Exit from the EU would have a profound impact on the strategic direction of the UK water sector. The impact may not be immediately felt – with business plans already set, investment needs defined and major projects commenced. However, the absence of EU Directives shaping water and environmental policy could see the UK diverge from a path which has driven consistency and common standards across European Member States for over 25 years. Key principles from headline European initiatives, such as the Water Framework Directive would be in question: UK policy makers could embark on changes to the industry’s regulatory framework that may be unrecognisable from the EU in the future.

The European influence
Market integration of the water and sewerage sector has not happened on the same scale as, for example, the European energy market for a variety of reasons, not least due to the very different physical characteristics of water distribution networks versus electricity or gas networks. There are, for example, no ‘water interconnectors’ between the UK and mainland Europe.

However, through various directives and policies, the EU has driven harmonisation of compliance frameworks across member states. As a result, the EU has arguably been the driving force behind many investment decisions for over 25 years in the water and sewerage sector. These standards and drivers derive from Directives such as:

- Urban Waste Water Treatment Directive
- Water Framework Directive, and associated directives, such as:
  - Nitrates Directive
  - Directives relating to dangerous/priority substances and chemical analysis
- Flooding Directive
- Groundwater Directive
- Drinking Water Directive
- Bathing Water Directive
- Sewage Sludge Directive
- Environmental Liability Directive

While the above Directives have had direct impacts on the water and sewerage sector, there have been many other pieces of legislation and policy which have driven industry approaches, including provisions relating to industrial emissions, procurement, employment, state aid and competition rules.

While all of the above has shaped and influenced how we see the sector today, the delivery of water and sewerage services, and industry structures, are diverse across member states: from liberalised markets to publicly delivered services, and everything in between.

While outcomes and targets are often the product of European Directives, Member States have considerable
scope for determining exactly how water and sewerage services are delivered – which is why you can see, for example, a wide variety of strategies and approaches to the management of sewage sludge, and in particular the implementation of bans on agricultural spreading, for example in Germany.

Of course, the status of any future reviews of European frameworks or current negotiations (such as TTIP – which may have some impact on the water and waste water sectors) would immediately be thrown into uncertainty should the UK vote to leave. From that point, the UK will need to develop and negotiate alternative provisions for establishing trading and cooperation arrangements with our European neighbours.

**The fundamentals: Four freedoms**

The position of European Directives on water quality and environmental standards, for example, may be subject to more long-term evolution should the UK decide to leave the EU, since much of the quality standards are heavily embedded into industry-wide strategy. However the exit of the UK will immediately call into question the position of the four fundamental freedoms.

The below (fictional) example can illustrate this: A UK water company (whose parent company is a European-based fund) is looking to invest in an innovative new sewage treatment process.

**Goods.** The upgrade to the secondary treatment process requires specialised diffused air blowers and control systems from a company in Germany, which have been proven in this application and are considered the industry standard. The basis on which these can be imported into the UK will need to be settled post-Brexit. The UK could require the water company to use UK manufactured components which may not be of the same specification, or import duties could be placed on the German goods, making them un-economic.

**Services.** The design consultancy is a Netherlands based specialist who has developed and patented a brand new treatment process. They are the only company able to deliver this new technology. At the moment the consultancy is free to provide services to the water company without restriction, but a future UK administration could, for example, place restrictions on foreign based service providers for certain industries.

**People.** The design consultancy typically delivers and project manages the deployment of this technology through an in-house subsidiary. The engineers employed by this subsidiary are all based in the Netherlands, of various European nationalities. The delivery team typically work on-site and have an excellent track record.

Following Brexit, the water company may be obliged to demonstrate that no other suitable capability exists in the UK before being able to engage these consultants. There may also be individual immigration restrictions depending on which countries the team members come from, complicating the delivery process and possibly leading to project delays.

**Capital.** The funds for the investment come from the European fund. At the moment capital controls are not permitted under EU law, but a future UK government could impose restrictions on how projects like this one (involving foreign owned delivery vehicles) are funded. The European investors would also have to consider how they could transfer profits from the UK investment out of the UK.

**Water industry specific issues: Short to long term**

Should the UK chose to leave the EU there probably won’t be fundamental changes overnight. There will no doubt be a transitional phase, and a period of time where some searching questions take place about what the UK’s vision for water and sewerage policy would be, absent the significant direct influence of the EU. Fundamentally however, price review and business planning processes have been completed for the foreseeable future, with companies now carrying out their investment plans for the next few years at least.

Any change would probably be for future investment periods, and would naturally be in line with whatever domestic legislation is in force at the time. However, some pertinent questions to consider may be:

- Would regulators abandon current investment plans and determinations, and revisit them?
- Would companies seek to revisit investment plans/seek additional TOTEX allowances.
- In the current investment periods, would there be the same consequences for non-compliance given the absence of European enforcement?
- How would existing or planned enforcement action be handled? Would new UK enforcements be started to replace EU ones?
- If a UK domestic law which has transposed EU requirements is to be enforced against a water company, would there be scope to challenge the validity of the law? One argument would be that these are part of UK law, like any other piece of domestically derived legislation. Another argument may be the absence of Europe would means these pieces of legislation are on shaky ground.

Given that the legislative framework for European
water policy has largely been transposed into domestic legislation, it would be a significant task to start picking this apart and start from scratch. For this reason, it is probably more likely that the future of water policy in the UK lies in subsequent amendments to existing legislation, which aim taken at the more obviously contentious issues.

Some changes are probably more likely than others. For example, from a public health perspective, it could be politically difficult for any future government to start degrading drinking water quality standards in earnest.

On the other hand, it could be more foreseeable that environmental quality standards could be lessened, particularly under the justification of economic development, growth and jobs. Certainly some of the more contentious areas of the Water Framework Directive, such as the ‘one-in-all-out’ principle for river water quality, could be revised. Additionally, certain principles such as full cost recovery could receive more flexible treatment in the future, depending on the political direction of a future UK administration.

A different regulatory framework could potentially mean some projects, that may have previously been in doubt, getting the consenting green light. The question of the environmental cost v overall benefits would of course be a tough question for any future policymakers.

Another important consideration would be the implications for any restrictions on capital flows for water companies, certainly with regard to the diverse ownership within the UK, and where profits are able to be directed. Again, this would be influenced by the political ideology of any future administration.

While the policy direction in the future may be significantly different to that of today, it is important to remember that policy is not created in a vacuum. European policy will continue to develop through technical, academic and policy expertise, and may still influence UK water strategies and policy outside of the EU.

Conclusion
As with many issues linked to Brexit, the long-term impact on the water sector is uncertain. There are some specific areas where change may be more likely such as environmental quality standards. On the other hand many major changes could be more readily apparent if there were to be significant shifts in political ideologies and policies in the UK. However, European policy simply by being such a large driver of the regional agenda and a body of technical knowledge in itself, could continue to influence UK policy approaches post-Brexit.

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What If?
Shepherd and Wedderburn has been for many years offering balanced and impartial advice on how the different scenarios might play out in the event of constitutional change.

With the EU referendum now only months away, members of our dedicated Brexit Advisers will continue to interrogate the ‘what if’ questions, relating to specific sectors, that will emerge when the UK decides whether to remain in or leave the EU.

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