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BRIEFING PAPER

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The UK-EU Trade and Cooperation Agreement: Level Playing Field

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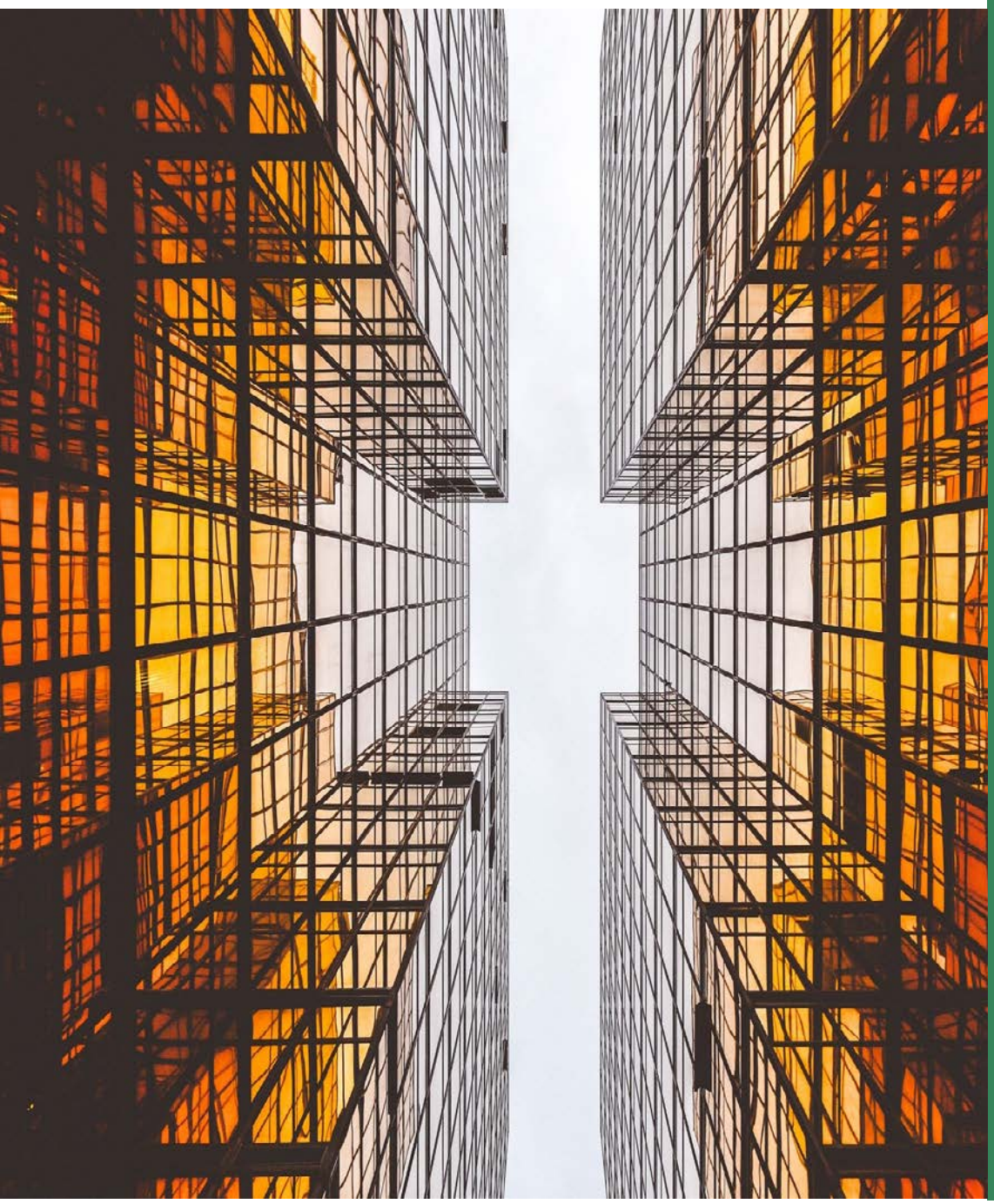

Contents:

Contents

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Summary

This briefing covers the outcome of the UK and EU negotiations on commitments to have a level playing field – an important part of the UK-EU Trade and Cooperation Agreement (TCA). These commitments cover competition policy, subsidy control, state-owned enterprises, taxation, labour and social standards, environmental protection and climate change.

Level playing field provisions in trade agreements are there to ensure competition is open and fair and that businesses from one trading partner do not gain a competitive advantage and undercut rivals from another. The TCA has the most extensive provisions seen in any free trade agreement to date.

Level playing field negotiations
The divergent positions of the EU and UK Government led to the level playing field being one of the most contentious areas of the negotiations.

Referring to UK-EU geographical and economic proximity, the EU proposed that legally binding commitments be included in the agreement, with EU rules and standards as a reference point, and a commitment to strong domestic enforcement mechanisms. The UK Government said the UK would maintain the highest standards in the level playing field areas, but the ability to set its own laws was central to its vision. It would not accept alignment with EU rules and obligations that go further than commitments in standard free trade agreements.

The most substantial disagreements arose over subsidies, where the EU proposed that the UK follows EU state aid rules as they change over time. The UK proposed to base its commitments on World Trade Organization anti-subsidy rules with weaker enforcement mechanisms.

The differences on environmental and climate, labour and social standards, concerned how far the parties should remain "dynamically aligned". The UK and EU disagreed over whether they be prohibited from lowering labour and environmental standards (non-regression clause), and whether one party should have to raise its standards if the other party raised theirs (the ratchet clause).

The Agreement
The resulting provisions in the TCA represent a compromise to find a balance between sufficient guarantees that future divergence of regulations would safeguard fair competition and the freedom of the parties to set their own rules for social and environmental protection and subsidy policy.

The main level playing field provisions are set out in Title XI of Part Two of the TCA. The EU and UK recognise that to prevent distortion of "trade or investment" between the parties, conditions are required to ensure a level playing field for open and fair competition. The TCA says that while the UK and EU are committed to maintaining and improving their respective high standards, they reaffirm their right to regulate and recognise that the purpose of the commitments is not to harmonise those standards.

Subsidies
The TCA requires both the UK and EU to have an effective system of subsidy control but neither has to comply with the rules of the other. Both subsidy control regimes must follow common "broad principles". These principles have to ensure that subsidies are proportionate, transparent and contribute to public policy goals.

A distinct feature is that one of the parties can take unilateral remedial measures if there is evidence that a subsidy of the other party risks creating a "significant negative effect" on UK-EU trade and investment.

The TCA provisions on subsidies do not amend the state aid provisions of the Withdrawal Agreement Protocol on Ireland and Northern Ireland. This means that EU state aid rules apply to subsidies affecting trade in goods between Northern Ireland and the EU.

Non-regression

The Agreement's provisions on labour and social protection, the environment and climate, recognise that both the UK and EU may establish their own levels of protection, without harmonising their rules. Non-regression provisions are there to ensure that protections are not reduced below the levels at the end of the transition period if that would affect trade or investment. The UK and EU both commit to maintaining effective oversight and enforcement systems, with administrative or judicial means of challenge and redress.

In the chapter on competition, both sides agree to maintain a domestic system that addresses anti-competitive business behaviours. A chapter on state-owned enterprises focuses on preventing anti-competitive practices among companies where governments are involved. Provisions on taxation include commitments to have good tax governance.

Dispute settlement provisions

The TCA has complex and bespoke provisions for dispute settlement between the parties. This involves consultations, recourse to an independent arbitration tribunal, and temporary cross-retaliation. The Court of Justice of the EU (CJEU) has no role in the dispute settlement provisions. The provisions on competition policy and taxation are excluded from the dispute resolution.

The most innovative aspect of the Agreement's dispute settlement is a rebalancing mechanism for the level playing field. If significant divergence in subsidy policy, labour and social policy, or climate and environment policy, arises between the UK and EU, and this has material impacts on trade or investment, both parties have the right to take countermeasures, subject to arbitration. In simple terms, if one side raises its standards and the other does not, the former can take reciprocal action. These rebalancing measures could include temporary suspension of parts of the Agreement or tariffs, but are not defined beyond that.

Further provisions allow for a review of the 'Trade' heading of the TCA. This is in case of a persistent dispute, including on the application of the relevant level playing field commitments. This mechanism opens up the possibility of the entire trade part of the agreement being suspended.

1. Overview

1.1 Negotiations

Commitments on Level playing field are among the key elements of the UK-EU Trade and Cooperation Agreement.[1] They concern cross-cutting provisions for **competition, subsidies, taxation, labour and social standards, environmental protection and climate policies**, which are not linked to a particular sector of cooperation. The purpose of these provisions is to ensure that competition is open and fair and that businesses of one party do not gain a competitive advantage and undercut their rivals in another country by avoiding the costs of more stringent regulations.

The negotiations on the level playing field provisions were contentious. In the non-binding Political Declaration that accompanied the 2019 Withdrawal Agreement the EU and UK set out a joint commitment to an ambitious economic partnership. The Political Declaration would form the departure point for the UK and EU negotiations. In the document, referring to the geographical proximity and economic interdependence of both markets, the parties agreed to ensure that commitments to "a level playing field for open and fair competition" will underpin their economic partnership. The precise nature of these commitments would be "commensurate with the scope and depth of the future relationship". This would be ensured by "robust commitments" – upholding the common high standards applicable at the end of the transition period in the areas of state aid, competition, social and employment standards, environment, climate change, and relevant tax matters.[2]

Following the UK's withdrawal from the EU on 31 January 2020, the UK and EU entered formal negotiations in March 2020, with the aim of securing agreement on their new partnership by the end of the year.

From the start of the negotiations, the UK and EU had fundamentally different approaches to the level playing field. The EU said that it would agree a free trade deal with zero tariffs and zero quotas only if the UK agreed to level playing field commitments. The EU emphasised that the UK-EU trading relationship was fundamentally different from that with its other trading partners due to geographic and economic proximity. This would justify legally binding commitments, with EU rules and standards as a reference point, and strong enforcement mechanisms domestically.

The UK Government reiterated the principle of sovereignty and it's right to regulate. It stated that the UK would maintain the highest standards in the level playing field areas but could not agree to obligations that go further than commitments in standard free trade agreements. The Prime

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1 Foreign, Commonwealth and Development Office, *UK/EU and EAEC: Trade and Cooperation Agreement*, CP 426, 30 April 2021 ('TCA')

2 *Political Declaration setting out the framework for the future relationship between the European Union and the United Kingdom*, 19 October 2019

Minister's written statement of 3 February 2020 on UK-EU relations set out the Government's position:

> The Government will not agree to measures in these areas which go beyond those typically included in a comprehensive free trade agreement. The Government believes therefore that both Parties should recognise their respective commitments to maintaining high standards in these areas; confirm that they will uphold their international obligations; and agree to avoid using measures in these areas to distort trade.[3]

For the level playing field areas, the EU and UK positions converged on competition, state-owned enterprises, and taxation (with an exception on tax avoidance). However, substantial divergences appeared with regard to subsidy control, social and labour regulation, environmental regulations, and the fight against climate change.

For further analysis of the UK and EU negotiating positions see Commons Library briefing 8852, The UK-EU Trade and Cooperation Agreement: Level Playing Field, section 1. See also Commons Library briefings 8834, The UK-EU future relationship negotiations: process and issues, sections 3 and 4.4; and 8977, UK-EU future relationship negotiations update: is an agreement possible?, section 3.

Despite some aspects of the level playing field – future (dis)alignment of subsidy rules and the enforcement of non-regression of labour and environmental standards – being among the most difficult subjects in the negotiations, parties reached an agreement on 24 December 2020.

1.2 Level playing field in the TCA

Level playing field provisions are set out in Title XI of Part Two [Level Playing Field for Open and Fair Competition and Sustainable Development] of the Agreement.

Chapter I of Title XI contains the **general provisions**. The Parties recognise in Article 355 that in order to prevent distortion of 'trade or investment' between the EU and UK, conditions are required to ensure a level playing field for open and fair competition. The Agreement should also contribute to the objectives of sustainable development. While the parties commit to maintaining and improving their respective high standards, they recognise that the purpose of the commitments is not to harmonise these standards.

Article 365 reaffirms the right of the parties to regulate. It acknowledges the precautionary approach to potential threats of serious or irreversible damage to the environment or human health (see further, section 7.1 below). Parties also commit to following the relevant scientific and technical information, and international standards and guidelines when they develop new regulations in the area of environmental protection and labour conditions.

Most modern free trade agreements contain provisions of some sort to uphold certain (international) labour or environmental standards or include pledges to maintain open competition. The TCA has the most

[3] UK/EU relations: Written statement, HCWS86, 3 February 2020

extensive provisions on level playing field seen in any free trade agreement to date.[4]

Chapter 2 of Title XI covers **competition**. The positions of the UK and EU converged on competition issues during the TCA negotiations. Both sides agree to maintain a competition law system that addresses anti-competitive behaviours. The UK and EU now operate separate competition regimes. The TCA does not change the UK or EU competition law rules, which are substantially the same but may diverge in the future. The UK and EU agree to enforce competition law in a transparent and non-discriminatory manner, and have competition authorities which shall co-operate on their activities. The general provisions on dispute settlement do not apply to the competition provisions.

Mutual commitments on **subsidy control** are set out in Chapter 3. Both the UK and EU are required to have an effective system of subsidy control and an independent body to oversee it from 1 January 2021. However, the Agreement does not require the UK Government to set up a control mechanism before any subsidy is paid out, as is required under the current EU regime. The UK can itself determine the precise nature of its domestic subsidy control regime and the role of any independent enforcement body, within the principles and rules agreed in the TCA.

The chapter on subsidies sets out the common "broad principles" according to which UK and EU subsidy control would operate. These principles have to ensure that subsidies contribute to achieving public policy objectives by addressing market failures or social problems. They have to be proportionate, necessary, and be the appropriate instrument to achieve the objectives. Their positive effect has to outweigh any negative impact on mutual trade.

Some subsidies are partially exempt from the TCA provisions, for example, temporary subsidies granted in response to a national emergency. Certain subsidies are prohibited if they "have or could have a material effect on trade or investment between the Parties". Conditions are created to grant subsidies in some areas, for example sustainable energy.

Chapter 3 further contains provisions on domestic enforcement, a bespoke dispute settlement mechanism and unilateral remedial measures.

Besides an independent enforcement body, the subsidy control system requires that the courts must be able to hear claims from interested parties, review subsidy decisions and grant effective remedies, in accordance with each party's domestic law. A unique feature for subsidies is that either side can intervene in the other's domestic court proceedings concerning the subsidy rules if the court permits it to do so. Additionally, a mechanism must be in place to recover subsidies which

4 International Trade Committee, Oral evidence: UK-EU trading relationship, HC 1206, 22 April 2021, Qq 110, 112

are provided unlawfully. However, if a subsidy is granted by an Act of Parliament, a recovery will not be required.

The TCA contains a set of specific provisions to address disputes on the application of subsidy provisions.

The provisions on subsidies in the Agreement do not amend the state aid provisions (Article 10) of the Withdrawal Agreement Protocol on Ireland and Northern Ireland, meaning that EU state aid rules apply to subsidies affecting trade in goods and wholesale electricity between Northern Ireland and the EU.[5] The TCA does not explain how the provisions of the TCA and Protocol will interact.

In Chapter 4 of the Agreement the UK and EU commit to ensuring that **state-owned enterprises**, companies with special rights, and designated monopolies, do not engage in anti-competitive practices or discriminatory and abusive behaviour creating barriers to trade and investment. These provisions put private businesses on an equal footing with businesses where the governments are involved when the latter engage in commercial activities.

Chapter 5 briefly deals with **taxation**. The agreement contains a commitment to good governance and upholding the taxation standards on exchange of tax information, anti-tax avoidance and transparency. The common provisions refer to international standards, including OECD standards. Finally, this aspect of the agreement is excluded from the general arrangements for dispute resolution.

For provisions on **labour and social protection, and the environment and climate**, the Agreement recognises that both the UK and EU may establish their own levels of protection.[6] As a European Parliament assessment sets out:

> Standards are not meant to be harmonised, but the parties endeavour to maintain and improve their respective high standards. The parties affirm each other's right to set their policies and priorities.[7]

At the same time, a form of non-regression approach is used which requires that the level of protection is not lowered below the level in place at the end of the transition period if that would impact trade or investment between the UK and EU. This means that in order to demonstrate a breach of the non-regression clause either party would have to show that any attempt to lower labour or environmental standards affects UK-EU trade or investment. The Institute for Public Policy Research has described this qualification as "setting a very high bar for proof".[8]

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5 HM Government, *Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community*, 19 October 2019, [Protocol on Ireland/Northern Ireland, p292]

6 TCA, Chapter 6 [Labour and Social Standards], Chapter 7 [Environment and Climate]

7 European Parliament note, First appraisal of the EU-UK Trade and Cooperation Agreement, PE 662.902, March 2021, p10

8 Marley Morris, The agreement on the future relationship: first analysis, IPPR, p7

The UK and EU both commit to maintaining effective oversight and enforcement systems, with administrative or judicial means of challenge and redress.

Chapter 8 sets out the foundations and broad objectives for trade and sustainable development. This is based primarily on the principles of and commitments to international agreements such as the Rio Declaration and the Sustainable Development Goals. The parties also commit to promote and implement the core labour standards recognised in the International Labour Organisation's (ILO) eight Fundamental Conventions.

1.3 Dispute resolution mechanisms

The dispute settlement mechanisms are central to the TCA architecture and must ensure the enforcement of the level playing field. The mechanisms deployed in this area are complex and the procedures vary between policy areas. Both the main TCA dispute settlement mechanisms apply, and additional bespoke mechanisms are set out for subsidies, labour standards, environment and climate. These are discussed in more detail in section 8 below. Provisions on competition policy and taxation are excluded from the dispute settlement mechanisms altogether.

The most innovative aspect of the agreement dispute resolution process is a rebalancing mechanism for the level playing field set out in Article 411. In certain circumstances, both parties have the right "to take countermeasures if they believe they are being damaged by measures taken by the other party in subsidy policy, labour and social policy, or climate and environment policy", subject to arbitration.[9]

This would be the case if significant divergences between the UK and EU in those areas would arise and have material impacts on trade or investment. In simple terms, if one side raises its standards and the other does not, it can take reciprocal action, subject to independent assessment by an arbitration tribunal.

The mechanism in the agreement foresees that, if consultations between the UK and EU are unsuccessful, either party can take unilateral temporary and proportionate "rebalancing measures," based on "reliable evidence" and not on "conjecture or remote possibility". Exactly what measures may be taken, or how connected they must be to the area of divergence, is not specified, suggesting that they need not be limited to the precise matter at dispute. The other party may challenge any such measures before an arbitration tribunal. This rebalancing mechanism is reciprocal, as opposed to the unilateral mechanisms initially proposed by the EU.

As the UK Government's summary document notes, if the rebalancing mechanism is triggered too frequently either side can initiate a review of the relevant provisions and the trade aspects of the TCA more broadly

[9] HM Government, UK-EU Trade and Cooperation Agreement: Summary, December 2020, para 81

and this may lead to adjustment of the balance of rights and obligations.

There is uncertainty as to how the level playing field provisions of the Agreement will be applied in practice and what effect they will have on specific sectors and on the UK-EU trading relationship in general.

During the negotiation of the TCA, there were significant differences in the UK and EU positions on labour and social standards, and environmental protection. They concerned the extent to which the parties should remain "dynamically aligned" and be prohibited from lowering labour and environmental standards (non-regression), and whether one party should have to raise its standards if the other party chose to raise theirs (ratchet clause). There was also a discussion on dynamic alignment with EU state aid rules. The resulting TCA does not require that the UK follows EU rules as they evolve. However, Sussex University UK Trade Policy Observatory researchers argue that the rebalancing mechanism included in the TCA constitutes a defensive version of dynamic alignment, in that rather than focussing on cooperation and harmonisation it provides alternative means for one side to coerce the other. But triggering the rebalancing mechanism of Article 411 repeatedly could have a rather destabilising effect on the overall cooperation:

> … if there is a series of rebalancing episodes, if either party triggers the review provided for in [Article 411], or anyway in the standard five-yearly review, there are likely to be high feelings on both sides of the table. That is, far from smoothing the path to cooperation, stability and certainty, the dispute settlement processes of the LPFs Title could have exactly the opposite effect. That, inevitably, will discourage investment in anything that depends on the smooth flow of UK-EU trade.[10]

1.4 Parliamentary scrutiny

UK Parliament

The UK Parliament passed legislation enabling the ratification and domestic implementation of the TCA on 30 December 2020 and the Agreement entered into provisional application on 1 January 2021. Since then parliamentary select committees have scrutinised aspects of the TCA on several occasions, including provisions on the level playing field.

- Committee on the Future Relationship with the European Union, Oral evidence: Progress of the negotiations on the UK's future relationship with the EU, HC 203, 6 January 2021
- HL European Union Committee, Uncorrected oral evidence: Future UK-EU relations: governance, 2 February 2021
- HL European Union Committee, 21st Report of Session 2019-21 Beyond Brexit: the institutional framework, HL 246, 22 March 2021

[10] Emily Lydgate, Erika Szyszczak, L. Alan Winters, Chloe Anthony, Taking Stock of the UK-EU Trade and Cooperation Agreement: Governance, State Subsidies and the Level Playing Field, UKTPO, Briefing Paper 54, January 2021

- HL European Union Committee, EU Environment Sub-Committee, 22nd Report of Session 2019–21: Beyond Brexit: food, environment, energy and health, HL 247, 23 March 2021
- International Trade Committee, Oral evidence: UK-EU trading relationship, HC 1206, 22 April 2021

European Parliament resolution

The European Parliament gave its consent to the TCA on 28 April 2021, paving the way for its full entry into force on 1 May 2021. Parliament's Resolution welcomed the agreement's "modern" level playing field provisions which "should be considered as a model for other future Free Trade Agreements negotiated by the EU". The Parliament also emphasised its key concerns for the level playing field:

- The need to ensure that significant divergence with material impact on trade or investment is broadly interpreted and can be demonstrated in a practical manner to ensure that the ability to use such measures is not unduly restricted.
- The need to monitor the new UK State aid regime and assess the efficacy of the mechanism to address unjustified subsidies;
  It recalled that provisions on the level playing field apply in a general manner, including in so-called special economic zones. This is a reference to the UK Government's plans to finance a number of new Freeports, "hubs for global trade and investment," across the UK.
- Regretting the limited provisions on taxation, the EP requested the Commission remain vigilant on questions of taxation and money laundering. It suggested a possibility to review this relationship four years after the entry into force of the Agreement should imbalances arise.[11]
- How a future possible unilateral lowering of social and labour standards by the UK would be addressed and contested under the Agreement.[12]

During the debate, MEPs from all major political groups stressed the importance of having enforceable level playing field provisions, including for social and environmental standards.

[11] European Parliament Resolution of 28 April 2021 on the outcome of EU-UK negotiations, para 18
[12] European Parliament Resolution of 28 April 2021 on the outcome of EU-UK negotiations, para 32

2. Competition policy

2.1 Negotiating positions

The positions of the UK and EU converged on competition issues during the TCA negotiations. Other EU and UK free trade agreements contain comparable provisions and adhere to similar principles of transparency, non-discrimination, and procedural fairness.

UK position

The UK's negotiating objectives (Chapter 21), which were published on 27 February 2020, highlighted a desire for both parties "to maintain effective competition laws, covering merger control, anticompetitive agreements and abuse of dominance, while maintaining the right to provide for public policy exemptions". The document argued that there is no need for legal or regulatory alignment. Rather, it promoted "regulatory freedom to respond to new and emerging challenges in these areas."[13]

It argued for "transparent, non-discriminatory rules and enforcement procedures" and "effective cooperation".

With one exception, chapter 22 of the May 2020 UK draft Comprehensive Free Trade Agreement was if anything more general than the provisions set out in the earlier negotiating objectives, referring generally to principles of "free and undistorted competition" and the importance to all of taking action against "anti-competitive business conduct".[14]

But paragraph 3 of Article 22.2 included a new emphasis on the importance of "cooperation and coordination" between competition authorities to achieve this, going as far as admitting the possibility of "a separate agreement" on effective competition law.

The proposed approach would reflect recent agreements with Canada, Japan and South Korea in excluding competition issues from the wider dispute resolution mechanism.

EU position

The EU's negotiating directives adopted on 25 February proposed that:

> 97. The envisaged partnership should provide that anticompetitive agreements, abuses of dominant position and concentrations of undertakings that threaten to distort competition are prohibited, unless remedied, in so far as they affect trade between the Union and the United Kingdom. The Parties should also commit to effective enforcement via a competition law and domestic administrative and judicial proceedings, permitting the effective

13 HM Government, The Future Relationship with the EU: The UK's Approach to Negotiations, CP 211, 27 February 2020, Chapter 16

14 HM Government, Draft working text for a Comprehensive Free Trade Agreement between the United Kingdom and the European Union (CFTA), 19 May 2020, Chapter 22

> and timely action against violations of competition rules, and to effective remedies.[15]

Section 2 of the EU draft Agreement of 18 March 2020 elaborates on commitments in competition set out in the negotiating directives. Anti-competitive practices are prohibited as far as those affect trade between the UK and the EU. There is no direct reference to EU competition law, but much of the text is "derived from EU law (largely copied from the EU treaties) and enforceable in the courts of each party", which would by extension require the UK "to apply competition rules essentially identical to those in force in the EU".[16]

There are provisions regarding cooperation on policy development and cooperation between competition authorities. Provisions on competition would not be covered by the Agreement dispute settlement mechanism (Part Five, Title II), except for the requirement to have an enforcement body.

2.2 The TCA

The TCA only briefly deals with competition policy in Chapter 2, Articles 358-362.

In it, the EU and the UK "recognise the importance of free and undistorted competition". Both agree to maintain a competition law system that addresses

- agreements and practices that seek to prevent, restrict or distort competition
- abuses of dominant positions, and
- mergers or acquisitions (for the EU, "concentrations") which have anti-competitive effects. This competition law system must apply to all economic actors regardless of nationality or ownership status.

The TCA does not change the substance of UK or EU competition law rules, which are substantially the same. So currently, what is likely to be unlawful under EU competition rules is also likely to be unlawful under UK competition rules. In the future, however, UK courts are not required to follow EU competition case-law. Divergences are likely to emerge over time. There is also the potential for parallel European Commission and UK Competition and Markets Authority investigations of the same conduct, if that conduct impacts trade both between EU Member States and, separately, in the UK.[17]

The UK and EU now operate separate competition regimes. The EU Merger Regulation, with its one-stop shop rule that allowed the European Commission to review mergers across national borders, no

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15 EU General Affairs Council, Directives for the negotiation of a new partnership with the United Kingdom of Great Britain and Northern Ireland, 5870/20, 25 Feb 2020

16 Institute for Government, UK–EU future relationship negotiations: key flashpoints (accessed May 2021)

17 See William Fry, The impact of Brexit on State Aid, Public Procurement, Merger Control and Competition Rules (accessed May 2021)

longer applies in the UK. Transactions now need to satisfy merger control rules in both the UK and EU.[18]

Each party is allowed an exemption from such competition law for "legitimate public policy objectives", so long as these exemptions are transparent and proportionate to those objectives.

The UK and EU agree to enforce competition law in a transparent and non-discriminatory manner, and have competition authorities which shall co-operate on their activities. This includes the exchange of information. In future, the UK and EU may enter into a separate agreement on co-operation and co-ordination between the European Commission, the competition authorities of the EU Member States and the UK's competition authority, which may include conditions for the exchange and use of confidential information. Officials from the UK and EU have indicated that they are keen for such an agreement to be finalised soon. It might include enhanced co-operation, mutual notifications and coordination of enforcement.[19]

Consistent with the negotiation positions of both sides, the general provisions on dispute settlement (Title I of Part Six) do not apply to the competition provisions.

Standards in other EU trade agreements

Other EU trade agreements contain provisions on competition that are comparable to the TCA.

Canada

Chapter 17 of the Comprehensive Economic and Trade Agreement (CETA) sets out arrangements for competition, highlighting "the principles of transparency, non-discrimination, and procedural fairness". Any exclusions will be transparent and both parties will share relevant information about such exclusions. There are no arrangements for dispute settlement. CETA also refers to a more detailed 1999 agreement between the EU and Canada on the application of competition laws.

Japan

Chapter 11 of the EU-Japan Economic Partnership Agreement, which builds on a 2003 agreement on anti-competitive activities, promotes similar principles. It permits exemptions, "provided that such exemptions are transparent and are limited to those necessary for securing public interest. Such exemptions shall not go beyond what is strictly necessary to achieve the public interest objectives that have been defined by that Party". The agreement is not subject to wider arrangements for dispute resolution.

South Korea

Chapter 11 of the EU-South Korea Free Trade Agreement of 2010 also highlights general principles of the type mentioned above. In

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18 See Norton Rose Fulbright, The impact of Brexit on antitrust and competition (accessed May 2020)

19 EU Relations Law, A missing piece of the puzzle: a Competition Law Cooperation Agreement between the UK and EU (accessed May 2021)

comparison with the Canadian and Japanese agreements, it discusses the role (and protection) of public monopolies and enterprises in more detail. The agreement is not subject to wider arrangements for dispute resolution.

The "continuity" trade agreements the UK has signed with Canada, Japan and South Korea largely replicate the competition provisions in the EU agreements.[20]

[20] For Canada, see UK-Canada Trade Continuity Agreement, 9 December 2020, p18 Ch17; for Japan, see House of Lords EU Committee, Scrutiny of international agreements: UK-Japan Comprehensive Economic Partnership Agreement, 19 November 2020, p26 para 80; for South Korea, see Continuing the UK's trade relationship with the Republic of Korea, September 2019, p32 para 111

3. Subsidy control

3.1 Negotiating positions

Background

Subsidy control was one of the most controversial areas during negotiations over the TCA and one of the last issues to be resolved.

Both the EU and UK have a mutual interest in robust controls of state support to businesses, which could ensure fair competition and trade with the other party. Despite this, both sides adopted different approaches to future cooperation on state aid/subsidies.[21] The UK sought to protect its regulatory autonomy and avoid provisions in this area that would go further than free trade agreements "normally" do. The EU saw alignment on state aid rules as essential to prevent UK subsidies to industries from threating to undercut EU businesses in the future.

UK position

As an EU Member State, the UK was part of the EU regime for state aid (see box 1 below). While Theresa May's Government was considering some form of incorporation of EU state aid rules in the UK rulebook, Boris Johnson's Government rejected any form of alignment with the EU in this area. Referring to the principle of sovereignty it rejected EU influence over UK domestic policy through state aid controls. The government also chose to use the term 'subsidies' instead of 'state aid', which is an EU law term.[22]

Box 1: EU State aid rules

As an EU Member State, the UK was part of the EU regime for state aid. The EU state aid controls are specifically aimed at creating a level playing field for businesses in the Single Market. Under Article 107 of the Treaty on the Functioning of the European Union, state aid is prohibited, if it threatens to distort competition and trade between EU Member States.[23] State aid refers to national public authorities offering grants, tax reliefs and various other forms of support, which favour specific businesses or industries. Member States are required to get European Commission clearance before making state aid available to businesses (ex-ante assessment). In practice, more than 90% of EU state aid is exempted from this procedure.

See further Commons Library briefing 6775, EU State Aid Rules and WTO Subsidies Agreement

As set out in its statement of 3 February 2020 on UK/EU relationships, the UK Government did not believe that to secure future cooperation it was necessary to be bound by an international treaty or guided by shared institutions in subsidies policy. Such commitments could hamper its aspirations to develop "separate and independent policies" on state aid. It was seeking a regime that is WTO-compliant and does not go

21 HL European Union Committee, Internal Market Sub-Committee, Uncorrected oral evidence: The level playing field and state aid, 27 February 2020, Q8

22 For background on (dynamic) alignment with evolving EU state aid rules see Commons Library briefing 8852, The UK-EU future relationship negotiations: Level Playing Field, 19 June 2020, section 2

23 *Consolidated version of the Treaty on the Functioning of the European Union* [2012] OJ C326, Art. 107-108

beyond the provisions included in other free trade agreements, such as CETA.

The Government's negotiating objectives, The future relationship with the EU. The UK's approach to negotiations of 27 February (Chapter 20) stated that reciprocal commitments on subsidies should be in line with the WTO Agreement on Subsidies and Countervailing Measures (SCM)[24] and could go beyond it regarding transparency, which would be comparable to the EU-Japan Economic Partnership Agreement. While the SCM Agreement covers only trade in goods, the government was willing to extend its commitments to cover trade in services too. This was a concession to the EU position as EU state aid rules cover all trade and do not distinguish between goods, services or movements of capital.

The EU's proposal was to base the UK state aid regime on EU state aid law. That would involve a role for the Court of Justice of the EU (CJEU) which has an exclusive competence to interpret EU law. The UK Government consistently ruled out "any jurisdiction for the CJEU over the UK's laws", or "any supranational control in any area".[25]

The UK's draft UK-EU Comprehensive Free Trade Agreement (CFTA), had a separate chapter on subsidies (Chapter 21). The proposal referred to WTO anti-subsidy rules as basis for cooperation on subsidies. Under the proposed terms, both sides would agree to notify each other bi-annually of their subsidies. A party concerned about a subsidy adversely affecting its interests would be able to request a consultation. The other party would give "full and sympathetic consideration" to that request and would use its "best endeavours" to address the adverse effects. The provisions would not be subject to the dispute settlement procedures of the Agreement.

EU position

From the outset of the negotiations the EU indicated that the enforcement of state aid rules was one of its main concerns among the level playing field obligations. Following the approach set out in the Political Declaration, the EU's negotiating directives required upholding "the common high standards" with regard to state aid and other areas. But they added a request for "corresponding high standards over time with Union standards as a reference point". The EU requested that EU state aid rules apply "to and in the UK".[26]

The EU draft Agreement on the New Partnership with the United Kingdom operationalised the positions set out in the Council's

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24 The WTO rules on state aid/ subsidies are laid out in the *Agreement on Subsidies and Countervailing Measures (SCM)*. This agreement frames the use of subsidies and the actions countries can take to protect their markets from the effects of another country's subsidies.

25 UK / EU relations: Written statement, HCWS86, 3 February 2020; see also Cabinet Office, PM meeting with EU Commission President Ursula von der Leyen, 8 January 2020.

26 EU General Affairs Council, Directives for the negotiation of a new partnership with the United Kingdom of Great Britain and Northern Ireland, 5870/20, 25 Feb 2020, para 96

negotiating directives.[27] The draft text on state aid required the UK to give effect to EU state aid law including future amendments in its domestic law.

Further, the UK would be required to establish an independent enforcement authority.

The UK would also have been required to ensure that its courts could apply state aid rules and could refer questions of interpretation of EU state aid law to the CJEU. In addition, the European Commission would have legal standing before UK courts to bring cases in respect of state aid measures adopted by UK authorities and would have a right to intervene in cases. These provisions would give EU law an unprecedented extra-territorial effect in a third country.[28]

Disagreements would be settled through a consultation mechanism within the Specialised Committee on Level Playing Field and Sustainability (SCLPF) and the agreement's overarching dispute settlement mechanism would apply.

The EU would be able to take "interim measures" if, for example, consultations failed or the SCLPF could not come to an agreement on whether the UK had adopted new EU state aid provisions.[29]

Agreements between the EU and third countries include varying degrees of commitments on state aid/subsidy controls. Generally, the closer the market integration, the more state aid or anti-subsidy rules form part of the agreement.[30] The EU's initial proposal compared to the EU-Ukraine Association Agreement, with the trading partner having its own independent regime which is based on full application of EU state aid rules. As stated above, the UK proposal was to follow the agreements building on the WTO rules-based systems such as CETA and the EU-Japan Economic Partnership Agreement which have relatively week enforcement provisions.[31]

Seeking a compromise

Throughout the first months of negotiations the UK and EU positions on state aid remained deadlocked. However in July 2020 the EU signalled willingness to drop its demand that the UK accepts future EU state aid rules (dynamic alignment) and CJEU oversight.[32] In exchange it expected the UK to sign up to a "shared philosophy" on future subsidy policy in combination with some form of equivalence mechanism where the UK

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27 European Commission, Draft text of the Agreement on the New Partnership between the European Union and the United Kingdom, UKTF(2020)14, 18 March 2020, Title III, Chapter Two, Section 1

28 Nikos Lavranos, EU UK agreement: an analysis of the EU's proposed dispute settlement provisions, Borderlex, 23 March 2020

29 The text did not explain the nature of such interim measures, but common understanding was that they would refer to tariffs on goods or (partial) suspension of the agreement. This is similar to 'remedial measures' included in the TCA.

30 Morris Schonberg, "Continuity or change? State aid control in a post-Brexit United Kingdom", *Competition Law Journal*, 47, 2017, p54

31 See further Commons Library briefing 9025, UK subsidy policy: first steps, 19 October 2020, section 4

32 "The hard Brexit choices that could yet deliver a deal," *Financial Times*, 27 July 2020

would have a solid framework and an independent institution to oversee it.

The UK Government reiterated in a statement on subsidy policy on 9 September 2020, that from 2021, the UK will no longer follow EU state aid rules but the WTO rules on subsidies. It will honour its obligations regarding subsidies included in its future free trade agreements. The government also reassured that it did not intend to adopt "1970s policies" of bailing out unsustainable companies.[33]

The government's statement of 9 September sat alongside the UK Internal Market Bill which was introduced in Parliament on the same day. The Bill as presented would empower Ministers to unilaterally reinterpret and disapply provisions on state aid in the Withdrawal Agreement Protocol on Ireland/Northern Ireland. It appeared that these controversial provisions could break the UK's legal obligations under the Withdrawal Agreement and international law to enact the Protocol. In response, the European Commission launched infringement proceedings against the UK. The provisions were eventually removed from the Bill, which has now become the UK Internal Market Act, but these developments put further pressure on the negotiations. See for background Commons Library Briefing United Kingdom Internal Market Bill 2019-21, 14 September 2020, Sections 6.5 and 6.8.

On 7 October, The UK's Chief negotiator David Frost confirmed to the House of Lords EU Committee that the EU had dropped the request of dynamic alignment with EU state aid rules. He disclosed that the UK had submitted a proposal on basic principles on subsidy policy. These principles focussed on transparency and proportionality of subsidies and would have regard for the effect of subsidies on trade and investment. Frost confirmed that the UK was willing to commit to such common principles, which are "important parts of a good subsidy system". But the level of detail on domestic policy, that the EU had been asking for, was to be decided after a domestic consultation followed by a possible legislative process.[34] Thus, the domestic setup of the UK subsidy system could not be part of the negotiation. A path to a compromise was emerging.

3.2 The TCA: Definitions and scope

Subsidy control provisions are covered in Chapter 3, Articles 363-375. The Agreement requires both UK and EU to have an effective system of subsidy control with an independent body to oversee it from 1 January 2021. Crucially, the UK has the right to regulate; it may determine the precise scope of its regime, within the principles and rules agreed in the TCA.

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33 The Department for Business, Energy and Industrial Strategy (BEIS), Government sets out plans for new approach to subsidy control, 9 September 2020

34 HL Committee on the European Union, Uncorrected oral evidence: Progress of negotiations on the future UK-EU relationship, 7 October 2020, Q8

The TCA **defines a subsidy** in Article 363 without referring to concepts of EU law, but it is seen by many as generally similar in scope.[35] A subsidy concerns financial assistance paid from the public purse, in various forms, including grants, loans or guarantees, foregone revenue or provision of goods and services. Also tax measures can be subsidies in some circumstances. A subsidy confers economic advantage and is specific – it benefits certain economic actors above others. A subsidy must have actual or potential effect on trade or investment between the Parties (Article 363 (1) (b)).

Article 364 limits **the scope** of a "subsidy", exempting compensations for the damage caused by natural disasters. Lesser conditions apply to other exceptional non-economic occurrences, such as a pandemic, and focussed responses to global economic emergencies. It is also made clear that subsidies of a social nature to consumers, rather than businesses, are allowed.

There is a new de minimis threshold of roughly £335,000 below which a subsidy is exempt. Further, the rules do not apply to agricultural and fisheries sectors, and the audio-visual sector, which includes film, broadcasting, and multimedia.

Article 365 provides that the principles of subsidy control do not apply to subsidies for services of public economic interest, such as social housing or public transport services to remote areas, if they would obstruct the delivery of such services. Generally, authorities compensating an entity for the service provision should be transparent, avoid overcompensation and prevent cross-subsidising other activities outside the scope of public interest. The subsidy control chapter of the TCA does not apply to compensations which amount to less than £795,000 over a period of three years.

3.3 Principles of subsidy control

Mutually agreed **principles** of subsidy control are covered in Article 366, and should be applied to determine the legality of an individual subsidy where this could have a material effect on trade or investment between the parties. See box 2 below.

Box 2: TCA principles of subsidy control (Article 366)

Each party must have an effective system of subsidy control that ensures that the granting of a subsidy respects the following principles:

(a) subsidies pursue a specific public policy objective to remedy an identified market failure or to address an equity rationale such as social difficulties or distributional concerns ("the objective")
(b) subsidies are proportionate and limited to what is necessary to achieve the objective
(c) subsidies are designed to bring about a change of economic behaviour of the beneficiary that is conducive to achieving the objective and that would not be achieved in the absence of subsidies being provided
(d) subsidies should not normally compensate for the costs the beneficiary would have funded in the absence of any subsidy

35 Phedon Nicolaides, One Agreement, Two Parallel Systems: Subsidies in the Trade and Cooperation Agreement between the EU and the UK, lexxion.eu, 5 January 2021

(e) subsidies are an appropriate policy instrument to achieve a public policy objective and that objective cannot be achieved through other less distortive means
(f) subsidies' positive contributions to achieving the objective outweigh any negative effects, in particular the negative effects on trade or investment between the parties.

Certain **subsidies that have or could have material effect on UK-EU trade**, are **prohibited** and others are **subject to conditions** (Article 367). The prohibited subsidies include unlimited state guarantees, and state support to rescue ailing or insolvent businesses without a realistic restructuring plan. However, such subsidies would be permitted in order to avoid social hardship, job losses or service disruption. Subsidies to banks and credit institutions are allowed subject to a credible restructuring plan and a prospect of long-term viability.

Exports subsidies for goods and services are prohibited, with some exceptions such as export credit guarantees. Also subsidies conditional on domestic content are prohibited. Subsidies to air carriers are allowed in exceptional circumstances.

Article 367 (13) sets out specific rules for large cross-border or international cooperation projects. Article 367 (14) regulates subsidies to sustainable energy and environmental sustainability.

Phedon Nikolaides, Professor of European economic law at Maastricht University has noted that the TCA allows subsidies that contribute to public policy objectives:

> Without explicitly stating so, [the TCA] allows subsidies that pursue a public policy objective, comply with certain principles, such as those of necessity and proportionality, and generate positive effects that outweigh their negative effects on trade and investment.[36]

In sum, "any subsidy in any form escapes from the obligations laid down in the Agreement if it has no 'material effect' on trade or investment".[37]

An additional **Joint Declaration on Subsidy Control Policies** covers subsidies for the development of disadvantaged areas, transport, and research and development. The Joint declaration provides non-legally binding guidance on what "appropriate subsidy policies" in these areas would entail. For example, beneficiaries of subsidies for the development of disadvantaged or deprived areas should be required to provide substantial contribution to the investment costs of a project. Also, the main purpose of regional aid should not be attracting businesses to relocate from the EU to the UK or vice versa. George Peretz QC of Monckton Chambers assesses:

> The value of these latter declarations is largely to make it clear that the UK government, committed to major investment in both transport and R&D, can do so within the framework of the

36 Phedon Nicolaides, One Agreement, Two Parallel Systems: Subsidies in the Trade and Cooperation Agreement between the EU and the UK, lexxion.eu, 5 January 2021
37 Ibid

Agreement – though it will be observed that it could also have done so within the framework of EU State aid rules.[38]

Transparency

The Parties commit to principles of **transparency** around subsidy controls (Article 369), agreeing to make information on individual subsidies and the names of recipients available on a public database or website. For this purpose, the UK Government has set up a new transparency database on gov.uk. The UK has also agreed to ensure that an interested party – for example a competitor of the beneficiary or a trade association – which intends to apply for a court review of a subsidy, has access to the relevant information about the subsidy. This would enable it to assess the application of the subsidy control principles of Article 366 and make an informed decision about its claim and the issues at stake. The transparency provisions are more profound than the commitments in FTA's like CETA.

Box 3: UK Guidance and future Subsidy Control Bill

On 31 December 2020, the government published guidance for public authorities which award subsidies, explaining their responsibility for the assessment of compliance with the UK's international commitments on subsidy control.[39]

A consultation about the design of a bespoke approach to UK domestic subsidy control ran from 3 February until 31 March 2021.

The UK Internal Market Act (Section 52) reserves to the UK Parliament the exclusive ability to legislate for a subsidy control regime. Later this year, the government is expected to bring forward a Subsidy Control Bill to establish a subsidy control system in domestic law.

3.4 Independent enforcement body

The TCA subsidy provisions require that the UK establishes an "**operationally independent" enforcement authority** (Article 371) with an "appropriate role". The Agreement does not require the government to assess subsidies in advance, or introduce a standstill period until a subsidy is cleared, as the EU state aid regime requires. So far the UK Government has not set up a subsidy control authority.

3.5 The role of courts

Besides an independent enforcement body, Article 372 requires that the courts are competent

- to review subsidy decisions taken by granting authorities or the independent body,
- to hear claims from interested parties, and
- to impose effective remedies, in accordance with either party's domestic law.

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38 George Peretz, The subsidy control provisions of the UK-EU trade and cooperation agreement: a framework for a new UK domestic subsidy regime, Monckton Chambers, 28 December 2020

39 HM Government, Guidance Complying with the UK's international obligations on subsidy control, 31 December 2021, para 3.2

That means a case can be brought through the domestic legal system of either side rather than through an arbitration procedure of the TCA. A unique feature is that, with the permission of the court, either party can intervene in the other's domestic court proceedings. This is a weakened down provision from the EU's initial proposal to have legal standing to bring cases before UK courts. Further, both parties must put a mechanism in place to **recover subsidies** which have been successfully challenged before a court. However, if a subsidy is granted by an Act of Parliament, recovery will not be required (Article 373).

3.6 Dispute settlement and remedies

The Agreement contains a complex set of bespoke provisions to address disputes on subsidies. First, there is the option of a consultation. If a consultation does not solve the dispute, a complaining party can take unilateral remedial measures, subject to arbitration. When a dispute relates to concerns over significant divergence of the subsidy control policy, parties can take rebalancing measures.

A **consultation procedure** is established under Article 370. It allows a party to request information on how the subsidy control principles of Article 366 have been respected in an individual case, if it considers that a subsidy (potentially) has a negative effect on trade or investment between the UK and EU. The party can escalate the case, requesting consultations within the Trade Specialised Committee on Level Playing Field for Open and Fair Competition and Sustainable Development which "shall make every attempt to arrive at a mutually satisfactory resolution of the matter". This consultation procedure, notes Kotsonis, "should also help flush out any potential concerns over the compliance of a subsidy that could otherwise escalate into a dispute".[40]

In more concerning instances, if either party considers that the other's individual subsidy presents a serious risk of causing "a significant negative effect on trade or investment between the parties," it can request information and consultations under the Article 374 **Remedial measures** procedure.[41]

If there is evidence to that serious risk, a party can "unilaterally take appropriate remedial measures." These measures have to be limited to what is strictly necessary and proportionate. Articles 374 (5) and 374 (6) stipulate that the existence of a serious risk of a significant negative effect must be backed by facts and reliable evidence, and not merely based on "allegation, conjecture or remote possibility".

The other party can challenge the complainant's remedial measures if it considers them excessive, and request a ruling of an arbitration tribunal in accordance with the Part Six provisions on dispute settlement. The tribunal will assess whether the remedial measure of the complainant is proportionate. If the complainant fails to comply with the arbitration

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40 Totis Kotsonis, "The Squaring of the Circle: Subsidy Control Under the UK-EU Trade and Cooperation Agreement", *European State Aid Law Quarterly*, Volume 20, Issue 1, 2021, pp561-575

41 The Partnership Council may maintain an illustrative list of what might amount to a significant negative effect on trade or investment (Article 374 (7)).

ruling, the other party can take remedial action in response. The arbitration tribunal will conduct its proceedings in accordance with Article 760 which sets outs an expedited process for establishing the tribunal and for the delivery of the tribunal's final ruling.[42]

Article 375 sets out that if one of the parties more generally fails to comply with the subsidy commitments of the TCA, the other may refer the matter to the horizontal dispute settlement procedure of the TCA (Title 1, Part Six). This does not apply to provisions on the independent body (Article 371) and courts (Article 372). An arbitration tribunal under the TCA will have no jurisdiction over the assessment and recovery of individual subsidies.

The **rebalancing** mechanism (Article 411) applies to the TCA commitments on subsidies (see section 8.5 below), in a similar manner it applies to labour and social, environmental standards or climate protection. The rebalancing mechanism provides that the parties can take "rebalancing measures" where significant divergence between the UK and the EU on subsidy control gives rise to "material impacts on trade and investment between the parties". A remedial measure and a rebalancing measure cannot be applied at the same time to remedy the impact of the same subsidy (Article 374 (15)).

Both remedial measures and rebalancing procedures for subsidies require that the assessment of a subsidy's impacts must be based on "reliable evidence and not merely on conjecture or remote possibility." Kotsonis summarises the differences between the remedies under the two procedures:

In terms of substance, there would not appear to be any material differences between what might count as 'remedial' or 'rebalancing' measure; both might involve the imposition of tariffs or quotas or the suspension of certain other preferential access commitments. However, on the basis that significant divergence in subsidy control policies would herald a systemic divergence in the way in which Parties approach subsidy control, this is likely to lead to longer term and wider distortive effects on level playing field conditions than the grant of any one or more time-limited subsidies. Accordingly, where a rebalancing measure is justified, this would seem to permit, in principle, the adoption of more draconian trade defence measures than that which would seem justifiable in the context of a remedial measure.[43]

In critique of the dispute settlement mechanism for subsidies, Nicolaides has pointed out that the system of remedial measures available to a

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42 For a detailed description of the subsidy dispute resolution procedure see Commons Library briefing 9139, The UK-EU Trade and Cooperation Agreement: governance and dispute settlement, section 5.1

43 Totis Kotsonis, "The Squaring of the Circle: Subsidy Control Under the UK-EU Trade and Cooperation Agreement," *European State Aid Law Quarterly*, Volume 20, Issue 1, 2021, p571

party in response to the other's harmful subsidies is "an inefficient system because it counters one distortion by creating another".[44]

The **review mechanism** described in section 8.8 below also applies to subsidies, making it possible to review or ultimately suspend the Trade title of the agreement if rebalancing measures have been taken too frequently.

In addition to the above dispute resolution procedures, with regard to trade in goods, Article 32 contains provisions on **anti-dumping and countervailing measures** which can be used to remedy the effects of harmful subsidies of the other party.[45] Article 32 states that anti-dumping and countervailing measures are to be applied in accordance with the provisions of the WTO SCM Agreement, which allows for investigations into the effects of subsidised imports on the domestic prices and industry. Countervailing measures can be introduced to offset the injury caused to domestic industry.

3.7 Issues and commentary

A compromise solution

There is a consensus among state aid/subsidy law specialists that the UK has done well in the negotiations in achieving independence from EU state aid rules and the jurisdiction of the CJEU.[46]

At the same time, the TCA subsidy provisions are, as professor Kenneth Armstrong puts it, a "delicately balanced" compromise with the EU objectives. The provisions are not as thin as the UK sought in terms of the WTO SCM Agreement. Instead, "the Agreement itself is the direct source of detailed substantive definitions of what constitutes a subsidy, certain prohibitions and any exceptions."[47] The resulting regime is substantially more robust than if the system was based merely on the WTO anti-subsidy commitments, and imports the EU approach to assessment of subsidies, argues subsidy law expert Totis Kotsonis.

> [I]n providing that subsidies should be granted only when they are consistent with the Subsidy Principles, the TCA imports an approach which is aligned with the assessment which the European Commission itself carries out in determining State aid compatibility with the internal market under EU law.[48]

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44 Phedon Nicolaides, One Agreement, Two Parallel Systems: Subsidies in the Trade and Cooperation Agreement between the EU and the UK, lexxion.eu, 5 January 2021

45 TCA, Title I Trade in Goods, Chapter 1, Article 32 Trade remedies

46 See for example, Emily Lydgate et al., Phedon Nicolaides, James Webber, George Peretz, Marley Morris

47 Kenneth Armstrong, An Uneven 'Level Playing Field' – the EU/UK Trade Agreement, University of Cambridge, 19 January 2021 (accessed May 2021)

48 Totis Kotsonis, "The Squaring of the Circle: Subsidy Control Under the UK-EU Trade and Cooperation Agreement", *European State Aid Law Quarterly*, Volume 20, Issue 1, 2021, p574

While consciously avoiding direct reference to concepts of EU law, the resulting regime is in substance, if not in form, rather similar to the structure under the EU State aid rules.[49]

The resulting TCA provisions are a new model of managing divergence, unprecedented in any other free trade agreement. International Trade Committee was told that the TCA would not limit the UK's freedom to negotiate new free trade agreements with third countries. The TCA sets a high bar, which the UK would have no intension to surpass with third countries.[50]

Flexibility in deciding policy priorities

The UK has achieved significant freedom in various policy areas previously regulated by specific EU state aid rules. The Sussex University Trade Policy Observatory (UKTPO) notes:

> The UK […] has negotiated for higher de minimis and public service subsidy thresholds, for special provisions to allow for a post-COVID19 special recovery programme to level up regions and to be able to keep a check on how the Member States of the EU use public money to stimulate their economies. It has also ensured that general provisions relating to tax and infrastructure projects will not be caught by the subsidy rules and that the dispute mechanisms that address problems with EU state aid and UK subsidies are independent of the European Commission and the European Courts.[51]

In policy areas such as environment and energy, research & development, or support for SMEs, where the UK has strong interests and towards which it has directed state aid in the past, the provisions of the TCA are general or absent, whereas the corresponding provisions in EU rules are much more complex. It can be argued that the UK will be able to grant larger subsidies to its companies without breaching the TCA in comparison to those which are allowed in the EU .[52] The threshold to demonstrate that a subsidy harms trade and investment is higher under the TCA than under EU rules.

Independence from the EU regime could present an opportunity to the UK to make its domestic subsidy controls more permissive and efficient.[53] James Webber, partner at Shearman & Sterling writes in Taking advantage of the opportunity presented by the UK's new subsidy control regime (27 January 2021) that the UK can now, for example:

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49 George Peretz, The subsidy control provisions of the UK-EU trade and cooperation agreement: a framework for a new UK domestic subsidy regime, Monckton Chambers, 28 December 2020

50 International Trade Committee, Oral evidence: UK-EU trading relationship, HC 1206, 22 April 2021, Q119-120

51 E. Lydgate, E. Szyszczak, L. A. Winters, C. Anthony, Taking Stock of the UK-EU Trade and Cooperation Agreement: Governance, State Subsidies and the Level Playing Field, UKTPO, Briefing Paper 54, January 2021; See also

52 Phedon Nicolaides, One Agreement, Two Parallel Systems: Subsidies in the Trade and Cooperation Agreement between the EU and the UK, lexxion.eu, 5 January 2021 (accessed May 2021)

53 George Peretz, The subsidy control provisions of the UK-EU trade and cooperation agreement: a framework for a new UK domestic subsidy regime, Monckton Chambers, 28 December 2020

- simplify and speed up approvals for productivity-enhancing projects, helping to attract globally mobile inward investment,
- improve research and development collaboration, enhancing the UK's competitiveness, and
- enable regional fiscal policy to support regional investment and the Government's levelling up agenda.

The bar of demonstrating that a subsidy has "material effect" on trade under the TCA and is therefore out of bounds, is high. The Government would therefore consider the effects of a subsidy within the UK when deciding whether to spend the money in the first place.[54]

Uncertainty about domestic effects

TCA subsidy provisions leave much of the internal settlement open to the UK Government's discretion. There's a degree of uncertainty about how the new UK commitments on subsidies will be implemented in practice and what these changes will mean for specific policy areas. Finding the balance between flexibility under the TCA and certainty for public authorities and businesses benefitting from subsidies may not be easy.[55]

For example, the TCA does not require the UK independent authority to assess the compliance of individual support measures – a role which was previously performed by the European Commission. The resulting uncertainty about individual subsidies could be addressed by introducing general block exemptions for certain types of subsidies. Experts argue that without such guidance, the burden on granting authorities would require resources and expertise to assess compliance and would still leave authorities open to legal challenge.[56]

Kotsonis notes that the current UK subsidy system "lack[s] any consideration for a subsidy's potentially distortive effects on competition in the UK internal market," or the UK internal subsidy competition, as opposed to competition with the EU. This issue may be clarified in the government's legislative proposals for UK subsidy control which are expected after the results of the recent consultation have been published.[57]

See box 3 above and Commons Library Briefing 9139, UK subsidy policy: first steps for the issues facing the independent UK state aid regime.

Mutual controls of implementation

While TCA provisions are bound to constrain UK domestic policy to some extent, the UK Government has mechanisms to monitor EU

54 James Webber, Taking advantage of the opportunity presented by the UK's new subsidy control regime, Shearman & Sterling, January 2021 (accessed May 2021)
55 Fiona Wishlade, Where is the UK on State Aid and Subsidy Control Post Brexit? University of Strathclyde Publishing, February 2021, Chapter 10
56 Totis Kotsonis, The Squaring of the Circle: Subsidy Control Under the UK-EU Trade and Cooperation Agreement, *European State Aid Law Quarterly*, Volume 20, Issue 1, 2021, pp573-4; Jonathan Branton and Alexander Rose have made similar proposals in UK Government launches consultation on new Subsidy Control rules, 4 February 2021 (accessed May 2021)
57 Prime Minister's Office, The Queen's speech 2021, p72

subsidies. As described above in section 1.4, the European Parliament is seeking assurances that "significant divergence with material impact on trade or investment is broadly interpreted" and that the enforcement mechanisms work in practice. It has specifically noted that provisions on the level playing field apply to UK Government's plans such as the freeports programme. But, as the International Trade Committee heard from James Webber, if EU subsidies have an adverse effect on the UK, the EU will have to consider that to a much greater degree than it would have to consider it in respect of any other third country.[58]

The effect on the Northern Ireland Protocol

The TCA provisions on subsidies in the Agreement do not amend the state aid provisions (Article 10) of the Withdrawal Agreement Protocol on Ireland and Northern Ireland. Under the Protocol, in order to prevent undue distortion of competition and trade, EU state aid rules continue to apply to subsidies that affect goods and the wholesale electricity market, insofar as these can affect trade between Northern Ireland and the EU. Experts generally agree that the application of Article 10 of the Protocol alongside the TCA can create legal and practical issues in the future.

State aid/subsidy experts have pointed out that under EU state aid rules, the Northern Ireland Protocol could also be interpreted as applying further than just Northern Ireland and covering business support in Great Britain. George Peretz QC & Alfred Artley have explained:

> EU state aid rules do not simply bite upon acts of the devolved and local government bodies in Northern Ireland, and those measures adopted by the UK government that are Northern Ireland-specific; rather they also catch all-UK measures (or measures affecting only part of the UK), whatever UK authority takes those measures, as long as they meet the test.[59]

For example, a UK-wide tax measure, benefitting a NI business might be caught by the EU state aid enforcement regime as it could potentially affect trade between NI and the EU.[60] This is often referred to as "reach-back" of EU state aid rules.

The EU sought to address UK concerns about the "reach-back" of the Protocol's state aid provisions, by giving a clarification in a unilateral declaration in the Withdrawal Agreement Joint Committee on Article 10(1) of the Protocol. However, the issue is not settled and the UK and EU views of the extent of "reach-back" appear to diverge. The UK Government's Technical Guidance on subsidy control (paragraph 7.1) points out that the "reach-back" situation could arise in certain, limited circumstances. But the European Commission's Notice to Stakeholders on state aid after the departure of the UK from shows a wide

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58 International Trade Committee, Oral evidence: UK-EU trading relationship, HC 1206, 22 April 2021, Q126

59 George Peretz QC, Alfred Artley, State aid under the Northern Ireland Protocol, *Tax Journal*, 15 May 2020

60 EU powers to review UK state aid under Irish Border Protocol to be assessed 'case by case', MLex, 24 January 2020; G.Peretz QC in "Boris Johnson's efforts to escape EU state aid rules 'mistaken'", *Financial Times*, 9 February 2020;

interpretation of which measures can "affect trade" between Northern Ireland and the EU.[61]

Experts have argued that co-existence of the two subsidy regimes in the UK may cause confusion and uncertainty for UK public authorities and companies. Some have called for the Protocol's state aid provisions to be replaced for the TCA regime during the negotiations or at some point in the future.[62]

See Commons Library Briefing UK subsidy policy: first steps, section 2.3 for further detail on state aid provisions in the Northern Ireland Protocol.

61 European Commission Notice to stakeholders, Withdrawal of the United Kingdom and EU rules in the field of state aid, 18 January 2021

62 See for example George Peretz, The UK's new subsidy regime: a marsh of uncertainty, Monckton Chambers, 1 January 2021;
James Webber, International Trade Committee, Oral evidence: UK-EU trading relationship, HC 1206, 22 April 2021, Q119

4. State-owned enterprises and designated monopolies

4.1 Negotiating positions

The issues around state owned enterprises were not contentious during the negotiations as both the UK and EU agree that state-owned enterprises and companies with special rights should not engage in anti-competitive practices or discriminatory and abusive behaviour creating barriers to trade and investment. Provisions on state-owned enterprises and designated monopolies put private businesses on an equal footing with businesses where the governments are involved. They ensure that provisions on fair competition in the agreement are not undermined by the unfair behaviour of such companies when they engage in commercial activities.

In their draft agreement texts, both the UK and EU proposed largely similar commitments on state-owned enterprises, which were in line with existing EU FTAs, including CETA (Chapter 18) and the EU-Japan Economic Partnership Agreement (Chapter 13).

The proposed obligations would address anti-competitive behaviours of state-owned enterprises, designated monopolies (sole suppliers of a particular service) and commercial enterprises to which public bodies have granted special rights in order to perform particular services. The latter can refer to services such as energy, water, public transport or certain social services, which public authorities contract out to private businesses but financially support their provision.

Background

With growing global participation of state-owned enterprises (SOEs) in cross-border trade and investment, various countries have moved to support effective competition among all market participants, both publicly and privately owned. There are, for example, initiatives in the framework of the Organisation for Economic Co-operation and Development (OECD). The principle of competitive neutrality, central to this policy area, implies that companies are not advantaged (or disadvantaged) on the market solely because of their ownership or nationality. In the recent years, stand-alone chapters on state-owned enterprises have been included in free trade agreements.[63]

The EU has its own rules on state-owned enterprises and entities entrusted with certain public services. Their core principle is that such enterprises are subject to competition and state aid rules in the same way as any other business to the extent these rules do not obstruct their ability to perform the services entrusted to them.[64]

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63 Minwoo Kim, Regulating the Visible Hands: Development of Rules on State-Owned Enterprises in Trade Agreements, *Harvard International Law Journal*, Vol. 58, No 1, 2017

64 OECD, Competitive Neutrality and state-owned enterprises: challenges and policy options, *OECD Corporate governance working papers*, 2011, p12

4.2 The TCA

In line with the proposals brought forward during the negotiations, Chapter 4, Articles 376-382, of the TCA covers state-owned enterprises, enterprises granted special privileges, and designated monopolies ('covered entities'). When carrying out commercial activities these enterprises must act in accordance with commercial considerations and may not discriminate against goods, services or entities of the other party (Article 380).

The TCA refers back to relevant international standards, including the OECD Guidelines on Corporate Governance of State-Owned Enterprises, which each party shall respect (Article 381).

Chapter 4 does not apply to enterprises if the size of their revenues derived from commercial activities is below a defined threshold.[65] In addition, the provisions do not apply when covered enterprises (Article 377):

- act as procuring entities, that is, buyers in government procurement,
- supply services in exercise of government authority,
- provide certain financial services (for example offering export and investment support, mandated by the government), or
- provide audio-visual services or some other services.

Each party commits to having an independent and impartial regulatory body (Article 381).

Article 382 sets out the mechanism to exchange information between the parties in case one has reasons to believe that its interests are being adversely affected by the commercial activities of a covered entity.

Relevant to fair competition between publicly owned and commercial enterprises are the provisions on subsidy control that apply to services of public economic interest (Article 365). They limit market-distorting advantages such as excessive government subsidies for a public service, which a company could use to boost its commercial activities.

The UK Government's assessment of the provisions is that they make the best use of international standards when regulating them, in line with provisions in other FTAs.

Recognising the increasing impact on trade of state-owned companies in a number of countries, both sides also support new or improved international trade rules to capture any market-distorting behaviour of state-owned enterprises and promote competitive neutrality.[66]

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65 100 million Special Drawing Rights in any one of the three previous consecutive fiscal years

66 Department for International Trade Press Release Britain is back: Liz Truss calls for new rules at WTO to tackle unfair trade practices, 3 March 2020; European Commission Communication, Trade Policy Review - An Open, Sustainable and Assertive Trade Policy, Annex COM(2021) 66 final, 18 February 2021, pp8-9

5. Taxation

5.1 Negotiating positions

Background

While the TCA was being negotiated it was generally assumed that any future UK-EU agreement would **not** contain any substantive provisions regarding tax.

Historically, taxation has remained largely a Member State competence. The major exception to this generalisation is indirect tax: primarily VAT – for which there is a substantive body of EU law establishing common rules across Member States – and, to a lesser extent, excise duties. There are no equivalent provisions with regard to other taxes, though all national legislation has to comply with the overarching provisions of the Treaty guaranteeing the free movement of goods, persons, services and capital across the Single Market and prohibiting discrimination.[67] Concerns about the scale of tax avoidance and evasion, both across the EU and internationally, have resulted in the introduction of a number of EU instruments relating to administrative cooperation to exchange information and help tackle tax evasion.

The Protocol on Ireland/Northern Ireland in the draft Withdrawal Agreement agreed in November 2018 included level playing field commitments regarding taxation, though, in comparison to other areas, these were relatively brief and appear to have been uncontroversial. Both parties committed to implementing the principles of good governance in the area of taxation, including global standards on transparency and exchange of information, fair taxation and OECD standards against Base Erosion and Profit Shifting (BEPS).[68] The UK stated that it would continue to apply its domestic law which transposes EU Directives on the exchange of information on taxation (Directive 2011/16), anti-tax avoidance rules (Directive 2016/1164), and country-by-country-reporting by credit institutions and investment firms (Directive 2013/36). Finally the UK reaffirmed its commitment to curb harmful tax measures as defined in the EU Code of Conduct for business taxation (a political agreement, as opposed to a legal instrument, agreed in 1997).[69]

The revised Political Declaration, agreed in October 2019, mentioned taxation in its discussion of level playing field provisions, noting that the parties should "commit to the principles of good governance in the area of taxation and to the curbing of harmful tax practices".[70]

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67 For more details see, HM Government, Taxation report: review of the balance of competences, 28 November 2012

68 For more details see, Commons Library briefing 5945, Corporate Tax Reform 2010-2020, 2 April 2021, section 6.2

69 Withdrawal Agreement and Political Declaration, 25 November 2018, pp353-4

70 Political Declaration setting out the framework for the future relationship between the European Union and the United Kingdom, 19 October 2019, para 77. An overview of the EU initiatives to tackle harmful tax competition is provided on the Commission's site (accessed May 2021).

EU position

The EU's draft future relationship agreement confirmed its view that a commitment to "implement the principles of good governance in the area of taxation" should feature in a future UK-EU agreement, and that at the end of the transition period the UK should apply common standards to those applicable in the EU in a number of tax-related areas:

- the exchange of information on income, financial accounts, cross-border tax rulings, country-by-country reports between tax administrations, beneficial ownership and potential cross-border tax planning arrangements,
- rules against tax avoidance practices, and
- public country-by-country reporting by credit institutions and investment firms.

The EU proposed that the Partnership Council (see section 8) could modify the common standards in order to include additional areas or to lay down higher standards.[71]

UK position

The Government's draft Comprehensive Free Trade Agreement set out the UK's general commitment to good tax governance (not subject to any dispute resolution mechanism), omitting the EU's supplementary requirement for non-regression on certain aspects of tax.[72]

There was little material change in either party's position on this issue following the Commission's draft negotiating directive in February 2020,[73] and the UK Government's negotiating objectives which followed it. In the latter case the negotiating objectives simply noted that "the Agreement could include commitments to the principles of good tax governance as reflected in international standards," but "should not constrain tax sovereignty in any manner".[74]

In his assessment of the level playing field published in March 2020, the IPPR's Marley Morris took the view that in the area of tax, the UK "would probably seek to water down the proposals for the UK to follow specific areas of EU law, given this conflicts with the UK's position of regulatory autonomy" although "there is most likely greater scope for compromise than in competition and state aid policy, given any disagreement here would relate to a relatively limited area of EU law".[75]

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71 European Commission, Draft text of the Agreement on the New Partnership with the United Kingdom, UKTF (2020) 14, 18 March 2020 pp32-3

72 HM Government, Draft UK-EU Comprehensive Free Trade Agreement (CFTA), 19 May 2020, p259

73 See European Commission, Recommendation for a Council Decision authorising the opening of negotiations for a new partnership with the United Kingdom of Great Britain and Northern Ireland, COM(2020) 35, 3 February 2020, paras. 94-5

74 HM Government, The Future Relationship with the EU: The UK's Approach to Negotiations, CP211, 27 February 2020 p17

75 Marley Morris, Negotiating the level playing field, IPPR, 5 March 2020, p14

David Frost, the UK's chief Brexit negotiator, gave evidence to the House of Lords EU Select Committee on 28 May 2020. Asked what the EU proposes beyond non-regression, regarding taxation he said:

> Tax is a bit different; it is not normally part of an FTA in quite this way. [The EU] are proposing commitment to good governance and OECD standards, where we do not have a big difference between us, of course. They are proposing non-regression on three specific tax measures about anti-avoidance, which really equate to EU directives, again policed by a dispute settlement mechanism that involves the European Court of Justice. We have some problems with that aspect of this. Generally on tax we have similar principles, as you would expect.[76]

5.2 The TCA

As anticipated the TCA only briefly deals with taxation (Chapter 5: Articles 383-5). The agreement retained the commitment to good governance (Article 383), although the Commission's proposal that this refer to EU Code of Conduct, as well as the relevant OECD provisions, was dropped. The agreement retained provision with regard to non-regression, but referred to standards agreed at OECD level, and not EU directives (Article 384). Finally provision to exclude this aspect of the agreement from the general arrangements for dispute resolution was retained (Article 385).

The European Commission's Q&A document on the TCA provides a summary of this section:

> **How will you ensure that taxation isn't used as a means to distort competition?**
>
> The Parties agreed on a good governance clause and commitments to uphold the taxation standards on exchange of tax information, anti-tax avoidance, and public tax transparency.
>
> These provisions are based on international standards, including OECD standards, related to the exchange of tax information; rules on interest limitation, controlled foreign companies and hybrid mismatches, as well as on the Party's domestic standards related to public country-by-country reporting.
>
> In addition to that, the EU and the UK set out, in a separate joint-declaration, specific principles on the countering of harmful tax regimes and affirmed jointly their commitment to apply these principles. They also agreed to hold an annual dialogue on their application of these principles.[77]

The joint declaration on countering harmful tax regimes is one of the series of declarations accompanying the TCA.[78]

In their overview of the TCA, the Institute for Government note, "the commitments for taxation do not in any way prohibit the choice to lower or raise taxes. They refer to international standards on preventing

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76 HL European Union Committee, Uncorrected oral evidence: Progress of UK-EU future relationship negotiations, 28 May 2020, Q4

77 European Commission, Questions & Answers: EU-UK Trade and Cooperation Agreement, 24 December 2020

78 See, Foreign, Commonwealth and Development Office, *UK/EU and EAEC: Trade and Cooperation Agreement*, CP 426, 30 April 2021 (Declarations, p2523)

tax avoidance", adding, "the commitments are not enforceable and are similar to what is found in other EU free trade agreements".[79]

Writing on the prospect of future tax competition between the UK and the EU, Alison Dickie and David Haworth (Freshfields Bruckhaus Deringer) underline that in these provisions "the key is that in each instance it is the OECD rather than the EU understanding of these rules that the UK has committed to maintain". They go on to observe, in relation to the joint declaration that, "it is understood that the EU's aim" in concluding this "was to replicate the EU code of conduct on business taxation":

> This is not currently binding on EU Member States which would seem to explain the rationale for including this as a less onerous commitment in a political declaration separate to the TCA. Nonetheless, it is expected that this will be sufficient to ensure the UK does not undo BEPS related changes to its patent box regime in a bid to attract IP heavy businesses to the UK.[80]

The writers concluded that part from the restrictions imposed by the TCA "opportunities remain" for the UK to make its tax regime more competitive but that it seemed "likely that divergences" between the two regimes "will in any event develop over time".[81]

In its summary document on the TCA the Government made a few observations on these provisions (emphasis added):

> Chapter 5: Taxation
>
> 88. The Agreement commits both Parties to uphold global standards on tax transparency and fighting tax avoidance (which the UK has played a leading role in developing and implementing through the G20 and OECD). It contains commitments to specific tax standards as they stand at the end of the transition period, including the international standards on exchange of information, anti-tax avoidance, as well as relevant standards in legislation on public country by country reporting by credit-institutions and investment firms.
>
> 89. The commitments on tax between the UK and the EU are also captured in a stand-alone Joint Political Declaration on Countering Harmful Tax Regimes. This is a political commitment to the principles of countering harmful tax regimes, and reflects the work done by the OECD in this area.
>
> 90. **There are no provisions constraining our domestic tax regime or tax rates.**[82]

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79 Institute for Government, UK–EU future relationship: the deal - Level playing field (accessed May 2021)

80 "Brexit: tax competition between the UK and the EU27", *Tax Journal*, 12 February 2021. For more on the UK's patent box rules and the changes made to ensure it was BEPS-compliant see, Helen Miller & Thomas Pope, Corporation Tax Changes and Challenges, Institute for Fiscal Studies, February 2015 pp5-6, 13-; Budget 2016, HC901, March 2016, para 2.99; and, PQ30815, 21 March 2016.

81 "Brexit: tax competition between the UK and the EU27", *Tax Journal*, 12 February 2021

82 HM Government, UK-EU Trade and Cooperation Agreement: Summary, December 2020, p19

Writing in the British Tax Review Alice Pirlot (Research Fellow (Law) at the Oxford University Centre for Business Taxation) argued that "this statement should be nuanced":

> The UK Government is right that the taxation chapter does not add any substance to the UK commitments in terms of standards and rules agreed in the OECD.
>
> However, the taxation chapter provides an additional legal basis for these commitments. The taxation chapter also carries a symbolic value, which is in line with the EU Good Tax Governance Agenda. Article 5.1 of the TCA on "[g]ood governance" almost reproduces the EU standard provision on good tax governance for agreements with third countries issued by the Council of the European Union in June 2018.[83]
>
> From this perspective, the EU–UK TCA could pave the way for the integration of similar provisions in future trade agreements concluded by the EU.[84]

[83] Council conclusions on the EU standard provision on good governance in tax matters for agreements with third countries [2018] OJ C193/5 (6 June 2018).

[84] Alice Pirlot, "Some observations on the tax-related provisions in the EU-UK Trade and Cooperation Agreement", *British Tax Review*, issue 1, 2021 pp1-14

6. Labour and social protection

6.1 Negotiating positions

It is common for free trade agreements (FTAs) to contain provisions on labour and social standards. The extent to which an agreement should protect labour standards was one of the key areas of dispute during the negotiation of the Trade and Cooperation Agreement (TCA).

The EU has adopted a wide range of instruments, mostly directives, on workers' rights. As a Member State of the EU, the UK was required to implement these directives in domestic law. As a result, a large portion of UK employment law is derived from EU law. For an overview, see Commons Library briefing 9099, End of Brexit transition: Workers' rights.

During the negotiation of the TCA, there were significant differences in the UK and EU positions on labour and social standards. They concerned the extent to which the parties should be prohibited from lowering labour standards (non-regression) and whether one party should have to raise its standards if the other party chose to raise theirs (ratchet clause).

Background

As noted above, trade agreements typically contain some provisions on labour standards. Since 2008, the EU has included such provisions in all their FTAs with third countries. The provisions are typically contained in the 'Trade and Sustainable Development' chapter of an FTA.

A typical EU trade agreement contains the following types of provisions:

- Commitments to certain multilateral standards (e.g. International Labour Organisation conventions)
- Obligations not to waive or fail to enforce domestic labour laws in order to encourage trade or investment, and
- Commitments to seek to ensure high levels of labour protection

On the whole, provisions tend to be aspirational or only create soft (non-enforceable) obligations. For example, most EU FTAs do not actually prohibit parties from reducing their domestic labour standards.

The enforcement mechanisms for labour provisions in EU FTAs are also relatively weak. Dispute settlement takes the form of arbitration before a panel of experts whose decisions are not binding. The parties cannot normally impose trade sanctions for breaches of labour provisions.[85]

The Political Declaration for the future UK-EU agreement, signed in October 2019, said that the agreement should ensure that both parties uphold labour standards set out in EU law at the end of the transition.[86]

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[85] For a detailed discussion of labour protections under EU and international FTAs, see: HL European Union Committee, Internal Market Sub-Committee, Uncorrected oral evidence: The level playing field and state aid, 27 February 2020

[86] *Political Declaration setting out the framework for the future relationship between the European Union and the United Kingdom*, October 2019, para 77

UK position

The UK's February 2020 negotiating objectives said that a UK-EU agreement should contain provision on labour standards that were similar to those in EU trade agreements with other countries, such as Japan and Canada. It said that this would involve a provision that prevented parties from reducing their labour standards in order to encourage trade or investment.[87]

The UK published its draft text for a UK-EU free trade agreement (CFTA) on 19 May 2020. The provisions on trade and labour were extremely similar to the EU-Canada Comprehensive Economic and Trade Agreement (CETA).

Article 27.4 of the UK draft (upholding levels of protection) was, in fact, a word-for-word copy of Article 23.4 of CETA. It stated:

> 1. The Parties recognise that it is inappropriate to encourage trade or investment by weakening or reducing the levels of protection afforded in their labour law and standards
>
> 2. A Party shall not waive or otherwise derogate from, or offer to waive or otherwise derogate from, its labour law and standards, to encourage trade or the establishment, acquisition, expansion or retention of an investment in its territory.
>
> 3. A Party shall not, through a sustained or recurring course of action or inaction, fail to effectively enforce its labour law and standards to encourage trade or investment.[88]

This provision contained only a soft obligation on reducing domestic labour standards ("recognise that it is inappropriate"). By contrast, it would have prohibited the parties from waiving or failing to enforce their labour standards to encourage trade or investment ("shall not").

The UK draft also contained a soft obligation ("shall strive to") to continue to improve labour standards in the future.

Like CETA, the enforcement provisions in the UK draft included dispute settlement through a panel of experts whose decisions would not be binding. Parties would have been unable to impose trade sanctions in response to breaches of the provisions on labour standards.

Domestic legal context

In domestic law, the European Union (Withdrawal) Act 2018 ensured that "EU-derived domestic legislation" would continue to have force even after the European Communities Act 1972 ceased to have effect at the end of the transition period. This meant most EU-derived workers' rights would continue to be protected in UK law, although they could be amended or repealed by future legislation.[89]

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87 HM Government, The Future Relationship with the EU: The UK's Approach to Negotiations, CP 211, 27 February 2020, para 75

88 HM Government, Draft working text for a Comprehensive Free Trade Agreement between the United Kingdom and the European Union, 19 May 2020, Art. 27.4

89 Commons Library briefing 9099, End of Brexit transition: Workers' rights, 22 December 2020

The Government also stressed that in various areas UK employment law went further than was required by EU law.[90]

EU position

The EU's negotiating directives were published on 25 February 2020. They said that due to the geographic proximity and economic interdependence between the UK and the EU, firm commitments were needed.

The EU mandate said any agreement should prevent the parties from reducing their labour standards below the level set by EU law at the end of the transition period. It also said parties should uphold high standards "over time with [EU] standards as a reference point".[91]

The EU published its draft text for a UK-EU free trade agreement on 18 March 2020. The provisions on labour standards were similar to those in the November 2018 Withdrawal Agreement (agreed by Theresa May).

Article LPFS 2.27 of the EU draft set out a non-regression clause. It said:

> 1. A Party shall not adopt or maintain any measure that weakens or reduces the level of labour and social protection provided by the Party's law and practices and by the enforcement thereof, below the level provided by the common standards applicable within the Union and the United Kingdom at the end of the transition period, and by their enforcement.[92]

This provision was very similar to Article 4 of Annex 4 to the Protocol on Ireland/Northern Ireland in the 2018 Withdrawal Agreement. That provision was understood as preventing the UK from reducing its labour standards below the level set by EU law at the end of transition.[93]

In addition, Article LPFS 2.28 of the EU draft contained a new "ratchet clause". It said:

> 1. Each Party shall seek to increase, through its relevant law and practices and through the enforcement thereof, the level of labour and social protection above the level of protection referred to in Article LPFS.2.27 [Non-regression of the level of protection].
>
> 2. Where both Parties have increased, through their relevant law and practices and through the enforcement thereof, the level of labour and social protection above the level referred to in Article LPFS.2.27 [Non-regression of the level of protection], neither Party shall weaken or reduce its level of labour or social protection below a level of protection which is at least equivalent to that of the other Party's increased level of labour and social protection.[94]

The effect of this provision was that if both parties raised their labour standards after the end of the transition period, it would have created a

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90 See for example HC Deb 29 October 2019 c203

91 EU General Affairs Council, Directives for the negotiation of a new partnership with the United Kingdom of Great Britain and Northern Ireland, 5870/20, 25 Feb 2020, paras. 94 and 101

92 European Commission, Draft text of the Agreement on the New Partnership with the United Kingdom, UKTF (2020) 14, 18 March 2020, Art. LPFS 2.27

93 HM Government, EU Exit: Legal position on the Withdrawal Agreement, Cm 9747, December 2018, para 54

94 European Commission, Draft text of the Agreement on the New Partnership with the United Kingdom, UKTF (2020) 14, 18 March 2020, Art. LPFS 2.28

new baseline of standards below which regression was prohibited. However, if only one party raised its standards, there would have been no hard obligation on the other party to follow.

The EU draft said that the provisions on labour standards would be subject to the ordinary rules on dispute settlement that applied to the whole agreement. This meant dispute settlement would take the form of arbitration and that a party could impose trade sanctions in response to a breach of the labour standards provisions.

Overall, the EU draft contained significantly stricter obligations than those normally included in EU FTAs. It contained a hard obligation on non-regression ("shall not") and a ratchet clause and these provisions were subject to stronger dispute settlement procedures.

Negotiations

In December 2020, several media organisations reported that the level playing field was one of the key remaining areas of disagreement in the UK-EU negotiations. Reporting suggested that one of the sources of disagreement was the so-called "ratchet clause" and the question of whether one party should have to align with the other if it decides to raise its labour standards. The Irish broadcaster RTE summarised:

> The European Commission was still looking for some way to ensure that there was a level playing field, that it remained level over time, and that there was a binding mechanism to ensure that was the case.
>
> Officials say that because the UK was still not engaging in the idea, the Commission on its own was forced to come up with suggestions. Combined with the impact of the IMB, and the whole question of trust, what it came up with appeared to toughen up the so-called "ratchet" clause, whereby if the EU raised its standards, the UK should as well.
>
> If they didn't, and British firms gained an edge over European ones competing within the same market, there should be the ability for the EU to retaliate with tariffs, or in another sphere.[95]

Neither side made public statements on this issue. However, the dispute was resolved and a provision on "rebalancing" was included in the TCA.

6.2 The TCA

The provisions on labour standards are contained in Title XI of the TCA ('Level Playing Field'). There are three key provisions:

- Non-regression from levels of protection (Article 387)
- Multilateral labour standards and agreements (Article 399)
- Rebalancing (Article 411)

Overall, the obligations on labour standards are stricter than those normally contained in EU FTAs. Most of the provisions are hard

95 "The level playing field: Brexit for slow learners", *RTE* [online], 12 December 2020 (accessed May 2021)

(enforceable) obligations. Furthermore, the parties can take "temporary remedies" (trade remedies) if some of these obligations are breached.[96]

Non-regression

Article 387 of the TCA sets out a non-regression provision on labour and social protections:

> 2. A Party shall not weaken or reduce, in a manner affecting trade or investment between the Parties, its labour and social levels of protection below the levels in place at the end of the transition period, including by failing to effectively enforce its law and standards.[97]

There are several points that should be noted about this provision.

First, like the EU draft, there is a hard obligation ("shall not") preventing either party from reducing its labour protections. If one of the parties reduces its labour protections in breach of this provision, it could lead to dispute settlement and the imposition of trade remedies (see below).

Second, like the UK draft, the obligation only applies where a reduction in protection affects trade or investment between the parties. This means that not every reduction in standards will necessarily be a breach of this provision.

Third, as was common between the UK and EU drafts, the parties are prohibited not only from reducing but also from failing to enforce their laws in a manner that affects trade and investment.

Fourth, the term "labour and social levels of protection" has a specific definition. It is defined as a party's laws and standards relating to:

- Fundamental rights at work
- Occupational health and safety standards
- Fair working conditions and employment standards
- Information and consultation rights at company level, and
- Restructuring of undertakings

For the UK, this captures all domestic legislation in these areas, even if it is not derived from EU law. For the EU, it only captures EU legislation.[98]

"In a manner affecting trade or investment"

As noted, the non-regression clause only prohibits the parties from reducing labour protections in a manner that affects trade or investment between the parties. This is similar to other EU and international FTAs. However, the use of the term "in a manner affecting" (TCA) rather than "to encourage" (CETA) suggests intent on its own may not be a breach.

There have been relatively few arbitration decisions on the meaning of these phrases in the context of provisions on labour standards. The most

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96 See Committee on the Future Relationship with the European Union, Oral evidence: Progress of the negotiations on the UK's future relationship with the EU, HC 203, 6 January 2021, Q1173

97 Foreign, Commonwealth and Development Office, *UK/EU and EAEC: Trade and Cooperation Agreement*, CP 426, 30 April 2021 ('TCA')

98 Ibid, Article 386

detailed discussion to date is in the final report of the arbitration panel in US-Guatemala CAFTA dispute.[99]

In the US-Guatemala case, the arbitration panel concluded that to "affect" meant to have some "material" impact:

> We begin by considering the plain meaning of "affecting trade". Both disputing Parties acknowledge that to "affect" is to "influence" or "make a material impression". We agree. Action or inaction that is in a manner "affecting trade" must influence or make a material impression upon some aspect of trade, that is, upon the cross-border exchange of goods and services.
>
> This means that an interpretation of Article 16.2.1(a) that treated as a violation every failure, through a sustained or recurring course of action or inaction, to effectively enforce labor laws simply because it occurred in a traded sector, or with respect to an enterprise engaged in trade, would not be consistent with its wording. It would require no proof of influence or material impression upon the cross-border exchange of goods and services. It would simply require proof of some effect on an employer or economic sector engaged in trade. This is not the same thing as an effect on trade. Had the CAFTA-DR Parties wished to cover every failure to enforce through a sustained or recurring course of action occurring in a traded sector or with respect to enterprise engaged in trade, they could easily have done so using clearer language. A failure to effectively enforce labor laws must affect some aspect of trade. The question is which effects on trade bring a matter within the scope of Article 16.2.1(a).[100]

The panel found that this meant that the measure had to produce some competitive advantage. However, it rejected an interpretation that would require evidence of an impact on prices or trade flows (which it concluded could be impossible to produce). The panel summarised:

> Thus our enquiry into whether a failure to enforce labor laws is such as to confer a competitive advantage in trade between the CAFTA-DR Parties focused principally on (1) whether the enterprise or enterprises in question export to CAFTA-DR Parties in competitive markets or compete with imports from CAFTA-DR Parties; (2) identifying the effects of a failure to enforce; and (3) whether these effects are sufficient to confer some competitive advantage on such an enterprise or such enterprises.[101]

It should be noted that the decision of the panel in the US-Guatemala arbitration does not bind a panel of experts convened under the TCA. As such, it is possible that a panel of experts may interpret provisions in the TCA in a different way.

Effective enforcement of labour standards

As can be seen above, Article 387 of the TCA prohibits the parties from weakening their labour standards by failing to effectively enforce them in a manner that affects trade or investment.

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99 For a discussion of this case see Phillip Paiement, "Leveraging Trade Agreements for Labor Law Enforcement: Drawing Lessons from the US-Guatemala CAFTA Dispute", *Georgetown Journal of International Law*, [2017] 49(2), 675

100 In the Matter of Guatemala – Issues Relating to the Obligations Under Article 16.2.1(a) of the CAFTA-DR FINAL REPORT OF THE PANEL June 14, 2017, June 2017, paras 167-168

101 Ibid, para 192

Article 388 clarifies that for this purpose enforcement means having an effective system of labour inspections. Parties must also have judicial and administrative routes for individuals to seek redress for breaches of labour laws, including interim relief.

6.3 Multilateral labour standards

In Article 399, the parties commit to promote and implement the core labour standards recognised in the International Labour Organisation's (ILO) eight Fundamental Conventions. These include:

- freedom of association and the right to collective bargaining,
- the elimination of all forms of forced or compulsory labour,
- the abolition of child labour, and
- the elimination of discrimination in employment.

The parties commit to promote the ILO's Decent Work Agenda. Each party also commits to implement all the ILO Conventions they have ratified, as well as the Council of Europe's European Social Charter.

The importance of this type of provisions was recently evidenced by a dispute settlement between the EU and the Republic of Korea.

In Article 13.4.3 of the EU-Korea FTA the parties "commit to respecting, promoting and realising, in their laws" the ILO's core labour standards. Before a panel of experts, the EU argued that Korea was in breach of this provision due to various deficiencies in its trade union legislation and its failure to implement four of the ILO Fundamental Conventions.

Before the panel, Korea argued that the phrase "commit to" meant the provision was aspirational. However, the panel found that the phrase did create binding legal obligation to respect, promote and realise the ILO conventions. The term "respect" meant not interfering with a right and the term "promote" meant ensuring third parties did not interfere with a right. By contrast, the panel decided the term "realise" did not create a requirement to comply with the ILO Conventions but, rather, an obligation to realise the principle of the freedom of association.[102]

The wording of Article 13.4.3 of the EU-Korea FTA is broadly similar to Article 399 of the TCA. In fact, under the TCA the parties commit to "effectively implementing" the core labour standards. However, the provisions on multilateral standards in the EU-Korea FTA and the TCA cannot be enforced by trade remedies. Professor Steve Peers explains:

> However, one similarity between the UK/EU and UK/S Korea treaties is crucial: the relevant provisions are both subject to a relatively limited form of dispute settlement, consisting of consultation followed by expert panels. No trade remedies can result, even if the panel finds a breach of the treaty. On the weak legal effect of a panel report, the EU/UK treaty is even blunter than the 'best efforts' clause in the EU/Korea treaty: 'the Parties share the understanding that if the Panel makes

[102] European Commission, Panel of Experts proceeding constituted under Article 13.15 of the EU-Korea Free Trae Agreement: Report of the Panel of Experts, 20 January 2021, paras 123-141

> recommendations in its report, the responding Party does not need to follow these recommendations in ensuring conformity with the Agreement.'[103]

6.4 Rebalancing

As noted above, one of the key areas of dispute during the negotiation of the TCA was the question of whether the agreement should contain a "ratchet clause". Under the EU draft text, if both parties raised their labour standards after the end of the transition period, it could set a new common baseline below which parties could not fall.

Ultimately, the TCA did not include this sort of ratchet clause. However, Article 411 sets out rules on "rebalancing". It provides that if future divergences between UK and EU standards on labour, environment, climate change or subsidy control cause "material impacts on trade and investment between the parties", the parties can take "rebalancing measures", which can include trade remedies.

More detailed information on rebalancing measures and the process for implementing and challenging them are set out below. However, in the context of labour standards, there are several points to note.

First, the threshold for triggering rebalancing measures is different from the threshold for triggering the non-regression provisions. A party will be in breach of the non-regression rules if it reduces its labour standards in a "manner affecting" trade or investment. By contrast, rebalancing measures can only be taken if divergence causes "material impacts" on trade and investment.

Second, for a number of reasons it is not clear exactly how divergence between the UK and the EU will be assessed.

In the first instance, the EU only has limited competence in the field of labour and social standards, meaning many issues are left to individual Member States.[104] This would suggest that divergence can only arise in areas where the EU has the competence to act.

In addition, it is not clear whether divergence can only arise from future acts of the parties or whether existing divergences can trigger the obligation, such as in areas where the UK has gone further than EU law.

More broadly, as with the non-regression provisions, it may be difficult to show that a particular divergence has impacted trade or investment.

Professor Catherine Barnard noted this issue in oral evidence to the Committee on the Future Relationship with the European Union:

> Going forward, which is where the rebalancing kicks in, when might the rebalancing mechanism apply to future developments in labour law? The question is what happens if the EU, as it might do, starts legislating a bit more enthusiastically in the field of labour law, because it has this European pillar on social rights and

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103 Steve Peers, Free trade v freedom of association? The EU/South Korea free trade agreement and the panel report on the EU challenge to South Korean labour law, EU Law Analysis, 26 January 2021

104 Consolidated version of the Treaty on the Functioning of the European Union [2012] OJ C326, Art. 153

> it is going to use it; it has shown signs of using it. The most interesting provision coming out under that is on minimum wage. It is not actually setting a minimum wage, but requiring states to think about minimum wages.
>
> Will that suggest that there is a disequilibrium, because the EU has this and the UK does not? On the other hand, we would say, "Look, we already have minimum wage legislation, which is regularly reviewed over time". It is not clear to me quite how these provisions will be triggered, if you think about concrete examples, because, as I have said, in respect of the non-regression, it is quite hard to argue that some smaller changes, significant for employees, will in and of themselves be enough to trigger the threshold of affecting trade or investment, even without the criterion of materiality.[105]

Ultimately, these issues will need to be addressed on a case-by-case basis with the potential of resorting to dispute settlement.

6.5 Dispute settlement

The level playing field provisions, including those on labour and social standards, are subject to their own separate dispute settlement process. This involves consultation between the parties and, ultimately, the establishment of a panel of experts. As in other EU FTAs, these are relatively weak provisions as the recommendations of the panel are not binding.[106]

However, there is one significant difference between the TCA and other EU FTAs. Specifically, Article 410 of the TCA provides that if a panel of experts finds that a party has breached a non-regression provision, and the respondent party has not taken steps to comply with the panel's report, the complaining party can take "temporary remedies". As a result, the provisions on non-regression from labour standards has a far stronger enforcement mechanism than in typical FTAs.

The provisions on dispute settlement are discussed in more detail in section 8 below.

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105 Committee on the Future Relationship with the European Union, Oral evidence: Progress of the negotiations on the UK's future relationship with the EU, HC 203, 6 January 2021, Q1169

106 TCA, Article 409(9)

7. Environment and climate

7.1 Overview

On environment and climate change, the TCA provides for both existing environmental standards and climate change measures to be maintained by both sides, together with more specific requirements for different sectors. A central theme of the TCA is the principle of non-regression, which commits both sides to not lowering environmental standards.

Both sides compromised somewhat during the negotiations. Whilst both the EU and UK are now free to introduce and enforce their own environmental and climate laws, they must do so in a way that doesn't gain an advantage in trade or investment. If either party feels a competitive advantage has been gained, they have the option to take rebalancing measures to address this.

Both Parties have agreed to continue respecting existing international environmental commitments, including the requirements of the Paris Climate Change Agreement, and to the sharing of information on the ratification, implementation and negotiation of existing or new multilateral environmental agreements.

7.2 The TCA: Definitions and terms

Environmental levels of protection

Chapter 7 of the TCA covers environment and climate. Article 390 sets out the definition of 'environmental levels of protection' as:

> …the levels of protection provided overall in a Party's law which have the purpose of protecting the environment, including the prevention of a danger to human life or health from environmental impacts, including in each of the following areas:
>
> a) industrial emissions;
> b) air emissions and air quality;
> c) nature and biodiversity conservation;
> d) waste management;
> e) the protection and preservation of the aquatic environment;
> f) the protection and preservation of the marine environment;
> g) the prevention, reduction and elimination of risks to human health or the environment arising from the production, use, release or disposal of chemical substances; or
> h) the management of impacts on the environment from agricultural or food production, notably through the use of antibiotics and decontaminants.

Climate level of protection

Climate level of protection is defined within the TCA as:

> …the level of protection with respect to emissions and removals of greenhouse gases and the phase-out of ozone depleting substances. With regard to greenhouse gases, this means:
>
> a) for the Union, the 40 % economy-wide 2030 target, including the Union's system of carbon pricing;

b) for the United Kingdom, the United Kingdom's economy-wide share of this 2030 target, including the United Kingdom's system of carbon pricing.

Environmental and climate principles

Article 393 sets out the Environmental and climate principles of the Trade and Cooperation Agreement. This states that:

> … each Party commits to respecting the internationally recognised environmental principles to which it has committed, such as in the Rio Declaration on Environment and Development, adopted at Rio de Janeiro on 14 June 1992 (the "1992 Rio Declaration on Environment and Development") and in multilateral environmental agreements, including in the United Nations Framework Convention on Climate Change, done at New York on 9 May 1992 ("UNFCCC") and the Convention on Biological Diversity, done at Rio de Janeiro on 5 June 1992 (the "Convention on Biological Diversity"), in particular:
>
> a) the principle that environmental protection should be integrated into the making of policies,
>
> b) including through impact assessments;
>
> c) the principle of preventative action to avert environmental damage;
>
> d) the precautionary approach referred to in Article 356 (2);
>
> e) the principle that environmental damage should as a priority be rectified at source; and
>
> f) the polluter pays principle.

Box 4: UK Draft Environmental Policy Statement and consultation

On 10 March the government published a Draft Environmental Policy Statement and launched a consultation seeking views on it which closes on 2 June 2021.

The environmental principles set out in the draft policy statement "*operate as a set of overarching principles in the development of all relevant policy with an impact on the environment*".[107] They closely match those set out in the TCA and their meanings are explained in the draft policy statement as follows:

- The **integration principle** is the principle that policy-makers should look for opportunities to embed environmental protection in other fields of policy that have impacts on the environment. It is an overarching objective which is relevant in all circumstances where the legal duty to have due regard to the policy statement applies.
- The **prevention principle** means that government policy should aim to prevent, reduce or mitigate environmental harm.
- The **rectification at source principle** means that if damage to the environment cannot be prevented it should be tackled at its origin.
- The **polluter pays principle** is the principle that those who cause pollution or damage to the environment should be responsible for mitigation or compensation.
- The **precautionary principle** states that where there are threats of serious or irreversible environmental damage, a lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation[108]

The policy statement is a statutory document and the Environment Bill requires that "*a Minister of the Crown to have 'due regard' to this policy statement when making policy*".[109]

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107 Defra, Draft Environmental Principles Policy Statement, 10 March 2021
108 Ibid
109 Ibid

7.3 Trade and sustainable development

Article 397 of the TCA sets out the foundations and broad objectives for trade and sustainable development. This is based primarily on the principles of and commitments to international agreements such as the Rio Declaration and the Sustainable Development Goals. Article 397 states that:

> The Parties recall the Agenda 21 and the 1992 Rio Declaration on Environment and Development, the Johannesburg Plan of Implementation of the World Summit on Sustainable Development of 2002, the International Labour Organization (ILO) Declaration on Social Justice for a Fair Globalization, adopted at Geneva on 10 June 2008 by the International Labour Conference at its 97th Session (the "2008 ILO Declaration on Social Justice for a Fair Globalization"), the Outcome Document of the UN Conference on Sustainable Development of 2012 entitled "The Future We Want", endorsed by the UN General Assembly Resolution 66/288 adopted on 27 July 2012, and the UN 2030 Agenda for Sustainable Development, adopted by the UN General Assembly Resolution 70/1 on 25 September 2015 and its Sustainable Development Goals.
>
> In light of paragraph 1 of this Article, the objective of this Chapter is to enhance the integration of sustainable development, notably its labour and environmental dimensions, in the Parties' trade and investment relationship and in this respect to complement the commitments of the Parties under Chapters 6 and 7.[110]

Article 400 sets out the commitment of both Parties to implementing multilateral environmental agreements:

> The Parties recognise the importance of the UN Environment Assembly of the UN Environment Programme and of multilateral environmental governance and agreements as a response of the international community to global or regional environmental challenges and stress the need to enhance the mutual supportiveness between trade and environment policies, rules and measures.[111]

To facilitate this commitment, the TCA requires both Parties to regularly exchange information on aspects of the ratification, implementation and negotiation of existing or new multilateral environmental agreements.

Subsequent articles in the TCA (401 to 406) set out the commitment of both Parties to international agreements in relation to specific areas of trade and sustainability. These are arranged under the following headings:

- Article 401 - Trade and climate change
- Article 402 - Trade and biological diversity
- Article 403 - Trade and forests
- Article 404 - Trade and sustainable management of marine biological resources and aquaculture

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110 TCA, Art. 397
111 TCA, Art. 400

- Article 405 – Trade and investment favouring sustainable development
- Article 406 - Trade and responsible supply chain management

7.4 Non-regression from levels of protection

During the negotiations the EU wanted the UK to ensure its laws matched EU environmental legislation. It pushed for "dynamic alignment" with a "ratchet clause" whereby if one party raised its environmental standards the other party could not then drop below this new minimum level. The UK however argued that as it was no longer part of the EU and unable to influence EU regulations it should have freedom to legislate independently.

The final TCA allows each party "to determine the environmental levels of protection and climate level of protection it deems appropriate and to adopt or modify its law and policies in a manner consistent with each Party's international commitments".[112] However, the TCA also aims to prevent either party weakening environmental legislation below the levels in place at the end of the transition period. Article 391 of the TCA states that:

> A Party shall not weaken or reduce, in a manner affecting trade or investment between the Parties, its environmental levels of protection or its climate level of protection below the levels that are in place at the end of the transition period, including by failing to effectively enforce its environmental law or climate level of protection.[113]

The TCA also states that the individual parties are able to make discretionary choices over the allocation of resources for ensuring levels of environmental protection are maintained.

> The Parties recognise that each Party retains the right to exercise reasonable discretion and to make bona fide decisions regarding the allocation of environmental enforcement resources with respect to other environmental law and climate policies determined to have higher priorities, provided that the exercise of that discretion, and those decisions, are not inconsistent with its obligations under this Chapter.[114]

In addition to the principle of non-regression, Article 391 of the TCA also encourages both parties to increase levels of environmental and climate protection. This states that:

> The Parties shall continue to strive to increase their respective environmental levels of protection or their respective climate level of protection referred to in this Chapter.[115]

7.5 Enforcement

The TCA sets out how each party should enforce its relevant environmental and climate legislation. Article 394 states that:

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[112] TCA, Art. 391 (1)
[113] TCA, Art. 391 (2)
[114] TCA, Art. 391 (3)
[115] TCA, Art. 391 (5)

> For the purposes of enforcement as referred to in Article 391, each Party shall, in accordance with its law, ensure that:
>
> a) domestic authorities competent to enforce the relevant law with regard to environment and climate give due consideration to alleged violations of such law that come to their attention; those authorities shall have adequate and effective remedies available to them, including injunctive relief as well as proportionate and dissuasive sanctions, if appropriate; and
>
> b) national administrative or judicial proceedings are available to natural and legal persons with a sufficient interest to bring actions against violations of such law and to seek effective remedies, including injunctive relief, and that the proceedings are not prohibitively costly and are conducted in a fair, equitable and transparent way.[116]

The establishment of the Office for Environmental Protection (OEP) under the Environment Bill will fill the enforcement gap left by the UK's departure from the EU. The OEP will "provide scrutiny and advice on the implementation of environment law and will receive and investigate complaints on alleged breaches of environment law by public authorities, with the ability to take legal action in serious cases".[117] However, delays to the Environment Bill's passage through Parliament have prevented the OEP from being fully established.

The OEP will have a statutory role in England and in Northern Ireland, subject to the approval of the Northern Ireland Assembly. In Scotland, Environmental Standards Scotland will fulfil this role and the Welsh Government plans to install an independent commissioner to carry out a similar role.

Further information on the Environment Bill and the establishment of the OEP is in the Commons Library briefing 9119 covering the Committee and Remaining stages in the Commons.

The TCA requires that the enforcement bodies of the UK must regularly meet with the European Commission to cooperate on monitoring and enforcement of Environmental and Climate law. However, the frequency with which these meetings must occur is not specifically mentioned in the agreement.

> The Parties shall ensure that the European Commission and the supervisory bodies of the United Kingdom regularly meet with each other and co-operate on the effective monitoring and enforcement of the law with regard to environment and climate as referred to in Article 391.[118]

7.6 Rebalancing

Rebalancing measures set out in Article 411 of the TCA are designed to prevent either side gaining an advantage in trade or investment if the other party introduces higher standards of environmental or climate protections. While recognising the right of each party to determine its future priorities with respect to environmental or climate protection,

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116 TCA, Art. 394
117 HL European Union Committee, Beyond Brexit: food, environment, energy and health, HL 247, 23 March 2021
118 TCA, Art. 395

Article 411 provides that if future divergences between UK and EU standards causes "material impacts on trade and investment between the parties", the parties can take "rebalancing measures", which can include trade remedies. For further detail see section 8.5 below.

7.7 Issues and commentary

EU Environment Sub-Committee Inquiry

On 23 March 2021, the House of Lords EU Environment Sub-Committee (part of the European Union Committee) published Beyond Brexit: food, environment, energy and health. This report followed an inquiry into the provisions in the TCA and looked at any challenges that could arise, how to resolve them an where UK-EU relations should progress from here. As part of the inquiry, the EU Environment Sub-Committee took evidence from a range of organisations in the fields of agriculture and food, fishing, environment and climate change, energy, chemicals, and health. Some of the key information from the inquiry and analysis from additional sources is set out below.

Enforcement

In written evidence to the EU Committee, Greener UK, a coalition of 12 major environmental organisations, questioned the enforceability of the environmental provisions in the TCA stating that:

> …the majority of the environmental provisions are not enforceable and while sanctions are available in relation to disputes about non-regression, the value of this is limited by the narrow focus on trade and investment impact.[119]

Greener UK went on to criticise the dispute mechanisms for dealing with environmental disputes stating that neither the environment nor trade and sustainable development were covered by the full dispute mechanism. Dispute settlement is covered in more detail in section 8 below however the comments from Greener UK stated that:

> For environment-related provisions to have a real impact, they must be supported by well-designed and effective governance mechanisms that enable meaningful enforcement where appropriate. However, the full horizontal dispute settlement mechanism applying to the core of the TCA does not apply to the environment or trade and sustainable development chapters. Instead, the agreement provides for a weaker mechanism involving consultations between the parties and the convening of a panel of experts.[120]

The House of Lords European Union Committee expressed similar concerns over the enforceability of some of the provisions in the TCA stating that:

> We are glad that the Government and the EU were able to find compromises on the environment and climate change Chapter of the TCA, though we share the concerns voiced by witnesses about the enforceability of some provisions.[121]

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119 Written evidence from Greener UK (EEH0030)
120 Written evidence from Greener UK (EEH0030)
121 HL European Union Committee, Beyond Brexit: food, environment, energy and health, HL 247, 23 March 2021

Non-regression

In giving evidence to the European Union Committee, Greener UK outlined its disappointment at the inclusion of a trade and investment test when assessing any weakening of environmental and climate standards. However, the group also welcomed the fact that it provided a stronger enforcement mechanism than other areas of the TCA.

> The inclusion of a trade and investment test is disappointing – providing proof of damaging economic impacts on the other party will be difficult and potentially a protracted undertaking. It is therefore not clear to what extent this provision will act as an effective safeguard against lower standards in the future. A non-regression mechanism that was broader in scope and applied irrespective of possible impacts on trade or investment should have been included in the TCA. However, it is welcome that the provision has a better enforcement mechanism attached, compared to the rest of the environment and sustainable development chapters. Either party can take action via temporary remedies if the other party does not conform to the assessment of a panel of experts in relation to a dispute.[122]

Brexit and the environment, a website funded by the Economic and Social Research Councill, provides analysis and commentary on how Brexit affects the environment. A recent article highlighted limitations in the non-regression elements of the TCA:

> Whilst the TCA concluded between the UK and EU does include non-regression and environmental progression, it does so in a limited way. For example, the commitment to non-regression is a limited environmental policy with direct trade and investment implications.
>
> The 2019 Political Declaration that the EU and the UK signed committed both sides to establish 'appropriate mechanisms'' to ensure environmental policy is adequately implemented and enforced. However, the UK Government was eventually forced to concede that the OEP – will not be fully up and running until at least the second half of 2021. In January 2021, the environment ministry (DEFRA) announced that because of COVID-19, the Bill would not receive Royal Assent until the Autumn. Even if it is adopted by 1 January 2022 (by then it would be a year late), environmental groups remain fearful that it will not be sufficiently independent to hold the Government fully to account.[123]

Devolved Policy

The environment is a devolved policy competence and as such concern has been raised by some analysts from Brexit & Environment over whether there will be a UK-wide level playing field and whether different UK nations will want to or be able to have different environmental standards to each other:

> …the Environment Bill is mainly England facing, leaving Scotland, Wales and Northern Ireland scope to develop their own bespoke systems. The Scottish Government has expressed its determination to dynamically align with EU rules. However, the highly contentious Internal Market Bill, which seeks to create a new UK-

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122 Written evidence from Greener UK (EEH0030)
123 Brexit & Environment, Environmental Regulation in the Post-Brexit Era, 23 March 2021

> wide level playing field, may limit the freedom of action of the devolved nations. They have voiced their fear that the rules of the largest market, England, will drive standards across the whole of the UK.[124]

The same concern was also raised by Colin T. Reid, professor of Law at the University of Dundee who gave evidence to the European Union Committee and stated that it represented a major challenge:

> There is a major challenge created by the UK Government agreeing such a far-reaching Agreement when responsibility for many of the matters covered lies in the hands of the devolved administrations.[125]

On 31 December 2020 the Scottish Government published an early assessment of what the outcome of the EU-UK negotiations means for Scotland. Commenting on the impact of UK's deal on Scotland, the Scottish Government stated its intention to remain aligned with EU rules where possible but highlighted the potential threat to environmental protections posed by the Internal Market Act 2020.

> Scotland is committed to maintaining high environmental standards through the UK Withdrawal from the European Union (Continuity) (Scotland) Bill, and intends to stay aligned with EU rules where possible and practicable to do so. However, protections risk being impaired by both the loss of participation in EU frameworks, systems and collaborative programmes, and by the threat to devolved competency in these areas posed by the United Kingdom Internal Market Act 2020.[126]

The Welsh Government has also expressed concerns about the complexity of certain aspects of the TCA. On 12 February 2021 (updated 11 March 2021) it published 'The new relationship with the EU: What it means for Wales' which examined the implications of the TCA for citizens, business, and communities in Wales. The section of the report covering 'Labour and Environmental Rights' questioned how the non-regression principle of the TCA would work and be enforced in practise, stating that:

> The intention is to eliminate any possible competitive advantage by either party through a reduction in the costs of production as a result of such changes. As a concept, it has precedents in other trade agreements. However, the nature of the high and complex regulatory standards of the EU Single Market, combined with the very large volume of existing EU-UK trade in goods, including integrated crossborder supply chains, makes this a particularly difficult issue to address. It is not immediately clear how this will operate in practice or how it will be enforced. The TCA provides for further work between the EU and the UK to oversee this issue.
>
> In any event, the legal nature and enforcement of these issues is now of a more complex nature. The precise nature of legal obligations in either jurisdiction may diverge over time. This could cause a lack of clarity and ultimately discrepancies, in interpreting issues such as social and environmental rights.

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124 Brexit & Environment, Environmental Regulation in the Post-Brexit Era, 23 March 2021
125 Written evidence from Prof Colin Reid (EEH0004)
126 Gov.scot, EU-UK negotiations: outcome analysis, 31 December 2020

> In any event, the whole TCA has an inherent vulnerability because of this. It provides for so-called "rebalancing", when either party believes that regulatory changes have led to divergence in a manner that gives one party a competitive advantage in trade or investment. This could lead to either party taking remedial action to address such imbalances, pending their review by an independent arbitration panel; and could ultimately lead to the termination of the trade provisions in the TCA.[127]

The House of Lords European Union Committee has also recognised the potential policy implications of the TCA for the devolved nations and has urged the government to fully address them as soon as possible:

> The TCA negotiated by the Government will affect the policy choices available to devolved administrations and legislatures in areas of devolved competence including the environment. There are already diverging environment and climate change goals across the UK, which could indicate challenges ahead. We urge the Government to address any concerns raised by the devolved administrations regarding the TCA's environment and climate change provisions - via the Common Frameworks programme or other routes - as fully and promptly as possible.[128]

Rebalancing

The rebalancing measures in the TCA were welcomed by a number of witnesses giving evidence to the House of Lords European Union Committee. However, several witnesses questioned how the rebalancing measures would be implemented in practise. Greener UK commented that:

> This process [rebalancing] should be a useful tool given much greater environmental ambition will be needed in the coming years, although the effectiveness of this novel mechanism remains to be seen.
>
> It is not yet clear how provisions such as rebalancing will work in practice … Early cases will be important in determining how terms are interpreted—for example, it will be for the arbitration tribunal to decide what is a material impact, significant divergence and reliable evidence.[129]

The European Union Committee welcomed the inclusion of rebalancing measures in the TCA citing the UK's leading role in climate change policies as an example of where a competitive advantage might be gained by the EU:

> We welcome the fact that the rebalancing measures help mitigate the threat of competitive disadvantage that could otherwise have limited the Parties' ambitions on environment and climate change protections. There are policies—especially in relation to climate change—where the UK's progress exceeds the EU's.[130]

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127 Gov.wales, The new relationship with the EU: What it means for Wales, 12 February 2021
128 HL European Union Committee, Beyond Brexit: food, environment, energy and health, HL 247, 23 March 2021 p37
129 Written evidence from Greener UK (EEH0030)
130 HL European Union Committee, Beyond Brexit: food, environment, energy and health, 23 March 2021, p37

Environmental Principles

The Environmental Principles set out by the government to replace those set out in EU treaties and law have received some criticism from the independent think tank Green Alliance. Writing for the think tank, Professor Maria Lee highlighted that UK faces "a necessarily complex legal situation, with a maze of retained provisions and inherited case law within which the principles will need to operate". She also "emphasised that this new legislation does not enforce the principles systemically or in the same legally binding way as the previous EU framework. They will apply only at a high level and ministers only need to pay them 'due regard'."[131] Further analysis from contributors to the Green Alliance blog were also set out:

> Professor Eloise Scotford of UCL described in greater detail the draft policy statement emphasising the scale of the challenge that Defra faces, given the multi-faceted nature of the principles and the multiple functions they serve. She said there was an unanswered need for the principles to influence thinking right from the earliest inception of a policy, not just to be bolted onto the end of the process.
>
> David Wolfe QC offered the benefit of his experience within the courts, in interpreting and applying the public sector equality duty. He noted that the Environment Bill set up the principles as process obligations for policy making in a similar way, but both the legislation and the policy statement lack the same clarity and strength of the equality duty.[132]

7.8 Climate change

The TCA sets out a range of principles covering the level playing field and environment, including climate change, as set out above. There are also some provisions and language that are specific to climate change, both in the area of non-regression and future collaboration.

The European Commission's Q&A document on the TCA called the provisions included on climate change "an ambitions framework for cooperation":

> The Agreement also establishes an ambitious framework for cooperation in the fight against climate change, as well as provisions for cooperation in the development of offshore energy, with a clear focus on the North Sea.[133]

The Summary document published by the UK Government in December 2020, does not refer to the framework but does highlight the high standards on climate change (and environment) embedded in the TCA:

> The Government has embedded into this Agreement our manifesto commitment to high labour environment and climate standards without giving the EU any say over our rules.[134]

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131 Green Alliance, The government is on the brink of making a mistake over environmental principles, 30 April 2021
132 Green Alliance, The government is on the brink of making a mistake over environmental principles, 30 April 2021
133 European Commission, Q&A: EU-UK Trade and Cooperation Agreement, 24 December 2020
134 Gov.uk, UK-EU Trade and Cooperation Agreement Summary, 24 December 2020

The TCA refers to climate change as "an existential threat to humanity". Article 764 (the fight against climate change), under the heading setting out the basis for cooperation between the parties. It also commits both Parties to uphold the Paris Agreement and do nothing to "materially defeat the object and purpose" of the Paris Agreement.

Specific provisions related to climate change include Article 392 on carbon pricing which requires both parties to have an effective carbon pricing scheme in place, covering certain sectors. It also requires existing levels of coverage to be maintained, as set out in Article 391 on non-regression.

Article 401 on trade and climate change (under the trade and sustainable development heading) states support for the Paris Agreement, including reference to the ambition to keep global temperature increases below 1.5°C, and sets a basis for trade that supports a green transition:

> (a) commits to effectively implementing the UNFCCC, and the Paris Agreement of which one principal aim is strengthening the global response to climate change and holding the increase in the global average temperature to well below 2 °C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1,5 °C above pre-industrial levels;
>
> (b) shall promote the mutual supportiveness of trade and climate policies and measures thereby contributing to the transition to a low greenhouse gas emission, resource-efficient economy and to climate-resilient development; and
>
> (c) shall facilitate the removal of obstacles to trade and investment in goods and services of particular relevance for climate change mitigation and adaptation, such as renewable energy, energy efficient products and services, for instance through addressing tariff and non-tariff barriers or through the adoption of policy frameworks conducive to the deployment of the best available solutions.[135]

Climate change is also listed in Article 770 on global cooperation on issues of shared economic, environmental and social interest which states that "parties shall endeavour to cooperate on current and emerging global issues of common interest".

The TCA also refers in several places to areas to support the reduction in greenhouse gas emissions. Article 319 and 320 specifically provide for the promotion and support of renewable energy. Article 367 (14) refers to subsidies that are allowed subject to conditions, if aimed at "delivering a secure, affordable and sustainable energy system and a well-functioning and competitive energy market or increasing the level of environmental protection".

Commentary

An article by UK in a Changing Europe, The EU-UK Agreement is the first to make climate change a make or break issue, published 25 January 2021 considers the language on climate change in the TCA is "one of the strongest in any trade agreement":

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[135] TCA, Art. 401 (2)

> Among the most important provisions is Article [764], which declares the fight against climate change as a one of the bases for cooperation, alongside democracy, the rule of law, human rights and the non-proliferation of WMDs.
>
> Further, Article [771] affirms that Article [764(1)] is an 'essential element' of the partnership established by the TCA as well as 'any supplementing agreement.'
>
> Essential elements are important when determining suspension or termination of a treaty in international law under the law of treaties.
>
> This language is one of the strongest found in any trade agreement, declaring that 'climate change represents an existential threat to humanity'.[136]

The article also highlights the requirement for both parties to have effective carbon pricing in place:

> Article [392] obliges both parties to 'have in place an effective system of carbon pricing' and suggests that they give serious thought on linking their respective carbon pricing systems to preserve the system's integrity and possibly increase its effectiveness and avoids major differences with Northern Ireland which will still apply the emissions trading scheme for some sectors under the Withdrawal Agreement.[137]

Analysis by Chris Papanicolaou of law firm JonesDay of the climate change provisions in the TCA, focused on implications for business, concluded that a movement away from net zero commitments by both Parties was unlikely given the provisions included in the TCA:

> The TCA includes tools and mechanisms for the enforcement of the level playing field commitments, including the ability of either party to impose duties unilaterally, subject to review by an arbitration panel, where a change creates a significant negative effect on trade or investment between the EU and the UK. If such measures are used too frequently, either side can trigger a review of these provisions and the trade aspects of the TCA more broadly, aiming to end with a different balance of rights and obligations.
>
> As an international treaty, the TCA does not give businesses the direct right to challenge a party's noncompliance. Equally, divergence from the commitments only becomes an issue where the impact distorts trade and investment between the parties. In the short term, it is difficult to assess the immediate impact on businesses in the context of environmental and climate change regulation, but a move by either the EU or UK away from rules designed to achieve climate neutrality by 2050 is unlikely, given the express provisions of the TCA designed to prevent this.[138]

The Energy and Climate Intelligence Unit (ECIU), in its analysis of the TCA supported this view and predicted the commitments to net-zero in the Agreement set a precedent for their inclusion in future trade deals:

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136 UK in a Changing Europe, The EU-UK Agreement is the first to make climate change a make or break issue, 25 January 2021

137 Ibid

138 Chris Papanicolaou, Climate Change Provisions of the EU-UK Trade and Cooperation Agreement, 3 March 2021

> For the first time in a trade agreement, and perhaps setting a precedent for future deals for example with the US and China, the net zero carbon emissions by 2050 target is embedded within the text.
>
> Specifically, the phrase 'each party reaffirms its ambition of achieving economy-wide climate neutrality by 2050' has many climate experts singing the praises of the deal, as a regression – going back on the net zero goal – could now result in the TCA being terminated, suspended or presumably causing tariffs to be imposed between the two trading blocs. It therefore appears that climate change and net zero is now a make-or-break issue for the success of the deal.[139]

Greener UK concluded about the agreement overall that it has "the potential to be dynamic and adjust over time to reflect new cooperative arrangements between the UK and EU". On climate change specifically it welcomed the provisions but expressed concern about the threshold for proof of any breach:

> The fight against climate change is explicitly specified in Article [771] as constituting an 'essential element' of the agreement. Furthermore, 'materially defeating the object and purpose of the Paris Agreement' is explicitly specified in Article [772] as constituting a serious and substantial failure to fulfil an essential element of this agreement. This is a very welcome provision, and means any serious breach can lead to the suspension or termination of all or parts of the agreement. However, we note that the threshold of demonstrating that a party has defeated the object and purpose of the agreement may be a high threshold to meet.[140]

The ECIU also highlighted that the TCA did not set out what would constitute a breach of the agreement on climate grounds:

> Actions that would constitute a breach of the deal in terms of climate change are not explicit in the TCA's text. Although Marley Morris, an expert that recently published a report on the Brexit deal, explains that to be directly in breach of the TCA, there would have to be a renouncement of the Paris Agreement from one side, or clarity that one party is not delivering.[141]

For further detailed analysis, Carbon Brief produced a detailed Q&A on the negotiations and the TCA in January 2021, which is available on their website.

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139 ECIU, Brexit: implications for energy and climate change (accessed May 2021)
140 Greener UK, Initial environmental analysis of the EU-UK Trade and Cooperation Agreement, 29 December 2020
141 ECIU, Brexit: implications for energy and climate change (accessed May 2021)

8. Dispute settlement

8.1 The general governance and dispute settlement mechanisms

Governance provisions for the TCA and supplementing agreements are set out in Title III of Part One of the Agreement. This includes a UK-EU **Partnership Council** to supervise the operation of the Agreement at a political level, providing strategic direction chaired by a UK Government Minister and European Commissioner.[142] Decisions will be taken by mutual consent and will be binding on the two parties. Either party can refer any issue relating to the implementation or interpretation of the TCA and supplementing agreements to the Partnership Council. It will have the power to adopt decisions and recommendations in relation to the application of the Agreement. The Partnership Council is supported by a set of committees. These include a Trade Partnership Committee covering the trade aspects of the TCA. This in turn is supported by several Specialised Committees including the Specialised Committee on Level Playing Field for Open and Fair Competition.

Title I, Part Six of the TCA set out mechanisms for "avoiding and settling disputes" between the parties in relation to interpretation and application of the TCA and supplementing agreements. This involves recourse to an **independent arbitration tribunal** if consultations between the two parties fail to reach a solution. These provisions are similar to those found in other international agreements, including the WTO agreement. The arbitration tribunal consists of a UK nominee, an EU nominee and a jointly agreed chair, drawn from a list of potential arbitrators established by the Partnership Council. All arbitrators need to be independent of the EU and Member States' and UK Governments.

Where one party feels that the other party is in breach of the TCA it can request **consultations**. These can take place in the Partnership Council or Specialised Committee. If the matter is not resolved within 30 days, the two parties can extend the consultation period or refer it to an arbitration tribunal. The tribunal has up to 160 days to make a ruling. Various timelines are set out in Part Six, although these are halved where the tribunal agrees that the matter is urgent.

Certain parts of the TCA are exempted from these provisions but they apply to most of Part Two (trade, transport, fisheries and other arrangements).

In cases of non-compliance with an arbitration tribunal hearing, certain treaty **obligations can be suspended**. This includes the possibility of **cross-retaliation** in certain parts of Part Two of the TCA, so that treaty obligations could be suspended in one area for a breach of obligations in another part of Part Two. Any such suspension must be proportionate and appropriate and can be challenged before an arbitration tribunal.

[142] The UK has appointed Lord Frost, Minister of State in the Cabinet Office, as its co-chair in the Partnership Council. The EU co-chair is Vice-President of the European Commission Maroš Šefčovič.

The suspension should be withdrawn if the responding party then complies with the initial ruling. The tribunal can be asked to rule on whether compliance has been achieved.

Unlike the Withdrawal Agreement there is no role for the Court of Justice of the EU (CJEU) in the dispute settlement provisions. The CJEU provides binding interpretations of questions EU law to arbitration panels in the WA dispute settlement process, where a matter raises such questions. The EU sought a similar role for the CJEU in the TCA, but this was opposed by the UK. Provisions of the TCA will be interpreted in line with public international law including the Vienna Convention on the Law on Treaties 1969.

8.2 Exceptions and Bespoke Provisions for the Level playing field

Article 735 (2) sets out exceptions to the Part Six dispute settlement provisions. These include the following provisions in the level playing field title (Title XI of Heading One of Part Two):

- Article 355(1), (2) and (4), setting out general principles and objectives in the general provisions of the level playing field title (see section 1.2)
- Article 356(1) and (3) covering right to regulate, precautionary approach and scientific and technical information in the general provisions (see section 7.2 above)
- Chapter 2 (Competition Policy) (see section 2.2 above)
- Article 371 (which provides that both parties establish an operationally independent authority with an appropriate role in its subsidy control regime) and Article 372 (which provides for domestic courts to hear claims, review decisions and grant remedies in Chapter 3 (subsidy control) (see sections 3.4 and 3.5 above)
- Chapter 5 (Taxation) (see section 5.2 above), and
- Article 411(4) to (9) in Chapter 9 (horizontal and institutional provisions) which enables either party to request a review of the trade heading (Heading One of Part Two) and for the parties to add other headings to the review. This is described further in section 8.6.

8.3 Panel of Experts for Labour, environment and climate, sustainable development

Chapter 6 (labour and social standards), chapter 7 (environment and climate) and chapter 8 (other instruments for trade and sustainable development) of Title XI have derogations from the Part Six dispute settlement provisions although these are not specified under Article 735 (2).

For each of these chapters, provisions for consultation (Article 408) and for a panel of experts rather than an arbitration tribunal (Article 409) are set out under chapter 9 (horizontal and institutional provisions) of Title XI.

Article 408 provides that a party may request consultations with the other regarding any matter arising under Article 355 (3) in chapter 1 (the mutual commitment to climate neutrality by 2050) and chapters 6, 7 and 8. Consultations have to begin within 30 days of the request with the aim of reaching a mutually satisfactory resolution of the matter.

Article 409 provides that where consultations do not reach a satisfactory resolution, a party may request that a panel of experts be convened to examine that matter. This can be done 90 days after the original request for consultations. This is longer than the minimum 30 day consultation period in the Part Six dispute settlement mechanism.

The panel of experts will be established and operate in a similar way to the arbitration tribunal outlined in the Part Six mechanism. It will be composed of three panellists. These will be selected from a list of at least 15 individuals established by The Trade Specialised Committee on the Level Playing Field at its first meeting after the entry into force of the TCA.[143] The list will consist of at least five nominations from each party and five individuals able to serve as chair. The list of potential chairs will not include nationals of either party. The experts will have specialised knowledge of the fields covered by these chapters, or in international dispute resolution, and meet similar criteria for independence from either party as the arbitration tribunal members.

The panel can seek information from other international bodies and experts where relevant (for example from the International Labour Organization or other relevant bodies). It will issue an interim report setting out findings within 100 days of its establishment. This can be extended to up to 125 days if the panel notifies the parties that it cannot meet the 100 day deadline. The parties can request that the panel of experts review particular aspects of the report within 25 days of its delivery. If there is no request to review, then the interim report becomes the final report. If there is a review, then the panel of experts needs to deliver a final report within 175 days of its initial establishment. This can be extended to up to 195 days if the chair notifies the parties that the earlier deadline cannot be met. These timelines are longer than those set out in Part Six, Title One for arbitration tribunals. The deliberations of tribunals can be extended to a maximum of 160 days.

The final report of the Panel of Experts will be made public. The interim and final reports will set out the findings of fact and whether the responding party has complied with its obligations, together with reasoning behind the findings.

Article 409 (19) provides that provisions of Title I of Part Six, relating to the establishment and workings of the arbitration tribunals, will apply to the work of the panel of experts unless otherwise provided by the Article.

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[143] Following a period of provisional application, the TCA fully entered into force on 1 May 2021. The various bodies set up in the Part One governance provisions had not met during the period of provisional application, but were expected to become fully operational once the TCA was fully applied.

Panel recommendations and compliance

Article 409 (9) states that the parties "share the understanding that if the Panel makes recommendations in its report, the respondent party does not need to follow these recommendations in ensuring conformity with the Agreement". This contrasts with Article 754 relating to the arbitration tribunal's rulings which "shall be binding" on the EU and UK.

Subsequent paragraphs in Article 409 nevertheless provide for further recourse to the panel of experts where the parties disagree on how the responding party should conform with its obligations. Under Article 410, the complaining party can then revert to the Part Six provisions for temporary remedies (including suspension of obligations) where the responding party does not comply with obligations. [144]

Article 409 (16) provides that if the final report of the panel determines that a party has not conformed with its obligations under the relevant chapter, the parties shall, within 90 days of the delivery of the final report, discuss appropriate measures to be implemented. The respondent party has to inform the complaining party, and its domestic advisory groups, within 105 days of the report being delivered of its decision on any measures to be implemented.

Article 409 (18) provides that where the parties disagree on measures to be taken the complaining party may request that the panel of experts decide on the matter. The panel of experts will deliver its findings within 45 days of this request.

Article 410 provides that the provisions for temporary remedies (Article 749) and for review of measures to comply with temporary remedies (Article 750) as set out in Part Six will apply (*mutatis mutandis*)[145] to disputes in Chapter 6 (labour and social standards) and Chapter 7 (environment and climate). Furthermore it states that the parties recognise that the remedies (including suspension of obligations and potentially cross-retaliation) authorised under Article 749 are available to the complaining party where the responding party does not conform with the report of the panel of experts. Article 749 and 750 are explained in more detail below.

Cross-retaliation for non-compliance

Under Article 749 a complaining party may suspend certain provisions of the Agreement if a respondent party does not comply with an arbitration tribunal. The complaining party also has the option of requesting "temporary compensation". It can then suspend obligations under the Agreement where there is no agreement between the two parties on what the compensation should be. It can also decide not to

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144 The Government's summary explainer on the TCA explains the Article as "tailored provisions" in relation to which "(a)ny recommendations made by the Panel of Experts are not binding on the Parties".

145 Article 410 (2) states that Articles 749 and 750 shall apply *mutatis mutandis*. *Mutatis mutandis* can be understood as meaning with the necessary changes having been made or with consideration of the respective differences.

request compensation and instead notify the responding party that it is suspending treaty obligations.

The notification shall specify the level of intended suspension of obligation. This can involve cross-retaliation across the trade, aviation, road transport and fisheries headings of Part Two, although retaliation should initially be considered within the same heading.

Article 749 (6) states that if the arbitration tribunal has ruled that there has been a violation in Heading One (trade) or Heading Three (road transport) of Part Two, the suspension may be applied in another title of the same heading "in particular if the complaining party is of the view that such suspension is effective in inducing compliance".

Furthermore Article 749 (8) provides that in Heading One (trade), Heading Two (aviation), Heading Three (road transport) or Heading Five (fisheries) of Part Two:

> if the complaining party considers that it is not practicable or effective to suspend obligations within the same Heading as that in which the arbitration tribunal has found the violation, and that the circumstances are serious enough, it may seek to suspend obligations under other covered provisions.

The complaining party needs to state the reasons for its decision. The suspension of obligations can commence 10 days after the complaining party has sent the notification of intended suspension.

Certain parts of the Agreement cannot be suspended under this Article. These are those parts of the TCA not covered by the Part Six provisions (for example the Part Three law enforcement and judicial cooperation provisions) and the social security coordination provisions. Suspension of obligations in relation to EU programmes or financial services commitments can only be applied in relation to disputes under those provisions (cross-retaliation does not apply).[146]

Arbitration on suspension of obligations

The suspension of obligations "shall not exceed the level equivalent to the nullification or impairment caused by the violation". If the respondent party considers that the notified level of suspension of obligations exceeds this level or that any proposed cross-suspension under the aviation heading or across the different headings identified in does not meet the principles or follow the procedures allowing for such cross-suspension then it can request an arbitration tribunal ruling on the matter. This needs to be done within the 10 day period following notification of the intended suspension. The arbitration tribunal will deliver its decision on this within 30 days. Obligations cannot be suspended until the arbitration tribunal has delivered its decision (Article 749 (11)).

The arbitration tribunal will rule on whether the intended suspension of obligations meets the equivalence criteria and, where applicable, the principles and procedures allowing for cross-suspension (Article 749

[146] See sections 4.2 and 4.3 of Commons Library briefing 9139, The UK-EU Trade and Cooperation Agreement: governance and dispute settlement for more detail.

(12)). Its decision will be final, and suspension of obligations shall be consistent with the decision. This may require the complaining party to adjust its proposed suspension measures.

Compliance following temporary remedies

The suspension of obligations or the compensation initially referred to is intended to be temporary. They will apply until one of the following occurs:

- the parties have "reached a mutually agreed solution"
- the parties have agreed that a measure taken brings the respondent party into compliance with the covered provisions, or
- relevant measures have been withdrawn or amended in order to bring the respondent party into compliance (Article 749 (13)).

Article 750 provides for review of measures taken to comply after the adoption of temporary remedies. Where a respondent party has taken measures to comply following the suspension of obligations or application of temporary compensation, it needs to notify the complaining party. The complaining party will then terminate the suspension of obligations within 30 days. It may also terminate the application of compensation. However, if the parties do not reach agreement on whether compliance has been achieved within 30 days of the responding party notifying that is has taken the measures to comply, then the complaining party will request a decision from the arbitration tribunal on this. The tribunal will deliver its decision on this within 46 days of this request. If the tribunal finds that compliance has been achieved, then the suspension of obligations or compensation shall be terminated. The level of suspension of obligations or of compensation can also be adjusted in light of the tribunal decision.

8.4 Provisions for subsidies

As described in further detail in section 3.6 above, the Agreement contains some bespoke provisions to address any disputes on subsidies. Disputes about compliance with the requirements may be addressed by consultation (Article 370) or engaging the Trade Specialised Committee on Level Playing Field. In addition, the Article 374 dispute settlement mechanism allows for temporary unilateral remedies taken in response to individual subsidies which have a significant negative effect on UK-EU trade and investment. These remedies are subject to arbitration. The related Article 411 rebalancing and review mechanisms described in the following sections also apply.

8.5 Rebalancing mechanism

The key to resolving differences between the UK and EU over the enforcement of commitments on the level playing field was the rebalancing mechanism.

Agreement on this mechanism

While other governance and dispute settlement provisions in the TCA can be compared to those found in other trade agreements, Dr Holger Hestermeyer has described the rebalancing mechanism as "utterly novel and remarkable".[147]

In her press conference announcing the TCA, Commission President Ursula von der Leyen stated that the agreed level playing field measures would mean "the EU´s rules and standards will be respected" and it would "have effective tools to react if fair competition is distorted and impacts our trade".[148]

Article 411 (1) to (3) sets out the mechanism. It recognises the right of either party to determine their own future policies in relation to labour, environmental and climate protection and subsidy control (Article 411 (1)). But it provides for a mechanism for either party to take "appropriate rebalancing measures" if there are "material impacts" on trade or investment between the parties arising as a result of significant divergences between the parties in these areas (Article 411 (2)). These measures should be restricted in scope and duration to "what is strictly necessary and proportionate in order to remedy the situation" with priority given to measures that least disturb the functioning of the Agreement.

Where a party wishes to impose a rebalancing measure, the following procedure set out in Article 411 (3) applies:

a. The concerned party notifies the other party through the Partnership Council of the rebalancing measures it intends to take, providing all relevant information. Consultations then commence and are deemed concluded within 14 days from the notification.

b. If no mutually acceptable solution is found, the concerned party may adopt rebalancing measures no sooner than five days from the conclusion of the consultations, unless the notified party requests the establishment of an arbitration tribunal within the same five day period. This would be based on the Part Six dispute settlement provisions for establishment of a tribunal, but Article 760 which sets out a bespoke expedited process for establishing an arbitration tribunal for the purposes of Article 374 (remedial measures in the subsidy control chapter) and Article 411 applies here. This includes a two day period to appoint a tribunal, and a further two day period deadline to hold its first meeting (rather than seven) and a seven day deadline for the complaining party to submit its case (rather than 20).[149]

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147 See HL European Union Committee, Uncorrected oral evidence: Future UK-EU relations: governance, 2 February 2021, Q8

148 See also European Commission Press release, 24 December 2020

149 See Commons Library briefing 9139, The UK-EU Trade and Cooperation Agreement: governance and dispute settlement, section 4.4

c. The tribunal shall deliver its final ruling within 30 days of its establishment. If it does not deliver its final ruling within this time period, the concerned party may adopt the rebalancing measures from three days after the expiry of the 30 day period. The other party can then take proportionate countermeasures until the tribunal delivers its ruling. Priority shall be given to such countermeasures as will least disturb the functioning of this Agreement.

d. Where the arbitration tribunal finds that the rebalancing measure by the concerned party is consistent with the "material impact" criteria set out in Article 411 (2), then the concerned party can adopt the rebalancing measure.

e. If the arbitration tribunal has found the rebalancing measures to be inconsistent with the "material impact" criteria, then the concerned party will need to withdraw or adjust its proposed measure and notify the other party what it intends to do within three days.

In relation to compliance or non-compliance with the tribunal ruling, relevant articles of the Part Six dispute settlement provisions apply in the same way. These are:

- Article 748 (2) [Compliance review] enabling the complaining party (in this case the party that has been notified of rebalancing measures and had requested the tribunal ruling) to seek a further ruling on whether the notified measures are in compliance with tribunal ruling.
- Article 749 [Temporary remedies] allowing the complaining party to request "temporary compensation" or suspend certain provisions of the Agreement. This includes the possibility of cross-retaliation across different parts of the Agreement, and provisions allowing the responding party to seek a ruling from the tribunal on whether these measures are proportionate (see explanation of Article 749 in section 8.3).
- Article 750 [Review of any measure taken to comply after the adoption of temporary remedies] allowing the complaining party to seek another ruling from the arbitration panel on whether compliance has been achieved.

When applied in Article 411 (3) these procedures "shall have no suspensive effect on the application of the notified measures pursuant to this paragraph".

f. Where rebalancing measures were adopted prior to the arbitration ruling in accordance with point (c), any countermeasures adopted pursuant to that point shall be withdrawn immediately, and in no case later than five days after delivery of the tribunal ruling.

g. Neither of the parties can invoke the WTO Agreement or any other international agreement to preclude the other party from taking rebalancing measures or countermeasures under this Article.

h. If the notified party has not requested a ruling from an arbitration panel in the time period set out under point (b) then it can initiate the arbitration procedure set out in Part Six but without the need for prior consultations in the Partnership Council, and Article 744 [Urgent proceedings] will be applied. This means the tribunal would need to deliver a ruling within 65 days, and an interim report within 50 days.

Also of relevance to this article is Article 762 which states that where a party takes a measure under treaty articles including Article 411, then the measure shall only be applied in respect of covered provisions within the meaning of Article 735 (those parts of the Agreement covered by the Part Six dispute settlement provisions) and shall comply in the same way (*mutatis mutandis)* with the conditions set out in Article 749 (3). The latter exempts certain parts of the TCA from cross-retaliation, meaning that cross-retaliation would be possible across the areas not exempt (see section 8.3 for explanation of covered and exempt provisions for the purpose of cross-retaliation).

8.6 Review provisions

Paragraphs 4 to 11 of Article 411 provide for a possible review of the Trade heading of the TCA. This review mechanism opens up the possibility of the entire trade part of the agreement being suspended in case of a persistent dispute. The road transport would be terminated alongside the trade provisions. The aviation heading could also possibly be terminated.

Under Article 411 (4) a review can take place no sooner than four years after the entry of force of the TCA at a party's request. Under Article 411 (5) a review can take place sooner than four years at the request of a party under more specific circumstances: this would be if the party feels that measures under the rebalancing mechanism have been taken too frequently or if a measure with a material impact on trade or investment between the parties has been applied for a period of 12 months or more. The parties can agree that other Agreement headings be added to the review.

There can be repeated reviews, but these need to be at least four years apart (Article 411 (7)). Reviews will address whether the TCA "delivers an appropriate balance of rights and obligations between the Parties" and whether there is a need for the terms of the Agreement to be modified.

Where a party considers that following the review there is a need for a treaty amendment then the parties "shall use their best endeavours to negotiate and conclude an agreement making the necessary amendments". The negotiations will be limited to matters identified in the review. If an amending agreement has not been concluded after one year of these negotiations, then either party may give notice to terminate Heading One (trade) or any other Agreement heading that had been added to the review. Alternatively, the parties may decide to

continue negotiations. If a party terminates Heading One (trade) following this process, then Heading Three (road transport) shall be terminated on the same date. The termination will take place three months after notice has been given. Where the trade heading has been terminated, Heading Two (aviation) will also be terminated unless the parties agree to integrate the relevant parts of the Title XI level playing field provisions into the aviation heading.

For further detail on the governance and dispute settlement mechanisms in the TCA, and the bespoke provisions for the level playing field, see Commons Library briefing 9139, The UK-EU Trade and Cooperation Agreement: governance and dispute settlement.

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