Standing the Test of Time: The Level Playing Field and Rebalancing Mechanism in the UK-EU Trade and Cooperation Agreement (TCA)

ABSTRACT: This article explores the dispute settlement elements of the UK-EU Trade and Cooperation Agreement's novel Level Playing Field rebalancing obligations, consisting of a requirement not to lower standards in areas of labour, the environment and subsidy policy such that an adverse material impact results to trade or investment flows between the parties. The test for violations of these provisions is narrowly framed, requiring strong evidence of significant harms and carefully calibrated retaliation. The system is enforced through review by a dedicated Panel of Experts procedure, just as other aspects of the LPF are subjected to the TCA's general dispute settlement system of state-to-state arbitration which excludes jurisdiction of either the UK or EU courts. The article will argue that the substantive and procedural features of the TCA's LPF mechanism affords wide opportunity for parties to practice regulatory divergence while evincing a commitment to shared values.

I. Introduction

During the negotiations of their future relationship following the United Kingdom's departure from the European Union in 2020, the EU insisted that any Free Trade Agreement (FTA) between the parties would need to have "robust guarantees for a level playing field … to ensure open and fair competition among our businesses."[1] The assurance against unfair competition, achieved via a feared 'race to the bottom' in standards was as much of a vital ingredient in the conclusion of successful negotiations between the parties as the UK's aim to have the regulatory autonomy to unleash marked-based innovations and reforms, one of the primary motivations for the Brexit vote.[2] The TCA was designed in part to address the concern that the UK, now a large third country market in close proximity to the EU, was believed to be planning a low regulatory environment or so-called 'Singapore-upon-Thames,' which could threaten not only the EU's economic standing but also undermine progressive goals in regards to the environment, labour and other matters.[3]

[1] 'Press statement by Michel Barnier following Round 6 of the negotiations for a new partnership between the European Union and the United Kingdom' European Commission (23 July 2020)
[2] Prime Minister Boris Johnson's speech in Greenwich (3 February 2020)
[3] Boris Johnson vows to business he will seize 'opportunities of Brexit' Financial Times (18 January 2021)

Concluded finally in December of 2020 and Entered into Force in April 2021, the LPF obligations of the UK-EU Trade and Cooperation Agreement (TCA) require that the parties remain on an equal regulatory footing with a view to preventing unfair competition for foreign investment and trade while acknowledging that the purpose of the agreement is not to 'harmonize the standards of the parties.'[4] The TCA itself is more than a simply trade agreement as it covers matters with criminal law enforcement as but one example. At the same time, it does not contain substantive protections for foreign investment in the manner of a BIT and many modern FTAs such as the Canada-EU Comprehensive Trade and Investment Agreement (CETA), also lacking investor-state dispute settlement. Indeed, LPF dispute settlement must be clearly distinguished from conventional investment arbitration; the TCA's LPF rules are not only about luring in foreign investors, but about competitiveness more generally.

The TCA's LPF system and associated dispute settlement is innovative because, as it governs continued relations between the EU and a former member of its Single Market, ultimately the TCA is an FTA uniquely designed to enable policy divergence rather than convergence. At the same time it aims to facilitate trade and investment between the parties in a manner which 'stands the test of time.'[5] Thus the LPF commitments in the agreement attempt to straddle a narrow line along which parties are able to veer away from existing rules provided that this does lead to significant, quantifiable harm to trade or investment flows between the parties. It seeks to achieve this while not deterring parties from pursuing their own regulatory reforms since any resulting retaliation by the other party is tightly circumscribed as well as subject to the TCA's dispute settlement provisions.

This comment will begin by briefly outlining the main features of the dispute settlement under the TCA's LPF obligations. It will then turn to the LPF's rebalancing obligations and the specialized system for unilateral retaliation for alleged breaches. This section will discuss the substantive obligations contemplated in the TCA's LPF chapter, highlighting the difficult evidentiary threshold for demonstrating breach. Section IV will consider in more detail the remedies available for transgression of the LPF's rebalancing provisions, observing problems with calibrating a proportionate response to an adverse effect on trade and investment flows. The next section considers the procedural elements of the dispute settlement mechanism designed to enforce the TCA's LPF obligations, review of which may be conducted by a dedicated Panel of Experts. Section V examines the TCA's general state to state arbitration

[4] Art 355.4
[5] Art 355.4

system as it applies to the LPF, noting some emerging concerns in relation to time frames and composition. Section V concludes with the observation that the TCA's LPF rules present a difficult test to establish violation, suggesting that the system may only be applicable to the most egregious situations, or perhaps even less; that it serves a largely symbolic function aimed at underscoring the TCA's two chief objectives of sovereignty and shared values.

II Dispute Settlement and the LPF

Before embarking on an analysis of the LPF obligations in the TCA it is important to set out in general levels how these obligations fit with the agreement's general dispute settlement mechanism. For some aspects of the LPF rules in the TCA, the agreement's main dispute settlement rules are fully excluded. This includes some of the general rules, competition, some of the subsidy obligations and taxation. Other LPF elements are fully subject to the general dispute settlement rules. This includes Article 355(2) of the LPF rules which outlines the precautionary approach to regulation and the rules on state-owned enterprises found in Chapter 4. Still other features of the LPF are subject to a modified version of the general dispute settlement rules.[6] Other aspects of the LPF, including the innovative rebalancing system, are subject to various modified dispute settlement rules as laid out in the LPF provisions themselves.

One special set of LPF rules applies to the non-regression provisions on labour and environmental standards in chapters 6 and 7 and the 'sustainable development' rules in Chapter 8, which concern the environmental but also some labour standards. These LPF rules consist of a special consultation procedure.[7] There is a special panel of experts instead of arbitrators designed to respond *ex post* to unilateral measures which the other party believes were undertaken unlawfully.[8] Disputes on the labour and environmental chapters are subject to additional dispute settlement rules.[9]

A party may retaliate where a panel report rules there is a breach of the non-regression clause (or of other aspects of the labour and environment chapters). In keeping with the general

[6] See Art 760
[7] Art 408
[8] Art 409
[9] Art 410

instances of retaliation under the TCA, there is also a review of whether the losing party ultimately has complied with the panel report, in which case the retaliation must be terminated.

The TCA's LPF rules also apply to subsidies. The general dispute settlement system cannot rule on subsidies in individual cases, except in certain circumstances, or on the recovery of subsidies in individual cases. This limit is outlined in Article 375(2) of the LPF provisions:

2. An arbitration tribunal shall have no jurisdiction regarding:

(a) an individual subsidy, including whether such a subsidy has respected the principles set out in Article 366(1) (ex-paragraph 1 of Article 3.4 [Principles]), other than with regard to the conditions set out in Article 367(2), Article 367(3), (4) and (5), Article 367(8) to (11) and Article 367(12) [Unlimited state guarantees], (3) to (5) [Rescue and restructuring], (8) to (11) [Export subsidies] and (12) [Subsidies contingent upon the use of domestic content]); and

(b) whether the recovery remedy within the meaning of Article 373 [Recovery] has been correctly applied in any individual case.

Another set of special rules applies to the subsidies component of the LPF obligations but is not reflected in the main dispute settlement rules. Under these provisions if a subsidy has allegedly caused a 'significant negative effect on trade or investment' or there is a 'serious risk' that it may do so, the complaining party, following consultations, can retaliate without prior approval by the arbitrators.[10] This unilateral retaliation may be challenged on a fast-track basis, although the arbitrators can only examine its compatibility with some of the rules in the subsidies section.[11] The challenge must be brought within five days, and has no suspensive effect. Additionally there are special rules expressly allowing 'return retaliation' if the arbitrators rule that the initial retaliation is in breach of the rules, but it has not been rescinded.

Perhaps most controversially, another set of modified dispute settlement rules applies to 'rebalancing' which covers divergences in future labour, environment or subsidies legislation,[12] as will be explored further below. Here the intended retaliation must be notified to the other side after which consultations then take place for 14 days and in the absence of an agreement during this period the rebalancing retaliation can be imposed. There is no prior requirement that arbitrators find a breach of the TCA, with a reasonable time to comply before this retaliation can take place. Within five days the other side can ask arbitrators to rule on

[10] Art 374
[11] Art 374.9
[12] Art 411

whether the retaliation is consistent with the TCA's rules on rebalancing. The arbitrators must rule within 30 days. If they rule against the retaliation, it must be discontinued. If it is not discontinued, 'return retaliation' is expressly possible.

From the above it is evident that dispute settlement under the TCA's LPF obligations is highly complex with many different avenues available depending on the nature of the alleged breach. These include both unilateral retaliation as well as remedies authorized by an arbitration panel. Space does not permit a full examination of all provisions in this article. Rather, the next sections will focus on the most innovative aspects of the LPF system, notably the rebalancing system for regulatory derogations which affect trade or investment.

III. LPF and Rebalancing: Substantive Elements

The essence of the TCA's LFP requirement is contained in the broad statement found in Article 355.4:

> The Parties affirm their common understanding that their economic relationship can only deliver benefits in a mutually satisfactory way if the commitments relating to a level playing field for open and fair competition stand the test of time, by preventing distortions of trade or investment, and by contributing to sustainable development. However, the Parties recognise that the purpose of this Title is not to harmonise the standards of the Parties. The Parties are determined to maintain and improve their respective high standards in the areas covered by this Title.

This approach is elaborated in Article 387.2 which states that parties shall not weaken or reduce their social or labour protections in a manner affecting investment between the parties from where the standards are at the end of the Brexit Transition Period (the end of 2020). This requirement applies also to environmental protection under Article 391.2. Chapter 8 of the TCA sets out the minimum international standards in areas such as labour and the environment to which the parties are committed, giving some shape to the substantive nature of the non-regression norms.

As noted above, Article 374 covers the LPF obligation as it applies to subsidies. The agreement enables unilateral retaliation against illegal subsidies without the prior authorisation of an arbitration tribunal, much as under the World Trade Organization (WTO) Agreement on Subsidies and Countervailing Measures (SCM). The threshold for such retaliation through the removal of tariff concessions is high – it requires "serious risk that it will cause, a significant negative effect on trade or investment between the Parties." Negative effects must be "based on facts and not merely on allegation, conjecture or remote possibility." The "the change in

circumstances … create a situation in which the subsidy would cause such a significant negative effect must be clearly predictable."[13] This appears to contemplate a blacklist by which the TCA's Partnership Council, the joint body charged with managing the implementation of the agreement, would identify subsidy types that would fall on a *per se* basis into this category. The language evidently suggests a rather high threshold for the retaliation to be warranted.

Most notably, there is an additional specialized 'rebalancing' section in the TCA designed to respond to significant divergences between the parties in labour, the environment and subsidy policy via unilateral retaliation by the other party. The essence is contained in paragraph 411.2:

> If material impacts on trade or investment between the Parties are arising as a result of significant divergences between the Parties in [labour and social, environmental or climate protection, or with respect to subsidy control], either Party may take appropriate rebalancing measures to address the situation. Such measures shall be restricted with respect to their scope and duration to what is strictly necessary and proportionate in order to remedy the situation. Priority shall be given to such measures as will least disturb the functioning of this Agreement. A Party's assessment of these impacts shall be based on reliable evidence and not merely on conjecture or remote possibility.

Such 'non-regression' clauses (also known as 'standstill' or 'ratchet' clauses) are common in modern FTAs, having first appeared in the North American Free Trade Agreement (NAFTA). They are seen as a key part of the movement towards the recognition of the role of states in ensuring the observation by investors of corporate social responsibility principles, such as they relate to the environment as well as human rights.[14] An example of such a provision can be found in the Canada-EU Comprehensive Economic and Trade Agreement (CETA):

> The Parties recognise that it is inappropriate to encourage trade or investment by weakening or reducing the levels of protection afforded in their labour/environment law and standards.
>
> 2. A Party shall not waive or otherwise derogate from, or offer to waive or otherwise derogate from, its labour/environment law and standards, to encourage trade or the establishment, acquisition, expansion or retention of an investment in its territory.
>
> 3. A Party shall not, through a sustained or recurring course of action or inaction, fail to effectively enforce its labour/environment law and standards to encourage trade or investment.[15]

[13] Art 374.5

[14] See e.g. M Footer, 'Bits and Pieces: Social and Environmental Protection in the Regulation of Foreign Investment' 18:1 Michigan State International Law Review 33 (2009)

[15] Art 23.4 (labour) and Art 24.5 (environment)

Such clauses are thought to have had provided rather limited protection, at least in the case of the environment.[16] Indeed, there have been very few disputes arising under FTAs for breach of non-regression provisions. One such claim was brought under the Dominican Republic-Central America United States Free Trade Agreement (CAFTA-DR). The US argued that Guatemala had failed to enforce its own labour laws in part by preventing workers from forming unions, allegedly resulting in their competitive advantage over US workers. The tribunal was unable to find that any weakening took place in a manner affecting trade, ruling that "attempting to establish that an effect on prices is due to a failure to enforce and not to … other factors would often be so fraught with difficulty as to make proof of trade effects impossible."[17] This assessment was despite the fact that the CAFTA tribunal articulated a relatively weak trade effects test; the US had needed to demonstrate merely that Guatemala's disputed practices had conferred "some competitive advantage on an employer or employers engaged in trade with the United States."[18] Commentators have noted that this appears to be a fairly low threshold, compared for example to the injury test in safeguard proceedings, which requires substantial industry-wide effects.[19] Yet the CAFTA tribunal still found no evidence that any cost savings that might have accrued to Guatemalan exporters as a result of the alleged enforcement failures provided a competitive advantage. The United States Mexico Canada Agreement (USMCA) non-regression model subsequently reversed the logic of the Guatemala ruling by placing the onus on the state enacting the regressive measure to justify that its non-fulfilment of a labour or environment standard does not affect trade or investment between the parties, which is otherwise presumed from the derogation.[20] This wording is not seen in the TCA.

The threshold for harm which breaches the TCA's LPF rebalancing obligation is undoubtedly a high one, as evident in the adjective 'material' in the phrase 'material impact.' Questions of interpretation under the TCA are to be resolved by reference to public international law (not EU or UK law). Title II Article 4 provides as follows:

> 1. The provisions of this Agreement and any supplementing agreement shall be interpreted in good faith in accordance with their ordinary meaning in their context and in light of the object and purpose of the agreement

[16] A Jordan, V Gravey, B Moore and C Reid, 'EU-UK trade relations: why environmental policy regression will undermine the level playing field and what the UK can do to limit it' Brexit and the Environment, Friends of the Earth (undated) at 8

[17] Dominical Republic – Central America – United States of America, In the Matter of Guatemala – Issues Relating to the Obligations Under Article 16.2.1(a) of the CAFTA-DR, Final Report of the Panel, circulated 14 June 2017, para 58-60.

[18] Ibid. para 190

[19] M Bronckers and G Gruni, 'Retooling the Sustainability Standards in EU Free Trade Agreements' 24:1 Journal of International Economic Law (23 Feb 2021)

[20] Art 23.4 footnote 9

in accordance with customary rules of interpretation of public international law, including those codified in the Vienna Convention on the Law of Treaties, done at Vienna on 23 May 1969.

2. For greater certainty, neither this Agreement nor any supplementing agreement establishes an obligation to interpret their provisions in accordance with the domestic law of either Party.

3. For greater certainty, an interpretation of this Agreement or any supplementing agreement given by the courts of either Party shall not be binding on the courts of the other Party.

While it is admittedly a different concept than 'material impact,' in public international law a 'material breach' of a treaty is one which violates 'a provision essential to the accomplishment of the object or purpose of the treaty.'[21] Here the adjective 'material' contemplates a violation so serious that it allows the other party to terminate the treaty. This will not be an easy standard to meet. The phrase 'material impact' of Article 411.2 also calls for an interpretation based on the ordinary meaning of the words.[22] The English dictionary definition of 'material' is one which contemplates a high threshold, synonymous with that which is 'significant, important' or 'significant or relevant, especially to the extent of determining a cause or affecting a judgement.'[23] This suggests that only the most egregious impacts on trade or investment are likely to be caught by this provision.

The constrained nature of the LPF rebalancing system is also revealed by an understanding of the meaning of 'impact' on investment. The dictionary definition of 'impact' speaks of 'a strong effect,'[24] suggesting something momentous as opposed to mundane, an outcome which is further emphasized by the modifier 'material.' The principal of effectiveness in treaty interpretation establishes that any provision in a treaty must be understood to have some significance and to achieve some end – it cannot be interpreted in such a way that would render the word meaningless.[25] Accordingly the word 'material' is not redundant – it is an adjective which confines the notion of impact to the most serious cases. The scope for reaction against mis-alignment between the two parties appears even narrower in this light.

Since the rebalancing system in the TCA has been aptly described as a new kind of trade remedy,[26] it is helpful to think of 'impact' as specified in the TCA as the opposite of a

[21] Vienna Convention on the Law of Treaties, Art 60(3)b (23 May 1969)
[22] Ibid, Art 31(1)
[23] Oxford English Dictionary, 2010 at 1091. It should be noted that the TCA has several other authentic languages besides English, namely all the other official EU languages (Art 780).
[24] Ibid, 2010 at 876
[25] Wintershall v Argentina, ICSID/ARB/04/14 Award (8 December 2008) at [165]
[26] S Lester, 'Will the Post-Brexit EU-UK Trade Agreement Limit Regulatory Competition?' Cato (28 December 2020)

'benefit' as found in the WTO SCM Agreement.[27] Analysis of 'benefit' by WTO panels and the Appellate Body has focused on market-based assessments, such as whether the recipient received a financial contribution on terms more favourable than would otherwise be available to it in the relevant market.[28] 'Impact' would seem to be the opposite of 'benefit' – the affected party suffered in a manner that it would not have done within the relevant market in the absence of the measure – essentially an injurious market distortion. Implicit references to market normality are seen in commentators' use of the word 'artificial' to characterize acquisition of a comparative advantage over the other party through the derogation from existing standards.[29] Clearly this approach raises complicated questions regarding the nature of the market in which the injured firm operates in the first place.[30]

Marked changes in comparative advantage, suggesting long-term transformations in trade or investment flows, will not be easy to demonstrate let alone attribute to certain regulatory causes, as the tribunal in *US v Guatemala* observed. This is because Foreign Direct Investment (FDI) flows tend to fluctuate significantly from year to year in response to many different factors.[31] It would accordingly be difficult to discern the signal of impacts from lower standards from the noise of movements from all other causes. Trade flows are somewhat more stable, but they are also highly variable, as well as dependent on other factors (such as the Covid-19 epidemic).[32] Parsing out which changes have resulted from which legal interventions, rather than other systemic or random factors, would be a difficult task.

Even more problematic, an assessment of the impacts for breach of the LPF obligations must be based on 'reliable evidence and not merely on conjecture or remote possibility.' But, again, in most cases, establishing a counter-factual – the situation that would have occurred had there not been material regulatory divergence on the LPF – would be hard without extensive guesswork.[33] For example, in the case of a diversion in foreign investment, the complainant would need to show that an investor that would have located in its territory decided

[27] Art 1(1)b
[28] Appellate Body Report Canada – Aircraft, WT/DS70/AB (adopted 4 August 2000) at [154] and [157]
[29] J Lebullenger, 'Specific procedures for settling labour disputes in Asia-Pacific trade partnership agreements' 5/6 International Business Law Journal 853-869 (2020) at 854
[30] D Underhalter, 'On Interpretation and Economic Analysis of Law' in M Jansen, J Pauwelyn and T Carpenter eds. *The Use of Economics and International Trade and Investment Disputes* (Cambridge University Press, 2017) at 80-81
[31] See e.g. 'Foreign direct investment distribution, UK trends and analysis: February 2021' Office of National Statistics (UK) (March 2021)
[32] See e.g. 'UK trade: January 2021' Office of National Statistics (UK) (March 2021)
[33] D Collins and TJ Park, 'Deafening Silence or Noisy Whisper: Omission Bias and Foregone Revenue under the WTO Agreement on Subsidies and Countervailing Measures' 51:6 Journal of World Trade 1069-1088 (2017)

instead to establish in the other party's territory because the regulatory environment in that jurisdiction was more attractive, not to mention lower or weaker in some measurable way. Alternatively, the complainant would need to show that the lower regulation in the other party's territory was the reason that an investor moved from its former location in one party into the other party's territory. In either case, establishing an investor's strategic motivation in this way would be a tough evidentiary burden.[34] The fact that the TCA neglected to provide a definition for 'significant divergences' further indicates that this test will be hard to apply in practice.[35]

Most commentators appear to agree that the retaliation against departures from the LPF obligations will be difficult to challenge. One asserts 'in practice it may not be all that easy to impose these [retaliation] measures, and if that's the case, there won't be much impact on a government's regulatory decisions.'[36] Another notes "having to prove that a lowering of labour or environmental protection actually has trade or investment effects may appear so formidable a condition as to render the disciplines of the non-regression and non-enforcement clauses illusory."[37] The assessment of what is meant by lowering of a standard in terms of an associated impact on the environment is a major problem with non-regression clauses in FTAs, severely impairing their functionality. It has been said that '[t]he difficulties and uncertainties in forecasting and measuring the effectiveness of environmental policies … as it develops over time create unanswered problems in applying non-regression clauses in practice.'[38] Environmental regulations pose particular challenges for trade tribunals[39] precisely because their causes and results are often diffuse and scientifically complex, complicating evidence-based approaches to establish sufficient 'equivalence' between approaches.

A plausible solution might be for non-regression type provisions, such as the TCA's LPF, would be to focus on the intent behind the lowering of regulatory standards, rather than requiring that a competitive effect on trade or investment to be proven. Still, establishing anti-

[34] As in this case of counterfactuals for subsidization cases at the WTO: C Lau and S Schropp, 'The Role of Economics in WTO Dispute Settlement and Choosing the Right Litigation Strategy: A Practitioner's View' in M Jansen, J Pauwelyn and T Carpenter eds. *The Use of Economics in International Trade and Investment Disputes* (Cambridge University Press, 2017) at 58

[35] AE Luyten, 'The EU-UK TCA: A Front-runner in Trade and Sustainable Development' Trade Experettes (16 March 2021)

[36] Lester, above n 26

[37] Bronckers and Gruni, above n 19

[38] A Mitchell and J Munro, 'No Retreat: An Emerging Principle of Non-Regression from Environmental Protections in International Investment Law' 50 Georgetown Journal of International Law (2019) 625 at 630

[39] E Lydgate, 'Non-regression clauses: sufficient to maintain the UK-EU future relationship on environmental standards and regulation?' <http://sro.sussex.ac.uk/id/eprint/81765/3/Non-regression%20clauses.pdf> (undated)

competitive intent is not necessarily any more straightforward.[40] Commentators caution 'the more intermediary steps between the regression [of the standard] and the encouragement, the more difficult it may be to demonstrate that the regression is the mechanism through which an "encouragement" is given effect, rendered even more problematic if subjective intent to encourage is required.'[41] In some EU treaties,[42] regression or non-enforcement is prohibited where it operates as 'an encouragement to trade' implying an intention on the part of the relevant regulatory. In such situations, it is the demonstration of that intent to affect trade or investment which is necessary, whereas the actual effects on trade or investment need not be shown.[43] Prohibiting the regression or non-enforcement of labour or environmental legislation merely on the basis of an intent to encourage trade or investment, without a showing of measurable effects, could have sweeping impact. This especially so if the requisite intent would not need to be specifically focused on the relationship between the treaty partners.[44] This may explain why the language of intent is absent from the text of the TCA.

It should be mentioned that some commentators believe that the TCA's rebalancing tests are broad in some respects. This is because they cover *any* weakening or reduction in domestic levels of labour and environmental protection, not just waivers or derogations from laws, or sustained or recurring non-enforcement.[45] One observer writes: 'The process is startling because of … the lax test for when they may be imposed …[it] requires there to be a "material impact" before these can be imposed but it is not clear what the word "material" adds. Any impact will have material effects.'[46] But the notion that divergences are presumptively impactful is not credible. If the qualifier 'material' did not expand the understanding of impact, then it would not have been included in the text of the agreement at all, under the principle of effectiveness mentioned earlier. Others hold that the rebalancing mechanism 'gives the parties significant room of manoeuvre to self-judge whether a certain situation justifies unilateral corrective measures.' The LPF provisions in the TCA 'could be an invitation to threaten to trigger these mechanisms, which in turn could provoke numerous small-scale trade wars.'[47] Yet again, his claim of 'significant room to manoeuvre' does not appear tenable given the

[40] Ibid
[41] Mitchell and Munro above n 38 at 680
[42] For example, Article 13.3(3) of the EU–Vietnam FTA (non-enforcement); Article 13.7(2) of the EU–Korea FTA (non-regression); Article 23.4 of the CETA (non-regression and non-enforcement).
[43] Bronckers and Gruni, above n 19
[44] Ibid.
[45] Ibid.
[46] D Chalmers, 'British Sovereignty Run by Europe' UK in a Changing Europe (29 December 2020)
[47] N Lavranos, "EU UK TCA: level playing field, disputes, energy and climate" Borderlex (29 December 2020)

clearly exceptional nature of the legal tests for materiality and necessity, as these concepts are understood in international law.

IV. Remedies and LPF Rebalancing

The primary remedy for breach of the TCA is to bring the offending measure into conformity with the agreement's obligations. Tariffs are presented as a secondary remedy.[48] The agreement therefore manages to preserve the parties' right to pursue an autonomous approach to regulation, subject to potential retaliatory tariffs. Retaliation can apply across different areas of the agreement,[49] permitting the EU and the UK to choose the most politically sensitive areas against which to take retaliatory steps. Yet again, the 'strictly necessary' standard for unilateral measures taken in response to material deviations in the LPF offers rather limited scope to impose any such tariffs. Under public international law the standard of 'necessity' is usually taken to mean that it is 'the only means for the State to safeguard an essential interest against a grave an immanent peril.'[50] In the field of trade, 'necessity' under the WTO's General Agreement on Tariffs and Trade (GATT) Article XX General Exceptions is similarly confined. It is understood to mean something close to indispensable; that there is no less trade restrictive way to achieve the desired goal.[51] Likewise, investment jurisprudence suggests that this is a very tough test for host states to meet.[52]

The TCA's LPF rebalancing tariffs must further be 'proportionate.' Proportionality tests are believed to be evident in the decisions of WTO panel and international investment law tribunals.[53] The principle of proportionality originates in German administrative and law and has been defined as 'a method of legal interpretation and decision making in situations of collisions or conflict of different principles and legitimate public policy objectives.'[54] It is thought to involve several steps, one of which compares the effect of the measure to the benefit

[48] Art 746.1
[49] Art 762 [conditions for rebalancing] and Art 696 [Scope].
[50] International Law Commission Articles on State Responsibility 2001, art 25(1)
[51] Appellate Body Report, Korea Beef, WT/DS161/AB at [161] (adopted 10 January 2001)
[52] See e.g. C Galvez, '"Necessity", Investor Rights, and State Sovereignty for NAFTA Investment Arbitration' 46 Cornell International Law Journal 143 (2013)
[53] V Vadi, *Proportionality, Reasonableness and Standards of Review in International Investment Law and Arbitration* (Elgar, 2018)
[54] B Kingsbury & S Schill, 'Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest – The Concept of Proportionality', in S Schill (ed), *International Investment Law and Comparative Public Law* (Oxford University Press, 2010) at 79

sought.[55] It is not clear that this is what is envisioned here in the narrow context of the LPF's rebalancing obligations. The most likely understanding of proportionality as it used here probably involves calibrating the response to the harm suffered. It may accordingly be likened to the assessment of appropriate countervailing duties against subsidies or even the quantum of compensation payable in international investment arbitration for expropriations. In the case of the LPF rebalancing, setting appropriate tariffs in response to material impactful divergences would be complex and complicated. The lack of a clear definition of appropriate "rebalancing measures" ideally with examples, further muddles the assessment.[56]

Article 761.1 of the TCA provides details on remedies for the purposes of the LPF provisions. One of the more significant rules is as follows: "The level of nullified or impaired benefits requested by the complaining Party or determined by the arbitration tribunal: (a) shall not include punitive damages, interest or hypothetical losses of profits or business opportunities."[57] While punitive damages are conventionally excluded from remedies as a principle of international law[58], the reference to hypothetical losses underscores the need for clear evidence-based harms to trade or investment flows.

Even were it feasible for a party to quantify the impact on trade or investment flows, this would need to be expressed not in monetary damages (as in the case of remedies in international investment law) but translated into preferential tariff concessions in favour of the other party which would thereby be removed, more analogous to countervailing duties in trade law. While declines in trade flows could provide some guidance for retaliatory tariffs on goods, for investment impact, as noted above there would need to be a calibration of the harmful effect of the investor's movement from one jurisdiction to the other, or even more problematically, its failure to establish in one party in the first place, instead choosing the other party's territory, in which case the 'impact' would be entirely hypothetical. A plausible guide to compensation in the latter case could be situations in which pre-establishment national treatment was

[55] P Ranjan, 'Using the Public Law Concept of Proportionality to Balance Investment Protection with Regulation in International Investment Law' 3:3 Cambridge Journal of International and Comparative Law (2012) at 856
[56] Luyten, above n 35
[57] Art 761.3
[58] ILC Articles on State Responsibility, Art 36. UN Commentaries at 99, adopted by the International Law Commission at its fifty-third session, in 2001, and submitted to the General Assembly as a part of the Commission's report covering the work of that session (A/56/10)

breached.[59] This might involve re-location costs or wasted capital expenses on premises and so on – a very messy exercise indeed.

In addition to the main remedy of tariffs for departures from the LPF, there is also the possibility for a limited reopening of the LPF commitments, providing essentially for a long-term rebalancing system aimed at accommodating permanent regulatory divergence. Overuse of the unilateral rebalancing system (whatever that might mean) can trigger a review of the LPF commitments entirely.[60] For example, if the UK pursued more far-reaching environmental policies, it may argue that EU business had an unfair advantage. Under such circumstances, it may seek to activate the 'rebalancing' mechanism in the short term and apply tariffs accordingly. In the longer term, the UK may wish to amend the TCA to take this divergence of approach into account. This goal is achieved by ensuring that any future negotiations are focussed on the LPF only as it applies to investment and trade, stimulating a limited tariff negotiation on goods in response to any derogation from the LPF provisions.[61]

Retaliation for breach of the LPF rebalancing measures may be challenged by reference to a Panel of Experts in a process outlined in Art 409. This procedure may be used if consultations between the parties have failed after five days, which is a rather short timeframe. After this point, the parties may request that the Panel of Experts be convened. The Panel of Experts is to be composed of three panellists, drawn from a list of at least 15 individuals (for which each party must name five). These people must have specialised knowledge or expertise in labour or environmental law or 'other issues' such as the resolution of disputes arising under international agreements and they must not be officials of either party. The terms of reference for the Panel of Experts is "to examine, in the light of the relevant provisions, the matter referred to … and to deliver a report…that makes findings on the conformity of the measure with the relevant provisions."[62] The Panel is authorized to request and receive information from persons with relevant information or specialised knowledge, potentially assisting in discharging the difficult evidentiary burdens noted earlier.

The Panel of Experts will issue an interim report (within 125 days) and a final report (within 175 days, with possibly extension to 195 days) setting out the findings of fact, its

[59] D Collins, 'National Treatment in Emerging Market Investment Treaties' in A Kamperman Sanders ed. *The National Treatment Principle in an EU and International Context* (Elgar, 2014) 161-182
[60] Art 411.5
[61] Art 411.8
[62] Art 409.5

determinations on the matter including as to whether the responding party has conformed with its obligations and the rationale behind any findings that it makes. The final report shall be made available to the public within 15 days. Importantly though, the Panel's findings are evidently not binding on the parties, as outlined in subsection 9: "the Parties share the understanding that if the Panel makes recommendations in its report, the responding Party does not need to follow these recommendations in ensuring conformity with the Agreement." If the final report of the panel of experts determines that a party has not conformed with its obligations, the parties shall, within 90 days of the delivery of the final report, discuss "appropriate measures" to be implemented taking into account the report of the panel of experts. If the Parties disagree on the consistency with the relevant provisions of any measure taken to address the non-conformity, the complaining party may deliver a request to the original Panel of Experts to decide on the matter, essentially a remand facility. The request shall identify any measure at issue and explain how that measure is not in conformity with the relevant provisions in a manner sufficient to present the complaint clearly. The Panel of Experts must deliver its findings to the Parties within 45 days of the date of the delivery of the request. The suspension of treaty obligations (for the LPF or any other component of the TCA) can become permanent if the objected-to change in law is not brought into conformity with the agreement, as this is the primary remedy for breach of the TCA.

As noted in Section II, a party may impose retaliatory tariffs where a panel report under the general arbitration mechanism of the TCA rules there is a breach of the non-regression clause or of other aspects of the LPF obligations. Some of the salient features of the general dispute settlement provisions of the TCA therefore deserve further attention.

V. General Dispute Settlement under the TCA

The TCA's general dispute settlement mechanism requires exclusivity: "The Parties undertake not to submit a dispute between them regarding the interpretation or application of provisions of this Agreement or of any supplementing agreement to a mechanism of settlement other than those provided for in this Agreement."[63] However it is clear that where the agreement covers material that is actionable under other disciplines, an alternative route for dispute settlement may be employed. Article 737 on choice forum adds:

[63] Art 736

1. If a dispute arises regarding a measure allegedly in breach of an obligation under this Agreement or any supplementing agreement and of a substantially equivalent obligation under another international agreement to which both Parties are party, including the WTO Agreement, the Party seeking redress shall select the forum in which to settle the dispute.

2. Once a Party has selected the forum and initiated dispute settlement procedures either under this Title or under another international agreement, that Party shall not initiate such procedures under the other international agreement with respect to the particular measure referred to in paragraph 1, unless the forum selected first fails to make findings for procedural or jurisdictional reasons.

It is likely that in order to avoid violating the exclusivity clause, a party which invoked a legal regime other than the TCA would probably need to make its arguments expressly in that other dispute settlement system without referring to the TCA.[64] This arrangement is designed to preclude the complaining party from bringing multiple proceedings under different systems. A party can still bring multiple complaints if the first forum it chose refuses to rule on the merits. This also acts to prohibit an attempt to bring a complaint to one forum after the first one has rejected the essentially identical complaint on the merits – a kind of cause of action estoppel.

Subsection 4 of this article clarifies that parties are not precluded from suspending obligations authorised by the Dispute Settlement Body of the WTO (e.g. countervailing duties for subsidies) or any other dispute settlement system of another FTA. For clarity, this section adds that WTO obligations, or any other international agreement between the parties, shall not be invoked to prevent a party from suspending obligations pursuant to the TCA's dispute settlement system. Thus, while parties must ensure that their international obligations are compatible with the TCA, such obligations may not operate to undermine the effectiveness of this agreement's enforcement mechanism.

One of the most important features of the TCA's dispute settlement mechanism is that decisions and rulings of the arbitration tribunal will only be binding on the EU and on the UK. They do not create any rights or obligations with respect to natural or legal persons, such as investors or traders.[65] This is outlined in Article 754(3) and (4) which reads:

3. Decisions and rulings of the arbitration tribunal cannot add to or diminish the rights and obligations of the Parties under this Agreement or under any supplementing agreement.

4. For greater certainty, the arbitration tribunal shall have no jurisdiction to determine the legality of a measure alleged to constitute a breach of this Agreement or of any supplementing agreement, under the domestic law of a Party. No finding made by the arbitration tribunal when ruling on a dispute between the Parties shall bind the domestic courts or tribunals of either Party as to the meaning to be given to the domestic law of that Party.

[64] S Peers, 'Analysis 4 of the Brexit deal: Dispute settlement and the EU/UK Trade and Cooperation Agreement' EU Law Analysis Expert insight into EU law developments (20 April 2021)
[65] Art 754.2

Furthermore, domestic courts have no role in the resolution of disputes between the parties under the TCA.[66] This provision, perhaps the most pivotal in the entire TCA, is critical because it removes the interpretation of the TCA from any reference to EU law, either as it currently exists or as it is developed by the Court of Justice of the European Union (CJEU). Extricating itself from the jurisdiction of the CJEU was one of the main reasons behind the UK's withdrawal from the EU.[67] The lack of CJEU oversight is fundamental to the LPF rules, which are focused on regulatory autonomy, even as they aim to restrict severe regulatory misalignments. Of course, this provision works both ways; it also excludes UK law as an interpretive aid to the TCA, as well as ousts the jurisdiction of the UK courts. Removing any affect on domestic law has been described as a strongly 'dualist' approach to the dispute settlement process which is binding at international level but not in domestic law – a clear indication of the UK's approach to sovereignty.[68]

As with state-to-state arbitration procedures found in many modern FTAs and the Panel of Experts re-balancing facility, the TCA's main arbitration process includes mandatory consultations followed by formal arbitration within a strict timeframe.[69] During consultations, each party shall provide the other party with sufficient information in its possession to allow a full examination of the matters raised. Each party shall endeavour to ensure the participation of personnel of their competent authorities who have expertise in the matter subject to the consultations.[70]

The arbitration tribunal itself to be composed of three arbitrators,[71] similar to investor-state dispute settlement and WTO panel procedures. The composition of the arbitration panel is established by agreement between the parties within ten days after the request for the establishment of an arbitration tribunal.[72] Sub-lists of arbitrators nominated by the EU and the UK, who must not be nationals of either party, are to be drawn up within 180 days of the TCA's entry into force (still not yet elapsed at the time of writing). There must be at least five persons

[66] Art 754.4
[67] 'The government's negotiating objectives for exiting the EU' speech of former Prime Minister Theresa May, (17 January 2017)
[68] Peers, above n 64
[69] Art 698
[70] Art 408
[71] Art 740.1
[72] Art 740.2

on each sub-list at all times.[73] Additional lists of individuals with expertise in specific sectors may be established with separate EU and UK nominated sub-lists.[74] Individuals on the lists must not be members, officials or other servants of the EU institutions, of the Government of a Member State, or of the Government of the UK[75] because the independence of arbitrators must be beyond doubt. These individuals must further possess the qualifications required for appointment to high judicial office in their respective countries or have recognized competence.[76] Arbitrators must also have demonstrated expertise in law and international trade[77] although expertise in international investment is not mentioned. Such expertise may be derogated from "in view of the subject-matter of a particular dispute."[78] The qualifications for arbitrators is more in line with standard FTA practice than that of the Panel of Experts which appears to contemplate non-legal expertise, perhaps a reflection of that body's fact-finding role.

Although deliberations of the arbitration tribunal are confidential, the arbitration tribunal's rulings are to be made publicly available by both parties.[79] The emphasis on confidentiality may be conspicuously contrasted with the movement towards greater transparency in international investment arbitration, as seen in the Mauritius Convention[80] as well as the recent work by the UNCITRAL Working Group on investor-state dispute settlement (ISDS) reform.[81] It would seem as though the arguments typically marshalled in favour of greater openness (enhancing legitimacy and accountability in the public's perception) are even stronger in the case of state-to-state arbitration than in investor-state dispute settlement where both parties are governments. The lack of transparency in the LPF dispute settlement procedure is further perplexing given the politically fraught context of the UK's departure from the EU. On the other hand, the media's sensationalization of Brexit may be precisely the reason why confidentiality is so essential.

It is noteworthy also that the TCA arbitration process does not appear to require the arbitral tribunal to disclose the reasons for its decision. This is in sharp contrast to generally accepted principles of international arbitration.[82] Reasoned decisions are thought to be

[73] Art 752.1
[74] Art 752.2
[75] Art 752.3
[76] Art 741.2
[77] Art 741.1 a)
[78] Art 741.3
[79] Art 754.6
[80] United Nations Convention on Transparency in Treaty-based Investor-State Arbitration (10 December 2014)
[81] Working Group III: Investor-State Dispute Settlement Reform, UNCTAD (February 2021)
[82] G Born, *International Commercial Arbitration* (Kluwer Law International, 2009) at 2450-2451

necessary to ensure legitimacy in the sense of fairness and can assist with future conduct. Again, the highly charged nature of the relationship between the UK and the EU, still present at the time of writing, suggests that the opacity of the dispute settlement procedure could be damaging in the long run, even as it may relieve some of the pressure of intense public scrutiny.

Article 751 on the Receipt of Information sets out how the arbitral tribunal may obtain additional information to assist it in rendering its decisions, which as noted earlier in the case of the LPF, will require the assessment of evidence on impact to trade and investment flows.

> 1. On request of a Party, or on its own initiative, the arbitration tribunal may seek from the Parties relevant information it considers necessary and appropriate. The Parties shall respond promptly and fully to any request by the arbitration tribunal for such information.
>
> 2. On request of a Party, or on its own initiative, the arbitration tribunal may seek from any source any information it considers appropriate. The arbitration tribunal may also seek the opinion of experts as it considers appropriate and subject to any terms and conditions agreed by the Parties, where applicable.

This article further establishes that tribunals 'shall consider amicus curiae submissions' in accordance with more detailed rules provided in the Art 409 on Rules of Procedure for Dispute Settlement which state:

> 5. Unless the Parties agree otherwise within five days of the date of the establishment of the arbitration tribunal, the arbitration tribunal may receive unsolicited written submissions from natural persons of a Party or legal persons established in the territory of a Party that are independent from the governments of the Parties, provided that they:
>
> (a) are received by the arbitration tribunal within 10 days of the date of the establishment of the arbitration tribunal;
>
> (b) are concise and in no case longer than 15 pages, including any annexes, typed at double space;
>
> (c) are directly relevant to a factual or a legal issue under consideration by the arbitration tribunal;
>
> (d) contain a description of the person making the submission, including for a natural person his or her nationality and for a legal person its place of establishment, the nature of its activities, its legal status, general objectives and its source of financing;
>
> (e) specify the nature of the interest that the person has in the arbitration proceedings…

The level of detail in these rules is welcomed, particularly since in some international tribunals (e.g. WTO panels), rules on amicus participation have been largely *ad hoc*. Broad discretion to consider amicus curiae briefs could go some way towards mitigating the otherwise lack of transparency in the arbitration process, potentially bolstering its legitimacy.

The arbitration tribunal must make every effort to take decisions by consensus, but if this is not possible, the arbitration tribunal will decide by majority vote. In no case will separate

opinions of arbitrators be disclosed.[83] The lack of minority opinions is in contrast with the (recent) custom of the WTO and investor-state dispute settlement, where although dissenting opinions are rare, they are permitted. Dissenting opinions are thought to undermine the perceived legitimacy of an arbitral institution and by extension, participant country's confidence in the system.[84] This is particularly the case for investor-state dispute settlement where there is no appeal from an incorrect decision. The rule against dissents is similar to that of the CJEU or the European Free Trade Association (EFTA) Court, a feature which has the disadvantage of undermining the potential clarity of the majority decision.[85] Disagreement among adjudicators is thought to have a positive effect on the development of the law, permitting different ideas to be fully considered, resulting in the acceptance of the strongest positions.[86] Interestingly, the drafting of any decision and report shall remain the exclusive responsibility of the arbitration tribunal and shall not be delegated.[87] This provision may help address the suspicion that some arbitrators pay their assistants to draft large parts of their opinions, in some cases even billing the parties for it,[88] surely an undignified practice with potentially harmful ramifications in terms of legitimacy and compliance.

It is not clear whether the TCA's dispute settlement system described above will be *ad hoc* or more permanent in nature. Some degree of permanence may be expected to provide greater stability in terms of ensuring consistency and predictability. The formalization of the dispute settlement system may ultimately depend on the extent to which it is used. In this regard, Paragraph 10 of ANNEX 48 on the Rules of Procedure for Dispute Settlement states that parties may appoint a registry to assist in the organisation and conduct of specific dispute settlement proceedings. Furthermore, within 180 days of the entry into force of the TCA, the Partnership Council will consider whether there are any necessary amendments to the rules (again not yet elapsed at the time of writing).[89]

[83] Art 754.1
[84] E Y Kim and P C Mavroidis, RSCAS 2018/51 Robert Schuman Centre for Advanced Studies Global Governance Programme-318, 'Dissenting Opinions in the WTO Appellate Body: Drivers of their Issuance & Implications for the Institutional Jurisprudence' (2018)
[85] MJ Clifton, 'Arbitration tribunal decisions and rulings in the UK-EU Trade and Cooperation Agreement: an initial examination' EU Relations Blog (29 December 2020)
[86] P Hogg and R Amarnath, 'Why Judges Should Dissent' 67(2) University of Toronto Law Journal 126 (2017)
[87] Annex 48 VI.16
[88] R Howse, ' International Investment Law and Arbitration: A Conceptual Framework' IILJ Working Paper 2017/1 MegaReg Series (17 April 2017) at fn 65
[89] Paragraph 10

The TCA further specifies that the Partnership Council may adopt decisions to issue interpretations of the provisions of Part Two (covering trade and investment).[90] The understanding of vague phrases (such as 'material impact') may benefit from constructive dialogue which promotes evolutionary and sustainable interpretations,[91] preventing confrontations and potentially forestalling withdrawal from the instrument altogether. States have so far been reluctant to seek joint interpretations of FTAs even in cases where there is significant legal uncertainty. This is somewhat surprising given that issuing a joint declaration is relatively easy for parties.[92] If a more permanent arbitration system comes into being under the TCA or if even if there are repeat arbitrators, then a system of informal precedent is likely to emerge. While this could add to predictability, the gravitas of a permanent adjudicatory body could conceivably increase the risk of 'judicial activism' undermining rights and obligations enshrined in the treaty text, and could exacerbate political tensions between the parties. One of the advantages of formal adjudication in FTAs is that it can help de-politicize disputes, distilling them into legal issues for which there are technical solutions arrived upon by specialists.

VI. Conclusions

Despite their important role in managing the UK and EU's ongoing relationship, the TCA's LPF obligations have been narrowly drafted, leaving little room for parties to bring successful claims for regulatory divergences in areas of labour, the environment and subsidy control. The LPF's re-balancing system, which establishes' injured parties' ability to levy compensatory tariffs against measures which have material impacts on trade or investment flows may be challenged by Panel of Experts – a body which is charged with not only evaluating the harms done to the parties' competitive position but also assessing whether the injured party's responses to these are strictly necessary and proportionate. Tariffs for breach of the LPF and other aspects of the TCA can also be authorized through the TCA's general dispute settlement system consisting of confidential state-to-state arbitration by a three-person tribunal. At no point to the courts of either the UK or the EU have any direct or interpretive role in the process.

[90] Annex 1: Rule 9
[91] T Gazzini, *Interpretation of International Investment Treaties* (Hart, 2016) at 338-339 at 329
[92] Ibid

While the TCA's LPF system is innovative and complex, itself unsurprising given the unprecedented context of a treaty which manages the departure of a significant member of a former economic union, its tightly-framed tests for impact and retaliation evince a mechanism that was purposefully crafted to discourage its use, or at least, its over-use. It would seem as though only the most extreme instances of adverse effects to trade and investment flows, with clearly quantifiable harms, will satisfy the agreement's requirements. The TCA's LPF obligations may even have been designed to serve a symbolic purpose – one in which parties are encouraged to remain true in spirit to their shared progressive values in relation to labour, the environment and subsidy policy, while fulfilling the fundamental purpose of the UK's departure from the EU: the capacity to chart its own path. Although the first months of the parties' post-Brexit relationship have been acrimonious, with legal action under the Northern Ireland Protocol forthcoming at the time of writing,[93] the LPF rules of the TCA accord a high degree of discretion to the parties founded on a core of shared ideals, a compromise which should help to ensure that the UK-EU relationship does 'stand the test of time.'

[93] Withdrawal Agreement: Commission sends letter of formal notice to the United Kingdom for breach of its obligations under the Protocol on Ireland and Northern Ireland (15 March 202)