

## Energy Sector Alert Series: Brexit and Energy—Leaving the EU While Staying Connected

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*In this eight-week alert series, we are providing a broad look at current and emerging issues facing the energy sector. Lawyers from across the firm are discussing issues ranging from cybersecurity, antitrust and intellectual property to the impact of both Brexit and the upcoming presidential election on the energy industry. [Read our recent publications](#), including articles from a previous alert series published earlier this year.*

It is still not clear what position the UK will take in negotiations on leaving the EU and what the remaining EU 27 countries (the EU 27) will accept.

The UK Prime Minister, Theresa May, recently confirmed that the UK plans to control immigration, reestablish sovereignty over its laws and not be bound by European Court rulings, suggesting a “hard” Brexit, in which the UK would seek to *trade with* the EU, rather than a more integrated “soft” Brexit, in which, for example, the UK still might be in the European Economic Area (EEA), like Norway. She also announced that the UK will apply to leave the EU by March 2017, triggering a two-year period for negotiation of the withdrawal to March 2019, unless that period is extended. Since then the UK Parliament has requested debate on both issues. There is also a UK court challenge to whether Mrs. May can apply to leave the EU without parliamentary approval. So we will have to see if Mrs. May’s plans hold.

*However, as regards energy, one thing is clear: there are strong arguments for continuing trade and coordination between the UK and the remaining EU 27 countries after Brexit.*

These are the main points as we see them now:

**1. Full access to the EU energy market for UK-based companies appears unlikely after Brexit.** If Brexit occurs, the main issue for energy is whether UK-based companies will continue to have full access to the “*Internal (EU/EEA) Energy market*” (the EU IEM) and *vice versa*, whether companies based in the EU 27 will have full access to the UK market.<sup>1</sup>

2. At first sight, this appears unlikely. It is hard to see how the UK and the EU 27 can agree given the

vote in the UK Brexit referendum, which was heavily influenced by demands to return sovereign control over legislation to the UK and not allowing free movement of workers. Equally, the EU position so far is that full access to EU markets will not be granted “à la carte,” i.e., the UK cannot just obtain full access to the EU without allowing what the EU sees as related fundamental rights, such as free movement of workers.

**3. However, there are strong arguments for continued cooperation between the UK and the EU in energy.** For example:<sup>2</sup>

- There is an existing network of interconnectors for electricity and gas between the UK and its EEA neighbors, with imports of electricity to the UK, which may be expected to continue after Brexit. That network is also being significantly expanded.
- There is also specific coordination between the Republic of Ireland (Eire) and Northern Ireland (which is part of the UK) in the all-island “Single (Irish) Electricity Market.” Similarly, there are significant links between the Irish and UK gas markets.
- Otherwise, as the UK energy regulator Ofgem states in its 2016 Report to the European Commission, “*European issues are embedded right across Ofgem’s organisation with policy developed at the domestic and European level.*”<sup>3</sup>

**4. What is unclear is on what conditions such cooperation will continue.** One would expect continuing trade without customs duties.<sup>4</sup> However, if the UK leaves the EU, the issue will be to what extent the UK can participate in the EU IEM from outside, *coordinating with it, rather than being in it and, if so, on what basis?* These appear to be the main issues:

1. State aid
2. Continued compliance or alignment with EU law (now and in the future)
3. Participation in EU (or EU-centered) institutions, like the European energy coordination committees for electricity and gas (ENTSO-E and ENTSOG) and cooperation with the Agency for the Coordination of Energy Regulators (ACER)
4. Changes to enforcement of the REMIT (the EU rules on market manipulation and insider trading on wholesale energy supply)
5. Energy trading
6. Impact on investments and public funding
7. Climate change (including emissions trading)

**5. State aid.** If the UK is not in the IEM, a key issue will be distortion of competition through state aid. For example, the proposed nuclear power station in the UK (Hinkley Point C) was subject to European Commission (EC) review, which led to some conditions being required by the EC.<sup>5</sup>

6. If a similar energy project arose, say for a wind farm or another renewable energy project after Brexit, what would happen? In principle, the UK would decide on any aid for the project, not the EC. Unless something else is agreed on, the UK would *not be bound by the EC Guidelines on State Aid for Energy and the Environment*.<sup>6</sup> In principle, this would give the UK more freedom to design its state aid schemes. However, some subsidies might be open to challenge in proceedings before the World Trade Organization (WTO). This would raise a new complexity, because the WTO rules

and procedures are not the same as the current EU ones. It will be interesting to see, therefore, whether the UK and the EU might consider a coordination mechanism in a trade agreement, so that specific issues could be resolved.

**7. Continued compliance or alignment with EU energy laws.** In Mrs. May's recent speech to the English Conservative Party conference, she spoke of keeping most existing EU laws, at least initially, but basing them on English, rather than EU, law. *So it appears likely that on Brexit most of the current energy rules will be retained. However, there will still have to be adaptations to various current requirements to coordinate with the EC and ACER.* After Brexit, if continued close cooperation or alignment is sought, there would also be the question of how the UK would update its UK law, so that the UK and EU could stay aligned.

8. Whether the UK then continues to keep all EU-based energy law is an open question. One would expect the UK to favor keeping most of it. The UK might also *have* to do so, if that is necessary to “stay connected” to the IEM. However, there may be areas where the UK would want to pursue a different line. The question will be which areas and whether the UK and EU can agree on that.

9. Specific solutions may also be required for the interconnectors themselves, which are “coupled” (i.e., link UK and Continental markets), shared markets such as the Single Electricity Market in Ireland, and other shared European projects which are linked to the EU, like the North Sea Countries Offshore Grid Initiative.<sup>7</sup>

**10. Participation in EU institutions?** A related issue is the UK's participation in committees like ENTSO-E and ENTSG for European transmission operators and the European Energy Agency, ACER. Non-EU countries are present in the ENTSGs, but some only as associated partners or observers. ACER is an EU institution. What happens will likely depend on the overall future energy relationship between the UK and the EU, but again one can see clear arguments for continued cooperation between the UK and the EU in the activities of these organizations.

**11. Changes to REMIT enforcement.** Another area which is likely to be part of UK/EU 27 discussions on cooperation is REMIT, the EU Regulation for Market Integrity and Transparency, which entered into force on December 28, 2011.<sup>8</sup>

12. The substantive obligations in the REMIT will not apply to companies after Brexit *as regards their UK activities*. However, companies may find that similar obligations are continued *as regards the UK* through national legislation modeled on the REMIT, but based on UK law, with changes as appropriate, such as data submission to Ofgem, which might then review it.

13. In addition, after Brexit, in principle UK companies trading in wholesale electricity and gas markets *in the remaining EEA* would still be subject to REMIT obligations, including its registration and reporting requirements (like any non-EU company). They would need to register with an EU national regulatory authority in one of the remaining EU 27 countries, to which they will also need to report the relevant transactions.

14. As a result, Brexit should change the current situation where large amounts of *UK market data* are sent by market participants to ACER (as the European data warehouse and first reviewer of the

system). Similarly, there should not be the current scheme of coordinated supervision with ACER as now for such markets.

15. Having said that, there may still be strong arguments for continued cooperation between the UK and EU, in particular, if market abuse effects may be cross-border. Practically, therefore, it may be that the UK might choose to apply the same or very similar rules and seek close cooperation with ACER. There is, for example, already a Memorandum of Understanding/Cooperation Agreement between ACER and the US FERC.<sup>9</sup> The question may be whether something similar is suitable for the UK, or whether it should be more specific, given that UK markets are so related to other European markets.

16. **Energy trading.** If the UK is not in the EU IEM, another issue is how will that affect trading? Various questions are raised. For example, what will happen to trading markets which link the UK and the EU 27, such as the UK's National Balancing Point for gas, which is currently linked to the Zeebrugge hub and Dutch TTF in the remaining EU 27? Will Brexit affect that and result in different patterns and liquidities?

17. Otherwise, in practice, will trading be subject to EU financial licensing arrangements (e.g., for MiFID<sup>10</sup> and EMIR<sup>11</sup>), with the UK also maintaining “equivalent” rules for the UK, albeit with adaptations and new types of cooperation similar to those noted for the REMIT? If so, will there be a need for *both UK and EEA trading compliance requirements*?

18. As in other financial services areas, a key issue is also whether all this will be synchronized to the date of Brexit, or will there be a transitional agreement to cover any gap until new rules are brought in?

19. **Impact on investment.** A particular concern now is the uncertainty created by Brexit and the risk that this may slow down future investments and/or increase their financing costs.<sup>12</sup> Currently, the UK benefits from low Continental wholesale energy prices and, as noted above, it has been planning significant investment in new interconnectors and new electricity-generating sources to become an electricity exporter in the long term.

20. **Access to public funding is uncertain and a potential concern.** After Brexit, EU funding for UK energy projects may be expected to stop, although the European Investment Bank has lent money to projects outside the EU in some cases. Practically, therefore, after Brexit, equivalent projects should be looking for UK funding, unless it could be argued there was also a gain to the EU. A similar issue may apply to funding of EU-supported projects agreed on before Brexit, to be implemented afterwards, if the UK is not in the EU IEM or an equivalent cooperation structure (unless the project is discontinued). Clearly, much will depend on when the changes in the terms and conditions for the funding will take effect, the nature of a project, and whether it furthers EU policy.

21. **Climate change.** This is an area where the UK has been in the forefront of change. Practically, on Brexit it appears that the EU's target in the COP 21 Paris Agreement may need “recalibration,” likely with the UK having its own target and the EU 27 another. That may mean further EU 27 action to achieve its targets, since the UK is ahead on carbon reductions.<sup>13</sup>

22. Otherwise, the UK has its own Climate Change Act and recently has adopted its Fifth Carbon Budget covering the period 2028-2032. So at first sight it appears that little may change. That said, many were concerned recently by the way Mrs. May dismantled the Department of Energy and Climate Change and included climate change responsibilities in a wider industry department, the “Department for Business, Energy and Industrial Strategy,” fearing a downgrading of environmental priorities.<sup>14</sup>

23. What is clear is that the UK's climate change approach will no longer be anchored in EU directives like the EU Renewables Directive,<sup>15</sup> with some arguing that, as a result, the UK might take a different view on how it will meet its targets. However, the UK would still be bound by its national and international decarbonization obligations. As in other business areas, it also remains to be seen whether the UK would seek to stay aligned with *future* EU developments, such as the coming EU Renewables Directive II.

24. **Emissions trading.** Another issue is what will happen to UK emissions trading. As matters stand, the EU Emissions Trading Scheme (ETS)<sup>16</sup> is part of EU policy, covering the current 28 Member States, plus Norway, Iceland and Liechtenstein. The level of the UK's emissions reduction is 16% from 2005 to 2020, while the EU average is 10%. So, if the UK is out of the EU after 2020, the remaining EU Member States will have to increase their contributions if the 2030 emissions reduction target is to be met. If the UK is out of the EU ETS, there will also be a loss of liquidity.

25. The UK will have to consider, therefore, whether it should continue such a scheme and, if so, whether it should be only UK-specific, or whether it would be better to seek to keep the UK in the EU ETS, provided the EU agrees. This may be another case for specific cooperation.

## Conclusion

What may be agreed on for energy in Brexit may well be affected by broader negotiations. Nevertheless, we hope that it is clear from the above overview of issues that there are many forceful reasons for the UK and the EU to stay connected on energy, even when the UK leaves the EU.

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<sup>1</sup> See, for example, [Vivid Economics: Impact of Brexit on the UK energy sector – A report prepared for the National Grid](#), November 2015.

<sup>2</sup> See, Ofgem, [2016 National Report to the European Commission](#).

<sup>3</sup> See, Ofgem, [Ofgem and Europe](#).

<sup>4</sup> See, House of Lords, [Revised transcript of evidence taken before The Select Committee on the European Union Energy and Environment Sub-Committee Inquiry on the Potential Implications of Brexit on Energy and Climate Change Policy](#) at page 7.

<sup>5</sup> See, Oxera, [Brexit: Implications for the energy market](#), July 2016, at pp. 2 and 3.

<sup>6</sup> See, [Communication from the Commission: Guidelines on State aid for environmental protection](#)

and energy 2014-2020, OJ C 200, 28.6.2014, pp. 1–55. The EC Guidelines do not cover nuclear energy.

<sup>7</sup> See, ENTSO-E, [The North Seas Countries' Offshore Grid Initiative \(NSCOGI\)](#).

<sup>8</sup> See, [REMIT - EU Legislation on Insider Trading and Market Manipulation in Wholesale EU Energy Markets Adopted](#).

<sup>9</sup> See, ACER, FERC, [Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information Related to the Monitoring of Wholesale Energy Markets](#).

<sup>10</sup> See, European Commission, [Updated rules for markets in financial instruments: MiFID 2](#).

<sup>11</sup> See, European Commission, [Derivatives/EMIR](#).

<sup>12</sup> See, Vivid Economics, [The impact of Brexit on the UK energy sector](#).

<sup>13</sup> See, FTI, [Brexit's Impact on the Energy Sector](#), July 2016.

<sup>14</sup> See, the FT Brexit Briefing, October 5, 2016.

<sup>15</sup> See, European Commission, [Renewable energy directive](#).

<sup>16</sup> See, European Commission, [The EU Emissions Trading System \(EU ETS\)](#).