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FITCH: ITALIAN REFERENDUM COULD PUT WATER SECTOR INVESTMENTS AT RISK

Fitch Ratings-Milan/London-03 June 2011: Fitch Ratings says that the remuneration of capital investments for Italy's water networks concession operators could be threatened by the referendum taking place on 12 and 13 June. Citizens will be asked whether they wish to abolish the reference to the 'adequate remuneration of investments' to which water asset operators are entitled under art. 154 of Legislative Decree n.152/2006. This remuneration is received through the water tariff that companies charge to end customers.

"Regulatory uncertainties about the future of investment remuneration resulting from the consultation may result in banks suspending lending to the sector until there is more clarity about alternative remuneration systems. This is likely to cause delays in investment execution and affect companies' ability to fulfil their concession obligations within their long-term economic and financial guidelines," says Francesca Fraulo, Director in Fitch's Energy, Utilities and Regulation team.

Fitch rates two major Italian water asset operators, Acea Spa ('A'/Stable) and Aquedotto Pugliese Spa (AQP; 'BBB-'/Stable). At this stage, it is too early to assess the impact this issue would have on the ratings.

The second uncertainty pertaining to the water sector concerns the privatisation law (art 23 bis of Law Decree No. 112) introduced in 2008. This law provides for the termination of contracts awarded to companies by local authorities in the absence of a public tender procedure by June 2013 or 31 December 2015 if, by these dates, public entities that are shareholders in those companies have not reduced their shareholding to less than 40% by 30 June 2013 and 30% by 31 December 2015. This issue is less relevant for Fitch's rated issuers from a rating perspective. However, for AQP this could be an even stronger argument for the proposal by the Regional Governor of Puglia to change AQP's legal status from a limited liability company into a non-profit oriented public sector entity. From a rating perspective, Fitch does not consider this an immediate negative rating trigger as the company is already 87% owned by the region and the rating incorporates a high degree of shareholders' support. Acea Spa's rating is currently de-linked from that of the City of Rome ('A+'/Stable). Under the current rating scenario, a reduction of the municipality's shareholding in Acea's water subsidiaries could be beneficial for the rating.

Italy's water sector has always been highly exposed to political risk. The public nature of water resources is a recurring argument for politicians to gain consensus around political programmes, limiting competition in the sector and reducing the water tariffs. Furthermore, the absence of a central independent authority setting clear mechanisms for tariff parameters has caused a progressive deterioration of the regulatory framework, affecting the transparency of companies' operating environments. However, since the introduction of the sector reform law (the Galli Law) in 1996, nothing has threatened the sector to the same extent as the upcoming consultation.

The likelihood of the referendum reaching its 51% quorum has increased since yesterday, when Italy's Supreme Court re-admitted to the consultation the question about the law that reintroduced the development of nuclear electricity generation capacity in the country. This question was going to be withdrawn from the consultation after the government, in reaction to the Fukushima accident in Japan, introduced a moratorium of 12 months for the law, which formally reintroduced the nuclear development programme. Clearly, the outcome will rely on the sensitivity of the Italian population to the nuclear cause. Italy previously halted the development of nuclear generation capacity through a referendum in 1987 after the Chernobyl accident.

Contacts:

Francesca Fraulo
Director
+39 02 879087 237
Fitch Italia S.P.A.
Vicolo Santa Maria alla Porta, 1
Milan 20123

Erwin Van Lumich
Managing Director
+34 93 323 8403

Media Relations: Peter Fitzpatrick, London, Tel: +44 20 3530 1103, Email: peter.fitzpatrick@fitchratings.com.

Additional information is available at www.fitchratings.com.