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CLIENT UPDATE

The signs point to a Hard Brexit – The UK government's White Paper

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In its White Paper of 2 February 2017, the British government set out in writing for the first time how it envisages the planned Brexit. The Paper has been criticised in the press for being vague, but it does enable some clear conclusions to be drawn as to British governmental strategy. Though sometimes only evident in the Paper's subtext, the message remains clear: Here comes the Hard Brexit. Companies will have to adjust to this.

As expected, the Paper contains a mass of by now familiar slogans such as "a stronger, fairer, more Global Britain", "make it a success", "a more open, outward-looking UK", and of course "our best days are still to come". Among the grand statements, the key legal issues have unfortunately been somewhat obscured. Nevertheless, the Paper indicates quite clearly that the UK is headed for a Hard Brexit.

In this regard, the Paper is not much of a surprise of course, as Prime Minister May had already hinted as much in her keynote speech of 17 January 2017. But many companies had hoped that such statements motivated by populism would be somewhat tempered once political reality set in. This hope now seems to have been pretty much dashed, all the more so as the British parliament does not seem willing to put the brakes on with regard to the withdrawal process.

1. The "Great Repeal Bill" – a clean cut

The first major step planned by the government is to introduce a "Great Repeal Bill", to take effect after Brexit. This pragmatic construction basically contains three elements.

- Firstly, the Bill will scrap the European Communities Act of 1972, such that EU law will then cease to apply in the United Kingdom. This is a logical step.
- The consequence of this, of course, would be to leave large spheres of life without legal regulation, as many areas of law are permeated by EU provisions. After 40 years in the EU, in some areas there is barely any separate national law now. To avoid a legal vacuum, therefore, all EU law will be frozen "as is" and the entire mass of regulations will be deemed applicable once again. The order to apply these laws will then, of course, come from Westminster rather than Brussels, and thus be an expression of British sovereignty.

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- Following Brexit, the idea is then to decide step by step what EU legal rules to keep and which to abolish. Ministries are already preparing this process and combing the entire legal system. As they do this, it is emerging that much of what has come out of Brussels is actually quite sensible and should not be changed, sources indicate. Ironically, this will mean that much is likely to stay the same for some time, at least as regards substantive law. The White Paper makes this clear, too.

2. Leaving the internal market

The most important point: leaving the internal market is now a done deal. The British side has given up on its original notion that British companies in future would still be able to profit from rules on free movement. What's left is only the general goal of concluding a free trade agreement for "the freest and most frictionless trade possible in goods and services".

This is a long way from what business on both sides of the Channel would like. But it is certainly a more realistic starting position for the upcoming negotiations than the cherry-picking that the Leave camp has been demanding up to now. Compared with existing economic integration, this is a clear step backwards. These goals are a long way from the "fundamental freedoms", i.e. free movement of goods, freedom to provide services and freedom of establishment, free movement of workers, and free movement of capital and payments.

In addition to this, a common customs union is no longer wanted. The background to this is that it will only be possible for the UK to conclude its own trade agreements with third countries if it is no longer part of the EU customs union. This will not make trade between the EU and the UK any easier. Britain is going to pay a high price for this freedom.

3. (No) free movement of goods

The Paper's goals do not include the Cassis de Dijon principle of mutual recognition, a pillar of the European economic order. This principle states that goods lawfully brought onto the market in one Member State are to be sold freely in all other Member States. This principle goes a long way beyond conventional rules in other free trade agreements and has been one of the key factors in making the EU's internal market a success. It has led to the removal of numerous non-tariff barriers to trade (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.

Maintaining comprehensive free movement of goods à la Cassis de Dijon now seems unlikely to be sought. Which is, ultimately, logical. This principle of mutual recognition is based on broad legal harmonization, which is precisely what London no longer wants.

4. Passporting?

Nor do the prospects look good for banks and the insurance sector to hold onto "passporting". Under 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 rules on freedom of establishment, undertakings can open establishments in other Member States without major restrictions (banking licence and similar).

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, as well as rules on competition including State aid. 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 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. Nor can British undertakings receive State aid without restriction (another Brexiteer demand) while their EU competitors are subject to the stricter State aid regulation by the Directorate General for Competition in Brussels.

So passporting would require that everyone falls under a single legal framework. This is precisely what the British side no longer wishes to accept, so it is only logical that the expectations of the banking and insurance sectors are being dampened. Full market access is now no longer the goal, only "mutual cooperation", whatever that means.

5. Free movement of workers

The status of workers in the relationship between the EU and the UK is another issue that remains completely open. Only students from the EU have been given certain, limited concessions up to 2018, which should actually be taken for granted, as the UK will still be a member of the EU at that point. This issue is receiving the Cinderella treatment, which implies that it has low priority, a bad signal for all companies reliant on foreign workers.

6. Competition law

Particularly revealing are the issues that the Paper fails to mention. Sensitive questions such as the entire competition policy (antitrust and merger control) are simply factored out. This is unlikely to be popular with companies, as they will need to deal with parallel bodies in the UK and the EU instead of Brussels' one-stop shop, leading to additional costs.

7. Loss of ECJ jurisdiction

The demand for an end to the ECJ's jurisdiction over the United Kingdom is of course high on the list of priorities. The judges in Luxemburg are to no longer exercise judicial powers over the UK. Although the authors of the White Paper admit that some kind of dispute resolution mechanism will be required in order to resolve differences of opinion when interpreting the planned free trade agreement, such a body is to have only very limited powers. Above all, it seems that the body's decisions are not to be directly applicable.

8. Interim conclusion

The conclusion remains sobering. The Paper shows that over the last few months the British side has significantly scaled down its expectations regarding an agreement. In the period after the referendum, the British foreign minister had boasted that continued full access to the EU's internal market could be taken for granted after Brexit. It is now understood, however, that this is unrealistic. It is not possible to enjoy the freedoms and benefits of the internal market and at the same time discard everything you don't like.
The British government's expectation management has become more honest. For the first time, it has described just how hard the Brexit will be in reality. Many voices have been saying that the planned "best deal for the UK" is perhaps wishful thinking after all, given such a radical decoupling. In any event, companies will have to adjust to this.

9. And what's the next step?

The mechanism of Article 50 TEU

Article 50 TEU states that the Member State must take any decision to withdraw from the Union in accordance with its own internal constitutional requirements. Following this, the European Council must be notified (declaration of withdrawal). The Paper emphasizes that this notification is to be given in March 2017.
Pursuant to Article 218(3) TFEU, the Union will then negotiate an agreement with the State that wishes to withdraw with regards to the details of the withdrawal and then conclude the agreement. In doing so, the framework for the future relationship between this State and the Union will be taken into account (Article 50(2), sentences 3 and 4 TEU). On the EU side, such an agreement regulating the exit modalities must be decided on by the Council with a qualified majority, approved by the European Parliament, and concluded within two years.

The exit then takes effect on the day the agreement comes into force, or should this not be within two years, then from the date on which the intended withdrawal was notified (i.e. without a "divorce agreement"). Article 50(3) EU provides for an exception whereby the Council unanimously extends this two-year period with the consent of the Member State wishing to leave the Union. This would be an option if negotiations were to be at an advanced stage when the exit agreement was concluded and their success within the new period highly likely.

Finally, Article 50(5) TEU provides that the Member State that has just left the Union can only rejoin following a new accession procedure under Article 49 TEU.

So there are three possible outcomes to the negotiations:

- Exit after the agreement is concluded and enters into force
- Automatic exit two years after notification
- Exit after the extension to the two-year period

The second variant would be the most problematic for the UK and EU, as all rules would automatically cease to apply to the UK, which would then be in a state of limbo. It might not even be a full member of the WTO at this stage. So the regulation in Article 50 TEU could put the UK under time pressure. The requirement of unanimity when extending the two-year period could also tempt EU Member States to demand a high price for their consent to such extension.

Transitional arrangement?

In harmony with Theresa May's keynote speech of 17 January 2017, the White Paper confirms that the United Kingdom will seek a transitional arrangement. This is intended to avoid an abrupt "cliff edge" Brexit. But once again, one question – of several that arise – is whether the ECJ will decide on disputes and whether the Commission is to retain competence as the competition authority for the entire EU and the UK, should the fundamental freedoms and competition rules continue to be applicable. The EU side is likely to insist on this. It also seems likely that the EU will continue to demand substantial financial contributions in this transitional phase (something the White Paper has ruled out). So it will not be easy to reach a transitional arrangement quickly.

10. Brexit exit?

Given the complexity of the issues that need to be resolved, it seems doubtful that an agreement can be reached under this level of time pressure. The UK could of course influence the timetable by delaying its declaration of withdrawal as such. For political reasons, however, that is not the plan, and the White Paper confirms this.
So the question arises of whether the British government can retract its declaration of withdrawal after it has been delivered. Article 50 TEU does not include a provision on this. But there are some indications that such retraction could be possible. Firstly, revocation is not explicitly ruled out in the agreements. The exit issue is also an expression of State sovereignty (it is conceivable that the political climate could shift and there be a change of government while negotiations are in progress).

Legal certainty and Article 50 TEU's intention of avoiding a "cliffhanger" argue against the possibility of retraction, however. Systematically, too, the option of extending the two-year period in Article 50(3) TEU would tend to indicate that a retraction would not be permissible. An extension of the period under Article 50(3) TEU is provided for only in certain circumstance, so a delay by some other means could be viewed as circumventing the provision.

It therefore remains unclear whether the UK could still "backtrack". Ultimately, however, it will not be lawyers but politicians who resolve this. Vassilios Skouris, former president of the Court of Justice of the European Union, has stressed that when a Member State declares its intention to leave the EU, the latter has a core interest in that Member State deciding to stay in the Union after all. This would be a good solution, but at the current time it looks like wishful thinking. For these reasons, therefore, companies should act on the assumption that the scenario outlined above will indeed come about and prepare requisite measures accordingly.

Gleiss Lutz regularly publishes information and assessments concerning Brexit. All articles can be found on the Gleiss Lutz website at: https://www.gleisslutz.com/aktuelles/brexit/

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