

Brexit

Key issues for the energy market and energy policy

1 February 2020

Background

On 31 January 2020 (at midnight CET, 11pm UK time, **exit day**), the UK ceased to be a member state of the EU, and the European Communities Act 1972 – the statutory basis for giving effect to EU law in the UK – was repealed. This is a profound change, but its immediate impact on UK law and regulation is limited in two important ways.

- Under the UK-EU agreement on the UK's withdrawal from the EU (the **Withdrawal Agreement**), virtually the whole of EU law remains "applicable to and in the UK" from exit day until at least 31 December 2020. The Withdrawal Agreement calls this the "transition period". Here, we call it the "**implementation period**", following terminology used in the European Union (Withdrawal Agreement) Act 2020 (the **Act 2020**). The 2020 Act implements the Withdrawal Agreement into UK domestic law.
- Under the European Union (Withdrawal) Act 2018 (the **2018 Act**), all the EU law that applies in and to the UK immediately before the end of the implementation period (a substantial proportion of all UK regulation) will continue in force as UK domestic law (with some modifications) unless and until it is replaced or amended by new UK legislation. Under powers contained in the 2018 Act, the UK government has already issued a large number of statutory instruments to amend that "on-shored" body of law, and make it fit for purpose as domestic UK legislation in a post-Brexit environment. These statutory instruments are due to come into force at the end of the implementation period.

The Withdrawal Agreement provides for the implementation period to end on 31 December 2020, unless the UK and EU agree, by 1 July 2020, that it should be extended for a further one or two years. The UK government has indicated that it does not wish to seek such an extension, and the 2020 Act states that the implementation period ends on 31 December 2020.

Deal or no deal?

The implementation period gives the UK and EU a time-limited opportunity to negotiate, against a stable background, the terms of their future relations in respect of trade and the other areas that are currently regulated by EU law. At the end of the implementation period, any given area of UK-EU relations either will or will not be regulated by a new UK-EU agreement (a **future relationship agreement**)

When the Withdrawal Agreement was being negotiated, "deal or no deal?" was used to refer to the fact that at the point when the UK ceased to be an EU member state, there would either be no agreement on the terms of the UK's withdrawal (and so effectively a legal vacuum in UK-EU relations), or the UK would enter a transition period in which, for the duration of that period, the status quo would be largely preserved. At the end of the implementation period, it is possible that the UK and EU will have reached agreement on all the aspects of their future relations that will be governed by future relationship agreements, or none of them, but it is also quite likely that they will have reached agreement on some, but not on others, so that the question "deal or no deal?" can only be answered for each individual topic or sector. Indeed, in some areas it may take time before it is clear whether the UK and EU will seek to

reach a bilateral agreement at all, rather than, for example, simply relying on the provisions of existing multilateral instruments like the WTO rules.

It will therefore necessarily take time for clarity on any possible "deal" outcomes to emerge. The shape of "no deal" outcomes is more predictable, but here too there is some uncertainty, since an agreement reached in one area may have effects that spill over into areas that are not explicitly addressed by it.

Brexit and the energy sector

Over most of the period between the 23 June 2016 referendum (when the UK voted to leave the EU) and exit day, energy policy and market issues were not generally at the forefront of public debate and commentary on Brexit.

Many EU and UK energy policies are closely aligned (see graphic at the end of this note). In many areas, the UK has played a key role in shaping EU energy policy. Although EU membership may have constrained UK policy choices from time to time, it has often been assumed that the UK's departure from the EU will not result in a major shift in UK energy policy or regulation. It remains to be seen whether that assumption is accurate.

On the other hand, businesses that interact with the energy sector only as consumers have generally – and probably correctly – assumed that even a "no deal" outcome at the end of the implementation period will not affect the UK's energy supplies anything like as disruptively as it has been suggested trade in some other sectors could be affected.

No deal

For any business, including those in the energy sector, it is prudent to consider the possible impacts of "no deal" at the end of the implementation period. If you are prepared for that, you are prepared for what is likely to be the most disruptive outcome. The detailed risk assessment for each business will be different, but one possible way of identifying the most pressing issues and trying to manage them might be to use the generic risk assessment matrix at the end of this note.

In some respects, the energy sector is like any other from a no-deal point of view. For example, those engaged in the construction of offshore wind farms could face significant difficulties in maintaining timely delivery of key supplies in a world of tariffs and border checks between, say, the UK and Germany. A further problem could be securing the presence of key non-UK national workers as and when they are required when EU free movement rules no longer apply. These are complex projects where failure to hit predetermined milestones may well give rise to a range of contractual claims (or attempts to invoke contractual flexibilities such as force majeure clauses) across the overall project supply chain, as well as concerns about compliance with the requirements of public subsidy arrangements.

However, the most distinctive consequences of Brexit for the energy sector all revolve around its impact on sector-specific regulation, and in particular the measures that comprise the EU's internal energy market (IEM), enabling more or less frictionless participation by UK and EU market players in each other's electricity and downstream gas markets. The no deal notices published by the [UK government](#) and the [European Commission](#) before exit day highlighted a number of issues that would affect cross-border trade in electricity in a no deal scenario, and these remain relevant in the context of no deal at the end of the implementation period. The EU did not include any proposals to facilitate the continuing function of the IEM in respect of the UK in the list of "contingency planning" measures that it would have taken to avoid disruption if there was no deal on exit day (see the Commission's [press release of 19 December 2018](#)).

The UK exports and imports significant amounts of electricity and gas over interconnectors with its EU/EEA neighbours. This trade is facilitated by IEM rules and helps to reduce UK wholesale energy costs. There is compelling commercial and policy logic on both sides for the continued operation of those interconnections in a no deal scenario, but the current basis on which they operate will lack legal underpinning once the implementation period comes to an end, and the UK not only is no longer an EU member state, but is no longer effectively treated as if it were still a member state.

In particular, once the implementation period expires, the UK would no longer participate in the EU's electricity "market coupling" arrangements and the "implicit auctions" that govern electricity interconnector flows. Alternative arrangements would need to be implemented to plug the legal gaps that would be left at this point in order to allow cross-border trade to continue. Any such new arrangements would be likely to be less efficient, leading to an increase in trading costs, even though it is unlikely that any tariffs would be payable on the exports or imports of gas and electricity themselves. For the majority of non-energy sector businesses in the UK outside Northern Ireland (NI), which are simply consumers of energy, the most significant likely impact of Brexit in the energy sector is this possible increase in energy costs.

However, it is important to distinguish here between NI and the rest of the UK (Great Britain, (GB)). The electricity and downstream gas markets of GB and NI operate and are regulated separately from each other, and the NI electricity market participates in a Single Electricity Market (SEM) for the island of Ireland. Since October 2018, the operation of the SEM has been based, explicitly, on IEM rules, and for this reason, the SEM is the subject of special provisions in the protocol to the Withdrawal Agreement that deals with Ireland and Northern Ireland (INIP).

There are a number of areas where INIP provides that certain elements of EU law must continue to apply to and in the UK in respect of NI, beyond the expiry of the implementation period. The "generation, transmission, distribution and supply of electricity, trading in wholesale electricity or cross-border exchanges of electricity" is one such area (along with other single market rules on goods, VAT rules and EU state aid rules). Accordingly, the relevant EU electricity market laws are listed in Annex 4 to INIP as continuing to apply. This includes the continuing jurisdiction of the European Commission and Court of Justice, and an obligation to implement amendments or replacements of those EU laws listed in Annex 4 that are adopted or enter into force after the expiry of the implementation period.

However, INIP provides a mechanism by which the application of these EU laws may not continue indefinitely, but depends for its continuation on the consent of the NI Legislative Assembly. If the Assembly votes by the requisite majority to continue with the package of regulatory alignment that includes the EU wholesale electricity market rules, then it shall continue in force; otherwise, it will lapse after two years. But the earliest time at which such consent can be expressed is four years after the end of the implementation period – i.e. at the end of 2024, which means that the EU laws that support the operation of the IEM / SEM will remain in force in NI until at least the end of 2026.

We now have a fair degree of visibility as to how the UK regulatory framework is to be adapted in a no deal scenario.

- As with EU law generally, the existing body of EU rules relevant to the energy sector will be carried over into UK law on Exit Day by the 2018 Act, with various modifications to that body of rules being set out in secondary legislation made under the 2018 Act.
- The UK government's **no deal notices** and relevant 2018 Act secondary legislation were prepared in the first instance to provide guidance for businesses and others preparing for the possibility of a "hard Brexit" on exit day, with no Withdrawal Agreement and no implementation period. However, the 2018 Act secondary legislation, in particular, was also drafted against the background of negotiations on the Withdrawal Agreement. Although they will need to be amended to take account of the INIP provisions on the SEM, this legislation offers some useful guidance into how the UK government sees a no deal scenario working in regulatory terms.
- The five Withdrawal Act regulations dealing with IEM issues, which cover some 140 pages of amendments to existing GB and NI legislation and to existing EU Directives and Regulations, were published in draft in December 2018 and made on 15 March 2019 after being approved by Parliament. They are:
 - The Electricity and Gas etc. (Amendment etc.) (EU Exit) Regulations 2019
 - The Electricity and Gas (Market Integrity and Transparency) (Amendment) (EU Exit) Regulations 2019
 - The Gas (Security of Supply and Network Codes) (Amendment) (EU Exit) Regulations 2019
 - The Electricity Network Codes and Guidelines (System Operation and Connection) (Amendment etc.) (EU Exit) Regulations 2019 (subsequently amended by the Electricity Network Codes and Guidelines (System Operation and Connection) (Amendment etc.) (EU Exit) (No 2) Regulations 2019 to reinstate the application of three network codes already implemented in GB but which otherwise would have fallen outside the category of "retained EU law")
 - The Electricity Network Codes and Guidelines (Markets and Trading) (Amendment) (EU Exit) Regulations 2019

Like all the "no deal" secondary legislation made under the 2018 Act, these regulations are expressed to come into force on exit day. The 2020 Act provides that they will instead come into force on "IP completion day", i.e. at the end of the implementation period. These Regulations are supplemented by the **Electricity and Gas (Powers to Make Subordinate Legislation) (Amendment) (EU Exit) Regulations 2018**, which maintain some flexibility for the future by effectively transferring to the Secretary of State (within GB) the European Commission's power to make "tertiary legislation" under the IEM framework.

- For the purposes of "onshoring" EU IEM and related law, some instruments (such as the Regulation on Capacity Allocation and Congestion Management in the electricity sector, which provides for market coupling) are revoked in their entirety; others are subjected to numerous, fairly mechanical, changes designed to reflect that the UK is no longer in the EU, and that EU institutions no longer have a role in the UK industry.
- For those seeking a short cut to the key policy objectives behind the new regulations, BEIS published a [helpful letter from the then Energy Minister Claire Perry](#), with an annex that summarises each of the principal sets of regulations on one page. The explanatory memorandum published alongside each set of regulations is another useful way to get a general sense of how they work.
- On 15 March 2019, Ofgem [published details of the revised Access Rules](#) for the BritNed, IFA and Nemo Link electricity interconnectors to be used in the event of no deal, which it has approved in decisions taken jointly with its regulatory counterparts in the Netherlands, France and Belgium, respectively. The revised Access Rules were then updated by decisions of 18 October 2019 (see [here](#), [here](#) and [here](#)). Amongst other things, the new rules, as is inevitable, include greater use of explicit auctions of capacity.
- Meanwhile, the development of the IEM continues at EU level. In particular, on 5 June 2019, the final pieces of the EU's Clean Energy Package, first proposed in 2016 and comprising significant reforms of the principal IEM legislation relating to electricity, were finally adopted. Most of the provisions in the new legislation do not fall to be implemented by member states until 2020 or later, but, under the Withdrawal Agreement, the UK will be required to implement all of them in respect of NI, and at least most of them in respect of GB.

It is of course not just the IEM EU legislation that is of particular relevance to the energy sector and requires to be adjusted as it is "onshored" in the event of a no deal Brexit. For example, at the point of Brexit, the UK will leave the EU Emissions Trading System (EU ETS), whose system of permits and emissions allowances regulates the greenhouse gas emissions of many power stations, as well as other energy-related installations such as oil refineries.

In a no deal Brexit, UK installations can no longer participate in the EU ETS, which is a "cap and trade" system in which allowances are freely tradable and administered through a central registry. Already, before exit day, in order to avoid potential problems with the UK issuing allowances in 2019, which could potentially undermine the integrity of the regime, the European Commission took action to suspend UK participation in the scheme.

And yet, partly because the framework used to implement the EU ETS also forms part of the UK's compliance with the Kyoto Protocol, the UK is not proposing simply to abandon that framework. The greenhouse gas permitting regime will remain, with modifications made by Withdrawal Act regulations, but the system of tradable allowances will be replaced by a straight tax on emissions, at least in the short term. The Finance Bill 2019 makes outline provision for a carbon emissions tax that would apply in place of the EU ETS obligations that currently apply to many energy sector businesses (and others). The details of this tax (to be levied for the first time in 2020 on 2019 emissions) remain to be worked out/implemented in regulations, but a price of £16/tCO₂e is the headline figure and it appears that provision will be made that is equivalent to the EU ETS system of "free allowances" for those operating in certain sectors (not including power generation). In the longer term, the government has proposed (in a [consultation published in May 2019](#)) to replace the carbon emissions tax with what would amount to a UK version of the EU ETS regime.

The approach taken in respect of the EU ETS is of course consistent with the UK's own climate change policies. However, it also reflects the fact that, if the UK wants, in the longer term, to be permitted once more to participate fully in the IEM, and not merely to be able to trade with EU counterparties on a less efficient basis, it is likely to have to commit to continue to follow many of the EU's rules – not only on energy market structures but also on key related policy areas such as state aid and environmental protection – to ensure a "level playing field".

Even before being compelled to do so by any agreement with the EU, but prompted in part by a requirement in the EU (Withdrawal) Act 2018, the UK government has published an [Environment Bill](#) designed in part to give continuing effect in UK domestic law to the key general principles (developed as much in case law as in legislation) of EU environmental law. It would also set up a new regulatory body that could exercise a monitoring and scrutiny role over government that is not dissimilar to that of the European Commission in the environmental field. The government has also made provision to replicate the EU state aid regime with a new UK state aid regime enforced by the Competition and Markets Authority. When the time comes, it will be interesting to see how this works.

Deal

What can the UK (or at any rate, GB) expect by way of a "deal" on energy with the EU after the implementation period expires? In some [slides published on 15 January 2020](#), the European Commission summarised the position as follows:

- "Not business as usual - UK will leave the EU's Single electricity market and its tools;
- New EU-UK mechanisms in some selected areas, taking into account FTA proposals to other third countries;
- New framework requires strong level playing field guarantees".

This approach matches the messages that the EU has been sending in the period after conclusion of the Withdrawal Agreement and the UK's 12 December 2019 general election, but before negotiations on a future relationship agreement begin. The UK is to take nothing for granted. Any approximation (and it can only be an approximation, given the need for new customs formalities etc.) to the close trading relations enjoyed up to the end of the implementation period depends on the UK not stepping back from EU norms in areas like competition and state aid, environmental protection and workers' rights.

It appears likely that the precedents for future UK-EU relations in the energy sector are not to be found in the pattern set by the UK's years of EU membership or the continued application of EU rules under the Withdrawal Agreement and INIP. More likely models are the agreements between the EU and the other members of the **Energy Community** (which comprises the EU, various Balkan states, Ukraine and Georgia) or the proposed **bilateral agreement between the EU and Switzerland**. Both of these show that for a country outside the EU or the EEA to participate fully in the IEM, it must enter into an agreement with the EU that would require, amongst other things, adherence to other EU energy legislation and state aid rules. In the case of Switzerland, such an agreement has been under discussion for a number of years. Either model would be possible for the UK to follow, but it remains to be seen whether a UK-EU agreement along these lines can be put in place before the end of the implementation period, given the wider political context.

Other considerations

We have focused in this note mostly on legislative and regulatory matters. However, for many energy sector businesses (and others), the most immediate impacts of exit day or the end of the implementation period may not turn entirely on legislative or regulatory change. Brexit will, for example, affect the interpretation of contracts, and a number of other practical everyday aspects of commercial life. It is important to review any clauses in contracts (existing or under negotiation) where rights or obligations could be triggered either by the legal changes of exit day or the end of the implementation period, or by events that take place as a result of those changes.

Provisions relating to "change in law", "material adverse change" and "force majeure" are obvious starting points; other parts of contracts likely to need review include provisions relating to interpretation, pricing and payment and dispute resolution. Other areas to focus on more generally include the **impact on employees and their families** (EU citizens working in the UK and UK citizens working in the EU) and, for those engaged in the export and import of goods between the UK and the EU, the need, sooner or later, to master new customs arrangements.

Contacts

Danielle Beggs

Partner

D +44 20 7246 7442

M +44 7771 842748

danielle.beggs@dentons.com



Charles Wood

Partner

D +44 20 7246 7663

M +44 7771 842834

charles.wood@dentons.com



Charles July

Partner

D +44 20 7246 7654

M +44 7703 230123

charles.july@dentons.com



Lucille De Silva

Partner

D +44 20 7320 3795

M +44 7789 922365

lucille.desilva@dentons.com



Christopher McGee-Osborne

Partner

D +44 20 7246 7599

M +44 7771 842846

christopher.mcgee-osborne@dentons.com



Adam Brown

Managing Practice Development Lawyer

D +44 20 7246 7014

M +44 7881 518384

adam.brown@dentons.com



Law stated as at 1 February 2020



Key EU and UK law and policies affecting the energy sector



Internal energy market

- Third package and Network Codes
- Clean Energy Package
- Independent regulation
- Market coupling
- REMIT (transparency)
- Cross-border Infrastructure Regulation

EU Emissions Trading Scheme

- State aid guidelines on energy and environment
- Decisions on individual competition and state aid cases (e.g. sector investigation of capacity markets)

- Renewables Directives
- 2030 Renewables policy



- Energy Using Product rules
- Energy Efficiency Directive (targets)
- Energy Union Measures

- Air pollution directives (LCPD, IPPC, IED, MCPD, NEC)
- EIA, Habitats, Birds, Water and Waste Framework, Environmental Liability Directives
- Offshore Safety Directives

Nuclear: positive policy etc. (EURATOM)

- Oil Stocking Directive
- Energy Union proposals on energy security

The underpinning of EU and UK law and policy in the energy sector is very similar – this is partly because the UK is implementing EU rules and partly because the UK has led the way in liberalising energy markets

 	
EU law/policy	UK domestic law/policy
Single, transparent market	Open, market-based system; constrained public funding; desire not to (over-)burden bill payers with subsidy costs; promoting consumer interests through competition
Competition ✓ State Aid ✗	
Mitigation of climate change/encouragement of renewables	Climate Change Act 2008 and carbon budgets; earlier measures promoting renewables
High levels of protection for natural environment and human health in other respects	Little that is not EU-based (exceptions include nuisance and aesthetic policy antipathy to some renewable technologies)
Energy security	Energy security
Energy efficiency	Energy efficiency
Nuclear: promotion and safety	Nuclear: promotion and safety
[No equivalent to MER UK at EU level] [Currently no firm policy/legislation on fracking at EU level]	Maximising economic value of recovery of petroleum from UK Continental Shelf (MER UK) Promotion of fracking (onshore)

Much of the EU regulation that is central to the functioning of the UK energy sector would be equally applicable if the UK were to leave the EU but remain within the Energy Community, although it remains to be seen whether this is an outcome that would be acceptable to any of the parties involved.

- Gas Act 1986 and Electricity Act 1989 licensing system
- Independent regulation
- Industry Codes
- Ofgem competition powers
- Interconnectors: cap and floor

- GHG Emissions Trading/Carbon Emissions Tax
- Climate Change Levy/Carbon Price Floor
- Emissions Performance Standard, "no new unabated coal"

- ROCs, FIT, RHI
- Degression, early RO closure, CfDs (Levy Control Framework)

- Capacity Market
- Positive planning policies WPS/WPPF
- Oil stocking, Refineries policy

- Implementation of air pollution and other environmental directives
- Environmental duties on licence holders/Ofgem

Heat policy? Energy Efficiency Directive implementation?

Nuclear: positive policy and site licensing etc.

- Petroleum Act 1998 and Energy Act 2016; MER UK strategy
- Other Oil and Gas Authority plans and strategies
- Positive planning policy

(GENERIC) OUTLINE BREXIT RISK ASSESSMENT MATRIX

Outline of risk and example	Likelihood of occurrence	(Certainty as to) timing of occurrence	Ability of business/others to mitigate	Potential severity of impact
Uncertainty about interpretation of existing contracts after the end of the transition / implementation period adversely impacts business. E.g. exposure to adverse action by counterparty under material adverse change/change in law clause.	High (almost certain to be some cases of this) – regardless of the extent of any post-Brexit deal(s) between the UK and EU.	More likely to occur after the end of the transition / implementation period than before. Some cases may emerge straight away, others may be latent for years.	High to mitigate going forward; lower to address cases that may have arisen as a result of contracts entered into between Referendum and now. Amendment may provide a solution, but requires agreement. Government unlikely to provide solution.	High (but not in all cases).
Uncertainty about future UK law/policy in areas no longer subject to EU control. E.g. UK courts, Minister, Parliament or regulators depart from EU precedents that they have previously followed.	Probably no more than medium in most cases, but will vary with sector and whether there is a deal/what its terms are.	Unlikely to occur before the transition / implementation period ends. Some cases may emerge straight away, others may be latent for years.	Limited ability for business to mitigate by legal means (as opposed to lobbying).	Could be high in some cases, but very difficult to generalise meaningfully.
Business <u>cannot</u> operate in EU markets/trade with EU counterparties. E.g. failure to agree on successor to current EU civil aviation regime for UK operators, leaving their planes grounded.	Low (even in the event of no deal), because cases of impossibility to continue operating are few and high profile, so solution is likely to be found in any event.	Only likely to occur if there is no deal or at the end of a transition period where negotiations have gone very badly.	Probably only HMG/EU can mitigate effectively in these cases, by reaching appropriate agreement.	High.
Business-critical extra costs/obstacles involved in operating in EU markets/trading with EU counterparties. E.g. critical increase in costs as a result of new customs arrangements; EU rules mean business must relocate, or terminate existing contracts with third party suppliers, to keep selling into EU.	Will vary strongly (high to low) between sectors and depending on whether there is a deal (and what sort of deal it is) or no deal. Requires separate analysis for each sector/outcome.	Unlikely to occur until the end of a transition period.	HMG/EU have postponed (through transition period) and can mitigate or even avoid altogether by agreeing a "good deal" for future EU/UK relationship. Serious contingency planning essential if businesses want to prepare for no deal: may be able to reduce but not avoid extra costs in a no deal scenario.	High (in some cases).
Lower ongoing/occasionally high costs/obstacles involved in operating in EU markets/trading with EU counterparties. E.g. lower cost increases as a result of new customs arrangements; higher costs to enforce "free trade" rights against EU member states/ counterparties – as even a "soft Brexit" is unlikely to provide for a UK business to take direct legal action against an EU counterparty or member	High in many sectors. Will vary with sector, but perhaps not so much with deal/no deal outcome?	Unlikely to occur until the end of a transition period.	HMG/EU have postponed (through transition period) and can mitigate or even avoid altogether by agreeing a "good deal" for future EU/UK relationship. Extent of contingency planning required/desirable will vary with sector: may be able to reduce but not avoid extra costs in a no deal scenario.	More likely to be medium or low in most cases (at least most of the time)?

state authorities.				
--------------------	--	--	--	--