

EXPLANATORY MEMORANDUM FOR EUROPEAN UNION LEGISLATION WITHIN THE SCOPE OF THE UK/EU WITHDRAWAL AGREEMENT AND THE WINDSOR FRAMEWORK

1. This explanatory memorandum covers two parallel EU legislative proposals:
 - I. **COM (2023) 148 final:** Proposal for a Regulation (EU) of the European Parliament and of the Council amending Regulations (EU) 2019/943 and (EU) 2019/942 as well as Directives (EU) 2018/2001 and (EU) 2019/944 to improve the Union's electricity market design, and;
 - II. **COM (2023) 147 final:** Proposal for a Regulation (EU) of the European Parliament and of the Council amending Regulations (EU) No 1227/2011 and (EU) 2019/942 to improve the Union's protection against market manipulation in the wholesale energy market.
2. Submitted by the Department for Energy Security and Net Zero on 21/04/2023.

SUBJECT MATTER

3. This legislative proposal outlines a series of targeted measures to improve the EU's electricity market design, and to offer additional protections against market manipulation in the wholesale energy market.
4. This proposal has been put forward by the European Commission in the context of significant disruption in European wholesale electricity markets following Russia's illegal invasion of Ukraine. The measures seek to protect consumers from price volatility in short-term electricity markets; promote a stable long-term price of energy; and boost renewable energy investment.

SCRUTINY HISTORY

5. The Directives and Regulations amended by these new proposals were subject to scrutiny under the following references:
 - (i) Regulation 2019/942: EU document 15149/16: EM dated 20 December 2016
 - (ii) Regulation 2019/943: EU document 15135/16: EM dated 20 December 2016
 - (iii) Directive 2019/944: EU document 15150/16: EM dated 20 December 2016
 - (iv) Directive 2018/2001: EU document 15120/16: EM dated 20 December 2016
 - (v) Regulation 1227/2011: EU document 17825/10: EM dated 7 January 2011

MINISTERIAL RESPONSIBILITY

Minister of State for Energy Security and Net Zero

INTEREST OF THE DEVOLVED ADMINISTRATIONS

6. Wholesale electricity policy is largely reserved across Great Britain and devolved in Northern Ireland. Officials from the Department for Energy Security and Net Zero are working closely with officials from the Northern Ireland Civil Service to manage the implications of UK and EU electricity market reform for Northern Ireland.
7. Officials in the Northern Ireland Civil Service have been consulted on this legislation and are content with this explanatory memorandum.

LEGAL AND PROCEDURAL ISSUES

8. These proposals have been made under Article 194(2) of the Treaty on the Functioning of the European Union. This article provides the legal basis for proposing measures covering (i) the functioning of the EU's energy market; (ii) promoting energy efficiency and energy saving, and; (iii) the development of new and renewable forms of energy. Both legislative proposals will be subject to the EU's ordinary legislative procedure.
9. The Swedish Presidency of the Council has publicly stated that it will aim to achieve an agreed position among Member States by the end of June 2023. Progress could be delayed due to the complexity of some of the proposals.

POLICY IMPLICATIONS

Background

10. On 14 March 2023, the European Commission ('the Commission') published its legislative proposal for reforming its internal electricity market. The Commission says its objectives are to 'boost renewables, better protect consumers and enhance industrial competitiveness'.
11. The Commission's draft reforms consist of two parallel legislative proposals. The first involves amending four sets of existing EU legislation: the 'Electricity Regulation' (2019/943), the 'Electricity Directive' (2019/944), the 'ACER Regulation' (2019/942) and the 'Renewables Energy Directive' (2018/2001). The second proposal amends the 'REMIT' Regulation (1227/2011) and the 'ACER Regulation' (2019/942).

Proposal I: Regulation of the European Parliament and of the Council amending Regulations (EU) 2019/943 and (EU) 2019/942 as well as Directives (EU) 2018/2001 and (EU) 2019/944 to improve the Union's electricity market design

12. The first of the EU's twin proposals include the most wide-ranging reforms to the EU's electricity market design. Article 1 of this proposal sets out amendments to

the Electricity Regulation 2019/943. Some of the key features of these amendments include:

- (i) Enabling EU transmission system operators (TSOs) to design so-called 'peak shaving' products. 'Peak shaving' is defined by the Commission as the ability of market participants to reduce electricity demand at peak hours determined by the TSO. To support this, the proposal also allows for transmission and distribution system operators to use data from dedicated metering devices for 'the observability and settlement of flexibility services, such as demand response and settlement', including from storage systems. This measure is primarily envisaged in member states where the roll-out of smart metering systems is limited.
- (ii) New obligations on Nominated Electricity Market Operators (NEMOs) to facilitate trade in energy 'as close to real time as possible and at least up to the cross-zonal gate closure time'. This involves a new commitment for the intraday gate closure time to occur, at the earliest, 30 minutes ahead of real time by 1 January 2028. There are also obligations on NEMOs to lower the minimum bid size to promote participation of small-scale flexibility providers and renewable generators. There are also new requirements for NEMOs to share order books in bidding zones.
- (iii) A commitment to establish 'regional virtual hubs' for the forward market. The European Network of Transmission System Operators for Electricity (ENTSO-E) will need to submit a proposal to the Agency for the Cooperation of European Regulators (ACER) by 1 December 2024 detailing how this might work in practice.
- (iv) An expanded role for the single allocation platform established under the 'Forward Capacity Allocation' Guideline (2016/1719). The platform will be required to facilitate the trade of long-term financial transmission rights between different bidding zones and the new virtual hubs established under this legislative proposal. There are also additional flexibilities for regulatory authorities to take action to increase the liquidity of the forward market to support effective hedging. This includes so-called 'market making' activities. The proposal also adds provisions covering compensation for offshore power generators operating in an offshore bidding zone.
- (v) New requirements on member states to incentivise the use of Power Purchase Agreements (PPA), and to increase uptake of so-called 'two-way' Contracts for Difference (CfDs).
- (vi) Additional requirements on member states and ENTSO-E to assess the flexibility requirements of electricity systems to secure supply and to

decarbonise their electricity system. There is also a specific requirement for EU member states to consider support schemes for non-fossil fuel flexibility services, where member states operate a capacity market.

- (vii) Additional requirements on transmission and distribution system operators to publish information on connection requests and capacity availability in their area. There are also amendments to the rules surrounding the charges that TSOs and distribution network operators can claim in their tariff calculation, which covers both capital and operational costs.

13. Article 2 of the new Regulation amends the Electricity Directive (2019/944). These amendments are broadly intended to provide additional protections for consumers, including by introducing new requirements to appoint a 'supplier of last resort' in the event of supplier failure and additional protections from disconnection for vulnerable consumers. Article 3 of this proposal deals with amendments to the Renewable Energy Directive (2018/2011), which seeks to clarify rules around direct price support that member states may introduce for renewable energy generators. Article 4 of this proposal deals with amendments to the ACER Regulation (2019/942). It broadly provides new powers for ACER to ensure compliance with the other articles of this proposal.

Proposal II: Regulation (EU) of the European Parliament and of the Council amending Regulations (EU) No 1227/2011 and (EU) 2019/942 to improve the Union's protection against market manipulation in the wholesale energy market

14. This proposal seeks to update the EU's existing safeguards on market manipulation, primarily covered by the 'REMIT' Regulation. Key aspects of this proposal include:

- (i) Updating key definitions related to market manipulation and insider trading. This is with the aim of promoting better alignment with similar definitions in EU financial market legislation. The proposal also seeks to promote greater cooperation and data exchange between regulators of energy and financial markets.
- (ii) Expanding the scope of reporting requirements for 'organised market places' to cover other markets, such as new balancing markets, and amendments to the process for collecting and disclosing inside information and market transparency data.
- (iii) Outlining responsibilities for ACER to assess the price for Liquefied Natural Gas (LNG). This includes specific obligations to create a daily LNG price assessment and price benchmark. The Regulation provides additional powers

for ACER to request relevant information from market participants to support the development of this price assessment.

- (iv) Expanding the remit of ACER to investigate market abuse cases with a cross-border element. The proposal sets out requirements on how ACER and other regulatory authorities must conduct these investigations, including harmonisation of fines set by regulatory authorities at an EU member state-level.

15. Full details of both proposals are publicly available on the Commission's website: tinyurl.com/3vjz9838

Potential implications of EU electricity market reform for Northern Ireland

16. Article 9 of the Windsor Framework commits the UK to applying aspects of EU energy law in Northern Ireland. The full set of legislation which the UK has committed to applying in Northern Ireland can be found in Annex 4 of the Windsor Framework. This 'Annex 4 legislation' applies in Northern Ireland insofar as it is relevant to the generation, transmission, distribution, and supply of electricity; trading in wholesale electricity, or cross-border exchanges in electricity. Provisions of this legislation relating to retail markets and consumer protection do not apply. Provisions of wider EU legislation referred to within an individual piece of legislation listed under Annex 4 will also apply if they are provisions governing wholesale electricity markets which apply in Ireland and are necessary for the joint operation of the Single Electricity Market (SEM).

17. Except for the amendments to the Renewable Energy Directive, the EU's parallel legislative proposals directly amend legislation listed under Annex 4 of the Windsor Framework. We therefore expect the European Commission to engage on these proposals in the normal way through the enhanced structures set up under the Windsor Framework. The UK Government was notified in March 2023 that these proposals have been adopted by the European Commission.

18. The Windsor Framework establishes new structured expert groups to allow detailed UK-EU discussion of new rules applied under the Windsor Framework across the full range of issues, including on goods regulation, the SEM, customs, agrifood and subsidy control. There are also new commitments to engage earlier and more intensively to consider the implications of new rules. Under Article 15 of the Windsor Framework, the EU is committed to providing the UK with all the information it considers relevant to allow the UK to fully comply with its obligations.

Reforms of electricity market design in the United Kingdom

19. As set out in the Energy Security Plan, the UK Government wants to support international efforts to drive the global transition to clean technologies. We

therefore welcome the EU's objective of promoting investment in renewable energy through its market arrangements.

20. In parallel to the EU's legislative proposal, the UK Government is consulting on potential reforms to the electricity market in Great Britain, via the 'Review of Electricity Market Arrangements' (REMA). First announced in April 2022 in the British Energy Security Strategy, REMA is a major review into Britain's electricity market design that will enhance energy security and help to deliver our world-leading climate targets whilst ensuring a fair deal for consumers. It encompasses all electricity-related (non-retail) markets, and all technologies are within scope to the extent that they currently do, or potentially could, participate in these electricity markets.
21. REMA aims to identify and implement the reforms needed to electricity market arrangements, in order to drive the necessary investment in, and efficient operation of a secure, cost-effective, low carbon electricity system by 2035. The Government published a first consultation in July 2022 and published a summary of responses in March 2023. We aim to publish a second consultation in Autumn 2023.
22. As set out in our initial consultation, the Government will need to consider the UK's international agreements and obligations for energy trading and co-operation, and consider the role and interactions of interconnection, both now and in the future. We will continue to engage the Commission, interconnected countries and other impacted stakeholders on these issues as we make further progress to implement the outcomes of REMA alongside our commitments in the Trade and Cooperation Agreement Energy Title. It is also important to ensure the UK and EU maintain dialogue to learn from each other's experiences of electricity market reform. On 9 March 2023, a UK Government delegation attended an event in the European Parliament to discuss this issue.
23. As energy policy is devolved for Northern Ireland, we are not envisaging the outcomes of REMA to be implemented in Northern Ireland. However, we will ensure any policy decision accounts for potential impacts on electricity trading between Great Britain and the SEM, which are connected via two subsea electricity interconnectors.
24. Alongside this, the Government will also deliver a reformed energy retail market in Great Britain as set out in the Energy Security Plan. We want to ensure the energy retail market works better for consumers, is more resilient and investable, and supports wider system transformation. Work is already underway to deliver these objectives, and as a next step we will be launching public consultations in summer 2023 to seek views from stakeholders on the most fundamental questions for reform.

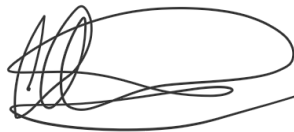
CONSULTATION

25. Neither the UK Government nor the Northern Ireland Civil Service have undertaken any impact assessment of these proposals. We will continue to monitor the need for further analysis and consultation as these proposals develop.

FINANCIAL IMPLICATIONS

26. There are no known financial implications for the UK Government or Northern Ireland Civil Service at this time. We will continue to assess the financial implications of this proposal as it develops.

MINISTERIAL NAME AND SIGNATURE

A handwritten signature in black ink, consisting of several overlapping loops and a long horizontal stroke at the end, enclosed within a faint oval outline.

The Rt Hon Graham Stuart MP

Minister of State for Energy Security and Net Zero

Department for Energy Security and Net Zero