Volume 1, Number 2 March–April 2024

THE GLOBAL REGULATORY DEVELOPMENTS JOURNAL

Editor's Note: Our Breadth of Coverage
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Reform of the EU's Electricity Market: Member States Reach an Agreement on Contracts for Difference
François-Charles Laprévote and Camilla Cozzani

It's Not Easy Being Green: The European Commission's New Guidance on Sustainability Agreements
Karel Bourgeois, Karl Stas, and Benjamin Geisel

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Volume 1, No. 2 March–April 2024

79 **Editor's Note: Our Breadth of Coverage**
Victoria Prussen Spears

83 **European Parliament Committees Adopt Their Position on the Proposed EU Forced Labour Regulation**
Christian Duvernoy, Brent J. Gurney, Hans-Georg Kamann, Jeffrey I. Kessler, Frédéric Louis, Stefan Ohlhoff, David J. Ross, Geoffroy Barthet, Georgia Tzifa, and Mariia Shulha

99 **Trends, Reform and Advantages in English Arbitration for Commercial Dispute Resolution**
John Laird, Edward Norman, and Roma Patel

109 **Introducing the Economic Crime and Corporate Transparency Act**
James Norris-Jones, Frances Carpenter, and Tim Vogel

115 **Reform of the EU's Electricity Market: Member States Reach an Agreement on Contracts for Difference**
François-Charles Laprévote and Camilla Cozzani

119 **It's Not Easy Being Green: The European Commission's New Guidance on Sustainability Agreements**
Karel Bourgeois, Karl Stas, and Benjamin Geisel

129 **UK Government Confirms Final Proposals for Cryptoasset Regulation**
Jessica Lee and Menelaos Karampetsos

139 **Financial Conduct Authority Begins New Era of Cryptocurrency Regulatory Enforcement with Salvo of Over 100 Noncompliance Warnings**
Tim Davison, Preston J. Byrne, and Jessica Lee

THE GLOBAL REGULATORY DEVELOPMENTS JOURNAL (ISSN 2995-7486) at $495.00 annually is published six times per year by Full Court Press, a Fastcase, Inc., imprint.

For customer support, please contact Fastcase, Inc., 729 15th Street, NW, Suite 500, Washington, D.C. 20005, 202.999.4777 (phone), or email customer service at support@fastcase.com.

Publishing Staff
Publisher: Morgan Morrissette Wright
Production Editor: Sharon D. Ray
Cover Art Design: Morgan Morrissette Wright and Sharon D. Ray

The photo on this journal's cover is by Gaël Gaborel—A Picture of the Earth on a Wall—on Unsplash

Cite this publication as:

The Global Regulatory Developments Journal (Fastcase)

Editorial Office

729 15th Street, NW, Suite 500, Washington, D.C. 20005
https://www.fastcase.com/

POSTMASTER: Send address changes to THE GLOBAL REGULATORY DEVELOPMENTS JOURNAL, 729 15th Street, NW, Suite 500, Washington, D.C. 20005.

Articles and Submissions

Direct editorial inquiries and send material for publication to:

Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway, #18R, Floral Park, NY 11005, smeyerowitz@meyerowitzcommunications.com, 631.291.5541.

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ISSN 2995-7486

Reform of the EU's Electricity Market: Member States Reach an Agreement on Contracts for Difference

François-Charles Laprévote and Camilla Cozzani*

In this article, the authors discuss the agreement reached by Member States within the Council of the European Union on the European Commission's proposal to reform the regulatory framework applicable to the EU's electricity market.

In March 2023, the European Commission (EC) presented a proposal to reform the regulatory framework applicable to the EU electricity market.

After various failed attempts, Member States now have found an agreement on the proposal (the General Approach) within the Council of the European Union.[1]

One of the most contentious issues between Member States concerned the use of two-way Contracts for Difference (CfD) for investments in existing facilities producing nuclear energy. Two-way CfDs are contracts signed between a public entity and a power-generating facility operator that provide at the same time a minimum remuneration protection for the operator, when the market price is below the strike price, and a limit to excess remuneration, when the market price is above the strike price (i.e., the operator paying back the difference between the two prices).

The EU electricity market design proposal promoted the use of two-way CfDs for investments in renewable and low-carbon energy facilities; that is, for the generation of electricity from wind, solar, geothermal, hydropower without reservoir, and nuclear energy.[2] Article 1(9) of the EC's proposal, which explicitly mentions investments aimed at repowering or extending existing power-generating facilities or at prolonging their lifetime, allowed Member States to use CfDs to subsidize existing power-generating nuclear facilities.

The Global Regulatory Developments Journal / March–April 2024, Vol. 1, No. 2, pp. 115–118.

ISSN 2995-7486.

France strongly supported this aspect of the proposed reform, which would have allowed the use of CfDs to support investments aimed at extending the lifetime of 56 of its nuclear reactors.

In contrast, Germany and other Member States have tried to exclude or limit the possibility of using CfDs for existing nuclear facilities, alleging that this could have distorted competition and reduced the incentives to invest in renewables. This is in line with the broader trend of divisions between EU Member States over the inclusion of nuclear energy and hydrogen derived from nuclear power in key legislative instruments of the European Green Deal.

The Council's General Approach provides that, as of three years after the entry into force of the new legislation, two-way CfDs will become the mandatory model of direct price support schemes for investments in new low-carbon, non–fossil fuel electricity facilities.[3] On the other hand, the Preamble to the General Approach clarifies that Member States will also be allowed to grant support schemes in the form of two-way CfDs for "new investments aimed at substantially repowering existing power generation facilities, or at substantially increasing their capacity or prolonging their lifetime."[4]

Design Principles

The compromise has been reached by specifying that all two-way CfDs will have to be compatible with five design principles. CfDs will have to be designed to:

1. Preserve incentives for the generating facility to operate and participate efficiently in the electricity markets, in particular to reflect market circumstances.
2. Prevent any distortive effect of the support scheme on the operation, dispatch and maintenance decisions of the generating facility or on bidding behavior in day-ahead, intraday, ancillary services, and balancing markets.
3. Guarantee the long-term economic viability of the power generating facility while avoiding overcompensation by an alignment of the level of the minimum remuneration protection and of the upward limit to excess remuneration with the cost of the new investment and the market revenues.

4. Avoid undue distortions to competition and trade in the internal market, notably by determining remuneration amounts through an open, clear, transparent, and non-discriminatory competitive bidding process. In situations where a competitive bidding process is not feasible, CfDs—and the applicable strike prices—should be structured in a way that prevents distribution of revenues to undertakings from creating undue distortions.
5. Avoid any other distortions to competition and trade in the internal market resulting from the distribution of revenues to undertakings.[5]

Conclusion

The EC will have to ensure the compatibility of CfDs with such design principles in its assessment of the schemes under Articles 107 and 108 of the Treaty on the Functioning of the European Union.

The Council has also reached an agreement regarding the use of the revenues generated by Member States through two-way CfDs. According to the General Approach, such revenues will be distributed to final customers, and Member States may also use them "to finance the costs of the direct price support schemes or investments to reduce electricity costs for final customers."[6]

The Council will now start negotiations with the European Parliament to define the final version of the proposed legislation.

Notes

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1. *See* Council of the European Union, Press Release, Reform of Electricity Market Design: Council Reaches Agreement (Oct. 17, 2023), https://www.consilium.europa.eu/en/press/press-releases/2023/10/17/reform-of-electricity-market-design-council-reaches-agreement/. The text of the General Approach is available at https://data.consilium.europa.eu/doc/document/ST-14339-2023-INIT/en/pdf.

2. Proposal for a Regulation of the European Parliament and the Council of March 14, 2023, 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 (COM (2023)148 final). Article 1(9).

3. *See* General Approach, *Ibid.*, Recital 30 and Article 1(9).
4. *Ibid.*, Recital 30.
5. *Ibid.*, Article 1(9), p. 61 for the future Article 19(b) of the Proposal.
6. *Ibid.*