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Release of UK and EU Negotiating Positions Provides Little Clarity on Brexit Outcome

Snap election in UK further muddies waters

In the era of modern diplomacy, countless international arrangements have been negotiated among diplomats and government officials out of the public eye. If the past few weeks are any indication, what is likely to be the most complex and far-reaching set of negotiations for Britain since the end of the Second World War – the so-called "Brexit talks" – appears to be heading in a very different direction. The opening negotiating positions, unusually, now are publicly available, and the parties have wasted little time setting out competing negotiating positions, at times with rhetoric that verges on acrimony.

Many will be looking to those negotiating positions to try to evaluate where the Brexit discussions are likely to head. Will there be a Brexit deal or not? If there is no deal, what are the implications of the UK "crashing" out of the EU at the end of the Article 50 negotiation process, currently mandated to end on March 29, 2019, unless that date is extended by unanimous consent of the EU member states? If there is a deal, what might it look like (a "hard" Brexit or a "soft" Brexit), and when will the principal elements fall into place?

For many businesses, the answers to these questions will be critical to evaluating what contingency plans are required and when (if ever) they must be put into place. These negotiations, however, are not taking place in a vacuum, which means that understanding macro-conditions and external political events may be equally important. In the past few weeks we have witnessed various political developments that should be factored into assessments of where the Brexit process is heading.

We examine each of these below. We do not do so to predict any specific outcome, as we do not believe anyone has the capacity to reliably predict the end of this process, but rather to put recent developments into context for the purpose of assisting businesses in making appropriate contingency plans.

Potential impact of the surprise election in Britain

Ten months after the unexpected outcome of the British referendum on continued membership in the European Union, Theresa May, who emerged victorious from the Conservative Party (or "Tory") leadership contest shortly thereafter and was anointed Prime Minister in July, has called a snap general election for June 8th, notwithstanding repeated promises not to do so. Commentators view the move as an effort by the Prime Minister to seek an endorsement of her Brexit strategy and to augment her slim parliamentary majority of 17 to enhance the chances of passing Brexit-related legislation, such as the Great Repeal Bill (intended among other things to convert directly-applicable EU laws into domestic laws and preserve European Court of Justice case law in a single legislative action), as well as her domestic agenda.

The widely-presumed Tory victory should not necessarily be viewed as confirming a "hard" Brexit. There are various views as to the tactical ramifications of the election. Some have speculated that it is intended to make clear to the remaining member states of the EU (the "EU27") that Brexit, from the perspective of the British, is irreversible, thereby removing an incentive for the EU27 to take a hard line. Those wishing for a "soft" Brexit have argued that an electoral mandate could make it easier for the Prime Minister to accept concessions towards the EU without paying a price at elections that otherwise would have been held in 2020 – a year after the Article 50 two-year deadline. But others have espoused the view that, with no effective opposition in Parliament (Labour has not positioned itself in opposition to Brexit, and support for the anti-Brexit Liberal Democrats, while enjoying a surge in support from Remain voters, is currently only at around 10%), the Conservatives are seeking the ability to leave the EU even on terms that (when they are known) will be unpopular with a majority of voters. If the Conservative majority in Parliament is significantly improved, the only thing that will be clear is that the Brexit negotiations will proceed without significant influence of the opposition.

The recent French election

Any effort to assess the direction of the Brexit negotiations would have been made infinitely more difficult had Marine Le Pen been elected President of France. That did not happen. While the centrist Emmanuel Macron is untested and will likely face significant challenges as he seeks to assemble a majority in the National Assembly, his statements to date on Brexit suggest he will favor taking a hard line in the negotiations. In the context of trade he has spoken of the importance of defending the integrity of the four freedoms on which the Single Market has been built. He has also expressed a desire to secure a deal that will ensure other members of the EU do not view withdrawal as an attractive option; "I don't want a tailor-made approach where the British have the best of two worlds" he has said. "That will be too big an incentive for others to leave and kill the European idea, which is based on shared responsibilities . . . ."

Dueling positions accompanied by public acrimony

Theresa May's edicts over the summer that she was not about to telegraph her negotiating positions have fallen by the wayside. In her speech at Lancaster House in January, a "white paper" published in February and her letter to Donald Tusk, the President of the European Council (whose members are the heads of state or government of the EU member states), on March 29th triggering the Article 50 process, she and her Government articulated in broad brush terms various elements of the UK's vision of the Brexit negotiations.

From the EU27, we have the formal view of the European Parliament and both the draft and final forms of the European Council's negotiation guidelines. We also have the more detailed draft negotiating directives of the European Commission (the EU's executive arm), which largely track the key issues that the European Council wants addressed in the first phase of negotiations. These include, most notably:

- safeguarding the rights of EU citizens resident in the UK and British citizens resident in the EU;
- settlement of Britain's financial obligations to the bloc;
- finding a "flexible and imaginative" solution to prevent the return of a hard border in Ireland;
- the need for a dispute resolution mechanism, subject to the jurisdiction of the European Court of Justice, that will cover the final withdrawal agreement; and
- perhaps most troubling to the UK, an insistence that "sufficient progress" must be made on the first two issues – protecting EU citizens' rights and settling the UK's financial obligations owed to the EU – before the EU27 is even willing to talk about a trade deal.

The Commission's recommendations – which will be replaced at a later stage by recommendations for the second phase of negotiations – will now be sent back to the European Council, where they are set to be adopted in late May.

The EU27 appears to be in no mood for compromise. While Britain hoped that the European Council negotiation guidelines might be softened during the month-long consultation process among the 27 capitals that followed the publication of draft guidelines, the European positions seem instead to have hardened.

Since the triggering of the Article 50 process, national leaders of the EU27 have displayed an unusual level of unity. When their representatives met in mid-April, they agreed almost unanimously – Poland reportedly was the only outlier – on the European Council's stance that separation and trade negotiations would not take place in parallel. The final negotiation guidelines from the European Council reportedly were approved by the heads of government of the EU27 at an April 29th summit in four minutes. Whether this level of consensus among European governments will continue is anyone's guess, but it will be as key a factor in the discussions as the negotiation guidelines themselves. And the guidelines are designed to maintain an EU united front: "So as not to undercut the position of the Union, there will be no separate negotiations between individual Member States and the United Kingdom . . . ."

A leak to the German newspaper *Frankfurter Allgemeine Sonntagszeitung* of an account of the first engagement between the EU and British negotiating teams during a private dinner in London and a subsequent call by European Commission President Juncker to Chancellor Merkel reporting the view that

Theresa May is "living in another galaxy" and was "deluding herself" – did not improve the mood. Nor did the Prime Minister's prompt response, accusing the EU of meddling in the UK's electoral process.

Though explained by some on the EU side as an effort to counter what they saw as a vastly inappropriate level of confidence on the British side as to the ease of unwinding a relationship spanning 45 years, the leaks and subsequent statements underscore not only the practical gaps, but also the enmity, between the two sides. As for the number and breadth or the gaps between the parties' respective positions, they appear to be many, and wide. For example:

- ***UK financial obligations***: The EU is seeking a single financial settlement covering obligations resulting from the entire period of the UK's membership in the EU, including contingent liabilities. While no hard number has been demanded officially, press reports and think tanks have put the total bill between €60 billion and over €100 billion. UK officials have reacted with outrage at these numbers, and some British ministers have been drawing comfort from a House of Lords publication from March that suggests any financial obligation to the EU is not legally enforceable once Britain leaves the bloc.

  This issue is thorny from both a legal and factual perspective. A group of European officials led by France and Poland have strengthened their language, and now ask Britain to effectively see out the rest of the EU's seven-year budget, which will conclude in 2020. The new approach would also require Britain to pay almost €12 billion into a rainy-day fund. A significant portion of the so-called Brexit bill reflects commitments for spending programs that were agreed to years in advance. There are also questions around offsetting claims by the British to shares of EU assets, though the EU27 view is that those assets are assets of the Union and not of individual member states. To complicate matters further, the bill is to be settled in euros, which in sterling terms is now far more expensive due to exchange rate movements following the referendum. And while the EU has spoken of a single settlement, it is likely to require the UK to continue making payments to the bloc even after it leaves the bloc, a bitter pill to swallow for the Prime Minister.

- ***Treatment of EU citizens in UK***: The EU27 has put agreeing reciprocal guarantees to safeguard the status and rights of EU citizens in the UK (and of UK citizens in the EU) as the "first priority for the negotiations." This issue is likely to be a second major stumbling block in the negotiations. On the issue of reciprocal rights, there is already disagreement over whether EU citizens in Britain should enjoy the same rights and privileges as they do today, and whether the European Court of Justice should retain jurisdiction to adjudicate whether such rights and privileges are being honored. European Commission President Juncker warned in April that there are 25 separate issues in respect of reciprocal rights of residents to be resolved.

  The Conservative Party, in the context of the ongoing election campaign, has reaffirmed its goal to cut net migration to the UK to "tens of thousands." And it has repeatedly rejected suggestions that the

European Court of Justice should retain jurisdiction to adjudicate whether such rights and privileges are being honored.

- ***Trade agreement***: In her Lancaster House speech, Theresa May called for "the greatest possible access . . . through a new, comprehensive, bold and ambitious free trade agreement," which "may take in elements of current Single Market arrangements in certain areas – on the export of cars and lorries, for example, or the freedom to provide financial services across national borders . . . ." The Prime Minister singled out those two sectors because those are two of the three sectors – the third being agriculture – that are critically important to the UK's national economy and that would be badly hurt by the absence of a trade deal.

  The EU's position, on the other hand, is that "preserving the integrity of the Single Market excludes participation based on a sector-by-sector approach," and that discussion of trade arrangements should not even begin until "sufficient progress" has been made on the UK's financial obligations and the protection of citizens' rights.

- ***Transitional measures***: Recognizing that a comprehensive trade deal is likely to take longer to negotiate than the time remaining on Article 50's two-year clock, Theresa May has stated her belief that a phased implementation process will be needed, to "give businesses enough time to plan and prepare" for the new arrangements. The EU negotiating position, however, is that any transitional arrangements must be clearly defined, limited in time, and subject to effective enforcement mechanisms. The EU27 is likely to insist that, during any transitional period, the UK will need to continue to comply with applicable EU rules, including new rules that the UK may have played no role in making, and remain subject to the jurisdiction of the European Court of Justice.

  These demands run directly counter to the demands of the Brexiteers, to be free of EU rule-making and free of the jurisdiction of the European Court of Justice. The prospect of postponing the realization of these loudly stated objectives, in order to preserve access to the EU market for goods and services, is likely to lead to an intense and potentially acrimonious battle within the Conservative Party, pitting those who wish to protect British businesses against those who are willing to exit the Union with no deal.

- ***Possibility of no deal***: In her Lancaster House speech Theresa May rejected the possibility that the UK would enter into a "punitive deal" that "some voices" were calling for to punish Britain for its decision to leave the EU, and stated that she was "clear that no deal for Britain is better than a bad deal for Britain." Her problem is that no deal for Britain – an exit from the EU with trade and investment rules governed solely by World Trade Organization rules and other extant multilateral and bilateral treaty arrangements – would itself be a very bad deal for the UK. The EU27, for its part, says that it will prepare itself to be able to handle the situation if negotiations were to fail. The EU, too, would be adversely affected by a "no deal" scenario, but probably not nearly as badly as Britain. For this reason (among others), the UK's bargaining position in the Brexit negotiations is uncomfortably weak.

In addition, there are issues over the fate of EU agencies and facilities located in Britain (including the European Banking Authority and the European Medicines Agency), which the EU27 believes should be transferred to continental Europe and that it is simply a matter of settling the arrangements for the transfer. The British are of the view that no decisions have been taken as to whether or not these agencies and facilities should leave Britain. While Theresa May highlighted the ability to set competitive tax rates and embrace policies that would attract businesses and investors (echoing remarks of her Chancellor regarding the prospect of turning Britain into a tax haven should Britain leave the EU without a trade deal), the EU27 is of the view that "[a]ny free trade agreement . . . must ensure a level playing field, notably in terms of competition and state aid, and in this regard encompass safeguards against unfair competitive advantages through, inter alia, tax, social, environmental and regulatory measures and practices . . . ." Security issues are also on the table, following the surprise addition to the negotiation guidelines that Spain would have a veto over future arrangements relating to Gibraltar.

Collision course?

A week after the reportedly disastrous London dinner, Michel Barnier (the lead negotiator for the EU27) delivered the first in a series of sharp messages that were exchanged between the two camps that day, raising fears that the UK was headed on a collision course out of the EU. "Some have created the illusion," he said, "that Brexit would have no material impact on our lives or that negotiations can be concluded quickly and painlessly. This is not the case . . . ." Theresa May responded by alleging that "there are some in Brussels who do not want these talks to succeed, who do not want Britain to prosper."

With the election of a committed supporter of the European project as President of France, attention now turns to Germany. A key question for those observing the negotiations is whether Germany will be driven by economic self-interest, which may enable Britain to get an acceptable deal, or will it take a hard line and resist special arrangements that, from the continental European perspective, could be viewed as undermining EU institutions and weakening the European project. Perhaps no country in Europe has gained as much from the European project as Germany; a unified Europe is more than an aspiration for many Germans; it is very much a part of the political firmament.

Any efforts on the part of the British to "cherry-pick" privileges from the Single Market (financial services or the automotive, agriculture and fishery industries, for example) would be viewed as setting a dangerous precedent, and Germany would bear the largest share of any shortfall resulting from a compromise over Britain's EU contributions. German officials are in agreement that even the ostensibly straight-forward question of guaranteeing the rights of EU citizens resident in Britain and of British citizens resident in the EU is fraught with legal and technical complexities that will complicate the negotiations. Finally, there is the question of the September elections in Germany, although these are not expected to yield significantly different approaches to Brexit, as both Martin Schulz and Angela Merkel, the top candidates for the chancellorship, agree that the four freedoms are indivisible.

Grappling with uncertainty

Businesses are left to predict the final contours of the relationship between Britain and the EU27. Will the British be successful in negotiating access for selective industries, notwithstanding the inconsistencies this would pose in terms of acceptance of the four freedoms and the current negotiating stance on the part of the EU27 that such access would be unacceptable?

In March, the Bank of England asked financial institutions to draw up plans for how they will deal with Brexit, including an assessment of the impact of the changed relationship with Europe and changes to regulatory regimes on business models. Since then, the UK Financial Conduct Authority has also been assessing EU financial sector regulations as part of the Great Repeal Bill exercise. Complicating contingency planning is the fact that the regulatory landscape on the continent is by no means static. Some EU27 member states are already complaining of a “race to the bottom” to attract British businesses seeking a soft landing within the EU. It remains to be seen what level of presence (in terms of head count and capital, for example) will be required for regulated operations to be deemed present in the EU and how EU regulators will adjust to the new dynamics.

Businesses also need to predict when decisions will need to be made. When Theresa May triggered Article 50 in March, thus starting the two-year clock, it was generally acknowledged that Britain would have only 18 months to actually complete exit negotiations. The complex system of approvals, particularly on the continent, means that the terms of the separation would need to be finalized by Autumn 2018 for approvals to be in place by March 29, 2019. For Britain, which wants to work on a trade agreement in parallel with the negotiations over the terms of withdrawal, this would be an unimaginably tight timetable. Canada’s free trade agreement with the EU, for example, took over seven years to negotiate. Practical considerations may further stress the timetable: the Europeans have expressed an unwillingness to start in earnest before the June 8th election, and the impact of Germany’s elections – which will be followed by the 8-10 weeks typically needed to form a governing coalition – will affect negotiations, though it is still uncertain to what extent and in what way.

We cannot safely predict how the landscape will shift over the course of the next two years. There are obstacles to a successful series of negotiations – some of them, such as the growing acrimony between the two sides, will be man-made, and others are the chance result of a complex game of geopolitical chess. On the other hand, there is much to be gained from a successful outcome. We are hesitant to speculate as to the likelihood of any particular outcome in large part because of the many moving pieces. All we can recommend without reservation at this juncture is that businesses should develop contingency plans, based on their own circumstances and exposures, and be ready to implement them in a timely manner if, and to the extent, necessary in light of evolving developments in the negotiations.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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