

BREXIT ENERGY INSIGHTS

How businesses across the continent expect Brexit to impact the energy sector

Till Brexit do us part



About the survey

During July 2017 Shakespeare Martineau and Becker Büttner Held surveyed a panel of 70 energy sector leaders selected from across the UK and other EU member states, to understand how they expect Brexit to impact the sector.

This report is based on the responses gathered from those experts to questions on a range of key issues for the energy sector, including infrastructure, investment and security of supply.

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The UK's exit from the EU is the defining issue of our time for UK businesses. But the impact goes beyond the UK. Potentially, every business sector across the UK and Europe could be affected. So what does the future look like for the energy sector?

Following the UK's triggering of Article 50 in March 2017, marking the official start of the formal Brexit process, we have now had several rounds of negotiations.

Both sides have prepared position papers which set out increasingly divergent stances in their expectations of the negotiating process. Complexities are growing and objectives are changing.

Whilst there is an inescapable truth that the UK's energy sector is heavily integrated with that of the rest of Europe, the outcome of these negotiations could have a wide-ranging impact on the sector across the continent.

Against this complex backdrop, law firms Shakespeare Martineau and Becker Büttner Held have carried out a well-timed opinion survey of energy sector leaders drawn from across the UK and elsewhere in the EU to find out their thoughts on how Brexit will impact the sector.

Autumn 2017



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Brexit impact: Are we putting security of supply at risk?

Energy organisations are acutely aware that due to the interdependency of UK and EU energy markets, a hard Brexit could increase the risk of security of supply issues.

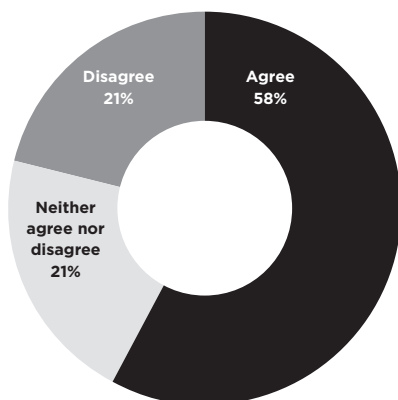
This seems to be especially urgent for the UK. The research shows that more than half of energy organisations (58%) believe there could be an increased risk to security of supply issues in the UK after Brexit. With 16 GW of new electricity interconnector capacity planned or under construction, chief among the concerns was the ability of planned new interconnectors to attract investment, putting at risk the UK's aspiration to significantly increase the capacity of its physical links to neighbouring countries.

Whilst most respondents said other parts of the EU would be unlikely to be affected in the same way, one in four thought the risk of security of supply issues would increase in these territories too.

According to data sourced from the UK Government's Department for Business, Energy and Industrial Strategy (BEIS), 5.8% of the UK's electricity and gas supplies in 2016 flowed into the country via interconnectors. An analysis produced by National Grid in 2015 has shown that increasing interconnector capacity could place a downward pressure on wholesale power prices; helping to offset capacity shortfalls whilst securing access to cheap energy supplies.

Depending on what the post-Brexit future looks like, it could become more difficult to access power from Continental Europe.

UK energy security of supply will be prejudiced by Brexit





“As identified by the majority of respondents, it is likely that the 4 GW of existing operational power interconnectors will continue to operate broadly as now, whereas the concerns come from the prospects for new interconnector projects post- Brexit. Outside of the internal energy market, these could lose EU capital grants and be reliant on open auctions to sell capacity. If a number of these planned projects don’t get off the ground, there would be a negative impact on UK security of supply, which is borne out by our survey results.”



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“The current EU framework for electricity and gas foresees several instruments to counter security of supply issues and emergency situations. Most recently, the EU has put in place a solidarity principle that ensures that Member States help out if such a situation arises. These rules will have to be taken into account by negotiators to make sure that the UK’s security of supply is not endangered. Hopefully, the technical fundamentals of a system that currently functions smoothly will not be touched.”

Brexit impact: Will low-carbon investment be affected?

Falls in the value of sterling since the EU referendum have served to enhance the UK's appeal as a place to invest. However, most energy organisations believe that sentiment regarding investment could change after Brexit.

About three quarters — 72% — of energy organisations believe that investment in UK-based renewable energy projects and other low-carbon technologies will decrease after Brexit. Only 9% thought investment in these areas would be likely to increase.

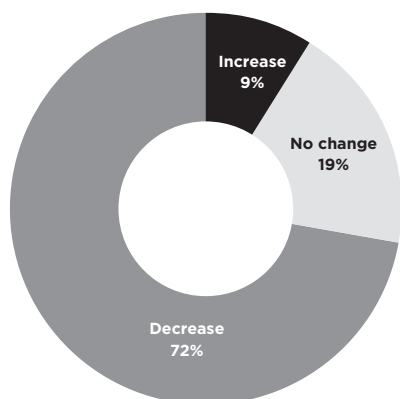
A similar percentage — 76% — believe investment headed for UK-based clean tech research and development initiatives would also suffer after Brexit.

In contrast, despite polarising opinion, the outlook for the UK's shale gas industry after Brexit is more positive. Around a quarter of energy organisations — 27% — believe this

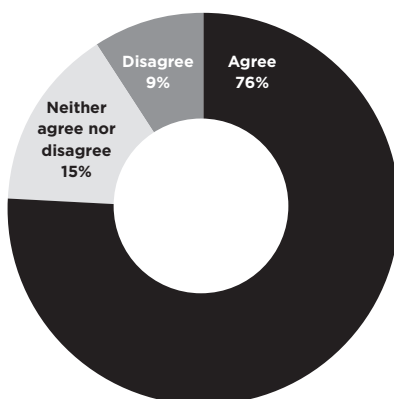
nascent industry could attract more investment, while a third — 35% — think investment levels will remain unchanged. While fracking for shale gas remains controversial, its proponents argue it could play a vital role in maintaining security of supply as a 'transition' fuel which supports the UK's decarbonisation programme.

With investor interest in the UK expected to take a step back after Brexit, will it increase in other parts of the EU? The research suggests this is unlikely - 42% of energy organisations believe that investor interest in the rest of the EU will also decrease after Brexit.

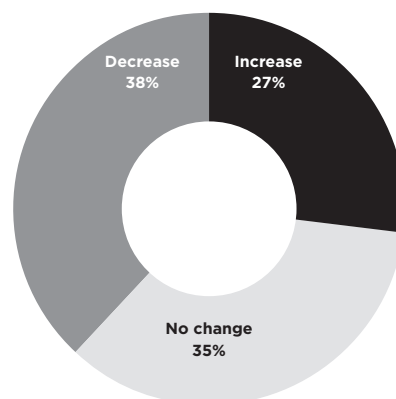
What extent do you believe the UK's attractiveness as a global destination for investment in renewables and other low carbon technologies will increase or decrease?



Brexit will harm the UK's 'cleantech' research and development capability



What extent do you believe the UK's attractiveness as a global destination for onshore shale gas development (fracking) will increase or decrease?





“The sterling exchange rate post-referendum has made the UK a cheap place to invest, however that needs to be countered by the high political risk in the UK that will continue for some time yet as a clear post-Brexit energy policy takes time to emerge.”

“The Government has already announced plans to close all unabated coal-fired power stations by 2025, and so a likely exit from the EU ETS will arguably have minimal impact on coal. The jury is still out on the prospects for UK shale gas, although the EU has not been particularly enthusiastic, and post-Brexit we might expect to see more UK government support to kick start shale development in order to bolster self-sufficiency.”



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“As with all other investments, low-carbon investment requires legal stability and certainty. Given the long amortisation periods and lack of alternative markets for revenue, the issue is especially prominent in the renewable energy sector.”

“Brexit has not brought with it stability and certainty until now, and it is unlikely it will in the near future. Therefore, potential investors from the EU will require safeguards and incentives to counter continuing uncertainties. However, the arguments presented by the UK Government in the RED negotiations leave little room for hope in terms of renewable energy development, at least when it comes to non-UK investment.”

“The prospect of an exit from EURATOM opens up serious concerns and there are wide-ranging consequences not only for the UK nuclear industry but also for the medical sector. Tasks carried out by the European Commission in the UK such as inspections and oversight look set to be transferred to the UK regulator whilst funding from EURATOM will no longer be available. This is a security concern.”

Brexit impact: Who will be affected the most?

With the countdown to Brexit underway and as yet, no clarity about how and to what extent the UK will continue to participate in the Internal Energy Market (IEM) post-Brexit, energy organisations operating in the UK and its neighbours are trying to second guess how the situation might affect them in their domestic markets.

The research shows that UK-based energy organisations are more pessimistic about Brexit than their non-UK counterparts — 74% of them think Brexit will have a negative impact on their organisations, compared with just 19% of the non-UK panel. Only 7% of UK organisations think Brexit will have a positive effect.

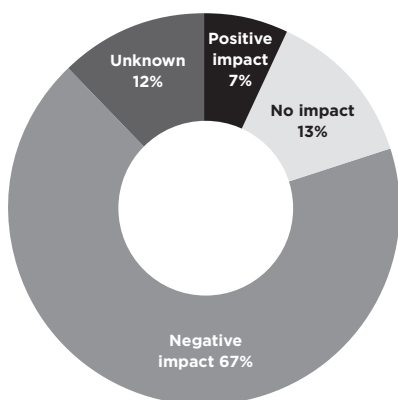
These findings suggest that UK-based energy organisations believe they have more to lose from Brexit than their non-UK counterparts. Despite potentially freeing them from EU regulatory controls and reducing red tape, UK-based organisations are concerned that Brexit will threaten EU and private sector capital funding for

existing and future energy projects. Without this funding, existing projects in the pipeline could be delayed, or even abandoned, and it would become even more difficult for the UK to achieve its domestic (Climate Change Act 2008) and international (Paris Agreement) commitments.

By contrast, two-fifths (41%) of non-UK energy organisations believe Brexit is unlikely to affect them significantly.

When weighing up the impact of Brexit on the EU energy market as a whole, the views of UK and non-UK energy organisations are more closely aligned — the majority (67%) believe Brexit will have a negative effect.

What impact do you think Brexit will have on the EU energy sector as a whole?





“A release from the EU Renewable Energy Directive and EU state aid rules would certainly give the UK more choices when it comes to decarbonisation. These choices could include the diversion of resources to nuclear, carbon capture and energy efficiency, and a scrapping of the renewable energy targets post-Brexit as part of a “Brexit bonfire of red tape” could be on the cards. However, the UK must still meet its Paris commitments, not to mention its own domestic Climate Change Act binding targets, and so perhaps the biggest Brexit impact will be the potential loss of EU funding in capital intensive areas such as offshore wind and interconnectors.”



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“This is a clear signal to UK and EU politicians and negotiators that energy managers from the UK see the potential for negative impacts on their business. The single market opens up opportunities not only for the sale of gas and electricity but arguably more importantly, for future technologies such as storage, green gas, and sector-coupling technologies. All businesses connected to the UK will already be asking themselves what impact Brexit might bring and hoping to convince negotiators to come up with mutually-beneficial solutions.”

Brexit impact: How would you rate overall confidence in the future?

In the current climate, energy organisations across Europe are circumspect about what the future might hold.

Rather than predicting that Brexit would have either a very positive or very negative outcome, most respondents preferred to take a middle line when asked how the sector might develop in the future. They were most confident of a positive outcome when asked to consider whether existing interconnectors would continue to operate as now after Brexit – they rated the likelihood of this as 7.3 out of 10.

In contrast, when asked to rate the likelihood that Britain would agree a comprehensive trade deal with the EU in the next two years, they were less positive – respondents gave this statement a probability rating of just 3.9 out of ten.

These findings suggest that energy organisations could be hoping for the best. The strong interdependency of the pan-European energy market facilitated by the physical interconnector links means there is a strong will on both sides to continue the status quo. For Britain, continued access to EU energy supplies is critical to meeting

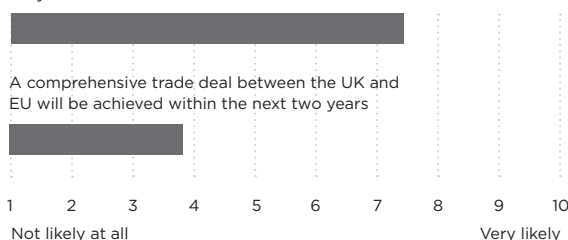
consumer demand in the future and ensuring security of supply, especially considering the speed of coal plant closures and the ongoing delays in new nuclear development. For the UK's neighbours, there are clear benefits in being able to reverse the flow of interconnectors and secure access to power imports from the UK at times of system stress, as witnessed in recent times in France. Furthermore, Ireland is almost completely dependent on interconnector flows from the UK for its gas.

Moreover, for so long as the UK has a clear domestic commitment to nuclear and renewables, it will remain an attractive inward investment location. However, this is likely to be dependent on a satisfactory cross-border trade deal.

The findings suggest that the biggest area of concern for energy organisations is the timetable for change — there is so much to do and so little time to do it.

How likely are the following?

Post-Brexit, the existing interconnectors between UK and the rest of the EU will continue to flow (in both directions), much the same as they do now





“When looking at how to preserve the status quo in the energy sector, one of the biggest concerns over Brexit is the UK nuclear industry and, in particular, UK nuclear fusion research. Protecting this will need some considerable efforts to work around the UK’s exit from the Euratom Treaty.”



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“Again, we are in the hands of the negotiators. Fortunately, it seems that the energy sector is not on the list of politically-controversial topics and has been kept out of political games until now. It seems to be widely acknowledged that technical solutions are key in the energy sector and that reliance on these rules benefits all stakeholders. Therefore, there is hope that any outcome which contradicts the technical realities on the ground can be prevented.”

Summary

Major treaties take around six months for translation and ratification. That leaves only 10 months to negotiate and agree all the details.

Time is not on our side.

With the UK scheduled to leave the EU at midnight on 29 March 2019, a large amount of politically-challenging legislation needs to be passed through Parliament in a short timeframe.

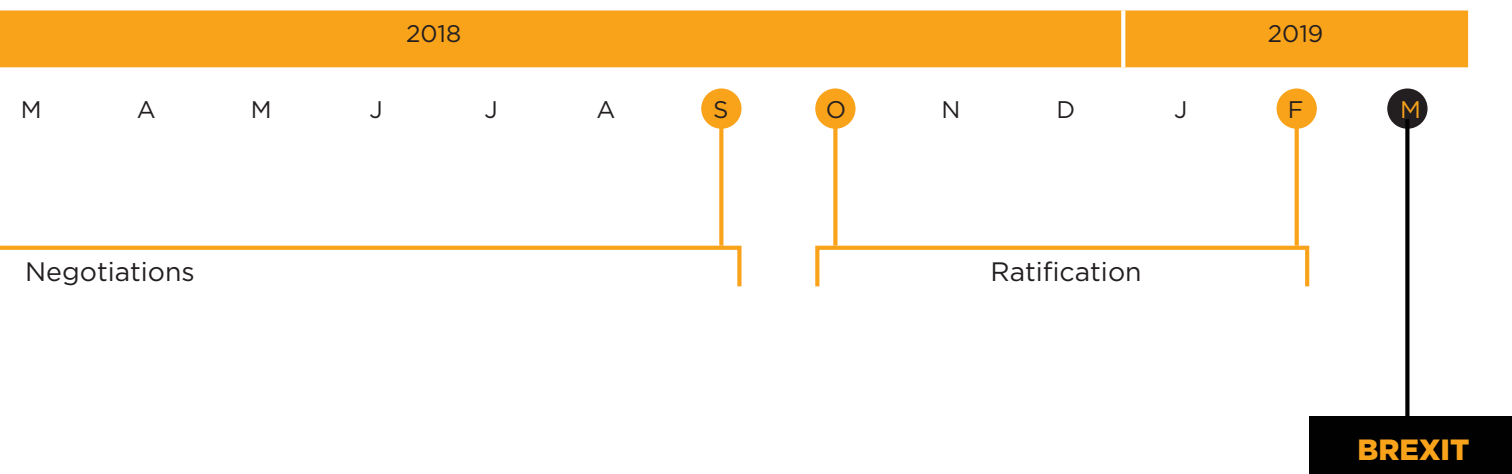
Against this backdrop and with Brexit negotiations progressing slowly, it is vital that agreement over a way of working for future energy provision is established at the earliest opportunity.

The UK's domestic energy policy is closely aligned to that of the EU and has been a leading force in the liberalisation of European energy markets and the formation of the IEM (Internal Energy Market). The entwined nature of UK/European energy provision means the outcome of negotiations could have a disruptive effect on businesses and energy users alike. With a high degree of mutual benefit, especially around security of supply, a 'technocratic' solution is needed.

The research echoes the sentiments of the wider UK energy sector and has made it clear that maintaining harmonised trading arrangements and staying in the IEM after Brexit is the desired outcome. But as the EU has warned, the UK will not be allowed to 'cherry pick' policies.

At this stage it is not clear whether the UK's ongoing involvement with the IEM will be possible or not. However, there is some hope that keeping a sharp focus on issues related to security of supply, infrastructure and investment, will ensure a mutually-beneficial solution is found.





Shakespeare Martineau & Becker Büttner Held working together

Operating within the energy sector is incredibly complex, exciting and fast moving.

Shakespeare Martineau and Becker Büttner Held are proud to have been working closely together on key issues affecting clients across the European energy sector for over 10 years.

Since the EU referendum result in June 2016, UK-based law firm Shakespeare Martineau and the Brussels office of German law firm Becker Büttner Held have been speaking to organisations across the sector about what Brexit means for them.

As most of the debate so far has centred on the UK's own attitudes and expectations, we undertook this survey to gain an understanding of the impact of Brexit across the EU energy sector as a whole.

In doing this, we also sought to drive some clarity around the similarities and differences in the opinions of business leaders in energy sector organisations across the continent.



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