

# Will energy trading with Europe stop after the Brexit transition?

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# ECA

*With the Brexit transition phase due to end on 31<sup>st</sup> December 2020, what will happen to energy trades with Ireland and Continental Europe. Electricity, in particular, relies on a common set of rules and agreements for cross-border trade to continue. If nothing is in place will the interconnector flows cease after 31<sup>st</sup> December?*

*The EU is intent on close cooperation when UK energy leaves the single market, but will the UK play ball? There is very little firm information available on how the energy sector will be affected. This Viewpoint assesses and speculates on the implications for gas and electricity in UK.*

## Carbon is the biggest potential change

The EU ETS (Emissions Trading System) would probably not apply in the UK. There is talk about developing mutual recognition of carbon certificates but this is speculative.

However, the EU is intent on implementing its Green New Deal so divergence is likely, which could threaten continued carbon trading.

Difficulties will relate to State Aid issues. The risk is that there is cross-subsidy through GB carbon pricing affecting electricity trade prices. The issue is unlikely to bite in practice as carbon policy principles are likely to be close enough.

## State Aid is where the UK government is aiming to make its mark

State Aid is any government subsidy to favour certain groups but can also cover rules that distort competition. There will be no role for the EU Commission or the European Court in policing UK rules and subsidies but UK will be bound by WTO rules on which the EU has based its principles. The WTO rules have no ex ante evaluation of measures but the EU will ensure that any trading deal includes protections against state aid abuses. This may be a stumbling block to achieving any deal.

However, there is nothing on the horizon that suggests UK will follow the route of state aid in energy that would threaten agreement on cross-border energy trades. Even the issue of the Electricity Capacity Regulation turned more on inadequate process by the EU Commission rather than any real issue of state aid discrimination.

## Market designs in electricity and gas are already fully aligned

The basic EU market principles were copied from the GB gas and electricity market models. Factors such as appointment of Nominated Electricity Market Operators are already national responsibilities under EU rules. There seems to be nothing in the medium term that UK or Europe would change that would lead to divergence.

## Institutional memberships will be different in some cases

**ENTSO-E and ENTSO-G membership is based on TSOs, not on the EU**

Even though these institutions were tasked with implementing the 3<sup>rd</sup> energy package network codes, their remit is wider. Both organisations include non-EU members (admittedly usually through the Energy Community Treaty (ECT). ECT Contracting Parties have agreed to much of the 3<sup>rd</sup> energy package Directives' content. ECT enforcement is through the Energy Community Regulatory Board and not the European Court. A separate adjudication procedure could therefore be applied for a UK agreement.

**ACER membership would cease**

ACER (Agency for the Cooperation of Energy Regulators) was set up under the 3<sup>rd</sup> Energy Package and only currently allows EU countries to be members. ACER's core responsibilities are:

- **REMIT** (Regulation on Wholesale Energy Market Integrity and Transparency) – ACER

plays a central role in market surveillance and has established a database of all transactions (national and cross-border) to detect market abuses. Ofgem would need to develop its own market surveillance functions. National Regulatory Authorities (NRAs) must enforce REMIT anyway. For interconnectors, NRAs either side need to cooperate but on a bilateral basis.

- **Network code implementation.** ACER has 'tie-breaker' responsibilities only where NRAs cannot agree. As with ECT contracting parties this tie-breaker role can be created by agreement.
- **JAO. The Joint allocation Office runs** interconnector capacity auctions, but not on the England-France Interconnectors. It only covers EU and EEA countries. Agreement on interconnector capacity auctioning would be required, but on a bilateral basis between NRAs.

## Will anything change for Ireland?

- **SEM** (Single Electricity Market for the whole island) is likely to remain intact; it is effectively governed by the Good Friday Agreement (GFA). This will be governed more by NI politics. The GFA predates SEM so it could be argued the SEM was never integral to seamless borders.
- **Interconnectors.** The EU border is the Irish Sea. In practice, the bigger issue was always agreement between Ofgem and Irish NRAs on using FTRs (Financial Transmission Rights) on the electricity interconnectors. This was to align with the SEM's non-physical forward markets. This was resolved quite happily by agreement between all the regulators involved.

There seems no reason why trade with Ireland should be affected.

## Interconnectors are the key interface between the UK and European markets

Factors in addition to capacity auctioning need to be considered, but none seem to be difficult:

- **Market coupling.** This process should continue as there is no reason why GB and continental exchanges should not be coupled. The process was devised by the

exchanges themselves and only adopted by the EU later. Market coupling obviously needs harmonisation of rules between exchanges. There may be differences in dispute procedure to the extent that there would be no ultimate recourse to the European Court. This is unlikely to be a material issue in practice as disputes will rarely be on regulatory issues.

- **Capacity auctioning in electricity.** It seems unlikely that the UK – the champion of auctions – would prevent allocation of auctioned interconnector access rights in electricity. Even in gas, auctioned access rights are coming in now that long-term contracts are ceasing.
- **Flow-based calculation in electricity.** This is a network codes requirement. But it is about the methodology for calculation of the amount of capacity that should be available on interconnectors. This will be affected by flows within countries. For GB, all interconnectors are DC anyway.
- **Licences.** These are issued jointly by NRAs so this would not change.

The main risk may be purely political because this could be the most obvious way that the UK government could signal that it is diverging.

## Extra things will need to be put in place but none are difficult

Brexit was justified as an opportunity for rules divergence and for a 'bonfire of regulations':

- Other than with carbon treatment, the reasons for divergence are absent in electricity and gas. This may change in the longer term.
- The UK pioneered the regulatory framework and is not likely to burn all its rules.

The prospects for January 2021 and beyond are therefore that most things will continue as before. Electricity and gas will continue to be traded and even market coupling is likely to endure. We have pointed to where some new arrangements will be needed in some areas; there will therefore be some implementation cost.