

CLIENT ALERT

Publication of the Draft UK/EU Withdrawal Agreement

What You Need to Know and What May Happen Next

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Introduction

The long-awaited draft agreement on the withdrawal of the United Kingdom from the European Union (the “Withdrawal Agreement”) was published on 15 November¹. This draft agreement was expressed to be in agreed form “at negotiator level”. If implemented, it would govern the terms of the UK’s departure from the EU on 29 March 2019 and provide for transitional arrangements that will apply from then until 31 December 2020, the “implementation period”. It also provides for the possible extension of the implementation period or the commencement of the “backstop” arrangements (about which see below). In addition, an outline of the political declaration setting out the framework for the future relationship (the “Future Framework”) between the EU and the UK was published². This outline is intended to form the basis for negotiating a treaty governing the long-term trading relationship that will apply after the end of the implementation period.

¹ https://ec.europa.eu/commission/sites/beta-political/files/draft_withdrawal_agreement_0.pdf.

² https://ec.europa.eu/commission/sites/beta-political/files/outline_of_the_political_declaration.pdf.

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Following approval by the UK cabinet on 14 November, the EU has started a process to obtain the approval of the draft agreement from the remaining 27 EU member states. This includes obtaining the approval of the European Parliament and the European Council. A meeting of the European Council is scheduled to take place on Sunday 25 November. The initial signs since the publication of the Withdrawal Agreement are that obtaining these EU approvals is unlikely to be problematic.

Both the Withdrawal Agreement and the Future Framework must be approved by the UK's Parliament in accordance with section 13 of the European Union (Withdrawal) Act 2018 (the "EUWA")³, the so-called "meaningful vote". Such a vote would need to take place after the meeting of the European Council, and it is likely this will be scheduled to occur before the end of 2018.

What is the Withdrawal Agreement?

The Withdrawal Agreement is not itself the long-term "deal" establishing the basis on which the UK and the EU will operate following the UK's exit. Rather, it is an agreement that provides a legal framework for matters arising out of the UK's departure and the cessation of the application of the EU treaties as from the "exit day" of 29 March 2019. The purpose of this is to create an environment which allows for the orderly separation of the UK from the EU and to avoid a "cliff edge" departure that might otherwise arise if the UK were to leave the EU next year with no such arrangements in place.

The Withdrawal Agreement covers eight key areas:

- The rights of UK nationals living in the EU and EU nationals living in the UK.
- Separation issues, to ensure a smooth winding-down of current arrangements and providing for an orderly withdrawal (for example, to allow for goods placed on the market before the end of the transition to continue to their destination; for the protection of existing intellectual property rights including geographical indications; the winding down of ongoing police and judicial cooperation in criminal matters and other administrative and judicial procedures; the use of data and information exchanged before the end of the transition period; issues related to Euratom⁴; and other matters).
- The creation of the implementation period lasting until 31 December 2020, during which the EU will effectively treat the UK as if it were a member state, with the exception of participation in EU institutions and governance structures.

³ <http://www.legislation.gov.uk/ukpga/2018/16/contents/enacted>.

⁴ European Atomic Energy Community.

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The transition period will help, in particular, administrations, businesses and citizens to adapt to the withdrawal of the UK.

- A financial settlement, which is aimed at both the UK and the EU, honouring financial obligations that were undertaken while the UK was a member of the EU.
- Governance arrangements for the operation of the Withdrawal Agreement.
- Provisions dealing with Northern Ireland which are intended to avoid a “hard border” between Northern Ireland and the Republic of Ireland. These provisions — known as the “backstop”— will apply as a default option in the event that a new trading arrangement has not been agreed on between the UK and the EU by the end of the implementation period. The backstop will provide a mechanism to permit trade to continue across the border as before without the need for customs checks on the basis that the UK as a whole will remain the EU Customs Union. The backstop arrangements will continue to apply until such time as both the UK and the EU agree that such arrangements shall cease, either in whole or in part.
- Provisions dealing with the UK’s military bases in Cyprus.
- Establishing a protocol that provides for the cooperation between Spain and the UK in relation to Gibraltar.

What about future trade arrangements?

The draft Withdrawal Agreement was accompanied by the draft Future Framework. In contrast to the 585 pages of the draft Withdrawal Agreement, the draft Future Framework is merely seven pages in length and is not legally binding. It will form the basis for negotiation on the longer-term trade deal between the UK and the EU, which legally cannot be struck until the UK has left the EU. Whilst it does contain some worthy aims of cooperation for mutual benefit, its publication does not provide businesses with any certainty as to what rights might be expected to come out of a future trade agreement. The draft Future Framework that was published on 14 November is subject to further negotiation, and the UK government has expressed its intention to complete this by the time of the meeting of the European Council on 25 November.

Once the UK has left the EU, attention will switch to the negotiation of a new treaty between the UK and the EU that will set out the long-term trade deal. The target deadline for concluding this treaty is before the end of the implementation period, 31 December 2020. In recognition, perhaps, of the challenge of concluding such trade deal on this timeline, the Withdrawal Agreement provides two options for extending the period. One is to extend the implementation period beyond 2020. The current draft of the Withdrawal Agreement does not contain a time limit on how long it can be extended, though the British government has stated that this would be for “a limited period”. The other option is to implement the “backstop”

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arrangements. In both cases, a decision on whether to use one of these options and, if so, which one, must be taken before 1 July 2020.

Why has this proven to be controversial?

The prospect of Brexit has split the UK politically, both in terms of those who are for or against Brexit as a concept and amongst those who support the idea of Brexit but disagree on how it should be implemented in practice. Notwithstanding its approval by the UK cabinet, in the current political climate it is likely that the Withdrawal Agreement will not have sufficient support in Parliament to obtain the approval required by the EUWA. Supporters of Brexit have objected primarily to the “backstop” provisions relating to Northern Ireland, which would require the UK to abide by the rules of the EU Customs Union following the end of the implementation period, with a modified special regulatory regime for Northern Ireland, in order to preserve the operation of the “Good Friday Agreement” of 1998 and to avoid a hard border until a long-term deal is struck.

These arrangements would continue in place until both the EU and the UK mutually agree that they should end. This, say the Brexiteers, keeps the UK effectively in the EU as a rule taker with no unilateral right to withdraw. Opponents of Brexit have similar criticisms that the UK would become a rule taker with no influence on the development of new EU rules and that such a deal is not fundamentally better than the UK’s current deal as a member state of the EU. In light of these political headwinds, there is a very real prospect of the UK not being in a position to enter into the Withdrawal Agreement because it does not have the support of Parliament as is required under the EUWA.

What happens after the parliamentary vote?

If Parliament agrees to the terms of the Withdrawal Agreement

The Withdrawal Agreement will come into effect as contemplated on 29 March 2019 and the implementation period would commence. The effect of this would be that, although the UK would no longer be a member of the EU and subject to the terms of the treaties, relatively little will change immediately from a practical perspective. Once the UK has left the EU, the details of a longer-term trading arrangement will be negotiated, with the objective of completing the new trade deal by the end of 2020. The contents of such trade deal will likely result in significant changes in the way businesses in the UK operate in relation to the EU.

While the draft Future Framework offers some indication of the direction of travel to businesses, it is at such a high level at present as to offer little certainty on which to plan. It is clear, however, that for financial services firms, “passporting” — that is, the right to operate throughout the EU on the basis of home state authorisation — will come to an end. But there is an intention to put in place close and structured cooperation on regulatory and supervisory matters and to make equivalence assessments of the respective regulatory regimes, to be concluded by the end of June 2020 (which is also the date by which a decision must be taken on whether to extend the implementation period or instigate the backstop).

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It is clear that financial services firms could consider their future operations on the basis that there will be some form of equivalence between the UK and the EU regulatory regimes where relevant EU legislation provides for equivalence. To put this another way, the UK's regulatory regime is unlikely to depart radically from the EU's regime, though the form of the UK's rules may be different.

In addition, firms will need to consider the impact on antitrust and merger control procedures. During the implementation period, the European Commission will retain its current "one stop" shop powers under the EU Merger Regulation (to review mergers across the EU and UK). The Commission will also retain its powers to investigate anti-competitive conduct in the UK (where there is a cross-border effect). After the implementation period, it is likely that mergers which satisfy the thresholds under the EU Merger Regulation may also be reviewed by the UK competition authority in parallel. Similarly, cartel cases may then be investigated by both the Commission (for their EU effects) and by the UK competition authority (for any UK effects).

If Parliament rejects the terms of the Withdrawal Agreement

There are four possible options, although given that each of them has been subject to objection from at least one key interest group, it is difficult to predict how they may develop in practice:

- The UK proceeds to exit the EU on 29 March 2019 without any deal — the so-called hard Brexit or "no deal" scenario.
- The timetable for Brexit is deferred in order to avoid a hard Brexit. There is a prescribed mechanism for doing this in Article 50 of the EU Treaty, which would involve the agreement of the UK and all the remaining 27 EU member states. Theresa May has said repeatedly that she will not do this under any circumstances, although this position might change if the only other option were a hard Brexit. It is unclear whether the remaining EU member states would be willing to agree to this, but again, their stance might be altered if the only immediate alternative were a hard Brexit.
- The UK and EU re-open negotiations to amend the Withdrawal Agreement. Whilst many UK politicians currently seem to be pinning their hopes on this being the best option, both Theresa May and the EU have ruled this out as an option (a view supported expressly by many EU leaders, including the Chancellor of Germany). Again, it is unclear whether this position would change if the only other option were a hard Brexit. It is likely this would need to be accompanied by an extension to the timetable, given that any new agreement would have to be ratified once agreed.
- The UK holds another referendum contemplating the possibility of remaining in the EU. This might be justified by offering what is being referred to as "a people's vote" on the relative merits of remaining in the EU compared with accepting the terms of the Withdrawal Agreement and/or having a hard Brexit. It is likely that this option would also need to be coupled with an extension to the timetable.

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What will happen if there is a hard Brexit?

Both the UK and the EU have issued statements confirming they are making plans for the contingency of a hard Brexit. It is unclear how well developed those plans actually are and, in any case, it is reasonable to expect that this would lead to a significant amount of disruption, particularly in the short term.

The EU has issued a short document⁵ which focuses on certain limited areas. Importantly, the EU does not at present suggest that it is proposing to allow for any de facto continuance of existing arrangements, save in relation to these limited areas:

- Certain rights for UK persons resident in the EU.
- Ability for EU clearing members of UK central counterparties such as the LCH⁶ to continue access to such CCPs⁷ to prevent risks to financial stability.
- Ability for aircraft to fly over EU territory and land for limited reasons, e.g. refuelling and safety but not for disembarkation of passengers.
- Provisions relating to indirect taxation on imports and exports from the UK.
- Subject to conditions, live animals and animal products to be allowed to enter EU from the UK.
- Adjustment to greenhouse gas emissions quotas.

The UK government has issued a number of papers identifying matters which need to be considered in the event of a hard Brexit, although there is less detail about what practical steps would be taken at the time, so this remains a work in progress.

In the financial services sector, the UK regulators have made proposals that would allow transitional arrangements for EU firms that currently undertake activities in the UK on a cross-border basis using passporting rights⁸. This will allow such firms to continue to operate on the same basis for a period of three years after the date of Brexit in order to allow them to apply for UK authorisation. It should be noted, however, that the EU has not proposed any similar arrangements for UK firms that operate using passporting rights, so these firms will need to apply for authorisation in the relevant member

⁵ http://europa.eu/rapid/press-release_IP-18-6403_en.htm.

⁶ London Clearing House.

⁷ Central Counterparty Clearing.

⁸ See the earlier Willkie bulletin [here](#).

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state. Local regulators in the EU have said that if firms have not put plans in place for this already, it is now too late to do so before a hard Brexit takes effect.

As noted above, there are scheduled to be various votes seeking approvals of the draft Withdrawal Agreement by the remaining EU member states, the European Parliament, the European Council and the UK's Parliament before the end of the year. We will continue to monitor these developments around Brexit and its impact on financial services and commercial firms.

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