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European Scrutiny Committee

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Documents considered by the Committee on 13 December 2017

Report, together with formal minutes

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Notes

Numbering of documents

Three separate numbering systems are used in this Report for European Union documents:

Numbers in brackets are the Committee's own reference numbers.

Numbers in the form "5467/05" are Council of Ministers reference numbers. This system is also used by UK Government Departments, by the House of Commons Vote Office and for proceedings in the House.

Numbers preceded by the letters COM or SEC or JOIN are Commission reference numbers.

Where only a Committee number is given, this usually indicates that no official text is available and the Government has submitted an "unnumbered Explanatory Memorandum" discussing what is likely to be included in the document or covering an unofficial text.

Abbreviations used in the headnotes and footnotes

AFSJ	Area of Freedom Security and Justice
CFSP	Common Foreign and Security Policy
CSDP	Common Security and Defence Policy
ECA	European Court of Auditors
ECB	European Central Bank
EEAS	European External Action Service
EM	Explanatory Memorandum (submitted by the Government to the Committee)*
EP	European Parliament
EU	European Union
JHA	Justice and Home Affairs
OJ	Official Journal of the European Communities
QMV	Qualified majority voting
SEM	Supplementary Explanatory Memorandum
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union

Euros

Where figures in euros have been converted to pounds sterling, this is normally at the market rate for the last working day of the previous month.

Further information

Documents recommended by the Committee for debate, together with the times of forthcoming debates (where known), are listed in the European Union Documents list, which is published in the House of Commons Vote Bundle each Monday, and is also available on the parliamentary website. Documents awaiting consideration by the Committee are listed in "Remaining Business": www.parliament.uk/escom. The website also contains the Committee's Reports.

*Explanatory Memoranda (EMs) and letters issued by the Ministers can be downloaded from the Cabinet Office website: http://europeanmemoranda.cabinetoffice.gov.uk/.

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Meeting Summary

The Committee looks at the significance of EU proposals and decides whether to clear the document from scrutiny or withhold clearance and ask questions of the Government. The Committee also has the power to recommend documents for debate.

Brexit-related issues

The Committee is now looking at documents in the light of the UK decision to withdraw from the EU. Issues are explored in greater detail in report chapters and, where appropriate, in the summaries below. The Committee notes that in the current week the following issues and questions have arisen in documents or in correspondence with Ministers:

Energy policy

The Committee takes note of the Government's observation that the transposition deadline for some of the energy policy legislation considered will probably fall during the post-Brexit implementation period of around two years proposed by the Prime Minister, although no assumptions are made as to the arrangements that will apply during that period.

European System of Financial Supervision

The Committee requests more information from the Treasury about new EU proposals to give the European financial regulators more powers, and the implications of the Brexit transitional period for the powers of the UK's domestic financial regulators under EU law.

Tax in the Digital Single Market:

- Will it be easier for the Government, outside the EU, to require digital businesses that currently route economic activity through other EU tax jurisdictions to have a permanent establishment in the UK and to pay higher corporate tax contributions?

Law enforcement—mutual recognition of freezing and confiscation orders

- Which of the EU mutual recognition instruments in which the UK participates are the most important from a law enforcement and criminal justice perspective?
- Does the Government intend these instruments to form part of the strategic agreement it is seeking with the EU on security, law enforcement and criminal justice?
- Are transitional arrangements likely to be needed to bridge any gap between the UK leaving the EU and a new strategic agreement taking effect?
- What is the significance of the distinction drawn between direct jurisdiction of the Court of Justice (which the Government opposes) and indirect jurisdiction?
- What type of dispute resolution model does the Government consider would be best suited to an agreement on the UK's future participation in EU criminal law mutual recognition instruments?

Summary

EU energy policy

We consider a number of documents relating to the future direction of EU energy policy, covering: electricity market design; renewable energy; energy efficiency; and governance. They include contentious proposals on future targets and on arrangements for co-operating and ensuring the smooth functioning of the market. With the exception of energy efficiency, where a progress report was considered, all of the other proposals were to be discussed at the Energy Council on 18 December. We waive the scrutiny reserve, allowing the Government to agree. In doing so, we signal our continued interest in the future energy relationship between the EU and the UK, noting the Government's observation that the transposition deadline for some of the legislation will probably fall during the post-Brexit implementation period of around two years proposed by the Prime Minister. We expect the Government to continue to negotiate this package of legislation with EU exit in mind.

Not cleared; scrutiny waiver granted; further information requested.

The European Public Prosecutor's Office (EPPO)

On 12 October, the proposed EPPO Regulation was finally adopted by the 20 Member States participating in the "enhanced cooperation". This is the process by which, in default of unanimity and with European Council agreement, a group of at least 9 Member States can proceed with an initiative. The EPPO will be in charge of investigating and prosecuting offences in relation to defrauding of the EU budget.

As the UK is not participating in the EPPO, a situation unlikely to be reversed given Brexit and the need for a Referendum under the European Union Act 2011 to approve UK participation, this development is of limited significance. Following four years of close scrutiny, we therefore clear the two texts under scrutiny: the original Commission proposal and the Council Presidency text which has led to the adopted "enhanced cooperation" proposal.

However, despite the Government's reassurances in its recent letter to us of 1 November, we seek final confirmation that there are no material implications for the UK: before exit and during any transition/implementation period as a non-participating Member State or for any post Brexit JHA cooperation with the EU as a third country.

Both texts cleared from scrutiny; further information requested.

Digital Single Market: Consumer contract rights relating to the online and offline sale of goods

The original proposed Directive on the online and distance sale of goods was presented in December 2015. It was aimed at breaking down barriers to cross-border online trade due to differing Member States' contract law on matters such as quality of goods, remedies for defective goods and guarantees. Together with a parallel proposal on supply of digital content, it is key to the realisation of the Digital Single Market.

An amended proposal now supersedes the original proposal. Following calls from a majority of Member States and EP Committees, the amended proposal now extends to both online and offline sales of goods, reflecting the outcome of a REFIT (regulatory "fitness for purpose" review) of existing EU consumer law. The previous Government seemed concerned about the original proposal leading to different contractual rules for online and offline sales. The current Government now merely notes that the extension in scope is significant, covering over 90% more sales transactions across the EU than the original proposal. It would capture many businesses who do not sell online or at a distance and who may not enjoy single market benefits. The Government highlights points of divergence between the "maximum harmonisation" proposal (where more or less stringent national requirements cannot be maintained) and current UK law, mainly within the Consumer Rights Act 2015 (CRA). The potential loss of the UK consumer's short term right to reject and be refunded for faulty goods is the chief concern of the Government. We follow up this concern, with reference to evidence given by stakeholders to the previous and current House of Lords EU Justice Sub Committee.

Assuming an exit day of 29 March 2019, the UK would not have to implement the proposed Directive as there is a two year transposition deadline. However, we question whether a transition/implementation period would alter this position and whether the UK might want to align with an adopted proposal in any case to facilitate a EU-UK trading relationship.

Amended proposal kept under scrutiny, though the original proposal is cleared; further information requested; drawn to the attention of the Business, Energy and Industrial Strategy Committee and the Justice Committee.

European System of Financial Supervision

The European Commission in September 2017 proposed substantial reforms of the functioning of the EU's financial supervisory authorities (the ESAs) for the banking, insurance and investment industries. These reforms would expand the powers of the ESAs, in particular for the European Securities & Markets Authority (ESMA); alter their governance structures to make them ESAs more assertive vis-à-vis the Member States' national financial regulators; and impose a new industry levy to fund their work.

The UK's withdrawal from the EU has driven these proposed reforms, at least in part. There are concerns that UK financial services firms might try to establish "letter box" entities in the EU, servicing EU-based clients from the UK without substantially moving their operations to an organisation within the Single Market as required by EU law. This, the Commission argues, increases the need for stronger ESAs which can ensure that all Member State regulators apply the EU's regulatory requirements for "third country" firms in the same way.

The Explanatory Memorandum from the Government about the proposals contained virtually no substantive assessment of the proposed changes. It does not reflect on the implications of the proposals for the UK financial services industry after Brexit, or during the "implementation period" after March 2019 during which the UK would remain subject to EU law but without formal political representation within the EU institutions and bodies, including the ESAs. We therefore retain the proposals under scrutiny and ask the

Minister to provide further information, particularly as regards the position and powers of the European Supervisory Authorities in the UK during any post-Brexit transitional period.

Not cleared from scrutiny; further information requested; drawn to the attention of the Treasury Committee.

Vehicle type approval

Trilogue negotiations have concluded on a proposed regulation on vehicle type approval processes and market surveillance of motor vehicles—the EU's regulatory response to the Volkswagen emissions scandal. A last-minute attempt by Germany and some other Member States to limit the ability of the Commission to audit Member State type approval authorities was rejected. The key provisions of the proposal remain intact and the Government considers the final deal a positive step towards restoring trust in the type approval system. A summary of the effects of the final text is provided at the end of the chapter. We clear the file from scrutiny in advance of COREPER in mid-December and the Council of Ministers soon thereafter, on the condition that scrutiny of the implications of Brexit for vehicle type approval processes continues through other files.

Cleared from scrutiny.

A fair and efficient tax system in the Digital Single Market

This non-legislative Communication outlines the Commission's concern that features of digital economy firms allow them to pay lower levels of corporate tax than traditional business models, and that action should be taken to prevent the erosion of Member States' tax bases. The Commission expresses a preference for a global solution, but also indicates that it is likely to propose EU legislation in 2018. A shortlist of somewhat underdeveloped 'temporary interventions' is provided. Council Conclusions regarding the Communication were agreed on 5 December, and broadly support the Commission's approach. Member States prefer a global approach, but also call on the Commission to assess its shortlist of possible interventions and to bring forward proposals in early 2018. However, concerted EU-level action is likely to prove challenging given that unanimity voting would apply to any proposal. We ask for further information about the proposals as well as the implications of Brexit for taxing the digital economy.

Not cleared from scrutiny; further information requested.

Proceeds of crime: mutual recognition of freezing and confiscation orders

The Government has opted into a proposed Regulation which would provide for court orders issued in one Member State for the freezing and confiscation of the proceeds of crime to be recognised and enforced in another. It considers that the proposal is "highly unlikely to take effect" before the UK leaves the EU but that opting in would "signal our commitment to cooperation in this important area". Writing four days ahead of the Justice and Home Affairs Council on 7/8 December, the Security Minister (Mr Ben Wallace) asks the Committee to clear the proposal from scrutiny or grant a scrutiny waiver so that the Government can agree a "general approach". We make clear that the Minister should have written earlier and that his letter does not provide the information previously requested

on the Government's expectations for future cooperation with the EU on this and other EU law enforcement and criminal justice measures, the role of the Court of Justice of the European Union, and possible transitional arrangements.

Not cleared from scrutiny; further information requested; drawn to the attention of the Home Affairs Committee, the Justice Committee and the Committee on Exiting the European Union.

Documents drawn to the attention of select committees:

('NC' indicates document is 'not cleared' from scrutiny; 'C' indicates document is 'cleared')

Business, Energy and Industrial Strategy Committee: Energy Union Governance [Proposed Regulation (NC)]; EU Renewable Energy Directive [Proposed Directive (NC)]; Digital Single Market: Consumer contract rights for the online and offline sale of goods [(a) Proposed Directive (C), (b) Amended Proposed Directive (NC)]; EU Electricity Market Design [(a) and (b) Proposed Regulations (NC), (c) Proposed Directive (NC)]; Energy Efficiency Directive [Proposed Directive (NC)]

Defence Committee: Operation SOPHIA [Council Decision (C)]

Exiting the European Union Committee: Proceeds of crime: mutual recognition of freezing and confiscation [Proposed Regulation (NC)]

Foreign Affairs Committee: Operation SOPHIA [Council Decision (C)]

Home Affairs Committee: Proceeds of crime: mutual recognition of freezing and confiscation [Proposed Regulation (NC)]

International Trade Committee: Trade defence actions against the EU [Commission Report (C)]; Comprehensive and Enhanced Partnership Agreement with Armenia [(a) and (b) Proposed Decisions (C), (c) Recommended Decision (C)]

Justice Committee: Digital Single Market: Consumer contract rights for the online and offline sale of goods [(a) Proposed Directive (C), (b) Amended Proposed Directive (NC)]; Proceeds of crime: mutual recognition of freezing and confiscation [Proposed Regulation (NC)]

Treasury Committee: European System of Financial Supervision [(a) Proposed Regulation, (b) Proposed Directive, (c) Amended Proposed Regulation (NC)]

1 Digital Single Market: Consumer contract rights for the online and offline sale of goods

Committee's assessment	Legally and politically important
Committee's decision	(a) Cleared from scrutiny (b) Not cleared from scrutiny; further information requested; document and chapter drawn to the attention of the Business, Energy and Industrial Strategy Committee and the Justice Committee
Document details	(a) Proposed Directive concerning contracts for online and other distance sales of goods; (b) Amended proposal for a Directive on the sales of goods
Legal base	Article 114 TFEU; ordinary legislative procedure; QMV
Department	Business, Energy and Industrial Strategy
Document Numbers	(a) (37390), 15252/15 + ADDs 1–2, COM(15) 635; (b) (39194), 13927/17 + ADD 1, COM(17) 637

Summary and Committee's conclusions

1.1 In December 2015, the Commission published two proposals aimed at boosting the EU digital economy by reducing contract-law related barriers to trade and making it easier for consumers to shop online across the single market. It envisages a uniform set of rules on business-to-consumer contracts across the EU, which would support the EU's Digital Market Strategy. The two proposed Directives addressed aspects of:

i) contracts for the supply of digital content (the "digital" content proposal),[1] for example, downloading a film from an online platform like Netflix; and

ii) contracts for the sale of goods online or by other distance selling[2] (the "tangible goods" proposal, document (a)),[3] for example the sale of a coffee machine from Amazon or clothes from the mail order catalogue or over the phone.

1.2 We have been scrutinising negotiations on the digital content proposal which have progressed to a general approach on 1 June 2017[4] and preparations for trilogues. However, negotiations were postponed on the tangible goods proposal, pending the completion of

1 2015/287, COM (2015) 634: Proposal for a Directive of the Council and the European Parliament on certain aspects concerning the supply of Digital Content.

2 Distance selling is where the two contracting parties are not in the same place at the same time (i.e. sales that are not face-to-face).

3 2015/0288, COM (2015) 635: Proposal for a Directive of the Council and the European Parliament on certain aspects concerning contracts for the online and other distance sales of goods.

4 http://data.consilium.europa.eu/doc/document/ST-9901–2017-ADD-1/en/pdf.

an EU Consumer Law REFIT[5] in May 2017.[6] Since then the implications of the REFIT have been discussed in both the Council and the European Parliament (EP), with a majority of Member States and two EP Committees[7] calling for an amended proposal applying to both online and offline sales. As the Government anticipated in its last letter to us on the original proposal,[8] an amended proposal was published on 31 October.

1.3 Such a uniform approach to all sales of goods, regardless of channel provides clarity for consumers and businesses in general and avoids unhelpful differences in rules for online and offline sales which the previous Government disliked.[9] But as the current Government identifies in the Explanatory Memorandum (EM) it has submitted on this amended proposal, it also assists those businesses offering multiple sales options: in-store, online and by mobile app. However, the current Government has also highlighted that such an extension of scope is significant. It will mean that 90% more sales transactions will now be caught by the new proposal, as will businesses who may not be single market beneficiaries as they do not sell online or at a distance. It hoped that the Commission would consider proposing a regime as proximate as possible to the existing Consumer Sales and Guarantees Directive (the CSG Directive),[10] which currently governs all sales, so as to minimise disruption to the vast majority of sales activity.[11]

1.4 Proposal (b) aims to reduce differences in Member States consumer law by repealing the CSG Directive and re-enacting many of its provisions with "maximum harmonisation" requirements. This means national law may not exceed the terms of the legislation and prohibits "gold-plating" or over-implementation of EU legislation when it is transposed into national law. The CSG Directive took a "minimum harmonisation" approach, leaving Member States free to adopt more stringent provisions to ensure a higher level of consumer protection. However, differences in Member State implementation have led to some discrepancies in the remedies available to consumers.

1.5 The new proposal provides for Member States to implement the adopted Directive two years after its entry into force.[12] Assuming the UK exits the EU on 29 March 2019, it will not have to implement the Directive, in default of arrangements for a transition/implementation period which requires the UK to comply with new EU legislation.

1.6 In its new EM, the Government highlights some basic differences in the original and amended proposal, but mostly rehearses the concerns it had in relation to the original proposal. It remains concerned about potential points of divergence between the CRA and

5 Regulatory "fitness for purpose" review.

6 Result of the Fitness Check of consumer and marketing law and of the evaluation of the Consumer Rights Directive, May 2017.

7 Internal Market and Consumer protection (IMCO) and the Legal Affairs (JURI) Committees.

8 See Second Report, HC 301–ii (2017–19), chapter 3 (22 November 2017).

9 The previous Government said in its Explanatory Memorandum of 5 January 2016 that it was "concerned that proposals could see two sets of rules existing for online and other distance sales of goods and for offline or face-to-face purchases. We think that this is confusing for both businesses and consumers and it would be better if the same rules applies whatever the sales route, except where differences are justified by the nature of the sales process (the existing withdrawal right under 2011/83/EU, for example, which gives consumers a 14 day right to return goods bought at a distance because they have not the opportunity to inspect them before purchase).

10 Directive 1999/44/EC of the European Parliament and of the Council on certain aspects of the sale of consumer goods and associated guarantees. This was originally transposed into UK law in the Sale and Supply of Goods to Consumers Regulations 2001, which amended remedies provided in the Sales of Goods Act 1979. the key requirement for traders to provide consumers with goods "in conformity with the contract", failing which a hierarchy of remedies, from repair and replacement to refund is available to the consumer.

11 See our Second Report, footnote 8.

12 The Directive will enter into force on the twentieth day following its publication in the EU's Official Journal.

the amended proposal, relating to conformity criteria of the goods, remedies available to consumers, including the loss of the short-term right to reject goods under the CRA, the time limits for reverse burden of proof and limitation and liability periods (see paragraph 1.11 below).

1.7 **We now clear document (a) as it has been superseded by the amended proposal (b).**

1.8 **However, we retain the amended proposal (b) under scrutiny. We would be grateful, when the Minister next writes to update us and respond to the questions below, if she would provide us with a summary of the key provisions in the amended proposal. The Minister highlights areas of divergence between the proposal and UK law but does not provide us with an overall summary of the proposal. We cannot simply rely on any description contained within the previous Government's EM on the original proposal because it is not clear to us how similar the two proposals are, disregarding the obvious difference that proposal (b) extends to the offline sales of goods.**

1.9 **Since the original proposal (a) was published, the people of the United Kingdom have voted to leave the EU. On current assumptions, the UK will exit the EU on 29 March 2019 and it would not have to implement the current proposal (b). However, the nature of a possible transition/implementation period is unclear and there is also the possibility that the UK may wish to align with EU consumer law after Brexit to facilitate a trading relationship with the EU. The Government has also acknowledged in its letter of 5 September[13] that the amended proposal would represent a very considerable extension of scope, covering over 90% more sales transactions across the EU. In the light of these very different circumstances and considerations, could the Minister confirm in due course:**

i) **Whether the Government will be carrying out a fresh Impact Assessment of the proposal, which goes beyond simply commenting on the Commission's Impact Assessment and noting separately that there are no "clear financial implications" for the UK. This should extend to considering a "no deal" outcome to the Article 50 TEU negotiations;**

ii) **What she means by the "options for implementation" for the UK, as we are unclear whether this refers to obligatory transposition into UK law, possibly during a transition/implementation period, or perhaps to regulatory alignment after Brexit to facilitate trade with the EU;**

iii) **Whether any decision as to implementation of or alignment with proposal (b) would depend on the negotiations and outcome on the digital content proposal? In other words, would a consistent "implementation" approach be taken to the two proposals?**

iv) **Whether the Government would consider implementing or aligning with the proposal if the areas in which proposal (b) diverges from UK consumer law, outlined by the Minister in paragraphs 1.20–1.37, persist in the final adopted text? We note, for example, relevant evidence given by representatives of "Which?" to the current and previous House of**

13 As reproduced in our Second Report, HC 301–ii (2017–19), chapter 3 (22 November 2017).

Lords EU Justice Sub Committee[14] on the original proposal (a). They were concerned about the potential lowering of UK consumer law protection, particularly if the short term right to reject faulty goods and obtain a refund is lost. Do other Member States share the same concerns and will the UK be able to build alliances with them to prevent any lowering of protection in proposal (b)?

1.10 **We draw document (b) and this chapter to the attention of the Business, Energy and Industrial Strategy Committee and Justice Committee.**

Full details of the documents

(a) Proposal for a Directive on certain aspects concerning contracts for online and other distance sales of goods: (37390), 15252/15 + ADDs 1–2, COM(15) 635; (b) Amended proposal for a Directive of the European Parliament and of the Council on certain aspects concerning contracts for the sales of goods, amending Regulation (EU) No 2006/2004 of the European Parliament and of the Council and Directive 2009/22/EC of the European Parliament and of the Council and repealing Directive 1999/44/EC of the European Parliament and of the Council: (39194), 13927/17 + ADD 1, COM(17) 637.

Key issues—document (b)

1.11 The Government informs us in its EM that key points of divergence between the CRA 2015 and the new proposal, document (b) include:

- Conformity criteria of the goods: quality standards may need to be reformulated to reflect the wording in the proposed Directive;
- Remedies available to consumers: UK consumers would lose their short-term right to reject goods (as afforded under the CRA). Instead consumers would first have to request a repair or replacement and could only reject goods if these remedies failed. The proposed Directive does not specify how many times the supplier can offer a repair or replacement before a consumer can access a partial or full refund (as opposed to a maximum of once under CRA). However, consumers would have a statutory right to withhold payment of any outstanding amounts until the defects were fixed. Furthermore, if the consumer rejected the goods after repair or replacement had not resolved the defect, the trader could only deduct from its refund a sum to reflect use in excess of 'regular use';
- Time limit for reverse burden of proof: the period within which a defect emerging is presumed to have been present on delivery would be extended from six months to two years; and
- Liability: (the period in which a fault has to appear before a consumer can make a claim) and limitation periods (the period is the period of time within which a party to a contract must bring a claim) for remedies: currently aligned at six

14 One-off oral evidence given by Lucy Rigby on "Contracts for the Supply of Digital Content and Contracts for the Online and other Distance Sale of Goods, on 10 May 2016, Q9 and oral evidence given to the "Brexit: Consumer Protection" inquiry by Peter Moorey, Head of Campaigns, Which? on 25 April 2017, Q1 and Q8.

years in England, Wales and Northern Ireland and five years in Scotland. The proposed Directive would lead to a reduction in the UK's liability period to two years.

The Government's view

1.12 In an Explanatory Memorandum of 21 November 2017, the Parliamentary Under Secretary of State and Minister for Small Business, Consumers and Corporate Responsibility at the Department for Business, Energy and Industrial Strategy (Margot James) says:

> "Since 2015, the Government has been supportive of the EU's efforts to create a Digital Single Market which will deliver for consumers and businesses, including new entrants to market.
>
> "The Government also welcomes initiatives which will bolster consumers' and traders' confidence in cross-border sales and it is our view that e-commerce will help to bring the reality of the single market closer to consumers and businesses alike."

1.13 Before turning to more detailed policy implications, the Minister addresses the question of implementation. She recognises that proposal (b) repeals and replaces the CSG Directive which was re-implemented in the UK by the CRA 2015. Reflecting on the maximum harmonisation approach of proposal (b), she says that the Government will have to review the CRA 2015 to identify where the UK imposes either less or more stringent statutory requirements. She says that the UK will have to consider "options for implementation" following the outcome of negotiations with the EU.

Policy implications

1.14 The Minister then proceeds to outline very similar policy implications to those identified in the previous Government's EM on the original proposal (a). She explains:

> "The main policy implications and concerns in relation to the Directive for the UK are therefore the same as they were when the original proposal was adopted and published, and these are set out below. We will continue to develop our views and engage with stakeholders once discussions begin on the revised proposal."

1.15 For ease of reference and given the importance of the proposal, we reproduce much of this in full, highlighting any material differences or additional points made by the Minister in this current Explanatory Memorandum.

1.16 The Minister says:

> "We continue to support the view that if the Digital Single Market reaches its full potential it will allow UK consumers to access more choice and lower prices for goods bought online across Europe and allow UK business to benefit from its position as a global e-commerce leader."

1.17 In the light of Brexit, she makes the additional comment on the amended proposal that:

> "It will therefore continue to be important after our exit from the EU that robust consumer protections are put in place to underpin e-commerce and reassure consumers when buying goods online from unfamiliar traders, or businesses based elsewhere in the EU. These protections will also provide clarity to businesses about their rights and obligations when selling goods and services online and cross-border."

1.18 She then explains the background to the amended proposal:

> "The UK has been engaged in Council discussions since they began on the original proposal in 2016. However, as a result of Member States' desire to extend the scope of the proposal to encompass both online and offline sales, negotiations are yet to begin on the substance of this file."

1.19 The Minister then identifies specific policy implications under the following six sub-headings.

Lack of future flexibility

1.20 She repeats the concern as identified in relation to the original proposal:

> "The UK has introduced or retained provisions that go beyond the existing minimum standards in EU law, and the Government would, in principle, be free to regulate further (provided that new rules did not fall below the European standard). If this proposal is adopted, then that flexibility would be lost and it would be impossible to either introduce more or less generous provisions."

Loss of key UK consumer protections

1.21 Again the Minister repeats the previous Government's view on the original proposal:

> "The Government supports the proposal to introduce a full harmonisation measure where there is evidence that minimum harmonisation and the resulting divergence in laws create barriers to e-commerce. However, the introduction of a full harmonisation Directive will be likely to have an impact on Member States who have chosen to go beyond the minimum requirements of the existing Directives in certain areas."

1.22 But she adds:

> "Our initial assessment is that the short term right to reject would be the chief concern for UK consumers and we discuss this in more detail below."

1.23 As with the original proposal the Government recognises that traders can offer consumers additional protections as part of their offering to customers, but the Minister clarifies this time that this is without the compulsion of a legal requirement.

1.24 She recalls the example of the British Retail Consortium's (BRC) response to the original proposal. This that many UK retailers intend to continue offering consumer rights that go beyond the proposed standards. But she comments that the Government is:

> "concerned that the baseline has to be set at an appropriate level in order to support consumer confidence and avoid a bias towards established players who are better able to signal additional protections to an established customer base, at the expense of new entrants, SMEs and more unfamiliar cross-border traders."

1.25 The Government expects several Member States to have concerns that full harmonisation will result in a reduction of consumer protection for their citizens. In the UK, the proposals, if finally agreed in their current form, will mean that certain key rights would need to be repealed for online and other distance sales.

1.26 She adds that this will therefore be an area of significant interest for the UK during negotiations on the new file. The UK will continue to work with stakeholders to develop an official UK position.

Loss of the short term right to reject

1.27 In similar terms to the Government's analysis of the original proposal, the Minister explains the importance of the UK consumers' current right to reject faulty goods and obtain a refund up to 30 days after purchase:

> "The UK has had, in effect, a right to reject faulty goods since 1893. This right was recently clarified in the Consumer Rights Act 2015 where, re-implementing the CSD, the right to reject faulty goods (i.e. goods which do not 'conform to the contract'), and obtain a full refund was set at 30 days. This right sits alongside the hierarchy of remedies contained in the CSD, which (as a minimum) requires the trader first to offer free repair or replacement before the consumer may rescind the contract and demand a refund. Where all the relevant conditions apply, a UK consumer can go straight to rejection and refund, within the time limit.
>
> "As this legislative proposal is based on maximum harmonisation and includes the same hierarchy of remedies (though some of the detail around it has been amended), the proposal if it passes un-amended, would be likely to require the UK, when implementing, to repeal the short term right to reject faulty goods. Repealing this right would mean that consumers would not be able to obtain a refund until, assuming other remedies were available, they had first pursued them, unless the retailer decided to provide more generous conditions."

1.28 The right is important for "building confidence in new suppliers is particularly important for the Digital Single Market where consumers will need confidence to try new, unfamiliar suppliers rather than sticking to tried and tested favourites".

Loss of a one repair or replacement limit

1.29 The Minister provides a fuller analysis of loss of the one repair or replacement limit than had been provided by the previous Government in relation to the original proposal. She explains that:

> "In the UK, a consumer who chooses not to exercise their right to reject immediately, and has a right to repair or replacement, may reject and, if appropriate, obtain a full refund if after one repair or one replacement, the goods still do not conform to the contract."

1.30 She then recalls that:

> "This protection was reviewed and clarified in the Consumer Rights Act 2015 where the limit of one repair or one replacement was introduced. The UK would need to repeal the one repair or one replacement limit under this proposal, to bring it into line with the proposed legislation; although (as has always been the case under the CSD), the right for the consumer to require a repair or replacement is always subject to either recourse being impossible or disproportionate."

1.31 Again the Minister identifies this issue as being key to consumer confidence:

> "The Government is concerned that the proposal does not contain a strict limit on the amount of repairs and replacements a supplier can offer before a consumer can access a partial or full refund. The Government sees a limit on the amount of repairs and replacements offered to consumers as key to consumer confidence, whilst balancing the interests of business who welcome the legal certainty that a (a non-time-based) limit provides.
>
> "The Government argues that the caveat to the requirement to offer repair/replacement is ambiguous and could lead to further disputes as consumers and traders argue about whether or not, in a given set of circumstances, the requirement to replace or repair is impossible or disproportionate, and how these terms are defined. Setting a clear limit on the repair/replacement process provides consumers with legal certainty that they will not be locked into an endless cycle of failed repairs or replacements, with the inconvenience this involves, or find themselves in dispute with a supplier over whether another repair is 'possible' or 'significantly inconvenient' to either party, or if a full refund does apply.
>
> "In addition, with the existing UK solution, business has clarity on their obligations to the consumer when things go wrong which reduces the likelihood of disputes arising between traders and consumers, and traders are prevented from locking the consumer into a long cycle of failed repairs or replacements when goods are faulty. They are therefore incentivised not to sell poor quality goods in the first place (i.e. because they will lose all monies from the sale)."

1.32 The Minister then looks to the response received from businesses and consumer organisations during the Commission's REFIT:

> "They suggest that the existence of a hierarchy of remedies for when things go wrong is in line with consumers' expectations as well as consumers' behaviour when seeking redress for faulty goods."

Liability period and limitation periods

1.33 The Minister explains that the CSG Directive sets a limit of two years from delivery of the goods during which a seller may be held liable for lack of conformity to the contract (including faults). She adds:

> "Though lack of conformity—breach of contract, in effect—gives rise to the hierarchy of remedies (repair/replace/refund), national legislation will make provision for a time limit during which those claims for breach of contract may be brought. Thus the Limitation Act, applicable in England and Wales and Northern Ireland, prevents actions for breach of contract being taken six years after the cause of action arose (five years in Scotland), which could, in principle be longer than two years after delivery of the goods."

1.34 She says that the UK has understood the minimum standard in the CSG Directive:

> "…as meaning that in principle a consumer could make a claim against a trader for breach of the lack of conformity condition at any point where the breach became apparent, which (as mentioned above) could occur after two years from the date of delivery."

1.35 She explains that the amended proposal (b) would restrict claims to those "where lack of conformity became apparent before two years from the date of delivery, although national limitation periods for taking action in relation to such claims are set at a minimum" (as with the current CSG Directive) "and so the six/five year minimums would not be affected".

Reversal of the burden of proof

1.36 The Minister explains that proposal (b) includes an extension to the reversal of the burden of proof. This means that:

> "in the event of goods having a fault, the consumer will have the benefit of a presumption for a period of 2 years that the goods were faulty when delivered. Under current law (the CSD, and as transposed into UK law in the CRA) this period is 6 months (minimum). During this period it is for the supplier, not the consumer, to prove that the goods, contrary to the consumer's claim, were satisfactory at the time of sale."

1.37 The Minister says that whilst the Government agrees that this could enhance consumer protection, it will "want to ensure that this extension to the reversal of the burden of proof does not impose a disproportionate burden on business and is justified by a robust cost/ benefit analysis".

Impact Assessment and Financial Implications

1.38 The Minister explains that a new Commission Impact Assessment has been published with the revised proposal, assessing the need to set uniform rules for all types of sale.

1.39 She adds that there are no clear financial implications for the UK from the proposal.

Timetable

1.40 The Minister says that:

> "We do not yet have a clear timetable for ongoing consideration of this revised proposal, although the Estonian Presidency have preliminarily scheduled a Council Working Group meeting on 19 and 20 December, at which point we expect they may set out the way forward for the file. It is then possible that Bulgaria will table further Working Groups during 2018."

Consultation

1.41 Since the original proposal was published on 9 December 2015, the Minister says that BEIS officials have met with a number of key stakeholders including Which?, the Federation of Small Business, the British Retail Consortium, the Law Society of England and Wales and the Competition and Markets Authority. Whilst negotiations were suspended those officials continued to engage with key stakeholders and will continue to do so throughout the negotiations.

Previous Committee Reports

Second Report HC 301–ii (2017–19), chapter 3 (22 November 2017); Eighteenth Report HC 71–xvi (2016–17), chapter 3 (16 November 2016); Sixth Report HC 71–iv (2016–17), chapter 3 (15 June 2016); Twenty-third Report HC 342–xxii (2015–16), chapter 5 (10 February 2016).

2 Energy Efficiency Directive

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; further information requested; drawn to the attention of the Business, Energy and Industrial Strategy Committee
Document details	Proposal for a Directive amending Directive 2012/27/EU on energy efficiency
Legal base	Article 194(2) TFEU; ordinary legislative procedure; QMV
Department	Business, Energy and Industrial Strategy
Document Number	(38340), 15091/16 + ADDs 1–13, COM(16) 761

Summary and Committee's conclusions

2.1 Reducing energy consumption is an important element of the EU's long-term climate and energy policy. As part of its "Clean Energy for All Europeans" proposals in November 2016, the Commission proposed a binding EU-level energy efficiency target of 30%. This contrasted with the European Council's agreement in 2014 to an indicative EU-level target of 27%, to be reviewed by 2020 "having in mind" a target of 30%. The Council was clear that targets "will not be translated into nationally binding targets".

2.2 The Commission also proposed to extend the national energy saving targets until 2030 and to make amendments to the provisions on metering and billing. Further details on the proposals were set out in our Report of 25 January.

2.3 The Minister for Industry and Energy (Richard Harrington) reports that a General Approach was agreed at the June Energy Council and that the UK abstained. While the balance of the compromise reached was acceptable, the UK abstained as the Commission refused to confirm the joint understanding reached with the UK in 2013 on what could be counted towards the UK's 2020 binding national energy savings target.

2.4 The Minister describes the text as a compromise which represented some progress towards ensuring that obligations are consistent with the UK's domestic objectives under the Climate Change Act, while failing to reflect the agreement reached at the European Council in 2014 that there should be no nationally binding targets post 2020.

2.5 The compromise is set out below in greater detail, but key points include:

- EU-level energy efficiency target of 30%, although silence on whether this is binding or indicative;
- binding national energy-saving target equivalent to 1.5% of annual energy sales from 1 January 2021 to 31 December 2025 and 1% from 1 January 2026 to 31 December 2030 (subject to possible increase to 1.5% following a review); and
- Member States are able to reduce this national target by up to 35% (rather than the originally proposed 25%) using a range of flexibilities.

2.6 In a subsequent letter to the House of Lords EU Committee, which reconvened earlier than this Committee following the general election, the Minister explained that the Commission's refusal to recognise the 2013 joint understanding could mean that the UK would fail to meet its 2020 target. The Minister also noted that the (now published) Clean Growth Strategy[15] ought to make a contribution to meeting the 2030 targets.

2.7 **We note the broad terms of the compromise and the Minister's explanation for the UK's position. We have also had sight of the Minister's letter of 10 August 2017 to the House of Lords EU Committee, which explained that the Commission's refusal to confirm the joint understanding reached with the UK in 2013 on what could be counted towards the 2020 target means that the UK may miss that target.**

2.8 **It is a matter of concern that the Commission appears to be changing the rules on what can be counted towards the 2020 target at a very late stage in that process. We would welcome an update on progress in persuading the Commission to recognise the earlier understanding and an explanation of the implications of failing to meet the 2020 target.**

2.9 **In the Minister's letter to the House of Lords EU Committee, he referenced the Clean Growth Strategy as making an important new contribution towards the 2030 efforts. The Strategy does include a range of initiatives on both industrial and domestic energy efficiency. We ask the Minister to confirm whether he considers that the measures set out in the Strategy are sufficient to meet the 2030 targets. How is the Strategy informing the UK's approach to negotiations of the Directive?**

2.10 **On the UK's withdrawal from the EU, the Prime Minister proposed in her Florence speech that there should be a post-Brexit implementation period of around two years during which the existing structure of EU rules and regulations would continue to apply. We note that this Directive would need to be transposed 24 months after entry into force. Is the Government negotiating on the basis that the UK may be required to implement the provisions of the Directive during any withdrawal period?**

2.11 **We note that negotiations with the European Parliament were expected to begin in December 2017. We would welcome an update on those negotiations, and responses to the issues that we have raised, well in advance of final agreement. The document remains under scrutiny. We draw this chapter to the attention of the Business, Energy and Industrial Strategy Committee.**

Full details of the documents

Proposal for a Directive amending Directive 2012/27/EU on energy efficiency: (38340), 15091/16 + ADDs 1–13, COM(16) 761.

Background

2.12 Full detail on the background and content of this proposal and of all of the other elements of the Clean Energy Package were set out in our Report of 25 January 2017.[16]

15 https://www.gov.uk/government/publications/clean-growth-strategy.

16 Twenty-ninth Report HC 71–xxvii (2016–17), chapter 2 (25 January 2017.)

2.13 As its meeting of 25 April, the predecessor Committee considered a letter from the Government which clarified some of the Government's concerns about the proposed targets and related measures. In particular, the Government was concerned that the Commission proposal had the potential to constrain Member States' flexibility to determine the most cost-effective pathway to meeting greenhouse gas emissions targets. Furthermore, the proposal excludes energy savings derived from EU-level action (such as product standards) and from measures already taken (such as insulation) which, once installed, will continue to generate energy savings throughout their lifetime.

2.14 The Minister reported that "a significant" number of other Member States shared the UK's concerns about the provisions relating to targets, although there was some support for a binding 30% target.

2.15 At its meeting of 25 April, the previous Committee granted a scrutiny waiver in advance of possible agreement at the June Energy Council.

The Minister's letter of 14 July 2017

2.16 The Minister thanks the predecessor Committee for granting a scrutiny waiver in advance of the June Energy Council. He notes that a General Approach was agreed, and summarises the key elements of the compromise text in the following terms:

- "A 30% EU-level target under Article 3 not currently defined as either indicative or binding. This was essentially a fudge to secure a qualified majority and means the final decision about the nature of the target will be taken in trilogues with the European Parliament.
- "A binding national energy-saving target under Article 7 equivalent to 1.5% of annual energy sales from 1 January 2021 to 31 December 2025 and 1% from 1 January 2026 to 31 December 2030. This will be reviewed by December 2024 to consider whether to raise the target for the latter period to no more than 1.5%.
- "The ability for Member States to reduce this national target by up to 35% (raised from 25% in the original proposal) using a range of flexibilities, including those the UK and other Member States were seeking to be able to count savings from long-term measures towards the target (though effectively capping the contribution of these flexibilities).
- "Sufficient safeguards to ensure that provisions relating to metering and billing of heating and cooling are cost-effective, proportionate, technically feasible and deliverable within defined timescales."

2.17 The Minister describes the text as a compromise which represented some progress towards ensuring that obligations are consistent with the UK's domestic objectives under the Climate Change Act, while failing to reflect the agreement reached at the European Council in 2014 that there should be no nationally binding targets post 2020.

2.18 While considering the balance of the compromise acceptable, the UK abstained as "the Commission refused to confirm the joint understanding reached with the UK in 2013 on what could be counted towards our 2020 binding national energy savings target."

2.19 In terms of next steps, negotiations with the European Parliament were expected to begin in December 2017. At the time of the Minister's letter, the EP had not adopted a position but it was expected to call for a higher and binding EU-level target and higher national targets. The UK would expect some Member States to try to use pressure from the EP to raise Council ambition back towards that in the original Commission proposal.

Subsequent ministerial letter to the House of Lords EU Committee

2.20 In a subsequent letter to the House of Lords EU Committee, which convened earlier than this Committee following the general election, the Minister clarified a number of the points included in his letter of 14 July.

2.21 The Minister confirmed that the text agreed by the Council did not allow Member States to count energy savings derived from EU-level action towards the 2030 target, apart from savings related to the renovation of existing buildings.

2.22 On the Commission's refusal to recognise the 2013 joint understanding on what could be counted towards the 2020 target, the Minister explained that this was relevant because, in updating the Directive, the Commission took the opportunity to update existing provisions in the Directive to clarify what savings Member States could count towards the 2020 target. In doing so, the Commission diverged from what had been the earlier joint understanding that early savings from supplier obligations could count towards the 2020 target. The impact of this was that there was now a risk that the Commission's latest interpretation of the text would not allow the UK to credit these savings towards its 2020 target. The UK continued to stand by its interpretation of the target in line with the joint understanding and on that basis remained on track to exceed its energy efficiency target under Article 7 of the Energy Efficiency Directive. Progress would be reported to the Commission on that basis.

2.23 The Minister recognised that current policies alone would not get the UK to the proposed 2030 target, but argued that the Clean Growth Plan (published since the Minister wrote) should make a further contribution.

Previous Committee Reports

Fortieth Report HC 71–xxxvii (2017–17), chapter 4 (25 April 2017); Twenty-ninth Report HC 71–xxvii (2016–17), chapter 2 (25 January 2017).

3 EU Renewable Energy Directive

Committee's assessment	Legally and politically important
Committee's decision	Not cleared from scrutiny; scrutiny waiver granted; further information requested; drawn to the attention of the Business, Energy and Industrial Strategy Committee
Document details	Proposal for a Directive on the promotion of the use of energy from renewable sources (recast)
Legal base	Article 194(2) TFEU; Ordinary Legislative Procedure; QMV
Department	Business, Energy and Industrial Strategy
Document Number	(38345), 15120/16 + ADDs 1–9, COM(16) 767

Summary and Committee's conclusions

3.1 The Commission's proposal forms part of the "Clean Energy for all Europeans" package proposed by the Commission at the end of November 2016. It aims to boost the proportion of EU energy generated by renewable energy sources.

3.2 The Commission set out a range of measures, including: an EU-wide target of 27% renewable energy by 2030; a requirement that any Member State falling below its 2020 target levels should pay into a fund to finance renewable projects; new provisions on financial support for renewable electricity schemes; new measures to boost the share of renewable energy in the heating, cooling and transport sectors; and an extension of the biofuels sustainability criteria.

3.3 The previous Committee first considered the proposal at its meeting of 25 January 2017. It pressed the Government for greater clarity on its concerns regarding subsidiarity, the legal base and its view that a number of the measures may equate to de facto binding targets. Noting that the proposal was set to enter into force on 1 January 2021, by which time it was expected that the UK would have left the EU, the Committee also asked the Government on what basis it was negotiating—i.e. from the perspective of possible third country or in a business as usual manner.

3.4 The Government indicated in response that, while the UK remained a member of the EU, it would continue to engage in existing EU business on behalf of UK citizens and with a view to supporting the EU in meeting its decarbonisation objectives. On the matter of targets, the then Minister clarified the Government view that both the proposal on the supplier obligation in the transport sector and the proposal setting the baseline at each Member State's 2020 target levels to be de facto binding targets. The Government no longer had concerns about the legal base, but was silent on the matter of subsidiarity.

3.5 Considering the Government's response at its meeting of 25 April, the previous Committee re-iterated its request for a subsidiarity analysis and urged the Government to approach the negotiations from the perspective of a third country and not only as an EU Member State.

3.6 The Minister for Energy and Industry (Richard Harrington) has written to update the Committee and to request a scrutiny waiver in advance of agreement to a possible General Approach at the 18 December Energy Council. He explains that the text of the agreement is still open to change, but that some improvements have already been made in relation to heating and cooling, biomass sustainability and permit-granting. The Government will continue to seek maximum flexibility for Member States to be able to develop their most cost-effective pathway for delivering their ambitious emissions reductions commitments. including deciding what contribution renewable energy should make to meet that commitment, whilst recognising the need for mechanisms to give the EU assurance over the delivery of its objectives on renewables. Any nationally-binding targets or endeavours should not impose significant costs on the UK.

3.7 In negotiations, the Government will also seek to minimise any administrative burden or implementation costs as far as possible, and to seek flexibility for Member States to set additional biomass sustainability standards to those in the proposal, or the ability for Member States to continue applying their existing domestic standards.

3.8 On Brexit, the Minister notes that it is still too early to assess whether and how the EU exit negotiations will affect the Clean Energy Package. While the Government expects the legislation to have been agreed before Brexit, the transposition deadline of at least some of the legislation, including the Renewable Energy Directive, might fall during any implementation period.

3.9 On subsidiarity and proportionality, the Minister sets out the Government's concerns in greater detail. While the Government agrees that some action at the EU level is necessary to attain the EU's energy policy objectives, it is also important to maintain Member States' responsibility for their energy mix. The Government is concerned that some of the specific policy suggestions, such as the transport sector target, do not respect that balance.

3.10 **We note that the final shape of any agreement is far from clear, but we are grateful that the Minister has set out the direction of travel and the principles that the Government will be following. We support the focus on flexibility, minimisation of administrative burden and respect for the balance of powers between the EU and its Member States.**

3.11 **On the implications of the UK's exit from the European Union, we take note of the Minister's view that it is still too early to assess whether and how the EU exit negotiations will affect the Clean Energy Package. We also note the possibility that the transposition deadline for this legislation may fall within any implementation period. While we accept that there can be no certainty as yet over the future relationship in the energy sector, we signal our continued interest in the matter and our expectation that the Government continues to negotiate with EU exit in mind.**

3.12 **The proposal remains under scrutiny, but we waive the scrutiny reserve in order that the Government might support a General Approach at the 18 December Energy Council. based on the principles set out in the Minister's letter. We look forward to an update from the Minister on the outcome of the Council meeting and an assessment of the prospects for agreement with the European Parliament. We draw this chapter to the attention of the Business, Energy and Industrial Strategy Committee.**

Full details of the documents

Proposal for a Directive on the promotion of the use of energy from renewable sources (recast): (38345), 15120/16 + ADDs 1–9, COM(16) 767.

Background

3.13 The current Renewable Energy Directive, agreed in 2009, set a target for 20% of energy to be renewable across the EU by 2020. Member States were set individual binding targets for consumption of energy from renewable sources and a sector-specific target to achieve 10% renewable energy in transport.

3.14 The Commission's proposal late last year set an EU-wide binding target for 27% of energy to be renewable across the EU by 2030. In line with the European Council agreement of 2014, there will be no targets for each Member State although the existing 2020 targets will remain and will be considered as the "baseline". The proposal covers: support schemes; heating and cooling; biofuels, bioliquids and biomass for transport; and biomass for heat and electricity. Full details on the background and content of the proposal were set out in our predecessors' Report of 25 January.[17]

3.15 The Government highlighted a number of concerns in its original position relating to:

- concern that a number of the measures may equate to de facto binding targets;
- some of the details of the proposal may be incompatible with the principle of subsidiarity; and
- the chosen legal base may not be appropriate.

3.16 In further correspondence, the then Minister indicated that:

- the Government no longer had concerns about the legal base;
- while the UK remains a member of the EU, the Government would continue to engage in existing EU business on behalf of UK citizens and with a view to supporting the EU in meeting its decarbonisation objectives; and
- the Government considered both the proposal on the supplier obligation in the transport sector and the proposal setting the baseline at each Member State's 2020 target levels to be de facto binding targets.

3.17 Responding in its Report of 25 April, the previous Committee re-iterated its request for the subsidiarity analysis. The Committee also expected the Government to approach the negotiations from the perspective of a third country—as well as that of an EU Member State—and asked to be updated on any issues which may arise specific to third countries.

17 Twenty-ninth Report HC 71–xxvii (2016–17), chapter 3 (25 January 2017).

The Minister's letter of 30 November 2017

3.18 The Minister writes to update the Committee on negotiations and to request a scrutiny waiver in order for the UK to be able to support a potential General Approach at the 18 December Energy Council,

3.19 On the UK's exit from the EU, the Minister says that it is too early to assess whether and how the EU exit negotiations will have an impact on the various dossiers included within the Clean Energy Package. He notes that the transposition deadline for the Renewable Energy Directive might fall during any implementation period and confirms that the UK's negotiating position is taking account of these factors.

3.20 Addressing the outstanding query from the previous Committee's earlier scrutiny seeking clarity over the Government's concerns surrounding subsidiarity and proportionality, the Minister writes:

> "On subsidiarity—the Government agrees that some action at EU level is necessary to attain the EU energy objectives. At the same time, however, it is important to maintain Member States' responsibility for their energy mix. In this context, for example, we have specific concerns around the proposals:
>
> - to prevent new biomass electricity plants greater than or equal to 20MW from receiving support payments or counting towards the renewables target; it should be for Member States to determine which technologies to support based on assessment of their national circumstances and energy needs; and
>
> - the transport sector target of 12%, which would effectively be a binding target restricting the UK's flexibility to decarbonise in the most cost-effective manner.
>
> "The Government's views on subsidiarity are in line with the October 2014 European Council conclusions, which stated that '[EU energy efficiency and renewable energy] targets will be achieved while fully respecting the Member States' freedom to determine their energy mix. Targets will not be translated into nationally binding targets.'
>
> "On proportionality—the Government has some concern about whether all the proposed actions in the Renewable Energy Directive are necessary to achieve the binding 27% EU renewable energy target. The Commission's reference scenario shows that—without any additional measures—the EU will reach 24.3% renewable energy by 2030 on the basis of current policies; so there is a legitimate question about whether the combination of the measures in this Directive and the linked Governance Regulation might be disproportionate to bridge a 2.7% gap. No additional specific UK analysis has been conducted on this. I understand, however, that the Commission's Regulatory Scrutiny Board questioned the proportionality of some measures in the proposal, and argued that only relatively limited additional efforts would be necessary to reach the EU-level target of 27%. In particular, the Board argued that issues with proportionality were particularly relevant

> for the options in the H&C [heating and cooling] sector set out in the Commission's Impact Assessment. The Commission took account of the Board's reservation, and replaced the H&C obligation with an endeavour. However, the Board did not require the Commission to submit a revised Impact Assessment.
>
> "Our position is to seek maximum flexibility for each Member State to be able to develop the most cost-effective pathway for them to deliver their emissions reductions commitments, including deciding what contribution renewable energy should make to meeting that commitment, whilst recognising the need for mechanisms to give the EU assurance that its objectives on renewables will be met."

Progress of negotiations

3.21 On the progress of negotiations, the Minister indicates that progress has been significant, but that some issues and division remain, in particular around the transport target and sub-target.

3.22 Regarding the EU-level renewable energy target, the target remains at 27% and there has been no push from Member States to raise or lower the target.

3.23 Reporting progress on heating and cooling (H&C), the Minister says that there continues to be a binding obligation for Member States to try to increase the level of renewables in the H&C sector. According to the latest text, however, Member States may aim for a yearly increase at any level above zero depending on their national circumstances. The Minister considers this an improvement compared with the original Commission proposal, where Member States had a binding obligation to try to increase the amount of renewables in the H&C sector by at least one percentage point per year. He believes it is important for Member States to have flexibility to decide how to decarbonise the sector based on their national circumstances in order to incentivise investment in low-carbon options and to avoid significant impacts on energy bills.

3.24 On district H&C,[18] the Minister says that the obligation for Member States to introduce measures to allow customers to disconnect from their district H&C systems remains, alongside new measures to increase heat from renewable and recoverable heat sources. However, the UK district H&C market meets a number of exemptions from implementation of these requirements, because of the small size of the market and lack of large networks.

3.25 The Estonian Presidency has presented several compromise proposals on transport, which are "significantly different" from the Commission's original fuel supplier obligation, says the Minister. The latest compromise is a 12% nationally-binding transport sector target which includes a 3% advanced biofuels sub-target. The cap on crop-based biofuels would no longer decline to 3.8% in 2030 (as in the original Commission's proposal), but would instead remain at 7%, which would allow Member States to use more crop-based biofuels to meet the 2030 target. At the same time, the double rewards for waste-based

18 Rather than having an individual boiler and pipe network inside one home or building, district energy schemes have a large centralised energy centre. which can provide heat, hot water and power to multiple buildings via a district heating and cooling pipe network.

biofuels that exist under the current Directive to encourage those fuels with higher greenhouse gas savings would no longer apply. Given the UK has agreed to move from crop-based biofuels to waste-based biofuels in the next decade, the Minister considers that the proposed accounting rules would make the 12% target and the associated sub-targets more difficult to meet.

3.26 On biomass sustainability, the Minister considers that the proposed criteria are more in line with UK standards than was the case with the Commission's proposal. Nonetheless, says the Minister, Member States would not be allowed to set additional sustainability or greenhouse gas criteria for publicly-funded projects and would be limited by those set out in the proposal. The UK will continue to argue that it should be possible for Member States to set additional sustainability and greenhouse gas criteria if they wish to do so, or at least be able to maintain their existing domestic standards, to protect sustainability.

3.27 Concerning permit-granting, the Commission had proposed that Member States should provide one or more contact points to coordinate the entire renewable energy project permit-granting process. Instead, the contact points will "guide" developers through the process. The Minister welcomes this improvement as it would not require the UK to change its processes unnecessarily.

3.28 On the opening of support schemes to cross-border participation, the Minister notes that this would now be voluntary. He considers this an improvement, given that it is complex and costly for Member States to be required to open up their support schemes. The Minister notes, however, that the requirement for Member States to publish a three-year forward-look schedule covering their expected allocation of support remains in the proposal. He believes the schedule should be indicative and should apply to a given Parliamentary cycle so as not to cross over Parliaments.

Possible General Approach

3.29 The Minister explains that the Presidency will be seeking to reach a General Approach on various elements of the Clean Energy Package at the 18 December Council. He judges this to be an ambitious objective. The Renewable Energy Directive in particular remains subject to change and so he is requesting a scrutiny waiver on the basis of a clear indication of priorities, and thus providing the Minister with the flexibility to engage effectively. The Minister apologises for having to request a waiver under urgent circumstances, noting that progress has been unexpectedly rapid.

3.30 He sets out the approach to both the Renewable Energy Directive and Governance Regulation in the following terms:

> "The approach to be followed at the December Council will be to continue focussing on seeking maximum flexibility for Member States to be able to develop their most cost-effective pathway for delivering their ambitious emissions reductions commitments, including deciding what contribution renewable energy should make to meet that commitment, whilst recognising the need for mechanisms to give the EU assurance over the delivery of its objectives on renewables. I will also seek to ensure that any nationally-binding targets or endeavours do not impose significant costs on the UK.
>
> "Our position is to seek to be part of the qualified majority that supports the Presidency's General Approach on these dossiers, so long as the outcome reached is satisfactory to the UK."

3.31 In addition, the Government will seek to minimise any administrative burden or implementation costs as far as possible, as well as the degree to which the Commission can issue recommendations or intervene in domestic policy. The Government will also seek flexibility for Member States to set additional biomass sustainability standards to those in the proposal, or the ability for Member States to continue applying their existing domestic standards. Finally, the Government will seek to align EU and UK policy where possible to minimise policy changes or costs; as well as focus the Governance framework to achieve the aims of the Paris Agreement and set timescales in line with those in the UNFCCC framework.

Previous Committee Reports

Fortieth Report HC 71–xxxvii (2016–17), chapter 5 (25 April 2017); Twenty-ninth Report HC 71–xxvii (2016–17), chapter 3 (25 January 2017).

4 EU Electricity Market Design

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; scrutiny waiver granted; further information requested; drawn to the attention of the Business, Energy and Industrial Strategy Committee
Document details	(a) Proposal for a Regulation on the internal market for electricity (recast); (b) Proposal for a Regulation establishing a European Agency for the Cooperation of Energy Regulators (recast); (c) Proposal for a Directive on common rules for the internal market in electricity
Legal base	Article 194(2) TFEU; Ordinary Legislative Procedure; QMV
Department	Business, Energy and Industrial Strategy
Document Numbers	(a) (38346), 15135/16 + ADDs 1–11, COM(16) 861; (b) (38347), 15149/16 + ADD 1, COM(16) 863; (c) (38348), 15150/16 + ADD 1, COM(16) 864

Summary and Committee's conclusions

4.1 Market design is the set of rules establishing the principles and details for participation in, and oversight of, the energy market. The three proposals considered in this Chapter represent the Commission's proposed overhaul of the rules as a response to the changing nature of the electricity market, notably the increasing volume of renewable energy. They aim to increase the efficiency and resilience of the market.

4.2 Our predecessors supported the Government's approach, sharing concerns about the way in which the provisions on capacity markets and regional cooperation would function in practice. They also sought re-assurance about the impact of the UK's withdrawal from the EU on electricity trading arrangements. The then Minister for Industry and Energy (Jesse Norman) confirmed that the UK would be able to trade electricity with the EU post-Brexit from outside the internal energy market but noted that the terms of such trade would depend on the outcome of negotiations.

4.3 An amendment was proposed to the rules governing the European Agency for the Cooperation of Energy Regulators (ACER) whereby a third country would be allowed to participate in the Agency on condition that it applied EU energy, environmental and competition law. The previous Committee was less confident than the Minister that this made no substantive change and therefore considered it unwise to agree to such text.

4.4 The Minister for Industry and Energy (Richard Harrington) has now written, requesting scrutiny waivers in advance of possible agreement to General Approaches on the Electricity Regulation and Directive (documents (a) and (c)) at the 18 December Energy Council, and on the ACER Regulation (document (b)) in January.

4.5 Regarding the ACER Regulation, the Minister explains that the proposed text on third country participation has reverted back to the current provisions whereby third country

participation in the Agency is conditional on complying only with EU energy rules and with "relevant" EU environmental and competition rules. The published compromise text further specifies that compliance with energy legislation need only be with "the main relevant" energy rules. These include "the rules on independent national regulators, third party access to infrastructure and unbundling, energy trading and system operation and consumer participation and protection".[19]

4.6 On the electricity Regulation and Directive, the Government has two outstanding issues, resolution of which will determine whether the Government abstains or supports the General Approaches:

- public intervention in the setting of retail electricity prices—while the current wording is largely acceptable to the UK and would allow implementation of the proposed UK energy price-cap, the Council is split on this issue, with half of the Member States supporting price regulation and half opposed; and
- resource adequacy assessments and capacity mechanisms[20]—the Minister believes that the current wording gives too much weight to a European adequacy assessment in determining whether Member States may operate capacity mechanisms. It is important for the UK's energy security, says the Minister, that a capacity mechanism can be operated where it is deemed necessary by the UK's national resource adequacy assessment.

4.7 **We note the swift progress made in these negotiations. Following earlier concern about the proposed new restrictions in the ACER Regulation on third country participation in ACER, we are pleased to note that the status quo will apply and that there will be no new restrictions. The Minister's letter to us is largely silent on the ACER Regulation. While we are content to grant a scrutiny waiver on that Regulation (document (b)) in advance of agreement in January, we look forward to receiving more comprehensive information on the outcome of discussions, including potential implications for UK participation in the Agency post-Brexit.**

4.8 **We are also content to waive the scrutiny reserve for the electricity Regulation and Directive (documents (a) and (c)) in order that the Government is able to lend its support to the General Approaches at the 18 December Council meeting based on the principles set out in the Minister's letter. We look forward to an update from the Minister on the outcome of the Council meeting and an assessment of the prospects for agreement with the European Parliament. We are drawing this chapter to the attention of the Business, Energy and Industrial Strategy Committee given that Committee's interest in the impact of Brexit upon energy and climate policy.**

Full details of the documents

(a) Proposal for a Regulation on the internal market for electricity (recast): (38346), 15135/16 + ADDs 1–11, COM(16) 861; (b) Proposal for a Regulation establishing a European Agency for the Cooperation of Energy Regulators (recast): (38347), 15149/16 + ADD 1, COM(16) 863; and (c) Proposal for a Directive on common rules for the internal market in electricity: (38348), 15150/16 + ADD 1, COM(16) 864.

19 12953/2/17 REV 2.

20 The financial support that EU Member States grant to electricity producers to safeguard security of electricity supply.

Background

4.9 The package of proposals aims to increase the efficiency and resilience of the internal energy market. Full details on the background to, and content of, the proposals were set out in our Report of 25 January 2017.[21] Key new suggestions include:

- conditions on the use of national capacity mechanisms, including participation by foreign and domestic capacity;
- establishment of Regional Operational Centres (ROCs) to undertake duties such as coordination of capacity calculation and security analysis;
- a ban on price controls;
- facilitation of consumer switching between energy suppliers; and
- strengthening of the role of the Agency for the Cooperation of Energy Regulators (ACER) in order to boost cooperation between Member States.

4.10 The Government considered that the proposals were largely in line with the direction of UK policy, but a number of initial concerns had been identified: the provisions on capacity mechanisms; the arrangements for regional cooperation; the strengthened role of ACER; consumer price regulation; and the potentially prescriptive nature of rules on risk-preparedness plans.

4.11 In its Report of 25 January, the Committee noted that this was a complex set of proposals to which the Committee expected to return once the Government had had an opportunity to assess their full implications. The Committee agreed with the Minister's initial concerns about the way in which the provisions on capacity markets and regional cooperation would work.

4.12 Responding to queries raised by our predecessors, the Minister assured them that the Government would continue to engage in the negotiations even though some or all of the legislation may not be in force by the time the UK has left the EU. He confirmed that the UK would be able to trade electricity with the EU post-Brexit from outside the internal energy market but noted that the terms of such trade would depend on the outcome of negotiations.

4.13 The Committee had queried an amendment to the new rules governing the European Agency for the Cooperation of Energy Regulators (ACER) whereby a third country would be allowed to participate in the Agency on condition that it applied EU energy, environmental and competition law. The Government indicated that the Commission's proposal made no substantive change.

4.14 Finally, the Minister also submitted a Checklist for Analysis of each proposal, largely summarising the Commission's assessment of the impact of the various proposals and giving UK-specific analysis on potential enforcement costs.

4.15 At their meeting of 25 April 2017, our predecessors considered the Minister's response to be largely helpful, although they were less confident than he that the proposed

21 Twenty-ninth Report HC 71–xxvii (2016–17), chapter 4 (25 January 2017).

amendment to the ACER Regulation represented no substantive change. The Committee considered it unwise to agree to text that would make third country participation in the Agency conditional on applying EU environmental, energy and competition law.

The Minister's letter of 5 December 2017

4.16 The Minister explains that the Estonian Presidency is aiming for a General Approach to be agreed in Council on 18 December on the proposals for a Regulation and Directive on the internal market in electricity (documents (a) and (c)), and early in the New Year for the ACER Regulation (document (b)). He is therefore requesting a scrutiny waiver in order to be able to vote in favour in Council, subject to conditions set out below.

4.17 The Minister is sorry to have to request a waiver with such urgency. This, he says, is because of the "exceptional speed" at which the Presidency is progressing the Electricity Market Design proposals. The Presidency has resisted calls for the pace to be set at a more reasonable level, explains the Minister, as it has placed a high premium on achieving a General Approach on these dossiers before the end of its term.

4.18 The Minister sets out the Government's approach in the following terms:

> "The proposals are largely consistent with our own electricity market reforms. Where we have raised concerns, we have generally been successful in securing changes to address them. The most significant of these include: Regional Operational Centres will be re-named Regional Security Coordinators and national system operators will retain decision making powers on all significant issues relating to security of supply; the UK will be able to retain its 30 minute Imbalance Settlement Period; and the UK's model for the use of interconnector revenues—which has been central to the UK's success in attracting investment for interconnectors—will be able to continue.
>
> "There are, however, two issues which are important to the UK and which have still not been finally settled. The first of these is public intervention in the setting of retail electricity prices. The current wording is largely acceptable to us and would allow the UK to implement its proposed energy price-cap. The Council is split on this issue, with half of the Member States supporting price regulation and half opposed. We are hopeful that the General Approach will allow for the UK price-cap but, if not, I am proposing that the UK abstains.
>
> "The second issue concerns the proposals relating to resource adequacy assessments and capacity mechanisms. The current wording gives too much weight to the European adequacy assessment in determining whether Member States may operate capacity mechanisms. It is important for the UK's energy security that a capacity mechanism can be operated where it is deemed necessary by the UK's national resource adequacy assessment. I am proposing that the UK should abstain if the General Approach does not meet these conditions."

4.19 On the ACER Regulation, the Minister writes in a separate letter to the House of Lords EU Committee:

> "We consider the latest version of the ACER Regulation a considerable improvement on previous versions. The conditions for third country participation now refer to the need to comply with relevant rules in the fields of environment and competition, as was in the original ACER Regulation. The voting procedure for the Board of Regulators has been changed from a simple majority to two-thirds majority which gives National Regulators a much greater degree of influence."

Previous Committee Reports

Fortieth Report HC 71–xxxvii (2016–17), chapter 6 (25 April 2017); Twenty-ninth Report HC 71–xxvii (2016–17), chapter 4 (25 January 2017).

5 Energy Union Governance

Committee's assessment	Legally and politically important
Committee's decision	Not cleared from scrutiny; scrutiny waiver granted; further information requested; drawn to the attention of the Business, Energy and Industrial Strategy Committee
Document details	Proposal for a Regulation on the Governance of the Energy Union, amending Directive 94/22/EC, Directive 98/70/EC, Directive 2009/31/EC, Regulation (EC) No 663/2009, Regulation (EC) No 715/2009, Directive 2009/73/EC, Council Directive 2009/119/EC, Directive 2010/31/EU, Directive 2012/27/EU, Directive 2013/30/EU and Council Directive (EU) 2015/652 and repealing Regulation (EU) No 525/2013
Legal base	Articles 192(1) and 194(2) TFEU
Department	Business, Energy and Industrial Strategy
Document Number	(38352), 15090/16 + ADDs 1–5, COM(16) 759

Summary and Committee's conclusions

5.1 The October 2014 European Council agreed that a reliable and transparent energy governance system without any unnecessary administrative burden would be developed to help ensure that the EU meets its energy policy goals, with the necessary flexibility for Member States and fully respecting their freedom to determine their energy mix.

5.2 On that basis, the Commission proposed—as part of its "Clean Energy for all Europeans" package—to streamline existing planning, reporting and monitoring obligations and require Member States to submit plans and reports to the Commission.

5.3 The previous Committee last considered this proposal at its meeting of 25 April, when it reviewed a letter from the Government in which the Government clarified its concerns over possible expansion of Commission competence. It was clear that the need for Commission involvement was not disputed but that the issue was the degree of involvement. The previous Committee expected the Government's next update to address this core concern.

5.4 The Government had also stated its intention to engage actively to defend the UK's interests and to support the EU to meet its decarbonisation objectives. Any UK access to the internal energy market and/or engagement in any governance mechanism post-Brexit would depend on the outcome of the Brexit negotiations.

5.5 The Minister for Energy and Industry (Richard Harrington) reports that negotiations have accelerated and that the Estonian Presidency will seek to agree a General Approach on this, and other elements of the Clean Energy Package, at the 18 December Energy Council.

5.6 On Brexit, the Minister notes that it is still too early to assess whether and how the EU exit negotiations will affect the Clean Energy Package. While the Government expects the legislation to have been agreed before Brexit, the transposition deadline of at least some of the legislation, including the Renewable Energy Directive, might fall during any implementation period.

5.7 In terms of the ongoing negotiations, the Minister strikes a positive tone, noting effective UK engagement. Details are set out below but, in summary, the changes have reduced the powers of the Commission and some of the more bureaucratic requirements.

5.8 The Minister sets out the principles on which he will continue to negotiate and seeks a scrutiny waiver on that basis. On both this Regulation and the linked Renewable Energy Directive, the approach to be followed will be to continue focussing on seeking maximum flexibility for Member States to be able to develop their most cost-effective pathway for delivering their ambitious emissions reductions commitments, including deciding what contribution renewable energy should make to meet that commitment, whilst recognising the need for mechanisms to give the EU assurance over the delivery of its objectives on renewables. The Government will also seek to ensure that any nationally-binding targets or endeavours do not impose significant costs on the UK and to minimise any administrative burden or implementation costs as far as possible, as well as the degree to which the Commission can issue recommendations or intervene in domestic policy.

5.9 **On the implications of the UK's exit from the European Union, we take note of the Minister's view that it is still too early to assess whether and how the EU exit negotiations will affect the Clean Energy Package. While we accept that there can be no certainty as yet over the future relationship in the energy sector, we signal our continued interest in the matter and our expectation that the Government continues to negotiate with EU exit in mind.**

5.10 **We note that the final shape of any agreement is far from clear, but we are grateful that the Minister has set out the direction of travel and the principles that the Government will be following. We can support the proposed approach.**

5.11 **The proposal remains under scrutiny, but we are content to waive the scrutiny reserve in order that the Government is able to lend its support to the General Approach at the 18 December Council meeting based on the principles set out in the Minister's letter. We look forward to an update from the Minister on the outcome of the Council meeting and an assessment of the prospects for agreement with the European Parliament. We are drawing this chapter to the attention of the Business, Energy and Industrial Strategy Committee.**

Full details of the documents

Proposal for a Regulation on the Governance of the Energy Union, amending Directive 94/22/EC, Directive 98/70/EC, Directive 2009/31/EC, Regulation (EC) No 663/2009, Regulation (EC) No 715/2009, Directive 2009/73/EC, Council Directive 2009/119/EC, Directive 2010/31/EU, Directive 2012/27/EU, Directive 2013/30/EU and Council Directive (EU) 2015/652 and repealing Regulation (EU) No 525/2013: (38352), 15090/16 + ADDs 1–5, COM(16) 759.

Background

5.12 The Commission's proposal envisages the establishment of a reporting system focussed on the five aspects of the Energy Union: decarbonisation; renewables and energy efficiency; energy security; internal energy market; and research, innovation and competitiveness. Under the proposal, each Member State would set out a ten year national plan as to how it will meet the identified goals in those five areas. The Commission would review the plans and would have the right to make recommendations either to the EU as a whole or to individual Member States. Full details on the content of the proposal were set out in our Report of 25 January 2017.[22]

5.13 At its meeting reported on 25 January, the previous Committee noted that the most contentious aspect of the proposal related to action that the Commission might recommend should it identify matters that, in its view, required action on the part of Member States. This was at the heart of the Government's concern about possible expansion of the Commission's competence. Recalling that all 28 Member States had agreed that some form of energy governance system was required, the previous Committee asked the Government what assessment it took, when it agreed to the October 2014 European Council Conclusions, of the possible form of a new governance system and its impact. The Committee asked how any governance system could function without giving the Commission some form of role in assessing Member State policies and making recommendations.

5.14 The previous Committee also asked on what basis the UK would be approaching the negotiations in the light of the UK's withdrawal from the EU.

5.15 In response, the Minister indicated the UK's intention to engage actively to defend the UK's interests and to support the EU to meet its decarbonisation objectives. Any UK access to the internal energy market and/or engagement in any governance mechanism post-Brexit would depend on the outcome of the Brexit negotiations.

5.16 On concerns about Commission competence, our predecessors understood from the Government response that the need for Commission involvement was not disputed but that the issue was the degree of involvement. They expected the Government's next update to address discussions that had taken place on the Government's core concern about Commission competence.

The Minister's letter of 30 November 2017

5.17 The Minister writes to update the Committee on negotiations and to request a scrutiny waiver in order for the UK to be able to support a potential General Approach at the 18 December Energy Council.

5.18 On the UK's exit from the EU, the Minister says that it is too early to assess whether and how the EU exit negotiations will have an impact on the various dossiers included within the Clean Energy Package. He notes that the transposition deadline for some of the legislation might fall during any implementation period and confirms that the UK's negotiating position is taking account of these factors.

22 Twenty-ninth Report HC 71–xxvii (2016–17), chapter 5 (25 January 2017).

Progress of negotiations

5.19 The Minister reports that negotiations on the Governance Regulation have seen significant progress at official-level meetings in Council, and through a series of non-papers presented by various Member States on the "backfill mechanism" (see below) in particular. The Minister believes that the UK has engaged effectively with its allies in Council and has seen a number of its suggestions reflected in the text. A number of key points of consensus amongst Member States have emerged through the various discussions, as set out below.

5.20 On the "backfill mechanism", the Minister says that additional clarity has been introduced about how the EU might seek to make up any gap to the binding EU-level renewable energy target. The current proposals call for a two-step system, under which Member States would submit their proposed contribution to the EU-level renewable energy target as part of their national plans, and would then be responsible for making up any gap in their performance against the EU trajectory. If the total sum of Member States' contributions did not add up to the EU renewable energy target, then the Commission would make non-binding recommendations to Member States in order to seek an increase in ambition (and consequently their contributions). If a gap then emerged in the overall trajectory to the EU-level renewable energy target, those Member States who were beneath their national trajectories would be required to make up such gap.

5.21 Regarding the baseline mechanism, the Minister says that the proposal for automatic financial payments by Member States who drop below their 2020 target level at any time during the 2020s has been removed. However, there has been broad support for the principle that Member States should not fall beneath that level between 2021 and 2030; so this principle is maintained as a legal obligation in the Renewable Energy Directive (RED). The Governance Regulation includes a provision, however, to the effect that Member States who fall beneath their baseline are deemed to be in compliance with the RED so long as they cover the gap by the end of the year following the year in which they fell below their 2020 target.

5.22 On the proposed National Energy and Climate Plans, the Minister reports that many of the "most burdensome" new reporting requirements on both energy efficiency and renewable energy have been removed; as have some "unnecessarily detailed" aspects of the national plans. The timelines for initial submission have been deferred on grounds of practicality, whilst the timescales for submission of later plans aligned with the UNFCCC (UN Framework Convention on Climate Change) framework have been retained.

5.23 Concerning climate reporting, the Minister says that these elements have largely been maintained or brought closer to those of the existing greenhouse gas Monitoring Mechanism Regulation (MMR) which will be superseded by this Regulation.

5.24 On the Commission's powers, the Minister explains that the Commission's powers to amend the template for the national plans have been restricted to those necessary to reflect agreements at the UNFCCC level.

Possible General Approach

5.25 The Minister explains that the Presidency will be seeking to reach a General Approach on various elements of the Clean Energy Package at the 18 December Council. He judges

this to be an ambitious objective overall, although progress on the Governance Regulation has been such that a General Approach is feasible. The Minister is requesting a scrutiny waiver on the basis of a clear indication of priorities, and thus providing the Minister with the flexibility to engage effectively. The Minister apologises for having to request a waiver under urgent circumstances, noting that progress has been unexpectedly rapid.

5.26 He sets out the approach to both the Renewable Energy Directive and Governance Regulation in the following terms:

> "The approach to be followed at the December Council will be to continue focussing on seeking maximum flexibility for Member States to be able to develop their most cost-effective pathway for delivering their ambitious emissions reductions commitments, including deciding what contribution renewable energy should make to meet that commitment, whilst recognising the need for mechanisms to give the EU assurance over the delivery of its objectives on renewables. I will also seek to ensure that any nationally-binding targets or endeavours do not impose significant costs on the UK.
>
> "Our position is to seek to be part of the qualified majority that supports the Presidency's General Approach on these dossiers, so long as the outcome reached is satisfactory to the UK."

5.27 In addition, the Government will seek to minimise any administrative burden or implementation costs as far as possible, as well as the degree to which the Commission can issue recommendations or intervene in domestic policy. The Government will also seek to align EU and UK policy where possible to minimise policy changes or costs, as well as focus the Governance framework to achieve the aims of the Paris Agreement and set timescales in line with those in the UN Framework Convention on Climate Change framework.

Previous Committee Reports

Fortieth Report HC 71–xxxvii (2016–17), chapter 7 (25 April 2017); Twenty-ninth Report HC 71–xxvii (2016–17), chapter 5 (25 January 2017).

6 Marketing of fertilisers

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; scrutiny waiver granted; further information requested
Document details	Proposal for a Regulation laying down rules for the making available on the market of EC marked fertiliser products
Legal base	Article 114 TFEU; Ordinary Legislative Procedure; QMV
Department	Environment, Food and Rural Affairs
Document Number	(37625), 7396/16 + ADDs 1–4, COM(16) 157

Summary and Committee's conclusions

6.1 Fertilisers may only circulate freely in the internal market if they comply with a set of conditions relating to agronomic efficacy, nutrient content, packaging, identification and traceability. Such products receive the designation "EC fertiliser".

6.2 At the moment, virtually all product types carrying the "EC fertiliser" designation are conventional inorganic fertilisers, whilst virtually all those produced from organic materials or recycled bio-waste are excluded, notwithstanding the contribution which they could make to the so-called "circular economy" by generating value from secondary, domestically sourced resources.

6.3 The Commission accordingly proposed a new Regulation establishing conditions with which all EC marked fertiliser products—including those made from recycled or organic materials—would have to comply in order to move freely on the internal market.

6.4 When the previous Committee last considered this proposal, at its meeting of 25 April 2017, it waived the scrutiny reserve in advance of possible agreement while Parliament was dissolved. Ultimately, agreement did not prove possible at that stage.

6.5 The Minister of State for Agriculture, Fisheries and Food (George Eustice) has now written again, noting that agreement in Council is imminent and that negotiations with the European Parliament are likely to start shortly. He explains that the outstanding issue is cadmium limits in phosphate fertilisers. The Government is working with other Member States to find an acceptable compromise. He asks the Committee to release the proposal from scrutiny to enable the Government to fully defend UK interests.

6.6 **We note the progress made and that negotiations could conclude quickly. The proposal remains under scrutiny but we are content to waive the scrutiny reserve to enable the Government to defend UK interests. We look forward to information as soon as possible on the final agreement, particularly on cadmium limits.**

Full details of the documents

Proposal for a Regulation laying down rules for the making available on the market of EC marked fertiliser products: (37625), 7396/16 + ADDs 1–4, COM(16) 157.

Background

6.7 The main instrument setting out EU rules applicable to fertilisers[23] is Regulation (EC) No. 2003/2003, which provides for the designation of "EC fertiliser" to be applied to products which comply with the conditions laid down in Annex I governing their agronomic efficacy and nutrient content. The Commission proposes to replace that Regulation with a new set of rules allowing organic fertilisers to be included. Further details on the background to, and content of, the proposal were set out in the Report of 4 May 2016.[24]

6.8 At its meeting of 4 May 2016, the previous Committee noted the Government's support for the proposal but retained it under scrutiny awaiting the Government's detailed assessment. The Committee subsequently engaged in correspondence with the Government around particular concerns regarding the setting of limits on cadmium content. The Government was concerned that the proposed cadmium limits would significantly restrict the supply of phosphate rock, which is used in the production of fertiliser. A limit was being sought that would mitigate the potential risks of cadmium deposited in soils from fertilisers, without setting them so low that the burden on consumers, farmers and manufacturers becomes excessive.

6.9 In a letter of 19 April 2017, the Minister explained that good progress had been made in Council discussions. His view remained that the legislation was, overall, a good regulation that would create a level playing field for organic and organo-mineral fertilisers, promote innovation, and protect national security by improving the safety of ammonium nitrate fertilisers within the EU.

6.10 A number of improvements to the text had been secured in negotiations, including a tightening of the limits on macroscopic plastic impurities in digestates and composts to bring the requirements closer in line to UK standards. There were still a few issues to be finalised, including cadmium limits and the frequency of detonation resistance testing for ammonium nitrate fertilisers.

6.11 Noting that the Presidency was seeking to agree a text before the end of June, the previous Committee waived the scrutiny reserve. It asked the Minister to provide a further update on developments in both the Council and the European Parliament.

The Minister's letter of 29 November 2017

6.12 On progress of discussions within the European Parliament, as requested by the Committee, the Minister notes that the proposal has had opinions adopted by all relevant European Parliament Committees.

6.13 The Environment, Public Health and Food Safety Committee suggested tightening limits for certain contaminants and pathogens. It also, with regards to cadmium content limits in phosphate fertilisers, suggested bringing forward the date from which the 20 mg/kg limit would apply (nine years after application of the Regulation instead of twelve).

23 In addition to conventional fertilisers providing plant nutrients, this term includes such products as soil improvers, liming material and potting compost.

24 Thirty-second Report HC 342–xxxi (2015–16), chapter 4 (4 May 2016).

6.14 The Committee for Agriculture and Rural Development proposed to add a greater focus on products improving the nutrition efficiency of plants, alongside creating better conditions for innovative fertilising products.

6.15 The Committee on International Trade proposed that the Commission had not focused enough on the potentially negative impact of tight cadmium limits on the market and on trade relations between countries. It suggested that more should be done to evaluate the impact of this regulation on the market as it is applied.

6.16 The Committee on the Internal Market and Consumer Protection (IMCO) amendments focused on reducing the administrative burden for economic operators, tightening quality requirements for specific fertilising products and requiring the Commission to report back on the functioning of the internal market for fertilising products.

6.17 On 24 October, the European Parliament voted to approve the draft text with amendments by 343 votes to 252, with 59 abstentions. The proposal was referred back to the IMCO committee, but allowing inter-institutional "trilogue" negotiations with the Council and the Commission to begin.

6.18 The issue still holding the proposal back is compromise on the cadmium limits in phosphate fertilisers. Positions on this are split within the European Parliament, reports the Minister, despite it voting narrowly in favour of the strict limits proposed but with longer implementation time periods. The Council is also divided, says the Minister, although there have been numerous proposed compromises which are finding support among Member States. The UK is working closely with colleagues in other Member States to find an acceptable compromise in the Council.

6.19 The Minister asks that the Committee considers releasing the proposal from scrutiny to enable the Government to fully defend UK interests, since the Presidency is keen to push the proposal forwards, and matters could move quickly into "trilogue" and the final negotiations.

Previous Committee Reports

Fortieth Report HC 71–xxxvii (2016–17), chapter 13 (25 April 2017); Thirty-second Report HC 342–xxxi (2015–16), chapter 4 (4 May 2016).

7 Mobility Package: Social Pillar

Committee's assessment	Politically important
Committee's decision	(a) Not cleared from scrutiny; further information requested (b) Not cleared from scrutiny; further information requested (c) Cleared
Document details	(a) Proposal for a Regulation amending Regulation EC 561/2006 as regards minimum requirements on maximum daily and weekly driving times, minimum breaks and daily and weekly rest periods and Regulation EC 165/2014 as regards positioning by means of tachographs; (b) Proposal for a Directive amending Directive 2006/22/EC as regards enforcement requirements and laying down specific rules with respect to Directive 96/71/EC and Directive 2014/67/EU for posting drivers in the road transport sector; (c) Consultation Document: first phase consultation of the Social Partners under Article 154 of TFEU on a possible revision of the Road Transport Working Time Directive (Directive 2002/15/EC)
Legal base	(a) and (b) Article 91(1) TFEU; ordinary legislative procedure; QMV (c) Article 154 TFEU
Department	Transport
Document Numbers	(a) (38783), 9670/17 + ADDs 1–5, COM(17) 277; (b) (38784), 9671/17 + ADDs 1–5, COM(17) 278; (c) (38814),—, C(17) 3815

Summary and Committee's conclusions

7.1 The EU's 'social rules' on the conditions for 'mobile workers' (drivers) in the road transport sector are, according to the Commission, out of date and difficult to enforce. The two legislative proposals considered here are part of the Mobility Package on transport, which we have been considering over the past weeks.

7.2 Increased competition in the road haulage sector following successive EU enlargements has led to downward pressures on profits and wages and an accompanying rise in illegal practices by companies seeking to circumvent EU rules.

7.3 The different perspectives of transport operators and other stakeholders in western European (the EU-15) and eastern European (the EU-13) Member States over existing provisions and the Commission's proposals demonstrate the difficulty of legislating on this issue. These difficulties have been particularly apparent in our ongoing consideration of revisions to the Posting of Workers Directive.[25]

25 Second Report, HC 301–ii (2017–19), Chapter 5 (22 November 2017)

7.4 The Parliamentary Under Secretary of State (Jesse Norman) tells us that the Government is currently looking at some of the potential downsides to the proposals on the Driving Time Regulation, with concerns focusing around the implications for driver fatigue and road safety of the additional flexibility around weekly rest times.

7.5 The Government is supportive of the proposed changes to the Tachograph Regulation, and believes that the revisions will have positive enforcement benefits and require only minor technical changes to put into effect.

7.6 The Commission's proposals for specific enforcement rules relating to the working time of mobile workers attract some reservations from the Government. The Minister tells us that there are "practical reasons why it may be time-consuming to check the working time rules alongside the driving time rules", and that the Government will be undertaking analysis to determine the scale of impact of this requirement.

7.7 **We would like the Minister to tell us what these "practical reasons" might be, and also to inform us in due course of the outcome of the analysis conducted. Does the Government believe that it would be more efficient and effective to conduct working time checks separately from driving time checks, and if so, why?**

7.8 **We would also like to hear from the Government in due course on its assessment of the implications for driver fatigue and road safety of the proposals on the Driving Time Regulation. The Minister has told us that the proposed requirement for drivers to return home for their weekly rest at least once every three consecutive weeks could indirectly benefit British drivers "through reducing somewhat their exposure to competition from foreign drivers that spend many consecutive weeks (or even months) away from their home base". Does the Government believe that the proposed Regulation strikes the right balance between improving working conditions for drivers and ensuring fair competition in the single market?**

7.9 **The Minister informs us that while these proposals do not directly affect Member States' positions on businesses from third countries (i.e. the UK post EU exit), the EU is likely to seek to amend a wider UN agreement on international road transport workers to which the UK is a contracting party.[26] Is it the Government's view that following UK exit, international agreements such as this one, negotiated under the aegis of the UN Economic Commission on Europe, will enable the UK to protect and promote its interests in this sector effectively?**

7.10 **The application of EU social rules to the transport sector has already proved contentious in the context of related negotiations on the Posting of Workers Directive. We are scrutinising the separate proposal to revise that Directive and recently noted that the Government abstained on the General Approach due to the transport provisions. We are awaiting a clearer articulation of the Government's concerns on that Directive.**

7.11 **We would like the Government to respond to the questions we have raised here once it has completed its assessments and consultations. In the meantime, we retain the legislative proposals under scrutiny.**

26 European Agreement concerning the Work of Crews of Vehicles engaged in International Road Transport (AETR).

Full details of the documents

(a) Proposal for a Regulation amending Regulation EC 561/2006 as regards minimum requirements on maximum daily and weekly driving times, minimum breaks and daily and weekly rest periods and Regulation EC 165/2014 as regards positioning by means of tachographs: (38783), 9670/17 + ADDs 1–5, COM(17) 277; (b) Proposal for a Directive amending Directive 2006/22/EC as regards enforcement requirements and laying down specific rules with respect to Directive 96/71/EC and Directive 2014/67/EU for posting drivers in the road transport sector: (38784), 9671/17 + ADDs 1–5, COM(17) 278; (c) Consultation Document: first phase consultation of the Social Partners under Article 154 of TFEU on a possible revision of the Road Transport Working Time Directive (Directive 2002/15/EC): (38814),—, C(17) 3815.

Background

7.12 There is an extensive set of EU 'social rules' in place for road haulage operators and road passenger transport operators. These seek to improve working conditions for 'road transport mobile workers', enhance road safety for all road users, and ensure fair competition between road transport operators in the single market. The rules apply to professional drivers (employed and self-employed) and to all transport undertakings engaged in the movement of goods by vehicles weighing over 3.5 tonnes or in the transportation of passengers in vehicles for over nine people.

7.13 The main social rules for transport are set out in Regulation (EC) 561/2006 (the Driving Time Regulation) and Directive 2002/15/EC (the Road Transport Working Time Directive). Enforcement provisions are set out in Directive 2006/22/EC (the Enforcement Directive) and Regulation (EU)165/2014 (Tachograph Regulation).

7.14 The Commission, in its explanatory memorandum, notes that road transport social rules are closely linked to internal market rules on access to the occupation of road transport operator, access to the international road haulage market and access to the international passenger road transport market. In addition, the Commission notes the applicability of Directive 96/71/EC (Posting of Workers Directive), which applies to all transport sectors whenever the conditions for a posting situation are fulfilled.

7.15 The Commission's evaluation of existing road transport social legislation, conducted from 2015 to 2017, concluded that:

> "The legislation remains a relevant tool, but it is only partially effective in improving working conditions of drivers and ensuring fair competition between operators….The insufficient effectiveness and efficiency of the social legislation is mainly due to unclear and unsuitable rules, diverging national interpretations and application of the rules, inconsistent and ineffective enforcement practices and a lack of administrative cooperation."

7.16 Since the legislation in question came in to effect, significant market changes have taken place, precipitated by the global economic downturn in 2007 to 2008, and the Eurozone crisis in 2009. The Commission notes that the road transport market has always been highly competitive and price-sensitive, and is dominated by a large number of small companies and owner-operators. These firms "tend to compete mainly on price, with labour costs being a key determinant".

7.17 The EU enlargements of 2004 and 2007 (the EU-13) led to increased competition in the sector and downward pressures on profits and wages. Lower labour costs in those Member States have led to practices such as letterbox companies, illegal cabotage and other illicit employment arrangements by companies seeking to circumvent EU and national legislation. This practice, known as 'social dumping,' leads to a distortion of competition. The Commission has sought to address this challenge through other proposals in its Mobility Package.

7.18 The competition faced by road transport operators in the EU-15 has resulted in some Member States taking unilateral, and in the Commission's view—disproportionate—measures to apply posting rules to the road transport sector.

7.19 These challenges have led to distortions of competition between road transport operators and persistent inadequate working conditions for drivers. In particular, the evaluation found that:

> "There has been a continuous pattern of…infringements since 2007–2008, with the provisions on rest breaks and rest periods being breached most frequently, followed by infringements concerning driving times and driving time records."

7.20 Member States are not required to carry out regular checks on compliance with working time provisions, and national enforcement agencies told the Commission that infringement statistics are also unreliable indicators of compliance, due to "random, insufficient and ineffective checks as well as sophisticated manipulation techniques".

7.21 Road transport operators also face high regulatory costs from complying with existing road transport rules since Member States interpret, apply and enforce them in divergent ways. For instance, apart from the unilateral measures on national minimum wage referred to above, some Member States impose financial and even criminal penalties for drivers taking their weekly rest breaks in their vehicles. Other Member States do not prohibit this practice.

7.22 The Commission observes that high regulatory costs of compliance with rules not only distort competition but also risk depriving drivers of their rights when working temporarily in another Member State, because there is a higher incentive for operators to circumvent the rules. It cites the example of eastern European drivers employed by eastern European companies, and paid eastern European-level wages despite working for several months in western Europe. These drivers typically lack access to adequate sleeping or toilet facilities, as their pay (which can be as low as 25% of the pay of a western European driver) is insufficient to meet the costs of spending prolonged periods of time in western Europe.

7.23 The Commission's impact assessment identifies the following deficiencies in the existing legal framework, which have contributed to a lack of effectiveness in the existing rules:

- lack of clarity or suitability in the current rules;
- differences in national interpretation and application;
- inconsistent and ineffective enforcement;

- insufficient administrative cooperation;
- unsuitability of posting rules for the highly mobile road transport sector; and
- disproportionate national measures for the enforcement of existing posting rules to road transport.

The Commission's proposals

(a) Amendments to the Driving Time and Tachograph Regulations

7.24 The Commission's proposed amendments to these Regulations seek to simplify and adapt them to the changing needs of the sector. The proposed changes are set out below:

- Private individuals using vehicles falling within the scope of the Driving Time Regulation are not obliged to record their driving times and rest periods.
- Drivers will be required to record work other than driving and periods of availability. This is to ensure more effective monitoring of drivers' working patterns.
- Drivers driving in a team will be allowed to take their required break in a vehicle driven by another driver.
- Weekly rest requirements are adapted to match the needs of the sector and actual practice in arranging transport schedules, particularly those for long distance operations. Drivers are given more flexibility to arrange their weekly rest periods over a period of four consecutive weeks. Any reduced weekly rest period should be taken together with a regular weekly rest of at least 45 hours and within three weeks. The Commission believes this will make it easier to check rest taken in compensation and will bring greater benefit to drivers.
- Drivers will not be allowed to take a weekly rest of 45 hours or more in a vehicle. If a driver is not able to take their weekly rest in a private place of their choice, employers are required to provide them with "adequate accommodation with appropriate sleeping and hygiene facilities".
- Transport undertakings will be required to organise drivers' work in such a way that they are able to return to their homes for a weekly rest at least once within a period of three consecutive weeks.
- Drivers currently take partial rest periods on ferries or trains while accompanying their vehicle, but this is not currently permitted by the rules. The Commission believes this creates an unnecessary burden and therefore its proposed amendment allows for this practice.
- International drivers often face long delays due to bad weather, unforeseen waiting time or traffic, that delay their return home and compel them to take their weekly rest break elsewhere so as not to fall foul of the rules. The Commission

proposes to allow drivers to postpone the start of their weekly rest period to reach their home, provided that they comply with daily and weekly driving time limits and with the required minimum duration of a weekly rest period.

- Member States granting temporary exceptions from the rules in urgent cases will be required to provide appropriate justifications based on exceptional circumstances and the need for immediate action.
- National penalties imposed for infringements of the Regulation must be proportionate to the severity of the infringement, and any changes to national penalty systems must be notified to the Commission.
- The obligation of Member States to cooperate and provide mutual assistance without undue delay is added to the Regulation. The text clarifies that exchange of data and information also covers data on the risk ratings of undertakings and any other information that may be required for effective and efficient enforcement.
- Tachographs: drivers will be obliged to record in a tachograph the position of their vehicle after having crossed a border, at the earliest suitable stopping place. The Commission believes this will make it easier to monitor compliance with social rules. Drivers using 'smart' tachographs will not be bound by this requirement, since these automatically record border crossings.

(b) Directive to amend rules on enforcement, and sector-specific rules on posting of workers in road transport sector

7.25 The Commission's proposal amends Directive 2002/15/EC (the Road Transport Directive). It also seeks to simplify and adapt rules of posting of workers to the specific needs of the transport sector. The main provisions of the proposed Directive are set out below:

- The scope of checks on driving times carried out by Member States will be expanded to include checking compliance with the working time provisions of the Road Transport Directive. At least 3% of days worked by drivers covered by mobile working time rules must be checked.
- Member States are required to share information on checks with other Member States upon request. A time limit of 25 days is given to respond to requests relating to checks on business premises. Responses to urgent requests, or those requiring only consultation of risk registers, for example, must be submitted within three working days.
- Member States are required to introduce a risk rating system for transport businesses, based on the relative number and severity of infringements of the Driving Time or Tachograph Regulations, or of national provisions transposing the Road Transport Directive.
- The Commission is to be empowered to make implementing acts to establish a common formula for calculating a risk rating of undertakings.

- The Commission is also empowered to make implementing acts to establish a common approach to recording and controlling periods of "other work" as defined in the Driving Time Regulation, and periods of at least one week when a driver is away from the vehicle (and therefore unable to input the necessary tachograph records).
- Drivers engaged in international road transport operations in a Member State for a period up to and including three days per calendar month, will not be bound by host Member States' rules on minimum pay rates and paid annual leave.
- Breaks and rest periods as well as periods of availability spent in the territory of a Member State are to be counted as working periods. Further provisions on the calculation of working periods are set out in the text of the Directive.
- Cabotage operations will not be affected by this Directive.
- The Commission seeks to reduce the administrative burden on transport operators by setting out the maximum information required to be provided by road transport operators established in one Member State to the competent authorities of another Member State at the start of a posting period.
- In addition, drivers will be required to make available (in paper or electronic form) a copy of the posting declaration, evidence of the transport operation, copy of their employment contract or equivalent document, and copies of the previous two months' payslips. Drivers subject to roadside checks will be permitted to contact their head office or transport manager to provide this last item of information. This information must be made available in one of the official languages of the host Member State or in English.

(c) Consultation of the Social Partners under Article 154 TFEU on a possible revision of the Road Transport Working Time Directive (Directive 2002/15/EC)

7.26 Article 154(2) TFEU requires that before submitting proposals relating to social policy, the Commission must consult management and labour on the possible direction of Union action.

7.27 The Commission has accordingly set out in this first phase consultation document some considerations relating to the effectiveness of the Road Transport Working Time Directive, and asks social partners for their views. Following receipt of views, the Commission will decide whether action is required, and if so, it will launch a second-phase consultation. This would cover the content of any proposal for action.

7.28 The provisions of the Road Transport Working Time Directive supplement the Driving Time Regulation, and takes precedence over the Working Time Directive, since it contains more specific provisions on workers in the road transport sector.

7.29 The Commission notes that since the 2005 deadline for the transposition of the Road Transport Working Time Directive, there have been a number of significant changes relating to terms of employment and business arrangements in the sector. The increased

internationalisation of transport operations, an increase in the number of operational bases, and the development of long sub-contracting chains have placed mobile workers under additional pressure and made it more difficult to monitor compliance with the Directive.

7.30 The Commission summarises the findings of an evaluation of the Directive carried out in 2015 to 2017.

- Working hours: the evaluation found that 40% of drivers across the EU regularly work more than the allowed maximum average of 48 hours per week. Non-compliance with working time limits is largely the result of weak enforcement. National enforcement authorities responding to the Commission stated that the four to six month reference period for calculating average weekly working time, plus the fact that work records would only be accurate if drivers correctly used a switch mechanism in the tachograph to record 'other work' meant that it was difficult to monitor compliance sufficiently regularly or effectively.

- Flexibility in the averaging of weekly working hours: the four to six month reference period for calculating average weekly working time encourages working patterns which could lead to negative effects on the health and safety of mobile workers in general and could also pose risks to road safety. The evaluation found that the long reference periods make it "effectively impossible" to monitor compliance at the roadside, as tachograph records are only available for a period of up to 29 days, and that checks at transport undertakings' premises are excessively time-consuming and resource-intensive. In situations where mobile workers have several employers and multiple working time records, the task of verifying these records is even more challenging.

The Government's Explanatory Memorandum of 5 July 2017

7.31 Competence for legislating in the area of transport is shared between the EU and Member States. The Government states that:

> "As the aim of the EU social legislation is to protect road safety, to ensure fair competition in the industry and to improve the working conditions of drivers at the European level, the Government agrees that action at the Union level is therefore justified."

Amendments to Driving Time and Tachograph Regulations

7.32 The Parliamentary Under Secretary of State (Jesse Norman), commenting on the proposed changes to the driving time and tachographs rules, states that

> "The proposed additional flexibility around weekly rest times may provide operators with greater flexibility with respect to scheduling. However, there are also potential downsides in terms of driver welfare and we will need to explore the potential implications of the proposals on driver fatigue."

7.33 He notes that the proposed new obligation on transport operators to organise drivers' work time so that they can return home for a weekly rest at least once every three weeks will probably benefit those drivers engaged in longer international journeys, although

operators are likely to bear additional costs as a result. He adds that UK drivers are generally able to, and do, return home at weekends, and will therefore probably not be affected by the provision. The Government is considering the road safety implications of these amendments.

7.34 The Minister adds that:

> "There could, however, be an indirect benefit to British drivers through reducing somewhat their exposure to competition from foreign drivers that spend many consecutive weeks (or even months) away from their home base."

7.35 So far as the proposed changes to tachograph provisions are concerned, the Minister states that:

> "[these] are expected to have positive enforcement benefits, and to only require minor technical change to put into effect."

Directive to amend rules on enforcement, and sector-specific rules on posting of workers in road transport sector

7.36 The Parliamentary Under Secretary of State expresses some reservations over the proposed obligation to require Member States to include checks on working time rules as part of roadside and premises checks, noting that there could be "material resource implications for the Driver and Vehicle Standards Agency (DVSA), which enforces the rules".

7.37 He adds:

> "there are practical reasons why it may be time-consuming to check the working time rules alongside the driving time rules. Further analysis will be undertaken to understand the scale of the impact."

7.38 In addition, the Government believes that the provision requiring the Commission to establish a common formula for calculating the risk rating of undertakings could have implications for the way that the DVSA currently operates. However, it notes that this would depend on the eventual policy that is set out following the adoption of the Directive.

7.39 The proposed amendments on better cooperation and exchange of data and information between Member States are not expected to affect enforcement capacity in the DVSA, and the Government is supportive of these provisions.

(c) Consultation of the Social Partners under Article 154 TFEU on a possible revision of the Road Transport Working Time Directive (Directive 2002/15/EC)

7.40 As this is a consultation document, the Government notes that there are no direct policy implications for the UK at this stage.

General policy and cost implications for the UK

7.41 The Parliamentary Under Secretary of State notes that as the Commission has already conducted targeted consultations as well as an open public consultation, the Government has no plans to issue a public consultation on the proposals. However, the Government will be consulting industry stakeholders with a view to informing the Government's negotiating position in the EU exit talks.

7.42 The Minister informs us that:

> "The legislative proposals do not directly affect Member States positions with respect to businesses from third countries. However, based on numerous precedents, it is likely that, should the proposed changes to driving times be adopted, the EU would propose that the wider UN AETR[27] agreement (to which the UK is a Contracting Party) should be amended to retain the alignment of the two sets of rules."

7.43 The Commission's impact assessment identified eventual potential savings of around €785 million (approximately £722 million) a year to EU operators from reduced administration costs. UK transport operators could expect to see their administrative costs cut by 59% (over a period of 15 years).

7.44 The Government notes that the Commission's impact assessment identified small short-term increases in enforcement costs for authorities and compliance and administrative costs for operators. The Explanatory Memorandum states:

> "As the proposals and the associated impact assessments begin to be discussed in working groups, we will consider whether it would be appropriate to also undertake a domestic Analysis Checklist."

Previous Committee Reports

None.

27 European Agreement concerning the work of crews of vehicles engaged in international road transport.

8 Mobility Package: emissions and fuel consumption of heavy duty vehicles

Committee's assessment	Politically important
Committee's decision	(a)-(b) Not cleared from scrutiny; further information requested; (c) Cleared
Document details	(a) Proposal for a Regulation on the monitoring and reporting of CO_2 emissions from and fuel consumption of new heavy-duty vehicles; (b) Commission Regulation implementing Regulation (EU) No 595/2009 as regards the determination of the CO_2 emissions and fuel consumption of heavy-duty vehicles and amending Directive 2007/46/EC and Commission Regulation (EU) 582/2011; (c) Commission Recommendation on the use of fuel consumption and CO_2 emission values type-approved and measured in accordance with the World Harmonised Light Vehicles Test Procedure when making information available for consumers pursuant to Directive 1999/94/EC
Legal base	(a) Article 192(1) TFEU; ordinary legislative procedure; QMV; (b) Regulation 595/2009
Department	Transport
Document Numbers	(a) (38794), 9939/17 + ADDs 1–3; (b) (39318), 11880/17; (c) (38813), C(17)3525

Summary and Committee's conclusions

8.1 Heavy-duty vehicles (HDVs) account for 25% of road transport-based greenhouse gas emissions in the EU. With these proposals, the Commission seeks to require Member States and vehicle manufacturers to monitor and report on the fuel consumption and CO_2 emissions of all new HDVs registered in the EU market from 2019 onwards. Vehicle testing would be carried out through a Commission-developed simulation software system called VECTO.

8.2 The Commission hopes that the obligation to test and report these figures will serve three main purposes: to contribute to the achievement of the EU's climate and energy targets; enable informed purchasing decisions and the deployment of more fuel-efficient vehicles; and contribute to increased competitiveness among EU HDV manufacturers, in a market where international competitors have made rapid advancements on more fuel efficient and low emissions HDVs.

8.3 The Commission has also issued a Recommendation focusing on the provision of consumer information on a new regulatory test procedure called the World Harmonised Light Vehicle Test Procedure (WLTP), which has already been introduced for certain specified new passenger cars from September 2017 and will apply to all new passenger cars from September 2019.

8.4 The new test, which has been developed by the EU and major economies such as Japan, Canada and India under the auspices of the United Nations Economic Commission for Europe, is intended to be used as a global standard. It will enable reporting on fuel consumption and CO_2 emissions obtained under real world driving conditions, and the Commission notes that the figures will, in many cases, be higher than those obtained under the previous testing system.

8.5 **The Government supports EU-level action to reduce HDV emissions and to set fuel consumption standards. The Parliamentary Under-Secretary of State for Transport (Jesse Norman MP) also agrees with the Commission's assessment that a lack of market transparency on HDVs' fuel consumption and CO_2 emissions contributes to a lack of incentive for innovation.**

8.6 In the Government's Explanatory Memorandum, the Minister expressed some concerns that the simulation software that HDV manufacturers would be required to use to measure and certify fuel consumption and CO_2 emissions might "conceal opportunities for manufacturers to 'optimise' modelled performance in a way that does not provide corresponding improvements in the real world".

8.7 He notes that the Commission and Member States agree with the UK on the need for on-road testing, but that a suitable procedure has proved "technically challenging and time consuming" to develop and that therefore an on-road test will be introduced as part of a "second package" after 2020.

8.8 The Minister also expressed concerns that the delegated powers granted to the Commission to amend data reporting requirements could increase the administrative burden on Member States. However, in a letter of 7 December providing an update on working group discussions, the Minister also tells us that the Government has, following discussions with the Driver and Vehicle Licensing Agency (DVLA), concluded that the risks of an increased administrative burden are very low and that, moreover, other Member States believe that such powers are necessary for the Commission to verify the results of future modelled tests.

8.9 The Minister also informs us that these latest Mobility Package proposals have made rapid progress through working groups, and that the Estonian Presidency now intends to seek from COREPER, on 15 December, a mandate to open trilogue negotiations with the European Parliament.

8.10 **The Government has told us that, regardless of the outcome of EU exit negotiations, the proposed Regulation and related implementing Regulation are likely to impact on the UK, since HDVs are typically manufactured for a Europe-wide market. This implies that although the UK will no longer be bound by EU commitments on greenhouse gas emissions and fuel efficient vehicles, UK freight transport operators are likely to continue to use HDVs complying with EU standards.**

8.11 **This also highlights the issue of regulatory alignment or divergence. Manufacturers of vehicle components feeding into European supply chains would need to maintain compliance with EU regulatory standards on fuel consumption and CO_2 so as to continue to do business.**

8.12 **The development of global harmonised standards such as the WLTP for the testing of passenger cars is welcome, and demonstrates that the UK will be able to play a constructive role in multilateral standard-setting bodies in the future. However, the possibility remains that in some areas, the EU will develop more stringent regulatory standards. The Government and UK manufacturers will need to decide whether to follow or diverge from those standards, and consider the economic implications of that decision.**

8.13 **The Government has indicated that it does not have issues with the Commission's Recommendation on the provision of consumer information on the WLTP, and we are content to release it from scrutiny. However, we retain the proposed Regulation and implementing Regulation under scrutiny, and request the Government to keep us informed of the outcome of the COREPER discussions on 15 December and the outcome of trilogue negotiations. In particular, we would like to know in what respects the proposals are amended following trilogue discussions, and the Government's views on the outcome reached. We also wish to kept informed of the timeframe for when this proposal will reach the Council.**

Full details of the documents

(a) Proposal for a Regulation on the monitoring and reporting of CO_2 emissions from and fuel consumption of new heavy-duty vehicles: (38794), 9939/17 + ADDs 1–3; (b) Commission Regulation implementing Regulation (EU) No 595/2009 as regards the determination of the CO_2 emissions and fuel consumption of heavy-duty vehicles and amending Directive 2007/46/EC and Commission Regulation (EU) 582/2011: (39218), 11880/17; (c) Commission Recommendation on the use of fuel consumption and CO_2 emission values type-approved and measured in accordance with the World Harmonised Light Vehicles Test Procedure when making information available for consumers pursuant to Directive 1999/94/EC : (38813), C(17)3525.

Background

8.14 In 2014 the Commission adopted a Communication on a strategy for reducing the fuel consumption and CO_2 emissions of heavy-duty vehicles, which identified a lack of transparency in the market regarding fuel consumption performance. It announced that a simulation tool, known as VECTO (Vehicle Energy Consumption and calculation Tool) would be used to calculate CO_2 emissions from new heavy-duty vehicles (HDVs), to be followed by legislation to monitor and report CO_2 emissions for all new vehicles placed on the EU market.

8.15 In 2015 the EU ratified the Paris Agreement, and committed to a reduction in domestic emissions by at least 40% by 2030 compared to 1990. The Commission consequently proposed an Effort Sharing Regulation on binding reductions in annual greenhouse gas emissions by Member States for 2021–2030. The impact assessment produced in relation to this proposal concluded that reductions in transport emissions would need to be around 19% by 2030 compared to 2005 levels.

8.16 In 2016, the Commission's European Strategy for low-emission mobility set out an ambition for the transport sector to reduce greenhouse gas emissions by at least 60% by 2050 compared to 1990 levels. The strategy set out an action plan to improve fuel efficiency and reduce emissions from HDVs.

8.17 Current legislation on the emission performance of HDVs are set out in Regulation EC 595/2009 which establishes common technical requirements for type approval with regard to emissions. Regulation EC 582/2011 sets out requirements for the approval of HDVs with regard to emissions and access to vehicle repair and maintenance information. These Regulations are part of the wide type approval Framework Directive,[28] which sets out the safety and environmental requirements that must be met before a vehicle can be placed on the EU market.

8.18 The Commission has now proposed two new Regulations. One concerns the monitoring and reporting of CO_2 emissions from new HDVs. The other is a related implementing Regulation, which concerns the determination of CO_2 emissions and fuel consumption of new HDVs using the VECTO software. These proposals are accompanied by a Commission Recommendation on the provision of consumer information on the CO_2 emissions of new cars, following the introduction of a new testing procedure.

8.19 The Commission notes that these proposals will facilitate the development of a methodology for differentiating infrastructure use charges for new HDVs in line with new CO_2 emissions, supporting implementation of its review of the "Eurovignette Directive".[29]

Reasons for the Commission's proposals

8.20 The Commission's background documents state that at present there is no certification, monitoring or reporting of CO_2 emissions and fuel consumption of new HDVs placed on the EU market. This, in the Commission's view, has given rise to a number of problems.

An opportunity to design policies to reduce fuel bills of transport operators

8.21 Fuel costs often amount to over a quarter of the operational costs of the more than 500,000 transport companies operating in the EU. Most of these companies are small and medium sized enterprises (SMEs) and as such would benefit from standardised information that would enable them to evaluate fuel efficiency, compare vehicles and make better informed purchasing decisions.

Increasing competitiveness challenges for vehicle manufacturers

8.22 In 2015, EU exports of lorries generated a €5.1 billion (£4.69 billion) trade surplus. However, EU HDV manufacturers face increasing global competitiveness pressures from manufacturers in the United States, Canada, Japan and China. These countries have all, in recent years, implemented certification and fuel efficiency measures to stimulate innovation and improve vehicle efficiency.

28 Directive 2007/46.

29 Proposal for a Directive amending Directive 1999/62/EC on the charging of heavy goods vehicles for the use of certain infrastructures. Considered by the Committee on 6 December 2017.

8.23 The Commission observes that the current lack of market transparency on these issues in the EU leads to less pressure for EU HDV manufacturers to improve vehicle efficiency and invest in innovation and that this stifles competition in the internal market. This in turn creates risks for the sector in relation to its global competitors.

A barrier to setting policies to reduce greenhouse gas emissions from the heavy-duty vehicles sector

8.24 The HDV sector accounts for 5% of total EU emissions, 20% of all transport emissions and about 25% of road transport emissions, according to 2016 data cited by the Commission. HDV emissions have increased by 14% since 1990, in comparison to an overall 20% increase in greenhouse gas emissions in the transport sector.

8.25 EU data projections show that without further action, HDV CO_2 emissions will increase by up to 10% by 2030 compared to 2010 levels. EU-level action has already been taken to curb emissions from cars and vans,[30] and the Commission observes that as a result, HDV emissions as a share of road transport emissions will increase to about 30% by 2050.

8.26 However, the lack of information on CO_2 emissions and fuel consumption is hampering effective action. Member States face difficulties in providing further incentives for the production and purchase of efficient HDVs, and in the design of schemes to promote emission reductions. At EU level, the Commission notes that:

> "the absence of robust and comparable data prevents the implementation and enforcement of future harmonised CO_2 emission standards across the EU market".

(a) Proposed Regulation on the monitoring and reporting of fuel consumption and CO_2 emissions of HDVs

8.27 Member States and vehicle manufacturers will be required to monitor and report to the Commission data on CO_2 emissions and fuel consumption of new heavy-duty vehicles registered in the EU.

8.28 The Commission's impact assessment concluded that it would be most cost-effective for national registration authorities and vehicle manufacturers to submit the required data to the European Environment Agency, rather than solely one or the other. The reasons were that national registration authorities still generally use paper files to register HDVs. The need to digitalise this data would generate administrative costs and would slow down the process.

8.29 The proposal's efficacy would also be impeded if vehicle manufacturers had sole responsibility for providing monitoring data. Their data would be based on sales data

30 Regulation (EC) No 443/2009 setting emission performance standards for new passenger cars as part of the Community's integrated approach to reduce CO_2 emissions from light-duty vehicles; Regulation (EU) No 510/2011 setting emission performance standards for new light commercial vehicles as part of the Union's integrated approach to reduce CO_2 emissions from light-duty vehicles; Commission Implementing Regulation (EU) No 410/2014 amending Implementing Regulation (EU) No 293/2012 as regards the monitoring of CO_2 emissions from new light commercial vehicles type-approved in a multi-stage process; and Commission Implementing Regulation (EU) No 293/2012 on monitoring and reporting of data on the registration of new light commercial vehicles pursuant to Regulation (EU) No 510/2011.

with no access to registration data. It would subsequently be impossible to allocate data to a particular Member State, and would make it more difficult for Member States to design effective national policies to encourage the uptake of more efficient HDVs.

8.30 Under the Commission's preferred option, national registration authorities would report annually to the Commission through the European Environment Agency the vehicle identification numbers of all new HDVs registered in their territory. Vehicle manufacturers would similarly submit monitoring data for those vehicles to the EEA. The agency would then combine both sets of data to obtain monitoring data at a Member State level. This would also ensure the full digitalisation of data.

8.31 In addition to vehicle identification numbers, Member States would be required to report:

- the manufacturer's name;
- the vehicle make;
- the code for the bodywork as specified on the certificate of conformity; and
- engine information as specified on the certificate of conformity.

8.32 This information would need to be provided by the end of February 2020 for all new HDVs registered in 2019.

8.33 Vehicle manufacturers would be required to report certain monitoring parameters for each vehicle placed on the EU market. These would be recorded by the manufacturer at the time of production and would include the following:

- vehicle classification;
- engine, transmission, axle, angle drive, tyre and aerodynamic specifications;
- descriptions of the vehicle and components;
- simulation parameters;
- vehicle driving performance per mission profile/load/fuel type; and
- certified fuel consumption and CO_2 emissions per mission profile/load/fuel type.

8.34 This information will be used to populate a central register managed by the European Environment Agency, which maintains a similar register for light-duty vehicles. The information provided will be publicly available to enable consumers to compare fuel efficiency across vehicle types and makes. The Commission notes that information that is sensitive on personal data protection grounds and fair competition would not be published. This would include individual vehicle identification numbers and the make or model of components such as transmission, axle or tyres.

8.35 The Regulation would confer implementing powers on the Commission concerning the verification and correction of the monitored data. In addition, to ensure that the data requirements and monitoring and reporting procedure remain relevant over time, as well

as to ensure the availability of data on new and advanced CO_2 reducing technologies, the Regulation would give the Commission delegated powers to amend the data requirements and the monitoring and reporting procedure set out in the annexes to the Regulation.

(b) Regulation implementing Regulation (EU)595/2009 as regards the determination of the CO_2 emissions and fuel consumption of heavy-duty vehicles and amending Directive 2007/46/EC and Commission Regulation (EU)582/2001

8.36 This Commission implementing Regulation will require vehicle manufacturers to use the EU's VECTO simulation software to measure and certify the fuel consumption and CO_2 emissions of HDVs as required under proposal (a) above.

8.37 The Commission's impact assessment states that the decision to opt for a simulation tool was made after considering other options for test procedures, including engine test beds, chassis dynamometer and on-board tests in real traffic with Portable Emission Measurement Systems.

8.38 The main reasons given for choosing this option are:

- test results for different types of HDVs will be directly comparable;
- cost efficiency compared to the high costs of laboratory testing;
- ability to deal with high variability across HDV series since vehicles are often customised to end-users' requirements;
- possibility of repeating tests;
- much greater accuracy such as the detection of small savings from single component optimisations; and
- comprehensiveness, as simulation includes all vehicle components and can therefore be used to optimise the total vehicle configuration to achieve lower fuel consumption.

8.39 Vehicle manufacturers will run the simulation test on the basis of certified input data of all the different vehicle components, and on the basis of a certified process of sourcing, managing and applying such input data. Manufacturers of "base vehicles"[31] will be granted licences to run the simulation software on all new vehicles produced and to make this information available to the vehicle purchaser.

(c) Commission Recommendation on the use of fuel consumption and CO_2 emission values type-approved and measured in accordance with the World Harmonised Light Vehicles Test Procedure when making information available for consumers pursuant to Directive 1999/94/EC

8.40 Directive 1999/94/EC[32] seeks to ensure that consumers have access on the fuel efficiency and CO_2 emissions of new passenger cars, including at point of sale.

31 Incomplete vehicles comprising at least an engine, chassis, gearbox, axles and tyres.

32 On the availability of consumer information on fuel economy and CO_2 emissions in respect of the market of new passenger cars.

8.41 A new regulatory test procedure for measuring CO_2 emissions and fuel consumption of light-duty vehicles is to replace the New European Test Cycle (NEDC), which no longer corresponds to current vehicle technologies or driving conditions.

8.42 The World Harmonised Light Vehicles Test Procedure (WLTP) will provide stricter test conditions and more realistic fuel consumption and CO_2 emission values. The new procedure was introduced for new type approvals on 1 September 2017 and will apply to all new passenger vehicles from 1 September 2019.

8.43 The current test has been criticised for providing unrepresentative measurements compared to actual road performance. The new test provides for a real driving emission test procedure and this, coupled with new requirements for declaring a maximum value of real-driving emissions, means, according to the Commission, that WLTP values will "in many cases be higher compared with NEDC values for the same car."

8.44 In contrast to the previous test, the WLTP will provide specific fuel consumption and CO_2 emission values for each individual vehicle, reflecting the vehicle specifications and optional equipment that affect those values.

8.45 The Recommendation covers the following main issues:

- the NEDC will continue to be used as the basis for all official information on new cars until 31 December 2018;
- official CO_2 and fuel efficiency measurements provided on the point of sale label must apply to the exact vehicle, including any optional extras or modifications;
- where posters or displays at dealerships group variants or versions of a new vehicle are grouped under one model, the information displayed should refer to the highest value CO_2 emissions within that group;
- where more than one model is specified, the information provided must include the official fuel consumption and official CO_2 emission values of all the vehicles referred to, or a range between the worst and best values of all the vehicles to which it refers.
- promotional material distributed electronically to consumers which include the use of online car configurators, should clearly demonstrate to consumers how different specific equipment and optional extras affect the fuel consumption and CO_2 emission values type-approved and measured in accordance with the WLTP;
- Member States that allow WLTP figures to be provided as additional information to consumers prior to January 2019 should include suggested additional wording to explain the replacement of one testing process by another and the relevant timeframes;
- where end-of-series vehicles after January 2019 carry NEDC values only, that these are accompanied by a disclaimer stating that the values are not comparable to values based on the WLTP; and
- Member States should ensure the launch of appropriate information campaigns to explain the new testing process to consumers, in particular the increase in fuel consumption and CO_2 emissions values.

The Government's Explanatory Memorandum of 5 July 2017

8.46 The Parliamentary Under-Secretary of State (Jesse Norman MP) writes with a detailed analysis of the proposals.

Subsidiarity

8.47 On subsidiarity, he agrees with the Commission that EU-level action would be the most appropriate, as there is already a common approach for the monitoring and reporting of fuel consumption and CO_2 emissions from cars and other light-duty vehicles.

8.48 He adds:

> "Monitoring at Member State level would require extensive cooperation and agreement among Member States, and harmonisation would be difficult without EU action due to differences in internal legislation and policy practices."

8.49 The Government shares the Commission's assessment that coordinated action is necessary to reduce road vehicle emissions and meet wider climate change objectives. The Minister agrees that the current lack of market transparency on fuel consumption and CO_2 emissions from heavy-duty vehicles contributes to a lack of innovation and slow improvements in energy efficiency.

Proposed Commission delegated powers

8.50 The Minister expresses reservations on the proposed delegation of powers to the Commission to amend "non-essential elements" of the annexes to the Regulation which set out the data parameters to be reported and the provisions for verifying and correcting reported data.

8.51 He notes:

> "An obligation to provide additional data parameters, however small, may place additional cost burdens onto national authorities if their current registration processes do not capture that data."

8.52 The Minister adds that some Member States either currently have or are moving towards more automated methods of electronic vehicle registration that will capture all the technical content in vehicle Certificates of Conformity. He states:

> "There is a risk that the Commission may use the delegated powers in the future to request further registration parameters that are collected by automated systems within other Member States, which may not be recorded at the point of registration within the UK."

Simulation software

8.53 The Minister expresses some reservations about the prescribed use of the VECTO simulation software, as it might

> "conceal opportunities for manufacturers to 'optimise' modelled performance in a way that does not provide corresponding improvements in the real world".

8.54 He notes that the Government has stressed to the Commission the need to include an on-road verification test in the Regulation to ensure that modelled results accurately reflect real world emissions performance. The Minister adds, however, that while the Commission and Member States agree with the UK on this issue, it has proved technically challenging and time consuming to develop a suitable procedure. The Commission's view is that such a procedure will in any event not be needed until 2020 at the earliest, and that therefore further development of on-road tests can be introduced as part of a second phase.

Reporting requirements

8.55 The Regulations would affect large-volume manufacturers of commercial vehicles, national registration authorities (the DVLA) and the Department for Transport. Small and medium-sized manufacturers and commercial vehicle-body builders fall outside the scope of the requirements, which apply only to "base vehicles" comprising at lease an engine, chassis, gearbox, axle and tyres.

8.56 The Government agrees with the Commission's impact assessment that mixed reporting of data by national authorities and HDV manufacturers would provide the most effective approach. In addition, it aligns with the approach already taken with respect to light-duty vehicles. Most importantly, the Minister notes that it will "provide the highest levels of data credibility at most sensible cost".

8.57 The Minister does not believe that the reporting of data is likely to add much additional burden to vehicle manufacturers or national authorities, as much of the data will be collected in any event as part of the new vehicle registration and vehicle type approval process.

The Commission's Recommendation on new car information

8.58 With regard to the Commission's Recommendation on new car information, the Minister notes that the regulatory burden is relatively light since the recommendation is to strengthen the existing system. A new statutory instrument will be required as current regulations specify the format of the new car label, and the new test procedure uses four different cycles compared to three at present.

8.59 The Government is already working with the Low Carbon Vehicle Partnership to consider the redesign of the new car label including voluntary information such as the vehicle's compliance with the Government's proposed Clean Air Zones. The Government is also working with its partner to examine consumer attitudes to and experience of new car information and to assess how this could better promote the purchase of lower emission vehicles. The Minister adds that the Government already funds an outreach programme to help businesses reduce transport fuel use and will use this to explain and publicise the forthcoming changes.

Implications for the UK post-EU exit

8.60 The Minister states that since HDVs are typically manufactured for a European market, this means that:

> "regardless of the outcome of EU exit negotiations, it is likely the proposed Regulation and implementing Regulation will impact on the emissions of vehicles purchased and operated in the UK in the future. The Recommendations on the changes to WLTP will have been implemented prior to leaving the EU."

Financial implications

8.61 The Government expects that the additional testing required to measure and certify fuel consumption and CO_2 emissions data for all new HDVs using the VECTO software is likely to impose additional costs on large volume manufacturers. The Commission expects that these costs will amount to around €1 (£0.92) per vehicle.

8.62 The Minister adds that any additional reporting requirements introduced by the Commission through Delegated Acts would impose cost burdens on national authorities or manufacturers if current databases do not record that information.

The Minister's letter of 7 December 2017

8.63 The Minister writes with an update on the progress of this proposal. He states that working group discussions have focused on concerns over the publication of a "small number of specific pieces of information that could potentially damage the commercial interests of manufacturers such as engine and aerodynamic performance data".

8.64 He goes on to state that a compromise has now been reached. All data will be available to accredited third parties, such as type approval authorities, to allow them to recreate tests and verify the results of modelling through real world testing.

8.65 The most commercially sensitive data will also be available publicly, grouped together in performance bands. Consumers, transport operators and third parties will benefit from the comparative information available, while the commercial interests of vehicle manufacturers will not be threatened.

8.66 The Minister states:

> "The compromise strikes a satisfactory balance and should promote transparency of performance data."

Proposed Commission delegated powers

8.67 The Minister informs us that following a discussion with the DVLA, and considering the way in which data is collected, the Government

> "now believe the risks of an increased administrative burden are very low."

8.68 In addition, other Member States expressed strong support for this aspect of the proposal, as they

> "were convinced that the powers are needed to be able to verify the results of future modelled tests and deliver robust future regulation."

Timeframe

8.69 The proposal has made rapid progress through working groups, and the Minister informs us that the Estonian Presidency now intends to seek a mandate from COREPER on 15 December, to open trilogue negotiations with the European Parliament in early 2018.

8.70 The European Parliament's Environment Committee is currently considering the proposal, and is expected to report in January. The Government believes, without seeking to pre-empt the European Parliament's consideration of the file, that its Environment Committee will focus on issues relating to transparency and the robustness of the reporting mechanisms.

Previous Committee Reports

None.

9 European System of Financial Supervision

Committee's assessment	Legally and politically important
Committee's decision	Not cleared from scrutiny; further information requested; drawn to the attention of the Treasury Committee
Document details	(a) Proposal for a Regulation on the European Supervisory Authorities; (b) Proposal for a Directive amending Directive 2014/65/EU on markets in financial instruments (MiFID II) and Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II); (c) Amendment of the proposal for a Regulation as regards the authorisation of CCPs
Legal base	(a)—(c): Article 114 TFEU, ordinary legislative procedure; QMV.
Department	Treasury
Document Numbers	(a) (39052), 12420/17 + ADD1–2, COM(2017) 536; (b) (39053), 12422/17, COM(2017) 537; (c) (39056), 12431/17, COM(2017) 539

Summary and Committee's conclusions

9.1 The European Commission in September 2017 proposed substantial reforms of the functioning of the EU's financial supervisory authorities (the ESAs) for the banking, insurance and investment industries. As we set out in more detail in "Background" below, these reforms would expand the powers of the ESAs, in particular for the European Securities & Markets Authority (ESMA); alter their governance structures to make the ESAs more assertive vis-à-vis the Member States' national financial regulators; and impose a new industry levy to fund their work.

9.2 It is clear from the Commission's Explanatory Memorandum that the UK's withdrawal from the EU has driven these proposed reforms, at least in part. There are concerns that UK financial services firms might try to establish "letter box" entities in the EU, servicing EU-based clients from the UK without substantially moving their operations to an organisation within the Single Market as required by EU law. This, the Commission argues, increases the need for stronger ESAs which can ensure that all Member State regulators apply the EU's regulatory requirements for "third country" firms in the same way.

9.3 The Economic Secretary to the Treasury (Stephen Barclay) submitted an Explanatory Memorandum on the proposals in October 2017.[33] It provides virtually no substantive assessment of the proposed changes. It does not reflect on the implications of the proposals

33 Explanatory Memorandum submitted by HM Treasury (16 October 2017).

for the UK financial services industry after Brexit, or during the "implementation period" after March 2019 during which the UK would remain subject to EU law but without formal political representation within the EU institutions and bodies, including the ESAs.

9.4 **The proposals are of major political and legal importance, substantially altering the European System of Financial Supervision as it was created seven years ago and expanding the powers of the Supervisory Authorities. In paragraphs 9.73 to 9.100 below, we have made an initial assessment of the proposals, in particular in the context of Brexit. In summary, we are most concerned about the proposal to allow the ESAs to set supervisory priorities for domestic financial regulators; the increased responsibilities of ESMA; the consequences of the post-Brexit "implementation period" for the formal representation of the UK's domestic financial regulators at EU-level; and the implications of new powers for the ESAs in relation to firms established outside the EU (which will become relevant once the UK becomes a "third country" vis-à-vis the Single Market).**

9.5 **Given the paucity of the Minister's original Memorandum, we ask him to write to us with the Government's substantive assessment of the proposals. His reply should cover at least the points listed below relating to the substance of the Commission proposals, the implementation period and the role of the ESAs once the UK becomes a "third country".**

The substance of the Commission proposals

9.6 **As noted in paragraphs 9.94 to 9.100, the Government's position on the Commission proposals is not clear. We would therefore like the Minister to clarify his views on:**

- **the ability of the ESAs to set the parameters of the UK's domestic supervisory priorities through the EU-wide Strategic Supervisory Plans;**
- **the reformed governance structures which would reduce the decision-making powers of the NCAs within the ESAs; and**
- **the extensive new powers for ESMA for which it may not be adequately equipped or resourced, in particular its direct supervisory responsibilities (including for managers of AIFs with EuVECA status).**[34]

The ESAs during the "implementation period"

9.7 **In relation to the post-Brexit "implementation period", during which EU law would continue to apply in the UK (see paragraphs 9.79 to 9.86), we ask the Minister to explain:**

- **whether the UK NCAs will remain members of the ESAs' Boards of Supervisors during the "implementation period", and if so whether the Government believes they can retain their voting rights;**

34 See paragraph 9.54 for more information on the proposed new ESMA supervisory powers over Alternative Investment Funds (AIFs).

- **whether the UK NCAs will remain subject to the ESAs' supervisory convergence procedures during this period, in particular the breach of EU law procedure, binding dispute settlement, and the new Strategic Supervisory Plans;**
- **with respect to UK-based firms, whether ESMA will retain its direct supervisory responsibilities; and**
- **whether the new industry levy would apply to UK firms (if it becomes applicable during the implementation period).**

The ESAs and the UK as a "third country"

9.8 **Lastly, the Commission proposals would alter the ESAs' role where third country firms seek permission to operate within the Single Market (see paragraphs 9.87 to 9.93 below). We would like the Minister to clarify the Government's position on:**

- **the ESAs' expanded role in the equivalence process, in particular with respect to the conclusion of "administrative arrangements" with the UK if it were to seek equivalence in a given sector;**
- **the requirement for the ESAs to seek legally-agreed mechanisms with the UK giving them the right to obtain information and perform on-site inspections within the UK;**
- **the provisions on the ESAs' monitoring of NCA authorisation of firms intending to outsource or delegate functions to the UK once it becomes a third country; and**
- **the expansion of ESMA's powers, in particular its proposed new direct supervisory responsibilities for non-EU prospectuses and benchmarks.**

9.9 **We expect a comprehensive reply from the Minister addressing our concerns about the implications of these proposals by 12 January 2018. We will also consider inviting him to give evidence to us in person, especially in relation to the implications of the transitional period and any subsequent UK-EU agreement on financial services for the parliamentary scrutiny process.**

9.10 **In the meantime, we retain these documents under scrutiny. We also draw these developments to the attention of the Treasury Committee.**

Full details of the documents

(a) Proposal for a Regulation amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority); Regulation (EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority); Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority); Regulation (EU) No 345/2013 on European venture capital funds; Regulation (EU) No 346/2013 on European social entrepreneurship funds; Regulation (EU) No 600/2014 on markets in financial instruments; Regulation (EU) 2015/760 on European long-term

investment funds; Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds; and Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market: (39052), 12420/17 + ADD 1–2, COM(17) 536; (b) Proposal for a Directive amending Directive 2014/65/EU on markets in financial instruments and Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II): (39053), 12422/17, COM(17) 537; (c) Amendment of pending proposal for a Regulation amending Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) and amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs: (39056), 12431/17, COM(17) 539.

Background

9.11 The EU made major changes to the supervision of the financial markets of its Member States in response to the 2008 financial crisis. Notably, it created the European System of Financial Supervision (ESFS). The ESFS is built on a two-pillar system of macro-prudential and micro-prudential supervision (conducted at EU-level by the European Systemic Risk Board (ESRB) and the European Supervisory Authorities respectively, and at Member State level by the relevant domestic financial authorities).[35] The EU-level institutions became operational in 2011.

9.12 The European Commission carried out a comprehensive evaluation of the ESFS in recent years, which has highlighted concerns about the governance and effectiveness of the ESAs in using their existing powers.[36] In addition, since the ESFS was created, the EU has taken significant steps towards a Banking Union for the Eurozone, which concentrated supervisory responsibility for large banks in the European Central Bank and created a Single Resolution Mechanism for failing institutions.[37] It has also begun creating an EU-wide Capital Markets Union to increase businesses' access to non-bank finance from other Member States.[38] The increased cross-border financial flows implied by these developments are not, the Commission says, reflected by the ESAs' current remit or powers.

9.13 The UK's withdrawal has also prompted a rethink of the EU's approach to financial regulation, in particular as regards supervision of UK companies that may seek to service customers within the Single Market after Brexit.

9.14 In the light of these developments, the Commission in September 2017 tabled a package of proposals to amend the 2010 Regulations which established the ESRB and the

35 In the UK, the participating national competent authorities (NCA) are the Bank of England and the Prudential Regulation Authority, the Financial Conduct Authority, and the Pensions Regulator.

36 European Commission, "Consultation on the review of the European System of Financial Supervision" (April 2013).

37 See Regulation 1024/2013 for the Single Supervisory Mechanism (cleared from scrutiny on 23 January 2013) and Regulation 1093/2013 for the Single Resolution Mechanism (cleared from scrutiny on 26 March 2014). A proposal for a pan-Eurozone deposit guarantee scheme remains under discussion but is unlikely to be adopted in the near future (see our predecessors' Report of 7 September 2016).

38 As part of the Capital Markets Union, the Parliament and Council have adopted a new Prospectus Regulation and securitisation standards. In 2018, the Commission is expected to table further legislative proposals to complete the CMU.

ESAs. We have set out the current functioning of the ESAs below, before discussing in more detail the substance of the new Commission proposals. We have covered a proposal relating to the European Systemic Risk Board in a separate Chapter in this Report.[39]

The European Supervisory Authorities

9.15 At EU-level, the micro-prudential pillar of the ESFS consists of the three European Supervisory Authorities: the European Banking Authority (EBA) in London;[40] the European Insurance & Occupational Pensions Authority (EIOPA) in Frankfurt; and the European Securities & Markets Authority (ESMA) in Paris.

9.16 The ESAs, whose founding Regulations are largely identical, have four broad sets of powers:

- **drafting Regulatory Technical Standards (RTS)[41] and Implementing Technical Standards (ITS)**,[42] both forms of statutory instrument, to give full effect to EU sectorial financial regulation within their remit. ESA standards are not in themselves legally binding, and can be amended by the European Commission before they are formally adopted with the agreement of the Member States;

- **issuing non-binding guidelines, recommendations and opinions** to both financial services providers and domestic regulators;

- **fostering regulatory and supervisory convergence** throughout the EU through dispute settlement powers in cases of disputes between NCAs, investigating potential breach of EU law by domestic regulators, and conducting peer reviews. The aim of these powers is to ensure that the national competent authorities across the EU apply European financial regulation in a "consistent and proper" way;[43]

- **exercising direct supervisory powers** (including authorisation and ongoing supervision of financial firms), which at present are only available to ESMA in respect of credit rating agencies (CRAs)[44] and trade repositories (TRs) for over-the-counter derivatives.[45]

9.17 In addition, the ESAs contribute to individual **Colleges of Supervisors**, the formalised structure within which the domestic regulators of a specific cross-border financial services provider discuss their supervisory approach to that entity.

39 See chapter 11 of this Report.
40 The EBA will relocate to Paris by March 2019 following the UK's decision to withdraw from the EU. A Commission proposal to that effect remains under scrutiny.
41 ESA Regulatory Technical Standards, if adopted by the Commission, take the form of Delegated Acts. Their aim is to "ensure consistent harmonisation" of EU financial services legislation.
42 Implementing Technical Standards, if adopted by the Commission, take the form of Implementing Acts.
43 European Commission Impact Assessment SWD(17) 308, p. 24.
44 See Regulation (EU) No 462/2013 on credit rating agencies.
45 See Regulation (EU) No 648/2012 (EMIR).

The Commission proposals

9.18 The European Commission's legislative proposals are a complex package of measures to address the shortcomings it identified relating to the powers, governance and funding of the European Supervisory Authorities.

9.19 With respect to the ESAs, there are three linked proposals. Their objective is to adjust and upgrade the ESAs framework, to ensure the Authorities can assume an enhanced responsibility for financial market supervision by making sure they are "adequately equipped in terms of powers, governance and funding". Collectively, they seek to make changes to twelve existing Regulations and Directives. The three legislative documents are:

- A proposal for a Regulation on the powers and competences of the European Supervisory Authorities (document A);[46]
- A proposal for a Directive to make consequential amendments to the Markets in Financial Instruments Directive and the Solvency II Directive (document B);[47] and
- An amendment to a pending proposal relating to ESMA's powers over central counterparties (document C).[48]

9.20 We have assessed the substance and implications of the ESA proposals below, drawing on the Explanatory Memorandum submitted by the Economic Secretary to the Treasury (Stephen Barclay) on 16 October 2017.[49]

Reform of the European Supervisory Authorities

9.21 The Commission argues that, while the ESAs "have played a key role in ensuring that the financial markets across the EU are well regulated, strong and stable", its evaluation has shown that there "remains significant potential to enhance regulatory and supervisory convergence within the EU". It is seeking to address this primarily by changing the ESAs' governance and funding structures, to make them less reliant on the instructions and funding from the National Competent Authorities (NCAs).

9.22 It also concluded that the UK's exit from the EU increased the need for a coherent supervisory approach to third country firms seeking access to the EU market, to ensure British firms would not seek to establish themselves in the Member State with the least intrusive regulatory approach after Brexit to preserve their current activities without substantially transferring operations into the EU.[50]

9.23 Moreover, in view of the proposed further integration of the Union's financial markets under the Banking and Capital Markets Unions, the Commission warns that increased financial integration also expands the channels of contagion between Member States in the event of adverse shocks, such as those experienced during the 2008 crisis. It therefore

46 See Commission document COM(17) 536.
47 See Commission document COM(17) 537.
48 See Commission document COM(17) 539.
49 Explanatory Memorandum submitted by HM Treasury (16 October 2017).
50 SWD(17) 308, p. 50.

wants to give the Supervisory Authorities a stronger role (and, in certain cases, direct supervisory responsibilities) to ensure that increased cross-border activity is effectively monitored.

ESA powers

9.24 As noted above, the European Commission is of the view that the current mechanisms used by the ESAs to ensure that NCAs apply EU law in consistent way need to be strengthened. It has also proposed to give them additional powers to ensure cross-border activities are supervised effectively.

9.25 The proposed strengthening of the ESAs' powers takes several forms:

- all three Supervisory Authorities will gain additional powers to ensure **supervisory convergence and coordination** between NCAs. In addition, EIOPA and ESMA would become able to publish the firm-specific results of **stress testing of financial institutions** within their remit (as the EBA already can);
- the ESAs will play a larger role in supervising access of non-EU firms active on the EU market, in particular by assessing the **equivalence of third countries' regulatory regimes** with EU sectoral legislation on an on-going basis; and
- ESMA will acquire new **direct supervisory responsibilities for a number of investment products and services** covered by EU law in the context of the Capital Markets Union, and EIOPA will play a more substantial role in NCA's assessment of the **internal models of insurers** under Solvency II.

9.26 We set out the substance of the proposals in more detail below.

Supervisory convergence and coordination

9.27 One of the key tasks of all three ESAs is to "actively foster supervisory convergence across the Union with the aim of establishing a common supervisory culture". In view of the envisaged degree of financial integration among EU Member States, the Commission wants to give the Authorities more powers to promote such convergence.

9.28 In particular, the Commission wants to require the ESAs to set EU-wide priorities for supervision in the form of a "Strategic Supervisory Plan" (SSP), against which all competent authorities will be assessed. As part of this process, NCAs would have to draw up annual work programmes in line with the Strategic Plan. In addition, peer reviews conducted between NCAs would become "independent reviews" with less direct involvement of the staff of the domestic regulators themselves, to "enhance the value added of these reviews and to insure impartiality". The Commission also proposes to allow the ESAs to request information from a broader range of third parties, for example if it suspects an NCA is not applying EU law properly. The Authorities would also be given the power to impose fines when a company fails to provide such information.

9.29 A separate element of the proposals would substantially alter the governance arrangements of the ESAs to make it easier for them to use their supervisory convergence powers across the board. These changes are set out in more detail in paragraphs 9.59 to 9.68 below.

9.30 In his Explanatory Memorandum, the Minister did not comment specifically on the SSP, the "independent reviews" or the new ESA powers to request information. He states that "any proposals to reduce inconsistencies in regulatory or supervisory practice between EU Member States should be proportionate to the risks posed", and, presumably referring to the Commission's concerns about the activities of UK firms after Brexit, "should not discriminate against the UK".

Supervision of non-EU firms active on the EU market

9.31 The Commission proposals also contain several provisions on the supervision of firms operating within the EU, but which are based in—or have outsourced functions to—non-EU countries.

9.32 First, the proposals reinforce the role of the Supervisory Authorities in the equivalence process. Under certain pieces of sectoral financial legislation,[51] the European Commission can make a legal determination that a non-EU country's regulatory regime for specific financial products or services is equivalent to the EU's.[52] In such cases, companies based in the country in question can apply to provide services throughout the Single Market without the need to establish a subsidiary within the EU (although it falls well short of the system of mutual recognition inherent in the "passporting" regime applicable to firms established within the Single Market, for example in terms of the type of service that can be offered or the type of client that can be targeted).

9.33 The Commission has proposed to formalise the role of the ESAs in providing advice to it when preparing equivalence decisions, and to entrust them with the responsibility for monitoring on an on-going basis the regulatory and supervisory developments in third countries which have an equivalence decision in place. They would submit a confidential report on their findings to the Commission on an annual basis, which will use this information to decide whether to maintain or withdraw the equivalence decision.[53] The ESAs would also have to agree administrative arrangements with the third country supervisor allowing for exchange of information, and permitting the ESA to perform on-site inspections.

9.34 Secondly, most likely in response to the UK's withdrawal from the EU, each Supervisory Authority will gain new powers to obtain information from national regulators about authorisation or registration of financial firms whose business plan "entails the outsourcing or delegation of a material part of its activities or any of the key functions or the risk transfer of a material part of its activities into third countries, to benefit from the EU passport while essentially performing substantial activities or functions outside the Union".

9.35 The information should enable the ESAs to assess whether the latter are effectively supervising outsourcing, delegation and risk transfer arrangements in third countries,

51 For example, the EMIR Regulation, the Markets in Financial Instruments Directive and the Capital Requirements directive. However, equivalence is not available in many other sectors of the financial services industry covered by EU legislation.

52 See Commission document SWD(2017) 102 for more information on equivalence in EU financial services legislation.

53 Equivalence decisions can be unilaterally withdrawn by the Commission.

and do not result in the circumvention of EU rules on applicable prudential and conduct requirements. However, the ESAs will *not* be able to override the decision of a national authority to approve such arrangements.

9.36 Lastly, the Commission has proposed a substantial expansion of the direct supervisory powers of ESMA in relation to a number of investment-related products and services, some of which concern products or services offered to EU-based customers by third country companies. These amendments are explained in more detail below.

9.37 The Minister's Explanatory Memorandum does not summarise the Government's position on these proposals, or offer an assessment of their implications for UK firms after Brexit.

New powers for ESMA

9.38 The final major element of the Commission proposals on the powers of the ESAs is a substantial expansion in the direct supervisory responsibilities of ESMA.[54]

9.39 ESMA is the responsible EU-level Supervisory Authority for EU sectoral legislation that affects capital markets, notably the second Markets in Financial Instruments Directive; the Benchmarks Regulation; the Prospectus Regulation; and the European Market Infrastructure Regulation (EMIR). A common thread that runs through these sectoral laws is that they typically create a framework for market participants to operate across the Single Market, but have kept supervisory responsibility for market participants at Member State level.

9.40 In addition to the general risk of divergent application of the relevant legislation by different competent authorities, the Commission expresses concerns that this is leading to "forum shopping":

> "There are concerns that home [competent authorities] might be less strict in enforcing rules, in particular on consumer and investor protection, in relation to activities carried out in Member States other than the home Member State. This might be due to constraints in (financial) resources or (language) skills or due to a lack of incentive or simply due to consumers or investors having problems to identify and to address the competent authority in another Member State."[55]

9.41 Moreover, the Five Presidents' Report on Completing Europe's Economic and Monetary Union of June 2015 set the objective of, ultimately, a single capital-markets supervisor for the entire EU.[56] In light of these developments, the Commission is now proposing to increase the direct supervisory responsibilities of ESMA to ensure greater consistency in the application of EU law and reduce the risk of regulatory arbitrage or forum shopping.

54 See paragraph 9.12 and footnote 6 for more information on the Capital Markets Union.

55 Commission Impact Assessment SWD(17) 308, p. 28.

56 The Five Presidents' Report is available on the European Commission website.

9.42 As with the other aspects of these Commission proposals, the Minister's Explanatory Memorandum failed to offer any meaningful insights into the Government's position on ESMA's potential new powers. However, given their significance, we have described them in more detail below.

Markets in financial instruments

9.43 Effective supervision of investment firms by the NCAs and ESMA depends on the level of information they have on market activity, for example to help them identify market abuse. Access to such data also improves market transparency for investors, increasing choice and reducing cost.

9.44 The second Markets in Financial Instruments Directive (MiFID II), which takes effect on 1 January 2018, seeks to improve the quality and accessibility of such data in a standardised way.[57] In particular, it requires data reporting services providers (DRSPs) to be authorised by an EU Member State's financial regulator and submit data in a standardised format.

9.45 The Commission now argues that data reporting services are "an inherently Union-wide business", and that regulatory and supervisory problems in this sector "cannot be addressed by Member State action alone". In addition, it wants to consolidate the collection of trading data within ESMA, replacing the current system where each NCA must gather data from multiple operators throughout the EU, which is then transmitted to ESMA for compilation and analysis, and then sent back to the competent authorities to be used as part of their supervisory responsibilities.

9.46 The Commission has therefore proposed to make ESMA directly responsible for the authorisation and supervision of data reporting services, and give the Authority the power to request information from market participants and NCAs to fulfil its supervisory tasks.

Benchmarks Regulation

9.47 Following the LIBOR and EURIBOR manipulation scandals, the EU adopted a Regulation to govern the accuracy and integrity of benchmarks used in financial contracts.[58] Under Article 29 of that Benchmarks Regulation, supervised entities such as banks, investment firms and insurance companies can only use a benchmark if its administrator is registered with ESMA and fulfils the requirements laid down by the Regulation.

9.48 For benchmarks administered by organisations based in a non-EU country, registration with ESMA normally requires an equivalence decision by the European Commission (recognising the regulatory regime of the third country in question as equivalent to the Benchmarks Regulation) and for the competent authority of that country to have concluded a cooperation agreement with ESMA.

57 See Directive 2014/65/EU, Title V.

58 Regulation 2016/1011. It was cleared from scrutiny and drawn to the attention of the Treasury Committee by the previous Committee on 25 November 2015. The initial proposal was the subject of a House of Commons Reasoned Opinion in November 2013 on the grounds that the draft Regulation introduced an overly prescriptive approach to benchmark regulation which diverged from international benchmark standards.

9.49 However, given the widespread use of third country benchmarks in EU markets,[59] Article 32 allows specific third country administrators to ask for "prior recognition" by the competent authority of an EU Member State. If such recognition is granted, which is conditional on compliance with the Regulation, its benchmarks can be used by supervised entities in the EU without registration. However, third country benchmarks already in use in June 2016 can be used until June 2020 as a transitional measure without requiring to go through this process.

9.50 Under the Regulation as it stands, ESMA coordinates the supervision of benchmark administrators by national competent authorities, and for "critical benchmarks", participates as a full member in the college of national supervisors which decides on a joint supervisory approach. However, under the Commission proposal, supervision of critical benchmarks[60] and all benchmarks administered from outside the EU (but used within it) would become the direct responsibility of ESMA. This includes responsibility for granting recognition or endorsement to third country administrators in the absence of an equivalence decision. As a result, national authorities would lose the ability to grant such recognition.

Prospectus Regulation

9.51 To raise capital through public offers or have securities admitted to be traded on regulated markets, companies need to provide potential investors with a prospectus which describes the company's business, structure and finances. In the EU, the contents and issuance of such documents are regulated by the new Prospectus Regulation,[61] which will replace the existing Prospectus Directive[62] from July 2019.

9.52 At present, the competent authorities of the Member States are responsible for approving prospectus documents before they can be marketed to investors. Prospectuses approved in this way by one country are automatically valid throughout the EU. The Commission now proposes to transfer the supervision of certain types of prospectuses to ESMA.[63] This means the Authority, rather than national supervisors, would be responsible for scrutinising and approving such documents before their publication.

9.53 Similarly, ESMA would be responsible for prospectuses submitted under the Regulation by companies based outside the EU. It would also take over responsibility for approving prospectuses aimed at EU investors drawn up under the laws of a third country (which will still only be permitted if that country's regulatory regime has been legally declared equivalent to the EU's, and it has a cooperation agreement with ESMA in place).

59 Letter from Harriett Baldwin to Sir William Cash (23 November 2015).

60 These are called "critical benchmarks" in the Regulation; to qualify as "critical", a benchmark must normally be used as a reference for financial instruments, contracts or fund performance valued in excess of €500 billion.

61 Regulation (EU) 2017/1129. The Regulation was cleared from scrutiny, and drawn to the attention of the Treasury Committee, on 25 January 2017.

62 Directive 2003/71/EC.

63 Including any prospectuses related to asset-backed securities, property companies, mineral companies, scientific research-based companies and shipping companies.

EUVECA, EUSEF and ELTIF Funds

9.54 The recent EU Regulations on investment funds for venture capital (EuVECA), social entrepreneurship (EuSEF)[64] and long-term investments (ELTIF)[65] introduced specialised fund structures to make it easier for market participants to raise and invest capital in innovative small and medium-sized enterprises, social undertakings and long-term infrastructure projects throughout Europe. However, supervisory responsibility was given to national authorities. The Commission argues that the divergent practices of those authorities in applying administrative requirements at the point of registration or during subsequent supervision of these Funds has created an "uneven playing field".

9.55 Although the Commission concedes that "the majority of the limited number of stakeholders replying [to its consultation question] on direct supervision of the asset management industry" saw NCAs as "better placed to perform this function", it is nonetheless proposing to transfer supervisory responsibilities—including authorisation and supervision—over these Funds from national authorities to ESMA, which will "support the objectives of those Regulations as it will further facilitate the integration, the development and marketing of such fund structures across borders".

9.56 However, this creates a complication for Funds which have EuVECA or EuSEF designation, but which hold more than €500 billion (£440 billion) in assets under management. By law, they must be managed by a fund manager authorised and supervised by their national competent authority under the Alternative Investment Fund Managers Directive (AIFMD). To avoid the relevant entities from being jointly supervised by both ESMA and a national authority for the same fund, the Commission proposes that ESMA should be responsible for ensuring both compliance with the EuVECA and EuSEF Regulations, and with the relevant national law implementing the AIFMD.[66]

Other proposed changes

9.57 In addition to the above, there are miscellaneous proposed changes to the ESAs' powers. These include permitting all three Supervisory Authorities to publish the stress test results of individual financial institutions,[67] and giving EIOPA a greater coordinating role in ensuring that national regulators assess insurers' internal models[68] in a consistent way.

9.58 With respect to the latter proposal, the Minister notes in his Explanatory Memorandum that "internal risk models used by insurance undertakings must reflect their particular circumstances, and the Prudential Regulation Authority (PRA) is best-placed to assess the appropriateness of an UK insurance undertaking's internal model in relation to its obligations under Solvency II".

64 See our Report of 22 November 2017 on EuVECA and EuSEF Funds for more information.

65 See the previous Committee's Report of 11 June 2014 for more information on the ELTIF.

66 In the words of the Commission's Explanatory Memorandum: "ESMA will ensure that [AIF] managers comply, next to sector specific provisions of the EuVECA or EuSEF Regulations enumerated in their Articles 2(2), with the national law implementing the AIFMD in the Member State of the managers' establishment".

67 Moreover, the methodology for the stress tests by all three ESAs will be set by the Executive Boards, rather than by the NCA-dominated Boards of Supervisors, to ensure that the simulations consider the interests of the Single Market as a whole.

68 The internal model quantifies a specific insurer's prudential requirements on the basis of its liabilities and risk margin.

ESA governance

9.59 The European Commission's evaluation of the ESFS found that the ESAs would benefit from stronger governance arrangements to enable them to use their powers to foster supervisory convergence between the NCAs more effectively.

9.60 Notably, the ESAs have the power (under the so-called "breach of Union law" procedure) to identify and address inadequate application of the EU legislation within their remit as applied by the NCAs, which can culminate in the imposition of requirements on specific financial institutions to alter their practice if the relevant national authority fails to act.[69] The ESAs can also act as binding arbitrator in dispute settlement between NCAs, and they can organise peer reviews to establish how different NCAs approach the same supervisory tasks.

9.61 However, since 2011 no breaches of EU law have been declared and no dispute settlement cases with a binding outcome have taken place.[70] The Commission has highlighted that the decision-making powers of the ESAs rests with their respective Board of Supervisors (BoS), on which only the Member States' national competent authorities have a vote.[71] Moreover, NCA peer reviews are carried out by panels comprised mainly of staff from the domestic regulators themselves. Although day-to-day management of the ESAs is handled by Management Boards, they are also dominated by a sub-set of NCAs, and they have few direct responsibilities.[72]

9.62 As a consequence, the national regulatory authorities have a substantial influence over ESA decisions that may affect themselves or their domestic market.[73] The Commission argues this is the reason the ESAs have been reluctant to use their powers to foster supervisory convergence between NCAs. It has also noted that the restriction of voting rights on the Boards to national authorities only "implies that an inherent EU perspective is both numerically underrepresented and carries no weight in terms of votes".

9.63 The Commission also highlights the need to bolster the ESAs' ability to ensure a common supervisory approach in the context of Brexit. This reflects concerns that UK-based firms, which currently benefit from the market access arrangements provided by the Single Market, may try to establish "letterbox companies" in those Member States with the least-intrusive level of regulation to provide services to EU-based customers mostly or wholly from the UK.[74] This, in the eyes of the Commission, requires divergent

69 Article 17 of the ESA Regulations.

70 BoS powers have not been delegated to the ESA Chairs, even though this is permitted. Similarly, there have so far been no cases of dispute settlements with binding outcome adopted by the ESAs, and the use of peer reviews has been limited and primarily thematic. There have been no formal recommendations following the identification of a breach of EU law.

71 The UK is represented by the Prudential Regulation Authority within the Bank of England on the Board of Supervisors of the EBA and EIOPA, and by the Financial Conduct Authority on the Board of Supervisors of ESMA. The UK is not currently represented on any of the three Management Boards. The BoS take decisions by simple majority, without weighted votes.

72 The Management Board is composed primarily of the Chairperson, and of representatives of six national authorities elected by the Board of Supervisors for periods of two and a half years at a time. The European Commission, as well as the Vice-Chair and the Executive Director of the relevant Authority, attend Management Board meetings in a non-voting capacity (except on budgetary matters, where the Commission has a vote).

73 For example, where a Supervisory Authority is seeking to declare a breach of EU law by that national authority.

74 All three ESAs have warned of the risk of UK companies establishing "letter box" companies within the EU after Brexit. See the warnings from the EBA, EIOPA and ESMA.

supervisory practices to be addressed as a matter of urgency to ensure that UK firms that continue to operate within the Single Market after Brexit are effectively supervised and compliant with EU law, irrespective of their host Member State.[75]

Governance reform

9.64 To address these perceived governance shortcomings, the Commission has proposed to replace the Authorities' Management Boards with new Executive Boards, which would have full-time members appointed by the Council after approval of a shortlist by the European Parliament, rather than being dominated by the NCAs.[76] The Executive Board would take over some key decisions from the Board of Supervisors, such as those relating to dispute resolution between competent authorities, breaches of EU law, and the new independent reviews, as well as deciding on the initiation of stress tests.

9.65 The Executive Boards would also be in charge of setting out supervisory priorities for the national competent authorities in the new "Strategic Supervisory Plan" (SSP; see paragraph 9.28 above). They would check the consistency of the work programmes of competent authorities with EU priorities and review their implementation. For ESMA, in situations where it will exercise direct supervisory powers (for example in relation to the authorisation of credit rating agencies or trade repositories), its Board of Supervisors would only be able to reject draft decisions by the Executive Board by a super-majority.

9.66 The Commission has also proposed a slightly different approach for the supervision of central counterparties (CCPs), which protect both counterparties to an over-the-counter derivatives trade from the default of the other.

9.67 A separate proposal from June 2017,[77] still under consideration within the Council and Parliament, would establish a new body within ESMA called the CCP Executive Session. This body would be responsible for handling tasks related to central counterparties in general, as well as the authorisation and supervision of CCPs. As part of the ESA reforms, the Commission has put forward an amendment to that pending proposal to clarify that the indirect supervisory powers of ESMA relating to CCPs (such as breach of EU law procedures or commissioning independent reviews) would lie with that Executive Session, and not with its general Executive Board or Board of Supervisors.

9.68 The Minister's Explanatory Memorandum does not put forward the Government's position on any aspect of these proposed governance reforms, or offer a view on the Commission's concerns that Brexit necessitates further supervisory convergence within the EU-27.

75 See Commission Impact Assessment SWD(17) 308, p. 96.

76 EBA and EIOPA would have three independent Executive Board members, in addition to the Chairperson. ESMA would have five, to reflect the proposed increase in its direct supervisory responsibilities (see paragraphs 9.38 to 9.56).

77 Commission document COM(17) 331. See our Report of 22 November 2017 for more information on the proposal.

ESA funding arrangements

9.69 The final element of the ESA reform package concerns the way in which the Authorities are funded. At present, the ESAs are resourced through obligatory contributions from the national competent authorities,[78] a subsidy from the EU budget, and—in the case of ESMA—fees paid by market participants subject to direct supervision.[79]

9.70 The Commission has taken the view that, in light of the proposed changes to the ESAs' powers and governance structures, the way in which the Authorities are funded also needs to be reviewed to ensure that they have the necessary resources to fulfil all their tasks. The Commission notes that their workload is likely to increase further when they have to "deal with third country issues for several markets and entities that are operating from the United Kingdom" after Brexit.[80]

9.71 The Commission therefore proposes that, instead of collecting contributions from the NCAs, the ESAs will charge a levy on indirectly supervised firms within their remit to cover 60 per cent of the relevant ESA's running costs, with the remainder being drawn from the EU budget. The direct contribution by NCAs would be eliminated entirely. The industry levy would be set on an annual basis, based based on the estimated workload for each Authority for each category of market participants.[81]

9.72 In his Explanatory Memorandum, the Economic Secretary notes that "the proposals for increased industry funding will…be contentious, and…unlikely to be supported by the financial services sector". However, the Minister failed to explain the Government's position on the shift from NCA contributions to an industry levy.

Our assessment

9.73 These proposals are important, both because of the substantive changes they seek to make to the current European system of financial supervision, and because the extension of ESA responsibilities in relation to third countries will become relevant to the UK after it ceases to be an EU Member State.

9.74 The Committee is concerned that the proposals go further than necessary in a number of ways. In particular:

- We are not convinced that the ESAs should be able to constrain the supervisory priorities of domestic regulators through the proposed Strategic Supervisory Plans;
- The consequences of making ESMA the responsible regulator for managers of Alternative Investment Funds where the latter have successfully applied for EU Venture Capital Fund (EuVECA) designation are unclear. This would require

78 .The ESAs get 60 per cent of their budget should from NCA contributions and 40 per cent from the EU budget. National contributions are proportionate to each country's share of votes under the Council qualified majority rule as it applied until October 2014. As a result, the UK contributes approximately 8 per cent of the NCA contributions each year (amounting to €4.4 million in 2016).

79 In 2016, the total budget for the three Authorities combined amounted to €95.6 million (£84.6 million), of which €52 million (54 per cent) was contributed by NCAs, €33 million (35 per cent) came from the EU budget, and the remainder (€10.5 million or 11 per cent) was collected as fees from the industry by ESMA.

80 Commission Impact Assessment SWD(17) 308, p. 71.

81 The Commission has requested the power to adopt a Delegated Act which will establish how the total amount of annual contributions are calculated and shared among the different categories of financial institutions.

the Authority to apply domestic rather than EU law, which will vary depending on which Member State authorised the Fund's manager, and lead to a two-tier system of supervision of AIFs;[82] and

- The new governance structures would severely reduce the influence of NCAs within the decision-making structures of the ESAs. While we accept that the current system may present conflicts of interest, we do not believe the Commission has demonstrated that these occur in practice, or how the proposed new set-up would lead to improved supervisory outcomes.

Implications of Brexit

9.75 The proposals also have clear Brexit implications. When the UK leaves the EU, it will become a third country for the purposes of EU law. As we noted in our letter to the Economic Secretary of 22 November 2017, this new status as a non-EU country has significant implications for the ability of UK-based financial services providers to market and offer their services to EU-based customers.

9.76 The exact implications of the UK as third country vis-à-vis the Single Market are different for each sector of its financial services industry. Once outside the EEA, UK firms will lose the "passport" that allows them to provide cross-border services to any EEA Member State without seeking authorisation in the countries concerned. In certain cases, a non-EU country like the UK can apply for a determination that its regulatory regime is equivalent to the EU's, after which its providers apply to sell their services into the EU without being based there (see paragraph 9.32 above). The Commission has now proposed to give the ESAs a larger role in scrutinising the regulatory regimes of third countries *before* such equivalence can be established, as well as a monitoring role afterwards to ensure that equivalence is maintained in practice. These new procedures would also apply to the UK, should they be in force if and when the Government applies for specific equivalence decisions.

9.77 However, the "third country" and equivalence provisions in EU financial services law may not apply to the UK immediately in March 2019, when the two-year withdrawal period under Article 50 TEU ends. The Prime Minister has called for a temporary post-Brexit "implementation period" during which the UK's market access to the EU on current, Single Market terms would be maintained. In return, the UK will have to apply EU legislation, including new laws that enter into force during that period, and accept the jurisdiction of the European Court of Justice.[83]

9.78 The package of Commission proposals on the functioning of the European Supervisory Authorities is therefore doubly relevant: during the "implementation period", this new legislation may apply in the UK despite formal withdrawal from the EU; in the longer term, the new powers for the ESAs—in particular ESMA with respect to new direct supervisory responsibilities for third country firms—may shape how the UK financial services industry engages with both regulators and customers based in the EU post-Brexit. We will address both aspects in turn.

82 See paragraph 9.56 for more information on the proposed new ESMA supervisory powers over Alternative Investment Funds (AIFs).

83 HC Deb 9 October 2017, vol 629, col. 53.

ESA reform and the "implementation period"

9.79 The Government is seeking a post-Brexit "implementation period", during which the UK would remain in the "existing structure of EU rules and regulations".[84] Although it has not explicitly confirmed the proposed scope of this arrangement, we presume that—in view of the position of the EU-27—the UK would remain bound by all EU financial services legislation during this period.[85] If not, it is unlikely that UK-based firms would be able to access the EU's markets on the same conditions as at present, which is one of the Prime Minister's objectives for the arrangement.

9.80 While in one respect this transitional period would delay the "cliff edge" of UK firms becoming third country entities for the purposes of EU financial services legislation, it raises another set of difficult questions with respect to the participation of the UK's domestic financial regulators in the work of the ESAs.

9.81 The NCAs play a major role in the functioning of the European Supervisory Authorities. As *ex officio* members of each Board of Supervisors, they have ultimate control over the appointment of the Chair of each Authority and the adoption of its budget, the issuance of draft regulatory standards to the Commission, and taking of decisions relating to dispute settlement and breaches of EU financial services law. It is likely that the Bank of England and the Financial Conduct Authority are influential players on the Boards, given the UK's large financial services sector and their wealth of technical expertise.

9.82 After March 2019, the UK regulators will no longer be members of the Boards of EIOPA, ESMA or the EBA, as membership of the Boards of Supervisors is restricted specifically to the competent authorities of EU Member States.[86] In addition, UK experts would no longer attend meetings where new regulatory or implementing technical standards are drafted, or be able to attend Council working parties on new Directives or Regulations affecting the ESAs.

9.83 However, conversely, it is not clear that the ESAs would lose their existing powers in relation to the UK's domestic regulators and firms during this transitional period. With respect to the former, this is because the broader definition of "competent authority" used to establish the scope of the ESAs' powers with respect to the NCAs (e.g. investigations for breaches of EU law, binding dispute settlement, and conducting peer reviews) could still apply to the UK NCAs during this period.[87] In addition, ESMA's direct supervisory powers would presumably apply to British firms for the duration of the implementation period as the relevant sectoral legislation would remain in effect in the UK.

9.84 Such a situation would clearly be highly problematic, as the regulators representing Europe's largest financial services industry would remain bound by EU law but have less say over the work of the ESAs than regulators from countries with much smaller financial sectors. However, the Minister did not indicate in his Memorandum whether this is, indeed,

84 Speech by Prime Minister Theresa May (Florence, 22 September 2017).

85 The guidelines on Brexit adopted by the European Council at 27 in April 2017 state that: "Should a time-limited prolongation of Union acquis be considered, this would require existing Union regulatory, budgetary, supervisory, judiciary and enforcement instruments and structures to apply".

86 In addition to the non-voting members, including the European Commission and the Chairperson of the Authority.

87 During the implementation period the UK's NCAs would, in the terms of the ESAs' Founding Regulations, remain the "authorities competent for ensuring compliance" with EU financial services legislation to which the supervisory convergence provisions apply.

the logical consequence of the transitional arrangement sought by the Government. We consider it unlikely that the other Member States would consent to the UK effectively remaining in the Single Market for financial services, but exempt its regulators from the same EU-level oversight as their domestic authorities.

9.85 These Commission proposals, if they enter into force during the implementation period, would exacerbate the gap between the UK's representation and the extent to which it is affected by the ESAs:

- the UK regulators would be subject to a Strategic Supervisory Plan into which they would have had no formal input and over which they would have had no vote;
- the ESA governance reforms would make it easier for the supervisory convergence powers to be used against NCAs, including the Bank of England and the FCA; and
- UK companies would have to pay a levy to the ESAs while their national regulators, uniquely, would not be on the ESA Boards.

9.86 The implications of the UK being subject to the EU's regulatory structures without its seat at the table within the ESAs are hard to quantify. However, plainly the influence of the UK's domestic regulators at EU-level would diminish. It could be mitigated to some extent if the UK's regulators were at least granted observer status on the Boards of Supervisors, in the same manner as the financial regulators of the EFTA-EEA states.[88] Ideally, the Bank of England, Prudential Regulation Authority and the Financial Conduct Authority should retain their voting rights on the ESA Boards of Supervisors during the transitional period.

Situation following the "implementation period"

9.87 After the end of the transitional period, should one be agreed, the UK will assume full "third country" status vis-à-vis the EU. In principle, at that point the ESA Regulations and sectoral financial legislation will cease to apply directly in the UK, and UK domestic regulators will no longer be part of the ESFS.

9.88 This means that the European Supervisory Authorities will no longer have any legal powers to compel the UK's domestic regulators to take certain actions or provide information. Similarly, UK regulators would cease to have any formal input into the works of the ESAs. To the extent that they were still represented (see above), the UK's NCAs would cease to be members of the Boards of Supervisors, the Management Boards and any relevant Colleges of Supervisors. As we have described above, Brexit will also substantially alter the terms on which British firms can provide financial services to EU-based clients without establishing a subsidiary within the Single Market.[89]

9.89 The legislative proposals we have described in this Report would increase the role played by the ESAs in acting as gatekeepers with respect to UK financial services providers seeking to access the Single Market after Brexit.

88 The ESA Regulations have been incorporated into the EEA Agreement. For Norway, Iceland and Liechtenstein, the EFTA Surveillance Authority carries out the tasks of the ESAs. The EFTA-EEA states NCAs have observer (i.e. non-voting) status on the Boards of Supervisors of the EFTA. If adapted for the UK's situation, it would have to address the lack of an independent, international authority that could assume the function of the ESAs or the EFTA Surveillance Authority for the UK alone. We therefore think it is most likely the ESAs will retain their powers in relation to the UK as if it were a Member State.

89 See paragraph 9.76 for more information.

9.90 The first set of these changes relates to the equivalence process. It is unclear whether the Government would, in the long-term, seek to obtain equivalence decisions for specific financial sectors.[90] We are awaiting a reply from the Economic Secretary to the Treasury on this point.[91] However, given the inherent difficulties in negotiating a bespoke trade agreement on financial services with the EU,[92] equivalence must be regarded as the most realistic fall-back option.

9.91 As these proposals make changes to the way the ESAs are involved in the equivalence process, they are clearly relevant in the Brexit context. The Authorities would have to "monitor regulatory and supervisory developments and enforcement practices and relevant market developments" in the UK, and submit a confidential report on its findings to the Commission on an annual basis (based on which the Commission would decide whether to maintain or withdraw the relevant equivalence decision).

9.92 In addition, the Commission is seeking to establish a right for the European Supervisory Authorities to demand information from the Bank of England and the Financial Conduct Authority, and perform inspections with UK firms after Brexit, in return for an equivalence decision on the post-Brexit regulatory regimes. While the UK will not be under a legal obligation to agree to such arrangements, such a refusal would make it less likely that equivalence is granted.

9.93 The second set of Brexit-related proposals are the expansion of ESMA's direct supervisory responsibilities for third country financial benchmarks used within the EU (see paragraph 9.47) and the publication of prospectuses within the EU by non-EU companies (see paragraph 9.51). With the information provided by the Minister, we are unable to ascertain to what extent this is likely to significantly affect the situation for UK companies after Brexit compared to the existing third country provisions under the Benchmark and Prospectus Regulations. It is clear, however, that it will limit the options for administrators of benchmarks seeking recognition, as they would always have to apply to ESMA rather than a domestic regulator of an EU Member State.

Assessment of the Minister's Explanatory Memorandum

9.94 The Minister's Memorandum does not make clear the Government's position on the lion's share of the proposals put forward by the Commission. We cannot reconcile this complete absence of information with the Government's own assertion, repeated in the Memorandum, that "until exit negotiations are concluded (…) the Government will continue to negotiate, implement and apply EU legislation".

9.95 The Memorandum also made no attempt to place the proposals in the context of Brexit. It is clear from the Commission's documents that it has taken the view that some UK firms will try to circumvent the application of EU regulatory standards to their operations while maintaining their current levels of access to EU clients after Brexit. In view of the UK's high standards of financial regulation and supervision, and as the substance of the relevant EU legislation is due to be retained or transposed into UK law through the (EU Withdrawal) Bill, we do not believe such suspicions are warranted.

90 See paragraph 9.32 for more information on equivalence.

91 Letter from Sir William Cash to Stephen Barclay (22 November 2017).

92 See for example the speech by Michel Barnier at the Centre for European Reform (20 November 2017) or the House of Lords EU Committee Report on Brexit and financial services, paragraphs 89 to 95.

9.96 Irrespective of our view, the concerns obviously are real. Yet, we do not know how the Government is trying to approach these issues. The Minister's Explanatory Memorandum does not refer in substance to the way in which Brexit is driving much of these proposals. He has not indicated whether the UK would accept these new "administrative arrangements" in return for equivalence, or assessed the implications of ESMA's new direct supervisory powers. He concludes his Memorandum by saying that "further technical analysis of this ambitious and complex omnibus proposal will be required in the context of the forthcoming negotiations on EU withdrawal".

9.97 In addition, the Minister has again made no reference to the Government's own ambitions for the future UK-EU trade agreements on financial services. The Treasury, as outlined in the Chancellor's Mansion House speech in June 2017, is seeking "a new process for establishing regulatory requirements for cross-border business between the UK and EU. It must be evidence-based, symmetrical, and transparent".[93]

9.98 We do not know to what extent this new joint regulatory approach would need institutionalised cooperation between the UK regulators and their EU counterparts, including the ESAs, and how this would be affected by the current proposals. The Government has recently confirmed it will seek to retain non-voting UK membership of at least one EU agency after Brexit.[94] Whether that objective also applies to the ESAs is unclear, but their Regulations do not currently allow for third country participation outside of the EEA framework.[95]

9.99 These are crucial issues, with important implications for the level of post-Brexit regulatory and legislative alignment the Government will maintain with the EU. While we appreciate that the ESA reform proposals are complex and politically sensitive, the Minister's Memorandum failed to meet the Government's own criterion that it should "present a clear account of the principal issues from a UK viewpoint, (…) providing the Government's own analysis and position".[96] In addition, since we received the Memorandum, the Secretary of State for Exiting the EU has provided us with a guarantee that "EU exit implications are set out as fully as we can in future Explanatory Memoranda".[97]

9.100 With the information available to us currently, we are unable to assess the implications of these documents, especially how they might affect UK-EU trade in financial services after Brexit. The Committee takes the potential implications of continued regulatory alignment with the EU after Brexit, without UK political representation in EU bodies and agencies, extremely seriously. We have therefore retained the proposals under scrutiny, and asked the Minister to write to us setting out the Government's position on the substance of these documents, including the "EU exit implications" (both during the transitional period, and for the UK as a "third country").

Previous Committee Reports

None.

93 Chancellor of the Exchequer Philip Hammond, Mansion House speech, 20 June 2017.

94 As reported by the *Financial Times* on 1 December 2017, Transport Secretary Chris Grayling "told aviation industry representatives that the government wanted the UK to remain in the European Aviation Safety Agency".

95 See paragraph 9.56 for more information on the participation of the EFTA-EEA countries in the ESAs.

96 Cabinet Office guidance.

97 https://publications.parliament.uk/pa/cm201719/cmselect/cmeuleg/588/588.pdf.

10 A fair and efficient tax system in the Digital Single Market

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; further information requested
Document details	Communication from the Commission to the European Parliament and the Council: A Fair and Efficient Tax System in the European Union for the Digital Single Market
Legal base	—
Department	HM Treasury
Document Number	(39054), 12429/17, COM(17) 547

Summary and Committee's conclusions

10.1 This non-legislative Communication[98] provides an update on the Commission's thinking regarding taxation of the digital economy. In it, the Commission expresses concern that current global tax rules were designed for 'brick and mortar' businesses, and are not suited to the reality of modern digital businesses, which may have very little physical presence in a market and rely on intangible assets such as intellectual property.

10.2 One consequence of this mismatch is that it is possible for digital providers to have a substantial economic presence in a country but to pay very little tax: the Commission provides statistics which suggest that the effective average tax rate for digital business models in the EU28 (8–10% on average) is less than half that paid by traditional business models (which pay an average of around 23%).[99] As digitisation of the economy accelerates and extends into traditional sectors of the economy (e.g., hospitality, transportation) the implications for Member States' tax bases are potentially significant.

10.3 The Communication asserts that the EU needs to respond to these challenges to achieve a modern tax system. It suggests that, given the global nature of the digital economy, the ideal approach would be reform of global corporate tax standards, driven by the work of the OECD's Task Force on the Digital Economy (TFDE). The Task Force is due to present an interim report to the G20 by spring 2018. The Commission states that it supports this process and wants it to reach ambitious conclusions with "meaningful policy options". This would entail changing the current definition of a permanent establishment (the threshold which determines whether a country has a right to tax a business in its jurisdiction), as well as the standards used to determine how to attribute profits to those permanent establishments.

98 European Commission, A Fair and Efficient Tax System in the European Union for the Digital Single Market 12429/17 (21 September 2017) https://esid.parliament.uk/Documents/302d04ec-c5fa-4c0c-bcd3-fefbb710ec66.pdf.

99 The Communication states that "on average, domestic digitalised business models are subject to an effective tax rate of only 8.5%, less than half compared to traditional business models." It suggests that 'digital international B2C model' businesses pay a slightly higher average effective rate of 10%. In contrast, traditional domestic business models pay an average rate of 21% and traditional international business models pay an average rate of 23%. This data is taken from the PwC 2017 Digital Tax Index. See: https://www.pwc.de/de/industrielle-produktion/executive-summary-digitaliiserungsindex-en.pdf.

10.4 The Communication suggests that there is a parallel role for EU-level corporate tax reform, and that its preferred option is for this to be achieved through its Common Consolidated Corporate Tax Base (CCCTB) proposal, which could be amended to ensure that it better reflects the challenges presented by the digital economy. Three prospective short term options are also identified: an equalisation tax on the turnover of digitalised companies; a withholding tax on digital transactions; and a levy on revenues generated from the provision of digital services or advertising activity. Prior to the publication of the Communication, ten EU finance ministers co-signed a political statement ('Joint initiative on the taxation of companies operating in the digital economy') that particularly supported the possibility of an 'equalisation tax' on the turnover generated in Europe by digital companies.[100]

10.5 The Communication concludes by calling on the Member States to agree a common position on this issue through Council Conclusions, in order to feed into ongoing OECD work. In the absence of adequate global progress, the Communication states that EU-level solutions should be advanced and that the Commission will be ready to launch a possible proposal by spring 2018.

10.6 On 12 October 2017 the Financial Secretary to the Treasury (Mel Stride) submitted an Explanatory Memorandum[101] to Parliament, in which he recognised the seriousness of the issue, and agreed that it merited consideration. The Minister said that the Government welcomed OECD work on this issue, given its global nature, but remained opposed to the European Commission's Common Consolidated Corporate Tax Base (CCCTB) proposal. He indicated that the Government would consider the other options on their merits.

10.7 ECOFIN Council discussed the Communication at its meeting on 5 December 2017.[102] In its conclusions,[103] the Council highlighted the urgency of agreeing on a policy response at international level, and called for close cooperation with the OECD and other international partners. In particular, the Council suggested that the concept of 'virtual permanent establishment' be explored, together with amendments to the rules on transfer pricing and profit attribution. The Council also recognised the interest of many Member States in temporary EU-level measures, calling on the Commission to assess thoroughly all options mentioned in its Communication, and looked forward to the Commission bringing forward appropriate proposals by early 2018.

10.8 **This Communication ("A Fair and Efficient Tax System for the Digital Single Market") expresses the Commission's view that certain features of the digital economy and current global standards on corporate taxation mean that digital business models pay significantly lower levels of tax than traditional business models. Given the acceleration of the digitisation of the economy, we note that this situation has potentially significant implications for Member States' tax bases. The Government acknowledges that this is a serious issue which merits consideration.**

100 Joint initiative on the taxation of companies operating in the digital economy https://pbs.twimg.com/media/DJ1-xTsXUAA4QSR.jpg.

101 Explanatory Memorandum submitted by HM Treasury on 12 October 2017 EM 12429/17.

102 Council of the European Union, Digital taxation: Council agrees input to international discussions (accessed 5 December 2017) http://www.consilium.europa.eu/en/press/press-releases/2017/12/05/digital-taxation-council-agrees-input-to-international-discussions/.

103 Council conclusions on 'Responding to the challenges of taxation of profits of the digital economy' (5 December 2017) http://www.consilium.europa.eu//media/31933/st15175en17.pdf.

10.9 **The chief effect of the Communication is to press the OECD's Task Force for the Digital Economy's (TFDE) interim report to the G20 in spring 2018 to present "meaningful policy options" which have the potential to tackle these concerns. However, the Commission also considers that EU-level action can complement global action, and indicates that its Common Consolidated Corporate Taxation Base proposal (which the Government opposes) is its preferred EU-level approach. The Communication also outlines three new short term approaches which could be used to address the issue on a temporary basis at EU-level, if progress is not made at a global level: an equalisation tax, a withholding tax on digital transactions, and a levy on revenues generated by digital transactions or advertising activity. These ideas are undeveloped, and the Commission indicates that further work on them is necessary. The Government says that it will evaluate these proposals on their merits.**

10.10 **The Economic and Financial Affairs Council agreed Council Conclusions in relation to this Communication at its meeting on 5 December 2017.[104] The Conclusions support the Commission's Communication, preferring a global solution but inviting the Commission to undertake further work on short term solutions and to bring forward appropriate legislative proposals in early 2018. Legislative proposals therefore appear probable.**

10.11 **We ask the Government to respond to the following questions:**

- **The Minister said that the Government would consider the three short-term options outlined in the Communication on their merits. What are the Government's preliminary views on each of these approaches?**
- **In the Government's assessment, does the Commission's analysis of the challenges of corporate taxation of the digital economy differ significantly from that of the OECD TFDE's analysis to date, and if so, in what respects? To what extent does the Government share the Commission's objectives for the TFDE's anticipated interim report?**
- **To what extent is the current US Government—which is undertaking substantial reforms of its system of corporate taxation, partly with the objective of persuading digital businesses to repatriate profits that are currently held offshore—supportive of the concerns and agenda of the OECD's Task Force on the Digital Economy? To what extent will it be possible to tackle the issue effectively at a global level without US support?**

10.12 **In relation to the UK's withdrawal from the European Union, we ask the Government to clarify:**

- **In what ways will leaving the European Union affect the UK's ability to tackle the challenges the digital economy presents in terms of corporate taxation? Will it be easier for the Government, outside the EU, to oblige digital businesses that currently route economic activity through other Single Market tax jurisdictions (e.g. Ireland) to have a permanent establishment in the UK and to pay larger corporate tax contributions, or does the EU's**

104 Council conclusions on 'Responding to the challenges of taxation of profits of the digital economy' (5 December 2017) http://www.consilium.europa.eu//media/31933/st15175en17.pdf.

limited competence in this policy area mean that the impact of a shift to third-country status will be limited? We ask for the Government to provide an explanation of its response.

- **What would be the implications for the UK, after it withdraws from the EU, of substantial EU integration in the area of corporate taxation—e.g., through the adoption of the CCCTB, or through the agreement of a digital 'equalisation tax'?**

10.13 **We ask for an update from the December meeting of ECOFIN Council as well as responses to these questions by 23 January 2018. In the meantime we retain this document under scrutiny.**

Full details of the documents

Communication from the Commission to the European Parliament and the Council: A Fair and Efficient Tax System in the European Union for the Digital Single Market: (39054), 12429/17, COM(17) 547.

Background

10.14 A number of global and European initiatives are currently in development that involve tackling issues relating to tax avoidance and/or aggressive tax planning. These are briefly summarised below.

OECD—base erosion and profit shifting (BEPS)

10.15 The OECD defines base erosion and profit shifting (BEPS) as "tax planning strategies that exploit … gaps and mismatches in [countries'] tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid". In October 2015 the OECD published a report, which had been developed by the Task Force on the Digital Economy (TFDE), setting out an Action Plan with 15 measures to address the BEPS problem.[105] This package of measures was endorsed by the G20 in November 2015 and by the more than 100 countries and jurisdictions participating in the Inclusive Framework on BEPS.

10.16 The report recognised that digitalisation and some of the resulting business models present some challenges for international taxation. However, the report also acknowledged that it would be difficult, if not impossible, to 'ring-fence' the digital economy from the rest of the economy for tax purposes because of the increasingly pervasive nature of digitalisation. While digitalisation and the resulting business models do not generate unique BEPS issues, some of the key features of digitalisation exacerbate BEPS risks.

10.17 In July 2017, at their summit in Hamburg, the G20 Leaders reiterated their support for the OECD's work on taxation and digitalisation, which followed the request made

105 OECD, Addressing the Tax Challenges of the Digital Economy, Action 1—2015 Final Report (October 5 2015) http://www.oecd.org/ctp/beps/addressing-the-tax-challenges-of-the-digital-economy-action-1–2015-final-report-9789264241046-en.htm.

by the G20 Finance Ministers at Baden-Baden in March 2017, that the TFDE deliver an interim report on the implications for taxation of digitalisation to the G20 Finance Ministers in April 2018.

EU Common Consolidated Corporate Tax Base (CCCTB)[106]

10.18 The Common Consolidated Corporate Tax Base (CCCTB) is a single set of rules to calculate companies' taxable profits in the EU. With the CCCTB, cross-border companies would have to comply with a single EU system for computing their taxable income, rather than multiple national rulebooks. Companies could file one tax return for all of their EU activities, and offset losses in one Member State against profits in another. The consolidated taxable profits would be shared between the Member States in which the group is active, using an apportionment formula. Each Member State would then tax its share of the profits at its own national tax rate.

10.19 The Commission had originally proposed the CCCTB in 2011, but that proposal was rejected by the Member States. The House of Commons European Scrutiny Committee issued a Reasoned Opinion in relation to this proposal.[107]

10.20 The Commission issued a modified proposal for a CCCTB—a two-stage process which would begin with the establishment of a Common Corporate Tax Base (CCTB)—in December 2016,[108] in response to which the European Scrutiny Committee drafted a Reasoned Opinion, which it recommended for debate.[109] Difficulties with scheduling a meeting for European Committee B meant that by the time it had debated and adopted the Reasoned Opinion (20 December 2016) the relevant EU deadline had been missed.

10.21 Little progress has been made on the CCTB proposal, which was most recently discussed at ECOFIN Council on 23 May 2017.[110]

EU Anti-Tax Avoidance Package (ATAP)[111]

10.22 In January 2016 the Commission published a package of hard and soft law measures, referred to as the Anti–Tax Avoidance Package (ATAP), aimed at preventing tax avoidance by large multinational companies within the EU. This package consisted of a proposed Council Directive to amend the Directive on Administrative Assistance and Mutual Cooperation in order to require Member States to adopt the BEPS Action Plan Country-by-Country reporting template, as well as a proposed Council Directive aimed at preventing tax avoidance within the EU through implementing three measures based on the outcomes of the BEPS Action Plan and three other measures.

106 European Commission, Common Consolidated Corporate Tax Base (CCCTB) (accessed 5 December 2017) https://ec.europa.eu/taxation_customs/business/company-tax/common-consolidated-corporate-tax-base-ccctb_en.

107 Reasoned Opinion of the House of Commons: Draft Directive on a common consolidated corporate tax base (7263/11) https://www.parliament.uk/documents/commons-committees/european-scrutiny/Reasoned-Opinion-Taxation-2011.pdf.

108 European Commission, Commission proposes major corporate tax reform for the EU (25 October 2016) http://europa.eu/rapid/press-release_IP-16–3471_en.htm.

109 https://publications.parliament.uk/pa/cm201617/cmselect/cmeuleg/71–xxi/7103.htm#_idTextAnchor005.

110 Council of the European Union, Outcome of the Council Meeting—3543rd Council meeting—Economic and Financial Affairs (23 May 2017)http://www.consilium.europa.eu/media/22301/st09581en17-vf.pdf.

111 European Commission, Anti Tax Avoidance Package (accessed 5 December 2017) https://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package_en.

10.23 The Directive on the scope of the mandatory automatic exchange of information in the EU was published in the Official Journal on 3 June 2016. The Directive lays down rules in order to strengthen the average level of protection against aggressive tax planning in the internal market entered into force on 8 August 2016 and will apply from 1 January 2018 (with a derogation until 1 January 2020 to apply the exit taxation rules).[112]

The Communication[113]

10.24 The Commission's Communication provides a high level analysis of what it considers to be the challenges facing the Members States in relation to taxation of the digital economy. It notes that existing tax systems are often based on the expectation that a company will have a physical presence where it undertakes activity, something that is increasingly less relevant when many digital businesses can operate with very little physical presence in a market. It also cites other factors, such as the increasing reliance on intangibles, as examples of how digitalisation is affecting tax regimes.

10.25 The Communication states that the EU needs to respond to these challenges to achieve a modern tax system, and that its response should be guided by the principles of fairness, competitiveness, sustainability and integrity.

10.26 The Communication states that the underlying principle for corporation tax is that profits should be taxed where the value is. However, with the digital economy it is not always very clear what that value is, how to measure it, or where it is created. The Commission therefore concludes that any long-term solution to this issue must resolve these questions.

Global solution

10.27 The Commission's preferred solution to these challenges is to adapt the general international corporate tax framework so that the digital economy is effectively taxed within it. This would ensure the consistency and coherence of tax rules worldwide, and provide businesses with stability and certainty. These rules "could then be integrated into a Commission proposal that would establish binding rules for digital companies operating in the EU's Single Market".[114]

10.28 The Commission notes that these issues are being considered by the OECD's Task Force on the Digital Economy (TFDE). This is a group of OECD countries who have agreed to examine digital taxation. The Communication says that the next important step in this area will be the interim report on the taxation of the digital economy that the OECD will present to the G20 in spring 2018. The Commission expects a high level of ambition from this report, and calls for the OECD to present "meaningful policy options".

112 European Parliament Legislative Observatory 2016/0011(CNS)—12/07/2016 Final act (accessed 4 December 2017) http://www.europarl.europa.eu/oeil/popups/summary.do?id=1447139&t=f&l=en.

113 European Commission, A Fair and Efficient Tax System in the European Union for the Digital Single Market 12429/17 (21 September 2017) https://esid.parliament.uk/Documents/302d04ec-c5fa-4c0c-bcd3-fefbb710ec66.pdf.

114 European Commission, Fact Sheet: Questions and Answers on the Communication on a Fair and Efficient Tax System in the EU for the Digital Single Market (21 September 2017) http://europa.eu/rapid/press-release_MEMO-17–3341_en.htm.

10.29 Specifically, the Commission states that new international rules are needed to determine where the value is created and how it should be attributed for tax purposes. Reform of international tax rules on permanent establishment, transfer pricing and profit attribution applicable to digital technologies is needed, in its assessment.

10.30 Permanent establishment rules are used to determine the threshold of activity that needs to be carried out in a country in order for a business to be taxable in that country, and are largely based on physical presence—an indicator which does not always effectively capture the activity of digital firms. Transfer pricing rules are used to attribute the profit of multinational groups to the different countries based on an analysis of the functions, assets and risks within the value chain of the group. The Commission states that these rules were developed for traditional business models, whereas digital firms are heavily reliant on intangible assets, and that the challenge of identifying and valuing intangible assets as well as determining their contribution to value creation requires alternative methods for attributing profit that better capture value creation in the new business models.

10.31 In the absence of adequate global progress in the OECD interim report, the Communication states that "EU solutions should be advanced within the Single Market and the Commission stands ready to present the appropriate legislative proposals". The Commission states that it will continue to analyse the policy options and consult with relevant stakeholders and industry representatives on this issue ahead of a possible legislative proposal by spring 2018.

EU-level solutions

10.32 At EU-level, the Commission states that its *Common Consolidated Corporate Tax Base (CCCTB)* proposal is its preferred option. It says that the CCCTB provides an EU framework for revised permanent establishment rules and for allocating the profit of large multinational groups using the 'formula apportionment approach' based on assets, labour and sales, which would better reflect where the value is created. The Commission states that there is scope to revise the current CCCTB proposal to ensure that it better reflects digital activities, and that discussions are already underway on this in the Council under the Estonian Presidency and in the European Parliament.

10.33 The Commission acknowledges that global or indeed European tax reform is a "multidimensional challenge" and is therefore likely to take time to resolve. On this basis it also identifies a number of "more immediate, supplementary and short-term measures" to protect the direct and indirect tax bases of the Member States.

10.34 The short-term measures identified are:

- *Equalisation tax on turnover of digitalised companies*—A tax on all untaxed or insufficiently taxed income generated from all internet-based business activities, including business-to-business and business-to-consumer, creditable against the corporate income tax or as a separate tax, with the objective of bring taxation to the level of corporate tax in the country in which the revenue was earned. According to Reuters, this approach was supported by finance ministers in ten EU Member States, including France, Germany, Spain and Italy, in a

letter written the week prior to the publication of the Communication.[115] The Commission's Fact Sheet, which supports the Communication states that "There is very little detail about this proposal available at the moment so it is impossible to say exactly how it would work in practice until the idea has been properly fleshed out."[116]

- *Withholding tax on digital transactions*—No detail is provided of this option, which is described as a "standalone gross-basis final withholding tax on certain payments made to non-resident providers of goods and services ordered online". A withholding tax, also called a retention tax, typically applies to employment income, and involves the tax being withheld or deducted from the income paid to the recipient. How an analogous arrangement would operate in the case of transactions between consumers and digital platforms is unclear.

- *Levy on revenues generated from the provision of digital services or advertising activity*—This option, about which little information is provided, would involve a separate levy being applied to all transactions concluded remotely with in-country customers where a non-resident entity has a significant economic presence. No further explanatory information is provided.

10.35 Further information is not provided about the possible approaches listed above. By the Commission's own admission, each possesses advantages and disadvantages, and would require further work. The Communication also acknowledges that questions arise about the compatibility of such approaches with the double-taxation treaties, State Aid rules, fundamental freedoms, and international commitments under the free trade agreements and WTO rules.

10.36 EU-level action on taxation is subject to unanimity voting in the Council, and so it will be challenging for the EU to adopt a common policy in this area.

The Government's view

10.37 On 12 October 2017 the Financial Secretary to the Treasury (Mel Stride) submitted an Explanatory Memorandum (EM) to Parliament, outlining the Government's views on the Communication.[117]

10.38 The Minister states that the Government is committed to the principle that corporation tax should be paid where value is created. By way of illustrating this support, he references to the 2015 Diverted Profits Tax (DPT), which is designed to counter erosion of the UK tax base via contrived arrangements which avoid trading in the UK through a UK permanent establishment or those which lack economic substance. He also notes that the Government has implemented/is currently legislating for a number of measures

115 Reuters, "France, Germany, Italy, Spain seek tax on digital giants' revenues" (9 September 2017) https://www.reuters.com/article/us-eu-tax-digital/france-germany-italy-spain-seek-tax-on-digital-giants-revenues-idUSKCN1BK0HX.

116 European Commission, Fact Sheet: Questions and Answers on the Communication on a Fair and Efficient Tax System in the EU for the Digital Single Market (21 September 2017) http://europa.eu/rapid/press-release_MEMO-17–3341_en.htm.

117 Explanatory Memorandum submitted by HM Treasury on 12 October 2017 EM 12429/17.

agreed as part of the OECD Base Erosion and Profit Shifting (BEPS) process. Finance (No. 2) Bill 2017 includes a measure to limit the deductibility of interest payments for tax purposes.

10.39 The Minister states that "the UK acknowledges that the digital economy may pose additional challenges for corporate tax systems" and recognises that this issue therefore merits serious consideration. The Minister states that the Government welcomes the work taking place through the OECD's Task Force on the Digital Economy, and notes that this process has been endorsed by the G7 and G20, "as reflects the global nature of the challenge".

10.40 The Minister is less enthusiastic about EU involvement in this policy area. He states that the Government believes there is value in discussing the issue at an EU level, as well as aiming for a common position that can be reflected in Council conclusions; however, he emphasises that EU discussions, and any conclusions agreed, "should seek to complement and reinforce the OECD work."

10.41 The Minister states that the Government will consider the three options outlined in the paper—the equalisation levy, withholding tax, and digital services levy—on their merits, and reiterates the Government's opposition to the Commission's Common Consolidated Corporate Tax Base (CCCTB) proposal, "as it does not believe this represents a proportionate or effective response to the challenges faced by corporate tax systems".

ECOFIN conclusions[118]

10.42 ECOFIN Council discussed the Communication at its meeting on 5 December 2017 and agreed Council Conclusions on this subject. The Conclusions appear to broadly align with the content of the original Communication.

10.43 In its conclusions, the Council highlights the urgency of agreeing on a policy response at international level. It calls for close cooperation with the OECD and other international partners. The Council suggests that the concept of 'virtual permanent establishment' be explored, together with amendments to the rules on transfer pricing and profit attribution.

10.44 The Conclusions also recognise the interest of many Member States for temporary EU-level measures, calls on the Commission to assess thoroughly all options mentioned in the Communication, and "looks forward to appropriate Commission proposals by early 2018, taking into account relevant developments in ongoing OECD work and following an assessment of the legal and technical feasibility as well as economic impact of the possible responses to the challenges of taxation of profits of the digital economy".

Previous Committee Reports

None.

118 Council conclusions on 'Responding to the challenges of taxation of profits of the digital economy' (5 December 2017) http://www.consilium.europa.eu//media/31933/st15175en17.pdf.

11 European Systemic Risk Board

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; further information requested
Document details	Proposal for a Regulation amending Regulation (EU) No 1092/2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board
Legal base	Article 114 TFEU; ordinary legislative procedure; QMV
Department	Treasury
Document Number	(39055), 12430/17 + ADD 1, COM(17) 538

Summary and Committee's conclusions

11.1 In 2010, the EU created the European Systemic Risk Board (ESRB) as the macro-prudential pillar of the post-crisis European System of Financial Supervision (ESFS). The Board monitors the build-up of risks in the EU's financial system, and issues warnings and recommendations to national and EU regulators if it believes action is necessary to preserve the stability of that system.

11.2 In September 2017, the European Commission proposed a number of technical changes to the composition and functioning of the ESRB to reflect the new legislative environment (in particular the creation of the Banking Union for the Eurozone),[119] and the anticipated increases in cross-border flows of capital as part of the Capital Markets Union.[120] The proposed changes are set out in paragraph 11.14 below. In parallel, the Commission also tabled plans for much more substantial reforms of the European Supervisory Authorities, which are the micro-prudential counterpart of the ESRB within the ESFS.[121]

11.3 The Economic Secretary to the Treasury (Stephen Barclay) submitted an Explanatory Memorandum on the proposal in October 2017.[122] In it, he briefly summarises the proposed changes to the ESRB Regulation, but does not state the Government's position on them.

11.4 **The Commissions proposals on the European Systemic Risk Board are technical in nature and uncontroversial, especially compared to the much more substantial reforms it has proposed in parallel on the powers and governance of the micro-financial European Supervisory Authorities. However, the Minister has failed to provide us with any information about the Government's position on the proposed changes to the ESRB.**

119 The Banking Union consists primarily of Regulation 1024/2013 establishing the Single Supervisory Mechanism and Regulation 1093/2013 establishing the Single Resolution Mechanism. A proposal for a pan-Eurozone deposit guarantee scheme remains under discussion but is unlikely to be adopted in the near future (see our predecessors' Report of 7 September 2016). The UK does not participate in the Banking Union.

120 The aim of the Capital Markets Union (CMU) is to increase EU businesses' access to non-bank finance from other Member States.

121 See chapter 9 of this Report.

122 Explanatory Memorandum submitted by HM Treasury (16 October 2017).

11.5 **Moreover, although the Bank of England will lose its seat and voting rights on the European Systemic Risk Board when the UK ceases to be an EU Member State, the exact implications of that are unclear. The Minister has not provided an assessment of the value of the ESRB's work for the UK, and in particular for the Financial Policy Committee of the Bank of England, which performs a similar function to the ESRB at UK-level.**

11.6 **As such, we are unable to clear the proposal from scrutiny. We ask the Minister to write to us with the Government's position on the changes to the ESRB, and its proposals for cooperation between the Board and the Bank of England after Brexit. In particular, we are interested in the Government's view on how the Bank of England's cooperation with the ESRB could be institutionalised after Brexit. We ask him to provide this information by 12 January 2018, after which we will consider this proposal again.**

Full details of the documents

Proposal for a Regulation amending Regulation (EU) No 1092/2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board: (39055), 12430/17 + ADD 1, COM(17) 538.

Background

The European System of Financial Supervision

11.7 The EU made major changes to the supervision of the financial markets of its Member States in response to the 2008 financial crisis. It introduced a Single Rulebook for financial regulation in Europe, and created the European System of Financial Supervision (ESFS). The ESFS is built on a two-pillar system of macro-prudential and micro-prudential supervision. At EU-level, these pillars consist of the European Systemic Risk Board[123] and the European Supervisory Authorities (ESAs) respectively. At Member State level, the ESFS is the responsibility of the relevant domestic financial authorities.[124] The EU-level institutions became operational in 2011.

Reform of the European Systemic Risk Board

11.8 The primary tasks of the European Systemic Risk Board (ESRB), which is responsible for macro-prudential oversight of the financial system in the EU,[125] are:

- contributing to the prevention or mitigation of systemic risks to financial stability in the EU, so as to avoid financial crises, in particular by monitoring and assessing cross-sectorial and cross-border risks and spill-overs to minimise the risk of contagion; and
- contributing to the smooth functioning of the EU's internal market by addressing divergent domestic practices that could facilitate regulatory arbitrage, and therefore concentrating risks.

123 See Regulation 1092/2010, cleared from scrutiny on 19 November 2009.

124 In the UK, the participating national competent authorities (NCA) are the Bank of England and the Prudential Regulation Authority, the Financial Conduct Authority, and the Pensions Regulator.

125 See Regulation 1092/2010, cleared from scrutiny on 19 November 2009.

11.9 The ESRB is located in Frankfurt, and its Secretariat is provided by the European Central Bank (ECB). The Board has no binding powers; instead, it issues warnings to identify systemic risks in the financial system, and making recommendations to the EU Member States' domestic macroprudential regulators on remedial actions to be taken to mitigate those risks. It also works closely with the EU's micro-prudential European Supervisory Authorities and international financial organisations.

11.10 The ESRB has a broad membership. Its voting members include primarily the EU's 28 national central banks (including, for the UK, the Bank of England), the European Central Bank, the European Commission and the European Supervisory Authorities. It normally takes decisions by simple majority, with each voting member have a single, unweighted vote.[126]

11.11 The European Commission carried out a comprehensive evaluation of the ESFS in recent years. It primarily highlighted concerns about the governance and effectiveness of the ESAs, including the implications of Brexit, which we have considered in a separate chapter in this Report.[127] With respect to the ESRB, the Commission concluded some technical changes were needed to adapt the Board to recent legislative developments, and to make its functioning more efficient. It tabled a legislative proposal to that effect in September 2017.

The Commission proposals

11.12 The European Commission argues that the institutional changes related to Banking Union, which concentrated supervisory responsibility for large Eurozone banks within the European Central Bank, and efforts to build a Capital Markets Union, make the context in which the ESRB was set up different from the one in which it now operates in. In particular, the Commission is concerned that the Board should be able to address the potential risks that arise from increased cross-border flows of capital within the EU.

11.13 As part of its package of reforms for the ESFS, the European Commission has proposed a series of changes to the composition of the European Systemic Risk Board (ESRB) and how it cooperates with European institutions. The proposed changes aim to "improve the ESRB's efficiency and effectiveness, improve coordination of macroprudential policies within the EU, and enable the ESRB to play a key role in the further development of the Capital Markets Union".

11.14 The proposed changes to the set-up and functioning of the ESRB are mainly of a technical nature. They include:

- making the President of the European Central Bank the *ex officio* Chairman of the European Systemic Risk Board;[128]
- raising the visibility of the Head of the ESRB Secretariat by consulting the Board before a candidate proposed by the ECB is appointed, and allowing the Head of the Secretariat to deputise for the Chair of the ESRB at external events;

126 A majority of two-thirds of the votes cast is required to adopt a recommendation for remedial action, or to make a warning or recommendation public.

127 European Commission, "Consultation on the review of the European System of Financial Supervision" (April 2013).

128 The President of the ECB, Mario Draghi, is already Chair of the ESRB. However, under article 20 of the current ESRB Regulation, the European Commission had to review "the modalities for the designation or election of the Chair".

- adding representatives of the Single Supervisory Mechanism and the Single Resolution Board, the key components of the Eurozone Banking Union, as voting members of the ESRB; and
- allowing the ESRB to address warnings and recommendations to the European Central Bank in relation to supervisory tasks not related to monetary policy.

11.15 The Commission explains that "the underlying structure of the ESRB will remain broadly unchanged".

The Government's view

11.16 The Economic Secretary to the Treasury (Stephen Barclay) submitted an Explanatory Memorandum on the proposal on 16 October 2017.[129] In it, he briefly summarises the proposed changes to the ESRB Regulation, but does not state the Government's position on them.

Previous Committee Reports

None.

129 Explanatory Memorandum submitted by HM Treasury (16 October 2017).

12 Proceeds of crime: mutual recognition of freezing and confiscation

Committee's assessment	Legally and politically important
Committee's decision	Not cleared from scrutiny; further information requested; drawn to the attention of the Home Affairs Committee, the Justice Committee and the Committee on Exiting the European Union
Document details	Proposal for a Regulation on the mutual recognition of freezing and confiscation orders
Legal base	Article 82(1)(a) TFEU; ordinary legislative procedure; QMV
Department	Home Office
Document Number	(38429), 15816/16 + ADD 1, COM(16) 819

Summary and Committee's conclusions

12.1 The Commission estimates that only a very small proportion of the proceeds of crime generated within the European Union—around 1% of criminal profits—is confiscated. The proposed Regulation is intended to improve the cross-border enforcement of court orders authorising the freezing and confiscation of the proceeds of crime and is part of a wider package of measures to disrupt and cut off funding for organised crime and terrorism which often has a transnational dimension. It would replace two EU Framework Decisions adopted in 2003 and 2006 which the Commission considers to be "out of date" and unworkable in practice. The UK participates in both Framework Decisions.[130] The proposed Regulation is subject to the UK's Title V (justice and home affairs) opt-in, meaning that it will only apply to the UK if the Government decides to opt in.

12.2 The Security Minister (Mr Ben Wallace) informed our predecessors in April that the Government was "considering opting into this measure", even though the proposed Regulation was "highly unlikely to take effect in the UK until the UK has left the EU". He considered that opting in would "signal our commitment to cooperate in this area" and said that a formal decision would be taken before the three-month deadline for opting in at the negotiating stage expired on 12 June.[131] He wrote again in July to confirm that the Government had decided to opt in:

> "Opting into this measure is consistent with the UK's approach to participating in EU mutual recognition measures to improve practical cooperation between Member States and will ensure that the UK continues to benefit through strengthening the ability of our operational agencies to have our asset recovery orders recognised and executed efficiently and effectively."[132]

130 Council Framework Decision 2003/577/JHA and Council Framework Decision 2006/783/JHA. The 2003 Framework Decision has been partially superseded by Directive 2014/41/EU on the European Investigation Order which establishes procedures for the freezing and transfer of evidence. The UK opted into the Directive and had to implement its provisions by 22 May 2017.

131 See the Minister's letter of 21 April 2017 to the Chair of the European Scrutiny Committee.

132 See the Minister's letter of 19 July 2017 to the Chair of the European Scrutiny Committee.

12.3 The Minister added that the Government was "examining the practical mechanisms in place now to support cooperation on law enforcement and criminal justice to help identify potential options for how we might work with our EU partners in the future". We invited him to share the findings with Parliament and to indicate:

- which of the mutual recognition instruments in which the UK participates the Government considers to be the most important from a law enforcement and criminal justice perspective;
- whether the Government intends these instruments to form part of the strategic agreement it is seeking with the EU on security, law enforcement and criminal justice;[133]
- when he expects the contours of a new strategic agreement to be discussed with EU negotiators; and
- whether he anticipates that transitional arrangements are likely to be necessary to bridge any gap between the UK leaving the EU and a new strategic agreement taking effect.

12.4 Asked whether the UK could continue to operate a system of mutual recognition with EU partners in the criminal law field after leaving the EU without also accepting some degree of oversight by the Court of Justice (CJEU), the Minister commented:

> "The UK's relationship with the Court of Justice will be a complex issue with impacts across all areas of our future relationship with the EU. The Department for Exiting the EU and Ministry of Justice are leading work to consider what that future relationship should be and any agreement on our future participation in a law enforcement and criminal justice will be made in that context."[134]

12.5 The Government's future partnership paper, *Enforcement and dispute resolution*, envisages that the UK's exit from the European Union "will bring an end to the direct jurisdiction of the Court of Justice of the European Union".[135] We noted that this contrasted with the commitment in the earlier White Paper, *The United Kingdom's exit from, and new partnership with, the European Union,* to "bring an end to the jurisdiction in the UK of the Court of Justice of the European Union" so that legislatures and courts in the UK will be "the final decision makers in our country".[136] We asked the Minister to explain the significance of the addition of "direct" in describing the potential future role of the Court in the UK. We also asked him to explain which of the dispute resolution models described in the Government's future partnership paper would be best suited to an agreement concerning the UK's future participation in EU criminal law mutual recognition instruments.

12.6 In his latest letter dated 4 December the Minister provides a brief update on the progress of negotiations and informs us that the Presidency intends to reach a general approach on the proposed Regulation at the Justice and Home Affairs Council on 7/8

133 See the Government's future partnership paper, *Security, law enforcement and criminal justice* published in September.
134 See the Minister's letter of 19 July 2017 to the Chair of the European Scrutiny Committee.
135 See the Government's future partnership paper *Enforcement and dispute resolution* published in August.
136 See the Government's White Paper, Cm 9417.

December. He says that the UK "continues to engage positively" in the negotiations and invites us either to clear the proposal from scrutiny or grant a scrutiny waiver to enable the Government to vote in favour of the general approach. On our wider questions, he draws attention to the Government's future partnership paper on *Security, law enforcement and criminal justice* and comments:

> "The details of our future relationship with the EU will be defined in negotiations and agreeing an effective way to work with our EU partners to recognise and execute orders to freeze and confiscate criminal assets will form an important part of those negotiations."

12.7 **The Minister cannot reasonably expect this Committee to perform its scrutiny functions effectively by requesting a scrutiny waiver (even less, clearance from scrutiny) a mere three days ahead of the Justice and Home Affairs Council which will be invited to agree a general approach. We ask him to report back to us after the Council meeting explaining:**

- **whether a general approach was agreed (and, if so, to provide a copy);**
- **how the UK voted and its reasons for doing so; and**
- **why he was unable to inform us sooner of the Presidency's intentions to seek an agreement.**

12.8 **We would also like to hear whether the Council has supported the Commission's choice of legal instrument—a directly applicable Regulation—or decided that a Directive would be more appropriate to implement mutual recognition arrangements in the criminal law field.**

12.9 **We note that there have been changes to the scope of the proposed Regulation to include "preventive type freezing orders which do not necessarily fall from criminal proceedings". We ask the Minister to explain how "a clear link to criminal activities" would be established in such cases and whether he is confident that the change to the scope of the proposed Regulation would have no adverse impact on the continued use of civil procedures under Part V of the Proceeds of Crime Act (POCA) 2002 to enforce non-conviction based confiscation orders in the UK.**

12.10 **We do not consider that the Minister has provided an adequate response to the issues raised in our earlier Report and ask him to do so. For convenience, these were:**

- **to explain whether the Government has concluded its examination of "the practical mechanisms in place now to support cooperation on law enforcement and criminal justice to help identify potential options for how we might work with our EU partners in the future";**
- **to indicate whether the Government will share its findings with Parliament;**
- **to tell us which of the mutual recognition instruments in which the UK participates are the most important from a law enforcement and criminal justice perspective and whether the Government intends them to form part of the strategic agreement it is seeking with the EU on security, law enforcement and criminal justice;**

- **to indicate when he expects the contours of a new strategic agreement to be discussed with EU negotiators;**
- **to explain whether transitional arrangements are likely to be necessary to bridge any gap between the UK leaving the EU and a new strategic agreement taking effect;**
- **to clarify the significance of the term "direct" inserted before "jurisdiction" in describing the potential future role of the Court of Justice in the UK; and**
- **to explain which of the dispute resolution models described in the Government's future partnership paper, *Enforcement and dispute resolution* would be best suited to an agreement concerning the UK's future participation in EU criminal law mutual recognition instruments.**

12.11 **Pending further information, the proposed Regulation remains under scrutiny. We ask the Minister to provide regular reports on the progress of negotiations. We draw this chapter to the attention of the Home Affairs Committee, the Justice Committee and the Committee on Exiting the European Union.**

Full details of the documents

Proposal for a Regulation on the mutual recognition of freezing and confiscation orders: (38429), 15816/16 + ADD 1, COM(16) 819.

Background

12.12 The Committee's earlier Reports listed at the end of this chapter describe the content of the proposed Regulation and the Government's position. They also provide an overview of an earlier EU criminal law measure—the 2014 Directive on the freezing and confiscation of the proceeds of crime—in which the UK does not participate. The main concern expressed by the then Coalition Government was that the Directive included within its scope non-conviction based confiscation which, in the UK, is governed by civil procedures under Part V of the Proceeds of Crime Act (POCA) 2002. The Government decided *not* to opt in to avert the risk that its participation might provide a basis for asserting that more stringent criminal law standards and safeguards should apply to Part V of the Act.

The Minister's letter of 4 December 2017

12.13 The Minister begins with an update on the progress of negotiations within the Council:

> "The scope of the measure has been widened to encompass preventive type freezing orders which do not necessarily fall from criminal proceedings, such as those found in Italian law. These types of orders were not originally within scope. However Member States, including the UK, were supportive of their inclusion, providing such proceedings have a clear link to criminal activities, and that procedural safeguards apply."

12.14 We had previously commented on the Commission's choice of a directly applicable Regulation to implement mutual recognition arrangements in the criminal law field—the first time a Regulation has been used for this purpose—rather than a Directive which gives Member States greater freedom to determine how common procedures should be implemented in their domestic laws. The Government had made clear that it was "neutral" on the choice of instrument, even though in a different context it has suggested that Regulations raised "profound implications for national sovereignty".[137] The Minister tells us that "the choice of legal form of the instrument between a Directive or a Regulation is still to be determined" and that the Government "is content with both options".

12.15 The Minister explains that the Presidency intends to seek agreement to a general approach at the Justice and Home Affairs Council on 7/8 December. He invites us to clear the proposed Regulation from scrutiny or to grant a scrutiny waiver so that the Government can vote in favour of the general approach.

12.16 Turning to the questions raised in our earlier Report agreed on 13 November, the Minister responds:

> "As you will be aware, the Government has recently published the future partnership paper *Security, law enforcement and criminal justice*, which sets out the Government's plan to seek a new relationship post exit from the EU, and which provides for practical operational cooperation on law enforcement measures. The details of our future relationship with the EU will be defined in negotiations and agreeing an effective way to work with our EU partners to recognise and execute orders to freeze and confiscate criminal assets will form an important part of those negotiations."

Previous Committee Reports

First Report HC 301–i (2017–19), chapter 24 (13 November 2017), Fortieth Report HC 71–xxxvii (2016–17), chapter 1 (25 April 2017), Thirty-fourth Report HC 71–xxxii (2016–17), chapter 1 (8 March 2017) and Thirtieth Report HC 71–xxviii (2016–17), chapter 2 (1 February 2017). See also see our earlier Reports on Directive 2014/42/EU on the freezing and confiscation of instrumentalities and proceeds of crime in the EU: Tenth Report HC 342–x (2015–16), chapter 21 (25 November 2015); Twenty-eighth Report HC 83–xxv (2013–14), chapter 13 (18 December 2013); Twenty-second Report HC 86–xxii (2012–13), chapter 9 (5 December 2012); Twelfth Report HC 86–xii (2012–13), chapter 5 (12 September 2012); Sixth Report HC 86–vi (2012–13), chapter 4 (27 June 2012); and Sixty-third Report HC 428–lvii (2010–12), chapter 1 (18 April 2012).

137 See, for example, the Government's position on the EU asylum reform package: Twelfth Report HC 71–x (2016–17), chapter 1 (14 September 2016). See also the Written Ministerial Statement on the outcome of the July Justice and Home Affairs Council.

13 Vehicle type approval

Committee's assessment	Politically important
Committee's decision	Cleared from scrutiny
Document details	Proposed Regulation on the approval and market surveillance of motor vehicles and their trailers, and of systems, components and separate technical units intended for such vehicles
Legal base	Article 114 TFEU, ordinary legislative procedure, QMV
Department	Transport
Document Number	(37497), 5712/16 + ADDs 1–4, COM(16) 31

Summary and Committee's conclusions

13.1 The Commission has proposed a framework regulation focussed on improving enforcement of vehicle type approval standards, partly in response to the September 2015 revelation that Volkswagen had been using a device to cheat type approval emissions tests. The proposal would make a number of changes to the functioning of the type approval system although, other than updating certain references in emissions regulations, it does not change the technical standards (emissions, braking, noise and so on) to which vehicles are approved. The proposal focuses instead on better enforcement of existing standards.

13.2 The Committee has been scrutinising the proposal since March 2016. Most recently, in April 2017, it granted the Government a scrutiny waiver to support a General Approach at Competitiveness Council in May 2017.[138] The Government subsequently wrote[139] to confirm that it had supported the General Approach,[140] and to provide an update on progress in trilogue negotiations.

13.3 The Government now writes[141] in advance of the final trilogue negotiation, to request that the Committee clear the proposal from scrutiny or grant a waiver in advance of the text being put to the Council of Ministers later this month.

13.4 The Minister (Jesse Norman) notes that one issue that has not yet been fully resolved by negotiations is whether the Commission will have the power to audit national type approval authorities, something a number of Member States oppose. Regardless of the outcome on this point, the Minister states that the UK's main objectives have been achieved. He reiterates the Government's support for the proposal as a whole, particularly its provisions regarding market surveillance, peer review of type approval authorities and joint assessments of technical services, sharing of information between Member States and the Commission and the enhanced safeguarding clauses.

138 Fortieth Report HC 71–xxxvii (2017–18), chapter 15 (25 April 2017).
139 Letter from the Minister of State at DfT to the Chairman (7 November 2017).
140 Regulation 9867/17—General Approach as formally agreed by the Competitiveness Council on 29 May 2017.
141 Letter from the Minister of State at DfT to the Chairman (5 December 2017).

13.5 Following the Minister's letter, a provisional agreement was reached between the Parliament and the Council in the final trilogue on 7 December. A last-minute push by Germany and a number of other Member States to remove the Commission's power to audit national type approval authorities was unsuccessful.

13.6 A summary of the main provisions of the provisional agreement is provided in the final section of this chapter.

13.7 **We thank the Government for its update in relation to the proposed regulation. We note the Government's support for the proposal, which includes provisions on enhanced market surveillance of vehicle approvals, peer review of type approval authorities and joint assessments of technical services and enhanced safeguarding clauses. We note the Government's judgement that the package will restore trust in the type approval system, and that it strikes an appropriate balance between obligations on manufacturers and cost-impact on consumers.**

13.8 **Despite the Government's assurance that it had achieved its negotiating objectives regardless of the outcome of the final trilogue meeting, we were concerned by the efforts of Germany and a number of other Member States to remove the provision giving the Commission the power to audit national type approval authorities, and therefore welcome its retention in the text. Given the conspicuous failure of national type approval authorities to detect the anomalous practices and performance of a large number of Volkswagen and other diesel vehicles, external audit of national type approval authorities appears not only justified but necessary.**

13.9 **In light of this, we are willing to clear the file from scrutiny. However, we emphasise that this clearance is on the understanding that scrutiny of the implications of withdrawal from the European Union for type approval processes by the UK Vehicle Certification Agency (VCA) will continue through scrutiny of other related documents, notably the proposal for a Council Decision at UN-ECE Working Party 29 (13120/17).**

Full details of the documents

Proposed Regulation on the approval and market surveillance of motor vehicles and their trailers, and of systems, components and separate technical units intended for such vehicles: (37497), 5712/16 + ADDs 1–4, COM(16) 31.

Background

13.10 The EU has a range of harmonising legislation, applicable in the whole of the EEA, governing the type approval of automotive products destined for sale in the single market. The EU framework legislation incorporates a number of standards agreed by the United Nations Economic Commission for Europe (UN-ECE), on the formulation of which the EU and its Member States have considerable influence.

13.11 The current requirements for type approval of motor vehicles and their trailers are set out in Directive 2007/46/EC, referred to as the 'Framework Directive'. The legal frameworks for the other two automotive product categories (motorcycles and agricultural vehicles) were both revised in 2013.

13.12 In 2013 the Commission completed a 'fitness check' of the Framework Directive which indicated that it was appropriate for the main aims of harmonisation, effective operation of the single market and fair competition, but that its effectiveness was reduced by differences in the interpretation and application between Member States.

13.13 In September 2015 it was revealed that VW had been using a device to cheat type approval emissions tests. This has led to suggestions that the EU's vehicle type approval regime needs tightening.

13.14 With this proposed regulation the Commission aims to ensure that vehicle type approval and market surveillance systems for motor vehicles and their trailers are effectively achieving the policy objectives of single market integration, safety and health of citizens and protection of the environment. In presenting the proposal, the Commission notes the harsh criticism of the existing framework after the discovery of the VW issue.

13.15 The proposal would make a number of changes to the functioning of the type approval system although, other than updating certain references in emissions regulations, it does not change the technical standards (emissions, braking, noise and so on) against which vehicles are approved. The changes focus on better enforcement of the existing standards, outlined below:

Market Surveillance—new obligations for Member States

13.16 New obligations are proposed for Member States to carry out market surveillance testing, to cooperate, to alert citizens of issues with testing and to review market surveillance activities at least every four years and report the results to other Member States and the Commission.

Market Surveillance—obligations for manufacturers and importers

13.17 The proposal sets out duties on manufacturers, importers and distributors to cooperate with market surveillance authorities and to show due diligence in avoiding supplying non-compliant vehicles.

Market Surveillance—new powers for Commission

13.18 The proposed Regulation would provide the Commission with new powers to establish criteria setting out the scale, scope and frequency of compliance verification testing to be carried out by Member States, to establish structures for information sharing and to carry out testing itself. The latter would be funded by a new top-up fee levied on all applicants for type approval across the EU.

Designation and monitoring of technical services

13.19 Technical services are the bodies designated by Member States to carry out approval testing. The proposed Regulation enhances the regular assessment of these bodies and requires Member States to share the results with the Commission and other type-approval authorities. Manufacturers would in future be required to pay for testing via approval authorities rather than paying technical services directly.

Powers to challenge type approvals

13.20 The proposal sets out additional powers for the Commission and Member States to challenge and refuse to accept type approvals which they believe are incorrectly issued, enhanced provisions for the suspension or withdrawal of type approval where it is thought to be incorrectly issued, as well as new powers for the Commission to rule on national measures taken under these provisions. The proposal specifies scenarios where a recall of vehicles by the manufacturer would be compulsory.

Functioning of type approval

13.21 The proposal sets out various enhancements to approval procedures, including compulsory five-year termination and renewal of a type approval, a more specific obligation for approval authorities to require testing of ongoing production, transparency obligations for manufacturers to aid third party testing of vehicle compliance and powers for the Commission to regulate type-approval authorities.

Powers for Commission to impose fines

13.22 The proposal would empower the Commission to impose administrative fines where they discover infringements of the Regulation, of up to €30,000 (£22,900)[142] per non-compliant vehicle.

13.23 On 19 April 2017, the then Parliamentary Under Secretary of State at the Department for Transport (Andrew Jones) provided the Committee with a letter updating the Committee on progress in Council Working Groups.[143] The Government was broadly content with the outcome of negotiations, and felt that, despite early reluctance from a number of delegations, they had managed to retain the key measures of the proposal. He indicated that the Government had also succeeded in removing the provisions that crossed its red lines, notably the Commission's proposal to fund its own testing with a levy on type approvals within Member States.

13.24 The Committee's report of 25 April 2017[144] summarised the progress that had been made in negotiations on an issue by issue basis and granted the Government a scrutiny waiver to support a General Approach at Competitiveness Council on 29 May 2017.

The Minister's letter of 7 November 2017[145]

13.25 The Parliamentary Under Secretary of State at the Department of Transport (Jesse Norman) informed the Committee that a General Approach was reached at the Competitiveness Council on 29 May 2017, and that the Government voted in support of the Council text, in line with the conditions of the Committee's scrutiny waiver ("subject to the Government's positive expectations being met"). The text of the General Approach is publicly available.[146]

142 £1 = €1.336, or £0.8821 = €1 as at 31 October
143 Letter from the Minister, DfT, to the Chairman (19 April 2017)
144 Fortieth Report HC 71–xxxvii (2017–18), chapter 15 (25 April 2017).
145 Letter from the Minister, DfT, to the Chairman of the Committee (7 November 2017)
146 Regulation 9867/17—General Approach as formally agreed by the Competitiveness Council on 29 May 2017.

13.26 The Minister stated that the one issue that was unresolved prior to the vote was the power for the Commission to fine non-compliant manufacturers where Member States have not taken action. A revision was agreed which means that the Commission retains the power to impose fines, but clarifies that the Commission cannot take action for which economic operators have been penalised so as to avoid cutting across the actions of Member States.

13.27 The Minister wrote that trilogue negotiations with the European Parliament were underway, and progressing well. He noted that the repair and maintenance provisions were one potentially difficult area for the negotiations, as the Parliament and the Council's positions were particularly far apart.

The Minister's letter of 5 December 2017[147]

13.28 On 5 December 2017 the Minister wrote to us to notify us that, although trilogue negotiations had not fully concluded, they were expected to do so on 7 December. COREPER would then consider the final text in mid-December before the proposal was put to the Council of Ministers in late December or early in the new year. As the Minister felt that there would not be enough time for the Committee to consider his update before a decision was made if he waited until the final trilogue meeting had taken place, he chose to write at this point in the process, to seek clearance or a scrutiny waiver from the Committee.

13.29 By way of background, the Minister provides a helpful overview of the history of this proposal. He reminds the Committee that the Government was supportive of the original proposal, particularly its provisions regarding market surveillance, peer review of type approval authorities and joint assessments of technical services, the forum for the sharing of information between Member States and the Commission, and the enhanced safeguarding clauses.

13.30 The Minister states that, as set out in Andrew Jones' letter of 19 April,[148] the Government was broadly content with working group negotiations on these issues and the General Approach which was agreed in May. The Government considered that this text managed to retain the key measures of the proposal, against the early reluctance from a range of delegations, and that the Government succeeded in removing the few provisions which it considered to be unhelpful.

13.31 Regarding trilogue negotiations, the Minister states that the European Parliament's position on the proposal was more radical than the Council General Approach. Changes to the Council text that have been secured are:

- in relation to market surveillance activities, an increased number of tests of vehicle emissions and safety, as well as checks on type approval documentation, although the number is similar to the current level of activity in the UK; and
- improved access to information for smaller businesses outside the main dealer network, in the context of the provisions on repair and maintenance.

147 Letter from the Minister, DfT, to the Chairman (5 December 2017).

148 Letter from the Minister, DfT, to the Chairman (19 April 2017).

13.32 The Minister states that one issue that has not yet been fully resolved, and was set to be discussed at a trilogue meeting on 7 December, was the role of the Commission in audits of type approval authorities. The Government indicates that it "would welcome further improvements in these areas", without specifying what such improvements would look like, and asserts that it "recognise[d] that compromise between the two positions was necessary", without specifying what these positions were.

13.33 In summary, the Minister states that:

- the UK's main objectives for the proposal had been largely achieved regardless of the outcome of the final trilogue negotiation;
- the package as a whole would be a positive step towards improving the type approval system and restoring trust in it (following the Volkswagen emissions scandal); and
- the proposals represent a fair balance between the obligations on manufacturers with the need to avoid cost burdens on consumers, and were important for both the UK automotive industry and consumers.

13.34 On this basis the Minister requests that the Committee clear the file from scrutiny or grant a waiver.

Trilogue agreement

13.35 The final trilogue negotiation took place on 7 December 2017. As the Minister had expected, the role of the Commission in audits of type approval authorities was the key issue of the negotiations.

13.36 The day before the trilogue took place, a news report suggested that Germany was leading a 'rearguard action' to keep European Commission auditors out of its domestic car-approval process:

> "In a late amendment to the Council position, Germany called for its vehicle-approval authority, the KBA, to have the power to select another technical service to carry out the checks on a random basis, rather than involving the Commission. In its proposed text … Berlin said that "any kind of audit means extra bureaucracy without being beneficial."
>
> "That would scrap the Commission's power to check up on the KBA and its peers. But that crosses a red line for MEPs who want to clamp down on national regulators, widely seen as being at fault in failing to catch Volkswagen's cheating. The carmaker was in 2015 caught by tougher U.S. authorities."[149]

13.37 However, the report also suggested that it appeared likely that the German effort would be unsuccessful, on the grounds that the Estonian presidency's position of allowing checks every five years had the support of a majority of countries, who were keen to see political agreement on new controls.

149 Politico Pro, Germany fights a rear-guard action to weaken EU car-approval rules (6 December 2017) (paywall).

13.38 A provisional agreement was reached at the final trilogue which will now be submitted to COREPER for endorsement.[150] Under the agreed rules, the European Commission would be allowed to carry out checks on national authorities every five years.[151]

13.39 In order to provide an overview of the effects of the regulation in its updated form, the key provisions of the regulation agreed in trilogue negotiations are summarised below:

Market Surveillance

- The Regulation introduces a market surveillance requirement, as has previously been included in the equivalent frameworks for motorcycles and agricultural and forestry vehicles. At a late stage of the negotiation a minimum level was agreed with the European Parliament which will require Member States to conduct one test for every 40,000 vehicles registered in the previous year.
- The Commission will also carry out its own market surveillance testing to verify compliance with this Regulation.

Commission audits of national type approval authorities

- The Commission will have the power to carry out audits of national type approval authorities every five years. Following an audit the Commission will make their recommendations to the Forum, which will take forward any necessary actions.

Peer review and accreditation

- The Regulation introduces a system of peer review covering the way that type approval authorities assess and monitor their technical services. If all of their designated technical services have been accredited by a national accreditation body then they are exempt from this requirement. Similarly, technical services will either be subject to evaluation by a joint assessment team—consisting of the Member State intending to designate the technical service, representatives from at least two other Member States and (optionally) the Commission—or must be accredited by the national accreditation service.

Safeguard procedures

- The Regulation will improve Member States' ability to challenge type approvals where doubt is cast on their compliance. This will allow the Government to restrict/remove products from the UK market before an EU wide resolution is reached. The Commission will have a role in convening discussions when approvals are challenged, and drawing conclusions, but the final decisions will be taken by vote of Member States.

150 Council of the European Union, Car emission controls: Council presidency and Parliament reach provisional deal on reform of type-approval and market surveillance system (7 December 2017).

151 Politico Pro, Type approval trilogue deal reached after four-hour session (7 December 2017) (Paywall).

Forum for Enforcement

- The Regulation creates a Forum for Member States and the Commission. Its objective is the promotion of good practices in order to facilitate uniform interpretation and implementation of this Regulation, facilitate the exchange of information on enforcement problems and increase cooperation.

Repair and Maintenance information

- The existing requirements have been retained with some improvements that will allow access to information for smaller businesses outside the main dealer network. This remains close to the Council's original position.

Previous Committee Reports

Fortieth Report HC 71–xxxvii (2017–18), chapter 15 (25 April 2017); Thirty-one Report HC 71–xxix (2016–17), chapter 16 (8 February 2017) and Twenty-fifth Report HC 342–xxiv (2015–16), chapter 6 (9 March 2016).

14 Trade defence actions against the EU

Committee's assessment	Politically important
Committee's decision	Cleared from scrutiny; drawn to the attention of the International Trade Committee
Document details	Fourteenth report from the Commission to the Council and the European Parliament on third country defence actions against the European Union in 2016
Legal base	—
Department	International Trade
Document Number	(38942), 11549/17 + ADD 1, COM(17) 401

Summary and Committee's conclusions

14.1 Effective trade defence instruments (TDIs) are essential in protecting domestic industries from dumped or subsidised imports. The use of TDIs is governed by strict WTO rules, with which the UK, as it implements an independent trade policy in the coming years, will need to comply.

14.2 The Commission reports annually on the trade defence actions of third countries against EU exporters. The document highlights clearly some of the challenges and trends that the UK's proposed Trade Remedies Authority will need to grapple with.

14.3 In particular, the report notes that TDI measures globally, including against the EU, continue to rise, with some of the world's largest economies—India, the United States, China and Brazil—being among the most prolific users of trade defence measures.

14.4 Industries such as steel continue to be the target of most trade defence measures—a consequence of ongoing excess capacity and over-production in China. The response to this by some countries has been to apply safeguard measures, which block particular imports from all countries. The Commission has found that EU steel exporters are sometimes included in the scope of anti-dumping investigations that in fact should properly be focused on China.

14.5 These examples demonstrate clearly the necessity of establishing a well-resourced trade dispute resolution body able to deal with such challenges from the outset. The Taxation (Cross-Border Trade) Bill seeks to set out a new trade remedies framework for the UK, and many of these issues are addressed in that bill. In particular, we note that the Government proposes the use of an "economic interest test" in determining whether or not to apply anti-dumping, anti-subsidy or safeguard measures. This sounds similar to the "Union interest test" which the Commission refers to in its report as a "WTO plus element", and which must be applied before trade defence measures can be imposed.

14.6 In this context, we note also that we have retained under scrutiny since 2013 the Commission's proposed draft Regulation on modernising TDIs, pending receipt of the Government's Impact Assessment and the progress of negotiations, particularly with regard to the lesser duty rule.

14.7 The report also brings out the importance of intervening actively in third country trade defence investigations and in the WTO to protect the interests of domestic exporters. The Commission sees the increased use of trade defence measures in the context of an "increasingly complex and often politicised global trading environment". As such, it states that "continuous efforts" were required to respond to third country actions. These included not just systematic technical interventions in ongoing proceedings, but also bilateral dialogues and the sharing of best practice with trading partners so as to strengthen awareness of compliance with WTO rules. Political interventions, notes the Commission, have also been necessary, however, many issues of concern persist.

14.8 **This mixed assessment demonstrates vividly the global economic context within which trade defence measures are imposed, and the need for effective and systematic interventions to protect domestic industrial interests. We therefore draw our Report to the attention of the International Trade Committee.**

Full details of the documents

Fourteenth report from the Commission to the Council and the European Parliament on third country defence actions against the European Union in 2016: (38942), 11549/17 + ADD 1, COM(17) 401.

Background

14.9 The Commission prepares an annual report on the trade defence actions taken by third countries against the EU. This is the fourteenth such report.

14.10 The WTO framework permits members to make use of trade defence instruments (TDIs) to combat unfair trade practices. There are three main types of TDIs—anti-dumping, anti-subsidy and safeguards measures—and they must be used in accordance with WTO rules, as they will otherwise be viewed as unlawful and unjustified protectionist measures.

14.11 The report notes that the EU deploys anti-dumping and anti-subsidy measures regularly, but has a "moderate and balanced approach", as well as standards that are more stringent than WTO rules. For instance, the EU has a mandatory "Union interest test", which considers the effect on the European economy of the imposition/non-imposition of TDI measures.

14.12 The Commission states that since 2010 there has been a significant increase in the use of TDIs by third countries against EU exports, most likely due to the global economic slowdown and stagnant demand, particularly in certain sectors. When a third country begins a trade defence investigation against EU exports, the Commission seeks to intervene through written submissions to the investigating authority and regular participation in hearings, to ensure that EU exporters' rights and interests are respected. The Commission also intervenes through consultation mechanisms in its bilateral agreements and in multilateral contexts where applicable.

Summary of report's main findings

14.13 At the end of 2016, 156 TDI measures affecting EU exports were in force, an increase on the 151 measures recorded at the end of 2015.

14.14 India, the United States, China and Brazil were the most active users of TDIs against the EU. Both India and the US deployed new TDI measures in 2016 against EU exporters, while China and Brazil remained stable.[152]

14.15 Anti-dumping measures are the most common—with 75% of TDI measures being of this type. Of the remainder, five were anti-subsidy measures and 35 were safeguarding measures.

14.16 The Commission notes that safeguard measures are applied to imports from all origins, with the intention of providing domestic producers with temporary relief from an unforeseen or significant increase of imports. The EU does not tend to use safeguarding measures.

14.17 Indonesia, India and four other Asian countries[153] used safeguarding measures frequently. Despite this, the report notes a decreasing trend in the number of new safeguard investigations, which dropped from 18 in 2015 to 12 in 2016. As a result, the number of new TDI investigations against EU exporters was 30, a drop of seven from 2015.

14.18 Of the 30 new measures, 10 related to safeguards, 19 to anti-dumping, and one to anti-subsidy cases.

14.19 India opened five investigations, the highest of any EU trade partner. Investigations relating to steel represented the highest proportion of new cases overall, with 17 out of the 30 concerning steel products. The Commission states: "Even though there is no overcapacity in the EU steel production, EU industries are often targeted by trade measures imposed by third countries against imports of steel".

14.20 It goes on to say that this applies particularly to safeguard measures but also that third countries sometimes (wrongly) include EU industries in the scope of anti-dumping investigations which otherwise mostly target dumped steel products coming from Asia—i.e. China.

14.21 In recognition of the continuing global excess capacity and overproduction in steel, the Commission has put in place a "steel surveillance mechanism" to monitor import trends that "threaten to cause injury to EU steel producers".

Recurring issues

14.22 The Commission cites four recurring issues in trade defence investigations brought by third countries. These are: anti-circumvention, rights of defence, injury and causal link, and the questionable use of safeguards.

152 India had 24 measures in place, an increase of 5; the US had 21, an increase of 3; China and Brazil had 19 and 15 TDI measures in place respectively.

153 Malaysia, the Philippines, Thailand and Vietnam.

Anti-circumvention

14.23 Circumvention refers to illegal practices such as trans-shipment, mis-declaration of origins, product modification or assembly operations. The intent of these practices is to avoid the payment of applicable anti-dumping or anti-subsidy duties.

14.24 There are currently no uniform WTO rules regarding circumvention. The Commission notes that anti-circumvention measures can become problematic when they capture genuine producers, and that this is an area which the Commission is monitoring closely.

14.25 In 2016, as in 2015, there were five cases against the EU involving circumvention. Turkey accounted for three of these, plus one new investigation, while Argentina initiated one case.

Rights of defence

14.26 Investigating authorities of countries initiating trade defence investigations are required to ensure that a "meaningful, non-confidential file" is made available to affected parties for consultation. While excluding business secrets, it should present redacted information "in the form of indexes or ranges that enable all parties to have a complete picture of the situation".

14.27 The Commission observes, however, that in many investigations, minimal information is provided in the non-confidential file, or is completely redacted. This means that parties are unable to effectively exercise their right of defence. In such cases, the Commission states that it "intervenes systematically, insisting on more transparency during the proceedings".

Injury and causal link

14.28 WTO rules require that trade defence measures should only be imposed when applicable conditions have been strictly fulfilled. However, the Commission notes that countries imposing measures often fail to demonstrate a clear causal link between the alleged dumped imports and the injury suffered by the domestic industry.

14.29 The Commission notes further that there can be several reasons for injury to a domestic industry that would not establish a causal link. These include: the inefficient utilisation of capacity; a drop in domestic demand; or an increase in the prices of raw materials and energy.

14.30 The Commission states that it pays particular attention to third country analyses of injury and causal link; as without such a link any measures represent protectionism.

Questionable use of safeguards

14.31 Safeguards are the most trade-restrictive instrument, and as such the Commission believes they should be used only in the most exceptional circumstances. Although 2016 saw a decrease in their use, the Commission continues to intervene systematically in "almost all' safeguarding investigations.

14.32 This is because it believes that many do not appear to respect the strict rules set out in the WTO Safeguards Agreement. For instance, many safeguard investigations, particularly those in South East Asia, refer only to imports originating in one country i.e. steel from China. In such cases, anti-dumping or anti-subsidy instruments, which can be country or even company specific, would be the most appropriate response, rather than restricting market access for all producers regardless of origin.

Main achievements

14.33 A number of countries either ended anti-dumping measures against the EU or imposed less restrictive measures.

14.34 The Commission highlights ten such cases.[154] Examples include China's ending of anti-dumping measures on certain steel products from the EU and Japan following a ruling by the WTO Appellate Body which concluded that the 2012 measures were in breach of WTO rules. Another example is Australia's lowering of duties for producers of processed tomato products from Italy. The Commission states that in 2015 Australia imposed anti-dumping duties based on the use of a methodology that "raised systemic concerns". This was because it "indirectly challenged EU agricultural green box payments (which are allowed under WTO rules) within the framework of an AD investigation".

14.35 The Italian government and affected companies asked Australia's Anti-Dumping Review Panel to review the measures, and the Commission also intervened, to demonstrate that the price of raw tomatoes purchased by the exporters in the production of the processed product was not influenced by EU green box payments. Australia accepted this argument and reduced the applicable duty, acknowledging that the cost adjustment methodology used was not appropriate.

The WTO

14.36 The report notes that the Commission is active in the WTO to defend EU interests in specific cases and to challenge trade defence measures if it considers that these violate WTO rules. The Commission also intervenes actively as a third party in WTO proceedings, "with the aim of addressing and monitoring issues of systemic concern and advocating for higher standards in trade defence investigations worldwide".

14.37 An example of a EU challenge to trade defence measures concerned Russian anti-dumping duties imposed against imports of EU light commercial vehicles. The EU requested the establishment of a WTO dispute settlement panel. The panel subsequently declared the duties in breach of WTO rules, agreeing with the EU on all procedural claims and recognising flaws in the analysis used by Russia, which in particular disregarded "massive overcapacity in the domestic LCV sector". However, Russia lodged an appeal in early 2017, and this matter is still pending.

14.38 The Committee intervened as a third party in two WTO disputes—involving US imposition of anti-dumping duties against South Korea and China. The parties challenged the methodology used by the US to establish targeted dumping. The Commission notes

154 These relate to the following countries: China, Australia, Brazil, Turkey, Morocco, Tunisia, Egypt, South Africa and New Zealand.

that the WTO Appellate Body reports in both these cases "are of particular interest to the EU, as this methodology, which artificially inflated dumping margins, is used by the US also in cases against imports from the EU".

14.39 The Commission takes part in WTO anti-dumping and anti-subsidy committees, where individual actions taken by WTO members are discussed and reviewed. The Commission also raises individual cases of concern in the Safeguard Committee, "in view of the intensive use of this instrument, which is a cause of major concern".

The Government's Explanatory Memorandum

14.40 The former Minister of State for Trade Policy (Lord Price), in an Explanatory Memorandum dated 14 August 2017, has little to comment on this report, noting simply that the document is a "list of decisions and measures taken by third countries against the EU". He adds:

> "The document is designed to be open and informative about trends and the EU Commission's general approach to trade defence instruments."

Previous Committee Reports

None.

15 Operation SOPHIA

Committee's assessment	Politically important
Committee's decision	Cleared from scrutiny; further information requested; drawn to the attention of the Defence and Foreign Affairs Committees
Document details	Council Decision (CFSP) 2017/1385 of 25 July 2017 amending Decision (CFSP) 2015/778 on a European Union military operation in the Southern Central Mediterranean (EUNAVFOR MED operation SOPHIA).
Legal base	Articles 42(2) and 43(2) TEU; unanimity
Department	Foreign and Commonwealth Office
Document Number	(38918),—

Summary and Committee's conclusions

15.1 The EU launched its Naval Force Mediterranean (EUNAVFOR MED), since renamed Operation SOPHIA,[155] in June 2015 to counter people-trafficking in the Southern Central Mediterranean.[156] Its core mandate is to identify, capture and dispose of vessels and other assets being used by migrant smugglers or traffickers, thus disrupting the business model of human smuggling and trafficking networks in the Southern Central Mediterranean, and in doing so prevent the further loss of life at sea. By July 2017, Operation SOPHIA had saved 38,000 lives and destroyed 463 smuggling vessels.[157]

15.2 In July 2017, the House of Lords EU External Affairs Sub-Committee published a report on Operation SOPHIA.[158] It concluded that the Operation had failed to achieve its objective of disrupting human trafficking in the region, because "meaningful EU action" would require action against those organising these activities on the ground in Libya. Based on these findings, the House of Lords report recommended closure of Operation SOPHIA, and its replacement with a naval operation focused solely on search and rescue for migrants at sea (see "Background" for more information).

15.3 The day after the publication of the House of Lords report, the Minister for Europe (Sir Alan Duncan) informed the Committee that a draft Council Decision had been circulated to extend the mandate of Operation SOPHIA from July 2017 to December 2018. The Minister's Explanatory Memorandum on the proposal made clear the Government's support for the proposed Decision, stating that the Government "remains of the view" that disrupting the business model of smugglers and traffickers "is the right objective"

155 The operation was rechristened 'SOPHIA' in 2015, named after a baby born to a Somali woman aboard a German vessel which had rescued her and 453 others in the Mediterranean.

156 See Council Decision (CFSP) 2015/778 of 18 May 2015.

157 Explanatory Memorandum submitted by the Foreign and Commonwealth Office (13 July 2017), p. 2.

158 House of Lords EU Sub-Committee on External Affairs, "Operation Sophia: a failed mission" (12 July 2017).

for Operation SOPHIA.[159] However, he recognised that the political conditions in Libya have precluded the Operation from moving its activities to inside Libyan territory where it "would have the greatest impact against the smugglers' business model".[160]

15.4 With respect to the implications of Brexit for the UK's participation in Operation Sophia and for cooperation with the EU on foreign and security policy matters more broadly, the Minister noted simply that "although we are leaving the EU, we remain committed to European Security and our future relationship with CSDP is subject to negotiation". This position was reinforced in the Government's position paper on post-Brexit foreign policy cooperation with the EU, which offers a partnership "unprecedented in its breadth (…) [and] in terms of the degree of engagement ".[161] With respect to the CSDP specifically, the paper notes the UK could "work with the EU during mandate development and detailed operational planning", as well as contributing "UK personnel, expertise, assets, or use of established UK national command and control facilities". The Government has not described the nature of any UK-EU institutional structures to facilitate such close cooperation.

15.5 The Council Decision extending Operation SOPHIA's mandate to December 2018, and expanding its remit, was adopted unanimously by the Member States on 25 July 2017.[162] The Government supported the Decision and overrode scrutiny, as there was no Committee in place at the time.

15.6 **We thank the Minister for his detailed Explanatory Memorandum, which provides a comprehensive overview of the Mission's objectives and the Government's assessment of progress made towards them.**

15.7 **However, we share the concerns expressed in the House of Lords Report of 12 July 2017 in light of the continued year-on-year increases in migrants arriving in Italy via the central Mediterranean route, despite the presence of Operation SOPHIA vessels. While we agree with the Minister that "break[ing] the business model of the smugglers and traffickers" is a worthwhile objective, it does not follow that it is necessarily the right objective for Operation SOPHIA. As a naval mission, it manifestly cannot address the root causes of the explosive growth in both human trafficking and traditional smuggling from Libya, primarily the collapse of central state authority and the rule of law in the country.**

15.8 **We must also place the UK's contribution to Operation SOPHIA in the context of Brexit. The Government has clearly expressed its support for Operation SOPHIA, and its position paper on post-Brexit cooperation with the EU on foreign policy and security matters raises the possibility of continued UK contributions to CSDP operations and missions, during both the planning and operational phases. However, the paper does not explicitly take a position on UK participation in specific existing CSDP activities. As such, it is unclear whether the Government will seek to remain associated with the Operation SOPHIA after the UK ceases to be a Member State (should the operation, or a successor mission, still be active by March 2019).**

159 Explanatory Memorandum submitted by the Foreign and Commonwealth Office (13 July 2017).

160 The Government reiterated this position in its response to the House of Lords report, published on 14 September 2017.

161 DExEU, "Foreign policy, defence and development: a future partnership paper" (12 September 2017).

162 See Council Decision (CFSP) 2017/1385.

15.9 **Given the above, we ask the Minister to:**

- **keep us informed of any further EU initiatives to bring peace and stability to Libya, as well as the outcome of the next review of Operation Sophia (and in particular whether the Council would extend its mandate again beyond December 2018, or modify its objectives);**
- **clarify whether the Government will seek to remain a contributor to Operation SOPHIA post-Brexit, in line with the aspirations expressed in its future partnership paper, should the mission be extended again beyond December 2018; and**
- **more generally, what institutional and legal framework the Government envisages would be necessary to allow for continued close involvement of the UK in the CFSP, and particular throughout all phases of specific CSDP operations or missions once it ceases to be represented on the Foreign Affairs Council and its associated bodies.**

15.10 **With respect to the Government's support for the Council Decision to extend the mandate of Operation SOPHIA until December 2018, we consider that this was an acceptable instance of a scrutiny override, as the operation's mandate was due to expire before the Committee would have been able to consider the proposed Decision.**

15.11 **Given the high-profile nature of Operation Sophia, its impact on both the victims and perpetrators of human trafficking in the Mediterranean, and the UK's leading role in its day-to-day operations, we are drawing this document to the attention of the Defence and Foreign Affairs Committees, the latter of which may wish to assess the functioning, achievements and shortcomings of the Operation in more detail in any follow-up to its predecessors' inquiry into Libya.**

Full details of the documents

Council Decision (CFSP) 2017/1385 of 25 July 2017 amending Decision (CFSP) 2015/778 on a European Union military operation in the Southern Central Mediterranean (EUNAVFOR MED operation SOPHIA): (38918),—.

Background

15.12 The EU launched its Naval Force Mediterranean (EUNAVFOR MED), since renamed Operation SOPHIA,[163] in June 2015 to counter people trafficking in the Southern Central Mediterranean.[164] It was conceived as one element of a broader EU comprehensive response to increasing inflow of refugees into Europe across the Mediterranean, including other initiatives to address its root causes, including conflict, poverty, climate change and persecution.[165] The mission's vessels patrol the high seas between Libya and Italy, and its operational headquarters are based in Rome.

163 The operation was rechristened 'SOPHIA' in 2015, named after a baby born to a Somali woman aboard a German vessel which had rescued her and 453 others in the Mediterranean.

164 See Council Decision (CFSP) 2015/778 of 18 May 2015.

165 Other elements of the strategy include, for example, the new European Fund for Sustainable Development which was formally established in September 2017.

15.13 Operation SOPHIA's core mandate is to identify, capture and dispose of vessels and other assets being used by migrant smugglers or traffickers, contributing to its primary objective of disrupting the business model of human smuggling and trafficking networks in the Southern Central Mediterranean, and in doing so prevent the further loss of life at sea. The operation is meant to move through four phases of activities:

- Phase 1: Deployment of forces to build a comprehensive understanding of smuggling activity and methods;
- Phase 2: Boarding, search, seizure and diversion of smugglers' vessels on the high seas. This activity will be extended into Libyan territorial waters once authorised by the Libyan authorities and United Nation Security Council;
- Phase 3: Further expansion of phase 2 to include taking operational measures against vessels and related assets suspected of being used for human smuggling or trafficking inside the coastal states territory; andand
- Phase 4: Withdrawal of forces and completion of the operation.

15.14 The operation moved to phase 2 in the autumn of 2015, but has not yet been able to expand its activities into Libyan coastal waters.[166] In June 2016, the Council extended Operation SOPHIA's mandate until July 2017, and added two supporting tasks: training the Libyan coastguards and navy; and contributing to the implementation of the UN arms embargo on the high seas off the coast of Libya.[167]

15.15 In December 2016, the Council adopted a Decision allowing the Mission to share information with third parties, in particular NATO.[168] At the time, the new Minister for Europe (Sir Alan Duncan) informed the previous Committee of the latest figures relating to the Operation's activities.[169] He argued that SOPHIA had had "considerable success" since it launched in July 2015, "saving almost 29,000 lives, destroying over 330 smuggling vessels and arresting almost 100 suspected smugglers".

Developments since December 2016

15.16 At the European Council meeting of June 2017, the Prime Minister committed a UK ship to Operation Sophia until December 2018.

15.17 On 13 July 2017, the Minister wrote to inform us that the European External Action Service had tabled a proposal for a Council Decision to extend Operation SOPHIA's mandate from July 2017 until December 2018, as well as establishing a budget of €6 million (£5.5 million)[170] for that period. Under the Athena mechanism for financing CSDP missions, the UK is expected to be liable for 16.7% (€1 million or £920.000) of the common costs.

166 Council of the EU, "EUNAVFOR Med: EU agrees to start the active phase of the operation against human smugglers and to rename it "Operation Sophia"" (28 September 2015).

167 See Council Decision (CFSP) 2016/993 of 20 June 2016.

168 See our predecessors' Report of 18 January 2017.

169 The Minister wrote in relation to a Council Decision allowing SOPHIA to share information with third parties, in particular NATO. See our predecessors' Report of 18 January 2017.

170 £1 = €1.336, or £0.8821 = €1 as at 31 October

15.18 In addition, the draft Decision also aimed to set up a monitoring mechanism of trainees to ensure the long-term efficiency of the training of the Libyan Coastguard; give the Operation the authority to conduct new surveillance activities and gather information on illegal trafficking of oil exports from Libya;[171] and facilitate exchange of information on human trafficking with Member States' law enforcement agencies, as well as EU agencies FRONTEX and EUROPOL.

15.19 The Minister for Europe (Sir Alan Duncan) submitted an Explanatory Memorandum on the proposal in which he describes, in some detail, the Operation's objectives and its progress so far in achieving them.[172] He writes that Operation SOPHIA between June 2015 and July 2017 had saved 38,000 people at sea (of which 12,000 by UK vessels), and that it has destroyed 463 smuggling vessels. He also notes that the initial phases of training the Libyan coast guard and navy have been completed, but that further training was delayed because the Libyan authorities were unable to pay their trainees a per diem.[173] The Minister argues that the training provided by the EU will enable the Libyans to save more migrants at risk of drowning, ensure that individual officers act in conformity with human rights norms, reduce overall migratory flows and disrupt human trafficking activities.

15.20 The day before we were informed of the proposed extension of the Mission until end 2018, the House of Lords EU External Affairs Sub-Committee published a report on Operation Sophia.[174] In it, the Committee argued that the Operation had failed to achieve its objective of disrupting human trafficking in the region. In fact, it found that the practice of destroying smugglers' boats had resulted in refugees being sent to sea in less seaworthy vessels, resulting in more deaths. The Committee recorded that Operation SOPHIA vessels had rescued over 33,000 people since June 2016, but that nonetheless the number of recorded casualties on the central Mediterranean route "increased by around 42% in 2016".

15.21 The report also concluded that "meaningful EU action" to disrupt human trafficking and smuggling necessitates action against those organising these activities on the ground in Libya. This, in turn, requires political stability and security in the country, which are unlikely to be established for some time yet. There is no single group that exercises effective control over all of Libya,[175] armed clashes continue on multiple fronts, and basic amenities such as water, electricity and healthcare are frequently unavailable. Based on these findings, the House of Lords report recommended closure of Operation SOPHIA until the Libyan government could provide sufficient security for onshore operations, and replace the naval operation with a search and rescue mission for migrants at sea.[176]

171 See UN Security Council Resolutions 2146 (2014) and 2362 (2017).

172 Explanatory Memorandum submitted by the Foreign and Commonwealth Office (13 July 2017).

173 This has now been resolved through voluntary donations by EU countries, including €695.000 (£640.000) by the UK.

174 House of Lords EU Sub-Committee on External Affairs, "Operation Sophia: a failed mission" (12 July 2017).

175 There are several competing political structures aiming to take control of Libya, including the internationally-recognised Presidency Council in Tripoli, the Islamist General National Congress (GNC) and the National Salvation Government (NSG), the latter two are located in the west of Libya.

176 House of Lords EU Sub-Committee on External Affairs, "Operation Sophia: a failed mission" (12 July 2017).

15.22 The Minister, in his Explanatory Memorandum on the extension of SOPHIA's mandate, provides an initial response to the House of Lords report, arguing against closure. He said:

> "Op Sophia's primary goal is to break the business model of the smugglers and traffickers. HMG remains of the view that this is the right objective. The military assets deployed are the most effective means of gathering the intelligence and conducting the surveillance needed to develop an understanding of smuggling networks and patterns of operation. Moreover, it would not make sense to end the mandate while numbers crossing the Central Mediterranean continue to increase."

15.23 The Government's formal response to the report was published on 14 September 2017.[177] It again concedes that the operation "has not delivered all that we had hoped", but that the UK's contribution to Operation SOPHIA, and efforts to ensure its effectiveness, "remain an important part of a whole-of-government approach to addressing the migration challenge, including humanitarian assistance and action to tackle smugglers". The Government also acknowledges that, in order to stem the flow of people trying to cross the Mediterranean, the priority needs to be "interventions upstream in countries of origin and transit", which would "reduce the need of individuals and families to leave their home country or move on from a safe third country in their region". It goes on to list various initiatives to achieve that objective in the Horn of Africa and the Sahel.

15.24 With respect to the implications of Brexit for the UK's cooperation with the EU on foreign and security policy matters, the Minister's Memorandum on the extension of the operation's mandate notes simply that "although we are leaving the EU, we remain committed to European Security and our future relationship with CSDP is subject to negotiation".

15.25 This ambition for continued cooperation was reinforced in the Government's Brexit position paper on foreign policy, published in September, which offers a partnership "unprecedented in its breadth, taking in cooperation on diplomacy, defence and security, and development, and in its depth, in terms of the degree of engagement that the UK and the EU should aim to deliver".[178] With respect to the CSDP specifically, the paper notes:

> "With this deep level of cooperation, the UK could work with the EU during mandate development and detailed operational planning. The level of UK involvement in the planning process should be reflective of the UK's contribution. As part of this enhanced partnership, the UK could offer assistance through a continued contribution to CSDP missions and operations, including UK personnel, expertise, assets, or use of established UK national command and control facilities."

15.26 However, the Government has not clarified what institutional or legal mechanisms would need to be put in place by "Brexit day" to enable this partnership to function in practice.[179] The UK will lose its representation on the Foreign Affairs Council and its

177 http://www.parliament.uk/documents/lords-committees/eu-external-affairs-subcommittee/operation-sophia-failed-mission/Government-response-operation-sophia.pdf .

178 DExEU, "Foreign policy, defence and development: a future partnership paper" (12 September 2017).

179 For example, the Norwegian Government notes with respect to its cooperation with the EU on foreign policy that "When the EU agrees on common positions and declarations on current foreign policy issues, Norway is invited to align itself with these positions and declarations, which, in the vast majority of cases, it does".

associated bodies, in particular the Political & Security Committee (which coordinates the Common Security and Defence Policy). While non-EU contributions of personal and assets to specific CSDP activities is relatively straightforward (as participation by Norway[180] and Switzerland[181] in specific CSDP missions demonstrates), it is unclear in what way the UK could remain involved—on a case-by-case basis—in the detailed mandate development and operational planning of CSDP activities, and the preliminary discussions within the EU institutions that precede formal decisions by the Foreign Affairs Council to deploy personnel.

15.27 The Council Decision extending Operation SOPHIA's mandate to December 2018 was adopted on 25 July 2017.[182] The Government overrode scrutiny, as there was no Committee in place at the time.

Our assessment

15.28 We thank the Minister for his detailed Explanatory Memorandum, which provides a comprehensive overview of the Mission's objectives and the Government's assessment of progress made towards them. However, we share the concerns expressed in the House of Lords Report. 181,000 migrants arrived in Italy by sea in 2016, and we understand that the numbers are significantly higher so far in 2017 compared to the same period last year. We cannot avoid questioning the effectiveness of the Operation if it cannot keep the levels of human trafficking stable, let alone reduce them.

15.29 While we agree with the Minister that "break[ing] the business model of the smugglers and traffickers" is a worthwhile objective, it does not follow that it is necessarily the right objective for Operation Sophia. As a naval mission, it manifestly cannot address the root causes of the explosion in both human trafficking and traditional smuggling from Libya, the primary one of which is the collapse of central state authority in the country. However, we take note of the fact that the Member States have unanimously supported the latest extension of the operation.

15.30 We ask the Minister to keep us informed of any further EU initiatives to bring peace and stability to Libya, in particular the launch of a CSDP mission as and when conditions in Libya allow. We also ask him to share with us the outcome of the next review of Operation Sophia (and in particular whether the Council would extend its mandate again beyond December 2018).

15.31 With respect to the Council Decision to extend the mandate of Operation Sophia until December 2018, we note the Government's override of scrutiny in July. We consider this acceptable as the Operation's mandate would have had expired before the Committee would have been able to consider the proposed Council Decision.

Implications of Brexit

15.32 We must also place the UK's contribution to Operation SOPHIA in the context of Brexit. Although the Minister has clearly expressed the Government's support for

180 Norway is participating in current civilian CSDP missions in Ukraine, Kosovo, the Palestinian Territories and the Horn of Africa.

181 See for example: Participation Agreement between the European Union and the Swiss Confederation on the participation of the Swiss Confederation in the European Union CSDP mission in Mali (EUCAP Sahel Mali).

182 See Council Decision (CFSP) 2017/1385.

Operation Sophia, and the Government has committed a ship until December 2018, it is unclear whether it will seek to remain associated with the operation after the UK ceases to be an EU Member State (should the Operation, or a successor mission, still be active in March 2019).

15.33 More pressingly, although it has been nine months since the Government sent the notification under Article 50 TEU, it has only set out its ambitions for post-Brexit cooperation with the EU on foreign policy and security matters, but not realistic proposals for their delivery. A smooth transition to the new relationship in this area will depend heavily on a clear statement of expectations and commitments from both sides, as well as the necessary institutional arrangements to replace the UK's withdrawal from the Foreign Affairs Council and its preparatory bodies.

15.34 We would therefore like the Minister to clarify how the "unprecedented" foreign policy partnership sought by the Government will be given shape in practice. In particular, we would like more information on the institutional framework, and any accompanying reciprocal legal obligations, that would be necessary by "Brexit day" to enable this partnership to function in practice.[183] If the UK is to continue participating throughout the life cycle of particular CSDP missions and operations including mandate development and operational planning, it is paramount that Parliament is aware of the structures that will facilitate such close cooperation. It is likely that continued, post-Brexit scrutiny of EU foreign policy making would remain necessary in such a scenario.

Previous Committee Reports

First Report HC 342–i (2015–16), chapter 2 (21 July 2015), Seventh Report HC 342–vii (2015–16), chapter 1 (28 October 2015), Ninth Report HC 342–ix (2015–16), chapter 1 (18 November 2015), Twenty-first Report HC 342–xx (2015–16), chapter 10 (27 January 2016); and (37881): Seventh Report HC 71–v (2016–17), chapter 17 (6 July 2016).

183 For example, the Norwegian Government notes with respect to its cooperation with the EU on foreign policy that "When the EU agrees on common positions and declarations on current foreign policy issues, Norway is invited to align itself with these positions and declarations, which, in the vast majority of cases, it does".

16 Comprehensive and Enhanced Partnership Agreement with Armenia

Committee's assessment	Legally and politically important
Committee's decision	Cleared from scrutiny; drawn to the attention of the International Trade Committee.
Document details	(a) Joint Proposal for a Council Decision on the signing, on behalf of the European Union, and provisional application of the Comprehensive and Enhanced Partnership Agreement between the European Union and the European Atomic Energy Community and their Member States, of the one part, and the Republic of Armenia, of the other part; (b) Joint Proposal for a Council Decision on the conclusion, on behalf of the European Union, of the Comprehensive and Enhanced Partnership Agreement between the European Union and the European Atomic Energy Community and their Member States, of the one part, and the Republic of Armenia, of the other part; (c) Recommendation for a Council Decision approving the conclusion by the Commission on behalf of the European Atomic Energy Community, of the Comprehensive and Enhanced Partnership Agreement between the European Union and the European Atomic Energy Community and their Member States, of the one part, and the Republic of Armenia, of the other part
Legal base	(a) Articles 207 and 209, in conjunction with Article 218(5) and the second paragraph of Article 218(8) TFEU (b) Articles 207 and 209, in conjunction with Article 218(6)(a) and the second paragraph of Article 218(8) TFEU (c) second paragraph of Article 101 EURATOM; (a) and (b) unanimity, (c) QMV
Department	Foreign and Commonwealth Office
Document Numbers	(a) (39074), 12503/17 + ADDs 1–6, JOIN(17) 36; (b) (39076), 12525/17 + ADDs 16, JOIN(17) 37; (c) (39075), 12527/17, COM(17) 549

Summary and Committee's conclusions

16.1 These Decisions authorise the EU to sign, provisionally apply (in part) and conclude (ratify) a Comprehensive and Enhanced Partnership Agreement (CEPA) between the EU and its Member States and Armenia.

16.2 Our First Report sets out the background to, and content of, this Agreement in more detail.

16.3 When we first considered these proposals, we raised concerns that:

- the proposals did not make it clear that the EU is only exercising competence to enter into this agreement to the extent that such competence is exclusive, in line with Government policy;
- contrary to usual practice, the EU is triggering provisional application of the entire CEPA and not just those parts within its exclusive competence;
- the Minster for Europe's (Sir Alan Duncan) Explanatory Memorandum provided insufficient justification for the assertion that there were no JHA issues that would trigger the UK opt-in; and
- the Minister's Explanatory Memorandum also did not address Brexit implications.

16.4 **We are grateful for the further and full explanations from the Minister, and clear these proposals. In doing so we regret that the Explanatory Memorandum did not properly set out from the outset the Government's position on matters raised in our previous Report, which are ones that have arisen before in relation to other agreements of this sort.**

16.5 **The Committee does not share the Minister's confidence that the new language in document (a) (on the signing and provisional application of CEPA) makes it clear that the EU is only exercising competence where it is exclusive:**

- **The insertion of a new recital in document (a) indicating that the signing of CEPA and its partial provisional application is "without prejudice to the allocation of competences between the Union and its Member States in accordance with the Treaties" appears to confirm that the issue of competence is being fudged. The regularity of such fudges undermines the effective implementation of the Government's own policy; and**
- **Limiting provisional application to matters within EU exclusive competence assists in clarifying that the EU is not acting outside the area of its exclusive competence, but does not ensure that it is not doing so in relation to the signature and conclusion of the agreement because exercising competence in relation to these functions is different to exercising it in relation to the triggering of provisional application.**

16.6 **We note that the Government characterises as "political commitments" those provisions of the "Justice, Freedom and Security" Title of CEPA framed in mandatory terms for the parties to co-operate; with the result that they do not engage the UK opt-in under Protocol 21 to the Treaties. We do not pursue this further as we consider that the Protocol is not engaged, albeit for a different reason; that the relevant decisions do not have a legal basis falling within Title V of part Three TFEU.**

16.7 **In relation to Brexit we draw attention to the intention of the Government to seek to replicate CEPA as a bilateral UK-Armenia agreement as part of the "Government's International Agreements Programme". We draw this aspect of our Report to the attention of the International Trade Committee.**

Full details of the documents

(a) Joint Proposal for a Council Decision on the signing, on behalf of the European Union, and provisional application of the Comprehensive and Enhanced Partnership Agreement between the European Union and the European Atomic Energy Community and their Member States, of the one part, and the Republic of Armenia, of the other part: (39074), 12503/17 + ADDs 1–6, JOIN(17) 36; (b) Joint Proposal for a Council Decision on the conclusion, on behalf of the European Union, of the Comprehensive and Enhanced Partnership Agreement between the European Union and the European Atomic Energy Community and their Member States, of the one part, and the Republic of Armenia, of the other part: (39076), 12525/17 + ADDs 1–6, JOIN(17) 37; (c) Recommendation for a Council Decision approving the conclusion by the the Commission on behalf of the European Atomic Energy Community, of the Comprehensive and Enhanced Partnership Agreement between the European Union and the European Atomic Energy Community and their Member States, of the one part, and the Republic of Armenia, of the other part: (39075), 12527/17, COM(17) 549.

The Minister's Letter of 22 November 2017

16.8 The Minister's response to the Committee is as follows:

> **"Adoption of the Council Decisions (report paragraph 0.7)**
>
> "The report asks whether any of the Council Decisions have been adopted. I can confirm the Council Decisions were adopted at the Education, Youth, Culture and Sport Council on 20–21 November, ahead of their signature and conclusion at the Eastern Partnership Summit in Brussels on 24 November.
>
> **"EU and Member State competences (report paragraphs 0.8–0.9)**
>
> "Since the Explanatory Memorandum on the Agreement was submitted to the Committee, revised versions of the Council Decisions were published, which I have attached. They do not substantively change the original Council Decisions but do help clarify the issue of EU and Member States competences raised in the report.
>
> "Firstly, recital 5 of Council Decision 12542/17 states that 'The signing of the Agreement on behalf of the Union and the provisional application of parts of the Agreement between the Union and the Republic of Armenia is without prejudice to the allocation of competences between the Union and its Member States in accordance with the Treaties'.
>
> "Article 3 of Council Decision 12542/17 sets out the limited EU competence provisions which are being provisionally applied. It also contains a caveat that provisional application applies to these parts 'only to the extent that they cover matters falling within the Union's competence, including matters falling within the Union's competence to define and implement a common foreign and security policy'.

"I am confident that the inclusion of this language ensures that the EU is only exercising competence where it is exclusive, in line with Government policy that normally Member States should exercise shared competence.

"Brexit (report paragraph 0.10)

"The report asks for further information as to the implications of Brexit on the Agreement. The Comprehensive Enhanced Partnership Agreements falls within the scope of the Government's International Agreements Programme, under which we intend to replicate the effects of key EU agreements by transitioning them in to bilateral agreements between the UK and the partner country. It is our intention to avoid any disruption to UK-Armenia relations when we leave the European Union, and transitioning this agreement will be one way of ensuring that we manage this.

"Justice and Home Affairs op-in (report paragraph 0.11)

"The report asks the Government to set out more fully why the UK opt-in does not apply in the case of the EU-Armenia Comprehensive and Enhanced Partnership Agreement. The provisions in the JHA chapter of the Agreement are in the main political commitments to co-operate. There are no specific JHA obligations that require the UK to do anything new or different. We can already co-operate on these issues and will continue to do so where appropriate. The only Article in the Agreement that provides a substantive obligation is Article 15, relating to the obligation to ensure full implementation of the EU-Armenia Agreements on the readmission of persons residing without authorisation, and on the facilitation of the issuance of visas, both of which entered into force on 1 January 2014.

"The UK is not party to these agreements and secured the addition of language ('The Parties that are bound by the following Agreements shall ensure the full implementation of') to clarify that the provision does not apply to the UK."

Previous Committee Reports

First Report HC 301–i (2017–19), chapter 18 (13 November 2017).

17 European Public Prosecutor's Office

Committee's assessment	Legally and politically important
Committee's decision	Cleared from scrutiny; further information requested
Document details	(a) Proposed Council Regulation on the establishment of a European Public Prosecutor's Office (the 2013 original Commission proposal); (b) Proposal for a Council Regulation on the establishment of a European Public Prosecutor's Office (the 2015 Presidency text)
Legal base	(a) and (b) Article 86 TFEU; EP consent; unanimity
Department	Home Office
Document Numbers	(a) (35217), 12558/13 + ADDs 1–2, COM(13) 534; (b) (36931), 9372/15,—

Summary and Committee's conclusions

17.1 The two texts under scrutiny sought at different times in the negotiations of the proposed Regulation to establish a European Public Prosecutor's Office (EPPO) to investigate and prosecute fraud and other criminal offences in relation to EU funds.[184] However, the texts differed in the nature of the models they proposed and the extent to which they would oust the competence of national authorities. This chapter concerns the adoption on 12 October by twenty Member States,[185] participating in enhanced cooperation, of text of the proposed Regulation,[186] following the European Parliament's consent.

17.2 The UK's long established position is not to participate in the EPPO[187] to preserve the autotomy of its prosecuting and investigative authorities. Despite having opted out of the proposal, concerns lingered in the UK before the Referendum about the impact of an EPPO on the remit and resources of Eurojust[188] and OLAF[189] or in creating indirect obligations on non-participating Member States. It may yet be important for any post-

184 As set out in the proposed Directive on the fight against fraud to the Union's financial interest by means of criminal law (the PIF Directive). The proposal was adopted by the Council on 5 July 2017: Directive (EU) 2017/1371.The Directive harmonises the definition of "fraud on the budget" offences (fraud, corruption, money laundering and misappropriation) as well as the penalties and statutes of limitations for such offences. The UK did not opt into the proposal before its adoption, not least because of its inclusion of some cross-border VAT fraud and the Government is not considering a post adoption opt-in: Thirty third Report, HC 71–xxxi (1 March 2017), chapter 16 (2016–17).

185 See the Council Press Release. Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Germany, Greece, Spain, Finland, France, Italy, Latvia, Lithuania, Luxembourg, Portugal, Romania, Slovenia and Slovakia participate.

186 Council Regulation (EU) 2017/1939 implementing enhanced cooperation on the establishment of the EPPO.

187 In accordance with the 2010 Coalition Agreement. Also the EU Act 2011 requires any future participation to be sanctioned through a referendum. The debate concerning the UK's intention to not opt into the EPPO proposal was held on 28 October 2013.

188 Eurojust is an EU agency, comprised of one senior judge or prosecutor per Member State, tasked with supporting judicial coordination and cooperation between national authorities to combat terrorism and serious organised crime affecting more than one Member State.

189 OLAF is an administrative (non-judicial) body already investigating fraud against the EU budget, corruption and serious misconduct with the European institutions and develops anti-fraud policy for the European Commission (see OLAF's website).

Brexit cooperation between the UK and the EU in the Justice and Home Affairs field to put these concerns beyond doubt. That is why we have retained these texts under scrutiny until now.

17.3 More information about the two texts appears at paragraphs 17.10–17.11 below. But, in summary, the first text (a) is the initial Commission proposal for a supranational model for an EPPO, with the EU having exclusive competence to investigate and prosecute. When opposed, both by way of a subsidiarity "yellow card" raised by national Parliaments/chambers[190] and in 2015 by Member States in Council, the relevant Council Presidency put forward its own text (b) for consideration. This is based on a Collegiate Model, with concurrent EU and national competences in this criminal law field.

17.4 In December 2016, negotiations on document (b) reached a critical stage. In default of unanimous support in the Council required by Article 86 TFEU, the Presidency concluded that the latest text should be put to the European Council to seek agreement to move forward under "enhanced cooperation" provisions. These require the support of at least nine Member States, but as the Presidency noted, the December text already had the support of a majority of Member States.[191]

17.5 The previous Government wrote to the previous Committee in February to update it on the latest discussions in Council and the prospect of an enhanced cooperation. However, it said little about the UK's position after Brexit either in relation to an EPPO or Eurojust, except that it would remain closely engaged regarding any impacts on Eurojust for as long as the UK was a contributing partner to the EU. In response, the previous Committee considered that, despite the decisions not to opt into the EPPO and the proposed Directive on the fight against fraud to the Union's financial interest by means of criminal law (the PIF Directive),[192] the UK as a non-participating Member State could still be affected by an EPPO, depending on the provisions in the enhanced cooperation proposal. The EPPO might even be relevant if the UK was to cooperate with the EU after Brexit in the area of criminal justice. In its Report of 1 March the previous Committee said:

> "Once the final outcome of enhanced cooperation on EPPO is known, we would be interested to learn from the Minister what, if any, future co-operation might be attractive to the UK after Brexit with Eurojust and even with an EPPO in terms of legal assistance on cross-border criminal matters, specifically fraud".

17.6 The Government has now written[193] to update the Committee on the final adoption of the enhanced cooperation text (b), to reiterate the Government's position in relation to an EPPO and to note how the Commission President, in his State of the Union address,

190 The Commission received 14 Reasoned Opinions from the national parliaments/chambers of 11 Member States, representing 18 out of a total possible 56 votes. For JHA proposals, 14 votes are required to raise a Yellow Card.

191 See further the Council Press Release of 7 February 2017.

192 Directive (EU) 2017/1371on the fight against fraud to the Union's financial interest by means of criminal law (EU).

193 See letter of 1 November, referred to in paragraph 17.27

had questioned whether the remit of the EPPO could be extended in future to the fight against terrorism.[194] This report chapter also includes a Government letter of 21 March which the previous Committee had already considered but not yet reported to the House.

17.7 **We thank the Minister of State for Policing and Fire Service at the Home Office (Nick Hurd) for his letter of 1 November 2017.**

17.8 **In the Minister's letter, he states that the UK is leaving the EU and that the Government is not considering any post-adoption opt-in in relation to the adopted EPPO Regulation before Brexit. Any future participation in an EPPO is in any event subject to a referendum requirement in the European Union Act 2011. In addition, the Minister tells us that "The EU legislation establishing the EPPO cannot and does not impose any obligation on states other than those participating in the EPPO. As such, we consider that this EPPO Regulation will not have a significant impact on the UK". He also tells us that the EPPO will not be able to become operational in terms of its investigative or prosecutorial functions until three years after the Regulation's adoption. Taking all of this into account, we are now content to clear documents (a) and (b) from scrutiny.**

17.9 **However, we would be interested in any further comments from the Minister that there is nothing in the following provisions of the adopted Regulation that could adversely affect in any way the UK's current participation in JHA measures or its ability to cooperate with the EU in such matters after Brexit:**

a) **Article 33 on Pre-Trial Arrest and Cross-Border Surrender, in terms of the UK responding to any European Arrest Warrant arising out of activities of a European Delegated Prosecutor;**

b) **Article 100 on "Relations with Eurojust";**

c) **Article 101 on "Relations with OLAF";**

d) **Article 102 on "Relations with Europol";**

e) **Article 104 on "Relations with third countries and international organisations";**

f) **Article 105 on "Relations with Member States of the European Union which do not participate in the enhanced cooperation on the establishment of the EPPO" (see also Recital 110); and**

g) **the reference in the Recitals to possible future extension of the EPPO remit, for example, to cross-border terrorism as mentioned in the State of the Union address.**

194 See the State of the Union Address 2017 given by Commission President Jean-Claude Juncker. Article 86(4) TFEU provides: "The European Council may, at the same time or subsequently, adopt a decision amending paragraph 1 in order to extend the powers of the European Public Prosecutor's Office to include serious crime having a cross-border dimension and amending accordingly paragraph 2 as regards the perpetrators of, and accomplices in, serious crimes affecting more than one Member State. The European Council shall act unanimously after obtaining the consent of the European Parliament and after consulting the Commission".

Full details of the documents

(a) Proposed Council Regulation on the establishment of a European Public Prosecutor's Office: (35217), 12558/13 + ADDs 1–2, COM (13) 534; (b) Proposal for a Council Regulation on the establishment of a European Public Prosecutor's Office—Policy Debate: (36931), 9372/15.

Background and previous scrutiny

17.10 As part of the original 2013 Commission supranational model for an EPPO proposed in (a), the EPPO would have had exclusive competence to investigate and prosecute offences concerning, preventing national authorities from doing so. It would have comprised: a central European Public Prosecutor (EPP) assisted by Deputies. In each Member State there would have been at least one European Delegated Prosecutor (EDP). The EDPs would have carried out the investigations and prosecutions under the authority and management of the EPP.

17.11 The alternative 2015 Presidency text (b) simply revised (a) in the light of the Reasoned Opinions by adopting a collegiate model for an EPPO. This provided for concurrent national and EU competences to investigate and prosecute fraud. At EU level, a Central Office would comprise of a College of European Prosecutors and Deputies and its Permanent Chambers. The national level would consist of EDPs—national prosecutors acting on behalf of the EPPO. The College would be responsible for monitoring the EPPO's activities and for strategic matters, including the consistent application of prosecution policy.

The new enhanced cooperation text

17.12 This text[195] carries forward the collegiate model for an EPPO set out in document (b), with concurrent competences for the EU and participating Member States, as described in paragraph 17.11.

Possible expansion of EPPO remit to cross-border terrorism crimes

17.13 As limited by Article 86(1) TFEU, the scope of this text remains to investigate and prosecute offences in the PIF Directive. However, the recitals to the proposal also refer to the power set out in Article 86(4) TFEU for the European Council to extend competence by unanimity and with the consent of the European Parliament to include serious crimes having a cross-border dimension. The Commission President's State of the Union speech referred to the ambition to extend the EPPO's remit in future to include cross-border crimes relating to terrorism.[196]

Relations with Eurojust

17.14 Article 100 provides that:

- the EPPO and Eurojust should become partners and should cooperate in operational matters in accordance with their respective mandates;

195 `Council Regulation (EU) 2017/1939 implementing enhanced cooperation on the establishment of the European Public Prosecutor's Office (EPPO).

196 See the State of the Union Address 2017 given by Commission President Jean-Claude Juncker.

- this may involve any investigations conducted by the EPPO where an exchange of information or coordination of investigative measures in respect of cases within the competence of Eurojust is considered to be necessary or appropriate;
- whenever the EPPO is requesting such cooperation of Eurojust, the EPPO should liaise with the Eurojust national member of the handling EDP's Member State;
- the EPPO may rely on the support and resources of the administration of Eurojust, with Eurojust providing services of common interest to the EPPO, set out in an Arrangement; and
- the operational cooperation may also involve third countries that have a cooperation agreement with Eurojust.

Relations with OLAF

17.15 Article 101 provides that OLAF should not open any administrative investigations parallel to an investigation conducted by the EPPO into the same facts, though it can start an "own initiative" investigation in close consultation with the EPPO. The EPPO can provide information to OLAF in cases where the EPPO is not investigating.

Relations with Europol

17.16 Article 102 provides that the EPPO shall have a close relationship with Europol and conclude a working arrangement for that cooperation.

17.17 2. For the purposes of its investigations the EPPO should be able to obtain, on request, any relevant information held by Europol, concerning any offence within its competence. Europol can also be asked to provide analytical support to a specific EPPO investigation.

Provisions affecting third countries

17.18 In addition to the provision in Article 100 on operational cooperation with third countries already cooperating with Eurojust, Article 104 sets out the basis for cooperation between the EPPO and third countries, including strategic exchange of information and secondment of liaison officers to the EPPO.

Provisions on non-participating Member States

17.19 Article 105 refers to relations with non-participating Member States like the UK. It provides:

> "(1) The working arrangements referred to in Article 99(3) with the authorities of Member States of the European Union which do not participate in enhanced cooperation on the establishment of the EPPO may in particular, concern the exchange of strategic information and the secondment of liaison officers to the EPPO.

> "(2) The EPPO may designate, in agreement with the competent authorities concerned, contact points in the Member States of the European Union which do not participate in enhanced cooperation on the establishment of the EPPO in order to facilitate cooperation in line with the EPPO's needs.
>
> "(3) In the absence of a legal instrument relating to cooperation in criminal matters and surrender between the EPPO and the competent authorities of the Member States of the European Union which do not participate in enhanced cooperation on the establishment of the EPPO, the Member States shall notify the EPPO as a competent authority for the purpose of implementation of the applicable Union acts on judicial cooperation in criminal matters in respect of cases falling within the competence of the EPPO, in their relations with Member States of the European Union which do not participate in enhanced cooperation on the establishment of the EPPO."

17.20 There has always been some concern in the UK about obligations being placed on non-participating Member States by an EPPO Regulation. However, "Member State" is defined in the Article 2(1) Regulation as a "Member State which participates in enhanced cooperation on the establishment of the EPPO". Also Recital (110) refers to non-participating Member States not being bound by this Regulation.

17.21 Recital 110 also adds that the Commission should, if appropriate, submit proposals in order to ensure effective judicial cooperation in criminal matters between the EPPO and non-participating Member States, particularly relating to judicial cooperation in criminal matters and surrender "fully respecting the EU acquis in this field as well as the duty of sincere cooperation". Article 33 provides for Pre-Trial Arrest and Cross-border surrender. When the Commission's supranational model for an EPPO was first published, there was some concern that the UK, although a non-participating Member State, might still be required to comply with a European Arrest Warrant (EAW) issued by the EPPO. Article 33 (2) provides that any EAW could be issued either by an EDP or by the competent authorities of a participating Member State:

> "Where it is necessary to arrest and surrender a person who is not present in the Member State in which the handling European Delegated Prosecutor is located, the latter shall issue or request the competent authority of that Member State to issue a European Arrest Warrant in accordance with Council Framework Decision 2002/584/JHA (1)."

17.22 In accordance with Article 332 TFEU, expenditure resulting from the implementation of the EPPO will be borne by the participating Member States.

The Minister's letter of 21 March 2017

17.23 The previous Minister of State for Policing and the Fire Service (Brandon Lewis) at the Home Office said he was writing in response to the Committee's Report of 1 March. He reiterated the Government's position that it would not seek to participate in an EPPO. He added:

> "The Committee rightly points out that the impact of an EPPO on the UK, as either a non-participating Member State or third country, is dependent on a

> number of different factors, which will not be known until negotiations on the instrument are concluded. The UK will continue to play an active role in negotiations where our interests as a non-participating Member State or third country could be affected."

17.24 Whilst stressing that the timescales for agreement of any EPPO under enhanced cooperation were unclear, he committed to providing the Committee with a response to its question about what, if any, future cooperation might be attractive to the UK after EU exist with Eurojust and EPPO in terms of legal assistance on cross-border criminal matters, specifically fraud.

The Minister's letter of 1 November 2017

17.25 The current Minister of State for Policing and the Fire Service at the Home Office (Nick Hurd) says:

> "I am writing to inform the Committee of the formal adoption of the Council Regulation implementing enhanced cooperation on the establishment of the European Public Prosecutor's Office. Following the General Approach that was reached on the text at the June Justice and Home Affairs Council, the European Parliament gave its consent to the setting up of the EPPO on 4th October. The Regulation was then formally adopted at the 13th October JHA Council meeting by those Member States participating in the enhanced cooperation process.
>
> "Twenty Member States are currently participating in the EPPO under enhanced cooperation: Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Germany, Greece, Spain, Finland, France, Italy, Latvia, Lithuania, Luxembourg, Portugal, Romania, Slovenia and Slovakia. Denmark, Hungary, Ireland, Malta, Poland, The Netherlands and Sweden are not currently participating.
>
> "The UK Government has always been clear that we will not participate in the EPPO Regulation, and we will not consider a post-adoption opt-in. The EU legislation establishing the EPPO cannot and does not impose any obligation on states other than those participating in the EPPO. As such, we consider that this EPPO Regulation will not have a significant impact on the UK.
>
> "The date on which the EPPO will assume its investigative and prosecutorial tasks will be set by the Commission on the basis of a proposal from the European Chief Prosecutor once the EPPO has been set up. This date will not be earlier than three years after the entry into force of the Regulation.
>
> "The Committee should note that Juncker, in his State of the Union address on 13th September, set out that he saw "a strong case for tasking the new European Public Prosecutor with prosecuting cross-border terrorist crimes". This received some support from participating Member States at the October JHA Council and it has now been added to the Commission's 2018

work programme. They plan to issue an initiative in Q3 2018 (during the Austrian Presidency of the EU) to extend the European Public Prosecutor's Office to include the fight against terrorism."

Previous Committee Reports

(a) and (b) Thirty third Report, HC 71–xxxi (2016–17), chapter 10 (1 March 2017); Tenth Report HC 342–x (2015–16), chapter 6 (25 November 2015); First Report HC 342–i (2015–16), chapter 37 (21 July 2015); (a) Nineteenth Report HC 83–xviii (2013–14), chapter 6 (23 October 2013); Fifteenth Report HC 83–xv (2013–14), chapter 1 (11 September 2013).

18 Documents not raising questions of sufficient legal or political importance to warrant a substantive report to the House

Department for Environment, Food and Rural Affairs

(39248) 14720/17 + ADD 1 COM(17) 643	Proposal for a Decision of the European Parliament and of the Council amending Council Decision 2003/17/EC as regards the equivalence of field inspections carried out in Brazil on fodder plant seedproducing crops and cereal seed-producing crops and on the equivalence of fodder plant seed and cereal seed produced in Brazil, and as regards the equivalence of field inspections carried out in Moldova on cereal seedproducing crops, vegetable seed-producing crops and oil and fibre plant seed- producing crops and on the equivalence of cereal seed, vegetable seed and oil and fibre plant seed produced in Moldova.

Department for International Trade

(39043) 12135/17 COM(17) 492	Communication from the Commission to the European Parliament, the Council the European Economic and Social Committee and the Committee of the Regions A balanced and Progressive Trade Policy to Harness Globalisation.
(39044) 12136/17 COM(17) 491	Report from the Commission to the European Parliament, the Council the European Economic and Social Committee and the Committee of the Regions. Report on the Implementation of the Trade Policy Strategy Trade for all Delivering a Progressive Trade Policy to Harness Globalisation.
(39098) 13094/17 COM(17) 585	Report from the Commission to the European Parliament and the Council Third Annual Report on the Implementation of the EU-Colombia/Peru Trade Agreement.
(39197) 14047/17 + ADD 1 COM(17) 641	Proposal for a Council Decision on the position to be taken on behalf of the European Union within the Joint Veterinary Committee set up by the Agreement between the European Community and the Swiss Confederation on trade in agricultural products in relation to Decision No 1/2017 regarding the amendment of Appendix 6 of Annex 11 to the Agreement.

Foreign and Commonwealth Office

(39238)	Council Decision on the Promotion of Effective Arms Export Controls.
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(39281)
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—
Council Decision in support of the Organisation of the Prohibition of Chemical Weapons activities to assist clean-up work at a former chemical weapons storage site in Libya in the framework of the implementation of the EU Strategy against Proliferation of Weapons of Mass Destruction.

(39290)
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—
Council Decision in support of the continued implementation of UNSCR 2118 (2013) and OPCW Executive Council Decision on the destruction of Syrian chemical weapons, in the framework of the implementation of the EU Strategy against Proliferation of Weapons of Mass Destruction.

(39303)
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Proposal of the High Representative of the Union for Foreign Affairs and Security Policy to the Council for a Council Decision amending Decision (CFSP) 2010/788 concerning restrictive measures against the Democratic Republic of the Congo.

(39304)
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—
Proposal of the High Representative of the Union for Foreign Affairs and Security Policy to the Council for a Council Decision amending Decision 2016/2382/CFSP, establishing a European Security and Defence College.

(39306)
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—
Council Decision in support of the Hague Code of Conduct and ballistic missile non-proliferation in the framework of the implementation of the EU Strategy against Proliferation of Weapons of Mass Destruction.

(39309)
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—
Council Decision (CFSP) 2017/2163 of 20 November 2017 amending Decision 2014/145/CFSP concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine.

(39310)
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—
Council Implementing Regulation (EU) 2017/2153 of 20 November 2017 implementing Regulation (EU) No 269/2014 concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine.

HM Treasury

(39057)
12433/17
COM(17) 542
Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions Reinforcing integrated supervision to strengthen Capital Markets Union and financial integration in a changing environment.

Formal Minutes

Wednesday 13 December 2017

Members present:

Sir William Cash, in the Chair

Douglas Chapman	David Jones
Steve Double	Andrew Lewer
Marcus Fysh	Michael Tomlinson
Kelvin Hopkins	

Draft Report, proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1.1 to 18 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Fifth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

[Adjourned till Tuesday 19 December at 10.00am.

Standing Order and membership

The European Scrutiny Committee is appointed under Standing Order No.143 to examine European Union documents and—

a) to report its opinion on the legal and political importance of each such document and, where it considers appropriate, to report also on the reasons for its opinion and on any matters of principle, policy or law which may be affected;

b) to make recommendations for the further consideration of any such document pursuant to Standing Order No. 119 (European Committees); and

c) to consider any issue arising upon any such document or group of documents, or related matters.

The expression "European Union document" covers—

i) any proposal under the Community Treaties for legislation by the Council or the Council acting jointly with the European Parliament;

ii) any document which is published for submission to the European Council, the Council or the European Central Bank;

iii) any proposal for a common strategy, a joint action or a common position under Title V of the Treaty on European Union which is prepared for submission to the Council or to the European Council;

iv) any proposal for a common position, framework decision, decision or a convention under Title VI of the Treaty on European Union which is prepared for submission to the Council;

v) any document (not falling within (ii), (iii) or (iv) above) which is published by one Union institution for or with a view to submission to another Union institution and which does not relate exclusively to consideration of any proposal for legislation;

vi) any other document relating to European Union matters deposited in the House by a Minister of the Crown.

The Committee's powers are set out in Standing Order No. 143.

The scrutiny reserve resolution, passed by the House, provides that Ministers should not give agreement to EU proposals which have not been cleared by the European Scrutiny Committee, or on which, when they have been recommended by the Committee for debate, the House has not yet agreed a resolution. The scrutiny reserve resolution is printed with the House's Standing Orders, which are available at www.parliament.uk.

Current membership

Sir William Cash MP (*Conservative, Stone*) (Chair)

Douglas Chapman MP (*Scottish National Party, Dunfermline and West Fife*)

Geraint Davies MP (*Labour/Cooperative, Swansea West*)

Steve Double MP (*Conservative, St Austell and Newquay*)

Richard Drax MP (*Conservative, South Dorset*)

Mr Marcus Fysh MP (*Conservative, Yeovil*)

Kate Green MP (*Labour, Stretford and Urmston*)

Kate Hoey MP (*Labour, Vauxhall*)

Kelvin Hopkins MP (*Independent, Luton North*)

Darren Jones MP (*Labour, Bristol North West*)

Mr David Jones MP (*Conservative, Clwyd West*)

Stephen Kinnock MP (*Labour, Aberavon*)

Andrew Lewer MP (*Conservative, Northampton South*)

Michael Tomlinson MP (*Conservative, Mid Dorset and North Poole*)

David Warburton MP (*Conservative, Somerton and Frome*)

Dr Philippa Whitford MP (*Scottish National Party, Central Ayrshire*)