Gleiss Lutz

CLIENT UPDATE

Next round of BREXIT negotiations - What lies ahead?

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As 2017 gives way to 2018, the many question marks surrounding the Brexit process remain. The main concern is whether the EU and the UK can agree on a transition deal and what it could look like. When the two-year period triggered by the notification of withdrawal on 29 March 2017 expires, the parties may still face a hard Brexit. But even if a temporary transitional arrangement is reached, it remains largely unclear what long-term solution should follow. Both the EU and the UK have identified certain goals in this regard.

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1. Brexit - Time is running out

Despite poor progress on Brexit talks throughout 2017, both sides were cautiously optimistic at the end of the year. The European Council's announcement on 15 December 2017 gave particular cause for hope, confirming that sufficient progress had been made in the withdrawal talks to advance to phase two: negotiating future (trade) relations. Previously, in an announcement on 29 April 2017, the European Council had insisted on a two-phase negotiation process. Council President Donald Tusk has warned that the second phase will be more challenging, one for which less than a year remains. However, it is already clear that it will be very difficult to meet the tight schedule for negotiations.

And, unfortunately, the timeframe is rather inflexible. Extension of the two-year period would require both a unanimous decision by the European Union and the UK's consent (Article 50(3) TEU). It is therefore all too understandable that the British government are not the only ones trying to work out whether there are other ways of stopping the countdown. With regard to the declaration of withdrawal, it is being debated whether this can somehow be reversed, e.g. by revoking or retracting the notification. It is not clear whether such "makeshift solutions" are even covered by the current legal framework. At present it seems more likely that a temporary transitional solution will be sought to maintain the status quo as far as possible, at least in practice.

2. Phase 2 of negotiations - A look into the (not so distant) future

Phase one of negotiations on the UK's departure from the EU is largely completed; an initial settlement was announced on 8 December 2017. When the European Council confirmed on 15 December 2017 that sufficient progress had been achieved in phase one, it not only cleared the way for phase two of negotiations – the scope of future relations – but also adopted the applicable guidelines spelling out the EU's terms for a transitional arrangement as part of the withdrawal agreement. For phase one the Council also issued detailed position papers for the negotiations with the UK on 22 May 2017. These are to be updated regarding phase two in early 2018. The Commission presented a detailed proposal in this regard on 20 December 2017.

3. Indications by the Council and the Commission on a possible transitional arrangement

Article 50 of the Lisbon Treaty does not explicitly provide for a transition period as part of the withdrawal agreement, meaning that the UK's exit cannot be postponed once the 29 March 2019 deadline expires. Formally, once the deadline expires, Great Britain must be treated as a third country. Nevertheless, there is a certain degree of flexibility available to cushion the effects of the exit. This is clearly in the parties' interests, both of whom emphasize that they welcome and are seeking close ties with each other post Brexit.

Both the Council and the Commission have already made it clear what the EU's terms for such a transition are. On the one hand there is the well-known mantra: The EU has clearly emphasized that it will only consider a package deal without any British "cherry-picking". The Council's guidelines of 15 December 2017 generally support the British proposal for a clearly defined two-year transition period. In its recommendation to the European Council for amending the negotiating directives on 20 December 2017, the Commission suggested that the transition period should end by 31 December 2020. According to both the Council and the Commission, the entire *acquis communautaire* is to be subject to negotiations.

During the transition period, the UK is to be treated as a third country and will no longer be represented in Union institutions, agencies, bodies and offices. Nevertheless, all EU regulations and enforcement structures shall continue to apply in full to the United Kingdom, as it will continue to enjoy the benefits of the Single Market. European courts shall also initially continue to have jurisdiction over the UK. Whether the UK is prepared to pay this price - even for a transitional period - for remaining in the EU internal market seems questionable and is likely to lead to heated debates.

4. The transitional arrangement: Will everything stay the same for now?

Even if the EU gets to dictate the terms for a temporary transition period, there are areas that will be directly subject to change once the UK's formal withdrawal takes effect on 29 March 2019 and cannot be postponed with the help of transitional arrangements in the withdrawal agreement. These include, most importantly, international trade agreements. On 29 March 2019 the UK will be a third country and as such will no longer automatically benefit from trade relations and agreements between the EU and other third countries. It is therefore understandable that the UK has already started exploring its options and contemplating future trade relations with third countries.

In theory, it would be possible to extend the transition period indefinitely. This would probably not be prohibited under the TEU. An additional, subsequent phase with a (deviating) transitional arrangement would also be at least conceivable. EU chief negotiator Michel Barnier has, however, made it clear that the transitional arrangements are to definitely cease with the end of the EU's multi-annual financial framework. The Commission's proposal for amending the negotiating directives on 20 December 2017 cites 31 December 2020 as the cut-off date for such arrangements.

5. And what is the long-term plan?

As already confirmed by the European Council in its press release on 29 April 2017, the British government has indicated that it will not seek to remain in the Single Market in the long run, but would like to pursue an ambitious free trade agreement with the European Union. Realistically, however, it cannot be expected that the economic integration of the two economic blocs will have even next to near the same quality as before. Here are some examples:

- This applies first to the free movement of goods – an issue that goes far beyond that of the customs union. The Cassis de Dijon principle of mutual recognition, a pillar of the European economic order, will hardly find its way into the free trade agreement in undiluted form. This principle states that goods lawfully marketed in one Member State are to be sold freely in all other Member States. It goes much further than conventional rules in other free trade agreements and has been one of the key factors in the success of the EU's internal market. It has led to the removal of numerous non-tariff barriers to trade (state approval requirements, product standards, protectionist licensing rules, other restrictions etc.). It was also of key significance for third country investors, as they could distribute products from one Member State to the entire EU without having to go through major approval processes in 28 countries. The comprehensive free movement of goods à la Cassis de Dijon will, however, almost be impossible to achieve in future. This principle of mutual recognition is based on broad legal harmonization, which is precisely what London no longer wants. By making (excessively) broad concessions to the United Kingdom the EU would also run the risk of undermining its uniform and harmonized legal system. This would hurt all of the remaining 27 Member States.

- This also applies, and even increasingly so, to the freedom to provide services and freedom of establishment. In these areas many – including EU companies – above all want to retain reciprocal access to the internal market for banks and insurance companies. Under the current rules on the freedom to provide services, financial service providers approved in one Member State may freely distribute their products in all

Member States. And under the current rules on the freedom of establishment, undertakings can open establishments in other Member States without major restrictions (banking licence and similar) (so-called “passporting”). This, too, derives from the idea that all institutions in the EU are subject to the same regulations, of course. Primarily, these include the strict EU rules on the banking union. Free movement for financial undertakings is only possible if there is a level playing field and all competitors are subject to the same rules. London-based institutions, for example, cannot be subject to looser regulation than their EU competitors (an option openly discussed on the British side) and then act on the internal market with a considerable competitive advantage. In contrast to the movement of goods, for example there are no international agreements for financial services that could serve as an example. There is speculation at present about a simplified mechanism for recognizing financial institutions. However, numerous EU stakeholders want such an agreement to also feature a suspension mechanism for financial market arrangements, specifically where a race to the bottom is triggered on tax and financial regulatory standards. This creates legal uncertainty and demonstrates that it will be hard to replace the extensive freedom to provide services and freedom of establishment with such rules. London-based financial institutions wanting to play it safe should therefore set up a subsidiary in the EU.

- Nor can British undertakings receive State aid without restriction (another Brexiteer demand) while their EU competitors are subject to stricter State aid regulations by the Directorate General for Competition in Brussels. So passporting would require that everyone falls under a single legal framework that includes State aid. This might also give Brussels a say in or even allow it to dictate the granting of State aid to Britain – something that would be almost unbearable for the Leave camp.

- Another central issue is the question of whether and to what extent Britain will continue to subject itself to the rulings of European courts. For the Leave camp this is a key issue of almost religious belief that should definitely be off limits. However, it seems unlikely that any future agreement could make do entirely without a judicial authority to settle disputes. Incidentally, this would not be in Great Britain’s interest, either, as UK companies want to enforce their free movement rights should they be violated by EU Member States.

These few issues already illustrate how difficult negotiations will be. As the British side categorically refuses to accept many of the aforementioned issues (“red lines”), full market access seems unrealistic. This has nothing to do with “punishment”, but is an inevitable consequence of the fact that full market access can only be granted where there is a level playing field. However, this would require harmonization, something that London does not want. It’s all very reminiscent of trying to fit a square peg in a round hole.

The temporary transitional arrangements envisaged by EU institutions that provide for largely continued application of the Union’s acquis therefore do not answer the questions regarding the long-term approach to structuring the UK’s withdrawal from the EU. This only buys time to further explore the options available post Brexit.

6. What does this mean for companies?

There is (unfortunately) no reason to relax. The negotiation parties’ positions are still miles apart and the British government is not making much of an attempt to convince its own voters of that compromises will have to be made. The recent cabinet reshuffle in Britain and the ongoing threats right up to the one to “withdraw without an agreement” have not made this any more likely.
Even if a hard Brexit can be avoided, it is still very likely that a future trade agreement will fall far short of the current standard of integration. It would be unrealistic to believe anything else. Companies will have to adjust to this.

Main contact
Ulrich Soltész, LL.M.
T +32 2 551-1020
E ulrich.soltesz@gleisslutz.com

Corporate
Christian Cascante, LL.M.
T +49 711 8997-151
E christian.cascante@gleisslutz.com

Gabriele Roßkopf, LL.M.
T +49 711 8997-309
E gabriele.rosskopf@gleisslutz.com

Ralf Morshäuser
T +49 89 21667-223
E ralf.morshaeuser@gleisslutz.com

Finance & Capital Markets
Helge Kortz, LL.M.
T +49 69 95514-696
E helge.kortz@gleisslutz.com

Kai Arne Birke
T +49 69 95514-452
E kai.birke@gleisslutz.com

Regulatory
Maximilian von Rom
T +49 69 95514-108
E maximilian.rom@gleisslutz.com

Benjamin Herz
T +49 69 95514-108
E benjamin.herz@gleisslutz.com

Real estate
Johannes Niewerth, LL.M.
T +49 30 800979-201
E johannes.niewerth@gleisslutz.com

Foreign Trade, Public law
Burghard Hildebrandt
T +49 211 54061-309
E burghard.hildebrandt@gleisslutz.com

Foreign Trade, Public law, Energy
Jacob von Andreae, B.A., M.A.
T +49 211 54061-315
E jacob.andreae@gleisslutz.com

Antitrust and State Aid
Ingo Brinker, LL.M.
T +49 89 21667-212
E ingo.brinker@gleisslutz.com

Ulrich Soltész, LL.M.
T +32 2 551-1020
E ulrich.soltesz@gleisslutz.com

IP (trademarks and designs)
Stefan Völker
T +49 711 8997-343
E stefan.voelker@gleisslutz.com

IP (patents)
Matthias Sonntag
T +49 211 54061-322
E matthias.sonntag@gleisslutz.com

Data protection
Christian Hamann
T +49 30 800979-113
E christian.hamann@gleisslutz.com

Employment
Thomas Winzer
T +49 69 95514-224
E thomas.winzer@gleisslutz.com

Doris-Maria Schuster
T +49 69 95514-422
E doris-maria.schuster@gleisslutz.com

Public law, Pharmaceuticals
Marco König
T +49 711 8997-421
E marco.koenig@gleisslutz.com

Litigation & Arbitration
Stephan Wilske, LL.M.
T +49 711 8997-152
E stephan.wilske@gleisslutz.com

Luidger Röckrath, LL.M.
T +49 89 21667-269
E luidger.roeckrath@gleisslutz.com

Tax
Achim Dannecker
T +49 711 8997-184
E achim.dannecker@gleisslutz.com

Stefan Mayer
T +49 69 95514-215
E stefan.mayer@gleisslutz.com