

WHAT WOULD
'NO DEAL'
MEAN FOR
YOU?



BREXIT

GLOSSARY

WTO

The World Trade Organisation administers the WTO trade agreements which govern trade between nations at a global level. It is also a forum for governments to negotiate trade agreements and a place for them to settle trade disputes.

MFN

Most Favoured Nation—a key WTO principle which prohibits discrimination between 'like' goods and services (and the relevant suppliers) from different WTO Members.

WTO Agreement

The Agreement establishing the World Trade Organisation was signed in 1994. Several other agreements, including GATT and GATS, were annexed to the WTO Agreement. When a country decides to join the WTO it also agrees to abide by the terms of the annexed agreements.

FTA

Free trade agreement, which must comply with WTO rules and be notified to the WTO.

WHAT LIES AHEAD FOR YOUR BUSINESS?

Negotiations between the UK and the EU are now well under way. However, the UK and EU remain miles apart on a number of issues and the UK/EU relationship being based on WTO rules, even for an interim period, looks like an increasingly realistic prospect.

In this guide, we have provided an overview of the WTO rules relating to both goods and services and have described some of the implications of a UK/EU relationship based on these rules. What is clear is that a relationship based on WTO rules differs significantly from the UK's current position as a member of the single market and customs union in relation to goods and many service sectors.

HELLO

We believe that now is the time to ensure you have taken appropriate steps to allow your business to continue to operate in what is likely to be a very different business and legal environment post 29 March 2019.



Chris Bryant

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AT A GLANCE



164

The WTO had 164 members in January 2017



23

Currently 23 participants in the TiSA negotiations (including the EU)



1995

The WTO Agreement, annexing GATT and GATS, entered into force on 1 January 1995



1948

The now defunct GATT 1947 entered into force on 1 January 1948



400

Over 400 disputes have been brought to the WTO since 1995



44%

In 2016, 44% of UK exports went to the EU

WHAT IS THE WTO?

GATT

Since 1995, the updated **General Agreement on Tariffs and Trade** ("GATT") has become the general agreement for trade in goods.

GATT contains an overall framework which sets out the principles and rules applying to goods trade, as well as exceptions to these rules and principles.

WTO Members' tariff schedules are annexed to GATT and set out the tariffs applied by each WTO Member in relation to specific goods.

GATS

The **General Agreement on Trade in Services** ("GATS") is the WTO agreement governing trade in services.

GATS applies to all service sectors except "services supplied in the exercise of governmental authority" and services related to the exercise of air traffic rights.

GATS consists of an overall framework which sets out the principles and rules and a schedule for each WTO Member listing its specific commitments and any exemptions.

OTHERS

There are a number of other WTO agreements including:

TRIPS
Trade-Related Aspects of Intellectual Property Rights

GPA
The Government Procurement Agreement

Resolving trade disputes between WTO Members is one of the WTO's core functions and there are a number of WTO documents relating to dispute settlement, including the Dispute Settlement Understanding.



Falling into the WTO rules is not an apocalypse... But it will not be as good as a free trade agreement.

Pascal Lamy, former
WTO Director-General



KEY WTO PRINCIPLES



Most Favoured Nation (MFN)

The MFN treatment obligation prohibits discrimination between 'like' goods and services and the relevant suppliers from different WTO Members. The main purpose of this obligation is to ensure equality of opportunity for suppliers from all WTO Members. However, there are a number of exceptions that are permitted under GATT and GATS, including in relation to FTAs.



National treatment

The national treatment principle means that foreign goods and services should be treated the same as domestic goods and services. This principle is found in both GATT and GATS but is handled slightly differently in each.

KEY GATT CONCEPTS



Market access

Market access for goods refers to government-imposed conditions under which a product may enter a WTO Member. The two main categories of barriers to market access are:

- tariffs; and
- non-tariff barriers (“NTBs”) which include, in principle, all measures other than tariffs used to protect a domestic industry.

Tariffs:

Tariffs are the most common and widely used barrier to market access for goods. The WTO does not prohibit the use of tariffs but they are subject to negotiations, which have led to successive reductions of tariffs.

WTO Members’ tariff schedules are annexed to GATT and set out the tariffs applied by each WTO Member in relation to specific goods.

In relation to many goods, WTO Members have also agreed to “bind” their commitments, which effectively means that there are ceilings on tariff rates.

Tariff rate quotas (“TRQs”) permit the total or partial suspension of standard tariffs in relation to a pre-determined volume of agricultural goods imported from another WTO Member. The goods falling within the TRQs are therefore imported on the basis of no tariffs or a more favourable tariff than the standard tariff.

NTBs:

Various forms of NTBs may constitute obstacles to market access for goods. There is no agreed definition of what constitutes a NTB but they include the following: rules on transparency of trade regulations; technical regulations; standards; sanitary and phytosanitary measures; customs formalities and government procurement practices. NTBs are particularly important in the context of Brexit due to the risk of regulatory divergence and the adoption of different product standards in the UK following its exit from the EU.



National treatment

GATT provides that imported and locally-produced goods should be treated equally after the foreign goods have entered the market. Imposing tariffs on imported goods is therefore not a violation of national treatment even if locally-produced products are not charged an equivalent tax.

WHAT IS GATT?



[GATT 1947] established the forum for negotiations on cutting tariffs that subsequently would take place over the following decades through multilateral trade rounds.



KEY GATS CONCEPTS



Market access

There is no presumed right of market access in GATS and WTO Members choose which sectors they are prepared to liberalise and the time scale. WTO Members set out this information in detailed schedules.



National treatment

The national treatment obligation prohibits a WTO Member from treating services and service suppliers of any other WTO Member less favourably than it treats domestic services and service suppliers. Unlike the national treatment provision in GATT, the national treatment obligation in GATS applies only to the extent that WTO Members have explicitly committed themselves to grant national treatment in respect of specific service sectors. The specific commitments to grant national treatment are often made subject to certain conditions, qualifications and limitations, which are set out in the schedules.



Modes of supply

GATS distinguishes between four modes of supplying services:

- cross-border trade;
- consumption abroad;
- commercial presence; and
- presence of natural persons.

WHAT IS GATS?

WHAT DO WTO TERMS MEAN FOR GOODS?

Tariffs

Trade between the UK and the EU:

Absent an FTA, the MFN tariff rates contained in the GATT schedules will apply to trade between the UK and the EU.

- MFN tariff rates differ significantly and higher tariffs are generally applied in relation to products that are produced in the EU.
- It remains likely that the UK and the EU will be able to agree a zero-tariff arrangement. However, even if a zero-tariff FTA is agreed, the position will be very different compared to the current position as a member of the single market and customs union.

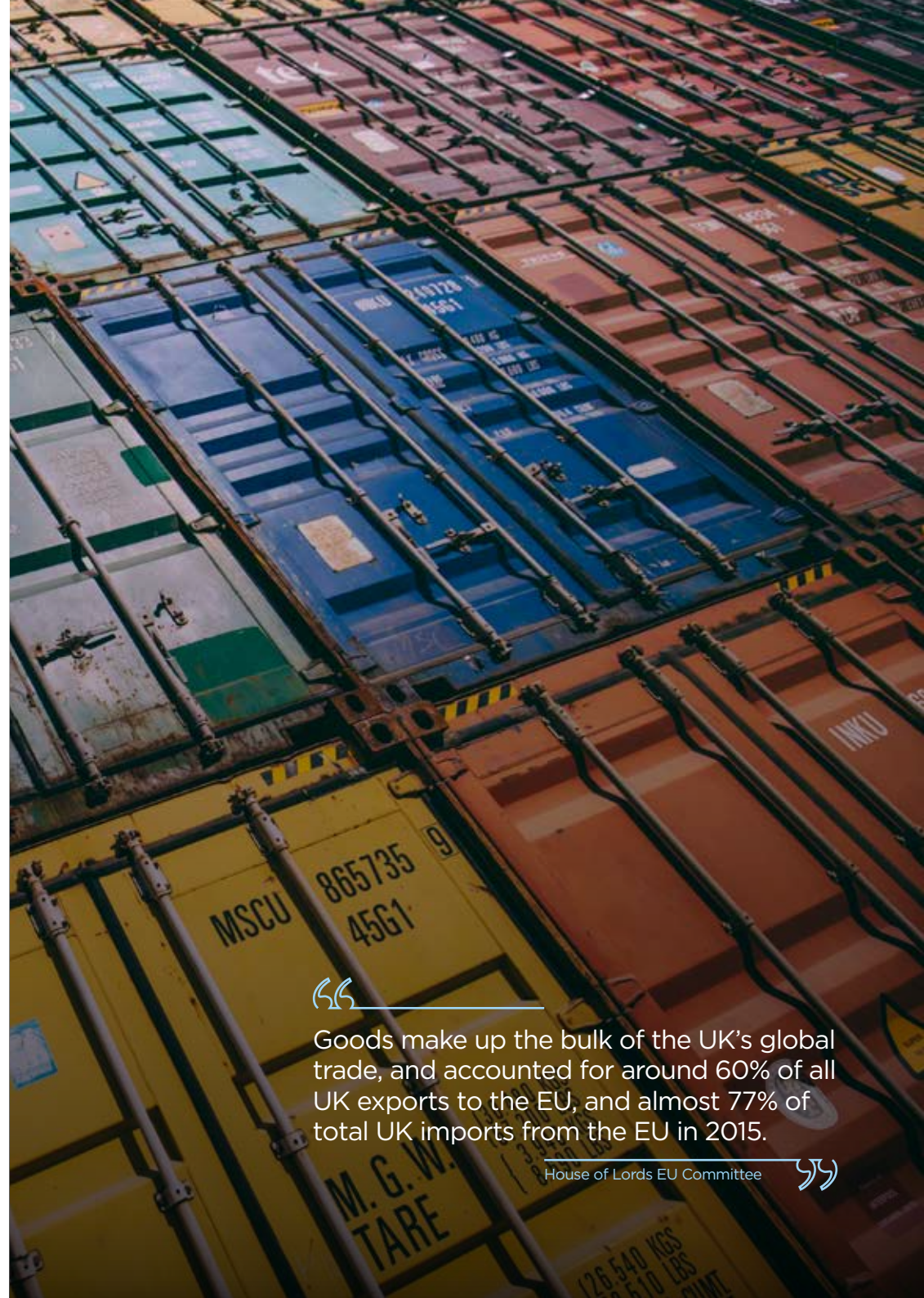


What is the customs union?

The EU customs union is designed to allow goods to flow freely between members. There are no customs controls within the EU customs union and a common external tariff is applied to all imports into the EU customs union from outside. Unlike the single market, there is no harmonisation of rules in a customs union.

The UK's own MFN tariffs:

- If the UK leaves the customs union, it will no longer be bound by the EU's common external tariff and will be free to set its own MFN tariffs on imports into the UK. While the Department for International Trade has said that the UK will, in the first instance, adopt the EU MFN tariffs, the UK could choose to reduce its import tariffs below EU levels, provided it continues to observe the MFN principle.
- The UK would not be able to set tariffs for imports at a higher level than the EU. The reason for this is that many tariffs in the WTO agreements are "bound" at maximum levels and the vast majority of the EU's applied tariffs are set at the bound tariff rates.
- The UK's MFN tariffs are important not only because they will apply to trade with countries with whom the UK does not have an FTA but because they also set the baseline for negotiation for any future FTAs, as an FTA is meant to create a situation more favourable than the WTO MFN position.
- Companies that import products into the UK may have the ability to influence the government in relation to the UK's future MFN tariffs and lowering these below the EU's current tariffs. This is most likely to be successful in relation to products that are not produced in the UK (but are protected at the EU-wide level).



Goods make up the bulk of the UK's global trade, and accounted for around 60% of all UK exports to the EU, and almost 77% of total UK imports from the EU in 2015.

House of Lords EU Committee



Brexit and TRQs

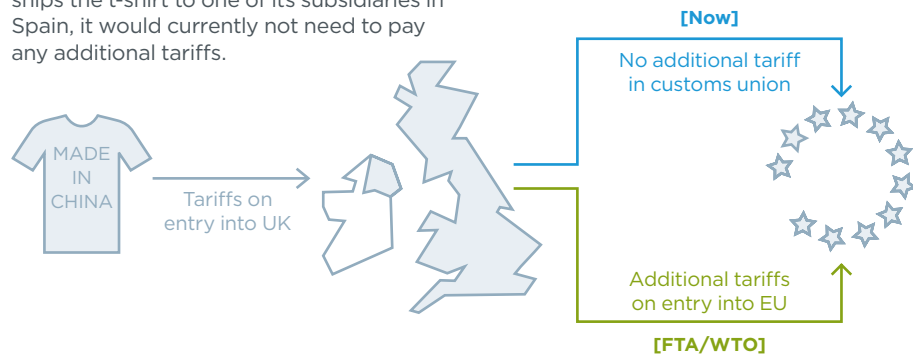
Some of the most important TRQ arrangements for UK importers relate to butter, cheese, poultry and sheep meat. Once the UK leaves the EU, these TRQs need to be apportioned between the UK and the remaining 27 EU Member States. The way the TRQs will be apportioned is a topic of negotiation between the UK and the EU. There is a risk that other WTO Members may raise complaints and request compensation regarding the new apportionment. However, these WTO Members would have to establish that they would be/are worse off under the new arrangements in order to be eligible for compensation.

Supply chain implications

Tariffs are generally applied in relation to the import of certain products from third (non-EU) countries into the UK. Due to the free movement of goods within the EU and the fact that the EU is a customs union, tariffs are not imposed if these products are subsequently exported from the UK to another EU Member State. For example, if a UK company currently imports a t-shirt from China, it will need to pay a tariff when the t-shirt enters the UK. However, if the UK company then ships the t-shirt to one of its subsidiaries in Spain, it would currently not need to pay any additional tariffs.

However, this will change once the UK exits the EU—in both a WTO scenario and if the UK and the EU enter into an FTA. Using the same example, if the UK company imports a t-shirt from China, it will need to pay a tariff when the t-shirt enters the UK. However, following Brexit, if the UK company then ships the Chinese t-shirt to one of its subsidiaries in Spain, the tariff would need to be paid again to allow the Chinese t-shirt to enter Spain. The reason why this would be the case, even if the UK and the EU agree a zero tariff FTA, is that a UK/EU FTA will only apply to goods originating in the UK or the EU and not to products imported into either the UK or the EU from third countries such as China.

Companies that use the UK as their base for importing goods from third (non-EU) countries and then export these goods to one or more of the EU27 will, therefore, need to consider restructuring their supply chain and/or options such as inward processing relief and customs warehousing (two HMRC-approved schemes which permit the suspension of import tariffs in certain scenarios).

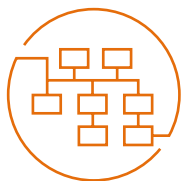


...in a classic negotiation, 'no deal' means a return to the status quo. In the case of Brexit, 'no deal' would be a return to a distant past.

Michel Barnier, EU Chief
Negotiator for Brexit



WHAT DO WTO TERMS MEAN FOR SERVICES?



Services under GATS

Absent a free trade agreement, UK firms' market access to the EU will be determined by GATS. The exact nature of market access following Brexit differs for each service sector, each mode of supply and each EU Member State. However, in many service sectors, the position would differ significantly from the current position as a member of the single market.



Financial services

EU Member States' commitments in relation to financial services under GATS differ but there are similarities in terms of the broad nature of commitments offered.

EU Member States have offered very limited commitments in relation to cross-border trade in a relatively small number of sub-sectors, such as insurance for air and maritime transport, reinsurance, provision and transfer of financial information and financial data processing. It is generally accepted that trade in financial services on the basis of GATS would mean the loss of passporting rights.

In relation to commercial presence, which is the ability of foreign-owned and controlled companies to establish affiliate, subsidiary, or representative offices in EU Member States, EU Member States have offered relatively comprehensive commitments covering virtually all financial services (although Member States can impose terms, conditions and procedures for authorisation of the establishment and expansion of a commercial presence).

Please see our guide "The WTO Rules and Financial Services: What will trade look like after Brexit?" for further information.



Management consulting

Unlike financial services, a WTO scenario in relation to management consulting would not be radically different than the status quo. There are no limitations applied by the vast majority of EU Member States in relation to the cross-border supply of management consulting and related services, meaning that UK-based firms could continue to supply management consulting and related services into the EU.

While the vast majority of EU Member States do not apply limitations in relation to the establishment of a commercial presence to supply management consulting and related services, a few EU Member States apply limitations in relation to commercial presence across various services sectors including management consulting and related services. These relate, for example, to the make-up of boards of directors and the legal structure of a firm first entering a market.

Trade in Services Agreement

A subset of WTO Members with an interest in service sector liberalisation is negotiating a plurilateral services agreement outside the auspices of the WTO—the Trade in Services Agreement (TiSA). At this stage, it is not clear whether EU Member States' TiSA commitments will go significantly beyond GATS. In the latest draft EU TiSA schedule, a relatively small number of EU Member States have proposed to undertake additional commitments in relation to cross-border provision of services. The UK will wish to enter TiSA in its own right (as opposed to as an EU Member State).



Did you know?

There are no EU-wide GATS commitments—across all four GATS modes of supply, EU Member States have their own individual market access and national treatment schedules.

HOW DO FREE TRADE AGREEMENTS FIT IN WITH THE WTO RULES?

Key exception to MFN

WTO Members have the right to depart from the MFN principle in order to enter into an FTA provided that:

- the FTA eliminates tariffs and other restrictive regulations of commerce on substantially all the trade in goods deemed to be originating products (see below); and
- the services aspects of an FTA provide for substantial sector coverage and the absence or elimination of substantially all discrimination between or among the parties at the entry into force of the agreement or on the basis of a reasonable time frame.

The FTA should also not result in new trade barriers for other WTO Members.

These requirements apply to both interim/transitional and final agreements. In relation to goods, GATT states that an interim agreement must be implemented within a “reasonable length of time” which is interpreted as meaning no longer than 10 years in most cases.



Rules of origin

Goods currently circulate freely between the UK and the EU. However, this will change if the UK and the EU enter into an FTA. ‘Preferential rules of origin’ are very likely to apply in a UK-EU FTA meaning that only ‘originating products’ (products that contain the percentage of local content specified in the FTA) are given preferential tariff treatment.

Applying rules of origin will generate significant additional administration,

and therefore costs and delays for UK businesses, especially businesses in the chemicals and manufacturing industries.

Some industries with an integrated EU supply chain and high levels of both imports and exports, such as the automotive sector, might be unable to comply with the local content requirements contained in the EU’s preferential rules of origin.

Substantially all trade and substantial sectoral coverage

In relation to goods, it is now generally accepted that FTAs should cover over 90% of goods.

The substantial sector coverage requirement in GATS means that virtually all services sectors must be covered to some extent in the FTA. However, substantial sector coverage does not mean that each service sector needs to be covered to the same extent or that the provisions in an FTA in relation to services need to be particularly detailed or far-reaching. For example, some EU FTAs only contain a few paragraphs covering services and reaffirm the respective parties’ GATS commitments; however, as the provisions are very broad and refer to all services, the substantial sector coverage requirement is satisfied.

The need to cover most sectors of the economy is one of the reasons why FTAs, including interim/transitional agreements, can take many years to negotiate.

Many media reports have referred to anticipated special arrangements between the UK and the EU in relation to specific sectors of the economy such as the automotive sector and/or the financial services sector. However, these reports are misleading because any UK-EU FTA would need to cover most sectors of the economy to be WTO compatible. This is not simply a theoretical legal point—the ‘Auto-Pact’ between the United States and Canada, for example, was found by a WTO Panel to lack “the trade coverage required” to fall within the free trade agreement exception in GATT.



ENFORCEMENT OF RIGHTS



How will rights be enforced in a WTO scenario?

The EU single market rules currently in place in the UK are part of domestic law and have direct effect. In the UK (and in other EU Member States), businesses and individuals can use domestic courts to enforce their rights, and, if needed, domestic courts can refer cases to the Court of Justice of the European Union.

If the UK and the EU do not enter into an FTA, any disputes concerning trade between the UK and the EU will be governed by the WTO dispute settlement procedure, which differs considerably from the current arrangements. Notably, businesses and individuals cannot themselves bring an action under the WTO dispute settlement procedures. Instead, they must lobby their governments to take action.



What is the Trade Barriers Regulation?

In the EU, the Trade Barriers Regulation (“TBR”) is the instrument through which businesses in the EU bring potential breaches of WTO rules to the attention of the European Commission and under which the Commission carries out an investigation. If the Commission decides that the complaint is admissible, it will open an investigation which can take up to seven months. At the end of the investigation, the Commission produces a report covering its analysis of the law and facts, as well as its envisaged course of action, which could include initiating the WTO dispute settlement procedure.

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The procedures set out in the TBR are likely to be mirrored to a large extent by the new UK legislation and it will become far more difficult, costly and time-consuming for UK companies to bring complaints in relation to issues concerning cross-border trade. The UK will also need to set up a body to assess complaints and take them forward at the WTO.



What is the WTO dispute resolution procedure?

Under the WTO dispute settlement procedure, the relevant WTO Members first enter into consultations in an attempt to resolve the dispute. If those consultations are unsuccessful, a panel will be established to produce a report (which is subject to appeal).

If the report finds that the relevant WTO Member has violated an obligation under a WTO agreement, the WTO Member is expected to comply with the findings in the report by withdrawing the WTO-inconsistent measure, or by modifying or replacing it. If the WTO Member fails to do so within the required period, it has to enter into negotiations with the adversely affected WTO Member with a view to agreeing mutually acceptable compensation. This compensation is not a monetary payment; rather, the WTO Member is supposed to offer a benefit, for example a tariff reduction, that is equivalent to the benefit that it has nullified or impaired by applying the measure in dispute. The compensation does not need to be, and is often not, in the same sector that is the subject of the dispute. Therefore, for example, a dispute regarding a measure taken in relation to financial services may be compensated for by a tariff reduction in relation to an

agricultural product. Another complicating factor is that the compensation must be consistent with the MFN principle. Therefore, WTO Members other than the complainant(s) may also benefit if compensation is offered e.g. in the form of a tariff reduction.

If agreement regarding compensations not reached within the required period, the adversely affected WTO Member can request authorisation to impose trade sanctions against the other party. These sanctions may be in a completely different sector than the subject of the dispute.

How would rights be enforced under a UK-EU FTA?

The most common procedure for resolving trade disputes is state-to-state dispute settlement where a state complains about violations of the free trade agreement by the other state to a joint panel. In free trade agreements containing an investment chapter, it is also possible to include a dispute settlement mechanism between investors and states which grants an investor the right to resort to international arbitration against a state's government.

GET IN TOUCH

Our cross-practice Brexit task force is here to help you to address the challenges and opportunities you may now face.

We are helping clients to understand their risks, assess contracts and devise strategies to influence the future UK/EU relationship.



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Polly specialises in financial services law and regulation. Having spent time on secondment to the FSA's Enforcement Division, she has a close understanding of how the regulator works in practice. Since the Brexit vote, Polly has been advising financial services clients on what it means for the financial services industry.



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Marieke advises clients across a range of sectors on the legal aspects of Brexit, as well as helping clients to identify the key risks and opportunities associated with Brexit. She also advises on the WTO rules in the context of Brexit and otherwise.

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Chris has over 15 years' experience in Brussels and London advising on the EU institutions, law-making processes and trade deals. He has helped clients to devise successful strategies to influence the EU and domestic laws.

Chris heads the firm's Brexit task force and is one of the leading experts and media commentators on this subject. He advises clients across all sectors, ranging from financial services to automotive.

Getting in touch

When you need a practical legal solution for your next business opportunity or challenge, please get in touch.

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About BLP

Berwin Leighton Paisner is an award-winning, international law firm. Our clients include over 50 Global Fortune 500 or FTSE 100 companies. Our global footprint of 14 international offices has delivered more than 650 major cross-border projects in recent years, involving up to 48 separate jurisdictions in a single case.

The Firm has won eight Law Firm of the Year titles, is independently ranked by Chambers and the Legal 500 in over 65 legal disciplines and also ranked in 'the top 10 game changers of the past 10 years' by the FT Innovative Lawyers report 2015.

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