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**Subject:** **State aid No. NN 24/2010– Italy –Compensation for the provision of instant interruptibility services in Sardinia and Sicily.**

Sir,

I am pleased to inform you that the European Commission has assessed Article 1 of Law 41 of 22 March 2010, which was notified by Italy pursuant to Article 108(3) of the Treaty on the Functioning of the European Union ("TFEU")[1], and has decided not to raise any objections to it on the ground that the measure does not constitute State aid within the meaning of Article 107(1) of the TFEU.

## I. PROCEDURE

(1) On 12 February 2010, following pre-notification contacts, Italy notified the Commission of the above measure pursuant to Article 108(3) of the TFEU for reasons of legal certainty. Additional information was submitted by letters of 19 February 2010, 29 March 2010 and 4 May 2010.

## II. DESCRIPTION

(2) The legal bases for the measure in national legislation are:

- Article 1 of Decree-Law 3/2010, converted into Law 41 of 22 March 2010[2] "*Conversione in legge, con modificazioni, del decreto-legge 25 gennaio 2010, n. 3, recante misure urgenti per garantire la sicurezza di*

[1] With effect from 1 December 2009, Articles 87 and 88 of the EC Treaty have become Articles 107 and 108, respectively, of the TFEU; the two sets of provisions are, in substance, identical. For the purposes of this Decision, references to Articles 107 and 108 of the TFEU should be understood as references to Articles 87 and 88, respectively, of the EC Treaty where appropriate

[2] Published on the Gazzetta Ufficiale No. 72 of 27 March 2010.

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*approvvigionamento di energia elettrica nelle isole maggiori*" (hereinafter: law 41/2010.)

- Deliberazione ARG/elt 15/10 of the Authority for Electricity and Gas (hereinafter: AEEG) of 9 February 2010.

**Detailed description of the measure**

(3) The notification concerns only Article 1 of Law 41/2010. This article introduces, for a period of three years (2010-2012), a modified system of compensation for industrial undertakings located in Sardinia and Sicily which accept to provide instant interruptibility services. Under the new system, the compensation is doubled compared to the Italian mainland.

(4) Instant interruptibility is a service rendered by final users of electricity to the transmission system operator (hereinafter:"TSO") in order to ensure security of supply and prevent blackouts. Users which conclude interruptibility contracts with the TSO[3] are typically industrial undertakings with relatively stable consumption profiles, since they must be able to guarantee a reliable amount of load reduction whenever the TSO requires it to reduce consumption (or load) to balance the network.

(5) The Italian TSO is Terna S.p.A, a private body entrusted with public service obligations. Interruptible users receive from Terna remuneration for this service. The cost sustained by Terna is considered a general system charge and is passed on to the users of dispatching services[4].

(6) In Italy, instant interruptibility has existed for several years throughout the Italian territory[5] including Sardinia and Sicily. Interruptible power contracted under the existing mechanism was 308 MW in Sardinia (corresponding to 7 consumption sites) and 45 MW in Sicily (also 7 sites).

(7) The new mechanism laid down by Article 1 of Law 41/2010 will replace the existing arrangement only in Sardinia and Sicily for a period of three years. According to the Italian authorities, the rationale for the new mechanism is that there is increasing pressure on the security of the electricity system on these two islands, which makes it necessary to increase the availability of interruptible loads to 500 MW on each island. According to Italy, due to the

[3] Contracts may however also be concluded with power suppliers.

[4] A notion which includes power plants, consumption points and the Single Buyer (a State-owned entity which aggregates demand and purchases electricity on behalf of certain users).

[5] Under this system, Terna determines the amount of interruptible reserves it requires, and selects the applicants (industrial users) in a two-step process. In a first step, a certain amount of interruptible capacity is allocated directly to users at a fixed price, to ensure that interruptible capacity is evenly distributed on the territory and spread on an adequate number of users. In a second step, if necessary, Terna allocates a supplementary amount of capacity among the selected users on the basis of a competitive tender (or "Dutch auction": the capacity is allocated to the users which accept the lowest remuneration). Users receive a fixed price set at € 150,000/MW/year, which corresponds to 10 interruptions during the year. Users receive also, for each additional interruption (from the 11th onwards) a variable price of EUR 3000/MW. If there are fewer than 10 interruptions, users pay back to Terna EUR 3000/MW for each interruption which did not take place.

characteristics of electricity supply in the islands, notably the poor interconnection with mainland Italy, the higher risk of plant outages and the lack of restart capacities, there is no real alternative to interruptibility to ensure system security, and a greater availability of interruptible loads can be obtained only by increasing the remuneration provided for the service.

(8) Under the new system, interruptible users will be selected on the basis of a competitive tender procedure (designed as a series of descending price auctions). The tender price, which corresponds to the maximum fixed price which Terna is prepared to pay for the service, is set at € 300 000/MW/year. Industrial users will bid below the maximum price. This price corresponds to 20 interruptions during the year. Users will also receive, for each additional interruption (from the 21st onwards) a price of EUR 3000/MW. If the required amount of interruptible capacity is not fully contracted after the initial tender, Terna will repeat the tender every three months until the entire 500 MW are contracted.

(9) Industrial users must commit to provide the service for three years (until the end of 2012) or face dissuasive penalties. The users' minimum consumption threshold is set at 1 MW. According to Italy, this should allow a wide participation of industrial users. According to estimates carried out by Italy, several hundreds industrial users would be potentially eligible in both islands. It is however difficult to estimate how many applications there will be, since the requirement to consume a minimum amount of electricity 24 hours a day implies that users may need to reorganize their production processes, for example by introducing night shifts or make investments in order to reduce the risks that interruptions cause damage to the machine park.

(10) Existing interruptibility contracts, concluded in Sardinia and Sicily under the previous scheme (interruptible power currently contracted is 308 MW in Sardinia and 45 MW in Sicily) will be terminated before their date of expiry (31 December 2010).

(11) The cost sustained by Terna will be passed on to users of dispatching services via a charge (dispatching charge - *corrispettivo di dispacciamento*) on their bills, as is already the case for the existing interruptibility mechanism applicable on the mainland.

## ASSESSMENT OF THE AID

### *State aid within the meaning of Article 107(1) EC*

(12) A measure constitutes State aid within the meaning of Article 107(1) of the TFEU Treaty if the following conditions are cumulatively fulfilled: the measure (a) confers an economic advantage to the beneficiary; (b) is granted by the State or through State resources; (c) is selective; (d) has an impact on intra-community trade and is liable to distort competition within the EU.

*State resources and imputability.*

(13) For a measure to be caught by Article 107(1) of the TFEU Treaty, it must be granted directly or indirectly through State resources[6] and be imputable to the State[7].

(14) The remuneration for the interruptibility service is paid to the relevant undertakings by Terna, a private company[8] entrusted with public service obligations which acts under the instructions of the Authority for Electricity and Gas (the AEEG).

(15) However, the resources required to finance the measure are collected through a charge (the dispatching charge – *corrispettivo di dispacciamento*) paid by users of dispatching services.[9] The dispatching charge accrues to Terna. However, if the proceeds are insufficient to cover Terna's costs (which include the remuneration paid for interruptibility services) the balance is transferred to Terna on a monthly basis by the Equalization Fund (Cassa Conguaglio del Settore Elettrico) which manages a dedicated fund, also provisioned through compulsory contributions[9]. The Equalization Fund is a public body established by law, which carries out its functions on the basis of instructions given by the AEEG.

(16) According to settled case-law, no distinction should be made between cases where a measure is granted directly by the State, and cases where it is granted by a public or private body designated or established by the State[10]. Therefore, the public or private status of Terna or the Equalization Fund is not determinant for the purpose of applying the State aid rules. The criteria to be applied here, according to the Essent[11] case law, are whether the contribution can be considered a (para-fiscal) charge, and whether the State, through the bodies designated by it, has control over the funds used to finance the measure.

(17) The dispatching charge is obligatory and is imposed by the State by means of *Delibere* of the AEEG which implement national legislation. Therefore, it

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6 See inter alia Preussen-Elektra, ibidem, paragraph 58.

7 See, *inter alia*, judgment of the ECJ of 22 May 2002 in Case C-482/99 *France* v. *Commission* (*Stardust Marine*), [2002] ECR p. I-4397 paragraph 24.

8 Terna is a private joint stock company. The State, through *Cassa Depositi e Prestiti*, owns 29.9% of Terna's shares.

9 Users of dispatching services pay Terna the dispatching charge, which is fixed ex-ante by the AEEG on the basis of estimates of the financial amounts required. Every month there is a clearing process between Terna and the Equalization Fund to establish any discrepancies between the funds collected through the dispatching charge and the expenses sustained by Terna for the provision of dispatching services, including interruptibility. The financial transfers received by Terna from the Equalization Fund (notably from the Conto per la gestione dei contribute a copertura degli oneri connessi al servizio di interrompibilità) ensure that the entire cost of dispatching is borne by users.

10 See judgments of the ECJ of 7 June 1988 in *Greece v. Commission*, Case 57/86 [1988] ECR p. 2855, paragraph 12; *Preussen-Elektra*, ibidem; preliminary ruling of the ECJ of 20 November 2003 in *Gemo*, Case C 126/01, [2003] ECR p. I-13769, point 23.

11 Judgment of the ECJ in *Essent Netwerk Noord v. Aluminium Delfzijl*, Case C-206/06, not yet reported.

represents a (para-fiscal) charge[12]. As regards State control over the funds, in *Essent* the Court concluded that there is control by the State when the intermediaries are not entitled to use the proceeds from the charge for purposes other than those provided by law[13]. This criterion is fulfilled in the case at hand, since Terna cannot appropriate the funds and use them for different purposes. As regards the Equalization Fund, in the *Iride*[14] case, the Court recently confirmed the Commission's consistent conclusion that monies accruing to accounts handled by the Equalization Fund belong to the State and thus constitute State resources.

(18) Therefore, the conclusion must be drawn that the interruptibility compensation is paid for through State resources. The measure is also imputable to the State since the legal basis for the measure is laid down in national legislation and in the Delibere of the AEEG, which is a public body.

*Selectivity*

(19) The measure is selective, since payment is made only to a certain group of users located in certain regions only, i.e. those whose consumption sites with more than 1 MW of consumption in Sardinia and Sicily, which excludes many categories of undertakings.

*Impact on competition and trade*

(20) The beneficiaries of the measure, which may include notably energy-intensive users, are industrial undertakings active on a variety of markets open to competition and on which there is intra-EU trade. Therefore, according to settled case-law[15], the measure is liable to affect intra-EU trade.

*Presence of an advantage*

(21) Since all other criteria of Article 107(1) are fulfilled, Article 1 of the Law 41/2010 can only escape qualification as State aid if the measure does not confer on its recipients an economic advantage which they could not have obtained under normal market conditions.

(22) In the case at hand, the Commission considers that, for the absence of an advantage to be substantiated, the mechanism should address a genuine need of the electricity system and the remuneration scheme for interruptible users should be in line with what a prudent market economy operator facing a similar need would have designed in order to satisfy that need.

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12 See *Essent, ibidem*, paragraphs 47 and 66.

13 *Essent*, *ibidem*, , paragraphs 69 and 70.

14 Judgment of the CFI of 11 February 2009 in Case T-25/07, *Iride*, [2009] ECR p. II-00245 (paragraph 39)

15 See, inter alia, the judgment of the ECJ in Philip Morris/Commission, (Case 730/79, ECR [1980] p. 02671, paragraph 11) and judgment of the ECJ in Air Liquide Industries/Ville de Seraing et Province de Liège (Joint Cases C 393/04 and C 41/05,[2006] ECR p.I-05293).

(23) Therefore, in a first step, the Commission has examined whether the technical requirements of the electricity system in Sicily and Sardinia could be met by the TSO through other functionally substitutable and potentially cheaper reserves.

(24) In a second step, the Commission has assessed whether in the islands concerned there is a demonstrable need for a higher level of interruptible loads. An unjustified increase in the level of interruptible resources required by the TSO might artificially increase the scarcity power of users who can provide the service, and could potentially bias the price outcome of the tender process.

(25) In principle, a price obtained as a result of a tendering process reflects the market price for the service concerned. However, in certain circumstances, the price outcome may be biased, and State aid may potentially be involved. Therefore, in a third step, the Commission has examined whether the service is procured at least cost to the system and the tender procedure is truly competitive, so that the resulting price can be considered a genuine market price.

*The notion of reserves and the role played by instantly interruptible loads*

(26) Since electricity cannot be stored and consumption (plus exports) must be matched by production (plus imports) at any given time, TSOs need to cater for all types of imbalances on the network. For example, there may be a peak in demand, a power plant may go out of service or an interconnection cable may trip. In this case, the TSO needs to be able to call on capacity reserves (either supplementary electricity production from available plants, or reductions in load, for example from interruptible users). Upward regulation is the term used to indicate measures taken to balance the system when there is not enough production to match demand. Conversely, downward regulation consists in balancing the system when demand is lower than expected (this may happen, for example, when the consumption of a large user suddenly stops because of a technical problem).

(27) There are various types of reserves, which are more or less valuable according to the time required to make them available on the grid. Generally speaking, primary reserve (or primary regulation) is the service, which is usually offered by a power plant[16] to actively detect and correct within a few seconds frequency instability problems which may give rise to black-outs. Secondary reserves are those which are available at relatively short notice (a couple of minutes) and are used to bring back the frequency to the normal value of 50 Hz and function by remote control. Tertiary reserves are available in a somewhat longer time span (15 to 60 minutes) and are used to replace secondary reserves.

(28) Interruptible loads can be shed very quickly (within milliseconds to one second). In various European countries, industrial users offer this type of

[16] This service may also be offered, in certain cases, by large consumers.

services to cover imbalances in the supply and off-take of electricity from the network, also on an instantaneous basis. For example, in 2006 the instant cut in power supply to aluminium smelters in Germany allowed for the effective management of a critical situation on the UCTE electricity network.

(29) The faster reserves are available to the grid, the more valuable they are. Therefore, secondary and tertiary reserves are not functionally equivalent or directly substitutable with one another, and their price is different. Reserves may be contracted and remunerated in different ways. Some reserves can be contracted on the market on a day-ahead basis (for example, the TSO may pay for a plant to be switched on, even though the plant may not be called upon to produce), whereas other reserves may be contracted on the basis of longer-term contracts. The remuneration often consists of a fixed and a variable component. An example of fixed component is the remuneration a plant receives for its availability to produce more electricity (even though the plant may never be called on to produce more). In this example, the variable component would be the price agreed per extra MWh produced by the plant when the reserve is actually called by the TSO.

(30) The decision which reserves to call on is taken by the TSO, which decides on the characteristics of the reserves required and then it calls on the appropriate type of reserves according to their economic merit order (their cost), with the cheaper reserves being called first. A market-conform system should therefore give priority to the cheapest reserves which meet the technical needs of the system.

(31) Italy argues that the service provided by instantly interruptible loads is akin to primary regulation and cannot be compared with other types of reserves, apart from pumping storage plants[17], which can also be used for load shedding but only during off-peak hours. The availability of primary regulation is limited in both islands, inter alia due to the obsolete character of power plants. Pumping storage capacity is also limited.

(32) Furthermore, Italy has explained that instantly interruptible loads cannot be replaced by secondary or tertiary reserves because load shedding is used mainly to stabilise the system frequency in case of loss of generating capacity, as a complement to primary regulation (this is particularly true for Sardinia). Load shedding is activated within milliseconds when primary frequency regulation is saturated, and is included in the defence systems (Wide Area Protection Systems). Secondary reserves (or secondary regulation) are much slower and are used to bring back the frequency to 50 Hz once the system frequency has been stabilised.

[17] Pumping storage plants are hydro-power plants which pump water uphill –and consume electricity- in off-peak hours, when electricity prices are low. The water stored uphill is used to produce electricity during peak hours, when electricity prices are high. The load of pumping storage plants (i.e. the consumption of electricity required to pump water uphill) can be shed only during off-peak hours, as during peak hours the power production of the plants is needed to cover peak demand.

(33) On the basis of these explanations, the Commission considers that there is a residual demand for instant regulation in the two islands concerned which cannot be satisfied in any other way than through interruptible resources.

*Factors explaining the need for more interruptible loads in Sardinia and Sicily*

(34) The Commission has examined the level at which interruptibility load requirements have been set for Sardinia and Sicily, in order to form a view as to whether such levels appear justified by the situation on the Sardinian and Sicilian markets. It is important to assess the actual needs of the system because an artificially high level of required interruptible resources would have an impact on price formation: in a situation where interruptible resources are scarce, large users who are indispensable to reach the set level of interruptibility may exploit their scarcity power to obtain a higher price.

(35) Italy has pointed out that the new interruptible loads requirements for Sardinia and Sicily have been developed on the basis of a study carried out by Terna already in 2008. The arguments outlined below were put forward by Italy to explain why the security of supply situation in Sardinia and Sicily is more critical compared to the rest of the country.

(36) As regards the Sardinian system, the main problem having a direct impact on security of supply is frequency stability[18]. Sardinia is connected to the mainland through direct current ("DC") interconnection cables: an obsolete cable, SACOI, which may be taken out of service soon (to be decommissioned or repaired) soon, and a newer one, SAPEI, still under construction, which is operational for less than 50% of its future capacity (less than 500 MW out of 1000 MW). This type of interconnection does not provide the advantages of European interconnection (the UCTE synchronous network) in terms of frequency stability as these are DC cables on which the current has no frequency, let alone a synchronised frequency[19]. According to the Italian authorities, interruptible loads in Sardinia serve primarily the purpose of avoiding under-frequency regimes.

(37) In Sardinia there are few, relatively large power generators which cause more serious disturbances in case of outage. These generators are also more prone to outages than on the mainland (in particular in the Sulcis area) which leads to

[18] Since power grids are subject to both injections and off-takes of energy, it is inevitable that there will be imbalances between generation and consumption. Such imbalances have an immediate impact on the frequency level, making ongoing frequency control necessary to avoid the grid becoming unstable. It has to be put in place as quickly as possible, as uncontrolled frequency levels can very quickly spiral out of control and cause a blackout. Indeed, if frequency disturbances are large, this may lead to the tripping of power plants, further increasing the risk of system failure.

[19] Within the UCTE area frequency disturbances are corrected by the automatic ramping up of power plants outside the area where the frequency disturbance takes place. However, the automatic response is based on the fact that the power plants that ramp-up detect the frequency loss. As Sardinia is connected with a DC cable that transports electricity that is not oscillating in frequency, a frequency loss in Sardinia is not detected and by consequence, not corrected by power plants outside Sardinia. For the same reason, ramping up would not restore frequency on Sardinia, even if frequency losses were detected.

more frequent perturbations of the electricity system. Such perturbations, which would be irrelevant on the mainland, induce dangerous under-frequency regimes in Sardinia, with ensuing risks of black-out.

(38) When they occur, black-outs tend to last longer in Sardinia, as available generators are slow to restart. In the future, there will be only one generator available as black start[20] resource, as some plants will be decommissioned with the entry into service of the second SAPEI branch. As prolonged black-outs may have a far-reaching economic impact and can endanger human lives, it is particularly important to avoid them. If a service level in line with European standards (UCTE) is to be ensured, it is therefore necessary, according to the Italian authorities, to have a higher ratio of interruptible loads to overall demand in Sardinia compared to the Italian mainland for a limited period of three years.

(39) Another factor influencing security of supply in Sardinia is the high proportion of unpredictable energy generation such as wind-power, which currently accounts for 40% of the minimum required load and is expected to grow further in the next few years. These installations benefit from priority dispatch in the context of State aid schemes in favour of renewable energies. If the wind falls suddenly, it may be impossible to start and ramp up at sufficient speed conventional plants that were not running, so as to avoid black-outs.

(40) Lastly, some of the older thermo-electric power plants must operate on a reduced regime because of environmental constraints.

(41) In Sardinia, this situation will persist until the second branch of the SAPEI cable (500 MW) is operational (not before 2011). Then it will be possible to use this second branch also for imports of electricity (at the moment the cable is used mainly for exports). The possible repair of the old SACOI cable would not take less than three years. When these infrastructure projects are completed, the security of supply situation will become less critical.

(42) The situation in Sicily is somewhat different. There is an alternate current connection to the mainland, which removes the problem of frequency stability. Besides, production is less concentrated as demand is approximately double that of Sardinia. Therefore, the situation would appear to be less critical than in Sardinia. However, Sicilian power plants are technically obsolete. In particular, they have a limited regulating capacity (cannot be easily ramped up to produce more), so they are of limited use in providing reserves. Sicily also has a high proportion of unreliable wind power production covering 50% of the minimum required load, as well as environmental constraints on the number of hours generators can operate. The situation is likely to improve when a new cable connection with mainland Italy (the Sorgente-Rizzicone connection) is built. However, this is also likely to take three years.

(43) Terna has calculated the amount of interruptible load required for the two islands on the basis of its 2008 report, taking into account existing primary regulation and the contribution of pumping storage plants. In particular, in

[20] Power plants actually need electricity to start. This electricity is under normal circumstances sourced from the electricity network, which during a black-out is not possible. Black-start facilities render the starting up of a power plant during a black-out nonetheless possible.

Sardinia, the worst case scenario taken as a basis for the calculation is the loss of an amount of power injection that makes the primary reserve insufficient, regardless of whether power is lost due to generation failures or cable trips.

(44) The Italian authorities also point out that the specifications for the service allow for 20% of the contracted capacity to be unavailable at any one time[21]. Therefore, a nominal 500 MW of contracted interruptible capacity correspond to only 400 MW of actually available capacity.

(45) In the Commission's views, these explanations indeed point to certain specific needs of the electricity systems in Sardinia and Sicily which arise notably from a combination of insufficient interconnection, obsolete generation parks and a high proportion of unreliable power generation (wind-power).

(46) It should be said that the number of black-outs which occurred on the two islands with the current level of interruptible capacity was not exceptionally high. According to the statistics provided by Italy indicate that in 2008 and 2009 a maximum of 229 MW of interruptible load was shed in Sardinia[22]. With this level of interruptible capacity, black-outs were not a frequent occurrence both in Sardinia and in Sicily (Sardinia: 4 blackouts since 2006, of which one in 2008 and none in 2009; Sicily: 5 black-outs since 2006, of which 1 in 2008 and none in 2009). It should however be noted that in Sicily 4 major black-outs occurred in the year 2007, which made it necessary to resort to rotating interruptions (PESSE) to ensure system security. Besides, according to Italy, on the islands black-outs tend to be of larger proportions and last for hours instead of minutes (as on the mainland).

(47) If in the near future the factors contributing to poor system security on the islands are exacerbated (for example by higher wind-power production, failure to replace obsolete generators, higher consumer demand) it is conceivable that more interruptible capacity will be necessary, also in order to operate with a more comfortable adequacy margin (system margins are currently particularly low, as indicated in the 2008 Terna report).

(48) In conclusion, the Commission considers that Italy's explanations as to the required level of interruptible capacity can be considered acceptable.

*Need for a higher remuneration of the service*

(49) The provisions establishing the new service on the islands also set a higher maximum price and a different price formation mechanism than on the mainland.

(50) Italy has explained that the compensation provided under the previous scheme was incapable of attracting a sufficient number of offers on the islands. The amount of interruptible resources cumulatively offered in the past has always been lower than the 500 MW set by the Law 41/2010. In Sicily, interruptible resources are currently negligible. According to Italy, this is an indication that the price paid (which was largely fixed, not established by public tender - see

[21] This is an element of flexibility which encourages the participation of smaller industrial users.

[22] No figures are available for Sicily because interruptible capacity is still negligible on the island.

footnote 4) did not sufficiently remunerate industrial users for the costs due to load shedding (interruptions in production) and the investments required to provide the service.

(51) Besides, the conditions set for Sicily and Sardinia require a high level of availability, reliability and continuity of the service. The longer duration of interruptions on the islands compared to the Italian mainland also increases the costs borne by users. The value of these resources for the system may also be higher as black-outs tend to last longer in Sardinia and Sicily, therefore entailing higher overall cost.

(52) The new system factors 20 interruptions into the fixed component of the price, whereas on the mainland only 10 interruptions are included in the price, and according to the statistics provided by Italy, industrial users on the islands have experienced interruptions approximately 5 times a year. Italy has explained in this respect that a single interruption lasting more than one hour counts as two (or more) interruptions for the purposes of compensation. In Sardinia, the average duration of load shedding is typically above one hour. Therefore, it was necessary to include in the fixed price component an accordingly higher number of interruptions a year. Besides, it is expected that interruptible resources will be used more often in Sardinia and Sicily than in the rest of Italy, due to the increasing number of critical situations.

(53) According to Italy, the higher price is also justified by the fact that now industrial users must commit to provide the service for three years, which was not the case previously, or face dissuasive fines. This represents an additional constraint and should be remunerated accordingly.

(54) In the light of these explanations, the Commission considers it plausible that Terna may have to pay a higher price for the interruptibility service in Sicily and Sardinia than on the mainland.

(55) The contracts already stipulated with users who provided interruptible services on the basis of the existing mechanism have been terminated a few months before their natural date of expiry of 31 December 2010. The Italian authorities have confirmed that the two mechanisms are mutually exclusive and that users will not receive double payments for the year 2010.

(56) The Italian authorities also explained the reasons why they decided to terminate the existing contracts. In particular, they explained that the new service was different from the one provided under the old contracts in that it entailed further obligations, in particular the need to commit for 3 years. It was therefore considered appropriate to contract right from the start the full interruptible capacity required under the new conditions. The Commission notes that, in any event, the residual duration of the existing contracts was not long, as they would have expired at the end of the year. The conclusion of three-year contracts with penalties associated to early termination also appears to improve security and continuity of supply, as it ensures that sufficient interruptible resources will be available throughout the period for which Terna foresaw critical conditions on the two islands.

*The tendering process*

(57) The Commission has then assessed whether the price formation mechanism is truly competitive and not tailor-made for specific undertakings.

(58) This assessment has been carried out *ex-ante*, that is, on the basis of the tender design and specifications, and not *ex-post*, on the basis of its actual results.

(59) The Commission has examined in particular the eligibility criteria for industrial users interested in offering the service. The main technical requirements for industrial customers wishing to participate in the new scheme are a minimum offer of interruptible capacity of 1 MW and a certain level of consumption around the clock, which is however relatively flexible[23]. These criteria are objective and do not seem overly restrictive. According to estimates provided by the Italian authorities, hundreds of industrial users in Sicily and Sardinia meet the consumption threshold of 1 MW and therefore qualify, potentially, for the tender. Even medium voltage users can apply for the mechanism and aggregate their loads in case of multiple consumption sites (minimum 10 sites). According to Italy, the amount of interruptible resources which may be offered could be up to 1000 MW on each island, thus exceeding the capacity Terna considers it necessary to acquire.

(60) Whether these potential resources will be tapped via the tendering process will depend on the remuneration of the service, as the minimum consumption requirements established by Terna may require investments in the reorganization of productive activities (for example the introduction of night shifts or investments to protect equipment sensitive to power cuts) which do not seem profitable at the moment. This process of adjustment may require time. Since auctions are planned every three months, new users should get the opportunity to obtain a share of the required interruptible resources in the future.

(61) It should however be noted that the results yielded by the first auction, carried out by Terna at the end of February 2010, have not yet shown increased interest on the part of smaller users.

(62) At the first auction Terna did not manage to contract the entire interruptible capacity required. In Sardinia, Terna contracted 298 MW, which were assigned to four existing industrial users (Alcoa: 260 MW, Syndial: 30 MW, Buzzi: 2 MW and Air Liquide: 4MW). No offers were received for Sicily. Terna will therefore need to organize further auctions (one every three months).

(63) An analysis of the outcome of the first auction indicates that, despite a considerably higher price, there has not yet been a significant increase in the amounts of interruptible resources offered, or in the number of bidders[24]. The

[23] In particular, there is flexibility as regards the required hourly offtake of electricity. According to Article 3.2 of Delibera AEEG/elt 15/2010 the average hourly power offtake from interruptible resources should not be lower than 50% of total contracted interruptible resources. Users are thus not obliged to consume the full amount of interruptible load every hour of the day, but can modulate consumption to a certain extent to suit their industrial processes.

[24] Under the previous scheme (applicable throughout Italy) there were 5 contracts in Sicily (7 industrial sites) and 6 contracts in Sardinia (7 industrial sites).

capacity was assigned to all participating users at the maximum price (EUR 300 000/MW).

(64) As regards the lack of interest from other users, the explanation may lie in the fact that the auction was organized at short notice: the tender was organised just one month after the adoption of the decree-law 3/2010, and the deadline for applications was short. In particular, a non-interruptible user wishing to take part in the auction might need to invest in the reorganization of its productive activities. It is unlikely that such investment could have been carried out –or even decided- in such a short period of time.

(65) Only the outcome of further auctions will provide a reliable indication of the real interest elicited by the new mechanism, as users who did not get an opportunity to bid at the first auction will be able to do so at a later stage.

(66) In these circumstances, is not possible to foresee with a sufficient margin of certainty whether there will be genuine competition in the bidding process, resulting in prices lower than the maximum. However, an ex-ante assessment of the conditions of the tender has led the Commission to conclude that, on balance, the tender mechanism can be considered sufficiently competitive, and in line with the tender that a prudent market economy operator would have organised to obtain the service at issue.

(67) An important element in the Commission's assessment is the fact that the scheme is limited in time (three years). This limitation is necessary, as the circumstances which make it necessary today to contract more interruptible resources on the two islands concerned will change in the near future, in particular with the entry into service of new interconnection cables and the replacement of obsolete power plants with new, more flexible generation units.

*Conclusion on the presence of aid*

(68) It can therefore be concluded that, under the present scheme, the Italian TSO Terna, acting on instructions from the State and in pursuance of objectives of general economic interest, procures on the market instant interruptibility services in the quantities it deems necessary, for a limited period of three years, to ensure a high level of security and continuity of supply in Sicily and Sardinia. Such services could not be replaced by other, cheaper resources. Since the remuneration granted to industrial providers of instantly interruptible resources is established through a tendering process which, on the basis of an ex-ante analysis of its criteria, can be considered sufficiently competitive, such remuneration does not constitute State aid, but the market price for the services provided. By procuring interruptibility services through this mechanism, Terna is thus behaving like a rational market economy operator.

(69) The Commission considers it useful to specify that this non-aid finding is limited to three years, to coincide with the duration of the scheme laid down in law 41/2010, because this finding does not result from the intrinsic nature of the measure, but from an analysis of the current and future situation of the electricity system on the islands concerned, which can only be carried out over a limited time span, especially considering the planned infrastructural

improvements which will substantially alter the situation in the near future[25] . Therefore, any extension of this measure beyond 2012 would need to be assessed in the light of the circumstances prevailing at that time. Similarly, modifications of the tendering and remuneration scheme before 2012 may constitute State aid and would necessitate a specific assessment.

(70) Italy has committed to carry out a monitoring exercise to gather data on the application of the scheme. In particular, Italy will provide a yearly monitoring report containing data on: the number of subjects which offered interruptible capacity at each auction, the volumes offered and the volumes accepted by Terna for each subject, the prices offered by users and accepted by Terna, the number of interruptions ordered each year, the identity of the undertakings subject to interruptions, the volume of electricity supplies to interruptible customers affected by the interruptions and the duration of each interruption.

(71) The data resulting from the monitoring exercise will make it possible for the Commission to form an ex-post view of the effects of the system. These data are considered necessary to guide the Commission's analysis the event that this scheme or a similar one remains in place after the period of three years covered by the present decision.

**CONCLUSION**

The Commission has accordingly decided to consider that the remuneration for instant interruptibility services laid down in Article 1 of Law 41/2010 does not constitute State aid caught by Article 107(1) of the TFEU in favour of the industrial providers of the service until 31 December 2012.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site:

http://ec.europa.eu/community_law/state_aids/state_aids_texts_en.htm

Your request should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
State Aid Registry
B-1049 Brussels
Fax No: +32-2-296 12 42

Yours faithfully,

For the Commission

[25] In particular, these improvements include the upgrade of the interconnection cables in Sardinia (the second branch of the SAPEI cable, which should become available in 2011 and the entry into service of the fully repaired SACOI cable, scheduled in three years time) and in Sicily (the future Sorgente-Rizzicone cable should take approximately three years to build).

*Joaquin ALMUNIA*

Vice-President of the Commission