Brexit Industry Insights

Energy

With the UK’s default to leave the EU without a deal, the energy sector is not immune to the impact of Brexit. The sector is faced with simultaneously navigating longer term transformation in how energy is produced and consumed, an increasing focus on decarbonisation and decentralisation, whilst mitigating the impacts of Brexit in the short term. The risk of the UK leaving the EU without a deal remains high, and the time to act is now.

Brexit and the Energy Sector

The energy sector is diverse, and the impact of Brexit will vary for different players in the industry depending on market focus, the energy products traded and the cost base. Many oil and gas companies established in the UK have global operations and are already well-versed at navigating a diverse political and regulatory landscape. Brexit is another change to this landscape that companies will need to manage. The UK’s withdrawal from the EU will see the UK leave the EU’s internal energy market. In 2017 the energy sector created £83.7bn in economic activity and supported 682,000 jobs. The UK is a net importer of electricity and gas; in 2017, the UK imported 4.2% of its electricity demand through interconnectors, and 36.8% of its gas.

What does this mean for business?

Some of the key implications for businesses operating in the sector are:

Cross-border supply chains

In a no-deal scenario, movements of goods between the UK and the EU27 would become imports and exports, resulting in customs compliance obligations. The EU applies a zero rate of duty to most hydrocarbon products for non-EU members. Post-Brexit, the UK’s draft no-deal tariff indicates it would take a similar approach to duty rates. Chemicals, plastics and equipment are more likely to be subject to a duty cost, which could impact energy supply chains, e.g. for energy infrastructure and spare parts.

Border delays could arise in a no deal Brexit, impacting the resilience of supply chains, especially in relation to critical spare parts or inputs to the refining process.

International commercial terms (INCOTERMS) will indicate which party is contractually responsible for customs duties and formalities. Trading businesses will often place responsibility for acting as importer or exporter of record – and completing the relevant customs clearance requirements – on a local counterparty. There is an increasing focus on INCOTERMS used as a result of Brexit and other changes in the international trading environment, in particular trade tensions between the US and China.
In focus: climate change and Brexit

The UK will remain party to the United Nations Framework Convention on Climate Change (UNFCCC) and Kyoto Protocol, as part of international efforts to combat climate change. The UK’s Climate Change Act establishes more ambitious emissions reduction targets than those set by the EU, requiring the UK to bring all greenhouse gas emissions to net zero by 2050. Brexit is not expected to impact the UK’s domestic strategy, but the nature of the UK’s relationships with both the EU and the rest of the world remains unclear.

Tax

Many trading companies rely on EU VAT simplifications, such as triangulation. When the UK leaves the EU, these EU simplifications will no longer apply to UK VAT registrations, which could lead to additional VAT registrations and associated administrative requirements, e.g. some EU member states require non-EU established entities to appoint a fiscal representative.

EU Directives, including the Parent-Subsidiary and Interest and Royalties Directives, will no longer apply. Accordingly relief from foreign withholding taxes arising in EU member states will rely on the application of double tax treaties. For multinational extractive companies, the wider tax landscape in both the UK and overseas is increasingly an item on the board agenda, irrespective of the Brexit outcome.

Regulation and legal

There will be a number of regulatory changes which companies will need to manage, for example:

**Derivatives trading**

Financial services is a highly regulated sector and trading in commodity derivatives contracts may constitute a regulated activity. In a no-deal Brexit scenario, the UK will be outside of the EU’s framework for financial services regulation. The UK has implemented temporary transition provisions for EU businesses, but where UK companies trade on EU exchanges or trade with EU counterparties, EU regulatory requirements will need to be met.

**Chemical substances**

In the absence of a regulatory alignment between the UK and EU, UK-based firms subject to the EU’s Registration, Evaluation, Authorisation & restriction of Chemicals (REACH) will face a regulatory trade barrier as their REACH registrations become invalid in a no-deal Brexit. In order to continue doing business in the EU post-Brexit, UK businesses will need to appoint an only representative or transfer registrations to an EU entity (although transfer of licenses could be a complex process as specific rules apply).

**Export controls on dual-use items (items which can be used for both civil and military purposes, such as chemicals)**

The overall framework of controls will not change, but there will be new licence requirements. Licences will be required for exports from the UK to the EU and vice versa, and an export licence issued by one of the 27 EU countries will no longer be valid for export from the UK.

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Many issues outlined above will apply to utility companies and those trading gas and power. In addition, the EU’s Regulation on Energy Market Integrity and Transparency (REMIT) prohibits insider trading and energy market manipulation and makes provision for monitoring of the market by regulators. UK market participants trading in the EU will need to register with an EU regulatory authority to avoid a disruption to cross-border trade, trade within EU wholesale energy markets, or trade within the Single Electricity Market. It is expected the UK will maintain the majority of REMIT in a no-deal scenario.

Some UK-based energy trading firms are either setting up trading desks in the EU, with requisite regulatory authorisations, or building on existing EU operations. Those operating in the nuclear sector will need to be prepared for new licensing requirements on dual use goods and changes to the authorisations for spent fuel and radioactive waste⁶.

**Utilities and trading gas and electricity with the EU**

In a no-deal Brexit, EU energy laws will no longer apply in the UK. Alternative arrangements are in place for trading of electricity via interconnectors in the event of a no-deal scenario⁴, although trading on interconnectors will be less efficient.

The mechanisms of cross-border trading of gas are not expected to fundamentally change⁵, although there will be changes to access rule approval, operator certification and gas network codes.

Post-Brexit, the UK will no longer be a member of Euratom and has passed legislation so the Office for Nuclear Regulation oversees domestic safeguards, and signed new agreements with the International Atomic Energy Agency (IAEA) to replace the existing trilateral agreements between the IAEA, Euratom and the UK.

**People**

Free movement of people will end once the UK leaves the EU, and this will impact all businesses operating in the sector to some degree. Existing EEA nationals working in the UK are required to apply to stay in the UK through the EU Settlement Scheme, while new entrants intending to stay in the UK for longer than three months will need a European Temporary Leave to Remain permit to work and reside in the UK. The UK is expected to introduce a new immigration regime from 2021.

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Energy supplies in Ireland

The UK government is continuing to work with the Irish government and the European Commission to seek agreement that the Single Electricity Market on the island of Ireland will continue. Ireland will have no direct connection to the main EU energy infrastructure post-Brexit. The Irish Offshore Operators Association (IOOA) estimated the potential cost of a total blackout in Ireland for a day would be £850m.6

International and EU regulations require countries to hold emergency oil stocks. Under EU rules, these stocks can be held anywhere in the EU. Approximately one third of Ireland’s emergency oil stocks are held in the UK.6 The Irish government has indicated that as a result of Brexit, it will move these stocks to Ireland and other EU member states. This is likely to mean some stocks are held further away from Ireland, leading to additional transport time and costs.

Multinational extractive groups often have a highly mobile international workforce; post-Brexit changes will need to be factored into existing processes. For example, immigration requirements for UK workers and short-term business visitors to the EU will need to be confirmed on a country by country basis. Dual social security liabilities could arise for employers and mobile employees if EU member states do not agree to reciprocal arrangements with the UK. Many multinational businesses already have experience of managing a mobile workforce, and post-Brexit changes will need to be factored in to existing processes.

Manage all key stakeholders to understand commitments and expectations. Engage with audit committees and liaise with trade bodies and regulators on preparations.

8. Irish Offshore Operators Association: as above
How can Deloitte help?
Deloitte has been supporting multiple businesses across a range of industries to understand the implications of, and prepare for, the UK’s withdrawal from the EU. We have supported many clients with their Brexit planning. Our teams combine Brexit insights, industry knowledge and technical expertise to support our clients with their Brexit readiness planning – from risk assessment to applying the lessons learned to optimise for the future trading environment.

For further information please contact Deloitte Brexit Support at brexitsupport@deloitte.co.uk

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Further reading

Official no-deal guidance for the energy sector

UK No-deal Technical Notices:
- Trading electricity if there’s no Brexit deal
- Trading gas with the EU if there’s no Brexit deal
- Civil nuclear regulation if there’s no Brexit deal
- Generating low-carbon electricity if there’s no Brexit deal
- Nuclear research if there’s no Brexit deal
- Running an oil or gas business if there’s no Brexit deal

UK Business Preparation Tool:
Prepare your business or organisation for Brexit

European Commission Brexit Preparedness:
- EURATOM Internal Energy Market
- Guarantees of the origin of electricity from renewable energy sources

Ofgem
Preparing for EU exit

This no-deal guidance is not exhaustive. Companies should routinely review the latest official updates and technical guidance as and when they are published by the UK, EU, and individual EU Member States.