SLAUGHTER AND MAY/

The future relationship between the UK and EU

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As the UK emerges from its COVID-19 lockdown the focus for many businesses has now switched back to the negotiations on the future relationship between the UK and the EU from 1 January 2021. This briefing summarises the current state of the negotiations and the main points of difference between the parties based on the legal texts published by both the UK and the EU as well as other relevant materials. It should be noted that both sets of texts are incomplete, and have been published as negotiating documents, and neither should necessarily be taken as the final positions of either party. We do not attempt to predict which compromises may be made on either side to reach consensus, or whether the final outcome of the talks will be an agreement.

The negotiations so far

On 15 June 2020 the UK and EU published a statement following a video conference between Prime Minister Boris Johnson, Commission President Ursula von der Leyen, President of the EU Council Charles Michel and European Parliament President David Sassoli. Three key takeaways are:

- First, the negotiations will continue through the summer and possibly into the autumn with "new momentum", whereas previously there had been speculation that if the UK concluded no acceptable conclusion to the talks was likely by the end of June it would move straight into "no deal" planning (euphemistically referred to by some as the "Australian option").
- Second, the UK formally confirmed that the transition period would not be extended beyond 31 December 2020.
- Third, the parties remain far apart on many issues of substance.

This is significant as if no agreement is reached and implemented by 31 December 2020 UK-EU trade would in principle revert on 1 January 2021 to World Trade Organization (WTO) rules.

The virtual summit followed publication by the EU on 18 March, and by the UK on 19th May of their respective proposals for a comprehensive UK-EU preferential - or free - trade agreement (FTA). Although the texts cover much of the same ground, and seek in many areas similar outcomes, the approach and structure are very different. The chief negotiators - David Frost for the UK - and Michel Barnier for the EU - did not hide the significant differences that exist, and lack of progress in the talks, at the conclusion of the fourth round of negotiations in June. The restricted round of talks from 29 June to 3 July appear to have ended in deadlock. Talks are due to resume again next week.

In terms of areas of agreement both parties desire a comprehensive FTA covering both goods and services, as well as agreement on various other topics including police and security co-operation, extradition, recognition and enforcement of civil judgments, air transport, energy and social

security. As regards defence and foreign policy it appears that the UK seeks only ad hoc co-operation outside of any institutional basis. The EU argues that this approach will impede future action. Whether this is in fact the case is unclear. The UK, France, Italy and the US took military action to overthrow the regime of Colonel Gadhafi in Libya on the basis of a UN Security Council resolution without EU involvement, and have subsequently backed different sides in the ensuing civil war (as have outside players). Nor was the EU involved in the Second Gulf War where Member States took opposite positions. The EU has, however, been involved in various peacekeeping missions, notably in the Balkans.

At its core, the differences between the parties turn on two key issues: sovereignty and the pursuit of economic advantage. The UK argues forcefully that as a sovereign state its future relationship with the EU should be based on a partnership between equals based in large part on the trade agreements the EU has concluded in the past with Canada, Japan and New Zealand, as well as EU proposals in trade discussions with the US in the context of the currently moribund Transatlantic Trade and Investment Partnership (TTIP).

The EU counters that the UK is geographically closer and a more important trading partner than those other countries, that all trade agreements are unique based on considerations of mutual advantage so there is no single template to follow, and that the UK is seeking a closer relationship than those other FTA partners. The EU is also concerned that UK companies could obtain a competitive advantage by undercutting EU companies in the EU and world markets. Angela Merkel has said that Britain will have to “live with the consequences” of Boris Johnson’s decision to abandon former Prime Minister Theresa May’s plans for close alignment with the European Union (although these were in fact rejected by the EU at the October 2018 Saltzburg summit).

Another EU claim is that the UK proposals are inconsistent with the October 2019 political declaration on the future relationship agreed by the current UK Government, although as this is not legally binding, and was intended only as a framework for the negotiations, this may not seem a compelling argument to many, but was insisted on by Michel Barnier in a speech in June 2020, where he stated that the UK kept backtracking on provisions of the political declaration.

Other relevant EU considerations are that EU trade matters more to the UK than UK trade to the EU – so the UK is likely to accede to the EU’s demands, and that if the UK is seen to benefit economically from Brexit then this could undermine the existing balance of rights and obligations underlying EU membership and its Single Market, and possibly encourage other Member States to leave – although the prospect of the latter seems extremely remote at present. Since the 2016 UK referendum most EU populist parties have toned down anti-EU rhetoric, and populism may be on the downturn following COVID-19. Doubtless Brexit fatigue has set in in many Member States given the COVID-19 pandemic, hard fought negotiations on how to support the worst affected Member States, the German Federal Constitutional Court’s decision to rule ECB quantitative easing as illegal, and negotiations on the next five year EU budget.

The remainder of this briefing will be devoted to the major areas of difference between the EU and UK. Not all points will be considered, and doubtless some differences will have been included in the published texts as negotiating points to be conceded in the discussions.

One agreement or several

The EU insists on a single agreement approach with an overarching scope covering all areas of the future relationship (although to be supplemented by other documents), and a single dispute

settlement mechanism. The UK seeks a suite of parallel agreements on specific topics each potentially with their own dispute settlement provisions, as well as different approaches to different chapters of the "core" FTA (i.e. non enforceability of certain provisions such as on subsidies and competition policy).

The UK approach certainly does not lack for precedent – Switzerland has hundreds of bilateral agreements with the EU (although most are interrelated in that termination of one agreement results in other agreements being terminated automatically), and agriculture is excluded under the European Economic Area (EEA) Agreement that provides Single Market access to goods and services for Iceland, Liechtenstein and Norway. The EU customs union with Turkey covers only manufactured goods with agriculture and iron and steel subject to separate regimes. The EU's desire for a single agreement is, however, consistent with its position in ongoing negotiations to update its relationship with Switzerland (which the EU regards as unsatisfactory), and the EEA states are less significant trading partners than the UK, and anyway have to accept existing and new single market directives and regulations as a condition of access to the Single Market.

No tariffs and market access to services based on mutual recognition

From the outset the parties have seemingly been in agreement on no tariffs on agricultural and manufactured goods (apart from a controversial EU safeguard provision on agriculture), and the UK has asked for mutual recognition in a variety of service sectors. The EU's position is that zero tariffs are almost unprecedented in FTAs (which generally exclude agriculture and retain some tariffs). Therefore, there is a need for a series of "level playing field" measures (see below).

The UK Minister for the Cabinet Office, Michael Gove, has responded that if no tariffs require level playing field measures, then the UK could accept some tariffs. This was initially rejected by the EU as unfeasible due to the lack of time to agree a line-by-line tariff schedule. There are recent media reports that the EU will propose a compromise resulting in tariffs being imposed if the UK diverges from level playing field measures. Although not without merit, there seems a lot of posturing here. EU tariffs (other than on many agricultural goods) are generally low, and it would not seem necessary to spend years negotiating FTA tariffs on thousands of categories of goods, as opposed to focussing on key products for both parties.

Alternatively, some or all agricultural goods could be excluded from the FTA. Agricultural products are excluded under the EEA Agreement and also under the customs union with Turkey – unless processed – although Turkish agricultural imports benefit from a separate preferential agreement, whilst trade in iron and steel is governed by a FTA.

The EU's Deep and Comprehensive Free Trade Agreements with Georgia, Moldova and Ukraine enable access to the Single Market on a sectoral basis based on EU certification that the relevant state has implemented and complies with EU law on top of general FTA provisions. These agreements were clearly designed, at the time, as a potential gateway to EU membership. All this goes to show that EU practice is in fact quite diverse.

Mutual recognition, for the EU, should be a unilateral decision accorded independently by each of the parties where it is in their commercial interest, and not negotiated ex ante or subject to a procedure for withdrawal. Existing "equivalence" decisions under EU law can generally be withdrawn on 30 days' notice, and cover only a limited number of areas. It would seem that the EU position on mutual recognition is designed to keep the UK in regulatory alignment in key areas

where the UK has a comparative advantage, such as financial services, or where the EU wishes to impose its own standards such as the General Data Protection Regulation (GDPR).

A potentially significant area of disagreement is over financial services. Detailed consideration of the regulation of financial services in the UK from 2021 is outside the scope of this briefing. However, documents published by HM Treasury and the Financial Conduct Authority in June 2020 indicate that the UK wishes to diverge from EU rules in certain areas in the short term as well as having the ability to tailor the prudential regulation of banks and investment firms to the specific needs of the UK market, whilst complying with international standards and achieving a broadly equivalent outcome. According to the Treasury "the government is reviewing the overall framework for financial services regulation in the UK, to determine how the framework needs to adapt to the UK's new position outside of the EU, and to ensure the framework is fit for the future". Separately, in a speech on 30 June 2020 Michel Barnier stated that the UK's "proposals are unacceptable" as they would severely limit the EU's regulatory and decision-taking autonomy and would retain many of the benefits of the Single Market without the obligations. While the planned deadline for making equivalence assessments has been missed, there remains no indication that the EU is willing to go beyond the aims stated in the Political Declaration.

Level Playing Field

Perhaps the most controversial aspect of the EU text that has drawn considerable criticism from the UK Government are EU proposals for a "level playing field". These proposals go far beyond "non-regression" clauses common in FTAs where the parties agree to not cut the level of, say, labour standards in order to gain a competitive advantage. For Michel Barnier they are "essential preconditions".

The provisions impose highly specific obligations, including on human rights' protection (this includes how the European Convention on Human Rights is implemented in UK domestic law), climate change, the environment, state aid, competition law and labour law. On state aid, the UK is required to keep in dynamic alignment with EU rules (meaning that it must follow any changes to the existing rules adopted by the EU in the future). The provisions on competition law are a carbon copy of existing EU rules in the Treaty on the Functioning of the European Union (TFEU). These provisions are to be enforced by a panel of experts.

The EU has sought to justify such detailed controls over major aspects of UK regulatory and legal policy on the basis of a fear that the UK could undercut EU standards in these areas and thereby obtain a competitive advantage (referred to as "social dumping") as well as the UK ask for no tariffs (see above). The Prime Minister made clear in a speech in February 2020 that it was not Government policy to seek a low cost low standards economic model. However the Government has also been adamant that it regards the provisions as incompatible with the UK being a sovereign state.

This is a position that has considerable historical and academic support (originating in the notion of sovereignty adopted at the Peace of Westphalia in 1648 that ended the Thirty Years' War in Europe), and has been embraced by the US, Communist and developing countries, although as with all such debates the contrary has also been argued with force on the basis that sharing sovereignty gives countries more weight in trade negotiations. The issue ultimately turns on whether sovereignty is unitary (you either have it or you don't) or it can be shared. We will not consider this topic further.

Under WTO law importing states' requirements on how a product is made are generally irrelevant (i.e. respecting high labour standards, or requirements to manufacture goods in an environmentally sustainable way); only the physical characteristics of the goods themselves are relevant, as other considerations are considered to be outside the scope of trade policy. Regional trade agreements may contain such provisions (such as the side agreements negotiated by the Clinton administration to the North American Free Trade Agreement (NAFTA) and the South American customs union MERCOSUR's ability to suspend Venezuela in 2016 over human rights concerns).

There is of course truth in the position of both parties. FTA partners of the EU outside of the Single Market have not agreed to similar level playing field provisions, and tying the UK to EU rules it has no influence over, and which may even be adopted to protect the EU market from UK exports, is inconsistent with the conception of UK sovereignty that underlay the "take back control" slogan of the successful leave campaign in the 2016 Brexit referendum. On the other hand, recent studies continue to show that geographical proximity is a significant determinant of trade flows, and the possibility of the UK to undercut EU firms' competiveness in the future is real even if it is not current Government policy. National policy can change over time as seen by the gyrations in the policy of successive Australian and US governments on climate change, or on environmental protection in Brazil.

Yet the converse possibility exists of the EU undercutting higher UK standards in the future on, say, animal welfare, and there is no possibility of the EU agreeing automatically to adopt higher standards should the UK decide to do so in specific areas. Indeed, the ability to set your own standards seems to be one of the main points of Brexit. Also, there seems little likelihood at present of the UK not retaining a robust system of competition, labour or environmental law, and if the UK were to adopt a deliberate low standards policy in the future the EU would always have the option of terminating the FTA.

Dispute resolution

The EU text provides for binding arbitration (which is common in FTAs) but with two highly unusual features. Any provision or concept of EU law referred to in the agreement shall in their application and implementation be interpreted in conformity with the judgments of the Court of Justice of the European Union (CJEU). Moreover should a dispute concerning any such matters come before the arbitral tribunal it shall request the binding interpretation of the CJEU.

Successive UK Governments since 2016 have rejected a role for the CJEU after the end of the transition period. Significantly, no similar provision exists in either the EEA Agreement or the EU-Turkey Customs Union. The EEA Agreement allows EFTA states to "opt in" to CJEU jurisdiction over their courts. No EFTA state has ever done so. It also provides for certain disputes before the Joint Committee to be referred by mutual agreement to the CJEU. This option has never been exercised. There exists a separate EFTA court, but its opinions are advisory, and not binding, unlike CJEU judgments. The EU's FTA with Canada (CETA) follows the customary practice in EU and other countries' FTAs of mediation followed by arbitration, which is the UK Government's desired outcome. Older EU FTAs relied only on diplomatic solutions.

The ostensible concern of the EU is the maintenance of the autonomy of EU law, which is a doctrine developed judicially by the CJEU holding that only the CJEU can issue binding decisions on the interpretation of EU law. The ability of the EU to conclude international treaties where questions of EU law come up as a question of fact, and not law, before another court or tribunal, and do not bind the EU erga omnes, was recently confirmed by the CJEU in Opinion 1/17 on the compatibility of the

investor-state dispute settlement provisions of the CETA. Those cases where the CJEU has struck down international dispute settlement courts or tribunals seem to turn on the drafting of the particular treaty rather than its substance and are therefore resolvable.

It is hard to see how an interpretation of EU law by an arbitral tribunal under an EU-UK FTA could bind the CJEU or its Member States. Member State courts regularly rule on EU law without making a reference to the CJEU, and FTA tribunals may rule on concepts derived from EU law without this in anyway affecting decisions of the CJEU in the future. From a UK perspective the EU demand seems more likely to be intended to tie the UK more closely to EU law and institutions. After all, requesting that the Supreme Court of one party to an FTA be exclusively empowered to interpret it is not seen in the practice of any other states.

Fisheries

Although a tiny fraction of both UK and EU GDP this topic has emerged as a significant stumbling block in the negotiations. The UK position is that as an independent coastal state it should have full autonomy in negotiating access to its coastal waters and exclusive economic zone under international law, and has proposed annual negotiations with the EU similar to those the EU has agreed with Norway. The EU proposes continuing "existing reciprocal conditions on access to waters and resources" which the UK interprets as a continuation of the common fisheries policy (CFP). Whilst international law gives existing Member States a right of some access to fish in UK waters, it is by no means prescriptive, and the UK is not obliged to continue existing levels of access (cf. the so-called cod wars with Iceland in the 1970s). Given its limited economic salience, we regard this essentially as a political issue as states seek to protect their domestic fishing communities rather than as raising any real issue of principle.

Future Steps

The future course of negotiations and the timetable to a putative agreement is hard to predict at present. The last round of restricted negotiations will doubtless be followed by a fifth and subsequent rounds although the dates remain to be set. Michel Barnier stated in a speech on 24 June 2020 that "a deal is still possible" but had to be reached by October in order to be ratified by the European Council and the European Parliament (and also by the UK Parliament), although the final decision rests with the European Council acting unanimously. He also stated that any agreement was dependent on implementation of the 2019 Withdrawal Agreement and noted that the EU regarded progress as unsatisfactory on implementation of the protocol on Northern Ireland and Ireland.

Whether October 2020 is realistic depends on whether – as a matter of EU law – the agreement falls within the exclusive competence of the EU under the common commercial policy, or under the dual competence of the EU and its member states as a so-called "mixed agreement". Exclusive EU competence seems to us unlikely in the light of the case-law of the CJEU, in which case the agreement will be at best able to be provisionally applied in those areas within the EU common commercial policy (like CETA), from 1 January 2021 pending ratification by national – and in some cases regional – parliaments across the EU. CETA has been provisionally applied since 2017 but has still not entered fully into force as not all Member States have ratified it.

The UK has no official deadline for agreement. The Prime Minister suggested that negotiations could be concluded in July, although Michael Gove is reported to have agreed with Michel Barnier that October is a more realistic target.

It is, of course, possible that agreement, and provisional application or ratification, will extend beyond December 2020. In this case, the strict legal position is that the UK and EU would revert to WTO rules for the interim. However, the parties might simply choose to ignore the hiatus, which, if measured in months, might be thought to be unlikely to trigger dispute settlement action at the WTO by UK/EU trading parties (which generally take years and where the remedies are limited).

Conclusion

Many other points of disagreement exist and on some, if not all, of them each side has negotiating points to advance. It would, however, seem that the EU has so far judged that the UK needs an agreement more than the EU, as UK exports to the EU are significantly greater as a percentage of UK GDP than the converse, and the EU is a significantly larger market benefiting from geographical proximity, unlike the US, or potential Commonwealth FTA trading partners. These are valid points, but as the Brexit vote showed economics do not always trump politics.

It would also seem that the December 2019 UK general election gave the Government a sufficient majority in Parliament and a political mandate (which Theresa May's government lacked) to walk away. Moreover, the economic costs of "no deal" are far less than those attributable, at least in the short to medium term, to COVID-19 (even if affecting different sectors) which has already seen a 20% decline in UK GDP. If the EU assumes that the UK will accede to all or even most of its contested demands it may be making a political misjudgement the future effects of which are hard to estimate. The consequences for the UK of "no deal" are unclear, and the Government may hope that negative ones would be swept up in the recession and unemployment caused by COVID-19 in the months, and possibly, years to come, whilst adopting mitigating measures for trade disruption.

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