

**Annual Report  
of the Netherlands Office of Energy Regulation (DTe)  
to the European Commission**

**Summary August 10, 2005**

## Summary / most important developments of the past year

### Developments on the Dutch energy market: general

#### **The Dutch energy market requires European harmonisation and market integration.**

The liberalisation of the Dutch energy market has progressed well, but further improvement is essential. Since 1 July 2004, all consumers have been free to choose their own energy supplier.

One year after the liberalisation of the market, however, the retail market is not fully developed. The rate of switching and consumer confidence in the market is still low. Market concentration is high, although there are many suppliers.

The gas wholesale market does not operate adequately and the opportunities for competition are limited. The creation of an independent 'Transmission System Operator' (TSO) for gas will facilitate the implementation of measures aimed at improving the operation of the market.

The electricity wholesale market has developed well in recent years, although the liquidity of the market is lagging behind other well developed markets. Regional market integration is important in order to improve liquidity.

DTe strives to improve the functioning of the market. To do this, DTe analyses the markets, makes recommendations and is active in making actual improvements. The effective functioning of market forces, however, is not limited to the Netherlands. In recent years, the major energy companies have positioned themselves strongly on the European market through acquisitions and by building positions in various countries. Trading activities on the European wholesale markets are often organised centrally. In addition, vertical integration (generation and retail supply), also at the European level, is an important strategy for these parties.

It is clear that the European regulatory framework is lagging behind these developments.

- The cooperation between European TSOs on the electricity market is still inadequate. The exchange of operational measurement data between some TSOs is still too limited. Uncontrollable transit flows (for instance due to extreme weather conditions and high wind-energy production) result in insecure operating situations. The calculation and allocation of transmission capacity is still too often isolated in relation to individual cross-border connections, rather than occurring in coordination with other cross-border connections. Border capacity allocation rules have not been harmonised, which results in insufficient cross-border arbitrage and inadequate utilisation of interconnectors.
- The national gas markets are still insufficiently developed in many cases. The creation of a European market is essential since there are only a small number of large suppliers.

- With regard to the integration of the retail markets, European harmonisation of the regulatory framework is still uncharted waters. The granting of licences and licensing conditions are regulated per Member State. No activities have been undertaken in relation to the harmonisation of, for instance, contractual conditions, switching procedures, the processing of metering data or invoicing.
- Close monitoring of the functioning of the market and market power by the national regulators is often lacking.

National regulators are bound by national frameworks of duties and powers. An important contribution can be made by the European Commission by facilitating effective cooperation between TSOs and between regulators. The harmonisation of market rules should result in integrated markets in which cross-border trade is efficient and interconnector capacity can be fully utilised. Harmonisation should also focus on 'best practice'. The enlargement of markets results in more competition, provided measures aimed at limiting the market power of international market parties can be implemented. The harmonisation of the European energy market is therefore essential for achieving better operation of the energy market in the Netherlands.

In this chapter, the following topics will be discussed:

- developments on the electricity wholesale market;
- developments on the gas wholesale market;
- developments on the retail market for electricity and gas;
- policy measures taken; and
- the energy regulator (DTe)

#### **a. Electricity wholesale market**

DTe monitors the market closely and reports on the level of liquidity, competition and transparency. The liquidity of the Dutch electricity wholesale market increased compared to 2003, but the level of liquidity is average compared to several neighbouring countries of the Netherlands.

There are considerable differences within Europe with regard to the transparency of market information. The Netherlands has an average score with regard to the level of transparency. For instance, publicly available information on the demand for electricity, the actual use of cross-border interconnector capacity and the results of trading on the forward market is not available or is only available to a limited extent in the Netherlands. This information is essential for market parties to enable them to operate and compete on the electricity market. DTe is of the opinion that the level of transparency of the electricity wholesale market should be harmonised throughout Europe.

The number of players on the electricity wholesale market increased in 2004. The improvement in liquidity is favourable to competition. On the other hand, situations do occur where only a limited number of parties are able to meet additional demand for electricity. To promote effective competition in the energy sector, it is important that sufficient trade takes place and that a sufficient number of market parties can be active on the market. For this reason, DTe recommends implementing a number of measures. More coordination between TenneT and foreign TSOs is necessary to increase the available cross-border import capacity in the short term and to introduce

a link to the German market. The import capacity must also be auctioned in smaller quantities than is now the case and to the auctions must be spread throughout the year.

In order to realise an imbalance market for electricity which operates properly in the short term, it is necessary to increase the volume that can be traded on the liberalised market. An important condition for developing activities on the electricity market is that traders have the means to protect themselves from financial risks. DTe recommends publishing more information about the OTC market and promoting international harmonisation in the area of transparency. Together with the market, DTe will examine possibilities for creating greater transparency with regard to the volumes traded on the OTC market. In addition, making the trade in interconnector capacity available during the day (intraday trade) contributes to greater liquidity. Together with the Belgian (CREG) and French (CRE) regulators, the opportunities for doing so will be worked out in more detail.

In December 2004, DTe approved the financing of the construction of a marine cable with a target capacity of 700 MW between the Netherlands and Norway, subject to certain conditions. The conditions included a bonus-malus system in terms of which rewards are given and penalties are imposed if the performance is respectively higher or lower than agreed. On the other hand, TenneT, the national TSO, will be rewarded if it delivers the cable earlier. A minimum number of days have been determined on which the cable must be available. The cable must be operational in 2008 and will make a positive contribution to the operation of the electricity market.

## **b. Gas wholesale market**

The operation of the gas wholesale market is still inadequate and there are too few opportunities for competition. There are, for instance, two marketplaces (GOS and Eurohub) which operate inadequately. In addition, the level of concentration on the market is too high and the activities of the TSO have not been separated sufficiently. Furthermore, the transmission and quality conversion support services are not allocated adequately and an efficient balancing regime does not exist.

DTe also sees a number of positive developments on the gas market. Although the TTF is a small marketplace which functions well, there are too few players on the market, the legal and actual procedures are not a barrier to entry and access to the transmission, balancing and quality conversion supporting services is non-discriminatory. The TSO is sufficiently unbundled from a legal point of view. Physically there is sufficient gas and transmission capacity and there is a sufficiently varied supply of transmission contracts.

Of the gas exchanges, only TTF is developing favourably, but it is lagging behind in comparison to the development of foreign marketplaces. The development of the Eurohub marketplace has been unfavourable. Hardly any trade took place on this marketplace at all last year. On the GOS marketplace it is not possible to sell gas on to third parties. Since GOS is the marketplace used most, this obstructs the development of the entire wholesale market.

DTe doubts whether the Dutch gas market can resolve the market imperfections observed of its own accord. In 2004 DTe consulted the market about solutions to the bottlenecks in the gas market. It emerged from this that:

- the provision of information by the TSO to the market parties must be improved;
- agreements must be made with the TSO for the development of a more economically oriented balancing regime;
- a cost-oriented penalty system must be implemented for the imbalance market;
- the cost of quality conversion from high calorific gas to low calorific gas must partly be socialised; and
- the rules governing imports must be improved.

In addition to the implementation of these measures, European market integration is important to reduce the level of concentration and to increase competition.

### **c. Electricity and gas retail markets**

Since the liberalisation of the market on 1 July 2004, all the suppliers to small users (consumers and small business buyers) must have a supply licence. This provides buyers with a guarantee that these suppliers have the necessary organisational, financial and technical qualities to carry out their task properly, namely to supply electricity or gas.

The concentration of the retail market is high, but is falling continuously. There are a considerable number of suppliers on the electricity retail market (21) and the gas retail market (16). The profit margins on the wholesale price are low.

The prices are largely driven by the development of the wholesale market in the Netherlands and therefore indirectly by the development of prices in neighbouring countries, fuel prices and the cost of CO<sub>2</sub> emission rights.

The switching rates are low, but relatively stable. A significant number of consumers do not even consider switching, for instance due to uncertainty with regard to the administrative processing of switches by energy companies.

The price spread is also low. For this reason, consumers can save little by switching and even less in the case of electricity than in the case of gas. Although the savings opportunities are the most important reason for Dutch consumers to switch, in the second quarter of 2005 a number of switches were observed which appeared to be motivated by concern about the high salaries and bonuses of senior managers of some energy companies.

The market is sufficiently transparent for consumers who are interested in switching and who are familiar with the Internet. Price comparison sites exist which provide information on differences between products and quality.

In 2005 DTe carried out research into the administrative processes of energy companies on three occasions. It appeared that the sector had halved the problems in relation to administrative

processing by 1 April 2005. The results of the most recent research are still not known. DTe also stipulated that the maximum period in which final settlements should be sent is eight weeks. Moreover, invoices were assessed concerning their clarity by means of voluntary agreements with the sector. It emerged that the invoices of supply companies were more than sufficiently clear. In addition, DTe completed its research into the completeness, reliability and correctness of the four Internet engines which generate price comparisons. It appears from this research that the completeness and correctness of the information provided improved slightly.

In December 2004, DTe decided to set a maximum for the cancellation fee, namely EUR 50. DTe is also examining the fairness of supply tariffs and issues companies with warnings if the tariffs are too high. DTe has the power to demand an amendment to supply tariffs, but until now it has never exercised this power.

Furthermore DTe has fined companies. DTe imposed fines for using "unfair and misleading" acquisition methods and for issuing DTe too late with data requested with regard to tariffs and contractual conditions.

#### **d. Policy measures taken**

##### ***Act for ownership unbundling [Splitsingwet]***

After the bill separating the ownership of the electricity grid or gas network companies and the other activities of energy producers and suppliers was approved by the Cabinet on 24 March 2004, the Minister of Economic Affairs presented the bill to the Lower House of the Dutch Parliament in October 2004. The bill was debated in December and returned to the Minister. In the second half of 2005, an amended bill will be debated in the Lower House. The act is scheduled to come into force on 1 January 2007.

##### ***Intervention and Implementation Act [Interventie- en implementatiewet]***

On 29 June 2004, the Lower House passed the Intervention and Implementation Act. Under this Act, DTe is given the power to monitor the energy market, to impose fines and to represent consumer interests. Furthermore the Act requires DTe to pay attention to the quality aspects of energy transmission. The Ministry of Economic Affairs introduced quality regulation of the electricity grids and gas networks in 2004. The obligation to provide data on the reliability of electricity grids and gas networks is not regulated by statute. The average duration of outages per connection has been integrated as a quality factor into the economic regulation of transmission tariffs. The first Quality and Capacity Plans are expected in December 2005.

#### **e. The energy regulator**

##### **Organisation of the Office of Energy Regulation**

The Office of Energy Regulation (DTe) (*Directie Toezicht Energie*) was an independent Office which operated under the name of *Dienst Uitvoering en Toezicht Energie* until 1 July 2005. Since 1 July 2005 DTe has operated as a Directorate of the Netherlands Competition Authority (NMa), which has been an autonomous administrative authority since that date.

**DTe's mission**

DTe's mission is "to make the energy markets work as effectively as possible and to protect consumers". DTe realises this mission by making a contribution to creating the conditions under which the market can operate as effectively and efficiently as possible and the interests of consumers can be guaranteed adequately.

**DTe's main tasks**

Freedom of choice must result in greater efficiency, competitive prices, better quality and more innovation in the sector. DTe *stimulates*, for instance, access for trading parties to the electricity grids and gas networks subject to reasonable conditions and tariffs. In addition, DTe attempts to encourage energy consumers to make deliberate choices.

Competition between the electricity grids and gas networks is not possible. DTe *regulates* the electricity grid and gas network managers to ensure that services are provided at fair prices. For instance, DTe determines maximum tariffs for the services of electricity grid and gas network managers and stimulates the electricity grid and gas network managers to guarantee the quality of the electricity grid or gas network.

DTe *supervises* parties in the energy sector. On the basis of reports from the sector, DTe regularly analyses whether the parties comply with the legal requirements. To do so, for instance, regular and incidental audits of electricity grid and gas network managers and suppliers are carried out.

DTe *monitors* the functioning of the energy markets. DTe wishes to know if market imperfections occur (or are in danger of occurring). DTe, for instance, conducts research into the liquidity of the markets. In order to monitor developments on the Dutch energy market, DTe has set up a monitoring system. DTe also advises the Minister on the development of new policy.

**Statutory duties**

The implementation of the Electricity Act of 1998 and the Gas Act and supervision of compliance with these acts is a task assigned to DTe. In relation to this, DTe carries out the following activities:

- taking regulatory decisions in relation to electricity and gas;
- taking tariff decisions in relation to electricity and gas;
- determining tariff structures and technical conditions for the transmission of electricity;
- determining guidelines for tariffs and conditions for access to gas transmission pipelines and gas storage installations;
- granting licences for the supply of electricity and gas to captive customers;
- issuing binding instructions and imposing interdicts;
- advising the Minister of Economic Affairs on granting his consent to the appointment of an electricity grid or gas network manager, on granting exemption from the obligation to appoint an electricity grid manager (section 15 of the Electricity Act of 1998) and on decisions on applications for privatisation;
- making a contribution through the international consultative structures set up by European regulators of the energy sector; and
- providing public information.

**Autonomy and accountability**

Its status as an independent administrative authority means that NMa formally operates at a greater distance from the Ministry of Economic Affairs. Since it was established in 1998, NMa was placed at a distance as an office of the Ministry of Economic Affairs, with its own responsibilities and powers. The most important change in the relationship with the Ministry of Economic Affairs since 1 July 2005 is that the Minister cannot issue instructions about the way in which NMa should act in individual cases. The Minister of Economic Affairs remains politically responsible for policy and legislation in relation to the energy sector and competition policy and has the power to issue NMa with general directives.