croatia's largest banks, Privredna Banka Zagreb, and the management seems favorable. There is a lot of potential business in the region: project financing, loans and several other products. The Adriatic republic could be one of the first countries to renew its power generating system, and it is planning to build a series of coal-fired power generation plants. Moreover, let's not forget that Unicredito Italiano controls another one of Croatia's large banks, Zagrebacka Banka.

Lombard: How should the Italian government become involved in this project?

Szegő: First of all, the government has singled out Eastern Europe as a strategic area in which Italian companies, not only of the energy industry, have the best opportunities to expand. This means that the government will back initiatives that go in this direction. The Treasury is still Enel's major shareholder and government approval is needed on many occasions. More importantly, moving in those countries is not easy, especially if the sectors in which you operate interface with local authorities a lot, and this is the case of energy companies. In this sense, diplomatic support is fundamental. ItalEnergy's main goal

Around 30% Of Power Exchanged



*Including bilateral agreements between companies



AN ITALIAN WITH HUNGARIAN ROOTS

Born near Como in 1934, Giorgio Szegő, the chairman of GME and ItaloEnergy, has Hungarian blood in his veins. In the late 1800s, his grandfather was a doctor in Budapest, who moved to Istria to create a hospital for children, near today's Croatian city of Rijeka (at that time both cities were part of the Austro-Hungarian Empire). Between the two World Wars, Rijeka became part of Italy, and Szegő's father left the border area to move further inside Italy. Szegő received a degree in Physics from the University of Pavia in 1956, and then spent six years between Germany – Technische Hochschule Darmstadt – and the United States, before starting his academic career as professor of mathematics in Italy. In 1975, he was appointed rector of the University of Bergamo, where he lectured financial mathematics. In 1984, he became professor of Monetary and Financial Market Economics at Rome's La Sapienza University, where he still teaches. An advisor of the International Monetary Fund in 1981 and in 1992, of the World Bank in 1982 and of the OECD in 1988, he was also chairman of the European Finance Association in 1988 and of the Italian institute of options and futures from 1990 until 1996.

is to co-ordinate all these efforts. Then, there is another factor that could turn out to be critical.

Lombard: What is that?

Szegö: The European Union wants to create an Energy Community for Southeastern Europe, for which it has planned a common Secretariat. Its headquarters will not be located in any of the participating countries since relationships among them are often difficult and Brussels does not want to be regarded as favoring anyone. ItalEnergy is already trying to take advantage of this decision. One founding partner, the GRTN, found a building in Rome that could host the headquarters of the Secretariat. This might help Italian companies since representatives of Southeastern European energy institutions will be staying here in Rome for long periods, increasing the chance of establishing good relationships with Italian partners.

Lombard: Are there other countries that present good opportunities?

Szegö: The Baltic countries are very interesting. Of course, they do not have the historical and geographical connections that the Balkan nations have with Italy. After their independence from the Soviet Union, Estonia, Latvia and Lithuania have been increasingly attracted by the Scandinavian countries. However, our Minister of the Foreign Affairs recently pointed out to me that these countries might be interested in diversifying their partners. For instance, one of the founders of ItalEnergy, the Acquirente Unico (Single Buyer) has performed some important tasks for the

Lithuanian government. This also paves the way for another kind of intervention.

Lombard: What kind of intervention?

Szegö: The former centrally planned economies can rely on managers and technicians with excellent specific backgrounds. Italian companies can create joint-ventures in these countries providing capital and marketing skills. In addition to that, these nations are important because they could represent as many launch pads for expansion in larger countries, such as Poland or Ukraine. The Italians supply the capital, the Lithuanians provide the know-how and the joint-venture can operate in Ukraine. Organizations like the World Bank and EBRD back such interventions because local governments don't view them as an act of economic "colonization" on the part of the more developed countries.

Lombard: You are also the chairman of the GME. The web-based Italian power exchange should become truly operational by the end of this year with the active participation of buyers. In the initial phase the market operated with the Acquirente Unico – a special purpose company set up by GRTN, the operator of the national power transmission grid – acting as the only buyer. What is the current situation?

Szegö: We need to improve the financial guarantees backing transactions between buyers and sellers. This is why we are trying to close a deal with a clearing house. At the moment we are in contact with the London Clearing House, the largest in Europe.

Lombard: Which financial institutions seem the most interested in the Italian power exchange?

Szegö: All of the major groups, i.e. Sanpaolo IMI, Banca Intesa, Unicredito Italiano, Capitalia, but also Deutsche Bank, UBS, Goldman Sachs and Morgan Stanley. We know Bank of America, Barclays and JP Morgan Chase are also very interested in the market and making great efforts to get ready. In addition, on October 1, we will launch Simultrade, an internet-based system thanks to

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which any player planning to join the market can simulate trading activity, thus understanding how the power exchange works, before entering. This will be a sort of training ground for newcomers.

Lombard: What will the next steps of the Italian power market be?

Szegö: Derivatives. We would like to be able to trade forward and swap instruments a few months after the cash market is launched.

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ItalEnergy :



ENERGY IN TUNE WITH YOU.

An efficient and transparent market

Gestore del Mercato Elettrico (GME - The Electricity Market Operator) is responsible for organisation and management of the Italian Power Exchange (IPEX), i.e. of the market for the trading of electricity. In practice, the Power Exchange is an electronic marketplace (all transactions take place through the Internet) where demand and supply meet defining the quantities and prices of the electricity to be traded. In addition, the Power Exchange is also a real physical market, where the schedules of electricity injections (generation) and withdrawals (load) into and from the grid are defined

Competitive market

The Power Exchange is a fundamental instrument for the creation of a competitive electricity market in Italy. It was created with the purpose of favouring the formation of efficient clearing prices enabling producers and consumers to buy and sell electricity on the basis of cost-effectiveness criteria. The leading players in the creation of the Power Exchange were the Ministry of Productive Activities (MAP), Autorità per l' Energia Elettrica e il Gas (AEEG, the Electricity & Gas Regulator), Gestore della Rete di Trasmissione Nazionale (GRTN - Independent System Operator), GME and Acquirente Unico (AU - Single Buyer), which gathered around the "Energy Table". After testing the correct operation of the overall system, these players made it possible to operationalise the Exchange on 31 March 2004.

Active demand side in 2005

Beginning on 1 January 2005, also the demand side will actively participate in the Power Exchange. Until then, all the demand side will be represented by GRTN. The start of active demand-side participation will be preceded by a few months of testing, as it happened for the supply side. Since the first day, very positive results have been achieved in terms of liquidity, i.e. of the quantities of electricity traded daily in the Power Exchange vs. the electricity traded in the overall system. In comparison with the main European Exchanges, the IPEX has high liquidity, which stands at around 30%, i.e. **about EUR 7bn per year**.

Benefits

The Power Exchange is an innovative instrument -

The 3 stages of the electricity market

8 Jan, 2004	Testing
31 Mar, 2004	Launch of the market
1 Jan, 2005	Active demand side

vs. the system of bilateral contracts (OTC market), whose prices and quantities are freely determined by the contracting parties - because it:

1. improves the price-setting mechanism reflecting the conditions of supply and demand;
2. fosters competition between market participants and favours the coverage of demand at the most advantageous prices available in the market;
3. operates transparently making quantities and prices constantly visible to all market participants;
4. is more flexible enabling electricity operators to procure additional electricity for covering sudden fluctuations in their requirements;
5. contributes to the coverage of supply deficits giving accurate and timely price signals both to producers and to consumers;
6. favours market stabilisation promoting the construction of new power plants and new power lines and the entry of new comers into the market;
7. separates electricity generation from electricity sales two competitive activities;
8. simplifies the commercial procedures of companies and provides more security of payment of the sold electricity through the guarantee systems offered by the market.

Liquidity European Exchanges

(average 2003)

Spain	85%
Italy*	30%
Scandinavian Countries	28%
Netherland	11%
Germany	9%
France	2%
UK	2%
Austria	2%

* first two months of activities (April-May 2004)

These benefits extend to all final consumers both those authorised to purchase electricity directly in the Power Exchange (wholesalers and companies defined as "eligible customers" but on condition that they are dispatching users) and households ("captive customers"). The latter customers are currently required to contract with their local distributor, they buy electricity indirectly in the Exchange through Acquirente Unico, a company established for this purpose. It should be stressed that the savings resulting from the possible decrease of the electricity price which is set in the Exchange are not immediately visible in the bill that customers receive, because the electricity traded in the Exchange is just one - albeit important - of the cost items in the bill. Price variations arising in the Exchange are transferred to the tariffs applied to final customers at a later stage.



Role and responsibilities

The main player of the IPEX is GME which is in charge of organising and managing all the mechanisms underlying the operation of the Exchange. GME SpA a company established in 2000, operates under neutrality, transparency and objectivity criteria promoting competition between producers and ensuring, at the same time, an adequate management of the resources required for dispatching.

The trading in the Power Exchange is all Internet-based thanks to a special information system to which market participants connect via secure access procedures and enter into on-line purchase and sale contracts.

Also the publication of preliminary market information, the submission of offers/bids, the notification of market results, of generating and consuming schedules and the invoicing of transactions are all Internet-based.

WWW.mercatoelettrico.org

Detailed reports on the activities of the Power Exchange are posted on GME's website. The site consists of a section reserved to each market participant (used for notifying the results of its purchase and sale offers/bids) and a public section, displaying the aggregated market results in terms of prices and quantities. GME is in charge of the entire process

As a central counterparty, GME manages all transactions in the Power Exchange, monitoring its operation from the central trading room. Furthermore, GME selects the submitted offers/bids on the basis of economic merit order (non-decreasing price order for supply offers and non-increasing price order for demand bids). Then, it purchases quantities of electricity from producers and subsequently sells them to consumers

Eligible customers

Participation in the Exchange is open to electricity producers, importers and wholesale customers, but also to the so-called "eligible customers" (large, medium and small companies but also associations) which, within a short time, will be able to directly procure electricity in the Exchange (so far, the demand side has not yet been active but managed through GRTN). "Captive customers", mainly households, are required by the applicable legislation to contract only with their local distributor. In this case, Acquirente Unico purchases electricity for them and sells it to the local distributors.

Organisation and operations

3 market session

The Power Exchange is organised into 3 markets:

- Day - **Ahead Market (MGP) it closes at 9:00 a.m.** of the day preceding the day to which offers/bid refer; this market hosts the majority of electricity purchase and sale transactions. Offers/bids may also be submitted in the days preceding the MGP session to which they refer, i.e. up to 9 days before.

- **Adjustment Market (MA) it opens at 10:30 a.m.**, after the notification of the MGP results, and closes at 2:00 p.m.; in this market, participants may revise the schedules defined in the MGP, by submitting additional supply offers or demand bids;

- **Ancillary Services Market (MSD) it opens at 2:30 p.m.**, after the notification of the MA results, and closes at 4:00 p.m. In the MSD, Gestore della Rete di Trasmissione Nazionale (GRTN) procures the resources required for managing, operating and controlling the system (intra-zonal congestion relief, creation of reserve capacity, real-time balancing).

The Green Certificates Market

Another important role that GME plays is the organisation and management of two other trading venues, i.e. the so-called GME's "non-electric markets": the Green Certificates Market and the Energy Efficiency Certificates Market. Green Certificates (CV) are issued by GRTN on the basis of producers' declarations. They certify the generation of electricity from renewable sources in the previous year or in the expected generating capability in the current year or in the subsequent year. The sessions of this market take place at least once a week, in the period from January to March of each year, and at least once a month in the remaining period. The trading is continuous between electricity producers and importers, GRTN, wholesale customers and associations registered with the Green Certificates Market. Energy efficiency certificates (TEE) are issued to electricity distributors and energy service companies (ESCOs). They certify the reduction of electricity consumption which has been achieved through energy-saving measures and projects aiming at increasing energy efficiency. The CV and TEE markets offer venues for the trading of these certificates between participants that must fulfil their renewables obligation by purchasing certificates in the market, because they have not reached their targets, and participants that have exceeded their targets and may obtain an economic benefit by selling their excess certificates