

BREXIT SECTOR VIEWPOINT: ENERGY

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Legal Briefings

The impact of Brexit on the energy sector depends on the wide range of possible outcomes from the post-Brexit negotiations, hinging on UK Government policy decisions and negotiation with the EU.

The UK's Brexit vote presents market and regulatory options which will be driven by a balance between achieving meaningful access to the UK and wider European energy markets and the desire to move away from EU legal and regulatory oversight in the UK.

Possible outcomes include:

- Bespoke bilateral agreement negotiated with the EU, including in relation to energy, potentially up to something close to continued membership of the IEM, albeit in some shadow form.
- 'Hardest' Brexit without reference to the EU in the event of no EU/UK deal being agreed.
- Continued membership of the Internal Energy Market (IEM) – similar to Norway's current arrangements, ie the UK implements the EU energy market regime, but loses voting rights and influence. However, our assumption is that this option is now off the table due to its incompatibility with the UK Government's wider 'hard Brexit' position to end the supremacy of EU over UK law (including being bound by the Court of Justice of the European Union)

A new relationship whereby the UK is substantively committed to the IEM is likely to mean continuing some level of indirect application of relevant EU Regulations and Directives and involvement in bodies of regulatory cooperation (eg ENTSO-E) cemented through the terms of a bilateral agreement with the EU (for example like the Treaty Establishing the Energy Community). A variety of significant issues will need to be addressed around access to EU energy markets and it will be a challenge to achieve in the short time frame before Brexit, although the issues could be resolved during the UK Government's proposed 'implementation phase' which would span the period from Brexit until the details of the long term deal had been bottomed out.

Despite its name, the UK government's "Great Repeal Bill", will seek to ensure that most EU law currently applicable in the UK remains UK law after Brexit, with change after that being a gradual process. This should reduce uncertainty for business. However, this cannot completely replicate the present situation as, for example, UK legislation cannot bind the remaining EU Member States to recognise UK conformity under that legislation.

THE NEED FOR CLARITY

Irrespective of the UK Government's approach to Brexit, the fundamental need for "the lights to stay on" - affordably and with reduced emissions - remains. Investment will still need to be incentivised to replace or enhance ageing infrastructure across electricity generation, grid upgrades and the UKCS.

- **Electricity:** The largest immediate risk may well be to investment, with Brexit-driven uncertainty resulting in increased cost and lack of clarity around significant funding sources (eg European Investment Bank (EIB)). Longer term, exclusion of the UK from initiatives such as market coupling and cross-border balancing add inherent uncertainty to any solution outside the IEM.
- **Upstream oil and gas:** The UK currently enjoys a fairly light-touch regulatory relationship with the EU in respect of the UKCS which may well continue largely unaffected post-Brexit. That said, any 'double compliance' (EU and UK) requirements would push up costs.
- **Gas sector:** The UK has one of the most mature and liquid gas markets in Europe, and constitutes a significant liquefied natural gas (LNG) hub. Physical integration between UK and EU markets is well developed, and seems unlikely to suffer absent a drastic change in UK energy policy - although other European gas trading hubs (eg TTF in Netherlands) may benefit, and UK supply security may be impacted by exclusion from 'solidarity principles'.
- **Interconnectors:** As a net importer of electricity, recent UK policy has promoted interconnection. A scenario in which the UK is no longer part of the IEM would require a new regime to deal with the UK/EU law interface.

Energy market participants will also need to bear in mind changes to the application of other EU law arising from Brexit – State aid, EU merger control and environmental/HSE being areas of key importance to so many transactions in the sector as well as the potential impacts of other changes such as the ability of the UK construction industry to support the energy sector's needs if immigration controls (on EU or other citizens) restrict businesses' ability to secure the necessary human resource.

PREPARE FOR THE UNKNOWN

Owners of energy assets and prospective investors can assess the potential consequence of Brexit on the energy sector, by asking for example:

- How will investment processes and supply chains (eg turbines) be affected?
- How should I structure my investment funds to overcome variables in currency rates?
- How will Brexit impact the effect of existing long term contracts and the issues to be addressed
- in new ones (eg risk allocation, territorial scope)?
- What are the tax implications of Britain leaving the EU?
- What are the key characteristics of my projects and where are they in their life cycle?
- How will Brexit impact my sources of funding for future projects (eg EIB)?

By assessing and quantifying these and asset-specific challenges, energy operators and investors can define and prioritise mitigation strategies. They may wish to lobby government and industry bodies with arguments to shape future policy and should monitor developments as the political landscape continues to shift and be prepared to modify their investment models and policies in response to evolving certainties.

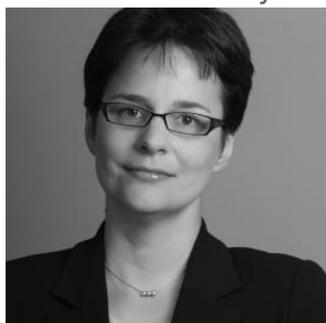
THE FUTURE REPRESENTS...

An interesting dilemma for the UK Government, that both stands apart from, and is fundamentally intertwined with, its view of the post-Brexit landscape. Visibility on energy policy direction should be forthcoming over the coming months – hopefully including a healthy dose of pragmatism. The inherent complexity and existing interconnectivity of the sector suggests an interesting few years lie ahead.

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KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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