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Brexit Threatens To Disrupt Cross-Border Energy Deals

By **Keith Goldberg**

Law360, New York (June 21, 2016, 6:05 PM ET) -- Voters in the U.K. will decide Thursday whether Britain should leave the European Union, and experts warn that a "Brexit" could make cross-border energy projects and energy trading more difficult and send developers who may have looked first at London for project funding to other global financial hubs instead.

The Brexit vote will determine whether the U.K. remains in the 28-member EU, and a potential departure of one of the union's most prominent members from both an energy and finance perspective could inject uncertainty into European energy markets and infrastructure that are increasingly connected.

“Overall, there is a potential for market disruption,” Herbert Smith Freehills LLP energy partner Silke Goldberg said. “The European electricity and gas markets are becoming more integrated. You have market coupling in the U.K. and the EU.”

Much of the uncertainty stems from the fact that no one knows what the extent of a Brexit would be, experts say. The U.K. could decide to become like Norway, a non-EU state that's a member of the European Free Trade Association and European Economic Area and part of an integrated energy market with the EU and subject to most of the EU's laws and regulations.

The U.K. could also choose to be like Switzerland, an EFTA member that negotiates a series of bilateral agreements with the EU, including an energy deal. Or it could simply broker an overarching free-trade agreement with the EU.

In addition, the energy policies of the U.K. and EU are closely aligned. Unless the U.K. opts for the Norway model, there are questions over how much a Brexit would cause those energy policies to diverge.

“The thing about Brexit is, by definition, it's uncertain,” said Kieron Dwyer, a London-based Mayer Brown LLP energy finance partner.

And that uncertainty might be enough to spook would-be energy deal makers, experts say.

“The biggest issue ... is probably more around the general investment environment,” Orrick Herrington & Sutcliffe LLP energy and infrastructure of counsel Lis Blunsdon said. “Bankers hate uncertainty.”

The uncertainty will probably manifest itself most when it comes to cross-border projects, such as grid interconnection and other electricity transmission projects between the U.K. and the EU, or cross-border gas pipelines.

“I can't think of [an] example where someone would be able to transport gas or electricity into the EU without complying with its rules,” Blunsdon said.

The potential for cross-border hurdles isn't limited to the physical transportation of electricity and gas. With financial regulation increasingly encroaching upon energy markets, participants in those markets will have to figure out what legal regimes apply to their trading activities, experts say.

“In terms of energy trading outside the U.K., it's difficult to see a scenario where we would be allowed to trade into Europe without complying with the EU rules,” Blunsdon said.

To look at an example of the potential cross-border energy headaches created by a Brexit, one need only to look at the potential energy market restructuring that Ireland would face, experts say. The Republic of Ireland is an EU member while Northern Ireland is part of the U.K., but they currently share a single electricity market, and the island receives much of its gas through interconnections with U.K. member Scotland.

A Brexit “would be a market disruption and create uncertainty in investment in interconnection,” Goldberg said.

However, experts say it would be in the best interests of both the U.K. and the EU to ensure the connections between their respective energy markets — physical and financial — remain solid.

“Interconnection is talked of as a pretty efficient way of smoothing out the energy markets across Europe,” Dwyer said. “Looking forward, it may be less straightforward in creating interconnectors between grids, but there's still enough in it for the European market and the U.K. market to make it work.”

The long-term impact of Brexit on energy project development could extend beyond mere cross-border deals. As a global financial hub, London is a gateway for the financing of large energy projects not only in Europe but in Africa and the Middle East as well.

A long-term concern among Brexit opponents is that London could lose some of its financial clout to other markets. If the U.K. can no longer take part in the relatively unfettered movement of capital within the EU, London might not be as attractive a financing spot for big, multinational players, experts say.

“If it were to become less attractive, because moving capital in and out of Europe would become more difficult for the big syndicated deals, they might move to Paris and Frankfurt,” Blunsdon said.

Others aren't so sure it would come to that. Not only does the U.K. have the banks and supporting services that energy developers need to finance their projects, but there's also a well-developed and stable legal framework underpinning all of it.

“People are confident in English law. That's not going to change post-Brexit,” said Mayer Brown financial services partner Guy Wilkes, a former official with the U.K.'s Financial Conduct Authority. “The reasons firms want to come to London will still be here.”

But all this only reinforces the notion that a pro-Brexit vote on Thursday would send the energy industry into uncharted territory, experts say. For starters, negotiating replacement trade agreements between an EU-free U.K. and the EU would likely take several years.

“There's no precedent for a major jurisdiction leaving the European Union,” Goldberg said. “We do not have any recent history to guide us at this point.”

--Editing by Christine Chun and Kelly Duncan.

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