EXPLANATORY MEMORANDUM TO

THE ELECTRICITY AND GAS (INTERNAL MARKETS) REGULATIONS 2017

2017 No. 493

1. Introduction

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

2. Purpose of the instrument

2.1 This instrument amends provisions of the Gas Act 1986 and Electricity Act 1989 which implement the European Union's Third Energy Package.

2.2 It provides the Gas and Electricity Markets Authority ("Ofgem") with powers to enforce the compliance of entities designated as nominated electricity market operators ("NEMOs") under Regulation (EU) No 2015/1222 of 24 July 2015 establishing a guideline on capacity allocation and congestion management ("the CACM Regulation") with the requirements of that Regulation.

2.3 It also amends the definition of "relevant producer or supplier", a term used in ownership unbundling provisions, which restrict persons with ownership or control of gas or electricity transmission systems from also owning. controlling or having certain kinds of connections with electricity generators, gas producers or energy suppliers. The effect of the amendment is to require Ofgem, when considering whether to certify persons as complying with the unbundling provisions, to take account of generation, production or supply interests wherever they are located, instead of only in EEA states.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Other matters of interest to the House of Commons

3.2 As this instrument is subject to negative resolution procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

4.1 The European Union's Third Energy Package of legislation[1] on the internal energy market was implemented in Great Britain principally by the Electricity and Gas

[1] The Third Energy Package consists of two Directives and three Regulations:

- Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC ("the Electricity Directive");
- Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in gas and repealing Directive 2003/55/EC ("the Gas Directive");

(Internal Markets) Regulations 2011 ("the 2011 Regulations"), which amended the Electricity Act 1989, the Gas Act 1986 and the standard conditions of electricity and gas licences.

4.2 The CACM Regulation is one of a number of EU Regulations (known as 'network codes' or 'guidelines') which have been adopted by comitology under the Electricity Regulation and the Gas Regulation, setting out technical requirements for cross-border energy trade and transmission.

4.3 Article 19 of the Electricity Regulation requires national regulatory authorities (Ofgem, in Great Britain) to ensure compliance with that Regulation and the guidelines adopted under it.

4.4 Ofgem's enforcement powers against electricity undertakings are contained in sections 25 to 28 of the Electricity Act 1989. Those sections give Ofgem enforcement powers against relevant persons, as defined in section 25(8), in respect of relevant conditions or requirements. A relevant requirement is a requirement imposed on a person under a provision which is specified in Schedule 6A as a relevant requirement in relation to that person.

4.5 The unbundling and certification requirements in Articles 9 and 10 of the Electricity Directive and the Gas Directive are transposed by sections 8C to 8Q of the Gas Act 1986 and sections 10A to 10O of the Electricity Act 1989. Sections 8H and 10F set out five tests which must be passed, or treated as passed, for a person to be certified as unbundled. Those sections were amended by the Electricity and Gas (Ownership Unbundling) Regulations 2014 ("the 2014 Regulations") which inserted new subsections (9A) and (9B) in each section. Where one or more of the five tests is not passed, subsection (9A) enables Ofgem to treat the tests as passed, provided Ofgem is satisfied that the person does not have a relationship with a relevant producer or supplier which might lead the person to discriminate in its favour.

5. Extent and Territorial Application

5.1 This extent of this instrument is England and Wales and Scotland.

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

6. European Convention on Human Rights

6.1 Jesse Norman, Minister for Energy and Industry has made the following statement regarding Human Rights:

"In my view the provisions of the Electricity and Gas (Internal Markets) Regulations 2017 are compatible with the Convention rights."

- Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators ("the Agency Regulation")
- Regulation (EC) No 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchange of electricity and repealing Regulation (EC) No 1228/2003 ("the Electricity Regulation"); and
- Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005 ("the Gas Regulation").

7. Policy background

What is being done and why

7.1 The Third Energy Package aims to integrate European energy markets, allowing liquidity to be shared across markets, increasing security of supply, and providing clearer investment signals for the placement of generation and interconnection assets.

7.2 The CACM Regulation establishes harmonised trading arrangements across the electrical interconnectors between national transmission networks, known as market coupling. It confers functions related to market coupling on entities which are designated by a national regulatory authority as nominated electricity market operators (NEMOs). NEMOs are power exchanges which are able to act as intermediaries between the participants in European markets. Ofgem is required to monitor and enforce the compliance of NEMOs with relevant requirements of the CACM Regulations.

7.3 This instrument amends the definition of 'regulated person' in the Electricity Act 1989 to include NEMOs and adds the requirements imposed on NEMOs by the CACM Regulation as a new category of relevant requirements. The established suite of monitoring and enforcement powers in sections 25 to 28 of the Electricity Act 1989 will therefore apply to NEMOs in relation to the specified requirements.

7.4 The Electricity Directive and Gas Directive require separation of the ownership and operation of transmission networks (transmission system operators – TSOs) from electricity generation, gas production and energy supply undertakings (described in Great Britain's transposing legislation as 'relevant producers or suppliers'). This is known as 'unbundling'. The aim of unbundling is to ensure that TSOs are independent of any relationship with relevant producers or suppliers, avoiding the potential for discrimination among network users and uncompetitive behaviour. National regulators have to certify that TSOs in their territories comply with the unbundling requirements. This is done in Great Britain by Ofgem. Unbundling certification must be endorsed by the Commission.

7.5 Due to the UK's particular geographical situation, and the lack of interface between GB transmission networks and those of non-EEA states, the Government considers that there is no real prospect of a GB TSO discriminating in its operation of GB transmission assets because of its ownership or control of other assets outside the EEA. In implementing the unbundling provisions, the Government therefore considered it unnecessary to require Ofgem to make an assessment of non-EEA state interests when making certification decisions, and the definition of 'relevant producer or supplier' was limited to those within the EEA on that basis.

7.6 The European Commission, while not calling into question any of the certification decisions that have been made by Ofgem, has questioned whether the inclusion of the EEA state limitation in the definition of "relevant producer or supplier" properly transposes the unbundling provisions in the Electricity Directive and Gas Directive. Having regard to the amendments that were made to the certification provisions by the 2014 Regulations, the Government considers that amending the definition to remove the EEA state limitation should not make any practical difference to the outcome of certification applications or reviews, and has decided to make this amendment.

7.7 This instrument includes transitional provisions which ensure that the amendments do not apply to existing applications for, or reviews of, certification, and that the making

of the amendments does not trigger a requirement for Ofgem to review existing certifications.

Consolidation

7.8 These Regulations only amend secondary legislation in one limited respect, by amending the review provision in the 2011 Regulations. The Department does not plan to consolidate those Regulations.

8. Consultation outcome

8.1 The Government conducted an eight week targeted consultation on 15th January 2016 on proposals to provide Ofgem with appropriate powers to enforce compliance of NEMOs with the requirements of the CACM Regulation. Eight responses were received, all of which were supportive of the proposed approach to regulation. A decision letter, including a summary of the responses is published on the electricity industry Joint European Standing Group website[2]

8.2 The Government has informed relevant stakeholders of its intention to amend the definition of 'relevant producer and supplier' and allowed a period of two weeks for comments. None of those stakeholders have objected to the change, although some have asked Ofgem for guidance about any changes to the information it requires on an application for, or review of, certification, in consequence of the amendment. Ofgem intend to update their guidance in due course.

9. Guidance

9.1 In relation to the regulation of NEMOs, Ofgem publishes general guidance on its approach to regulation and enforcement[3]. Ofgem intend to update their guidance on unbundling certification.

10. Impact

10.1 The impact on business, charities or voluntary bodies of the CACM enforcement provisions is largely on NEMOs, and has been assessed to be negligible. The impact of the amendment to the unbundling provisions is expected to consist of some possible additional administrative requirements for applicants for certification and certified persons, in providing information to Ofgem about relevant producers or suppliers in non-EEA states. The extent of any additional information requirements is for Ofgem to determine but is not expected to be significant.

10.2 The impact on the public sector is exclusively on Ofgem, and is not expected to be significant.

10.3 An impact assessment for the implementation of the CACM regulatory requirements is submitted with this memorandum and is published alongside the Explanatory Memorandum on the legislation.gov.uk website. No impact assessment has been prepared for the other provisions of this instrument.

[2] https://gallery.mailchimp.com/d919930dfbffc8e4d3684958d/files/CACM_NEMO_regulation_response_final.01.pdf

[3] www.ofgem.gov.uk/publications-and-updates/enforcement-guidelines

11. Regulating small business

11.1 The legislation applies to activities that could potentially be undertaken by small businesses. No specific measures have been taken to minimise the impact on small businesses.

12. Monitoring & review

12.1 Regulation 51 of the 2011 Regulations requires the Secretary of State to review those Regulations every five years. Since this instrument amends provisions of the Gas Act 1986 and Electricity Act 1989 which were inserted by the 2011 Regulations and are already subject to review under regulation 51, it is not considered appropriate to include a separate review provision in these Regulations. Instead, regulation 51 is amended to provide for future reviews under that regulation to include a review of these Regulations.

13. Contact

13.1 Joe Parsons at the Department for Business, Energy and Industrial Strategy Telephone: 030 0068 5337 or email: Joseph.Parsons@beis.gov.uk can answer any queries regarding the instrument.