THE BREXIT NEGOTIATIONS

It is often said that the UK has a relatively weak negotiating position in the Article 50 negotiations. First, the UK is negotiating to a deadline with more to lose than the rest of the EU. Second, the EU can deploy all the expertise and knowledge of the European Commission while the UK is locked in an all too political debate as to what exactly its objectives should be.

One category of the arguments that the UK could have deployed to improve its negotiating position derive from the obligations and constraints that the EU faces as a member of the WTO. So far the UK has been reluctant to deploy such arguments either through lack of familiarity with WTO rules and a belief that WTO mechanisms are too slow and do not produce results or a fear that making WTO arguments would breach the obligation of sincere cooperation or otherwise poison the negotiations and reduce goodwill.

Recent developments in the negotiations have shown that the EU has no such compunctions and does know how to exploit WTO arguments in the negotiations.

In this note we will explain the WTO issue that has arisen and highlight some other ways in which WTO arguments are relevant in the negotiations.

1. The EU Demonstrates the Relevance of WTO Arguments in the Negotiations

As we mentioned in the last View from Brussels, the UK White Paper on the future relationship showed that the UK was intending to use the continuing protection of EU geographical indications (“GIs”) as a negotiating chip in the negotiations for a future relationship. Although the protection of GIs is a regular feature of trade agreements, being regulated in WTO Agreement on Trade-Related Aspects of Intellectual Property (TRIPS) and most of the EU’s bilateral trade agreements, the EU had designated this a withdrawal rather than a future relationship issue, just as it had rather illogically done for the Irish Border (see here). GIs are politically important for the EU and much less so for the UK. Witness, for example, the efforts deployed by the EU to protect the GI for Champagne; Spain was forced to abandon references to “méthode
champenoise" for its sparkling wine as a condition of accession and Switzerland had to agree to prevent the Swiss town called Champagne from indicating on its white wine precisely where it had been produced. The result is that there are around 3000 EU GIs, of which the UK benefits from a relatively small share.

Even though the UK does not have many GIs, the beneficiaries do appreciate their importance and so the Government could not countenance depriving them of their protection. It therefore announced in the White Paper that:

- The UK will be establishing its own GI scheme after exit, consistent with the WTO Agreement on Trade-Related Aspects of Intellectual Property (TRIPS). This new UK framework will go beyond the requirements of TRIPS, and will provide a clear and simple set of rules on GIs, and continuous protection for UK GIs in the UK. The scheme will be open to new applications, from both UK and non-UK applicants, from the day it enters into force.

The proposal effectively requires holders of EU GIs to apply for protection under the new UK regime. This has two benefits for the UK. It provides the UK with leverage over the EU in the negotiations for a future relationship and frees the UK from the EU system allowing it negotiating space with third countries, many of whom object to the EU reserving the most prestigious food denominations to itself. Demands for protection for Parma Ham and Feta Cheese nearly scuppered the EU free trade agreement with Canada.

The EU has now deployed a WTO argument to neutralise this gambit. It is reported to have pointed out that providing automatic protection of UK GIs but requiring GIs from other countries to reapply, would breach the national treatment obligation in Article 3 of TRIPs – which requires WTO members to accord to nationals of other members treatment no less favourable than that it accords to its own nationals with regard to the protection of intellectual property.

It is unclear how the UK will react. It could render its new regime non-discriminatory so that Scotch whisky producers amongst others would have to submit new applications – or revert to the common-law protection based on passing off. But this is unlikely to satisfy the EU which wants all existing GI protections preserved – including, it may be presumed these that it has granted to third countries (such as Tequila for Mexico). Accepting the EU demand is likely to require the UK to protect GIs which have very little recognition and reputation in the UK and require the UK to apply rather low standards for protection.

Whatever, the outcome of the discussion on GIs, this incident illustrates an important point. It is that WTO arguments do not have to lead to actual or threatened dispute settlement to have a useful effect but can be used to force a change in negotiating position of the other party. This happens not only because the parties attach value to complying with their WTO obligations but also because it brings other interest groups – be they departments of the Commission, other institutions and Member States, or simply business groups into the discussion.

2. Other WTO Issues that are Relevant to the Negotiations on the Future Relationship

National treatment for GIs is by far not the only instance where the WTO obligations of the EU and post-Brexit UK are relevant. Here are a few examples:

**MFN Treatment**

The cornerstone of all WTO agreements is the obligation to treat all countries equally (or, in WTO parlance, to accord most favoured nation ("MFN") treatment to all WTO members). There are exceptions, of course, but these are limited and conditional. This is a major constraint both for the EU and the UK on what can be agreed in respect of the future relationship.

The UK wants frictionless trade at the border. The EU is arguing that the White Paper proposals for a Facilitated Customs Arrangement are WTO-illegal but do not appear to have made constructive counter proposals. What is clear however is that the new arrangements allowing all aspects of the frictionless trade need to be covered by either a customs union or a free trade agreement if they are to be limited to the EU. If it is not, the same frictionless trade must be accorded to all WTO members. The transition period, if it comes
to pass, will presumably be a time-limited customs union between the EU and the UK and being very close to the pre-existing trade relationship is not likely to be problematic.

The conditions for either a customs union or a free trade agreement include that there should be trade liberalisation between the parties and that freedom of trade with third countries should not become more restricted as a result. The more restrictions are imposed on EU-UK trade compared to the pre-existing situation where the UK was a Member State of the EU, the more difficult it will be to satisfy the first of these conditions. And the second condition may require the EU and the UK to compensate third countries for the loss of the ability to treat the UK and the EU as one and the resulting increased restrictions on trade. Both conditions plead for as close a trade relationship as possible between the UK and the EU.

The backstop for Northern Ireland contained in the draft Withdrawal Agreement, due to come into force at the end of the transition period if no better solution is found during the transition period, will also be a customs union between the EU and “the United Kingdom in respect of Northern Ireland” as the draft Withdrawal Agreement puts it. It is quite unclear what special arrangements may be put in place for the border between Ireland and Northern Ireland but WTO considerations are likely to need to be taken into consideration.

Mutual recognition and conformity assessment

The essential element of the internal markets for goods and services is the mutual recognition by Member States of the products and certificates of other Member States. This is achieved either on the basis of harmonised rules or on the basis of a prohibition on unjustified restrictions. In many cases, it is the loss of mutual recognition rather than customs duties that it is feared will impede trade following Brexit in the absence of a future trade agreement.

What do the WTO agreements have to say on the subject? Actually, quite a lot. The WTO agreement on Technical Barriers to Trade (TBT Agreement) states, for example, that

- Members shall ensure that technical regulations are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade. Members shall ensure that technical regulations are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade. (Article 2.2); and

- Members shall ensure, whenever possible, that results of conformity assessment procedures in other Members are accepted, even when those procedures differ from their own, provided they are satisfied that those procedures offer an assurance of conformity with applicable technical regulations or standards equivalent to their own procedures. (Article 6.1)

The rules for sanitary and phytosanitary measures are if anything even clearer. The WTO Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement) provides, for example, that:

- Members shall accept the sanitary or phytosanitary measures of other Members as equivalent, even if these measures differ from their own or from those used by other Members trading in the same product, if the exporting Member objectively demonstrates to the importing Member that its measures achieve the importing Member's appropriate level of sanitary or phytosanitary protection… (Article 4.1)

Since the UK will, initially at least, have the same technical and sanitary and phytosanitary regulations as the rest of the EU and its certification bodies will be operating to the same standards, it would seem that the EU would be failing to comply with its WTO obligations if it ceased on the day after Brexit to accept UK products and certificates that were acceptable the day before Brexit. The argument that the treatment of UK products and certificates must change the day after Brexit because the UK no longer participates in the other freedoms is unlikely to be accepted under WTO law. Nor, in most cases, will the argument that compliance with the rules is no longer subject to the supervision of the European Commission or the European Court of Justice justify the difference in treatment, especially since the EU will have the burden of proof that this difference in enforcement supervision justifies the difference in treatment.
Enhanced equivalence in financial services

One of the most sensitive topics in the discussions on a future relationship has been financial services. The UK has accepted (in the White Paper) that the current level of access based on common rules and “passporting”, will not be available and is seeking a level of access that has been described as “enhanced equivalence”. Equivalence refers to arrangements whereby the EU currently recognises that the rules and supervision of third countries for certain financial services offer equivalent levels of guarantees to those of the EU so that their operators are allowed to provide the relevant financial services directly to EU customers. The EU has so far insisted that equivalence decisions are entirely unilateral and “in the EU’s gift” and that it is perfectly free to terminate equivalence on short notice. The “enhanced equivalence” sought by the UK seeks to provide assurances of greater stability and seek to render withdrawal more difficult.

However, as we mentioned in July, the WTO General Agreement on Trade in Services (GATS) already provides limits on EU freedom of action on equivalence since it provides that where equivalence regimes exist, even if “autonomous”, all WTO Members must be provided with "adequate opportunity" to participate. In other words, although the EU may be free to terminate its equivalence regimes completely, it cannot refuse to apply them to the UK or withdraw equivalence arbitrarily from the UK. Since the UK has the closest alignment of rules and cooperation of any WTO Member, it is difficult to see how these regimes could be justifiably withdrawn from the UK alone.

The UK therefore already has some guarantees on the application of the equivalence regime through the GATS and should therefore only seek in the negotiations to increase this and extend its scope to other financial services.

---

We do not suggest, of course, that the UK does not need to agree a future trade relationship with the EU and can rely on the WTO to guarantee continued access. We simply wish to underline that the starting point for negotiations is not that trade between the EU and the UK must in the absence of a trade agreement between the EU and the UK be as difficult as with third countries that also do not have a trade agreement. The starting point should be that both parties have WTO obligations not to erect unjustified restrictions to trade between them and the high degree of convergence in legislation and existing trade relationships will make many new restrictions difficult to justify.

The EU takes its WTO obligations seriously and rather than simply responding "sue us if you dare" will have to respond with concrete proposals. Indeed, it can even be pointed out that EU Member States are also WTO Members in their own right and have corresponding obligations. Many Member State officials faced with products of the UK which manifestly comply with EU rules and certification requirements after Brexit in the same way that they did on the day before Brexit may also consider a change in treatment unjustified. The EU has every interest to avoid such a chaotic result and will not therefore, also for this reason, be able to afford to ignore WTO obligations.

3. Contacts

Lode Van Den Hende, Partner  
T +32 2 518 1831  
lo.de.vandenhende@hsf.com

Morris Schonberg, Senior Associate  
T +32 2 518 1832  
morris.schonberg@hsf.com

Eric White, Consultant  
T +32 2 518 1826  
eric.white@hsf.com

Gavin Williams, Partner  
T +44 20 7466 2153  
gavin.williams@hsf.com
If you would like to receive more copies of this briefing, or would like to receive Herbert Smith Freehills briefings from other practice areas, or would like to be taken off the distribution lists for such briefings, please email subscribe@hsf.com.

© Herbert Smith Freehills LLP 2018
The contents of this publication, current at the date of publication set out above, are for reference purposes only. They do not constitute legal advice and should not be relied upon as such. Specific legal advice about your specific circumstances should always be sought separately before taking any action based on the information provided herein.