Regulatory Framework

September 2005

The Delibera n. 166/05

The regulatory review process

Continuous contacts ....

Oct/2004	First contact
Feb-Apr/2005	Technical meetings
May/2005	Public Consultation Document
Jun/2005	SRG Comments on Consultation
Jun-July/2005	Proactive discussion
July 30th, 2005	Criteria for setting tariffs (Delibera n°166/05)
Aug 5th, 2005	Tariff Approval (Delibera n°179/05)

.... to protect the value

Key elements

Stability and transparency

- 4-year from Oct. 2005 to Sept. 2009
- RAB based on “re-valuated historical cost” methodology

Allowed return

- In line with WACC of power transmission

Incentives

- Injected gas volumes
- New investments
- Retention of excess efficiency
- Y, Q, W parameters

Long term visibility

- Impact on the following regulatory periods
  - premium on new investment up to 15 years
  - 50% retention of excess operating efficiency gains

Benefits from 1st period

- Commodity overlap on development capex
- 50% retention of efficiency gains

Figures

RAB	■ 10.754 m€ (pipes and LNG*)
Return	■ Allowed return of 6,7% pre-tax real on existing assets ■ Allowed return plus premium on new investments starting from the year after spending
Revenues split	■ 70% capacity component ■ 30% commodity component
Efficiency factor	■ Applied to operating costs and depreciation ■ 2.0% on capacity revenues ■ 3.5% on commodity unit revenue

(*) LNG RAB to be approved by the Authority

Tariff system

Tariff structure

Tariffs designed ….

- **Entry-Exit system**
- **Interruptible capacity**
- **Flexible capacity**
- **Incentives to gas export**
- **Metering charge**

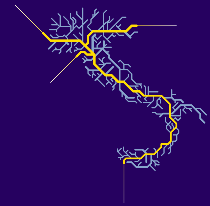
…. to support the market

Revenues flows

Revenues

	From opening RAB	From 1st period develop. capex	From new investments
Capacity	70%	0%	100%
Commodity	30%	100%	0%

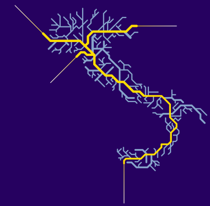
Revenues flows



Revenues

	From opening RAB	From 1st period develop. capex	From new investments
Capacity	70%	0%	100%
Commodity	30%	100%	0%

How the formula works



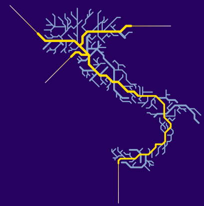
- Revenues
  - From opening RAB
  - From 1st period develop.capex
  - From new investments

Step 1: Reference revenues

Step 2: First thermal year revenues — year 1

Step 3: Roll revenues forward — year 2 to year 4

Reference revenues from opening RAB



Revenues
- From opening RAB
- From 1st period develop.capex
- From new investments

STEP 1

	2nd period	
Opening RAB	**10.660 €m**	
Rate of return	**6.7 %**	**x**
▪ Allowed return on RAB	714 €m	=
▪ Depreciation	498 €m	+
▪ Opex	342 €m	+
Reference revenues	**1.554 €m**	**=**

Regulatory Asset Base (RAB)

Revenues		
From opening RAB	From 1st period develop.capex	From new investments

STEP 1

	RAB derivation
First period opening RAB	**9.493 €m**
■ Maintenance & Development capex (1.477 €m)	
■ Work in progress 2004 (389 €m)	
■ Working capital (106 €m)	
■ Depreciation and Disposals	
Second period opening RAB	**10.660 €m**

Adjusted by inflation

… 12% value growth

Allowed rate of return

Revenues

From opening RAB | From 1st period develop.capex | From new investments

STEP 1

	WACC
Risk free	4,26%
Beta unlevered	0,38
Beta levered	0,56
Market risk premium	4,0%
Cost of EQUITY	**6,5%**
Cost of debt	4,67%
Tax shield (irpeg)	33%
Net cost of DEBT	**3,1%**
Leverage (D/D+E)	41,18%
WACC nominal post-tax	5,1%
Inflation	1,7%
WACC real pre-tax*	**6,7%**

... in the middle of the range proposed by the Authority

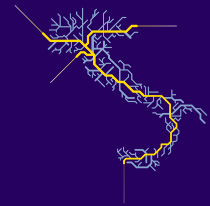
(*) Parameters to be confirmed by AEEG technical report

Depreciation

Revenues

From opening RAB | From 1st period develop.capex | From new investments

STEP 1



	Depreciation derivation
Gross asset value 2004 (*)	**18.145 €m**
Technical asset life	
▪ Pipes	40 years
▪ Buildings	40 years
▪ Compression stations	20 years
▪ Metering equipments	20 years
▪ Others	10 years
Depreciation year 2004	**498 €m**

(*) Net of fully depreciated assets and working progress

Operating costs

Revenues

From opening RAB | From 1st period develop.capex | From new investments

STEP 1

	Opex derivation
Allowed opex year 2000	**377,5 €m**
▪ Roll $opex_{2000}$ forward	383,6 €m
▪ New capex opex	16,5 €m
Allowed 1st period opex	**400,1 €m**
Actual opex year 2004	**283,2 €m**
Claw-back (50%)	**58,4 €m**
2nd period allowed opex	**341,7 €m**

(*) Net of pass-through costs

First year revenues from opening RAB

Revenues

From opening RAB | From 1st period develop.capex | From new investments

STEP 2

Reference revenues

70 %

Capacity reference revenue

30 %

Commodity reference revenue

Reference volume (79,1 bcm) ÷

First year unit commodity revenue =

Actual volumes in gas year 05-06 x

First year capacity revenue

First year commodity revenue =

The first year revenues

Revenues from opening RAB updating

Revenues

From opening RAB | From 1st period develop.capex | From new investments

STEP 3

Revenues

Capacity

Commodity

Capacity RETURN → **Cost plus**

- RAB_{2004} annual updating
  - Depreciation
  - Adjustment by inflation

Capacity CO+Amm → **Revenue Cap**

- Adjusted by inflation
- X-factor = 2%

Unit commodity revenue → **Price-cap**

- Adjusted by inflation
- X-factor = 3,5%

Revenues flows

Revenues

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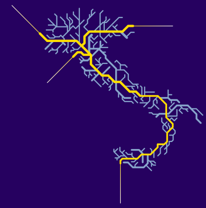
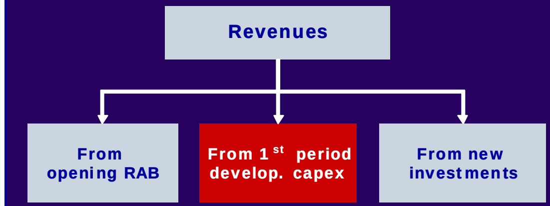
How the formula works





Step 1: First thermal year revenues — year 1

Step 2: Roll revenues forward — year 2 to year 4

Development capex revenues overlap: 1st year

Revenues

From opening RAB | From 1st period develop.capex | From new investments

STEP 1

First period development capex	**997 €m**
▪ Commodity component	4,98%
First period commodity incentive	**50 €m**

Reference volume (73,1 bcm) ÷

First year unit commodity overlap =

Actual volumes in gas year 05-06 x

First year commodity overlap =

Development capex revenues overlap: updating

Revenues

- From opening RAB
- From 1st period develop.capex
- From new investments

STEP 2

Unit commodity overlap → No adjustment

- Lasts 6 years from year of capitalization
- 2001 capex incentives expire in 2008/9 thermal year
- Revenues from unit commodity overlap determined by market growth vs reference volume (73.1 bcm)

Revenues flows

Revenues

	From opening RAB	From 1st period develop. capex	From new investments
Capacity	70%	0%	100%
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How the formula works

Revenues

From opening RAB

From 1st period develop. capex

From new investments

Step 1: First thermal year revenues **year 1**

Step 2: Roll revenues forward **year 2 to year 4**

Revenues from new investments

Revenues

- From opening RAB
- From 1st period develop. capex
- From new investments

STEP 1

Different investment categories

- T1: maintenance
- T2: safety, quality and market support
- T3: development of regional network
- T4: development of national network
- T5: development of national network for import
- T6: development of entry capacity at border

Revenues from new investments
1st year

Revenues

- From opening RAB
- From 1st period develop. capex
- From new investments

STEP 1

RNI = Return + Depreciation + Opex

	Return	Depreciation	Opex
	$NI^{SPENDING} \times (6,7\% + Premium)$	$NI^{OPERATIONAL} \times (1/DC)$	CO
T1	-	From 2,5% to 10% according to technical-economical asset life	-
T2	1% for 5 years		-
T3	2% for 7 years		-
T4	2% for 10 years		-
T5	3% for 10 years		Actual
T6	3% for 15 years		Actual

Revenues from new investments updating

Revenues

From opening RAB | From 1st period develop. capex | From new investments

STEP 2

RNI

Return ⇒ **Cost plus**

- Annual updating
  - Depreciation (if in operation)
  - Adjustment by inflation

Depreciation ⇒ **Revenue Cap**

- Adjusted by inflation
- **X-factor = 2%**

Operating costs ⇒ **No adjustment**

- Actual incremental costs related to the new investment
- Applied to categories T5 and T6