THE VIEW FROM BRUSSELS

THE BREXIT NEGOTIATIONS – DEVELOPMENTS IN OCTOBER

There have been no new policy papers from the Commission in October as it has concentrated on trying to make progress on outstanding issues in preparation for the European Council meeting on 18-20 October.

Away from the limelight there was a telling development at the WTO. The behind-the-scenes technical discussions produced an "agreement" between the UK and the EU on how to divide the EU tariff rate quotas (TRQs) contained in the existing EU goods schedule to the WTO. TRQs allow limited quantities of highly tariff-protected goods into the EU at lower rates. The UK and the EU sent a joint letter to the rest of the WTO membership proposing that the TRQs provided for mostly agricultural products in the EU schedule be divided according to consumption over the last three years, which would have allowed the resulting technical correction to be rapidly certified and enter into force. Remarkably, this offer was immediately rebuffed as inadequate almost before it was made by another joint letter from the seven most important beneficiaries of the TRQs demanding a renegotiation to preserve their existing access opportunities. At present these countries can export the whole of their allocation of a TRQ to the UK or elsewhere in the EU, but they will lose this freedom under the UK/EU's proposed approach. This will inevitably make the separation much more complex.

This month we will comment on the state of the negotiations as they appear in the light of the European Council meeting and on the differing legal views that will shape the political negotiation on the main outstanding issue in the first phase of the negotiations – that is the financial settlement.

THE EUROPEAN COUNCIL MEETING

As has been widely reported, the European Council did not find that "sufficient progress" had been made on the priority issues and did not authorise the start of negotiations on second phase issues, in particular on the future relationship with the EU and the transitional arrangements.

The European Council Conclusions are brief. They welcome the progress on citizens’ rights, acknowledge progress on convergence on principles and objectives on the Northern Ireland border and note the UK’s statement that it will honour its financial obligations but that this has not been translated into firm and concrete commitments. Evidently, the main obstacle to progress is the financial settlement which we discuss in Section 3 below.

However, the last paragraph of these brief European Council Conclusions contains some significant indication of what the Union envisages will follow. The last sentence of the Conclusions authorise the Council in its Article 50
formation (that is, without the UK) together with the Union negotiator to start "internal preparatory discussions" on the "future relationship and on possible transitional arrangements". This is significant. The Union negotiator has stated that he wants to progress to discussion on these issues and is now authorised to do so with the 27 Member States in the Council. They will now be able to discuss the proposals that the UK has advanced (see the UK papers on preparing for our future UK trade policy and on the customs bill). If the Union negotiator continues to operate, as previously, in a transparent manner, the UK will inevitably be informed of his position and should be able to react. This is a good substitute for true negotiations. At the very least, the discussion will help to resolve a major obstacle to advancing work on the future relationship – which is to establish a common EU-27 position. Past experience in such exercises and the diverging interests of the remaining 27 EU Member States indicate that this will be no easy task.

Also noteworthy in the European Council Conclusions is the specification that future negotiating guidelines to cover the second phase of the negotiations will relate to the future relationship and possible transitional arrangements which are in the interests of the Union and comply with the conditions and core principles of the guidelines of 29 April 2017. As mentioned in our view from Brussels last month, these core principles specify that transitional arrangements must be clearly defined, limited in time, and subject to effective enforcement mechanisms. Also, any time-limited prolongation of Union acquis will require existing Union regulatory, budgetary, supervisory, judiciary and enforcement instruments and structures to apply.

THE FINANCIAL SETTLEMENT

As mentioned above, the main obstacle to progress is the financial settlement and it is therefore worth examining the differing views on either side of the channel.

Although this is an intensely political matter and the parties are entitled to come to any settlement they please, the legal situation does inform the negotiating position of each side and will indeed regulate the situation if no agreement should be reached. Unfortunately, the parties seem to have convinced themselves of conflicting legal positions and it would seem that reaching an agreement will require a reconciliation of these legal positions. The EU has drawn up a long list of financial commitments (discussed below) that it considers the UK must settle in the form of a "single financial settlement" and the UK, while announcing that it will abide by its international law obligations, does not seem prepared to specify what these obligations are concretely. The UK is offering to pay to secure access to the single market during the transitional period. For the EU however, paying for continued access to the single market and benefitting from the work of EU agencies and other EU infrastructure is a separate matter from settling existing financial commitments.

We do not intend to give a full legal analysis of the arguments (which the parties have been careful not to publish) but would sketch out the issues as follows:

The EU Treaty

Article 50 TEU is silent on financial matters. It merely provides that on withdrawal the EU Treaty will cease to apply to the leaving Member State. One might therefore argue that since all the alleged liabilities result from the application of EU law, none of these liabilities will survive withdrawal.

The Vienna Convention on the Law of Treaties

The Vienna Convention on the Law of Treaties (VCLT), which even if it does not apply directly to the EU is a codification of general international law, addresses the consequences of the termination of a treaty in Article 70 (1):

"Unless the treaty otherwise provides or the parties otherwise agree, the termination of a treaty under its provisions or in accordance with the present Convention:

a) releases the parties from any obligation further to perform the treaty;

b) does not affect any right, obligation or legal situation of the parties created through the execution of the treaty prior to its termination."

Article 70(1)(b) is often referred to in connection with the financial consequences of Brexit. However, it relates to all rights, obligations and legal situations – not just to financial ones. If it served to preserve the UK's existing obligations under the EU Treaty relating to financial matters, it would preserve other obligations and indeed also rights as well – directly contradicting Article 50(2) TEU.
Also, on its face it refers to obligations between the parties (the Member States), not to obligations to an organisation set up by the treaty (the European Union). The obligations of the UK under the EU budget law are owed to the Union rather than to the other Member States.

Interestingly, when the House of Lords examined Article 70 VCLT (see House of Lords "Brexit and the EU budget", HL Paper 125, at para 133), it received conflicting advice on whether Article 70(1)(b) constituted a legal basis for regulating financial obligations on Brexit. In the end it considered that Article 70(1)(b) was not applicable but appeared to do so on the basis that Article 50 TEU "takes precedence over Article 70(1)(b)" VCLT. This does not resolve the issue since Article 50 TEU does not regulate the financial consequences of withdrawal. The fact that Article 50 TEU is silent on the matter does not necessarily mean that there are no financial obligations.

The competing models

Given the lack of clear guidance in EU or international law, the parties have been resorting to different models. The UK sometimes advances the model of a golf club. When a Member leaves, he is not entitled to reimbursement of his membership fee but is equally not liable to pay membership fees after expiry of the period of notice, and still less to pay for the refurbishment of the clubhouse even if this had been decided when he was a member. The analogy is weak however and depends on certain assumptions as to the nature of the obligations of membership. Obviously, the statues of a golf club could provide that certain obligations do survive resignation. The key is to clarify the nature of the obligations and since they were created under EU law, establishing their nature will involve interpreting EU law.

Sometimes the UK's financial obligations on Brexit are referred to as a "divorce bill" thus invoking divorce law as an analogy. It is sometimes argued that Brexit therefore requires an equitable division of liabilities and assets. Of course, this analogy is also not satisfactory if only because the financial consequences of divorce vary between legal systems and often depend on the terms of the "marriage contract".

The EU approach to the UK's financial obligations arising from Brexit appears to be based on the UK's approval of successive Multiannual Financial Frameworks (MFFs) and the Own Resource Decision of 2014 (ORD). It argues that by approving these measures, the United Kingdom committed to fund a share of the Union obligations defined by the ORD and further defined in a series of legal acts governing the various programmes. It lists the main items as being:

1. The Reste à Liquider (RAL) (amounts committed but not yet disbursed) from the successive Multiannual Financial Frameworks during which the United Kingdom was a member of the Union;
2. The financial programming for the period between the date of withdrawal of the United Kingdom and the end of the MFF 2014-2020;
3. The liabilities as recorded in the consolidated accounts of the Union which are not balanced by corresponding assets, i.e.:
   a) Pensions and other employee benefits
   b) Provisions (e.g. for the Joint Research Centre)
   c) Financial liabilities not related to borrowings
   d) Payables and accrued charges other than RAL
4. The contingent liabilities disclosed in the consolidated annual accounts;
5. The specific costs related to the withdrawal process (for this item the paper states that the UK should be responsible for 100% of the costs).

There is no explanation as to why these obligations should continue to apply to the UK after Brexit whereas all other EU rights and obligations will cease to apply. The Commission's argument seems to be based on a contractual analogy: that on termination of a contract outstanding liabilities need to be accounted for. The weakness of this model or argument is that contracts do not specify (as arguably is the case of Article 50 TEU) that on termination contract law will cease to apply.

Adjudication and Enforcement

An additional difficulty in settling the financial consequences of Brexit without an agreement is the lack of any forum for adjudication and enforcement.
While the European Court of Justice of the EU (CJEU) is exclusively competent for adjudicating questions of EU law between Member States by virtue of Article 344 TFEU, the UK will no longer be a Member State following Brexit and will not be bound to accept the jurisdiction of the CJEU. Indeed, one can also argue that the CJEU has (like other courts and the EU itself) only conferred competences and would not in fact have jurisdiction over such disputes in the absence of a clause in an Article 50 Agreement conferring jurisdiction pursuant to Article 272 TFEU.

Since the EU is not a State, it cannot bring action before the other potential jurisdiction, the International Court of Justice. The remaining Member States could bring an action against the UK (which accepts "compulsory jurisdiction") but such action would likely require them to demonstrate an obligation owed to them rather than an obligation owed to the EU.

The UK and the EU could of course agree to some other form of dispute resolution such as international arbitration, for example at the Permanent Court of Arbitration in the Hague. Article 344 TFEU should not be an obstacle to such a reference if it is done after the UK ceases to be a Member State.

Conclusion

It must be concluded that the failure of Article 50 TEU to provide for rules on financial settlement poses a serious obstacle to achieving an agreement on the terms of withdrawal. By insisting that the "single financial settlement" should be agreed in the first phase and that discussions on a future relationship and the transition cannot even start until such agreement is reached, the EU is maximising its leverage in securing a favourable outcome based on a weak or uncertain legal position.

However, the issue of the financial settlement risks blocking the Article 50 negotiations even though the future relationship and the transition would appear to be of much greater economic importance. In an ideal world where politics and emotion played less of a role, the parties would agree to leave this issue to last rather than insisting that it be resolved first.

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