GMCA GREATER MANCHESTER COMBINED AUTHORITY

LOW CARBON HUB BOARD

Date: **15th July 2016**

Subject: **BREXIT – Potential Implications For GM LCH**

Report of: **Mark Atherton, GM Director of Environment**

PURPOSE OF REPORT

This report provides an overview of the potential implications of BREXIT for the UK's Energy and Environment policy. Although it is too soon to be clear, possible implications for the GM Low Carbon Hub's work programme have been identified where possible.

RECOMMENDATIONS:

The Board are recommended to:

i) Discuss and note the potential implications of Brexit on the Low Carbon Hub's work.

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TRACKING/PROCESS	[All sections to be completed]	
Does this report relate to a Key Decision, as set out in the GMCA Constitution or in the process agreed by the AGMA Executive Board	No	
EXEMPTION FROM CALL IN		
Are there any aspects in this report which means it should be considered to be exempt from call in by the AGMA Scrutiny Pool on the grounds of urgency?	[Please state any reasons here]	
AGMA Commission	TfGMC	Scrutiny Pool
15th July 2016	[Date considered at TfGMC; if appropriate]	[Date considered/or to be considered at Scrutiny Pool; if appropriate]

1.0 Background

This briefing note provides a short synopsis of areas of GM Low Carbon policy and programmes which might see changes as a result of the UK referendum decision to leave the European Union.

To leave the European Union, the Government will have to invoke Article 50 of the Lisbon Treaty, which starts a two-year 'negotiating period' and during which the status quo would continue. If the UK leaves the European Union, a range of possible outcomes could occur, from remaining in the common market with most of the same rules and regulations, to a free trade agreement, to no trade agreement at all. As well, many EU regulatory requirements are implemented through UK parliamentary legislation which remain binding unless and until parliament revoke them.

2.0 Potential Impact on UK Energy Strategy

Some commentators anticipate that leaving the European Union could create a significant slowdown on energy policy development as the Government turns its focus to the future EU-UK trade relationship. A number of policy areas may be reviewed within the context of the European requirements and their potential removal. However, it will not be clear which requirements are eligible for removal until the end of the two-year negotiation period, leaving a significant period of potential policy and regulatory limbo.

2.1 Energy Market - The European Commission has set a goal for energy to 'flow freely across the EU - without any technical or regulatory barriers', and has set ambitions to redesign the European electricity market, setting common standards, to achieve that aim. Some large UK energy market players have called for the UK to remain a member of the Internal Energy Market in any negotiation however there could be a call from deregulatory advocates to remove the regulatory 'red tape' that was previously required by European law.

2.2 State Aid - EU State Aid restrictions have potentially limited Ministers' ability to support favoured technologies or industries, as well as make changes to individual schemes which have already received State Aid approval, such as Contracts for Differences and the Capacity Market. The Government, for example, could use the removal of State Aid restrictions to favour nuclear energy investments, reduce business energy costs, or ban diesel generation from participating in the Capacity Market.

2.3 Energy Prices - The fall in value of sterling will create upward pressures on energy prices; this will be felt quickly through oil imports which are traded in USD; exacerbated by the increase in the cost of barrel of oil from $39 in April to $48 at the end of June. Petrol and diesel prices could increase, reversing the previous 12 month trend which saw prices fall by 4.6% and 7.6% respectively. In the medium term gas, and less significantly coal prices may increase, as supplies from advanced purchases reduce and new supplies need to be sourced. This could put upward pressure on gas and electricity costs, which may vary across suppliers.

2.3 Security of Supply - The UK currently imports gas and electricity from the EU through interconnectors. By 2019 it was predicted that up to 25% of our energy would be sourced this way. Our ability to do this will be dependent on the relationship we strike, e.g. A 'Norway model" which limits State Aid, would keep us inside the EU's internal energy market; whereas a "Swiss model" may see us at times exporting our energy when its cheap and importing EU energy when its expensive.

Investment is potentially needed either in interconnectors or back up generation capacity to manage periods of high demand. The uncertainty could reduce investor confidence and could result in inaction, putting pressure on our security of supply at peak periods of demand. The uncertainty could possibly increase the cost of capital, although this will be partially offset for foreign investors as their risks could be partially offset due to the drop in sterling. The issue of risk and increased cost of capital is true for all energy infrastructure investment which could simultaneously put longer term pressure on the energy prices and security of supply.

3.0 European Targets

3.1 2020 Renewables Target.

The renewable target requires the UK to meet 15% of UK final energy demand from low carbon or renewable sources by 2020. There does not appear to be UK legislation implementing this requirement. The Government could decide to reduce or remove the renewables target, and pull back funding on related schemes, such as the Renewable Heat Incentive. GM does not have its own renewable energy target.

3.2 2020, 2030 and 2050 carbon targets.

The new European carbon targets require a carbon reduction of at least 40% from 1990 levels by 2030. These targets are seen as ‘in line’ with UK carbon targets, mandated under the Climate Change Act 2008, and so the removal of these European targets would not have much direct impact. EU targets are subject to infraction proceedings whereas UK targets are subject to the courts so UK penalties, if any, are more challenging to forecast. GM has its own 2020 target (48% from 1990) but no 2030 target. GM has however signed up to the `Under 2 MoU’ and Integrated Covenant of Mayors (now combined into one) which require 80-90% carbon reduction by 2050. This is an international, rather than solely EU commitment.

4.0 Potential Impact on Specific Energy Policies

4.1 Contracts for Difference - This scheme would be expected to continue in order to meet UK carbon budgets, although the removal of State Aid restrictions could allow changes to the scheme to target support at specific favoured technologies.

4.2 Capacity Market - There would likely be more significant reforms of the Capacity Market, as Government is interested in discouraging diesel and gas engines and encouraging centralised CCGT but has been previously limited by the requirement to request new State Aid permissions. Actions might include targeting coal and diesel generation to participate in the Capacity Market, which could impact both CHP and demand side response.

4.3 Renewable Heat Incentive - The Government committed in the Spending Review to fund the Renewable Heat Incentive until April 2021 with £1.3 billion in funding. However, if the renewables targets are removed, the Government could choose to withdraw this funding. The results of a consultation on scheme changes was expected to be published this summer, but could be delayed as part of any broader review. RHI currently provides income to the RSLs involved in the NEDO project from Air Source Heat Pumps installed and a number of other small scale heat schemes in GM receive RHI.

4.4 Heat Network Infrastructure Project - The Government announced in the November Spending Review it would provide £320m for district heating until April 2021. This spending is not linked to any European targets, but is instead intended to deliver infrastructure spending and meet UK carbon budgets, but continued political support will be important within the new Prime Minister's Government.

4.5 The EU Emissions Trading Scheme - This scheme is set out in UK legislation, although linked to specific pieces of European legislation (e.g. the Greenhouse Gas Emissions Trading Scheme Act 2012). Other non-EU countries (such as Norway) participate in the EU ETS, and this route could be left open to the UK following Brexit.

4.6 Carbon Price Support and other carbon taxation measures. These carbon taxes are set in UK law and would be unlikely to change immediately. However, lobbying efforts to change carbon taxes would increase, as many of them were designed to remain eligible with European State Aid requirements. For example, HM Treasury might be willing to consider removing Climate Change Levy for all CHP generation. Energy tax reliefs for businesses, previously restricted by State Aid, could also be reviewed.

4.7 Charging methodology - Europe requires that the balance of transmission charges on generators should not be more than 2.5 Euros per MWh, which is expected to be breached by 2020. Ofgem plans to cap transmission charges at this level, and the remainder of transmission costs will be levelled on demand users. Remit provides an EU-wide regulatory framework specific to wholesale energy markets that requires regular reporting obligations on market players. The Electricity Market design package, expected in Winter 2016, focuses on the harmonisation of the EU energy market, including capacity mechanisms and opening up access to electricity markets for demand response providers. The implementation of these measures in the UK could be delayed or not taken forward following Brexit negotiations.

4.8 Energy Efficiency Directive Article 8 - The Energy Saving Opportunity Scheme (ESOS), which were created to meet European obligations, could be at risk of removal. If so, this might reduce the demand for GM businesses to improve their energy efficiency and demand for consultancy advice.

4.10 Urban air and water quality. The UK has been directed by European courts to improve air quality in urban areas before 2020, following the UK's intention to meet the requirements only by 2030. Brexit could result in a reduction in ambitions in meeting air quality standards. EU Water quality regulations, under the Water Framework Directive, have largely been transposed into UK law, with the potential exception of some bathing water standards.

4.11 Energy Performance in Buildings Directive - The EPBD requires the calculation of the energy performance of buildings. The requirement is implemented in the UK through Energy Performance Certificates and Display Energy Certificates, which are under review this year already. The EPBD also sets minimum energy performance requirements, already implemented through building regulations. An obligation to meet EU near-zero carbon home requirements in 2018 is potentially at risk, as the current Government has previously removed efficiency requirements to lower home building costs.

5.0 EU Funding

The impact of Brexit on existing EU funding is still unclear. For Transnational funding (H2020, Interreg etc), the current messages seem to suggest `business as usual'. Existing projects (contracted) should continue as normal as most will be completed within 2 years. New applications for Transnational funding should also be progressed as we are still in the EU with consequent rights and responsibilities. The likelihood of success of new projects bids might however be diminished.

The impact on ERDF funding is less clear at this stage. Existing contracted projects will continue and, recent advice suggests, that any projects currently in the pipeline should be progressed. The ability to contract new projects (eg in 2017) may be impacted by a potentially shortened widow of delivery.

6.0 Wider Financial Implications

If the current turbulence in the financial markets continues, a further period of reduction in public spending may be required to balance the books. If this follows the previous approach to austerity, local government can expect to bear a significant proportion of further cost reduction measures. Any further changes in national political leadership may also have an effect on current policy direction.