

Brexit the Energy Union: what do the negotiation positions imply?

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Brexit is taking place at a crucial moment for the energy systems of both the United Kingdom (UK) and the European Union (EU). As the energy transition goes on, their interdependence is set to grow. However, a wide range of energy-related policy areas is expected to face the uncertainty caused by the UK's decision to leave the EU. This commentary analyses the implications of the energy-relevant aspects of the respective negotiating positions as defined by the UK White Paper and Article 50 letter, and the European Council negotiation guidelines.

What is at stake?

The UK's ageing power generation fleet needs significant investment, many of which were planned considering permanence within the EU. At the same time, the Union energy framework is under a reform process, which will now need to take into consideration the unknowns of Brexit. Several issues are at stake.

Trading arrangements. The EU and the UK are not going to stop trading gas and electricity, as price differentials are expected to stay. Still, increasing interdependence needs a range of cross-border cooperation arrangements to regulate market coupling, balancing markets, and capacity allocation, which are increasingly subject to the Internal Energy Market (IEM) discipline. Exiting the IEM would be conducive to a sub-optimal allocation of investments on both sides of the Channel and higher costs for consumers.

Climate policies. The UK is a frontrunner in emission reductions and a net buyer of emission allowances under the EU Emission Trading Scheme (ETS). A withdrawal from EU targets will require a difficult political renegotiation between the 27 or a reduction of the EU's climate ambitions – potentially compromising the Paris commitments. At the same time, a UK withdrawal from the ETS would potentially cause an oversupply that might jeopardise the current EU efforts to reform the scheme.

The Irish conundrum. Ireland is only connected to the Internal Energy Market (IEM) through the UK. The Brexit consequences on energy would be acute for Ireland, which depends on the UK for access to resources under tight supply conditions – under regimes established within the EU framework and currently in evolution.

Amidst these uncertainties, it is clear that a disordered Brexit from the energy and climate framework would cause considerable economic losses and political confusion.

Different approaches

The UK and the EU seem to have different positions on the future of network industries. According to the government's White Paper, the UK does not want to remain part of the single market. However, it proposes to continue cooperation on networks, signalling a preference for a separate deal – presumably aiming at the continuation of the current trading regime, and UK membership of those bodies in charge of implementing the cooperation arrangements. At the same time, a narrative of “taking back control” seems incompatible with the EU having any say in the future UK's state aid discipline or any supranational dispute settlement mechanism.

On the other side, the EU guidelines mention that “preserving the integrity of the single market excludes participation based on sector-by-sector approach”, implying that the IEM does not fall outside the single market discipline. This means that in the EU's view no energy-specific arrangement can guarantee the continuation of current energy relations outside a comprehensive framework.

Neither Norway nor Switzerland

In other words, whilst the UK seems to reject the 'Norwegian' option, the EU excludes the 'Swiss' option. These options are often portrayed as models of future energy relations, but both the EU and the UK are right to reject them: many commentators overlook that these models actually do not exist with specific reference to energy.

There is no energy agreement between the EU and Norway. The energy relations fall within the European Economic Area (EEA) discipline, of which Norway is member. This implies a highly institutionalised dynamic relation, serving as a long-term agreement with countries that do not intend to be members of the EU. The UK is unwilling to follow this path due to the concessions it would have to make to join the EEA in terms of free movement, budgetary contributions, and adoption of EU legislation, on which EEA members have little influence.

The relation between the EU and Switzerland is based on more than 120 bilateral sectoral treaties, in derogation to the traditional EU approach. Trusting Switzerland's willingness to join the EU, the EU conceded a sectoral approach to gradually adapt the Swiss framework to the EU *acquis*. When Switzerland clarified that it was no longer seeking membership, the EU did not hesitate to treat energy as a bargaining chip. An energy deal was blocked by Brussels, first in relation to the Swiss referendum on migration, and then as a response to the Swiss reluctance to agree to a comprehensive institutionalisation of dispute settlement. As a result, Switzerland's large water reservoirs remain excluded from cross-border balancing initiatives, implying higher costs for electricity operators and consumers. Offering the UK a separate agreement on energy means offering to London a preferential status compared to Switzerland.

Is an energy agreement still possible?

The quickest way the UK could get a sectoral agreement granting access to the IEM with no objections from the EU side would be by joining the Energy Community Treaty (ECT). However, the ECT is framed as a pre-accession instrument, which can hardly constitute the blueprint for a long-term energy relation. Under this scheme, the UK would have to incorporate EU legislation having no influence on the decision-making process, whilst the EU would not be able to rely on effective enforcement, which is non-judicial and ultimately depends on the level of political discretion of the ECT Ministerial Council.

In the long term, it is realistic to consider an energy chapter in a future trade agreement with the UK, aimed at aligning the two energy systems as much as possible. Traditional trade deals or any default relation under WTO rules would not counter the uncertainties and net welfare losses stemming from a loss of the UK's membership of the IEM. An energy chapter would solve this problem without being a sectoral agreement, as it would be part of a comprehensive deal.

However, this is likely to take a lot of time, whilst key investment decisions are needed by 2020. In the meantime, it would be wise to set up a transitional arrangement aimed at maintaining the UK's access to the IEM's trading arrangements and implementation bodies – at the condition that the UK does not repeal energy and climate legislation transposed already. To this end, the ECT might provide a transitional framework with a sunset clause. To fill any vacuum and cope with the weaknesses of the ECT enforcement, a joint transitional authority – as proposed by Andrew Duff in a recent EPC paper - could settle the remaining disputes. However, it must be made clear that such an arrangement would be temporary and not offer the UK an energy treatment more favourable than other third countries.

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