TRAVERS SMITH

Brexit: a Q&A guide

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CONTENTS

TRAVERS SMITH

The UK's future trade relationship with the EU

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The UK Government has indicated that it wishes to conclude an ambitious and wide-ranging free trade agreement with the EU, to govern its trading relationship after Brexit. The following Q&A explains how such agreements typically work and sets out our thinking on what a possible EU-UK FTA might look like.

Q1. What is a free trade agreement?

Put simply, the term "free trade agreement", or FTA, encompasses any arrangement between two or more countries on any aspect of trade. There is a tendency to think of trade agreements as being largely concerned with reducing import tariffs i.e. the duties which are levied on different types of goods when they imported into one country from another. However, trade agreements deal with many other aspects of trade which are equally if not more important in practice, including:

- Non-tariff barriers: removal or reduction of "non-tariff barriers", or NTBs, such as quotas, subsidies and "technical barriers to trade", or TBTs, (e.g. regulatory requirements which may differ from one country to another, so that products/services which are legal in country A cannot be sold in country B).
- Investment: the terms on which a national of one country can invest in another (these are known as "bilateral investment treaties" or BITs), including the rights and protections afforded to those individuals (e.g. protections against appropriation of property without compensation).
- Trade facilitation: e.g. measures to reduce border red tape.

The role of trade agreements in reducing non-tariff barriers and reducing border red tape is often under-appreciated.

The role of trade agreements both in reducing NTBs and promoting trade facilitation is often under-appreciated. For example, in relation to goods, NTBs have been estimated to add around 10% to the cost. Meanwhile, in relation to services, it is not uncommon for NTBs to prevent cross-border trade altogether or make it uneconomic. Similarly, the impact of border red tape on costs of imported goods is estimated to be equivalent to an additional tariff of between 2-15%.

Another under-appreciated point is that, although the EU has no agreements with China and the US relating to tariffs or non-tariff barriers, it does have agreements relating to issues such as trade facilitation. Without

these, trade in goods between the EU and China and/or the US would be significantly more difficult than at present. As well as negotiating its future trading relationship with the EU, the UK will need to reach agreement with these and other third countries on how matters dealt with under these EU-negotiated arrangements will be handled after Brexit.

Q2. What do free trade agreements typically cover?

Ambitious FTAs of the type which the UK government is aiming to conclude with the EU typically cover all the aspects of trade mentioned in answer to Question 1 above. They may also cover additional issues such as government procurement and intellectual property. Such agreements (including schedules) are extremely complex and contain a high level of technical detail relating to thousands of different types of products and services; they typically run to over 1000 pages (including schedules).

The main aim for parties negotiating an FTA is usually to achieve a significant improvement on the terms of trading available to them based on their WTO commitments, which effectively act as a "baseline" for discussions. For example, in relation to tariffs, WTO members commit not to impose tariffs on other WTO members above a certain level; these are known as WTO "MFN" or "Most Favoured Nation" commitments. An FTA would seek to either remove those tariffs altogether or to reduce them by a significant margin in relation to goods traded between the parties to the FTA.

Sometimes, free trade agreements also contain MFN provisions, but these are not the same as WTO MFN commitments – see text box opposite.

MFN PROVISIONS IN FREE TRADE AGREEMENTS

Article 7.8 of the EU-South Korea FTA is an MFN provision. It states that if one party agrees to grant greater access for services to another country in a subsequent FTA, the same treatment will be extended to the EU or to South Korea, as the case may be. This means that if any EU-UK FTA goes further than the South Korean model in relation to services, that treatment may have to be extended to South Korea.

For obvious reasons, this may make the EU reluctant to give the UK a better deal than South Korea in relation to services. There is a potential "get out" clause which states that the MFN obligation does not apply where the subsequent FTA "stipulates a significantly higher level of obligation." However, that may raise issues for the UK in terms of sovereignty, as it might require a closer relationship with the EU than would be politically acceptable in light of the vote to leave.

Q3. Is it possible to have partial or sectoral free trade agreements?

Subject to some exceptions (e.g. relating to developing countries), free trade agreements between WTO members must cover "substantially all trade" between the parties in goods or services (as the case may be).

This rule is designed to encourage countries to undertake ambitious free trade agreements, as opposed to narrow agreements relating only to particular sectors. Since both the EU and the UK are WTO members, it will be difficult for them to ignore this rule by concluding a narrow sectoral agreement. If they were to do so, other WTO members could bring proceedings before a WTO Dispute Resolution Panel claiming that they should be given the same preferential treatment as would apply between the EU and the UK under the sectoral agreement. In view of this, many commentators consider that the UK government's suggestion of special deals with the EU for certain sectors is, at the very least, problematic.

That said, there would be nothing to stop the EU and the UK concluding a free trade agreement which provides for a higher level of integration for certain sectors, with others receiving a lower level of preferential treatment – provided that the agreement as whole was comprehensive i.e. it covered substantially all trade in goods and/or services.

Q4. How long do trade agreements take to negotiate and ratify?

There is no definitive answer as to how long it would take the UK to negotiate trade agreements with the EU or

the rest of the world, but relatively few have been concluded within the two year time limit provided for in Article 50. Most take at least 3-4 years.

The wider the scope, the longer the agreement takes to negotiate. Given the importance of the UK-EU deal, it is likely to take a significant amount of time, hence the concern over the two year deadline imposed by Article 50 and the probable need for potentially quite extended transitional arrangements. The government has argued that agreement should be achievable within a reasonably short timeframe because there is already a high degree of regulatory convergence between the UK and the EU. However, no existing FTA between the EU and a third country provides for the level of market access which the UK appears to be seeking.

Even if the EU were to agree to allow the UK to maintain current levels of access in many areas, translating that into an FTA will be a complex and time-consuming task. In reality, the EU is likely to be reluctant to preserve the UK's current level of access without appropriate mechanisms (including independent dispute resolution) to ensure that the UK continues to remain closely aligned with the EU in relevant areas of regulation. To the extent that the UK wishes to continue participating in aspects of the Single Market (such as the Single European Sky), the EU may also demand a significant financial contribution. Given this background, it seems to us that the negotiations are likely to be far from straightforward.

Ambitious trade agreements typically also require a substantial number of negotiators – for example, Canada had about 100 staff working on its agreement with the EU. As at November 2016, the UK's Department for International Trade (DfT) had recruited fewer than 200 staff. To conduct negotiations simultaneously with the WTO, the EU and third countries (as the government will need to do over the coming years in order to achieve its objectives), the DfT is likely to need considerably more resources.

Q5. How are trade agreements enforced?

Each agreement will normally contain its own specific enforcement mechanism, the extent of which will vary depending on the complexity and scope of the trade agreement. Enforcement is not usually open to individual businesses (unless they can persuade their home state to take up a complaint on their behalf); it can normally only be conducted at state-to-state level.

That said, some FTAs (such as the proposed TTIP between the EU and the US) contain provisions allowing enforcement by individual businesses, known as "investor-state DR mechanisms". Such provisions are also common in bilateral investment agreements or BITs (these are trade agreements setting out the terms on which an investor from country A can invest in country B and usually contain protections against e.g. appropriation of property by the host country). Enforcement mechanisms also vary from one agreement to another – see textbox.

EXAMPLES OF ENFORCEMENT MECHANISMS

- The **Switzerland-China** free trade agreement requires the parties at first instance to resolve the dispute by consultation. Failing this, an inter-governmental arbitration procedure shall be convened.
- The **Canada-Korea** agreement allows the complaining party to select either the WTO or a panel to settle disputes.
- The **EU-South Korea** agreement provides for resolution by a 3 person arbitration panel (one arbitrator nominated by each party and one neutral arbitrator to act as chairperson).
- The **EU-Ukraine** Association Agreement provides for resolution of most disputes by arbitration but where the question is one of EU law (e.g. in areas where Ukraine has agreed to align its own law with that of the EU), then the Court of Justice of the European Union must rule on the point.

Q6. After Brexit, can the UK continue to benefit from existing EU trade agreements?

The EU has free trade agreements with over 40 other countries/trading blocs. Some commentators take the view that if the relevant trade agreement was a "mixed competence" agreement i.e. signed not just by the EU but by all the Member States (as is often the case), then the UK could continue to benefit from it after Brexit. However, others argue that the non-EU party would not be bound to carry on trading with the UK on those terms; in particular, the non-EU party may well take the view that it only agreed to those terms because it thought it was dealing with a multi-member trading bloc of over 500 million people, not a single country of only about 65 million.

It therefore seems doubtful that the UK can take the benefit of all the EU's trade deals after Brexit, although in practice some countries may be prepared to continue trading with the UK on the same or similar terms, at least for the majority of goods/services covered (and on condition that the UK reciprocates by keeping to its commitments under the relevant EU-negotiated FTA).

LOSING THE BENEFIT OF EU TRADE AGREEMENTS: HOW BAD WOULD IT BE?

A recent report of the Trade Policy Research Centre suggested that the EU's FTAs only benefitted about 9% of UK goods exports and 11% of UK services exports. This is because most of the EU FTAs are with relatively small markets – so although the number of agreements is significant, they account for a relatively small proportion of the EU's overall trade with the rest of the world.

That said, in monetary terms, the amounts at stake are by no means trivial; on 2015 figures, about £50 billion in exports would stand to be affected (although it is very unlikely that all of this trade would be lost). Having to renegotiate these agreements will also add to the already daunting task facing the UK's new Department for International Trade.

Q7. If a trade agreement can be reached with the EU, will it have to be ratified by all EU Member States?

In short, it seems likely that the answer to this question will be "Yes" – although it may be possible to structure the agreement so as to avoid this or to bring any EU-UK FTA into force provisionally (see below). It is also important to distinguish between a future EU-UK trade agreement (which is likely to require ratification) and any withdrawal treaty concluded under Article 50 (where the position on ratification is less clear, although the EU and UK appear to be proceeding on the basis that ratification is not required).

Ratification is problematic because it is time-consuming and effectively gives Member State legislatures a right of veto (as has occurred with the EU-Canada agreement, which is still not fully ratified). Although the European Union has exclusive competence in relation to international trade (which should mean that ratification by individual member states is not needed), the EU's trade agreements have become increasingly wide-ranging in scope, prompting arguments that such agreements trespass upon areas of competence which are shared with the Member States. This prompted some Member States to press for ratification of the EU-Canada FTA, which the European Commission reluctantly agreed to - whilst reserving its position on the exclusive competence point more generally.

On 16 May 2017, the Court of Justice of the European Union (CJEU) ruled that the EU's free trade agreement with Singapore must be ratified by the national Parliaments of all EU Member States. However, it concluded that for the most part, the EU does have a wide-ranging exclusive competence to conclude trade agreements - and that the only aspects of the Singapore agreement where competence is shared with the Member States (and which therefore require ratification) concerned indirect foreign investment and investor-state dispute resolution procedures. It is not unheard of for trade agreements to be concluded without such provisions (although most recent EU trade agreements, particularly those with more developed economies, have included

them). If the EU and the UK wanted to avoid a protracted ratification process, they could choose to omit such provisions or deal with them in a separate agreement.

That said, many Member States are likely to want to exert influence on the Brexit negotiations and may therefore bring political pressure to bear on the Commission to agree to ratification, as occurred with the Canada-EU trade deal. Much could therefore depend on how far the European Commission is prepared to resist such pressure - but if nothing else, the CJEU ruling is likely to strengthen its bargaining position.

An alternative solution would be to accept that Member States will have to ratify any EU-UK FTA, but to agree that most provisions of the FTA can be brought into force provisionally - as has happened with the EU-Canada agreement (although this approach has been criticised on the grounds that Member States are effectively being forced to implement something which they may ultimately reject).

Q8. If no trade agreement with the EU can be reached prior to Brexit, what is the UK's position?

If the UK leaves the EU with no trade agreement in place and no transitional arrangements, it will have the status of a third party country in the eyes of the EU. This means UK businesses will in theory trade with the EU based on WTO rules, which is likely to have a significant disruptive effect (see *Reverting to WTO rules*). No EU-UK agreement would also potentially mean no arrangements with the EU on trade facilitation (see Question 1), which would put the UK in a worse position than third countries such as the US, China and Japan. Lack of transitional arrangements is likely to exacerbate the level of disruption (see *Transitional Arrangements*).

Q9. What might an EU-UK deal look like?

Despite the UK government's insistence that it wants a "bespoke" deal with the EU, it is likely that any EU-UK deal will draw on existing models.

Although the government has stated that it is seeking a "bespoke" deal with the EU which is not based on any existing models, it is likely that precedents will play a role in the negotiations – particularly given the time constraints under Article 50. In addition, the EU may well be concerned that giving the UK a "special deal" may have implications for its relations with other non-EU member states, who may be encouraged to demand comparable treatment. Much will therefore depend on what the EU is prepared to offer. It is possible that the UK could adopt something of a "pick and mix" approach, seeking to combine different aspects of existing EU arrangements with third countries (which would allow the EU to maintain that the UK was not getting special treatment). Examples might include:

- **The EU-Canada FTA:** this has been widely held up as a possible model for any EU-UK FTA, although in terms of services access, it would fall some way short of replicating the UK's current level of access as an EU Member State. The government's White Paper on Brexit also gave some prominence to the dispute resolution provisions in the EU-Canada FTA, suggesting that they may be a favoured option for the UK.

- **The EU-South Korea FTA:** in relation to goods, this agreement includes a number of provisions designed to reduce red tape relating to goods exports which the UK may wish to replicate, particularly in relation to "rules of origin" paperwork (see *Customs Arrangements*) and product testing/certification. In relation to services, some commentators have suggested that this agreement would be a better model for the UK than the EU-Canada FTA.

- **The EU-Ukraine Association Agreement**: this agreement gives significantly wider market access than the EU-South Korea or EU-Canada FTAs, but on condition that Ukraine aligns its own law with that of the EU in areas covered by the agreement. It does not, however, provide for free movement of people. This model may be politically difficult for the UK because of the need to align itself with EU law (although without committing to some degree of alignment, it is hard to see how the UK will secure the depth of

access which it seeks). Although the agreement has its own dispute resolution mechanism, questions on interpretation of EU law have to be referred to the Court of Justice of the European Union. This too may be politically problematic, although it may be that the EFTA Court could be considered as compromise (see below).

- **The EU-Swiss arrangements:** the EU is known to be unhappy with its arrangements with Switzerland and like the EU-Ukraine agreement, they may be politically problematic as a model for the UK (because they effectively require the Swiss to align themselves with EU law in particular areas). Aware that involvement of the Court of Justice of the European Union would probably be politically unacceptable to the Swiss, it is understood that the EU has proposed that disputes should be resolved instead by the EFTA Court – but as yet, that proposal has not been accepted by the Swiss.

- **The EU-Turkey customs union:** a key problem which the UK will face in leaving the EU is the reintroduction of customs controls between the UK and EU member states, which has the potential to be extremely disruptive to goods trade. One option might be to enter into a partial customs union with the EU, as Turkey has done in relation to industrial goods and processed food (but not agricultural produce). However, this would require the UK to align its external tariffs with those of the EU and thus constrain its ability to pursue free trade deals with third countries (Turkey is able to conclude its own trade deals, but its customs union with the EU has sometimes proved something of a handicap in that regard). For more detail, see *Customs Arrangements*.

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Transitional arrangements

Transitional arrangements

What, if any, transitional arrangements will there be to bridge the "gap" between full EU membership and moving to a new UK-EU relationship? We look at why transitional arrangements may be needed and what form they might take.

TRANSITIONAL ARRANGEMENTS: THE BASICS

Q1. Why are transitional arrangements desirable?

If the UK were to leave the EU without any form of agreement (including as to transitional arrangements) in place, it would be exposed to a number of potentially significant "cliff edge" risks. Examples would include:

- **Financial services:** certain contracts between UK financial services businesses in the UK and their customers in the EU would become illegal to perform. Given the large sums involved, the consequences for financial stability could be extremely serious.

- **Goods trade with the EU:** the sudden introduction of customs controls at Channel ports raises the prospect of serious delays and disruption, as it is far from clear that the UK has the necessary resources or infrastructure in place to cope with such a change (nor is it clear that ports or customs administrations on the continent would be adequately prepared). See *Customs arrangements*.

The UK government has stated that it recognises the concerns of business about such cliff edge risks and that Brexit may therefore require what it terms "an implementation phase." Transitional arrangements providing for a continuation of current trading arrangements in some form may also be needed if, as many commentators predict, the two year period provided for by Article 50 proves insufficient for the UK to (a) renegotiate its future relationship with the EU; and/or (b) make the necessary changes at a practical level to be ready to implement that new relationship.

Merely passing legislation will not address the many practical issues raised by the UK's exit from the EU, nor will it preserve access to EU markets.

Q2. Won't the EU (Withdrawal) Bill be sufficient to deal with any transitional issues?

The EU (Withdrawal) Bill is a unilateral measure which will only provide certainty as regards legislation derived from EU law after Brexit. It cannot deal with issues such as whether or not UK businesses can continue to provide goods or services to the EU on current terms for an interim period, since this will require agreement from the EU. Many transitional issues also relate primarily to practical rather than legal matters, such as the time and additional

resources likely to be required to put in place an efficient system at Channel ports (both in the UK and the EU) to allow for the reintroduction of customs controls without causing significant delays to goods traffic. Again, these issues cannot be fully addressed merely by the UK passing legislation on a unilateral basis.

TRANSITIONAL ARRANGEMENTS: POSSIBLE MODELS

Q3. What might transitional arrangements involve and why might they be problematic?

The UK government has so far provided little detail on what the "implementation phase" of Brexit might involve. In our view, given the serious cliff edge risks outlined in answer to Question 1 above, it would be highly desirable for UK to maintain its current participation in the Single Market and to remain within some form of customs union with the EU for a defined period, so as to allow both business and government more time to adapt. Indeed the UK government has indicated that it wishes to maintain current arrangements for at least 2 years after March 2019. However, this is politically controversial, as it would appear to contravene several of the UK government's red lines. For example, the EU would be likely to insist that the UK continued to abide by rulings of the Court of Justice of the European Union as regards interpretation of Single Market rules. It would also probably insist on the UK continuing to make budget contributions towards the administrative costs of the Single Market and may require continued free movement of EU citizens.

The UK government has not explained how its proposals for transitional arrangements can be reconciled with its 'red lines' on issues such as the ECJ.

Q4. Could the EEA provide a basis for transitional arrangements?

An interim arrangement modelled on the Agreement on the European Economic Area (EEA) could provide a compromise solution. In particular, it contains provisions which could allow the UK to enact temporary "safeguard" measures so as to address concerns about immigration in the short term, pending the UK's full exit from the EU (when it will regain full control over immigration).

In addition, although EEA-EFTA member states make contributions to the EU budget, they do so at a lower level than full EU members. It is also possible that the UK could ask for disputes over its compliance with Single Market rules to be referred to the EFTA Court rather than the Court of Justice (see text box).

However, EEA-EFTA States are outside the EU Customs Union. This means that the UK would need to reach a special arrangement with the EU in order to remain within the EU Customs Union on an interim basis.

Alternatively, it could seek an interim customs union with the EU, similar to the arrangement which Turkey has (although Turkey's arrangement is not intended to be temporary). See further our Q&A entitled *The EEA Agreement*.

EFTA COURT INSTEAD OF ECJ?

There are a number of arguments that the UK could make to persuade the public that the EFTA Court model would make a significant difference in practice and ought therefore to be acceptable, at least for an interim period. For example:

- its judgments are advisory not binding;
- the system for national court referrals is likely to result in fewer cases coming before the Court; and
- it might be possible for a UK judge to sit on any panel dealing with cases involving the UK, so the UK would potentially have a greater sense of involvement in the make-up of the court (as compared with the Court of Justice where it only has 1 judge out of 28, with no guarantee that he/she will hear all UK-related cases).

Q5. Is a "bespoke" transitional arrangement feasible?

The UK government has indicated that it would prefer to approach transitional arrangements on a bespoke, 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. 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).

Q6. Are there any other models which would provide a basis for transitional arrangements?

Another possible approach to transitional arrangements that draws on existing models (rather than a "bespoke" arrangement) would be to use agreements that the EU has with a number of countries in Eastern Europe such as Ukraine or Moldova as a template.

These "association agreements" allow a significant degree of participation in the Single Market, although they do not provide for free movement of people. However, the Ukraine agreement, for example, provides for the involvement of the ECJ in relation to any dispute relating to the interpretation of Single Market rules. As such, the association model arguably contravenes the government's red lines on the ECJ.

TRAVERS SMITH

Reverting to WTO rules

Reverting to WTO rules

Whilst the UK government is aiming for a wide-ranging free trade agreement with the EU, it has also indicated that "no deal is better than a bad deal." This raises the prospect of the UK leaving the EU without any form of agreement on its future trading relationship, leaving it reliant on World Trade Organisation (WTO) rules. The FAQ below explains what the WTO is, how it works and what problems may arise from relying solely on WTO rules after Brexit.

WTO

Q1. What is the WTO?

The World Trade Organisation (WTO) is an international organisation designed primarily to facilitate trading arrangements amongst its 164 members, in particular by removing barriers to trade. In relation to goods, the WTO has tended to focus on tariffs i.e. duties imposed on imported goods. Successive multi-lateral rounds of negotiations have resulted in significant tariff reductions for many categories of goods, reducing costs for businesses and consumers.

The WTO also tries to reduce/remove other, less visible, trade barriers including quotas, domestic subsidies, non-domestic taxes and "technical barriers to trade" or TBTs (e.g. national regulatory requirements) which can distort market access. All of these are known collectively as "non-tariff barriers" or NBTs.

In relation to services, tariffs are irrelevant and the WTO's focus has been on NBTs such as restrictions on who can provide certain services or the manner in which they can be provided. However, as NBTs are more difficult to identify than tariffs, it is generally felt that the WTO has been less successful in this area (both for goods and services) and has not been able to go as far as the EU (which has sought to harmonise standards so as to provide a "level playing field" across the Single Market, regardless of the nationality of the goods or service provider).

KEY WTO AGREEMENTS

The two key WTO agreements are:

- the General Agreement on Tariffs and Trade (GATT); and
- the General Agreement on Trade in Services (GATS).

The WTO has recently negotiated a new treaty on trade facilitation (see Question 7). It is also responsible for important agreements on intellectual property (TRIPs) and public procurement (Agreement on Government Procurement or GPA).

In recent years, the WTO has made limited progress with further liberalisation; this has resulted in a renewed interest on the part of many countries in bilateral free trade agreements.

Q2. What do WTO rules cover?

On entry to the WTO, each member negotiates a schedule of concessions setting out specific commitments on trade that it will provide to other WTO members. For example, it may commit to impose maximum tariffs of x% on certain goods or to allow a provider from another member state to provide certain services which were previously reserved to nationals of the first member state.

The UK is already a member of the WTO but its commitments are set by the European Commission acting on behalf of all EU member states. This is because (a) EU member states agree to give the Commission the lead role in trade policy; and (b) the EU Customs Union necessitates the use of a "Common External Tariff" for goods i.e. the same import duty is payable when goods enter the EU, whether the point of entry is the UK or another EU member state. The UK will therefore require its own UK-specific set of commitments when it leaves the EU (see below).

Each member of the WTO agrees to provide equal trading terms including lower tariffs and customs duties to all WTO members in the areas covered by its commitments; this is known as the **most-favoured-nation (MFN)** principle. In reality, many nations use their MFN tariff commitments as an import duty ceiling and the actual tariffs imposed on WTO members in practice are often set at a lower level.

National treatment is the obligation to accord the same treatment to goods/services of other WTO members as the WTO member accords to goods/services provided by its own nationals (again, in the areas covered by its commitments).

However, a WTO member's commitments will often contain a significant number of exceptions and derogations from these principles, particularly in relation to services and certain categories of goods such as agricultural produce. In relation to services, the GATS provides for commitments to be made in relation to 4 different "modes" of service provision (see below); these too are often subject to significant derogations. Indeed, in some cases, WTO members will specify that they are "unbound" i.e. they make no commitment at all in relation to the type of goods or services specified in the schedule.

FREE TRADE AGREEMENTS

Free trade agreements (FTAs) are an exception to the usual MFN rule. They allow WTO members to go further than their WTO commitments but without having to offer that preferential treatment to all other WTO members (it would only be extended to the other party to the FTA). It is also increasingly common for countries to have bilateral trade facilitation agreements relating to issues such as customs formalities (see below).

Q3. How are WTO rules enforced?

The WTO has its own dispute resolution procedure, with a set timetable, which can be used if a WTO member fails to adhere to its obligations. A WTO member must have incurred harm as a result of the non-compliance to initiate proceedings. The WTO prefers members to consult with each other first and try to resolve any dispute informally before any formal action is taken. If this fails, an aggrieved WTO member can request that the WTO appoint a panel which will hear from both members and produce a report of its findings. If the panel decides that a WTO member is in breach of a WTO obligation, it will provide a recommendation which is presented to all other WTO members; unless it is rejected, it will become a ruling within 60 days

If the infringing WTO member does not comply, it is expected (but not obliged) to provide compensation to the aggrieved member, which could take the form of lowering trade barriers in other areas not subject to the dispute (but which would benefit the "winning" party). If satisfactory compensation is not agreed or provided, the aggrieved WTO member may request permission to retaliate by suspending its own obligations to the individual member in the same sector. For example, it could increase its tariffs on the infringing party's goods.

DISPUTE RESOLUTION: HOW LONG DOES IT TAKE?

In reality, the process is much slower than the WTO suggests on its website. The increase in complaints received by the WTO has significantly slowed down the process. For example, a complaint by the US against the EU in 2001 took 7 years to be resolved.

EU AND WTO

Q4. How do the EU's WTO commitments compare with the UK's current level of access?

Most commentators agree that, as compared with the current position, the UK's access to EU markets would be substantially reduced if it is unable to reach a free trade agreement with the EU and relies solely on WTO rules. For example, in relation to many types of financial services, the EU has made no commitments at all in relation to cross-border trade (i.e. financial services provided from the UK to customers in an EU member state). This contrasts with the current position, where UK firms can use their passporting rights to provide many types of financial services throughout the EU, without having to establish themselves in other Member States. In other sectors, the EU has made commitments but these are often subject to significant reservations, which may vary from one Member State to another.

Q5. How can I find out what commitments the EU has made under GATT and GATS?

You will need to examine the EU's schedule of commitments, which can be accessed via the WTO's website. Please contact us if you would like help with this; alternatively, your trade association may be able to assist you. If you provide services, you should be aware that the WTO treaty on services (GATs) defines trade in services in terms of four modes of supply as set out below. These are significant when considering a WTO member's commitments under GATS e.g. it may have committed to Mode 1 access, but not Mode 4:

- **Mode 1: Cross border supply**: refers to services where a customer in Member State Y receives the services from a supplier in Member State X. This may include consultancy services/advice provided by email, phone etc or banking services provided electronically.
- **Mode 2: Consumption abroad:** applies where a customer in Member State Y has to move to Member State X to use/obtain the service from a provider in Member State X. This includes tourists, students or patients.
- **Mode 3: Commercial presence:** refers to services where a service supplier in Member State X establishes a presence through a locally-established office or subsidiary in Member State Y to provide the service.
- **Mode 4: Presence of natural persons:** refers to the presence of persons from Member State X travelling to Member State Y to provide a service ("fly in, fly out"). WTO members will often include restrictions in their commitments covering visa/permit requirements, duration of stay, quotas, training requirements and residency.

UK AND WTO

Q6. Will the UK be able to rely on WTO rules after Brexit?

The UK is already a member of the WTO in its own right, so "re-joining" the organisation should not be an issue. However, the UK will need to make the transition from the current arrangements - whereby the EU negotiates commitments on its behalf (for the whole of the EU as a bloc) - to a position where the UK has its own separate, UK-specific commitments.

Critically, the UK would in principle need to get its own schedule of WTO commitments agreed by all 163 other WTO members. This is a potentially time-consuming exercise. The obvious shortcut would be to maintain the existing EU commitments – which is what the UK government is proposing to do. Indeed, there is a minority view amongst commentators that legally, this is all the UK needs to do. However, there are 2 main complicating factors:

- **Quotas:** Copying across the EU's commitments would not work for all products/services. For example, the EU has agreed to allow imports of many agricultural products at a lower preferential tariff rate only up to the level of an EU-wide quota (beyond which a much higher standard tariff applies – in many cases effectively making it uneconomic to import). Clearly, measures such as quotas would have to be divided up between the UK and the EU. Agreement with the EU would therefore be needed on these issues before a UK-specific set of commitments can be presented to the WTO.

- **Agreement of other WTO members:** The UK's commitments would need to be agreed to by all 163 other WTO members and some countries may seek to exploit the situation in order to extract a better deal for some of their key exporters, particularly in relation to sectors such as agriculture. Trade experts giving evidence to Parliamentary Select Committees generally thought that, ultimately, these obstacles were capable of being overcome through negotiations – but that this could potentially take time.

If the UK could not get a schedule of commitments agreed in time for Brexit, it is thought that many countries would still be prepared to apply WTO rules to the UK and trade with it on the basis of a draft schedule of commitments. However, if other countries refused to allow UK exporters to benefit from their WTO commitments, there may be little that the UK could do to combat this (as there would be uncertainty over the UK's ability to use the WTO dispute resolution mechanism and in any event, such proceedings take years to resolve). The UK's main option would presumably be to take retaliatory measures against imports from the country concerned – but that could be undesirable if, for example, UK consumers or businesses rely heavily on those imports.

> *"None of these arrangements [i.e. the EU's current WTO quotas] should be modified without our agreement."*
>
> Letter from Permanent Representatives to WTO of the US, Canada, Brazil, New Zealand, Thailand, Argentina and Uruguay (Sept 2017)

Q7. Do other countries rely solely on WTO rules?

Very few countries rely solely on WTO rules in relation to their trade with the rest of the world. For instance, the EU has a number of trade facilitation agreements with other countries, designed to reduce red tape at borders. Examples include agreements relating to:

- **Mutual recognition** e.g. where parties to the agreement agree to accept product safety testing carried out by recognised providers in the other party's jurisdiction. The EU currently has these types of agreements with Australia, Canada, Japan, New Zealand, USA, Israel and Switzerland.

- **Streamlining of customs formalities**, such as the possibility for businesses to obtain Authorised Economic Operator (AEO) status, allowing them to benefit from simplified and fast tracked custom procedures. The EU has agreements with numerous third countries (including the US, Japan and China) covering this aspect of trade.

In practice, these agreements are often quite significant in ensuring rapid movement of goods, particularly given the extent to which modern supply chains are reliant on "just in time" delivery. They also reduce costs, often by a significant amount (it is estimated that the cost of complying with customs red tape can be equivalent to an additional tariff of 2-15%, depending on the goods in question and the level of bureaucracy involved).

WILL THE WTO TRADE FACILITATION TREATY HELP?

The WTO has negotiated a trade facilitation treaty, which has recently come into force. Whilst this may help the UK with post-Brexit trade arrangements, it would not, for example, ensure access to the AEO system. Moreover, the key to avoiding delays and minimising costs at borders will be the actual implementation of trade facilitation measures in practice and assuming the UK does not remain in any form of customs union with the EU, significant work will be required at Channel ports in particular to adapt systems and facilities for the introduction of customs controls on EU-UK trade. See *Customs arrangements*.

Without trade facilitation agreements after Brexit, current UK testing and certification bodies may lose their recognition from the EU. UK exports could be subject to additional testing at the point of entry to the EU. This could significantly increase costs for exporters. The UK could also lose access to the EU's AEO system. UK businesses with AEO status would no longer be recognised in the EU or the other countries with which the EU has specific agreements with. This again could significantly increase the time and cost for UK exporters in complying with customs procedures.

Q8. Can the UK negotiate free trade agreements with other countries?

Once it has left the EU, the UK will be free to reach trade agreements with third countries, such as the US, which could open up significant new opportunities for UK firms. The UK will not be able to conclude any agreement before Brexit, although this would not necessarily prevent informal talks from taking place.

That said, before they start to negotiate in earnest with the UK on trade, most countries will want to know what the UK's WTO commitments are and what its trading position with the EU is likely to be (at least in broad outline, if not in detail). Trade negotiations are also complex, time-consuming and resource-intensive (Canada is reported to have had around 100 staff working on its recent agreement with the EU); as a result, it may be some time before the UK can point to a raft of significant new trade agreements.

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TRAVERS SMITH

Customs arrangements

Customs arrangements

Brexit is likely to involve leaving the EU Customs Union. If customs controls are reintroduced on trade routes to and from the EU, this may result in delays and cost increases due to increased border formalities. These changes will have implications not just for UK exporters but for any UK businesses which rely on goods imported from the EU. The FAQ below explains the current arrangements and looks at what might replace them on Brexit.

CUSTOMS UNIONS: THE BASICS

Q1. What is a customs union?

A customs union is a trade bloc where the partner countries agree to remove tariff barriers on each other's goods, to have a common external tariff against third countries and to remove the majority of customs formalities (thus facilitating free movement of goods). This can be distinguished from a free trade agreement, where the partner countries agree to remove tariff barriers on each other's goods but there is no common policy vis-a-vis third countries and full customs formalities will normally continue to apply.

The UK is part of the EU Customs Union; as such, not only are no tariffs payable on goods imported into the UK from the EU (and vice versa) but the majority of customs formalities have been removed. This means that at Channel ports, for example, HGVs can simply roll off ferries and continue their journey to their destination, without having to wait for customs clearance.

"[DEXEU] 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."

Brexit-supporting think tank, The Bruges Group

Q2. What are the key advantages of a customs union?

Free trade agreements tend to focus on reducing/removing barriers to trade such as import tariffs. The key advantage of a customs union is that, as well as removing tariffs, it reduces border red tape so that goods can flow freely between the member states with minimal transaction costs.

Typical border red tape where there is NO customs union includes:

- **Additional paperwork:** Goods must usually be accompanied by a customs declaration explaining what they are and where they are from, together with a VAT declaration indicating their value (which may need to be supported by an invoice). Whilst not necessarily difficult to comply with, all this adds to administrative costs. By way of example, large courier firms such as DHL typically charge about £15 per item shipped to cover the administrative costs they incur. In some cases, paperwork may also be required to prove the origin of the goods (see Question 8 below).

- **Conformity testing:** Some goods (e.g. many electrical products) may be refused entry, unless accompanied by paperwork demonstrating that they comply with relevant product standards. Alternatively, the goods may have to be held at the point of entry until samples have been tested by a UK lab to demonstrate conformity, for which a fee will be charged and storage costs will have to be incurred until the test results are received.

- **Delays:** Where customs controls are in place, goods must await customs clearance before they can leave port and some may need to subject to full customs inspections. This has the potential to introduce delays, which may in turn undermine the efficiency of just-in-time distribution systems or result in perishable goods being unfit for consumption by the time they reach their final destination.

WHAT IS THE ECONOMIC IMPACT OF A CUSTOMS UNION?

Some idea of the economic impact of a customs union may be gained from a 2014 World Bank report. This suggested that replacing Turkey's partial customs union with the EU with a free trade agreement (without a customs union) would result in costs increasing by about 2% and Turkey's exports to the EU decreasing by 3-7%.

Q3. What are the disadvantages of being in a customs union?

The main disadvantage of being in a customs union is that it restricts the freedom of the parties to conduct independent trade policies. In particular, all members of the customs union must agree to maintain the same external tariff vis-à-vis third countries. Membership of a customs union does not necessarily prevent a country concluding trade deals; for example, Turkey is in a partial customs union with the EU but retains the ability to conclude free trade agreements with third countries. However, its freedom to negotiate is heavily constrained by the fact that it has agreed to align the majority of its goods tariffs with those of the EU.

Q4. Why might the introduction of customs controls be problematic for business?

For reasons outlined at Question 2 above, customs controls are likely to impose extra administrative costs on business. Importers are likely to find that the cost of goods imported from the EU will increase due to the additional transaction costs, whilst exporters may find that their goods become less competitive than those of EU rivals. In the short term, there is also a risk of significant disruption to trade. For example:

- According to the Port of Dover, each roll-on-roll-off ferry contains on average about 2 miles of traffic - and Dover handles about 100 miles of traffic each day (including about 12,000 HGVs). It is not clear that the UK has the necessary resources or infrastructure in place to cope with the application of customs controls to such a high volume of traffic (nor is it clear that ports or customs administrations on the continent would be adequately prepared either).

"Nearly 30% of all food consumed in the UK comes from the EU and it all arrives in lorries […]. The RHA fears that massive queues of lorries could build up at ports with not enough experienced staff to cope with a backlog while fresh food supplies rot."

The Road Haulage Association, February 2017

- According to the UK Chamber of Shipping, customs declarations to HMRC would be likely to increase from 85 million per year to over 300 million, which

would have significant implications for IT systems and staffing. In particular, HMRC's computer system, CHIEF, does not at present have the capacity to handle this level of customs declarations.

- Port facilities would also need to be reconfigured to allow for inspections (at present there are insufficient facilities to detain significant numbers of HGVs for checks to be carried out).

- Widespread reliance on "just in time" distribution systems means that it is not inconceivable that shortages of goods could arise within a relatively short period, as occurred during the fuel protests of 2000.

These are not necessarily insurmountable problems (see Questions 9 and 10 below) but they highlight the need for careful planning; they may also make it highly desirable for the UK to remain in some form of customs union with the EU for an interim period, to allow more time to prepare for the introduction of customs controls.

A CUSTOMS UNION WITH THE EU

Q5. Could the UK remain part of the EU Customs Union after Brexit?

It may be possible for the UK to effectively remain in the EU Customs Union for a transitional period - indeed, from a practical perspective, there may be a strong case for maintaining existing arrangements because both the UK and its EU partners (particularly France) will need time to adapt to the reintroduction of customs controls (see Question 4 above).

However, as regards the longer term, it is generally thought that a non-EU country cannot be in the EU Customs Union (the ' Customs Union'); even EEA-EFTA countries are not members. The only non-EU country that is linked to the EU in a customs union relationship is Turkey, which has a partial customs union with the EU covering industrial goods and certain processed agricultural products.

Q6. Can/should the UK form a customs union with EU, as Turkey has done?

A fully comprehensive customs union between the UK and the EU would only make sense if the UK were planning to remain within the Common Agricultural Policy and Common Fisheries Policy (which does not appear to be the case). However, there does not seem to be any reason in principle why the UK could not seek an arrangement with the EU similar to Turkey's (which is a partial customs union, covering only industrial goods and processed food, not agricultural products) – or even Single Market membership coupled with a partial customs union.

The main advantage would be avoiding increased costs due to red tape at borders between the UK and the EU (see Question 2). The main disadvantage would be constraints on the UK's ability to conduct an independent trade policy (see Question 3).

The balance of advantage here is hard to judge. The cost to business of increased border red tape could be considerable, given the extent of EU-UK trade – some estimates put the additional costs as high as £4 billion per year (see "Implementing Brexit: Customs", by the Institute for Government, September 2017). There is also a real prospect of significant short term disruption when customs controls are first introduced (see Question 4). On the other hand, the EU appears to be finding it increasingly difficult to conclude ambitious trade agreements – as demonstrated by the difficulties with ratifying the Canada-EU deal and the level of political opposition to the TTIP deal with the US. In the longer term, there may be more to be gained from being able to act more swiftly and decisively on trade matters – in which case, the UK's interests may be best served by

seeking the maximum possible freedom on trade policy (making any form of customs union with the EU undesirable).

Q7. Could the UK seek a customs union with the EU covering only certain sectors?

It has been suggested that for some sectors, such as car manufacturing, the UK could seek a special sectoral deal with the EU; if this included a sectoral customs union, this could avoid some of the problems arising from the UK leaving the EU Customs Union, particularly in relation to rules of origin (discussed further at Questions 8 and 9 below). However, such an arrangement would not meet the WTO requirement for free trade agreements relating to goods (including customs unions) to cover "substantially all trade" in goods (see *Reverting to WTO Rules* for more detail). Whilst it is true that Turkey's customs union with the EU is not fully comprehensive, the only exception is for agricultural produce – so the EU and Turkey would not doubt argue that the vast majority of their goods trade is in fact covered by the arrangement.

That said, there may be scope for a sectoral deal as part of a wider EU-UK free trade agreement – see further Question 9 below.

RULES OF ORIGIN

Q8. What are rules of origin and why might they be problematic?

Rules of origin are relevant where one country has a free trade trade agreement with another, as the UK envisages for its future relationship with the EU. Such an agreement is likely to allow goods to be imported into the EU at lower tariffs than would apply under WTO rules (see *Reverting to WTO Rules*).

However, in order to benefit from this preferential treatment, UK businesses would have to demonstrate that a certain percentage of the product (e.g. at least 60%) originated in the UK. This can become quite complex where the product has been assembled using parts imported from another country which does not benefit from the same preferential treatment. Research suggests that where tariffs are already low, many businesses consider that the cost of proving origin outweighs the benefit of any preferential tariff – and therefore opt to pay the higher WTO tariff rather than comply with rules of origin. In other cases, rules of origin can deter businesses from exporting to a particular territory altogether. Particular concerns have been raised about the impact of rules of origin on complex supply chains, such as those in the automotive sector.

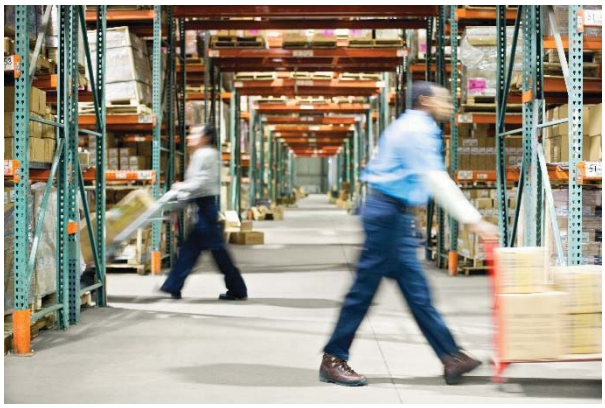
Q9. What can be done to minimise the impact of rules of origin?

Rules of origin are explained in answer to Question 8 above. In order to minimise their impact, the UK could seek agreement from the EU to the following:

- **Self-certified origin documentation:** the EU-South Korea FTA provides for approved exporters to self-certify the origin of their goods by means of an "origin declaration", instead of having to obtain a certificate from customs authorities. This should be easier to comply with than the standard approach to rules of origin, although approved exporters are expected to retain further documentary proof of the origin of the goods for at least 5 years and be prepared to produce it on request. There are therefore some additional administrative costs to this option, compared with being in a customs union.

- **Cumulation of origin:** the EU-South Korea FTA also provides for "cumulation of origin". This would be helpful to the UK because it would mean that a car assembled in the UK using parts from elsewhere in the EU would still be regarded as originating in the UK (even though a high percentage of the vehicle may in fact have been manufactured outside the UK). Without cumulation, UK car manufacturers might have to restrict the percentage of parts coming into the UK from the EU or elsewhere – and UK components suppliers might find that EU car manufacturers would switch to competitors based in the EU.

A requirement for proof of origin could be dispensed with altogether (for goods traded between the UK and the EU) if the UK agreed to maintain tariffs on imports from non-EU countries which matched the EU's tariffs on such imports into its territory. In that situation, there would be no concern that goods being exported from the UK were unfairly taking advantage of the UK's preferential tariff arrangements with the EU. However, it is not clear that this would work as a long term solution, assuming that the UK intends to enter into free trade agreements with countries outside the EU. Such trade deals would be likely to mean that goods from those countries could be imported into the UK at tariffs below those which would apply for imports of the same goods into the EU. This would probably cause the EU to insist on rules of origin checks, at least in relation to categories of goods which could benefit from the UK's trade arrangements with third countries.



That said, the UK could agree with the EU that, whatever deals it strikes with third countries, it will maintain the same tariffs in certain sectors (e.g. all automotive products) where UK-EU supply chains are particularly highly integrated. Such an arrangement would potentially allow for a form of sectoral deal, as suggested by some commentators. Provided that it formed part of a wider EU-UK free trade agreement covering most types of products, it would not necessarily be incompatible with the WTO rule requiring such deals to cover "substantially all" trade in goods.

POSSIBLE SOLUTIONS

Q10. Assuming customs controls are introduced on Brexit, what can be done to make clearance as quick and efficient as possible?

The UK could seek agreement from the EU to the following measures:

- **Authorised Economic Operator (AEO) system:** essentially, this system allows approved importers and exporters to make use of simplified, fast-track procedures, so that most goods can clear customs with only a documentary check (rather than a full customs inspection, which may involve delays while the container is opened up to verify the contents). The EU has such arrangements in place with the US, Japan and a number of other major economies. The Japanese government has strongly advocated continued participation by the UK in the AEO system post-Brexit.

- **Mutual recognition of conformity testing:** certain products, such as electrical goods, need to be accompanied by proof that they meet relevant standards (without which they will be refused entry). Such proof is normally provided by a certificate from an approved testing facility. Mutual recognition involves each country recognising that testing facilities in its jurisdiction can issue valid certificates under the other country's regulatory regime. As a result, rather than the goods having to be held in port while testing is carried out, the testing can be done in the country of export, with proof of compliance being demonstrated by a certificate to satisfy customs requirements.

The following could be used in the event of a hard Brexit with no EU-UK trade agreements in place:

- **Electronic systems:** technology such as number plate recognition can play a role in speeding up customs procedures e.g. an HGV arriving at Dover could be cleared automatically if its number plate has been notified in advance and UK customs has already been sent adequate documentation explaining what is being carried etc (and can therefore take a decision in advance on whether to pull the HGV over for inspection or effectively wave it through on the basis of the documentary checks). However, this is likely to require substantial investment in new IT systems and facilities.

- **TIR Convention:** TIR stands for "Transports Internationaux des Routiers" and could be a solution for HGV traffic transiting the UK on the way to Ireland. The TIR system essentially allows goods to be sealed by customs authorities at the point of departure, thus allowing the cargo to pass through other customs checkpoints subject only to a check of the TIR documentation (rather than a full inspection). This could be helpful for EU HGV traffic heading to Ireland because the cargo could be sealed in the EU and thus potentially pass through the UK without having to pay customs duty, as its ultimate destination would be another EU country. However, UK customs authorities would no doubt wish to check that HGVs arriving in Ireland matched up with their records of HGVs entering the UK (and that the system was not being abused for the purposes of smuggling goods into the UK without paying import duties). TIR will also involve some additional costs for HGV operators.

Q11. How realistic are the UK government's proposals for dealing with customs after Brexit?

At the time of writing, the UK had published a position paper on customs in the context of the Article 50 negotiations (August 2017) together with a White Paper (October 2017). One option being proposed involves a variety of measures designed to reduce border red tape, including technological solutions such as number-plate recognition (so as to allow HGVs to roll off ferries without having to stop, provided they have declared their cargo to customs electronically and in advance). Many of these measures are discussed in our Q&A on Customs Arrangements (see in particular Qs 9 and 10).

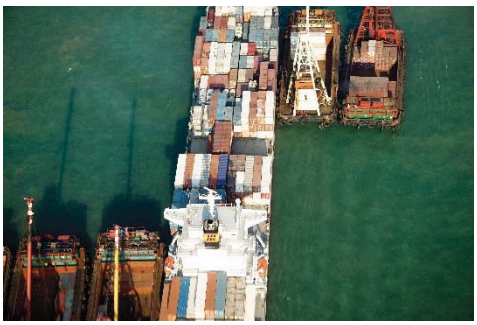
The other, much more ambitious option would involve the UK agreeing that its customs treatment of goods entering the UK but intended for the EU will mirror that of the EU, thus removing the need for customs controls between the UK and the EU. This would be a better solution for UK businesses which are part of EU-wide supply chains, as it would minimise disruption to their current arrangements. In particular, it would avoid the problems caused by "rules of origin", which are explained at Qs 8 and 9 of our Q&A on Customs Arrangements. However, for reasons explained in Q12 below, the EU may well have serious reservations about this approach.

The EU's anti-fraud agency has accused the UK authorities of turning a blind eye to a VAT and customs fraud estimated to have cost €5 billion in lost revenue. Understandably, this may make the EU cautious about agreeing to a "light touch" customs regime after Brexit.

Q12. Why might the EU have concerns about the UK's proposals?

In order to achieve the "freest and most frictionless" customs arrangements with the EU, the UK will need to persuade it that adequate measures are in place to detect and/or deter smuggling and other forms of customs fraud. For example, the EU will be aware that large scale smuggling of products as mundane as garlic has taken place on the land border between Norway and Sweden – so it highlights the issues that will arise in relation to

Northern Ireland and the Republic of Ireland and also, arguably, at ports such as Dover or Holyhead where the majority of goods traffic consists of HGVs. In neither case is it practical to inspect all consignments manually.



Garlic became popular with smugglers after a 9.6% tariff was imposed on garlic imports from outside the EU. Being outside the EU and not having any garlic growers of its own to protect, Norway does not impose any tariffs on garlic – making it an attractive point of entry for smugglers. The garlic was then loaded onto a lorry and sent across the border with Sweden without being declared, in the hope that it would not be checked and would avoid the 9.6% tariff. Unfortunately for the smugglers, they were caught – but not before an estimated 100 tonnes of Chinese garlic had been smuggled into the EU via Sweden, avoiding around €13.1 million in customs duties. The Swedish authorities believed the scam was coordinated from the UK.

The concern for the EU is that once the UK is free to conclude its own trade deals, it will lower the tariffs it imposes on many goods – including, quite possibly, garlic and many other foodstuffs (like Norway, the UK does not have many garlic growers to protect). Any product where the UK tariff is substantially lower than the EU tariff will potentially attract smuggling of this kind.

More recently, OLAF, the EU's anti-fraud agency, has claimed that the UK failed to act on warnings about a customs fraud relating to Chinese textiles and footwear being declared to UK customs at well below their actual value – allegedly because the goods were ultimately destined for other EU countries, so the UK would not stand to suffer any loss of VAT on the sales (although it would have benefited economically because of the use of UK ports, rather than other destinations such as Rotterdam). According to OLAF, the EU lost almost €2 billion in customs revenue and Member States lost over €3 billion in VAT.

As the UK's paper admits, "there will [be] an increase in administration compared with being inside the EU Customs Union" – and this in turn will mean extra costs for businesses trading with the EU after Brexit.

These issues - particularly the allegations of lax UK enforcement where non-UK goods entering the UK are destined for non-UK markets - are likely to make the EU cautious about accepting UK proposals for "light touch" customs arrangements (although it will face pressure from its own exporters to reach a deal with the UK which ensures that bureaucracy is kept to a minimum). One possibility is that the EU might demand a compensation mechanism for Member States which can show that they have suffered loss due to lax customs enforcement in the UK.

But whatever the outcome, as the UK's paper admits, "there will [be] an increase in administration compared with being inside the EU Customs Union" - and this in turn will mean extra costs for businesses trading with the EU after Brexit.

TRAVERS SMITH

The EEA Agreement

The EEA Agreement

This Q&A looks at how the EEA Agreement might work as a model for the UK's post-Brexit relationship with the EU.

THE EEA: THE BASICS

Q1. What is the EEA and the EEA Agreement?

The EEA is an internal market covering the EU Member States and EEA-EFTA States (Iceland, Liechtenstein and Norway - see Q3 below) focusing on the free movement of goods, services, capital and people. The EEA Agreement is narrower in scope than the EU Treaties (see Q4) and is arguably more focussed on economic rather than political objectives; in particular, unlike the EU Treaties, it does not contain the objective of an "ever closer union" between its members.

The EEA Agreement is more focussed on economic than political objectives and does not contain the objective of "ever closer union" between its members.

From a business perspective, EEA membership would enable the UK to continue to participate in the Single Market. Trade in most goods would thus continue to be tariff free, although the UK would be outside the Customs Union, which could increase border red tape (see *Customs arrangements*). The UK would, however, be free to conclude its own trade agreements (subject to certain constraints – see Q7).

The UK would also lose the formal voting rights over EU legislation which it currently possesses as an EU Member State; this would probably make it more difficult to influence the development of Single Market rules (see Q6).

Q2. Is the EEA Agreement a realistic model for the UK's post-Brexit relationship with the EU?

As noted at Q1 above, the EEA model would involve the UK remaining a participant in the Single Market. At the time of writing, however, the UK government's stated position was that it intends to leave the Single Market. On the face of it, this would suggest that the EEA model should be wholly discounted. However, there are a number of ways in which it could still be relevant to the Brexit negotiations:

- **Support for a "softer" Brexit:** The general election in June 2017 left the government without a majority and arguably did not provide a clear endorsement of its proposals for the UK's post-Brexit relationship with the EU. On the contrary, many commentators have interpreted the vote as favouring a

"softer" Brexit which could, potentially, involve membership of the Single Market, based on the EEA model. As an "off the shelf" model which has already been agreed by the EU with several other Member States, such an option should also be easier to negotiate than a more "bespoke" EU-UK relationship (although it would not be without its difficulties – see below). Several continental think tanks (e.g. the Robert Schuman Foundation and Bruegel) have suggested that Brexit could provide a catalyst for a reorganisation of the EU and the EEA, potentially giving the EEA-EFTA States a greater say in Single Market legislation whilst enabling EU member states to pursue greater integration, should they wish to do so. Such reform would take time but it would address a key concern about the EEA model, which is that, compared with EU membership, the UK would stand to lose influence (see Q6 below).

- **Use of parts of the EEA framework:** Even if there is no change to the UK's stance on the Single Market, elements of the EEA Agreement may provide a useful template for aspects of the UK's post-Brexit relationship for the EU. For example, it has been suggested that the institutions of the EEA Agreement could be used by Switzerland as a mechanism to supervise and enforce its complex relationship with the EU. In addition, the EEA Agreement (or aspects of it) could also provide a useful template for transitional arrangements between the UK and the EU, pending the conclusion of negotiations over the longer term relationship.

In our view, the EEA model should not be ruled out as "too difficult" – but there will need to be political willingness from all relevant parties to make it work.

That said, for reasons explained at Q16, it may be difficult for the UK to make a quick and "seamless" transition from EU membership to becoming a fully fledged EEA-EFTA State, alongside Iceland, Liechtenstein and Norway. Given the 2 year deadline for the UK to leave the EU under Article 50, this might suggest that the EEA option should be dismissed as impractical. However, a potential solution to this problem would be for the UK to ask the EU for a "mirror" EEA Agreement i.e. a separate agreement on the same terms as the EEA Agreement (see Q17). In view of this possibility, it seems to us that the EEA model should not be ruled out as "too difficult" – although clearly, there will need to be political willingness from all relevant parties to make this work.

Q3. Which countries are members of the EEA?

The EEA as a territory covers **Iceland**, **Liechtenstein** and **Norway** (the "EEA-EFTA States") together with **all the EU Member States**.

Iceland, Liechtenstein and Norway are also members of the **European Free Trade Association** (EFTA), membership of which is a pre-condition of joining the EEA (see Q16). The fourth EFTA member is Switzerland, but it does not participate in the EEA. In this Q&A, "EEA-EFTA States" refers to Iceland, Liechtenstein and Norway (not Switzerland).

THE EEA AGREEMENT: KEY FEATURES

Q4. Which EU policy areas are not covered by the EEA Agreement?

The following areas which are covered by the EU Treaties are not covered by the EEA Agreement; EEA-EFTA States are thus free to pursue their own independent policies in these fields of activity:

- **Common agricultural and fisheries policies** – to the extent that the UK wished to continue to subsidise farming and fishing, it would need to establish its own mechanisms for doing so funded from its own resources. In addition, whereas UK agricultural products and fish can currently be sold tariff free throughout the EU, EEA-EFTA States are subject to some

tariffs (see Q8 below). In practice, it is likely that transitional arrangements would need to be negotiated so that both government and UK producers have sufficient time to prepare for the introduction of a new regime in these areas.

- **Trade policy** – the UK would be free to conclude its own trade agreements (subject to certain constraints – see Q7) and set its own tariffs for goods from outside the EEA. However, it would stand to lose the benefit of existing trade agreements negotiated on its behalf by the EU.

- **Customs union** – EEA-EFTA States are not part of the Customs Union and the UK would also need to re-establish customs controls on trade with EU Member States. See Q8 and *Customs arrangements*.

- **VAT** – the UK would be free to set its own rates of VAT (the EEA Agreement does not cover direct or indirect taxation).

- **Monetary union**— unlike the EU Treaties, there is no commitment to joining the euro (whilst the UK and Denmark have opt-outs, these are more in the nature of exceptions to the general rule).

- **Freedom and security** - the UK would need to find a way to replace the current mechanisms for cooperation and exchange of information on matters of national security.

More generally, as noted at Q1 above, the EEA Agreement does not include the objective of an "ever closer union" between its members and is arguably more focussed on economic rather than political objectives. Two further differences (compared with EU membership) which are of particular relevance to businesses are as follows:

- current rules on **jurisdiction and enforcement of judgments** would not apply (as EEA-EFTA States are not parties to the Brussels Regulation – although their membership of the Lugano Convention preserves some of the benefits of the Brussels regime); and

- the EEA-EFTA States have not chosen to sign up to legislation on **EU-wide intellectual property rights**, such as the Community Trade Mark or the Community Design Right (although they are bound by e.g. EU legislation designed to harmonise national IP rights).

That said, as an EEA-EFTA State, the UK would (as a general rule) continue to be subject to most of the key EU legislation on employment, competition law, state aid, public procurement, pensions, company law, financial services, data protection, intellectual property and consumer protection.

Q5. Do EEA-EFTA States still have to make contributions towards the EU/EEA budget?

EEA-EFTA States must still make budget contributions but at a lower level than EU Member States.

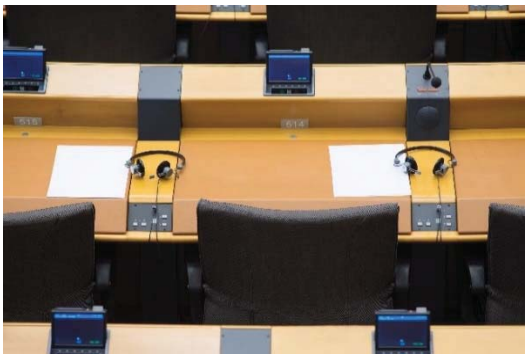
EEA-EFTA States are still required to make contributions towards the EU/EEA budget, although these are not as high as those required from full EU Member States. If the UK were to contribute on the same per capita basis as Norway, it is estimated that the UK's contributions could fall by 25% per person (House of Commons Library Briefing Paper, 28 July 2016). However, estimates differ and some commentators have suggested that if the UK were to lose its rebate, it could end up paying almost as much as it does now.

On the other hand, the higher the UK's contribution, the less money the EU will need to seek from remaining Member States after Brexit to balance its budget; as such, a higher level of contribution could make the EU

more willing to make concessions to the UK on other aspects of the Brexit negotiations (such as the size of the "divorce bill").

Q6. What influence do EEA-EFTA States have over EU legislation?

EEA-EFTA States have no formal voting rights over EU legislation and no formal representation in key EU decision-making institutions (notably the EU Council of Ministers and the European Parliament); they only have the opportunity to influence the shape of a legislative proposal from the European Commission during the early consultation and drafting stages. Compared with the current position, many commentators consider that this would substantially reduce the UK's ability to shape such legislation, particularly once the European Commission's proposal has been finalised – and particularly in relation to fields where the UK has historically played an influential role, such as financial services.



In practice, countries such as Norway have attempted to address this "influence deficit" by maintaining a significant diplomatic presence in Brussels. Some of the deficit could arguably be made up by the UK taking up the opportunity to represent itself on international standard setting bodies, where it is currently represented by the European Commission acting on behalf of the EU as a whole (the ability to influence international standards is significant because they are often incorporated into Single Market legislation on standards for goods etc). However, such measures would, in our view, be unlikely to compensate fully for the loss of influence over the EU's own legislative process that comes from being a full EU Member State.

That said, taking a broader perspective, it is arguable that the probable loss of influence over EU legislation relevant to the EEA Agreement should be weighed against the greater freedom of action which the UK would stand to gain in relation to matters which are not covered by the EEA Agreement, such as trade, agriculture, fisheries and so on. A number of think tanks have also suggested that in the longer term, it may be possible for EEA-EFTA States to secure a stronger role in the legislative process for Single Market legislation (see Q2).

Finally, if it is accepted that the UK is going to leave the EU, the appropriate comparator is not EU membership but other models for UK-EU relations. For example, even where the UK made a complete break with the EU, this apparent return of sovereignty would arguably be illusory in many areas, because businesses would want the government to align itself with EU rules (over which the UK would probably have less influence than it would as an EEA-EFTA State).

EFTA currently has 27 free trade agreements covering 38 countries – but EEA-EFTA States are also free to negotiate bilateral agreements without going through EFTA.

Q7. Are EEA-EFTA States free to make their own trade agreements with third countries?

Unlike EU Member States (where competence over trade policy is given to the European Commission), EEA-EFTA States are free to conclude their own trade agreements with other countries. Some of these are negotiated collectively through EFTA, which currently has 27 free trade agreements covering 38 countries. But EEA-EFTA States are also free to negotiate bilateral agreements without going through EFTA; for example, Iceland has negotiated a free trade agreement with China which took effect on 1 July 2014.

This freedom would have some advantages for the UK. Although it would lose bargaining power as compared with its current position as a member of the world's largest trading bloc (the EU), it would be able to tailor its

negotiating position to the interests of UK businesses and consumers. That said, continued participation in the Single Market would impose certain constraints on the UK's freedom to conclude free trade agreements.

For example, in relation to services, the UK might ideally wish to offer generous access to third countries, in the hope of securing better access for its own service providers. However, there would always be the risk that the EU would impose new Single Market rules in that area, which (as an EEA-EFTA State) the UK would be obliged to accept. This in turn would make it difficult for the UK to offer a firm commitment that it would not impose any new restrictions in relation to services of that particular type.

Q8. Is trade in goods between EEA-EFTA States and the EU "frictionless" and tariff-free?

Although trade in most goods with the EU is tariff free, this does not apply to all food and drink products.

Not entirely. Trade in most goods – with the notable exception of agricultural products and fish – is tariff-free, but the EEA-EFTA States are outside the Customs Union, which means that a certain amount of border red tape is inevitable. In particular, in order to benefit from tariff-free treatment on entry into the EU, businesses in EEA-EFTA States must be able to prove that their goods originated in the EEA – and that they are not, for example, cheap Chinese imports which have been "rebadged" to look as if they come from say, Norway. Such "rules of origin" necessitate additional paperwork to accompany the goods when they pass through customs posts in the EU. For more detail, see *Customs arrangements*.

In addition, although most EEA-produced goods benefit from zero tariffs, this does not apply to all food and drink products (see Protocols 3 and 9 of the EEA Agreement). For example, Norwegian salmon sold as whole fish face a tariff of 2% (which is low enough not to make that much difference), but Norwegian smoked salmon faces a much more significant tariff of 13%. As a result, the bulk of Norwegian salmon (whole fish) is shipped to an EU country (usually Poland) for smoking; following that processing, it can be treated as goods of EU origin and sold tariff free (within the EU).

Q9. What is the position as regards free movement of people in the EEA-EFTA States?

Free movement of people is a key principle of the EEA Agreement, just as it is a key principle of the EU Treaties. However, Article 112 of the EEA Agreement contains "safeguard" provisions which potentially allow EEA-EFTA States to impose restrictions on free movement of people (among other things) where there are "serious economic, societal or environmental difficulties of a sectorial or regional nature liable to persist." There is no equivalent of Article 112 for EU Member States under the EU Treaties.

Significantly, Article 112 allows an EEA-EFTA State to act unilaterally without seeking prior consent from other parties to the EEA Agreement, including the EU. As such, the protection would appear to be stronger than the "emergency brake" negotiated by the UK government prior to the referendum (which required the UK to seek approval from the European Commission before any restrictions could be implemented).

Using Article 112, Liechtenstein has been able to maintain the imposition of quotas on immigrants which were originally agreed on its accession to the EEA Agreement (and were envisaged as temporary). Although Liechtenstein is a much smaller country than the UK, it appears that the same measures were provisionally agreed in relation to Switzerland when the latter was seeking to join the EEA Agreement (but these plans were abandoned when a Swiss referendum resulted in a "no" vote for EEA membership).

Notwithstanding the disparity in size between the UK and Liechtenstein, there are also some striking parallels when it comes to immigration:

- **Population density:** the UK's population density (of 269 people per square kilometre) is higher than that of Liechtenstein (235) or Switzerland (210) - and in England, the figure is over 400 per square kilometre; and

- **Local impact:** as Conservative MEP Vicky Ford has pointed out, Liechtenstein's population of 37,000 is about the same as that of the town of Wisbech in Cambridgeshire, which has had over 1000 immigrants in recent years, putting significant pressure on local services (whereas Liechtenstein only gives residency permits to about 90 people per year).

Article 112 of the EEA Agreement could provide a basis for the UK to restrict free movement of people, at least on a temporary basis.

The grounds for the UK invoking Article 112 might be similar to those accepted by the European Commission in relation to the "emergency brake" negotiated by the UK in the run-up to the EU referendum. In particular, the Commission accepted that the UK would be justified in invoking the emergency brake because it has experienced an "exceptional inflow of workers from elsewhere in the European Union" and "has not made full use of the transitional periods on free movement of workers which were provided for in recent Accession Acts." It considered this to be "the type of exceptional situation that the proposed safeguard mechanism is intended to cover."

If the UK sought to make use of Article 112, it is likely that it would want to go further than the measures envisaged under the emergency brake, which only related to in-work benefits. However, the referendum vote and its aftermath could be used to support an argument that the "exceptional inflow of workers" is causing serious "societal difficulties" (e.g. a substantial rise in reported hate crime relating to immigrants generally and pressure on local services in areas which have received high numbers of immigrants) - and that consequently further measures to restrict free movement are justified (at least for a temporary period). It is also worth noting that Liechtenstein's measures were always intended to be temporary, but in practice it has been allowed to maintain controls ever since it joined the EEA in 1994.

That said, it is unclear whether such a stance would be acceptable to the other EEA-EFTA States and/or the EU, particularly given the latter's emphasis on the principle of free movement of people as being "indivisible" from the other key principles of Single Market membership. In practice, the best option for the UK would be to seek prior agreement with the EU and the other EEA-EFTA States on any measures designed to restrict free movement.

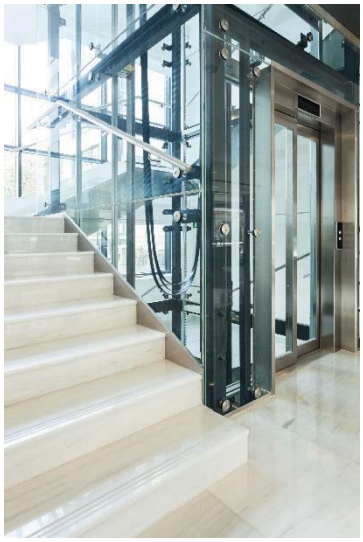
EEA INSTITUTIONS AND LAW-MAKING

Q10. How do EEA institutions differ from those of the EU?

The EEA has its own institutions which (broadly) parallel those of the EU, although as noted below there are some differences. In particular, several EEA institutions, notably those involved with deciding which legislation is incorporated into the EEA Agreement, are operated jointly with the EU, to facilitate coordination with the latter.

The key EEA institutions are as follows:

- EEA-EFTA States are represented on the **EEA Council**, which is broadly the EEA equivalent of the EU Council of Ministers, although the European Commission and the Presidency of the EU Council of Ministers are also represented on it (so it is not exclusively controlled by EEA-EFTA States).



- EEA-EFTA States are also represented (by ambassadors) on the **EFTA Standing Committee.** This Committee reaches common positions (as regards the views of the EEA-EFTA States) on which EU measures to incorporate into the EEA Agreement. It is assisted in doing so by the **EFTA Secretariat**. Those common positions are then discussed with representatives of the European Commission in the **EEA Joint Committee** and a decision is reached on which legislation to incorporate into the EEA Agreement and whether any amendments are necessary (also assisted by the EFTA Secretariat). It is important to note that the EEA-EFTA States are not free to pick and choose which EU measures to sign up to; where new EU legislation is within the scope of the EEA Agreement, it must be incorporated (but there may sometimes be debate as to whether certain legislation is "EEA-relevant" – see Q11).

- Monitoring and enforcement of the EEA Agreement is carried out by the **EFTA Surveillance Authority** (ESA), which is the EEA equivalent of the European Commission. However, unlike the European Commission, the ESA cannot propose legislation and the administrative work related to adoption of EU legislation is carried out by the **EFTA Secretariat**, rather than the ESA.

- Rulings on the interpretation of EEA law (following referrals from national courts of EEA-EFTA States), appeals against ESA decisions and infringement proceedings brought by the ESA against EEA-EFTA States are dealt with by the **EFTA Court** – the EEA equivalent of the Court of Justice of the European Union. See Qs 12-14 below.

- Parliamentarians from EEA-EFTA Member States are represented on a **Committee of MPs**, which is the nearest equivalent in the EEA to the European Parliament (although, unlike the European Parliament, the Committee has no formal decision-making power).

Q11. How does new EU legislation get adopted by the EEA/EFTA States - and what is the "slow implementation problem"?

Once relevant EU legislation has been passed, the EEA-EFTA States must then agree to incorporate the relevant EU act into the EEA agreement. There are 2 key points to note here:

- **EEA relevant or not?** Not all acts marked by the EU as "Text with EEA relevance" are subsequently adopted by the EEA. For example, EEA-EFTA States do not participate in arrangements relating to the Community Trade Mark (although the relevant legislation is marked as "EEA-relevant"). However, as noted at Q10 above, EEA-EFTA States cannot generally pick and choose which EU measures they sign up to; if the relevant legislation falls within the scope of the EEA Agreement, it must be incorporated.

- **The slow implementation problem:** The process for incorporating EU legislation into the EEA Agreement is somewhat bureaucratic and typically results in a time lag of 6-24 months in the

implementation of measures, as compared with the EU. In addition, EEA-EFTA Member States cannot benefit from new rights under an EU Directive until all of them have implemented it in their national law, so the time lag can in some circumstances be even worse. For example, there have been significant delays in Norway and Iceland over the implementation of recent EU financial services legislation (in part due to constitutional concerns); as a result, financial services providers based in Liechtenstein have been unable to take advantage of new rights under that legislation.

In practice, this means that some businesses in EEA-EFTA Member States may find themselves at a commercial disadvantage vis-à-vis their competitors in EU Member States. On the other hand, there may occasionally be advantages in having a time lag, particularly where the main effect of a measure is not so much to facilitate market access but to impose stricter or more burdensome rules on business (in which case the time lag will allow for a longer "grace period" before full compliance is required). That said, the "slow implementation problem" could be avoided altogether if the UK pursued the option of a "mirror" or "parallel" EEA, as outlined at Q17.

THE EFTA COURT AND THE CJEU

Q12. How does the relationship between the EFTA Court and EEA-EFTA States differ from the relationship between the CJEU and EU Member States?

There are a number of differences between the EFTA Court and the Court of Justice of the European Union (CJEU) which may be significant in the context of Brexit:

- **Advisory, not binding:** Whereas CJEU preliminary rulings on the interpretation of EU law are binding on EU Member States, EFTA Court opinions on the interpretation of EEA law are only advisory. From a national sovereignty perspective, this could make the EFTA Court a better "fit" for the UK. That said, if a national court refused to follow an EFTA Court opinion without clear grounds for distinguishing it, the EFTA Surveillance Authority may initiate infringement proceedings (on the grounds that failure to follow EFTA Court rulings breaches the overriding principle of homogeneity in the EEA Agreement). Indeed, in practice, it appears that EFTA Court opinions are almost always followed.

> *"Traditional EFTA values are the belief in liberalism, free trade and market orientation as well as in self-responsibility. The EFTA Court does not carry a French rucksack."*
>
> Carl Baudenbacher, President of the EFTA Court (2017)

- **No obligation to refer:** Whereas the national courts of full EU Member States are obliged to refer questions of EU law to the CJEU unless they are "acte claire", no comparable obligation is imposed on the national courts of EEA-EFTA States with regard to referring questions of EEA law to the EFTA Court. It follows that national courts have more scope for resolving questions themselves. This may result in fewer referrals to the EFTA Court - and in practice, this appears to have been the effect in the existing EEA-EFTA States. It is possible that the UK might see this as an advantage of EEA membership, since it arguably restores a degree of sovereignty to UK courts. EEA-EFTA States are also free to provide that references may only be made from courts of last resort, e.g. the equivalent of our own Supreme Court. That said, it would not prevent the EFTA Court or the CJEU dealing with the same issue on a reference from another EEA-EFTA State or a full EU Member State – possibly leading to conclusions at odds with those arrived at by the UK courts.

- **Closer to common-law approach:** Carl Baudenbacher, President of the EFTA Court, has suggested that the EFTA Court could be a "better fit" for the UK because in his view it often takes a more pragmatic, evidence-based approach to legal questions (closer to the approach adopted by common law courts) than the CJEU. That said, where the CJEU has already ruled on a matter, there is limited scope for the EFTA Court to diverge from it in a significant manner (see Q13).

Q13. What is the status of CJEU rulings in EEA-EFTA States?

The EEA Agreement states that the EFTA Court and EEA-EFTA States must be uniform in their approach with any case law before the date of the EEA Agreement i.e. 1 January 1994 (see Article 6 of the EEA Agreement); after that date, the EFTA Court is only under an obligation to take due account of decisions made by the CJEU (see Article 6 of the EEA Agreement and Article 3(2) of the ESA/EFTA Court Agreement). It follows that, strictly speaking, CJEU case law after 1 January 1994 is not binding on the EFTA Court or EEA-EFTA States.

However, in practice, the EFTA Court has effectively treated CJEU decisions post-dating the EEA Agreement as if they were binding. It has even gone as far as reversing EFTA Court case law when the CJEU interpretation in a later ruling was different (e.g. see L'Oreal E-9/07 and E-10/07 [2008] EFTA Ct. Rep. 258). For its part, the CJEU has also taken EFTA Court rulings into account, even though there is no formal agreement or requirement for this. Both courts recognise the need to interpret EU law in a uniform manner to preserve the integrity of the EEA as an internal market. In case of conflict, the EEA Agreement provides for the following:

- The Joint Committee keeps case law of both courts under constant review to ensure uniformity;
- If the Joint Committee cannot resolve a difference between CJEU and EFTA Court case law, the "Contracting Parties to the dispute may agree to request the CJEU to give a ruling on the interpretation" (Article 111 of the EEA Agreement); and
- Article 107 of the EEA Agreement also gives EEA-EFTA national courts the power to refer interpretation questions to the CJEU, although to date, we are not aware that any of them has done this.

Q14. Can EEA-EFTA States intervene in cases before the CJEU?

The right of EEA-EFTA States to intervene in cases before the CJEU is limited to non-institutional cases i.e. they cannot intervene in cases where one of the parties is an EU institution (e.g. the European Commission). The thinking behind this limitation is unclear, since many such actions concern infringement proceedings brought by the European Commission and turn on the interpretation of Single Market legislation - matters in which EEA-EFTA States clearly have an interest, just as EU Member States do. This limitation does not apply in reverse i.e. EU Member States may intervene in any case before the EFTA Court, even those where an institution established under the EEA Agreement is a party (see Protocol 3, Article 40 of the EU Treaty).

MAKING THE TRANSITION FROM EU TO EEA

Q15. Is it possible for the UK to leave the EU but remain in the EEA?

Most commentators take the view that upon leaving the EU, the UK will also cease to be a party to the EEA Agreement and would therefore have to apply to rejoin (see Q16). However, others argue that leaving the EU does not necessarily mean leaving the EEA – and that unless and until the UK gives notice to terminate its participation in the EEA Agreement, it will remain party to it. Proceedings initiated in the Irish High Court which might have resolved this question have been dropped, but there remains the possibility of a judicial review in the English courts on the point, once the UK government has taken a decision on whether it needs to give notice to leave the EEA as well as the EU.

The Brexit negotiations appear to be proceeding on the basis that the UK will not be able to remain in the EEA. The lack of clarity on this point is unfortunate because, if the UK could be certain about remaining within the

EEA, the dynamics of the negotiation with the EU could change quite substantially; instead of facing a substantial "cliff-edge" risk under Article 50 (with its 2 year negotiating deadline), the UK would at the very least be able to use the EEA Agreement as a "fallback position", allowing it more time to negotiate the best possible longer term deal with the EU.

Some commentators argue that leaving the EU does not necessarily mean leaving the EEA Agreement – and that unless and until the UK gives notice to leave, it remains a party to the EEA Agreement.

Q16. What would need to happen for the UK to become a fully-fledged EEA-EFTA State?

Some commentators consider that unless the UK gives notice to leave the EEA Agreement, it can remain a party to it (but that adjustments would obviously have to be made to reflect the fact that the UK was no longer an EU member state) – see Q15.

However most commentators take the view that on exiting the EU, the UK will also leave the EEA and would therefore need to reapply to join the EEA Agreement. If this is correct, the UK would face a number of obstacles, which are explained in more detail below. Given sufficient time, these obstacles may well be capable of being overcome, but it is probably unrealistic to expect them to be resolved by the time the UK is due to leave the EU in 2019.

In the short term, a possible solution for the UK would be to seek a "mirror" or "parallel" EEA Agreement – that is, a deal with the EU on the same terms as the EEA Agreement, but which would be legally separate from it. The UK would then remain in that relationship until it had managed to resolve any outstanding issues with becoming an EEA-EFTA State – see Q17. The problems with the UK becoming a fully-fledged EEA-EFTA State in the short term are as follows:

In the short term, a possible solution would be for the UK to seek a "mirror" or "parallel" EEA Agreement – that is, a deal on the same terms as the EEA Agreement but legally separate from it.

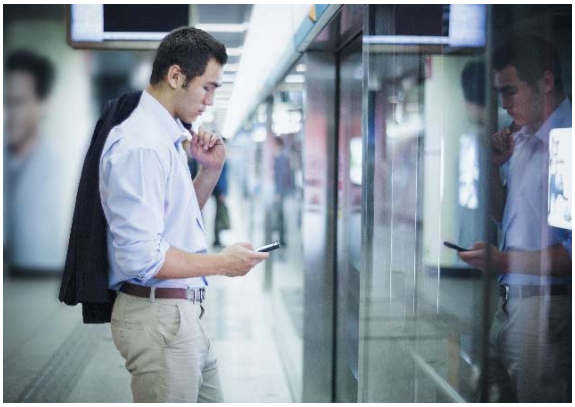
- **EFTA membership:** the UK would need to become a member of the European Free Trade Association (EFTA). This would require unanimous consent of the three EEA-EFTA States and Switzerland (as the only non-EEA member of EFTA). It is possible that an EFTA state could veto the UK's membership. For example, Norway vetoed Slovakia's potential membership over concerns regarding the latter's ability to implement EU legislation adopted under the EEA Agreement in a timely manner.

  Other concerns may relate to the UK being a much larger country which would potentially upset the existing balance of power within the EEA-EFTA States, where Norway is currently the main player and/or the UK's membership complicating the process for negotiating future EFTA trade agreements (because the UK's interests in some areas would be different from those of the current members). It is also possible that the UK's EFTA membership application could be derailed by a popular vote e.g. in Switzerland, certain issues can be made the subject of a referendum where there is sufficient public support for a vote.

- **Ratification:** the UK's accession to the EEA Agreement as an EEA-EFTA State would require ratification not just from the EU in its own right, but also from the 27 remaining EU Member States and the 3 existing EEA-EFTA States i.e. 30 countries in all. A number of those countries have legislative provisions which could (with sufficient public support) result in ratification becoming the subject of a popular vote (e.g. the Netherlands). In other countries, a Parliamentary vote would be required.

  This could be a protracted process which carries the risk of the UK's accession being effectively blocked - although the same issues are likely to arise in relation to most other models for the UK's post-Brexit relationship with the EU (e.g. it is quite likely that a free trade agreement or association agreement with the UK would need to go through a ratification process).

Q17. A "mirror" or "parallel" EEA Agreement: what is it and how would it help?



The idea of a "mirror" or "parallel" EEA Agreement is intended primarily to overcome the problems outlined at Q16 above, which could make it difficult for the UK to effect a quick and seamless transition from EU membership to being an EEA-EFTA State. Instead of re-joining the EEA Agreement on Brexit, the UK would enter into a legally separate agreement with the EU on the same terms as the EEA Agreement.

As such, the agreement would give the UK continued membership of the Single Market, whilst avoiding the timing and political obstacles of becoming a fully-fledged EEA-EFTA State (e.g. the requirement to join EFTA and the probable requirement for ratification of the UK's participation in the EEA Agreement by all EU Member States plus the three EFTA States). Such an arrangement would also enable the UK to circumvent the "slow implementation" problem described at Q11.

For this solution to work effectively, the UK would probably need to "borrow" the institutions of the EEA Agreement – for example, the other EEA-EFTA States would need to agree that the EFTA Surveillance Authority would have responsibility for monitoring the UK's compliance and that questions from UK courts on the interpretation of relevant law would be referred to the EFTA Court. Although this might appear a somewhat cumbersome arrangement, the EU has already made a similar proposal for Switzerland to "dock" with the institutions of the EEA Agreement as a way of supervising its complex network of bilateral arrangements with the EU (see Q2).

A "mirror" or "parallel" EEA Agreement could help to overcome the difficulties which the UK is likely to encounter in seeking to become a fully-fledged EEA-EFTA State.

There could of course be political objections from the EEA-EFTA States. However, since decisions of the EEA-EFTA institutions concerning the UK would only relate to the UK's "mirror" or "parallel" EEA agreement, they would not directly affect the existing EEA-EFTA States. Similarly, whilst it could be argued that the UK's use of the EEA-EFTA institutions would impose additional burdens on staff and resources, such concerns could be met by the UK agreeing to pay for the costs of its use of the relevant institutions and to fund any additional resources required.

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