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SUBMISSION TO THE DEPARTMENT FOR EXITING THE EUROPEAN UNION BY TRAVERS SMITH LLP

FIRST SUBMISSION: TRANSITIONAL ARRANGEMENTS AND PRINCIPLE 12 OF THE WHITE PAPER ("SMOOTH, ORDERLY EXIT")

Travers Smith LLP is an international law firm with offices in London and Paris. The firm advises a variety of clients from publicly-listed and private companies and financial institutions to central banks, operators of financial market infrastructure and other public bodies, often in relation to complex, multi-jurisdictional legal and regulatory issues[1].

This submission focusses solely on transitional arrangements and Principle 12 (smooth, orderly exit) of the White Paper entitled "The UK's exit from, and new partnership, with the European Union" (the "**White Paper**"). A separate submission (the "**Second Submission**") focusses on the remaining principles set out in the White Paper. We may submit further written evidence to assist HM Government's deliberations on the UK's negotiating objectives for the withdrawal from the EU.

1. We welcome the recognition by the Prime Minister in her Lancaster House speech and in the White Paper that a key objective of the negotiations should be to achieve a "smooth, orderly Brexit" avoiding "cliff edge" risks (Principle 12). However, we make the following observations and/or recommendations as regards transitional arrangements:

The "cliff edge" risks are plausible and significant

2. In our view, the "cliff edge" risks posed by leaving the EU without any form of agreement (including as to transitional arrangements) are both plausible and significant. To take just two examples amongst many:

    - **Goods trade with the EU:** Leaving the EU without any form of agreement would involve the re-introduction of customs controls on goods trade between the UK and the EU. According to the Port of Dover, each ferry contains on average about 2 miles of traffic - and Dover alone handles about 100 miles of traffic each day[2] (much of which consists of HGVs[3], with customs declarations expected to increase from 85 million per year to 300 million[4]). Given this level of traffic, the sudden introduction of customs controls at

1 Whilst we advise many regulated fund managers, corporate finance houses and other financial institutions, we do not focus on global investment banks or insurers, so this evidence does not refer to the issues particularly relevant to them.

2 See: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/279135/Port_of_Dover.pdf.

3 According to the Road Haulage Association, 4.4 million powered freight vehicles moved between the UK and mainland Europe in the 12 months to June 2016, of which 4 million transited through the Dover Straits route by ferry or tunnel. See: https://www.rha.uk.net/news/press-releases/2017-02-february/brexit-and-road-haulage-%E2%80%93-the-customs-control-dang-en

4 See evidence from the UK Chamber of Shipping to the House of Lords EU Internal Market Sub-Committee: http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/eu-internal-market-subcommittee/brexit-future-trade-between-the-uk-and-the-eu-in-services/written/41495.pdf

Channel ports raises the prospect of serious delays and disruption[5], as it is far from clear that the UK has the necessary resources or infrastructure in place to cope with such a change[6] (nor is it clear that ports or customs administrations on the continent would be adequately prepared). Widespread reliance on "just in time" distribution systems means that shortages of goods could arise within a relatively short period, as occurred during the fuel protests of 2000[7].

- **Financial services:** Leaving the EU without any form of agreement (in particular as regards access or its equivalent to the single market and key provisions supporting the inherent stability of our financial systems) would lead to the fragmentation of liquidity and credit which are the life-blood of the smooth and efficient operation of the financial markets; it would also reduce customer choice and increase costs. These are not matters that operate in a vacuum. Safe and efficient markets promote financial stability and economic growth for all. Any systemic failure of these markets would be a source of financial shocks. Given the very large sums involved[8], the consequences for the UK and EU economies would be extremely serious, if not devastating.

3. Although HM Government has stated that it will seek to avoid cliff edge risks, some statements in the White Paper give the impression that it has not recognised the full extent of what is likely to be required to mitigate these risks[9]. This impression may have been unintentional and may not accurately reflect HM Government's thinking; however, such statements risk undermining business confidence in HM Government's approach, which could prove very damaging (see further paragraphs 9-11 below).

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5 Pro-Brexit think tank The Bruges Group has stated that *"David Davis' Department for Exiting the European Union must focus on addressing the logistical trade hurdles of delays at customs posts. The alternative will be even worse congestion on the M20 after Brexit than that which exists at present."* See: https://www.brugesgroup.com/images/papers/whatitwilllooklike.pdf at page 24.

6 The Road Haulage Association has stated that *"[w]e are not re-assured by recent government statements"* to the effect that HMRC's systems have the capacity to cope with the introduction of customs controls. In particular, it notes that *"[f]or EU continental road haulage [HMRC] has NO system [for dealing with customs clearance]"*. See footnote 3 above for reference. As well as additional IT capacity and staff, physical port infrastructure (on both sides of the Channel) would need to be adapted to facilitate a higher level of customs inspections.

7 See: http://news.bbc.co.uk/1/hi/uk/924574.stm. The fuel protests also caused problems for critical service providers such as the NHS, with some hospitals running short of key supplies.

8 Focusing, for example, solely upon the UK revenue streams derived from financial transactions which currently benefit from access to the EU single market, a report by Oliver Wyman indicates that about £18-20 billion of revenue could be at stake in a "low access" post-Brexit scenario; the actual amounts of money at stake in relation to financial transactions themselves (as opposed to the revenue derived from them by financial services providers) are likely to be considerably higher. In addition, the potential risks to market confidence in the financial system, the direct and indirect costs of which are impossible to gauge, would be substantial if HM Government and the EU institutions were unable to agree the continuance of measures put in place at the EU and international level during the past 20 years to support the integrity and safe operation of the international markets. Such measures include those relating to the "plumbing" of the financial system by protecting the efficient and effective operation of our systemically important financial market infrastructure (including payment systems, central counterparties and central securities depositories), as well as the market functions of the Bank of England and other central banks. See: http://www.oliverwyman.com/content/dam/oliver-wyman/global/en/2016/oct/OW%20report_Brexit%20impact%20on%20Uk-based%20FS.pdf .

9 For example, in a section discussing future UK-EU customs arrangements, the White Paper implies that the introduction of customs controls on leaving the EU will not give rise to significant problems because: *"[w]e already have highly efficient processes for freight arriving from the rest of the world – the vast majority of customs declarations in the UK are submitted electronically and are cleared rapidly"* (paragraph 8.44). This statement omits to mention that systems capable of processing high volumes of customs traffic do not currently exist at Channel ports (see footnote 6). The necessary staff, infrastructure and IT systems are likely to take longer to put in place than the 2 year period provided for under Article 50 – hence the concern about the cliff edge risk from the abrupt introduction of customs controls without adequate preparation. Mitigation of this risk is likely, in our view, to require agreement with the EU 27 for the UK to remain in some form of customs union with the EU for at least a transitional period, pending the completion of preparations on both sides of the Channel for the introduction of customs controls.

The approach to transitional arrangements should be designed to minimise avoidable loss of jobs and investment

4. Even a fairly cursory discussion of the cliff edge risks as set out above demonstrates that appropriate transitional arrangements will be of central importance in ensuring a "smooth, orderly Brexit". However, merely stating that transitional arrangements are a key negotiating priority is not, in our view, sufficient.

5. Faced with significant cliff edge risks of the types outlined above, businesses may well conclude that they cannot afford to await the outcome of negotiations and will start to implement contingency plans now, leading to loss of jobs and investment in the UK prior to Brexit. For example, a financial services business may conclude that in order to be confident of being able to continue to serve its clients, it will have to re-locate or re-structure a significant part of its existing business away from the UK and seek authorisation in another EU member state – and it cannot await the outcome of the Article 50 negotiations because by that stage, there will not be enough time to secure authorisation or carry out the necessary re-structuring. It may also decide that, for regulatory and/or business reasons (including, in the case of financial market infrastructure, for essential "settlement finality" reasons), it will need to change the governing law of its contracts (including its rules) from English law to the law of an EU 27 member state in order to preserve fundamental protections for its systems from the insolvency of overseas participants[10]. We note that some financial services businesses have already made announcements to this effect, as have some airlines (motivated by similar concerns about access to EU air transport markets)[11].

6. It would be highly desirable to minimise any further loss of jobs and investment in the UK. The key to doing so, in our view, is to ensure that businesses can have confidence that (a) it is more likely than not that appropriate transitional arrangements will be delivered; and (b) in the event that this is not possible, HM Government has (or will have) adequate contingency plans in place. That said, we would note that for a material part of the issues we identify in our Second Submission in relation to financial markets, unilateral contingency measures put in place by the UK are highly unlikely to provide the degree of safety and efficiency that participants in those markets have come to expect and require.

Some form of accord on transitional arrangements should be reached as early as possible

7. Ideally, HM Government should seek **some form of agreement with the EU on transitional arrangements as early as possible in the course of the Article 50 negotiations** and we welcome the Prime Minister's recognition of this in her letter to European Council President Tusk dated 29 March 2018 (page 4, paragraph iv). That said, we recognise that full agreement on these matters may not be achievable until towards the end of the process[12]. A more realistic approach could be to seek an early "high level" agreement recognising that if the UK were to leave the EU without any form of agreement at the end of the Article 50 process, the result would be a disorderly Brexit, which is in nobody's interest. In order to prevent that, the high level agreement would commit both sides to negotiating detailed transitional

10 For an example of the challenges posed by insolvency issues, see our paper entitled "Settlement Finality: System Significance – Brexit Implications", set out at Annex 4 in our Second Submission.

11 See: http://www.bbc.co.uk/news/business-38663537

12 For example, it may be difficult to design transitional arrangements in detail without knowing what the UK's future relationship with the EU will be. That said, in many areas, the key concern of business is to avoid the "cliff edge" risk of trading arrangements suddenly changing overnight, without sufficient time to prepare. The key objective would therefore be some form of continuation of current arrangements for a finite period - that period being long enough to enable satisfactory alternative arrangements to be put in place. In such cases, whilst it would obviously be desirable to know the "final destination", it is not absolutely necessary provided that the transitional period is long enough to allow preparations to be made for a worst case scenario (the shape of which could more easily be predicted in advance).

arrangements, tailored to the nature of the UK's future relationship with the EU – but if agreement cannot be reached on that future relationship, then both parties commit to maintaining current arrangements for a defined period after the UK's exit from the EU (of at least several years) so as to allow more time to make the necessary adjustments. As to the precise form that such an interim arrangement could take, please see Annex 1.

8. By helping to negate many of the cliff edge risks, such an arrangement would give many businesses the time and space to adopt a "wait and see" approach to the Article 50 negotiations, which would help to minimise avoidable loss of jobs and investment; and to ensure continuing confidence in the safe and efficient operation of the UK/EU financial markets after Brexit. Whether it will be acceptable to the EU remains to be seen; from a purely self-interested standpoint, some EU member states may consider that a longer period of uncertainty operates to their advantage, because it may prompt more UK-based businesses to relocate some or all of their operations to their territory. However, from the perspective of the financial markets, we consider that it should be evident very quickly to all countries that the failure to reach a swift accord on the continuance of those existing legal arrangements (e.g. as to settlement finality) that safeguard the financial system would rapidly introduce material and internecine systemic risks and shocks for all of the EU (and wider) economies. We would, therefore, expect rapid resolution in the mutual interests of the UK and the EU 27 member states of transitional arrangements for finality and related measures for the reciprocal protection of their financial market infrastructure.

Maintaining business confidence will require regular meaningful communication and engagement from HM Government

9. It will also be crucial in our view to maintain confidence in the likelihood of an outcome which will avoid the "cliff edge" risks described above, especially if early agreement on transitional arrangements is not possible. As such, it would be highly desirable for HM Government to **keep businesses informed as to progress of negotiations on transitional arrangements on a regular basis and in a reasonable level of detail**.

10. We accept that a balance will need to be struck between openness and the desire to secure the best deal for the UK, which may sometimes favour more limited disclosure. However, businesses can only make decisions on the information available; concrete details of how transitional arrangements will work are far more likely to build confidence than generalised assurances that concerns are being taken into account. In particular, we consider that HM Government needs to **take care to avoid statements which could give the impression that it has not appreciated the seriousness or complexity of a particular issue** (such as those highlighted at paragraph 3 above in connection with the White Paper).

11. HM Government should also **take steps unilaterally to ensure that the UK is prepared for a negotiating outcome which falls short of the ambitions articulated in the White Paper and communicate these plans to businesses**. For example, in relation to customs controls, plans can be drawn up now for their introduction (assuming a "worst case" relationship with the EU based on WTO rules only); it may even be appropriate to start work on their implementation well before the Article 50 negotiations have concluded (especially if the UK's future relationship with the EU is unlikely to involve any form of customs union). All these steps would in our view help to maintain business confidence in the ability of the UK to cope with the cliff edge risks posed by a disorderly exit from the EU.

Travers Smith LLP
[ ] May 2017

ANNEX 1: FORM OF TRANSITIONAL ARRANGEMENTS

The simplest form of transitional arrangement would be an agreement with the EU to maintain many of the current EU-UK trading arrangements for a defined period (probably with substantially reduced participation by the UK in any EU decision-making), thus allowing both the UK and the EU more time both to prepare for separation and to negotiate a free trade agreement. These arrangements should include remaining within the EU Customs Union or inside a separate UK-EU customs union with substantially equivalent effect to avoid the cliff edge risk described at paragraph 2 above.

However, this approach may make it difficult for HM Government to claim that it has left the EU. Consequently, it may be preferable to seek a transitional arrangement on substantially the same terms as the EEA Agreement (but without seeking to join the EEA Agreement itself). As EEA-EFTA States are outside the EU Customs Union, a temporary customs union with the EU would also be necessary. The EEA model would potentially allow HM Government to point to progress on certain issues of concern to Leave voters, whilst promising that they will be addressed more fully when the transitional arrangements expire:

- **More control over immigration:** whilst the EEA model involves acceptance of free movement of persons, it provides stronger safeguards than the EU Treaty framework, allowing EEA-EFTA States to suspend their obligations for economic and social reasons. This could provide the basis for temporary restrictions on immigration[13].

- **Lower contributions:** although EEA-EFTA States make contributions in return for Single Market access, those payments are at a lower level than is the case for EU Member States; the UK could therefore expect a reduction in its payments to the EU by pursuing this model[14].

- **EFTA Court rather than CJEU:** disputes would be dealt with by the EFTA Court rather than the CJEU (see Annex 2 for discussion of how this would arguably make a significant difference in practice).

A further option would be to approach transitional arrangements on a sector-by-sector basis, with the UK only continuing to participate in Single Market arrangements where it felt that it was necessary for particular types of business. Such an approach might be less prone to domestic political objections, but it is not without its own problems. From a practical perspective, it is likely to take considerably longer to negotiate than a "blanket" continuation of current arrangements as outlined above (thus potentially distracting attention away from issues relating to the UK's longer term relationship with the EU) and will be less straightforward to implement. From a legal perspective, it may be problematic because of WTO rules requiring trade agreements to cover "substantially all trade" in goods and/or services, as the case may be; sectoral deals would be unlikely to meet this criterion (although if the transitional arrangements are of relatively short duration, other WTO members may be prepared to tolerate this as a technical breach of the WTO rules, but not one which they would seek to challenge).

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13 See: "Single Market participation and free movement of persons" by Dr Richard North: http://eureferendum.com/documents/BrexitMonograph001.pdf and, by the same author, "Flexcit: a plan for leaving the European Union" (July 2016) which advocates use of the EEA model as part of a phased approach to Brexit: http://eureferendum.com/Flexcit.aspx. See also: "The Case for the (Interim) EEA Option" by the Adam Smith Institute: http://www.adamsmith.org/s/The-Case-for-the-interim-EEA-option-5.pdf

14 Norway's contribution in 2014 was about £586 million or £115 per capita. By comparison, the UK's contribution in 2014 was £9.8 billion or £152 per capita, suggesting a reduction in the order of 25% might be possible. See House of Commons library paper "Brexit: some legal and institutional alternatives to EU membership", July 2016 at page 32.

ANNEX 2: DIFFERENCES BETWEEN CJEU AND EFTA COURT

If the EFTA Court were used solely to resolve disputes between the EU and the UK, the key differences between the CJEU and the EFTA Court would be as follows:

- **Independent and institutionally separate from CJEU - can and does form its own view (subject to CJEU not having already ruled on the same point):**
    - for examples of the EFTA Court adopting a different approach from the CJEU, see Judge Baudenbacher's speech on 13 October 2016 ("Baudenbacher")[15] at pages 12-14.

- **Better suited to pragmatic common law approach:**
    - for examples/discussion, see Baudenbacher at pages 12-14.

- **Greater involvement by UK-nominated judge compared with CJEU:**
    - the CJEU is divided into 10 chambers, with a UK-nominated judge siting in only 2 – whereas if the UK were to participate in the EFTA Court, a UK-nominated judge would in all probability be able to sit on all cases concerning the UK[16].

If, additionally, national courts in the UK had the ability to make referrals to the EFTA Court under arrangements similar to the EEA Agreement, key differences would also include:

- **EFTA Court rulings on questions referred from national courts are advisory, not binding on EEA-EFTA States**:
    - a point of some constitutional importance to EEA-EFTA States as it arguably shows greater respect for national sovereignty.

- **No obligation on national courts to refer to EFTA Court - likely to mean fewer referrals than under current arrangements**
    - there would be more scope for national courts to take their own view of a matter of EU/EEA law without a referral or to leave it for more senior courts to consider whether a referral was required, should the case be appealed (whereas under current arrangements, the courts are legally obliged to refer to the CJEU unless the point of EU law at issue is clear).
    - as a result, there could well be fewer referrals to the EFTA Court than under the current arrangements with the CJEU; a comparison of Norway with Finland and Sweden suggests that this would be a reasonable expectation[17].

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15 http://1exagu1grkmq3k572418odoooym-wpengine.netdna-ssl.com/wp-content/uploads/2016/11/Baudenbacher-Kings-College-13-10-16.pdf

16 The EU is reported to have offered the Swiss the possibility of "docking" to the EEA/EFTA institutions and in relation to the EFTA Court, the proposal was for Switzerland to nominate a judge who would sit in all cases concerning the sectoral agreements between the EU and Switzerland. See Baudenbacher at page 5.

17 In the 21 years to 2015, courts in Norway made 47 requests to the EFTA Court for an Advisory Opinion (average of 2.2 per year). See: http://www.efta.int/sites/default/files/documents/eea/seminars/eea-a15/2015-09-02-efta-court.pdf at slide 17. Over the same period, courts in Sweden and Finland made, respectively, 121 and 95 requests to the CJEU for a Preliminary Ruling (equivalent to the EFTA Court Advisory Opinion). See http://curia.europa.eu/jcms/jcms/p1_219055/en/ at pages 97-99. This suggests that Norwegian courts make significantly less use of the referral procedure than countries with comparable populations and economies (even allowing for the fact that Sweden and Finland, as EU member states, are subject to more EU legislation than Norway). For comparison, the UK courts make about 14 referrals to the CJEU per year on average.