EXPLANATORY MEMORANDUM TO

THE ELECTRICITY TRADING (DEVELOPMENT OF TECHNICAL PROCEDURES) (DAY-AHEAD MARKET TIMEFRAME) REGULATIONS 2021

2021 No. XXXX

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department of Business, Energy and Industrial Strategy and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This instrument is required to implement new cross-border electricity trading arrangements at the day-ahead market timeframe, in accordance with provisions in the Trade and Cooperation Agreement ('TCA') between the United Kingdom and the European Union.

2.2 It imposes a duty on transmission system operators ('TSOs') to develop technical procedures required under such arrangements and a duty on relevant electricity market operators to cooperate with TSOs and each other, for the purposes of facilitating the development of those procedures. It also provides the Gas and Electricity Markets Authority with powers of enforcement in respect of those duties and provisions relating to the allocation and recovery processes for costs associated with the development of the procedures.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 The territorial application of this instrument includes Scotland.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is England and Wales and Scotland.

4.2 The territorial application of this instrument is England and Wales and Scotland.

5. European Convention on Human Rights

5.1 The Minister of State, the Rt Hon Anne-Marie Trevelyan MP has made the following statement regarding Human Rights:

"In my view the provisions of The Electricity Trading (Development of Technical Procedures) (Day-Ahead Market Timeframe) Regulations 2021 are compatible with the convention rights."

6. Legislative Context

6.1 On 29 March 2017, the Prime Minister at the time triggered Article 50 of the Treaty on European Union, starting the United Kingdom's exit from the European Union. A Withdrawal Agreement was then secured on 17 October 2019 and the United Kingdom officially left the European Union on 31 January 2020.

6.2 The United Kingdom then entered the Transition Period where European Union legislation continued to apply in full. This included Regulation (EU) No 2015/1222 of 24 July 2015, establishing a guideline on capacity allocation and congestion management ('CACM'). The regulation harmonised rules within the Internal Energy Market for cross-border electricity trade at the day-ahead market timeframe, known as market coupling.

6.3 The Electricity Network Codes and Guidelines (Markets and Trading) (Amendment) (EU Exit) Regulations 2019 revoked CACM after the end of the Transition Period as Great Britain was no longer a member of the Internal Energy Market.

6.4 Ahead of this, the United Kingdom secured the TCA with the European Union. Title VIII (Energy) and Annex ENER-4 of the TCA set out requirements for the development of new cross-border electricity trading arrangements at the day-ahead market timeframe that are distinct and separate from those established under CACM.

6.5 The TCA was ratified in the United Kingdom under the European Union (Future Relationship) Act 2020 ("the 2020 Act"), receiving royal assent on 31 December 2020. This instrument exercises powers under Section 31 of that Act, whereby a relevant national authority may by regulations make such provision as considered appropriate to implement the TCA.

6.6 The TCA has yet to be ratified by the European Parliament, but it has been provisionally applied since 1 January 2021 by virtue of Article FINPROV.11 of the TCA (entry into force and provisional application).

6.7 Article FINPROV.9 of the TCA makes provision for a process of final legal revision of that Agreement and for the revised version of the Agreement to replace the signed version from the beginning. Section 37(4) and (5) of the 2020 Act makes provision for any references to the TCA in the 2020 Act or other enactment are to be read as modified under the revised version of the Agreement. Accordingly, the cross references to the TCA in these Regulations will be modified accordingly.

6.8 This instrument implements provisions relating to the efficient use of electricity interconnectors and the requirement to develop technical procedures in respect of the day-ahead market timeframe in accordance with Article ENER.13(1)(f), Article ENER.14, Article ENER.19 and Annex ENER-4 of the TCA.

6.9 Article ENER.13(1)(f) of the TCA requires each Party to ensure 'capacity allocation and congestion management across electricity interconnectors is coordinated between concerned Union transmission system operators and United Kingdom transmission system operators; this coordination shall involve the development of arrangements to deliver robust and efficient outcomes for all relevant market timeframes, being forward, day-ahead, intraday and balancing'.

6.10 Article ENER.14(1) states 'For capacity allocation and congestion management at the day ahead stage, the Specialised Committee on Energy, as a matter of priority, shall take the necessary steps in accordance with Article ENER.19 [Cooperation between transmission system operators] to ensure that transmission system operators develop

arrangements setting out technical procedures in accordance with Annex ENER-4 within a specific timeline'.

6.11 Article ENER.19(1) states 'Each Party shall ensure that transmission system operators develop working arrangements that are efficient and inclusive in order to support the planning and operational tasks associated with meeting the objectives of this Title, including, when recommended by the Specialised Committee on Energy, the preparation of technical procedures to implement effectively the provisions of:

(a) Article ENER.13 [Efficient use of electricity interconnectors];

(b) Article ENER.14 [Electricity trading arrangements at all timeframes];

(c) Article ENER.15 [Efficient use of gas interconnectors];

(d) Article ENER.16 [Network development]; and

(e) Article ENER.17 [Cooperation on security of supply]'.

6.12 Article ENER.19(2) states 'The Specialised Committee on Energy may recommend that each Party requests its transmission system operators to prepare the technical procedures as referred to in the first subparagraph of paragraph 1'.

6.13 Article ENER.19(3) states 'Each Party shall ensure that its respective transmission system operators request the opinions of the Agency for the Cooperation of Energy Regulators and the regulatory authority in the United Kingdom designated in accordance with Article ENER.12 [Independent regulatory authority] on the technical procedures, respectively, in the event of a disagreement and in any event before the finalisation of those technical procedures. The Parties' respective transmission system operators shall submit those opinions together with the draft technical procedures to the Specialised Committee on Energy'.

6.14 Annex ENER-4 (Allocation of electricity interconnector capacity at the day-ahead market timeframe) sets out the framework for the development of the technical procedures for the day-ahead market timeframe.

6.15 This instrument does not modify or introduce legislation in Northern Ireland as energy (other than nuclear) is a transferred matter.

7. Policy background

What is being done and why?

7.1 Following the end of the Transition Period, Great Britain's electricity market was uncoupled from the European Union Internal Energy Market.

7.2 The TCA sets out principles for new cross-border electricity trading arrangements at the day-ahead market timeframe that will replace previous market coupling. It will be based on the concept of 'multi-region loose volume coupling', where cross-border transmission capacity on an interconnector and electricity are auctioned together and the energy market in Great Britain maintains independence.

7.3 Once operational, the arrangements will apply to all Great Britain's electricity interconnectors including existing links to France, the Netherlands and Belgium, as well as Ireland and Northern Ireland where trading is undertaken with the Single Electricity Market.

7.4 Whilst the TCA sets out the principles for the arrangements, the detailed technical procedures still need to be developed. Until new arrangements are operational, trading will continue using less efficient explicit auctions where transmission capacity on an interconnector and electricity are bought in separate auctions. Since the two commodities, transmission capacity and power are traded at two separate auctions, there is a lack of information about the price of the other commodity at the time of purchase. This lack of perfect information about prices between the two commodities can result in inefficient utilisation of interconnectors and adverse flows.

7.5 For example, a market participant seeking to take advantage of price differentials will purchase lower-cost electricity in one market to sell in another interconnected market with a higher price. They must then purchase transmission capacity which is subject to short-term demand and price fluctuations. This creates additional risk and lack of price certainty when purchasing electricity as the price of capacity can change closer to delivery. This in turn increases the likelihood of electricity flowing from higher-price markets to lower-price markets ('adverse flows') if capacity prices rise closer to delivery. If a higher-price market is exporting electricity due to adverse flows, it cannot import lower-price electricity from elsewhere as interconnector capacity is finite. Instead, the market must rely on more expensive generation locally resulting in upward pressure on wholesale prices.

7.6 In contrast the arrangements within the TCA will auction electricity and capacity together. Market participants have better information to make trading decisions and electricity will flow in accordance with the price differential. This means under normal circumstances, Great Britain will import when it can take advantage of lower-cost electricity from a connected market.

7.7 The intention of this instrument is therefore, not only to achieve compliance with an international treaty but to ensure an enforcement mechanism is in place to prevent delays in developing the technical procedures. This will avoid market participants and consumers in Great Britain from being exposed to prolonged costs associated with inefficient interconnector trade at the day-ahead market timeframe.

7.8 The TCA also places obligations on the United Kingdom and the European Union ('the Parties') as the signatories. For example, Article ENER.19(3) states that the Parties shall ensure that TSOs request regulatory opinions on the technical procedures. This instrument imposes these duties onto the relevant parties, in this case, the regulatory authority and TSOs.

7.9 The regulatory framework within Great Britain is such that multiple TSOs exist with distinct roles and responsibilities. For the purpose of developing technical procedures, references to TSOs will only capture the Interconnector Operators and the Electricity System Operator – this is reflected in the definitions of this instrument.

7.10 This instrument, therefore, places an obligation on these TSOs to develop technical procedures in accordance with Annex ENER-4 of the TCA. To achieve this, they must send, the technical proposals to the Specialised Committee on Energy ('SCE') – the specialised committee for energy established under Article INST.2 of the TCA. These activities must be completed within timeframes as directed by the Secretary of State, informed by timelines detailed in Annex ENER-4.

7.11 Article ENER.19(1) of the TCA states that the Parties shall request that their TSOs take these actions, where recommended by the SCE. It was however, agreed between the Parties that a joint request would be made ahead of the formation of the SCE, to meet

the timelines set out in the TCA. The Department has sent a letter to TSOs notifying them of this request.

7.12 The TCA also states that the Parties must ensure TSOs request the opinion of the Authority in the event of a disagreement and on final technical procedures, to be included when sending them to the SCE. The instrument, therefore, places an obligation on TSOs to request an opinion in both scenarios and on the Authority to provide an opinion when requested.

7.13 The Authority is defined as the Gas and Electricity Markets Authority (represented by Ofgem) and designated as the independent regulatory authority for Great Britain in accordance with Article ENER.12 of the TCA. To ensure that opinions reflect views that are specific to Northern Ireland, the instrument states that the Authority must provide the Northern Ireland Authority for Utility Regulation with relevant information and opportunities to make representations which the Authority must have regard to and ensure those representations are taken into account in the opinion as appropriate.

7.14 Although the instrument places obligations on TSOs to develop technical procedures, they will need to work closely with other relevant parties to facilitate this requirement. This instrument, therefore, includes cooperation provisions that require TSOs to work with relevant electricity market operators, non-UK transmission system operators and the European Network of Transmission System Operators for Electricity. To this effect, the instrument also includes provisions that require relevant electricity market operators to cooperate with each other and TSOs to facilitate the development of the technical procedures.

7.15 This instrument also provides the Authority with powers to determine how costs incurred by TSOs and relevant electricity market operators when developing technical procedures are to be allocated and recovered. It provides the Authority with a power to request information from TSOs and relevant electricity market operators which it considers is necessary to facilitate the Authority in making such a decision, with an obligation on those parties to provide such information within 3 months of the request. It is important to note that these powers will only cover costs associated with development and implementation, not enduring costs that are incurred once new arrangements become operational.

7.16 Placing obligations on relevant persons is not sufficient by itself to ensure that technical procedures are developed without delay. An appropriate enforcement mechanism is also necessary to act against non-performance. The instrument applies Section 25 of the Electricity Act 1989, so that obligations placed on TSOs and relevant electric market operators under this instrument are enforceable by the Authority as if they were relevant requirements on a regulated person for the purposes of that Act.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

9.1 Consolidation is not required for this instrument.

10. Consultation outcome

10.1 Statutory instruments made under the powers in the European Union (Future Relationship) Act 2020 do not require consultation, and a consultation has not been conducted for this instrument.

10.2 Technical input relevant to this instrument has been provided by the Gas and Electricity Markets Authority, the Northern Ireland Authority for Utility Regulation, and the Northern Ireland Department for the Economy.

11. Guidance

11.1 The Government has published Secretary of State guidance related to this instrument on GOV.UK, which can be found at:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/958195/secretary-of-state-electricity-trading-arrangements-guidance.pdf

12. Impact

12.1 There is no, or no significant, impact on business, charities or voluntary bodies.

12.2 There is no, or no significant, impact on the public sector.

12.3 An Impact Assessment has not been prepared for this instrument because the impacts are below the threshold required to carry out a full Impact Assessment under the Government analytical guidance. A De-Minimis form has been completed to accompany this instrument.

12.4 This instrument is likely to lead to administrative costs, incurred by market participants involved with the development of technical procedures. The costs are expected to fall on TSOs and relevant electricity market operators, who are directly involved in this exercise. The analysis of costs used information from the CACM implementation cost report as a proxy, estimating it to be approximately £3 million.

13. Regulating small business

13.1 No specific action is proposed to minimise regulatory burdens on small businesses.

13.2 The basis for this decision is that the scale of the impacts identified in connection with this instrument is small, and they do not fall disproportionately on small businesses.

14. Monitoring & review

14.1 The Department does not intend to monitor this instrument.

14.2 As this instrument is made under the European Union (Future Relationship) Act 2020, no review clause is required.

15. Contact

15.1 Elliot Spindler at the Department for Business, Energy and Industrial Strategy can be contacted with any queries about this instrument. Telephone: 0207 215 4807 Email: elliot.spindler@beis.gov.uk.

15.2 Ronan Devaney, Deputy Director for Climate and Energy – Trade and Europe can confirm that this Explanatory Memorandum meets the required standard.

15.3 The Minister of State, the Rt Hon Anne-Marie Trevelyan MP, at the Department for Business, Energy & Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.