Level Playing Field Obligations: Insurance Policy or Tinderbox for Future Trade Disputes?

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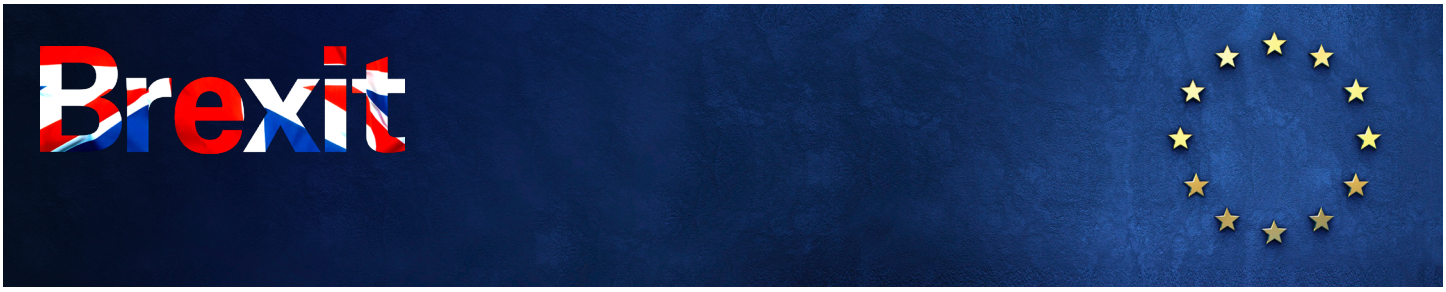

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Bill Batchelor
Partner / Brussels
32.2.639.0312
bill.batchelor@skadden.com

One Manhattan West
New York, NY 10001
212.735.3000

Avenue Louise 523
1050 Brussels, Belgium
322.639.0300

Takeaways

- The TCA requires parties to maintain standards in nontrade-related policy areas, particularly social, labour and environmental.
- The provisions potentially may disrupt EU-UK trade disputes.
- It remains to be seen if the provisions will be used in practice.

As is standard for trade agreements, the Trade and Cooperation Agreement (TCA) requires both sides to seek to facilitate trade and investment by applying similar principles or international standards, including working with international organisations on technical standards; providing transparency for new trade-related technical regulations; and committing to common principles on data, digital trade, subsidy controls and taxation.

But the TCA goes further by including "level playing field" provisions that require the parties to maintain current and future standards in nontrade-related policy areas, particularly social, labour and environmental. The fear in the EU was that degrading these standards in the UK would create a lower cost base and unfair trading advantage for UK businesses. This limitation on changes in domestic legislative areas means the TCA's level playing field provisions are among the most politically charged.

Commentators remain divided as to the likelihood that these restrictive provisions will be used in practice, pointing to the anaemic nature of similar obligations in other trade deals. Yet the obligations were agreed to at the 11th hour at the EU's insistence that it wanted to have an ability to influence the UK's future legislative standards in nontrade-related policy areas. On paper at least, the provisions have the potential to be a source of disruption for future EU-UK tit-for-tat trade disputes if deployed.

Nonregression Obligations

First, the TCA contains nonregression commitments that seek to prevent the EU or UK from obtaining a trade advantage through weakening social or environmental legislation, or its enforcement.

These require the EU and UK not to weaken or reduce current legislative protections "in a manner affecting trade or investment" for (1) labour and social standards and (2) environmental protection. Both are widely defined to cover areas that are in large part the competence of individual EU member states and only tangentially the subject of EU legislation. The TCA requires the EU to commit to nonregression in respect of its member states' labour and environmental laws; therefore, the EU must ensure its member states comply with the nonregression obligation.

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The nonregression obligations cover many legislative areas where some UK politicians and commentators have advocated post-Brexit deregulation, including workers' hours, health and safety, genetically modified crops and chemicals regulations.

EU controls on financial services sector remuneration — an EU law said by some to be ripe for repeal — highlight the complexities. At the time the provisions were introduced in 2013, the UK sought to annul a key element of those rules specifically relating to a cap on bonuses on the basis that it went beyond the EU's legislative authority on workers' pay (an exclusively national competence under Article 153(5) TFEU). The advocate general of the EU Court of Justice concluded that the provision was a prudential measure to discourage excessive risk-taking and, therefore, within EU competence. The same distinction will now be essential to argue that nonregression does not apply to any UK changes to remuneration rules. The EU, fearing the loss of talent to the UK due to more flexible remuneration packages, may argue these are rules on fair working conditions, so no regression is possible. The stronger argument is that these are prudential rules, not worker protections, so they fall outside the level playing field, and the UK is free to repeal or amend them.

Another challenge in applying nonregression obligations is the level of materiality required before divergent measures result in trade or investment distortion, triggering the nonregression obligation. EU Chief Negotiator Michel Barnier has noted this may be a low threshold. Commenting on whether the UK's decision to permit a pesticide banned by the EU engaged the nonregression rules, he reportedly stated, "Pesticides concern public health, the health of farmers, farm workers and consumers. ... Depending on where you set the threshold in that area it can also have an impact on competition and competitiveness." Analogously, the EU has taken the position that very little trading nexus is required to engage EU state aid rules applicable in Northern Ireland. For example, a tax benefit granted to a business based outside Northern Ireland, but potentially doing business there, would be caught.

Trade Retaliation for Future Divergence

Secondly, the backward-looking nonregression obligations are accompanied by a forward-looking provision seeking to prevent future substantial divergence in labour, social, environmental and subsidy control laws. This "rebalancing" clause permits trade retaliation "if material impacts on trade or investment between the Parties are arising as a result of significant divergences" between the EU and UK in these areas. The rebalancing measures must be proportionate to the level of alleged trade or investment impact.

On paper at least, the speed with which retaliatory measures can be imposed is exceptionally fast in trade law terms, where disputes often take months or years to decide. Measures can be applied within 14 days unless the other side appoints an arbitral tribunal to decide the dispute. If the tribunal does not decide within 30 days — as would rarely be the case in complex trade matters — the complainant can immediately impose tariffs (or otherwise suspend operation of the TCA). The other side can retaliate with counter-measures until the tribunal has ruled on the dispute. Each side agrees to waive use of World Trade Organisation (WTO) dispute resolution to protect itself from the other's measures under this provision. Therefore, neither side can claim protection from the WTO against these types of lightning retaliatory tariffs.

Analysis

Nonregression obligations — albeit in less detailed terms — have been a common feature of recent EU trade agreements, for example with Japan, Canada and South Korea. Obligations restricting future legislative changes are uncommon and tend to be stated only in vague, aspirational terms. By contrast, the TCA's level playing field provisions as related to future divergence are detailed and specific.

Commentators have questioned how realistic the application of this contentious provision is likely to be in practice. Labour standards protection clauses have been difficult to apply in other trade agreements. In a US-Guatemala trade dispute, the arbitration panel found that weak enforcement by Guatemala of labour law standards, while proven on the facts, could not be shown to have resulted in any meaningful trade benefit to Guatemala.

In theory, the implications are far-reaching and more intrusive than analogous provisions in other free trade agreements. The EU (or UK) might choose to adopt, say, new minimum wage or environmental controls legislation, issue an impact assessment (calculating the cost to its domestic industry) and demand the other side follow suit or face retaliatory measures to that same value.

The UK has promised greater "state activism" post-Brexit in a manner that the EU may consider creates substantial divergence with its subsidy control rules. In a manner that might foreshadow this type of trade dispute, the European Commission has recently published a proposal to sanction companies receiving competition-distorting subsidies from non-EU governments through penalties or conduct remedies. (See our 24 June 2020 client alert, "EU Proposes Controls on Mergers, Market Conduct and Public Contracts To Combat Foreign Subsidies," and our 16 September 2020 client alert, "EU Will Propose Merger Control Legislation for Foreign-Subsidized Companies' Acquisitions in 2021.") If it becomes law, this proposal will be applicable to companies in receipt of UK aid.

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It is likely, however, that aggressive use of rebalancing measures to force legislative alignment on nontrade-related policies would be considered politically unacceptable interference in either party's lawmaking. The rebalancing provision contains procedures for reassessment after four years at the request of either party, with the potential to unravel the trade relationship. On this view, the level playing field provisions are an insurance policy for a political eventuality that may never occur.