ALLEN & OVERY

Brexit Law – EEA membership: what does it mean?

Implications of EEA membership outside the EU – different name, same game?

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Issue in focus

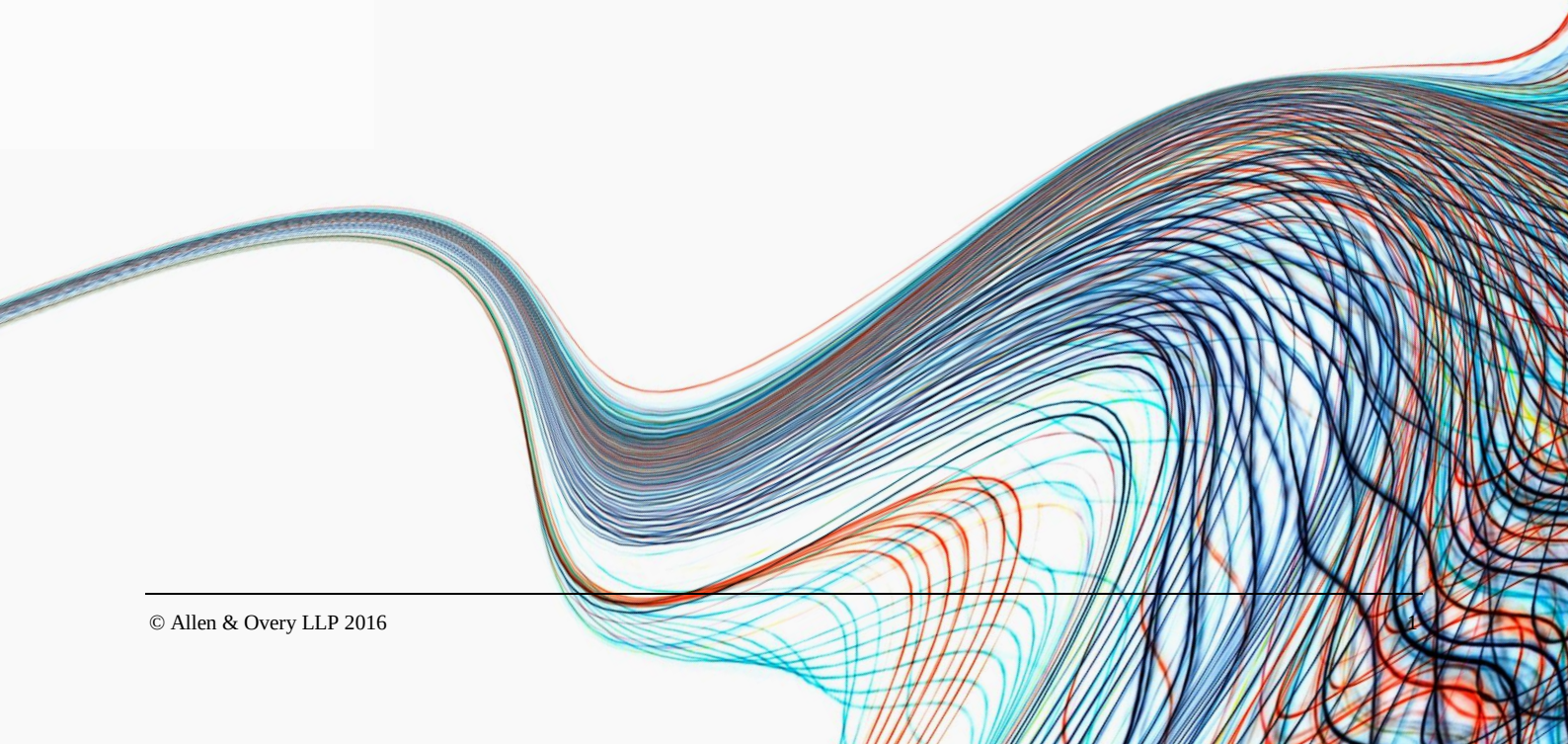
There has been much discussion about the UK adopting, post-Brexit, the so-called 'Norwegian model', which is generally understood to be shorthand for a scenario whereby the UK leaves the European Union (**EU**) but remains part of the European Economic Area (**EEA**).

In this short specialist paper we explain what the EEA actually is and what membership currently involves. We first consider the structure of the EEA, its relationships with the EU and the European Free Trade Area (**EFTA**) and the differences between those three organisations. Second, we consider the institutions of the EEA and how they interact with those of the EU. Finally, we consider how EU law currently applies to the non-EU EEA contracting parties, taking competition law as an example.

What is the EEA?

The EEA is an internal market established in 1994 by an international agreement between Iceland, the Principality of Liechtenstein and the Kingdom of Norway (together, the **EEA EFTA States**), the EU Member States (together with the EEA EFTA States, the **EEA States**) and the EU itself (the **EEA Agreement**). The objective of the EEA Agreement is to create a homogenous free trade area based on common rules that allows Iceland, Norway and Liechtenstein to participate alongside the EU Member States in the Single Market, without having to commit to integration on areas unconnected to the Single Market.

The EEA Agreement therefore binds all members to certain forms of economic integration and conformity with a single body of economic law, but without any requirement to pool political sovereignty or any ideological commitment to an 'ever closer Union'.



In areas of policy that are relevant to the Single Market (see the 'EEA relevant' *info box* below), the EU rules largely apply within EEA Member States. In particular, the four fundamental freedoms of the EU – free movement of capital, goods, services and persons – apply in full to all EEA Member States, as do other EU rules closely linked to the functioning of the Single Market, such as the competition and State aid rules and certain rules relating to transport and environment policy.

To ensure conformity as between the EEA and the EU, the EEA Agreement is dynamic in that it is continually updated so that the Single Market remains homogenous throughout the EEA: once new EU legislation has been incorporated into the EEA Agreement, each of the EEA Member States is bound by it regardless of whether they also happen to be members of the EU.

The EU, EFTA and the EEA

The **EU** is an ***economic*** and ***political*** union between 28 European countries: Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and – currently – the UK (together, the **EU Member States**).

The **EFTA** is an intergovernmental organisation created to promote ***free trade*** and ***economic integration***. The four members of EFTA are Switzerland, Iceland, Norway and Liechtenstein (the **EFTA States**).

The **EEA Agreement** is an agreement between Iceland, Norway and Liechtenstein (the **EEA EFTA States**), the EU Member States and the EU itself, which grants the EEA EFTA States access to the Single Market without the need to obtain full EU Member State status. The EEA therefore comprises 31 States in total.

Application of EU rules to EEA EFTA States

The EEA Agreement provides that all EU legislation in the policy areas of the Single Market shall be incorporated into the EEA Agreement and shall thereby also apply to the EEA EFTA States. For example, the main substantive EU rules on anti-competitive behaviour, merger control and State aid are incorporated directly into the EEA Agreement and apply throughout the EEA. Provisions of the EEA Agreement are also required to be read in conformity with the case law of the Court of Justice in areas concerning the Single Market.

However, the EEA Agreement is not as extensive as the EU Treaties and does not cover EU policies such as: common agriculture and fisheries policies; customs union; common trade policy; common foreign and security policy; justice and home affairs; taxation or economic and monetary union. However, the EFTA States remain free bilaterally to commit to integration with the EU that goes beyond the ambit of the EEA Agreement; for example, all EFTA States (including Switzerland) are part of the EU's passport-free travel area, Schengen.

The fourth EFTA State, Switzerland, is not an EEA Member State (having rejected membership in a national referendum in 1992) and is not required to implement EU law (although it may choose to do so through bilateral agreements – for example, the EU-Switzerland bilateral free trade agreement). Such agreements are static: there is no formal mechanism to update and incorporate new EU law into Swiss law, nor are there any surveillance or judicial mechanisms to monitor compliance

Importantly, particularly given the level of attention that this issue had during the EU referendum campaign in the UK, EEA membership does not oblige the EEA EFTA States to negotiate free trade agreements with non-EEA countries as part of the EU. EFTA States can negotiate their own free trade agreements, and, indeed, have done so. Should the UK adopt EEA-only membership, this may be perceived as an important freedom that the UK has gained from Brexit.

The 'Four Freedoms' of the European Union

An important element of the EU is the protection of the four fundamental economic freedoms – the free movement of goods, services, capital and persons. Since the beginning of what is now known as the EU, these four freedoms have been the central tenets of promoting a harmonised economic free trade area

throughout Europe. While the free movement of persons received the most media attention during the UK referendum campaign, the promotion of the free movement of goods and services (including the 'passporting' of financial services) has been of significant importance in establishing a successful trading area.

Despite the position taken by some commentators (notably supporters of Brexit) that the free movement of persons is an EU political concept closely aligned with the goal of 'ever closer Union', the principle that EU nationals can move between and reside in all EU Member States is considered an ***economic*** right for the purposes of the EEA and therefore applies equally throughout the EEA alongside free movement of goods, services and capital.

That said, Article 112 of the EEA Agreement provides that in the event of ongoing, serious economic, societal or environmental difficulties relating to a particular region or sector, a party to the EEA Agreement can unilaterally take safeguard measures to remedy the situation, by giving one month's notice to the other parties to the EEA Agreement. Liechtenstein has used this provision to impose restrictions on the free movement of persons and these restrictions have been reinforced by Protocol 15 of the EEA Agreement (on Transitional Periods on the Free Movement of Persons), which enables Liechtenstein to maintain quantitative limitations for new residents, seasonal workers and frontier workers in relation to nationals of EU Member States and other EFTA EEA States.

Bound by EU rules with no 'seat at the table'?

An oft-repeated critique of the 'Norway model' is that it requires full compliance with EU rules within the policy areas of the Single Market, but does not grant EEA EFTA States a 'seat at the table', ie a vote on, or – better still – veto right over, new EU rules that will become binding within their jurisdiction under the EEA Agreement.

While it is true that the EEA Agreement does not grant EEA EFTA States formal access to the decision-making institutions of the EU (the European Commission (**EC**), European Parliament and European Council), the EEA Agreement provides for input from the EEA EFTA States at various stages of the EU legislative process when EEA-wide proposals are being considered. In practice, however, EEA EFTA States do not have a significant influence over the substance of EU laws.

'EEA Relevant' laws

Where the EC submits a legislative proposal to the European Council that it considers to fall within an area covered by EEA Agreement and therefore should bind EEA EFTA States, it must indicate that the future act shall apply to the EEA (in which case the relevant EU legislation will be marked as 'EEA Relevant'). The EFTA Secretariat and experts sitting on EU/EFTA joint committees will ultimately determine which EU laws are EEA relevant.

However, the EU and each of the three EEA EFTA States must be in unanimous agreement before EEA relevant EU legislation is formally incorporated into the EEA Agreement. Although there are dispute resolution provisions in the EEA Agreement that apply if no agreement can be reached, in practice the fact that unanimous agreement is necessary does provide scope for an EEA EFTA State (at least temporarily) effectively to veto the incorporation of new EU legislation into the EEA Agreement.

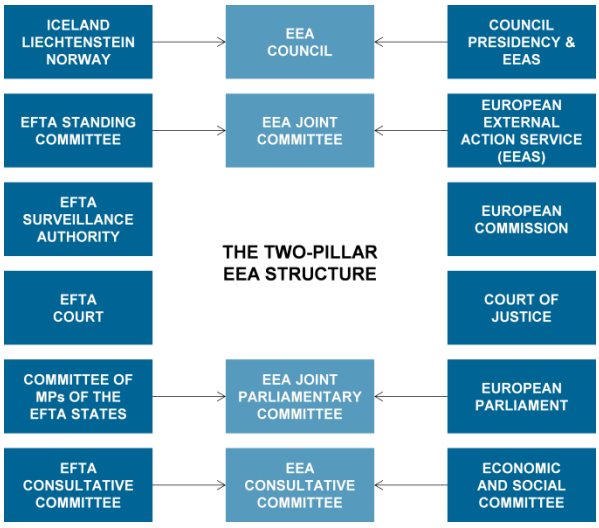
The EEA institutions – a 'two-pillar' structure

In order to achieve a homogenous EEA-wide trade area, all EEA-relevant EU legislative acts, including ***Regulations*** and ***Directives*** of the EU (see *info box* below), must be continuously incorporated into the EEA Agreement so that they apply to EEA EFTA States in the same way as they do to EU Member States.

The mechanism by which the EEA Agreement achieves homogeneity and equivalence throughout the EEA is through an institutional framework consisting of 'two pillars': the EU institutions form one pillar and the EEA EFTA States and their institutions form another. Critical to the functioning of the EEA is the overriding principle that the economic law of the EEA must be interpreted in a uniform way in both pillars.

For the purposes of this note, the EEA institutions that are of most interest are the EFTA Surveillance Authority (**ESA**) and the EFTA Court, which broadly correspond in terms of their functionality to the EC and Court of Justice, respectively.

A graphical representation of this is shown below:



Source: http://www.efta.int/eea/eea-agreement/eea-basic-features

EU Directives and Regulations

Aside from the core Treaties establishing what is now the European Union (the Treaty on European Union (**TEU**) and the Treaty on the Functioning of the European Union (**TFEU**)), EU legislation takes the form of either EU Directives or EU Regulations.

EU Directives broadly require a Member State to enact national legislation that is compliant with and ensures the implementation of the objectives of that particular Directive. The means of achieving that objective are not dictated, and Member States have a period of time to determine how best to implement the necessary legislation within their legal system, after which time certain types of Directive may become 'directly effective' meaning that EU citizens are able to rely on a Directive even if a Member State has failed to implement it.

By contrast, ***EU Regulations*** are a binding form of legislative act that become enforceable across the entirety of the EU simultaneously. They are prescriptive and do not require further implementation into national law.

The difference between EU Directives and Regulations could become of vital importance should Brexit occur. This is due to the fact that Regulations will immediately cease to apply (unless the UK remains an EEA Member State, on which see further below), whereas EU Directives would apply in substance through the relevant UK implementing legislation unless and until such legislation is repealed or amended (albeit the relevant UK implementing legislation may require amendment if, for example, it refers to EU institutions).

EFTA Surveillance Authority

The ESA, based in Brussels and with a staff of 70 officials, monitors and enforces the obligations of EEA EFTA States and private undertakings under the EEA Agreement. It does so in close contact and cooperation with the EC in order to ensure that there is a harmonious interpretation of Single Market rules throughout the EEA. Like the EC, the ESA has the power to investigate breaches of EEA law on its own initiative or as a result of complaints. The ESA is, for example, therefore responsible for the enforcement of EEA competition and State aid law (including the

imposition of fines and the recovery of any aid found to be unlawful) and is also competent to assess mergers between companies meeting the relevant EFTA jurisdictional thresholds.

EFTA Court

The EFTA Court, based in Luxembourg, is the judicial authority responsible for upholding EEA law within the EEA EFTA States. The EFTA Court consists of three judges, one nominated by each of the EEA EFTA States. In addition to the three regular judges, the EFTA Court includes six *ad hoc* judges for situations where a regular EFTA Court judge cannot act in a particular case (with two *ad hoc* judges nominated by each EEA EFTA State), a registrar responsible for the administration of the EFTA Court and for certain procedural and other issues, and a staff of 13 personnel providing legal and administrative assistance. The EFTA Court is therefore considerably smaller than the Court of Justice, which consists of one judge from each of the 28 EU Member States and 11 Advocates General.

The EFTA Court's jurisdiction over the EEA EFTA States is broadly equivalent to that of the Court of Justice's jurisdiction over EU Member States, and hence it is competent to hear infringement actions brought by the ESA against EEA EFTA States with regard to the implementation, application or interpretation of EEA law, as well as appeals against decisions of the ESA and disputes between EEA EFTA States on the application and interpretation of the EEA Agreement.

Consistent with the homogeneity principle noted above, Article 3.1 of the Agreement between EFTA States on the establishment of a Surveillance Authority and Court of Justice (the **ESA/EFTA Agreement**) stipulates that the EFTA Court shall follow the rulings of the Court of Justice given prior to the date of the EEA Agreement as to the interpretation and application of EU laws incorporated into the EEA Agreement. Article 3.2 of the ESA/EFTA Agreement goes on to stipulate that the EFTA Court "*shall pay due account*" to rulings of the Court of Justice given after the date of the EEA Agreement, though in practice the EFTA Court does not distinguish between Court Justice case law pre- and post-1994. Notwithstanding, the EFTA Court remains free to distinguish prior Court of Justice judgments on the facts of cases under review, as it did with its interpretation of the Deposit-Guarantee Directive in a high-profile ruling as to the protection afforded to UK and Dutch customers of Landsbanki's online 'Icesave' deposit accounts (see *info box* 'EFTA Court and the Icesave case').

We discuss below the jurisdictional issues that arise between, on the one hand, the Court of Justice and the EFTA Court, and on the other, the EC and the ESA, when dealing with competition law (including cross-border merger control) and State aid related matters.

EFTA Court and the Icesave case

On 28 January 2013, the EFTA Court handed down its judgment in a high-profile dispute between the ESA (supported by the EC) and Iceland as to the interpretation of the Deposit-Guarantee Directive (the **Directive**) in the context of compensation for UK and Dutch customers of Landsbanki's online 'Icesave' deposit accounts following Landsbanki's collapse in October 2008. [1]

The ESA argued that Court of Justice case law (in particular case C-222/02 *Paul and Others*) required the Directive to be interpreted as imposing an obligation on EEA Member States not only to ensure that a deposit-guarantee scheme is set up but also that in the event of deposits being unavailable, the aggregate deposits of each depositor are in fact covered in all circumstances.

However, the EFTA Court held that while the Directive did oblige EEA Member States to introduce a scheme and ensure its supervision, it did not oblige them to ensure the payment of aggregate deposits in all circumstances. Specifically, Iceland was not required to ensure that deposit protection payments were made to Landsbanki's customers in the UK and the Netherlands "*in a systemic crisis of the magnitude experienced in Iceland*". Not only did the EFTA Court disagree with the ESA (and EC's) interpretation of *Paul and Others*, it also held that the earlier Court of Justice case was to be distinguished on the facts insofar as the Court of Justice was primarily considering the alleged liability of German authorities resulting from negligence in the conduct of banking supervision.

[1] Case E-16/11.

The institutions in context

Competition policy

As noted above, EEA EFTA States are required to apply all of the EU competition rules, as well as incorporating into EEA law any subsequent legislative measures adopted by the EU in this regard. Articles 53 and 54 of the EEA Agreement (relating to anti-competitive agreements and abuse of dominance) correspond to Articles 101 and 102 of the TFEU (respectively).

The EEA competition rules are enforced across the EEA by the ESA and by the EC. The EC enforces both EU and EEA competition rules where there is an effect across the EEA (including EU territories). The ESA enforces competition rules in the EEA EFTA States, where the effect on competition is limited to the territory of the three EEA EFTA States. National competition authorities in EEA Member States also have the power to apply the prohibitions contained in the EEA Agreement competition provisions (Articles 53 and 54) and a system for cooperation with national competition authorities (and national courts) has been established to ensure uniform interpretation of the rules across the EEA.

An important element of competition enforcement is the ability of competition authorities to conduct 'dawn raids' on those undertakings they suspect of breaching competition rules. While the EC is primarily responsible for conducting such raids across EU Member States and the ESA across EEA EFTA States (in each case, along with the relevant national authorities), in limited circumstances the ESA has the power to request that the EC conducts a dawn raid in an EU Member State with the active participation of the ESA.

If the UK were to remain part of the EEA post-Brexit, it would therefore continue to be bound in substance by EU competition rules under the EEA Agreement. Indeed, where a UK-based undertaking is alleged to have breached EEA competition laws, it would seem likely that such conduct would continue to be investigated by the EC (as opposed to the ESA) on the assumption that its impact – to the extent wider than the UK – would not be confined to the EEA EFTA States.

Merger control

By virtue of Article 57 of the EEA Agreement, the EU's merger control rules (as set out in the EU Merger Regulation (**EUMR**)) apply equally to EEA Member States. Indeed, Article 57(2)(a) provides that the EC retains exclusive jurisdiction to decide upon mergers that have a 'Community dimension' (broadly that the EU's turnover thresholds for merger notifications are triggered) and that for these purposes a Community dimension shall also include within its ambit the EEA EFTA States.

The result is that the principle of a 'one-stop-shop' for cross-border mergers in the EEA that have a Community dimension is maintained.

That said, the ESA does have jurisdiction over those mergers that have an 'EFTA dimension' but fall short of having a 'Community dimension'. The turnover thresholds required to meet the 'EFTA dimension' test are very high (and equivalent to EU thresholds), the primary threshold being triggered if the parties generate in aggregate turnover of EUR5bn worldwide and EUR250m within the EEA EFTA States (provided that it is not the case that two-thirds of this turnover is generated in one EEA EFTA State).

In practice, mergers with an EFTA dimension are unlikely to arise, as only cases in which merging parties have very high levels of turnover in the EEA EFTA States, but not throughout the rest of the EU Member States are caught. Indeed, to date, the ESA has not received a merger control notification.

However, given the size of the UK economy vis-à-vis those of the existing EEA EFTA States, it is possible that if the UK left the EU but remained in the EEA, a larger number of M&A transactions could trigger the EFTA merger control thresholds by virtue of turnover generated by merging parties in the expanded EEA EFTA States. That said, it seems unlikely that many such transactions would not also trigger the existing EUMR thresholds, with the net result being that the EC is likely to retain its position as the primary regulator of cross-border mergers within the EEA.

State aid

Broadly speaking, State aid is defined for the purposes of EU law as any advantage granted by an EU Member State or through State resources on a selective basis to undertakings that distorts or threatens to distort competition and affects trade between EU Member States.

The State aid rules in the EEA Agreement are broadly equivalent to the EU rules, in that there is a general prohibition on State aid, subject to certain limited exceptions (for example State aid granted to correct market failures in certain conditions). As noted above, in the case of the EEA EFTA States, the ESA enforces the general prohibition on State aid and decides how the exceptions to the prohibition should apply. In its enforcement of the State aid rules, the ESA has equivalent powers and similar functions to those of the EC, including powers to request relevant information from EEA EFTA States, to carry out on-site inspections and to order repayment of any aid granted in breach of the EEA Agreement. To date, the ESA has assessed a range of high-profile State aid cases, including tax exemption schemes, measures relating to the financial crisis and state support to carbon capture and storage projects.

Will the UK remain a member of the EEA on leaving the EU?

A technical – but potentially very significant – question that has not received much attention to date is whether the UK, following a split from the EU, would need first to leave and subsequently re-apply to join the EEA or, alternatively, whether the UK would remain a party to the EEA Agreement notwithstanding an exit from the EU.

The now infamous Article 50 TEU sets out the procedural requirements for an EU Member State to withdraw from the EU. Subject to the agreed terms of a Member State's withdrawal, the basic legal consequence of a withdrawal from the EU is that the EU Treaties and Protocols no longer apply in that Member State.

A separate mechanism for withdrawing from the EEA is set out at Article 127 of the EEA Agreement, allowing any 'Contracting Party' to withdraw by providing at least 12 months' written notice to the other Contracting Parties. There is no separate definition in the EEA Agreement of 'EU Member States'. However, in the preamble to the EEA Agreement, the EU Member States are **listed individually** and, along with the EU itself, Iceland, Liechtenstein and Norway, are **collectively referred** to as the 'Contracting Parties'. On one reading of the EEA Agreement therefore, the UK is a Contracting Party by virtue of being one of the individually listed EU Member States that has signed it.

On its face, this would suggest that it would be open to the UK to exit the EU following the procedure set out in Article 50 TEU, but take no action under Article 127 of the EEA Agreement. However, this raises the question of whether the UK would remain an EEA Contracting Party. One difficulty in that respect is that the territorial ambit of the EEA Agreement (as defined under Article 126(1)) is limited to the territories to which the EU Treaties apply, plus Norway, Iceland and Liechtenstein, creating a paradox of the UK potentially being party to an international economic and trade agreement, the territorial ambit of which does not cover the UK.

This kind of detailed (and unprecedented) legal issue gives a flavour of some of the difficult technical issues that will need to be traversed carefully by Boris Johnson (as Secretary of State for Foreign Affairs and the Commonwealth) and David Davis (as Secretary of State for Leaving the EU), the cabinet ministers charged by the new Prime Minister with steering the course to Brexit.

Concluding remarks

On balance, under the EEA system the UK framework would not look entirely dissimilar in substance to its current model.

The key EU provisions relating to the Single Market (or their equivalents) would still apply and would be interpreted consistently with EU law. If EEA membership is the Brexit route adopted, the implications for the UK may therefore largely become one of a change in procedure and institutions.

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