

Priorities for the energy sector following the UK's decision to leave the European Union

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Priorities for the UK energy sector

The process for Britain to exit the European Union (EU) will present opportunities and risks for the UK energy industry and its customers. This paper presents the suggestions of the energy industry to the UK government on what it believes should be its key priorities in its negotiation to leave the EU.

Delivering the investment required

The energy sector is undergoing a period of significant change: as large thermal plant retires it is being replaced by a lower carbon generation mix. This includes renewables, biomass, new nuclear, and more efficient and flexible thermal generation, as well as more local sources of power. The required level of investment is substantial; the UK Government expects¹ that over £140bn needs to be invested in new generation capacity by 2030, whilst other sources have put this figure even higher. Whatever the outcome from Brexit negotiations, the UK must remain an attractive location for investment in order to keep the lights on and reduce carbon emissions.

The UK government has the appropriate domestic policy tools in place, principally through the Capacity Market (CM), Carbon Price Floor (CPF), and Contract for Difference (CfD) auctions that provide industry with the right framework to deliver this investment. It is imperative that the government continues with the implementation of the Electricity Market Reform (EMR) package and in doing so provides the long term stability that investors require. Setting out a timetable for future CfD rounds and the funding for low carbon technologies would go a long way to providing a suitable investment climate for low carbon generation.

Delivering the best outcome for customers

In order to deliver the best outcome for UK energy customers from any Brexit negotiation, the energy sector has identified the following key priorities:

- minimising domestic policy uncertainty in order to encourage continued investment;
- efficient trading of power and gas over the interconnectors to enhance security of supply, promote competition and reduce costs by sharing available resources and capacities;
- access to supply chain products free of tariffs and non-tariff barriers;
- maintaining liquidity in both electricity and gas markets; and,
- ensuring access to a skilled and mobile labour force.

It is not clear whether membership of the Internal Energy Market (IEM) is necessary to meet these objectives going forwards but it will be vital that there is an EU/UK framework that delivers the ability to import and export power and gas efficiently. It will continue to be important for the sector to be able to recruit the best personnel globally and to attract them to the UK. Whilst this will not require full free movement of labour, it does mean there will need to be a sensible and proportionate migration system that does not inhibit the competitiveness of the UK industry.

¹ <https://www.nao.org.uk/wp-content/uploads/2016/07/Nuclear-power-in-the-UK.pdf>

The Internal Energy Market

Over the last twenty years the EU has developed the IEM through a number of legislative packages for electricity and gas market liberalisation, and a programme to strengthen cross-border infrastructure. Measures are still in the process of being agreed and implemented and further harmonisation measures are in the pipeline. The IEM is widely regarded as having led to greater efficiency in trading power and gas, with the result that it has enabled access to diverse sources of energy at reduced costs to customers and led to improvements in security of supply.

Energy UK members support several aspects that the IEM delivers, for instance: access to power and gas across borders, enhanced liquidity, easy access to supply chain materials (through wider Single Market access), and the pan-European Emission Trading Scheme (EU ETS).

Whilst ensuring access to power and gas through the IEM is of utmost importance, the energy industry has concerns regarding future membership of the IEM if following Brexit it meant the need to accept changes set out by the EU without UK participation in its governance arrangements. If the UK is required to follow the rules of the IEM, including all future evolutions of those rules, but is not involved in the decision-making there is an increased risk that measures could result in unnecessary costs, impact security of supply, or have other disadvantages for the UK system. For instance, negotiations are currently taking place regarding a move to an EU-wide 15-minute imbalance settlement period (ISP) which although potentially beneficial to other countries, would impose costs that outweigh any potential benefits for UK customers. The UK may yet secure an exemption from this to maintain the current 30 minute ISP, but in the future the UK may need to implement changes to which it has had no input in and may have little influence in securing an exemption from.

The UK must continue to engage closely with the EU on energy matters through formal and informal channels to ensure developments meet UK requirements. Future engagement should include the retention of full membership of the European Network of Transmission System Operators for Electricity (ENTSO-E) and the European Network of Transmission System Operators for Gas (ENTSO-G) and Ofgem should maintain a strong presence within the Agency for the Cooperation of Energy Regulators (ACER).

Additionally, it should be noted that the UK's decision to leave the EU has some important implications for the Republic of Ireland since it is only able at present to access the IEM via GB and currently operates a Single Electricity Market (SEM) with Northern Ireland. As part of the UK and EU discussions, special consideration should be given to ensuring that the SEM continues to have access to energy supplies through the GB system.

Access to the Internal Energy Market through interconnection

The UK and European gas and electricity networks are linked through interconnectors that provide a connection between the transmission systems of different countries and provide an opportunity to trade electricity and gas driven by price differentials. If the UK were outside of the IEM, it is as yet unknown what rules would apply in order that trade over the interconnectors continues, but Energy UK members stress the importance that UK retains access to cross-border flows of both gas and electricity to ensure continued security of supply.

Whilst the UK is not currently heavily dependent on gas imports from Continental Europe, it is important that in times of limited supply or excess demand all potential sources are made available. In addition, interconnectors provide an important contribution to the UK electricity mix. The UK is currently a net importer of electricity (contributing 5.8 per cent of electricity supply² in 2015) and against a backdrop of tight supply margins, interconnection provides a diverse and competitive source of power for UK customers.

Whilst Energy UK members are supportive of more economic and efficient electricity interconnection, many GB generators highlight the fact that power traded over interconnectors do not pay network charges or some policy costs, such as the Carbon Price Floor. This leads to market distortions based on policy rather than competitive pressures. Leaving the IEM might present the opportunity to reconsider the policy and regulatory distortions faced by GB generators and electricity traded over the interconnectors.

Climate change and sustainability

The energy sector plays a vital role on decarbonising the economy and reducing carbon emissions. Energy UK supports the government's commitment to the legally-binding targets within the Climate Change Act and the decision to implement the Committee on Climate Change's advice on the level of emissions within the 5th Carbon Budget. The industry welcomes the Prime Minister's intention to ratify the Paris Agreement by the end of the 2016.

Upon exiting the EU, the UK would no longer be bound by its EU climate change and renewable energy targets. Based on current government announcements, the UK would however continue to reduce carbon emissions unilaterally and this position is strongly supported by Energy UK members. The Emissions Reduction Plan should provide the first signals to investors on how this will be achieved.

The UK's action on climate change contributes strongly to the EU's performance as a trading bloc as Member State contributions are currently submitted collectively to the United Nations Framework Convention on Climate Change (UNFCCC). The UK's above average performance masks the lack of action on climate change from some other Member States, whilst still supporting the EU's internationally agreed ambitions. Although the arrangements for the UK to leave the EU would have limited impact on the UK in terms of its own climate policy, it could potentially have a more significant impact for the EU in its delivery of its commitments under the Paris Agreement.

EU Emissions Trading Scheme

The energy industry is clear that EU Emissions Trading Scheme (EU ETS) is the best pan-European instrument to drive investments to deliver carbon reductions across the traded sectors and would support the UK remaining within the scheme. However, presently, the EU ETS price has not been strong enough to deliver the investment signal required and as a result the UK established the Carbon Price Floor (CPF) which came into effect on 1st April 2013. The CPF establishes a minimum price of carbon emissions from electricity generation in GB.

2 www.gov.uk/government/uploads/system/uploads/attachment_data/file/540933/Chapter_5_web.pdf

Energy UK members support the strengthening of the EU ETS to provide a robust carbon price that provides the investment signals needed to decarbonise the energy system cost-effectively. However, it is recognised that the effect of proposed changes to the EU ETS are unlikely to deliver a sufficient carbon price signal in line with the UK's CPF until well into the next decade. In the absence of a strong EU ETS price, the CPF still has an important role to play.

Energy UK believes that in negotiating exit from the EU, the UK should explore opportunities to remain within the EU ETS scheme providing it can still influence its governance structure. Without the UK at the table, the pressure on strengthening the price of allowances might reduce to the detriment of global action on climate change. In this instance it may be necessary to consider the role of the UK in the EU ETS more broadly and alternative policy options should be considered.

Financial Regulation

Over the last five years the EU has been tightening financial services regulation in line with G20 commitments in response to the global financial crisis. The energy sector is affected since commodity trading is within the scope of the revised Markets in Financial Instruments Directive (MiFID II). If the UK remains subject to MiFID II, it is important that the requirements on commodity trading firms are proportionate and that duplication of regulation and reporting or other administrative burdens are avoided. Whether or not the UK remains within the EU Single Market, it is recognised that the UK is likely to implement a strict market abuse regime to maintain confidence in the integrity of markets and to protect customers. The role of the Regulation on Wholesale Energy Market Integrity and Transparency (REMIT) will be important to ensure the integrity of the gas and electricity markets in this regard.

Conclusion

Delivering the investment required to develop a sustainable and low carbon economy at least cost to customers is a priority for the energy sector. Government has established the framework to bring forward investment through measures such as the Capacity Market, Contract for Difference and Carbon Price Floor, and focus should remain on the implementation of these measures.

Energy UK members support several aspects of the IEM and highlight the potential benefits that access to European markets enable. However, the energy industry has concerns regarding future membership of the IEM if following Brexit it meant the need to accept the rules as set out by the EU without UK participation in its governance arrangements, or final say over its implementation in GB. As part of any discussion, the impact on the SEM in Northern Ireland and Republic of Ireland should be given special consideration.

There may be potential benefits from reviewing existing European legislation to ensure that objectives, such as environmental and financial, are met in the most efficient way for UK industry; many generators argue that this includes the potential to level the playing field with respect to GB generation and electricity traded over the interconnectors. It is important that any review should be well managed to ensure a stable and predictable framework to support investment.