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Negotiating Brexit

A lawyer's perspective on how political positioning for Brexit might impact UK energy policy

An optimist might think that the UK and the EU could negotiate Brexit by putting aside all the things that both sides agree on and focusing their energies on the smaller list of issues that divides them? Negotiations are seldom like that in practice. For many businesses, making the best of Brexit may be the biggest strategic challenge you face in the next decade.

As John Maynard Keynes put it “When the final result is expected to be a compromise, it is often prudent to start from an extreme position.” Add to the mix a healthy dose of national politics, the fear of contagion and the fact that this negotiation will play out in the crucible of public opinion and we are likely to see some robust rhetoric from both sides as each seeks to position politically and create leverage for the Brexit negotiations.

It has started already, of course, with France, Germany and others indicating that there can be no Brexit negotiations until the UK triggers Article 50 of the Treaty on the European Union, starting a two year clock that leads to the UK's exit from the EU, even if the terms of that exit have not been agreed.

In any normal negotiation, the UK would be strongly advised not to trigger Article 50 until a deal on exit and the UK's continuing relationship with the EU had been finalized - after all who starts a negotiation by confirming that if they can't do a deal in the next two hours, they agree to give away all their points. But this is no ordinary negotiation and the Prime Minister could come under increasing political pressure from within the Conservative party to trigger Article 50 and evidence her commitment to deliver Brexit.

So what could this all mean for the UK energy sector? Energy policy was never a specific target of the Brexit agenda. There was, and is, no particular clamor for us to leave the single energy market or ditch our commitments to decarbonization. But could Brexit cause collateral damage in those areas?

As we know, the most challenging issue in the Brexit debate is likely to be how to reconcile a reduction in free movement with unfettered access to the Single Market without sending out a message to other EU Member States that they too would be better off with an à la carte approach to Europe.

There are no simple answers to that one, but in that context is the UK going to feel the need to argue an isolationist agenda (if only to position the debate)? Might it argue that the UK is not dependent on the EU to keep the lights on or to keep customers' bills down; that the UK doesn't need EU state aid rules or new EU interconnectors and could go it alone without them; or that it would withdraw the EU's access to natural gas and LNG through the UK's pipeline infrastructure? Will the EU start from anywhere but the premise that the UK needs to be fully in the club to get access to the single energy market?

To build a credible Brexit negotiating position around an isolationist approach, the UK may need to make changes to existing UK energy policy: a more pronounced dash for new gas generation, an acceleration of the UK's commitment to deliver new nuclear, a revision to the UK's plans to build new interconnectors and potentially a revisiting of the UK's policy to phase out coal by 2025. Any increased commitment to build new baseload generation could come at the expense of investment in renewable technologies with the Levy Control Framework budget post 2020 still uncertain.

None of this would be good for investor confidence, which is still seeking both policy stability after the flurry of policy changes that followed the 2015 general election, and an effective price signal for investment in new baseload generation. All eyes will be on December's capacity auction to see if the additional 3GW on sale will trigger the needed increase in the auction clearing price.

It seems highly likely that there will be tactical positioning from both sides with a view to the endgame. Market participants should factor that into their thinking, but remain optimistic that the final compromise will not be as radical as some of the intervening rhetoric.

For more resources on readying your business for Brexit, including our Brexit toolkit and latest thinking visit our Brexit Hub at: www.hoganlovells.com/brexit and/or sign up for our [Brexit Bulletin](#).

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