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Brexit Law – your business, the EU and the way ahead

Brexit – the UK and free trade

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The position of the UK in the World

At the heart of what Brexit could actually mean for businesses with a trading link to the UK will be the terms of trade agreed between the UK and its major trading partners. These terms will differ from sector to sector and will directly affect the barriers that businesses may face when looking to move goods and services around the world (and the price of those goods and services). Any goods could be subject to new rules on tariffs, quotas, standards of treatment, competition law rules, IP and many other areas. Although Free Trade Agreements (**FTAs**) have traditionally covered the movement of goods, the second generation of agreements now increasingly also covers issues such as the movement of workers, services and capital, the role of public procurement and sustainable development principles, including labour rights and environmental protection.

As a member of the EU, the UK benefits from more than 50 FTAs that the EU has concluded as part of its Common Commercial Policy. Whilst the EU represents all of its Member States in trade negotiations with non-EU countries, some elements of trade deals have to be signed off by both the EU and all the individual Member States. This is because, under these "mixed agreements", competence on certain issues (such as agriculture, fisheries, social policy, health and consumer matters) is shared by the EU and its Member States. However, in practice, negotiating trade deals with third countries has been the preserve of the EU. The UK will need to find a way of either preserving the direct benefit of these agreements or replacing them. This may be far from an easy task. Similarly, the World Trade Organisation (**WTO**) framework is likely to play a key role in defining the UK's trading relationships, at least in the short to medium term.

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Free Trade Agreements – the basics

International trade agreements are governed by principles of international law, namely international conventions, international custom (laws implied from general practice or conduct), general principles (common laws and principles established by nations) and judicial decisions.

In broad terms, the specific nature of each trading arrangement will result in differing levels of integration between the parties. They may be FTAs (which may remove or reduce tariffs within the trading group), customs unions (establishing common tariffs for countries outside the union), common markets (alignment within a trading group on issues relating to goods or services) or economic unions (the trading group adopts common economic policies). Within these arrangements, there are a number of topics which are likely to be negotiated, including the movement of goods, services and people, rights relating to investments and market access, intellectual property, competition policy and the administrative framework for the functioning of the agreement (including the resolution of disputes). One common feature of trade agreements is that they take a significant amount of time to agree (on average several years) and their conclusion is frequently delayed by political deadlock.

There is no general principle of international law which allows for free trade. A country that is not party to any international trade arrangement (including the WTO) may set its own domestic tariffs and import laws. Generally, exports from countries with this arrangement are subject to higher levels of tariff and non-tariff barriers (**NTBs**). In practice, a significant part of international trade is conducted in the absence of a bilateral international trade agreement and within the framework of the WTO rules. This would be the fall-back position in the event that the UK was unable to conclude FTAs with the EU and/or other trading partners.

World Trade Organisation – key principles and concepts

The WTO is an intergovernmental organisation with over 160 member countries. It was established in 1995 as a negotiating forum focused primarily on removing trade barriers. It evolved out of the General Agreement on Tariffs and Trade (**GATT**) which dated from 1948. The WTO operates under a multi-layered framework of agreements negotiated by WTO members and implemented in 1995 under the "Uruguay Round" of negotiations. Simplistically, it is made up of:

- an umbrella agreement which establishes the WTO;
- the Annexes (the key ones being GATT for goods, the General Agreement on Trade in Services (**GATS**) and the agreement on Trade-Related Aspects of Intellectual Property Rights (**TRIPS**)); and
- schedules containing the members' commitments.

The WTO is based on certain key principles, the most important of which are two principles of non discrimination: the "Most Favoured Nation" (**MFN**) concept, and the principle of National Treatment, both of which are described below.

Trade in goods under GATT is regulated by a schedule of concessions (**Goods Schedule**) for each WTO member, reflecting specific tariff concessions and other commitments given during negotiations. Each member's schedule of concessions classifies a large number of goods and is divided into separate parts covering MFN concessions (which are split further into tariffs for agricultural products, quotas for agricultural products and tariffs for other, non-agricultural products), preferential concessions, concessions on non-tariff measures and specific commitments on domestic support and export subsidies on agricultural products.

GATS Article I:2 sets out four types of supply of trade in services: cross-border supply, supply for consumption abroad, service by a supplier in one member through commercial presence in the territory of any other member, and service through the presence of natural persons of a member in the territory of another member. WTO members may only make commitments (set out in their Schedules) in relation to certain types of service

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provision. These commitments set out the sectors being opened, the extent of market access applicable to those sectors (for example, whether any restrictions on foreign ownership will apply) and any applicable limitations on national treatment (see below), such as whether any rights granted to local companies will not be granted to foreign companies.

In some cases, issues relating to the supply of goods under GATT and services under GATS may overlap (e.g. where a service is provided in conjunction with a particular good). Here, a measure could be considered under both GATT and GATS.

Most Favoured Nation

The MFN rule is one of the most important in international economic law and is a principle of non discrimination – that a country must treat other countries at least as well as it treats its "most favoured" country. Under the first Article of GATT, WTO members must extend any advantage (with respect to the measures mentioned in Article I:1 of GATT) which has been granted to one country to all like goods originating in all other WTO member countries.

As an example, if a country imposes a 10% tariff on car imports from one country under the auspices of a trade agreement, it cannot impose a different level of tariff on imports of the same goods from a different country. The MFN principle arose as a way of ensuring that tariffs and other concessions applied equally to all trading partners in respect of the same goods.

There are exceptions to the MFN principle, such as anti-dumping measures, subsidies and emergency measures, although these may be challenged through the WTO dispute settlement system (see below).

The principle is also subject to an exception for regional trade agreements which may be settled between countries and blocs and as between parties to customs unions.

National Treatment

The concept of National Treatment is slightly different. It seeks to prohibit discriminatory national measures against imported goods. Under one of the main provisions of GATT, the tax and regulatory treatment (taxes, internal charges, laws, regulations etc) of "like" foreign goods must be just as good as the treatment given to domestic goods. Clearly defined commitments such as specific tariffs on goods are "bound", i.e. national treatment rules apply. However, other goods or certain types of service may be "unbound" between a WTO member and others. The National Treatment rules have been the subject of a number of disputes relating to complex issues of similarity between two products, and how to define a standard in this regard.

Origin of goods

Another key concept of FTAs is the methodology for defining the origin of goods falling within the scope of the agreement. This is necessary to ensure that goods attract the preferential treatment offered by the FTA (such as reduced rates of customs duty) and for other associated issues, such as whether quotas or anti dumping measures will apply. Under often highly complex rules of origin, FTAs may require that a minimum level of content or processing occurs within a member country of the FTA in order for the preferential tariff rates to apply. The complexity arises partly because, in today's global value chains, it can be extremely difficult to determine the origin of a product with multiple components sourced or processed in a number of different countries.

The complexity also arises because the rules of origin themselves can be complex, with distinctions within an FTA depending on the specific context of the rule (e.g. whether a rule of origin is being used to settle a subsidies question or an anti-dumping measure). WTO rules of origin also allow for a certain amount of "cumulation". That is, they require a certain percentage of the total value or composition of the product concerned to have been produced by WTO members.

WTO dispute resolution

The WTO's Dispute Settlement Understanding (**DSU**) contains a framework for resolving WTO disputes between WTO members. The DSU establishes a Dispute Settlement Body (**DSB**), composed of representatives of all WTO members, which oversees disputes that arise under the WTO system.

In the event of a dispute, the parties must first try to resolve the dispute amicably through a consultation process. If a settlement cannot be reached within 60 days of consultations, the complainant member state can request that a Panel is set up. A Panel is usually

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composed of three people, and will receive written and oral submissions from the parties and any other WTO members having a substantial interest in the matter. The Panel will also often engage experts to advise it. The proceedings are usually confidential, and any private parties are excluded even if they are directly affected by the measures which are the subject of the complaint. In principle, a dispute should be resolved in no more than 12 months, or 15 months if there is an appeal.

The Panel issues a report, first to the parties and subsequently to all WTO members. In principle, the Panel is aiding the DSB in resolving the dispute, but in practice the decision in the Panel's report is final (absent an appeal) because only a consensus of the DSB against the Panel's decision can block it.

The DSB's decision can be appealed before three members of the seven-member WTO Appellate Body on points of law. Under the DSU, appellate proceedings should last no longer than 60 days, although, in practice, they almost always take longer. Once the Appellate Body's report has been sent to the DSB and the parties to the dispute, the DSB must adopt it, unless all WTO members reject it.

The DSU also contains provisions designed to ensure that WTO members comply with DSB rulings and recommendations. These include the payment of compensation by the state in question, and the suspension of concessions to which the state in question is entitled (also known as 'retaliation').

Clarifying the UK's position under the WTO

The UK was a member of GATT and was also a founding member of the WTO, as part of the EU in 1995. EU Member States coordinate their position in WTO negotiations. However, the European Commission carries out almost all WTO negotiations on behalf of its members. The UK is bound by the Goods Schedules and Services Schedules negotiated by the EU and has no specific schedules of its own.

Following Brexit, however, the UK would no longer have the benefit of these arrangements and would likely have to agree its own country-specific commitments. It may be possible for the UK to adopt the EU's schedules, at least as an interim measure. This could be relatively straightforward, save as regards the allocation of the UK's share of the EU-wide quotas provided for in the schedules. There is also a question on the timing of the UK's negotiations with the WTO and whether these could take place informally alongside the negotiations with the EU over the terms of the UK's exit from Europe following service of the Article 50 notice.

What comes next?

Whilst much needs to be resolved in the coming months and years, it is clear that the UK's ability to regularise its arrangements under the WTO and establish replacement FTAs with its other major trading partners will be key. Businesses need to carefully model the impact that different trading terms will have on their upstream and downstream supply chains and the interplay redefined trading terms will have with wider sector regulation.

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Your Allen & Overy contacts

Matthew Townsend
Partner – London
Environmental & Regulatory Law
Tel +44 20 3088 3174
matthew.townsend@allenovery.com

Jeffrey Sullivan
Partner – London
Arbitration
Tel +44 20 3088 2919
jeffrey.sullivan@allenovery.com

Lydia Challen
Partner – London
Tax
Tel +44 20 3088 2753
lydia.challen@allenovery.com

Francois Renard
Partner – Hong Kong
Antitrust
Tel +852 2974 7110
francois.renard@allenovery.com

If you would like to discuss the issues raised in this paper in more detail, please contact any of the experts above or your usual Allen & Overy contact.

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